



FORECAST REPORT 86

NEW ZEALAND TRENDS IN
PROPERTY AND CONSTRUCTION

FIRST QUARTER 2018

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Cover: Verto Apartments, Auckland

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CONFIDENCE TODAY INSPIRES TOMORROW

RIDER LEVETT BUCKNALL

With a network that covers the globe and a heritage spanning over two centuries, Rider Levett Bucknall is a leading independent organisation in cost management and quantity surveying and advisory services.

Our achievements are renowned: from the early days of pioneering quantity surveying, to landmark projects such as the Sydney Opera House, HSBC Headquarters Building in Hong Kong, the 2012 London Olympic Games and CityCenter in Las Vegas.

We continue this successful legacy with our dedication to the value, quality and sustainability of the built environment. Our innovative thinking, global reach, and flawless execution push the boundaries. Taking ambitious projects from an idea to reality.

FORECAST 86

Prepared by the New Zealand Institute of Economic Research (Inc.) exclusively for Rider Levett Bucknall, Forecast is produced quarterly and provides detailed local construction market intelligence and knowledge.

CONSTRUCTION MARKET INTELLIGENCE

Forecast is supplemented by Rider Levett Bucknall's construction market intelligence publications: the International Report, regional (including the Oceania Report) and country specific reports.

KEY POINTS IN THIS ISSUE

Construction activity rebounds

There was a rebound in both residential and non-residential construction in the September quarter, following an easing over the first half of 2017.

Net migration turning

There are signs net migration has turned, with population growth likely to slow over the coming years. However, with population growth having outpaced construction growth particularly that of new dwellings in the past few years, we expect construction demand to remain strong over the next few years.

Demand for industrial building picks up

Demand for factories and storage buildings have picked up, as businesses have become more optimistic about investment.

Interest rates likely on hold until late 2018

While there is uncertainty over many of the new Government's policy changes, more expansionary fiscal policy will be a feature of the next few years. Although the growth outlook remains solid, there are downside risks from heightened political tensions offshore. That, along with inflation being contained, means there remains little urgency for the Reserve Bank to lift interest rates. We continue to expect the Official Cash Rate to remain on hold until late 2018.

Burwood Hospital, Christchurch



BUILDING ACTIVITY TRENDS

Construction activity rebounded in the September quarter, after declines over the first half of 2017. Capacity constraints in the construction sector, along with tighter access to financing, had seen some construction developments put on hold. These constraints limited the extent to which construction activity could ramp up, despite strong underlying demand.

Net migration shows signs of turning in recent months, as the number of people moving to New Zealand eases and the number of New Zealanders leaving the country picks up. However, the surge in population in recent years should continue to support underlying construction demand over the next few years, given population growth has outpaced the growth in house-building and other construction activity. It typically takes around two years

for the full effects of population growth to flow through to construction activity, with some catch up likely over the coming years. Hence we expect a solid pipeline of construction activity.

Despite the rebound in construction activity more recently, construction cost inflation has moderated, both in Auckland and the other regions across New Zealand. Construction sector firms report it being slightly easier to find both skilled and unskilled labour, with migrants helping to alleviate labour shortages in the building industry.

Although the new Government has indicated it is looking to reduce net migration, we expect the slowing in the number of skilled migrants coming in to work in capacity constrained sectors such as construction will be modest. This means migrants will still

likely help to fill skills shortages in the construction sector over the coming years.

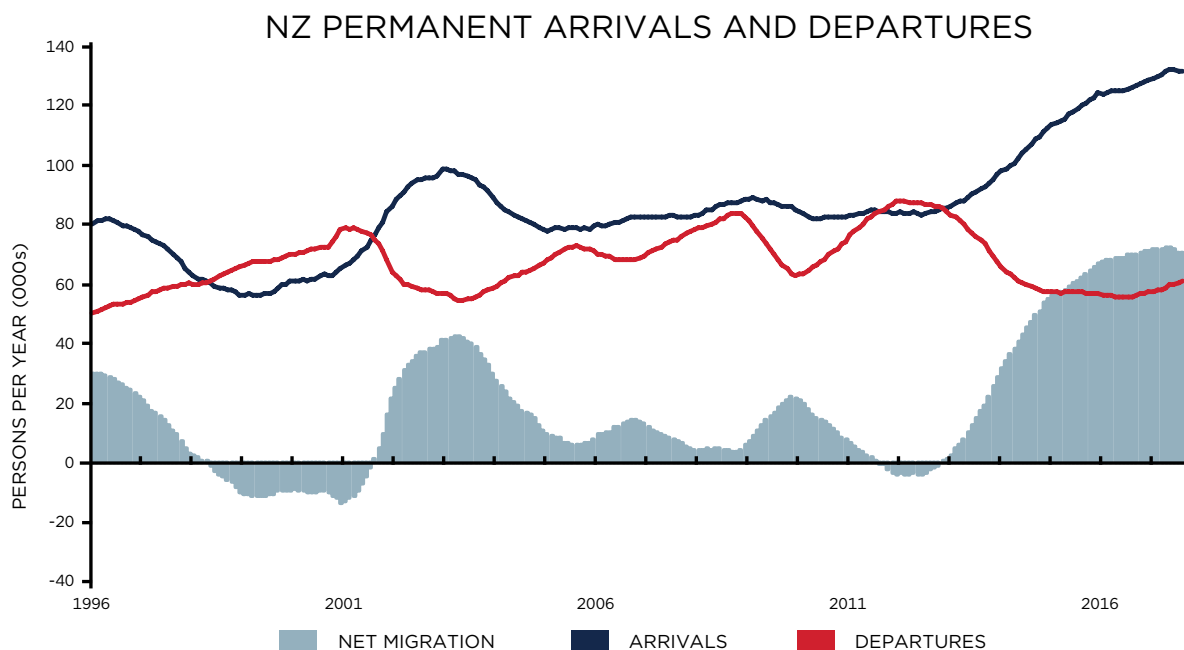
The relatively high construction cost inflation in Auckland indicates capacity pressures in the Auckland construction sector remains more acute than in the other regions. We expect further moderation in construction cost inflation across New Zealand in the coming years, as labour shortages and bottlenecks in the supply of materials ease.

In particular, we expect construction cost inflation in Auckland will continue to ease as capacity in the Auckland construction sector increases to meet growing demand. However, strong construction demand means that despite some easing we expect construction cost inflation will remain relatively high.

FIGURE 1

Net migration turning around

Net inflows per year



Source: Statistics NZ, NZIER

BUILDING ACTIVITY OUTLOOK

Despite some slowing in population growth more recently, the surge in population over the past few years should continue to support strong construction demand over the next few years. Capacity pressures are easing in the construction sector as higher construction costs encourage more resources, including labour, to be directed towards the sector.

Non-residential construction activity lifted in the September 2017 quarter, after declines over the first half of the year. We expect further growth in non-residential construction over the coming year. Continued strong tourism activity continues to drive demand for new hotel developments, while demand for industrial buildings is lifting as businesses feel more optimistic about investment.

ECONOMIC BACKDROP

While there is uncertainty over many of the new Government's policy changes, more expansionary fiscal policy will be a feature of the next few years. This will provide a short-term stimulus to the economy. This stimulus, combined with the lagged effects of strong population growth in recent years, will continue to support solid economic activity for the next year.

The combination of increased fiscal stimulus from the Government and continued labour shortages from a slowing in net migration, is likely to see a slightly faster pick-up in inflation.

INTEREST AND EXCHANGE RATES

We continue to expect the Reserve Bank will start lifting the OCR from November 2018. While inflation pressures are expected to be slightly stronger, domestic and offshore political uncertainty means the Reserve Bank will likely wait to assess the situation before commencing tightening.

The new Government has announced a review of the Reserve Bank Act. This review will consider two changes: adding maximising employment to the price stability objective, and moving to a committee model for the setting of monetary policy.

The Policy Targets Agreement already requires the Reserve Bank to consider stability in output, interest rates and the exchange rate when implementing monetary policy. Adding an employment objective with no numerical target attached is unlikely to have a material impact on the interest rate outlook.

Similarly, a move to a committee decision-making model would simply mean a formalisation of the current system, where the Reserve Bank's policy making Governing Committee comprises of the Governor, Deputy Governor, and Assistant Governor.

Uncertainty around the formation of the new Government, and subsequent policy changes, had dampened demand for the New Zealand dollar. However, the release of GDP data indicating the New Zealand economy performed strongly over the past year boosted the currency. We expect the New Zealand dollar will ease as the prospects for the other major economies improve and the interest rate differential narrows.

BUILDING INVESTMENT

The NZIER *Quarterly Survey of Business Opinion's* architects' measure of own activity points to a solid pipeline of construction work across the residential, commercial and Government sectors.

Population growth and high numbers of tourist inflows continue to drive demand for non-residential construction. As business confidence continues to improve we expect this will support further investment into a wide range of buildings, including industrial and offices.

BUILDING CONSENTS

Demand for new hotel developments remains the top driver of growth in non-residential construction demand over the past year. Demand for industrial and social buildings is also picking up, as businesses feel more optimistic about investment.

The average value per square metre consented continues to ease from very high levels, indicating further moderation in non-residential construction cost inflation.

Building consents by sector

Despite the recent turnaround in net migration, we expect population growth (while moderating) and tourism demand will continue to underpin many of the longer-term trends:

- Office growth to accommodate the higher number of white collar workers.
- Public sector spending on education and healthcare facilities.

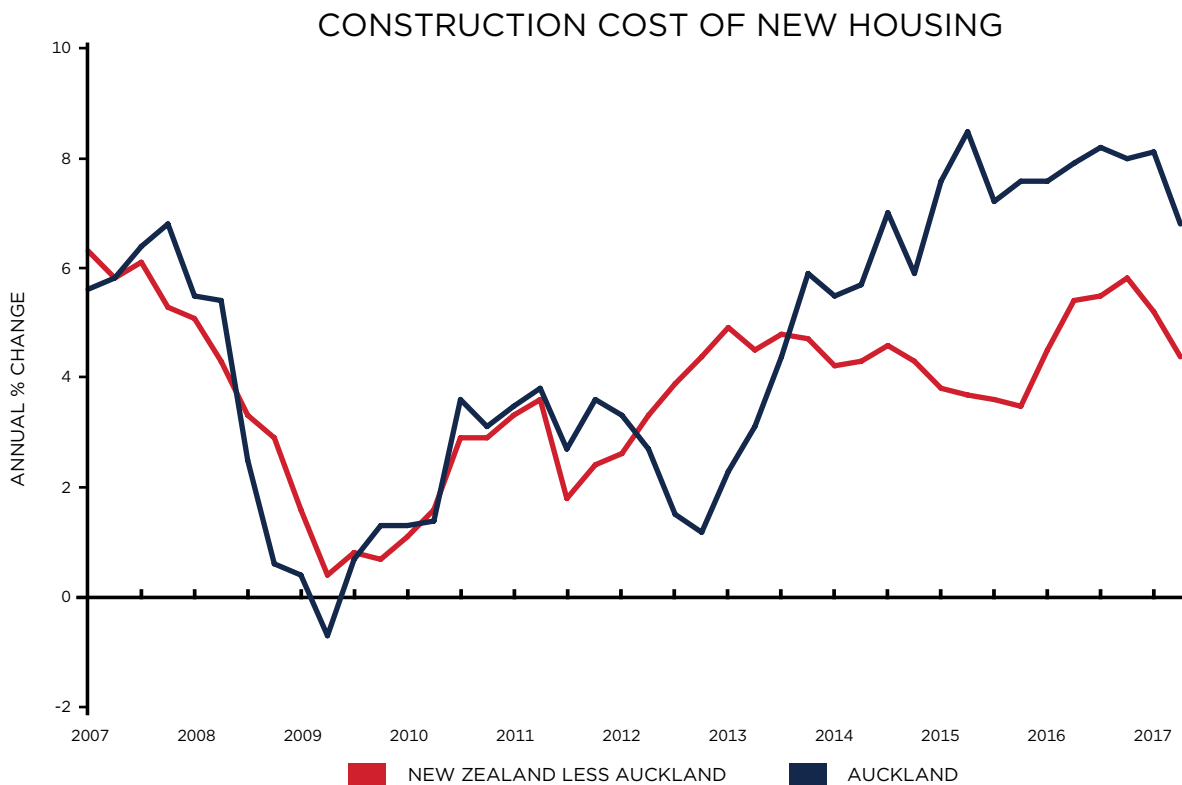
- New accommodation buildings in response to the continued high numbers of international visitors, as well as strong domestic tourism activity.

We expect earthquake strengthening activity will also contribute to non-residential construction demand.

FIGURE 2

Construction cost inflation moderating

Annual % change in residential construction cost



Source: Statistics NZ, NZIER



Building consents by region

Despite some slowing around mid-2017, Auckland continues to lead the growth in non-residential construction demand over the past year. Growth has been particularly strong in demand for new accommodation buildings, reflecting the acute capacity pressures in the Auckland tourism sector. Strong growth in hiring in the professional services sector is also boosting demand for new office space in the region.

Non-residential construction demand has also increased in neighbouring regions Waikato and the Bay of Plenty over the past

year (figure 6). In Waikato, this has been driven by stronger demand for new office and industrial buildings, reflecting the spill-over effects of strong population growth from Auckland. Meanwhile, growth in the Bay of Plenty has been driven by stronger demand for new education buildings and retail outlets. We expect non-residential construction demand in these 'halo' regions will continue to lift over the coming years.

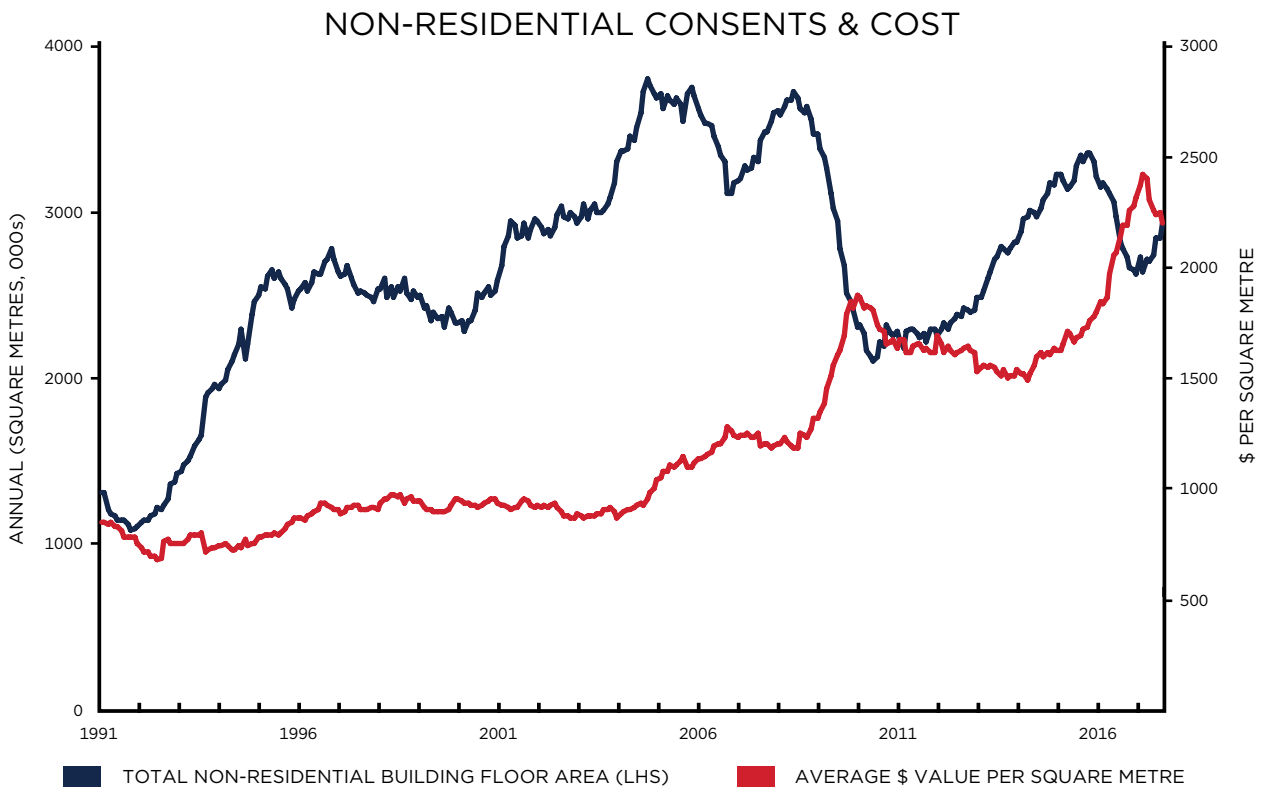
In contrast, non-residential consent issuance in other main cities such as Wellington has eased over the past year. Although

demand for accommodation and healthcare facilities have increased, this has been offset by lower demand for retail outlets and office buildings in the region.

Non-residential consent issuance in Canterbury continues to drop on lower demand for healthcare and education facilities over the past year. Post-earthquake rebuild activity should continue to underpin non-residential construction demand, although the level of activity is likely to continue to ease over the coming year.

FIGURE 3
Construction costs still high despite recent slowing

Annual floor area; \$ per square metre

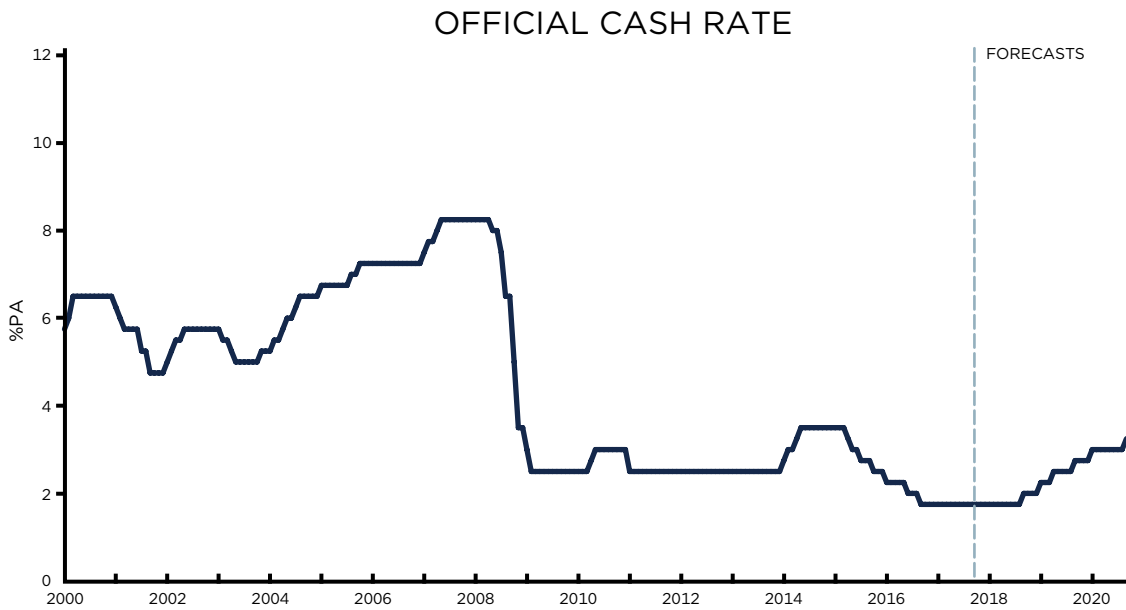


Source: Statistics NZ, NZIER

FIGURE 4

We expect interest rates on hold for much of 2018

%pa

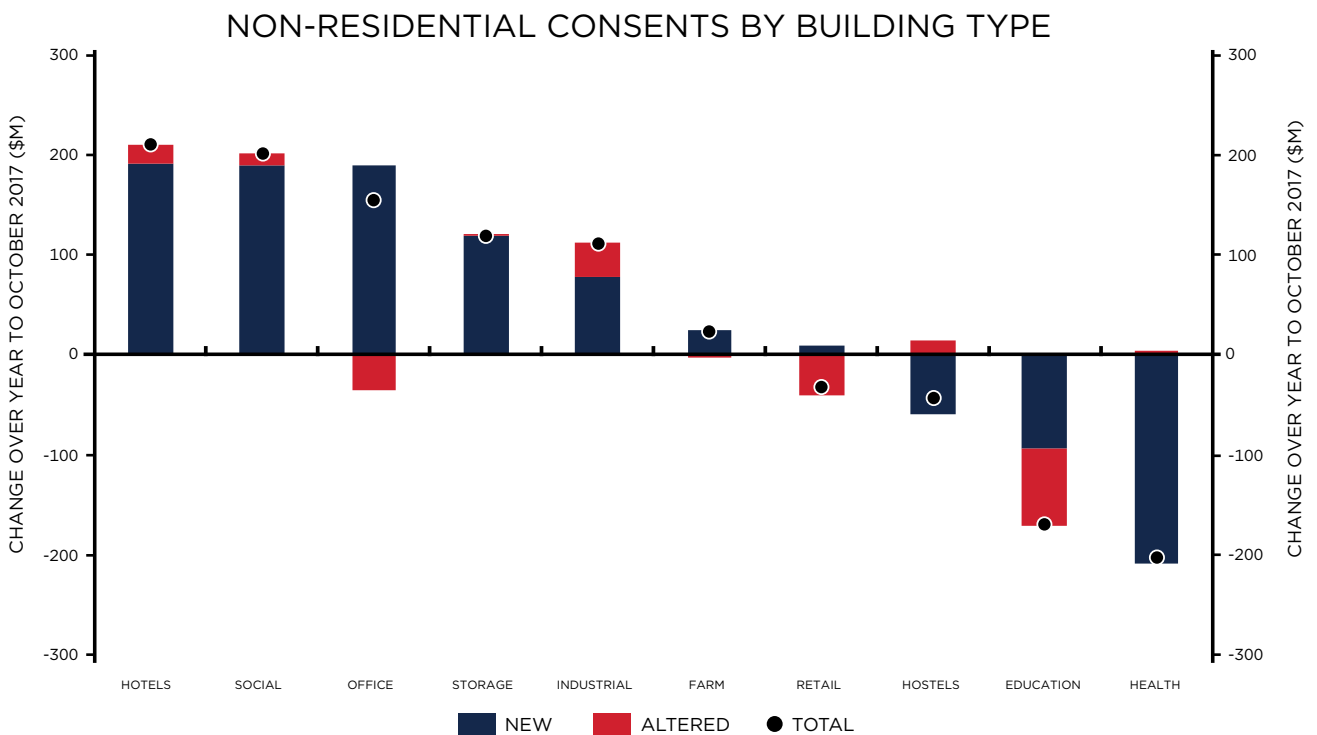


Source: RBNZ, NZIER

FIGURE 5

Strong tourism activity continues to drive demand for hotel developments

Annual change in consents, \$m, year ended October 2017

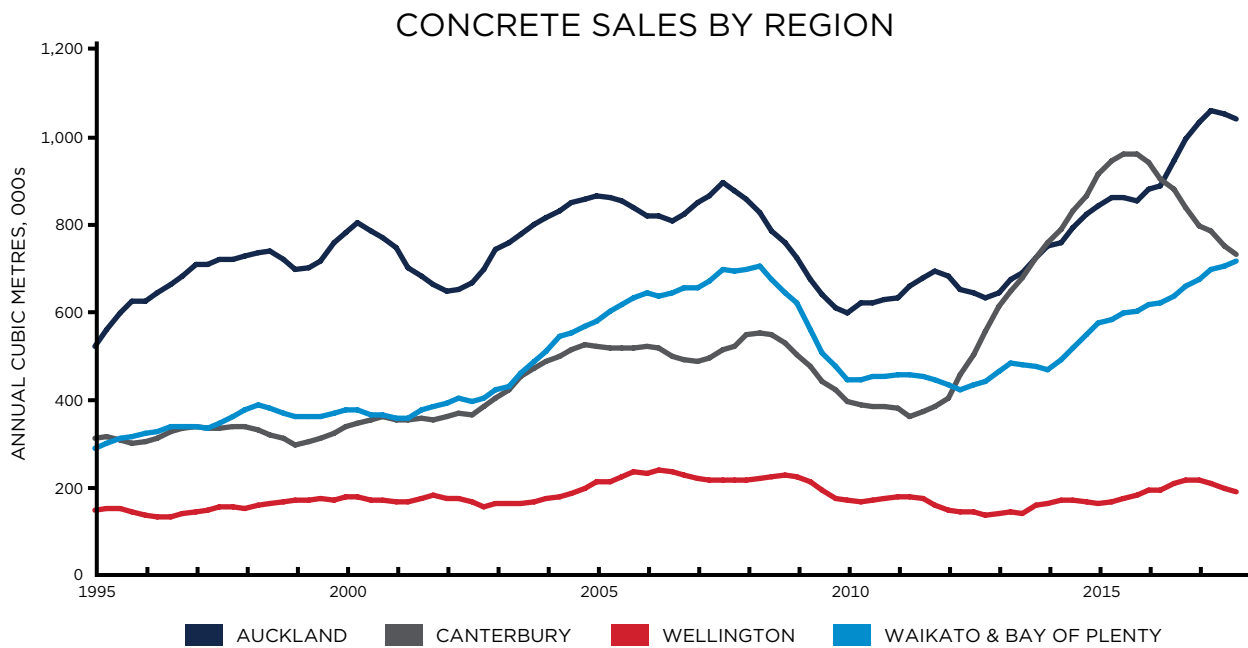


Source: Statistics NZ, NZIER

FIGURE 6

Construction demand eased in mid-2017, but still high

Annual cubic metres, 000s



Source: Statistics NZ

TABLE 1

Non-residential building consents by region and sector

\$m of consents for the year ending October 2017; red colour shading for decline in consents from previous year

REGION	SECTOR									
	HOSTELS, PRISONS ETC	ACCOMODATION	HEALTH	EDUCATION	SOCIAL, CULTURAL, RELIGIOUS	RETAIL	OFFICE	STORAGE	INDUSTRIAL	FARM
NORTHLAND	0.8	16.6	8.8	17.5	11.1	8.5	7.9	5.8	6.8	10.6
AUCKLAND	119.3	231.1	109.2	408.3	206.0	322.5	637.5	330.3	150.1	26.8
WAIKATO	3.5	15.1	17.7	58.6	19.5	67.6	72.0	61.9	96.5	56.1
BAY OF PLENTY	0.0	3.8	32.3	82.8	19.1	67.2	49.8	65.9	51.9	10.2
GISBORNE	0.0	0.1	0.1	5.5	5.2	0.8	11.1	2.0	2.8	2.4
HAWKE'S BAY	4.7	0.2	14.3	12.6	15.7	10.4	9.6	23.4	39.7	6.0
TARANAKI	0.0	0.8	1.9	13.3	10.7	2.4	8.8	5.3	16.5	25.0
MANAWATU-WANGANUI	4.8	2.1	6.1	34.0	10.9	30.4	11.7	10.6	14.4	17.0
WELLINGTON	3.7	58.7	52.2	89.4	54.7	50.1	178.2	21.6	32.7	7.8
NELSON	0.1	0.0	4.0	2.6	0.5	4.7	29.5	12.3	4.3	0.4
TASMAN	0.0	0.3	0.7	4.3	0.0	1.1	3.7	9.9	7.4	5.7
MARLBOROUGH	7.6	0.3	5.2	5.9	1.4	1.6	3.2	3.0	13.9	3.1
WEST COAST	0.0	8.7	43.7	1.9	1.7	1.9	0.2	0.6	1.0	2.9
CANTERBURY	31.9	73.4	116.3	223.5	195.2	150.3	239.3	227.7	99.6	53.7
OTAGO	21.9	37.6	22.3	71.7	29.9	44.0	51.1	13.9	30.2	18.1
SOUTHLAND	4.8	1.7	0.1	5.5	0.2	7.5	3.5	5.1	47.5	14.6

Source: Statistics NZ, NZIER



BUILDING COSTS

The Capital Goods Price Index for Non-Residential Buildings (CGPI-NRB) (the Index) is an official measure of cost movements in the sector. The Index excludes GST. We use the Index as an indicator of cost escalation.

The Index is a national average across all building types. We therefore advise caution in applying the increase in the CGPI-NRB as an indicator of cost escalation for specific projects.

The Rider Levett Bucknall Fourth Quarter 2017 Oceania Report provides local regional comment and tender price relativity between the main New Zealand and Australian centres. This publication is available at www.rlb.com or on request from any Rider Levett Bucknall office.

We forecast construction cost inflation to moderate to 4 percent by the end of 2018. Beyond that, we expect annual construction cost inflation to ease to around 3.5 percent by 2021, as capacity pressures in the construction sector eases.

Despite the solid construction growth outlook for the next few years, we do not expect the inflation to be as strong as the mid-2000s given that the lower inflation environment limits the extent to which rising costs can be passed on quickly, and strong net migration is alleviating skills shortages in the building sector.

FIGURE 7

Non-residential building cost escalation

CGPI-NRB index, annual % change



Source: Statistics NZ, NZIER forecasts

TABLE 2**Non-residential building cost index**

YEAR	QUARTER	INDEX	QUARTERLY % CHANGE	ANNUAL % CHANGE
2012	MARCH	1351	0.1	1.3
	JUNE	1352	0.1	0.7
	SEPTEMBER	1354	0.1	0.5
	DECEMBER	1358	0.3	0.7
2013	MARCH	1365	0.5	1.0
	JUNE	1372	0.5	1.5
	SEPTEMBER	1383	0.8	2.1
	DECEMBER	1402	1.4	3.2
2014	MARCH	1413	0.8	3.5
	JUNE	1429	1.1	4.2
	SEPTEMBER	1440	0.8	4.1
	DECEMBER	1456	1.1	3.9
2015	MARCH	1471	1.0	4.1
	JUNE	1480	0.6	3.6
	SEPTEMBER	1494	0.9	3.8
	DECEMBER	1502	0.5	3.2
2016	MARCH	1514	0.8	2.9
	JUNE	1529	1.0	3.3
	SEPTEMBER	1548	1.2	3.6
	DECEMBER	1586	2.5	5.6
2017	MARCH	1595	0.6	5.4
	JUNE	1613	1.1	5.5
	SEPTEMBER	1629	1.0	5.2
	DECEMBER	1648	1.2	3.9
2018	MARCH	1664	1.0	4.4
	JUNE	1680	1.0	4.2
	SEPTEMBER	1697	1.0	4.1
	DECEMBER	1715	1.1	4.0
2019	MARCH	1732	1.0	4.0
	JUNE	1748	1.0	4.0
	SEPTEMBER	1765	1.0	4.1
	DECEMBER	1781	0.9	3.9
2020	MARCH	1797	0.9	3.8
	JUNE	1813	0.9	3.7
	SEPTEMBER	1829	0.9	3.6
	DECEMBER	1845	0.9	3.5
2021	MARCH	1861	0.9	3.5
	JUNE	1877	0.9	3.5
	SEPTEMBER	1893	0.9	3.5
	DECEMBER	1908	0.8	3.4

Notes: The current and forecast CGPI-NRB is a national average, which does not differentiate between regions or building types. We therefore advise caution in applying the increase in the CGPI-NRB as a measure of cost escalation for specific building projects.

Source: Statistics NZ, NZIER forecasts

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