



FORECAST REPORT 87

NEW ZEALAND TRENDS IN
PROPERTY AND CONSTRUCTION

SECOND QUARTER 2018

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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 87

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

Non-residential construction picked up in the December quarter, led by stronger demand in Auckland. Although residential construction eased slightly over the quarter activity remained at high levels.

Net migration continues to slow

A lift in the number of people leaving New Zealand and easing in the number of people moving here is driving a slowing in net migration. However, the strong population growth of recent years should continue to underpin solid underlying demand for construction over the next few years.

Demand for industrial building picks up

Despite a drop in business confidence reflecting uncertainty over the effects of new Government policies, demand for industrial buildings remains strong. Meanwhile, high numbers of tourist inflows continue to support demand for construction of hotels.

Interest rates likely on hold until 2019

The growth outlook remains solid, buoyed by demand from strong tourism activity and the surge in population in recent years. However, inflation remains contained. Combined with the uncertainty over the effects of new Government policies here in New Zealand, as well as ongoing diplomatic tensions offshore, there is little urgency for the Reserve Bank to tighten monetary policy, and we expect it will keep the Official Cash Rate on hold until at least the first quarter of 2019.

BUILDING ACTIVITY TRENDS

Construction lifted in December 2017, reversing out the decline in activity over the first half of last year. Underlying construction demand remains strong, but capacity constraints continue to hamper the degree to which construction activity can ramp up. The announcement by the new Government that it will step in to underwrite the financing of some residential developments as part of its Kiwibuild programme should ease some of the financial constraints.

Net migration continues to slow, reflecting both increased numbers of people leaving the country and an easing in the number of people moving to New Zealand. Although migration numbers are volatile from month to month, the trend is one of slowing net migration. An increased number of non-New Zealand residents are driving the higher number of permanent

departures, likely reflecting people leaving as the tenure of their temporary work and student visas comes to an end.

We expect further slowing in net migration, driven by a further easing in the number of people coming into the country on student visas. Meanwhile, the number of people coming in on work visas is likely to remain high as migrants help to relieve labour shortages in some sectors including construction. The number of technicians and trades' workers moving to New Zealand on a work visa has increased sharply in recent years, with these workers outnumbering professionals moving to the country over the period 1 July 2017 to 31 January 2018.

Despite the easing in net migration since the middle of last year, strong population growth in recent years should continue to support

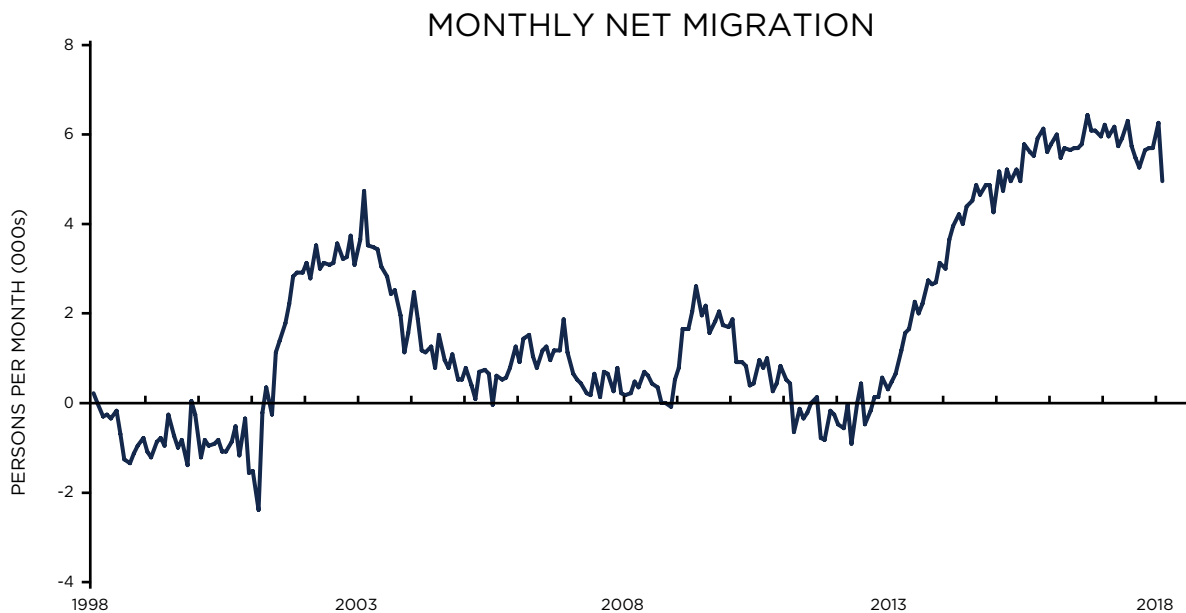
underlying construction demand over the next few years. This is particularly the case for residential construction, where increased housing demand from the surge in population has outpaced house-building activity in recent years.

There has been a shift towards demand for multi-unit dwellings over the past year, reflecting the increasing recognition of the need for higher density housing as a more efficient means of meeting the increased housing demand from population growth. We expect further growth in demand for apartments and townhouses over the coming years, particularly given the Government's plans to underwrite financing of housing developments as part of its Kiwibuild programme to build 100,000 dwellings over the next decade. Standalone houses remain popular, but we expect demand for this type of housing will continue to soften, especially in Auckland where there is a shortage of land readily available for housing.

FIGURE 1

Net migration slowing

Net inflows per month, seasonally adjusted



Source: Statistics NZ, NZIER

Although underlying construction demand remains very strong, capacity constraints continue to limit the rate of growth. The announcement by Fletcher Building in mid-February that it will stop bidding for “vertical construction” work after fulfilling its existing contracts introduces a high degree of uncertainty over who will fill the gap in carrying out construction of high rise and commercial or Government buildings. The exit of Fletcher Building from the market leaves a gap in construction sector firms operating in the “vertical construction” sector with a large enough balance sheet to take on construction projects of that magnitude.

Meanwhile, construction sector firms continue to report acute labour shortages. Skilled labour is particularly hard to find, although shortages have eased slightly from levels seen in mid-2016. Migrants have helped to alleviate labour shortages, with marked increase in the number of technicians and trades’ workers moving to New Zealand on a work visa in recent years. Although the Government has indicated its intention to tighten migration policy settings, we expect the number of construction workers moving to New Zealand on work visas will remain elevated, given the amount of construction activity required over the coming years.



BUILDING ACTIVITY OUTLOOK

The construction pipeline should be solid for the next few years, as house-building activity lifts to meet increased demand from the surge in population in recent years. Although capacity and financing constraints have hampered the extent of growth in construction over the past year, the Government's intention to underwrite financing of some residential construction developments under its Kiwibuild programme should support construction growth. Construction costs are also moderating, although capacity pressures in the sector are likely to keep costs elevated over the next two years.

We expect further growth in non-residential construction, although weaker business confidence in the wake of the new Government taking office may see some softening in the near term. The new Government's plans to restrict overseas investment has the potential to weigh on demand for commercial developments. Nonetheless, strong tourism activity continues to drive demand for hotels, and there has also been strong growth in demand for industrial buildings.

A key uncertainty is the announcement by Fletcher Building of its intentions to exit the "vertical construction" sector after fulfilling its existing contracts. Besides leaving a gap in companies who can carry out large-scale commercial and Government developments, Fletcher Building's exit from the sector is putting upward pressure on construction costs. There has been a recent shift in contract terms. Where previously the risk of cost over-runs had fallen on the lead contractors, alternative forms of contracts are emerging, with the risk shared between the contractor and the commissioning party.

ECONOMIC BACKDROP

Uncertainty over the effects of the new Government's policies has weakened business confidence. However, the effects have largely been on sentiment, with firms reporting demand in their own business holding up.

The economic growth outlook remains solid. Population growth is slowing, but there is still a large degree of building activity required to accommodate the surge in population over recent years. Given the lagged effects of population growth on economic activity, particularly construction, we expect a moderation in economic growth from the slowing in population growth will not become apparent until 2021.

We expect tourism will remain strong over the coming years as the improvement in the global economy encourages tourists from a wide range of countries to visit New Zealand. Tourism spending will be an important contributor to regional economic development.

INTEREST AND EXCHANGE RATES

Inflation remains contained, and there is heightened uncertainty both here in New Zealand over the effects of new Government policies and offshore from deteriorating diplomatic relations. This all points to no urgency for the Reserve Bank to start tightening monetary policy. We expect, however, that by early next year there will be evidence of cost pressures getting more widely reflected in rising output prices. We now forecast the Reserve Bank to lift the Official Cash Rate from February 2019.

The new Reserve Bank Governor Adrian Orr has signed a new Policy Targets Agreement

with the new Government, and signalled changes will be made to the 1989 Reserve Bank Act. Changes include an additional target for monetary policy to support "maximum levels of sustainable employment" in addition to keeping inflation at its 2 percent mid-point target over the medium term. To the extent that the Reserve Bank was already be considering the effects of monetary policy on economic activity under the previous PTA, this addition should not necessarily change how monetary policy is implemented.

The move to a committee-based decision-making model for monetary policy formalises the fact that an internal Governing Committee is already collectively making decisions on monetary policy. However, the introduction of external voting members to the committee, albeit a minority, still has the potential to influence the outcome of monetary policy decisions. For now, we do not expect any material changes to the interest rate outlook.

Following the depreciation prior to the election and after the formation of the Labour-led coalition government, the NZ dollar has been more buoyant in recent months. Looking ahead to early 2019, a considerable differential will have opened up between the Fed Funds Rate and the OCR – based on current market pricing of further Federal Reserve tightening steps. In addition, by then the European Central Bank will most likely have ended its monthly liquidity injections and mapped out a course for tightening policy. This – in tandem with rising global bond yields – is expected to put increasing downward pressure on the NZ dollar.

BUILDING INVESTMENT

The NZIER *Quarterly Survey of Business Opinion's* architects' measure of own activity points to some softening in the pipeline of commercial and Government work. The surge in population and tourism activity in recent years have increased demand for accommodation buildings and infrastructure. However, with the new Government reprioritising its spending there is now uncertainty over the viability of some infrastructure projects.

BUILDING CONSENTS

Demand for social buildings have overtaken hotel developments as the top driver of growth in non-residential construction demand over the past year. However, we expect strong tourism activity to underpin further increases in demand for hotels over the coming years. Meanwhile, demand for industrial buildings continues to improve.

In contrast, demand for education buildings and healthcare facilities have fallen over the past year, albeit from very high levels, particularly in Canterbury.

Building consents by sector

Although net migration continues to slow, we expect population growth (while moderating) and tourism demand will continue to underpin many of the longer-term trends:

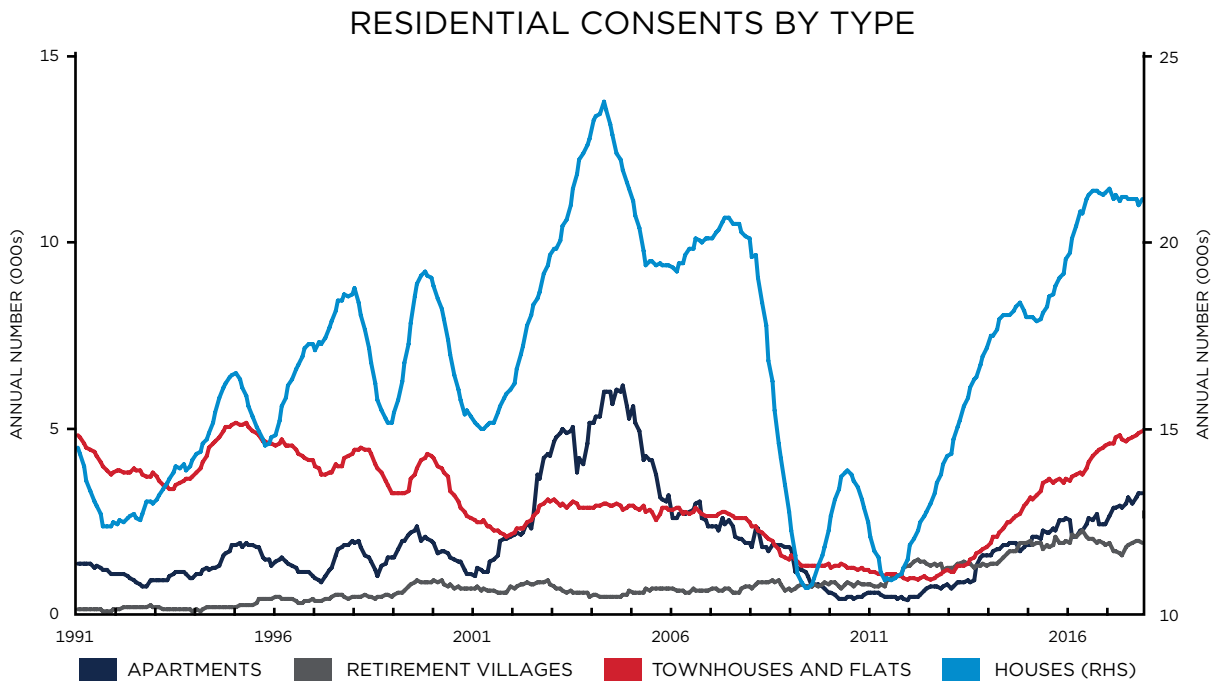
- Office growth to accommodate the higher number of white collar workers.
- New accommodation buildings in response to the continued high numbers of international visitors, as well as strong domestic tourism activity.

Earthquake strengthening activity should also contribute to non-residential construction demand.

FIGURE 2

Increased demand for higher density housing

Annual % change in residential construction cost



Source: Statistics NZ, NZIER



Building consents by region

Auckland continues to lead growth in non-residential construction demand over the past year. Demand in Auckland strengthened across a broad range of sectors, with particularly large increases in demand for hotels and social buildings. With capacity pressures in the Auckland tourism sector remaining acute, we expect a further strengthening in demand for hotels.

The regions neighbouring Auckland have also seen solid increases in demand for non-residential construction. In Waikato, demand for office space and education buildings have increased, reflecting the spill-over effects from Auckland's strong population growth in recent years. Meanwhile, the Bay of Plenty has seen strong increases in demand for education buildings and retail outlets.

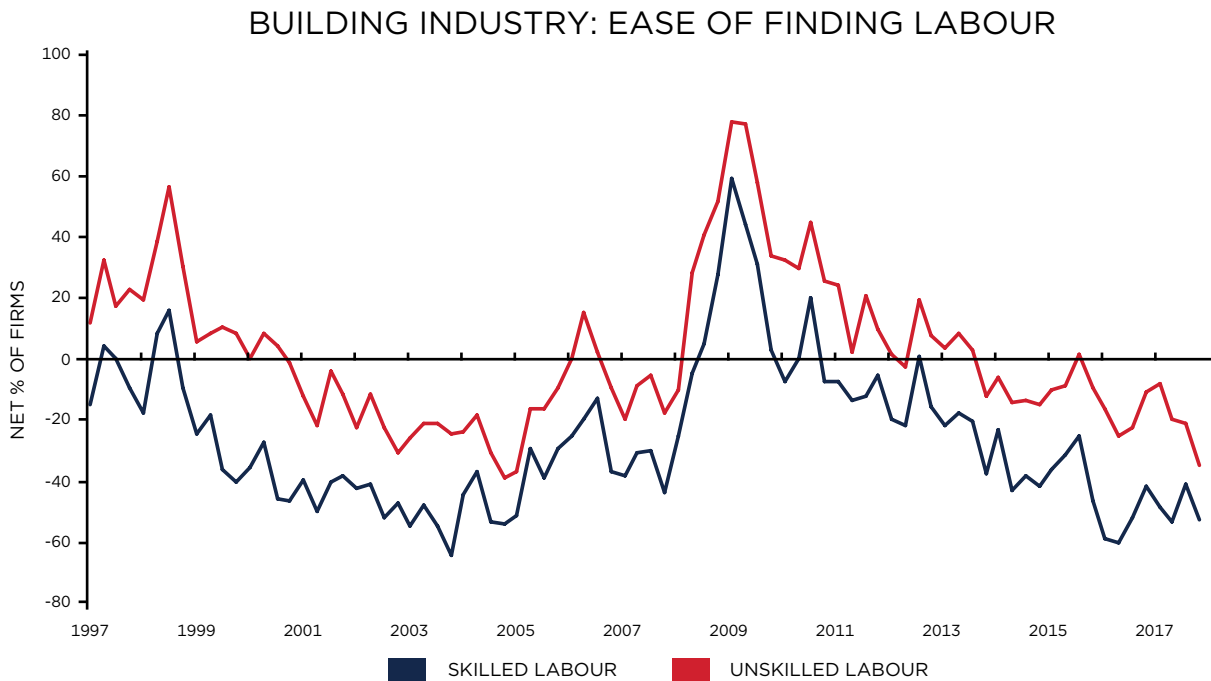
In contrast, non-residential construction demand continues to fall in Canterbury, with particularly large declines in demand for healthcare and education facilities.

Non-residential construction demand has also fallen in Wellington, reflecting lower demand for retail outlets and office space. Business confidence has been particularly soft in Wellington in the wake of the new Government taking office, and this may further dampen demand for investment in new buildings over the coming year.

FIGURE 3

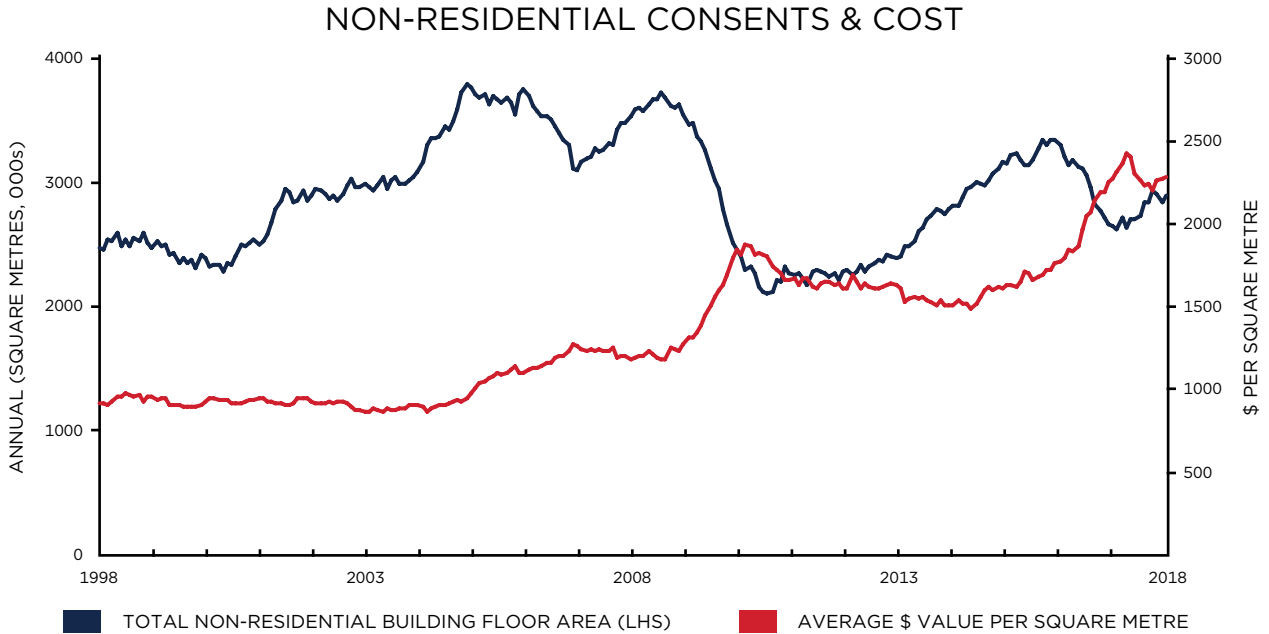
Labour shortages still acute in the building sector

Net % of firms



Source: NZIER

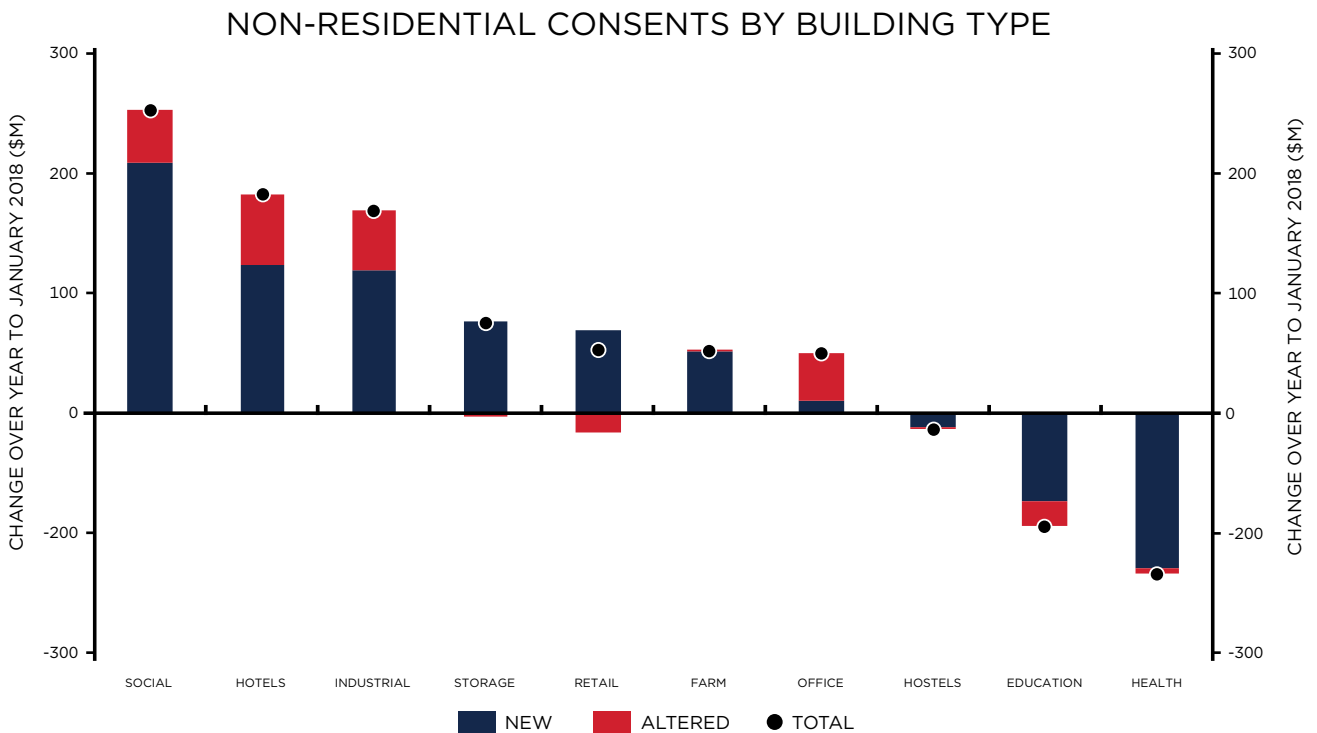
FIGURE 4
Construction costs moderating but still elevated



Source: Statistics NZ, NZIER

FIGURE 5
Strong tourism activity continues to support demand for hotel developments

Annual change in consents, \$m, year ended January 2018

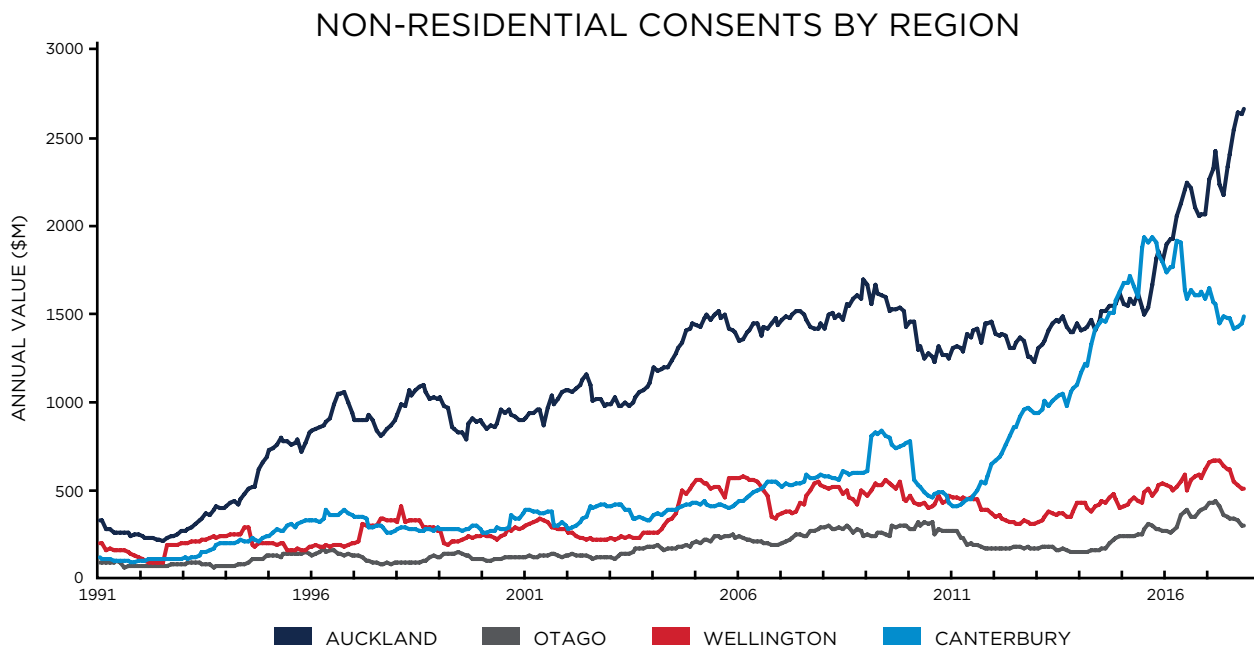


Source: Statistics NZ, NZIER

FIGURE 6

Construction demand strengthening in Auckland

Annual value (\$ million)



Source: Statistics NZ

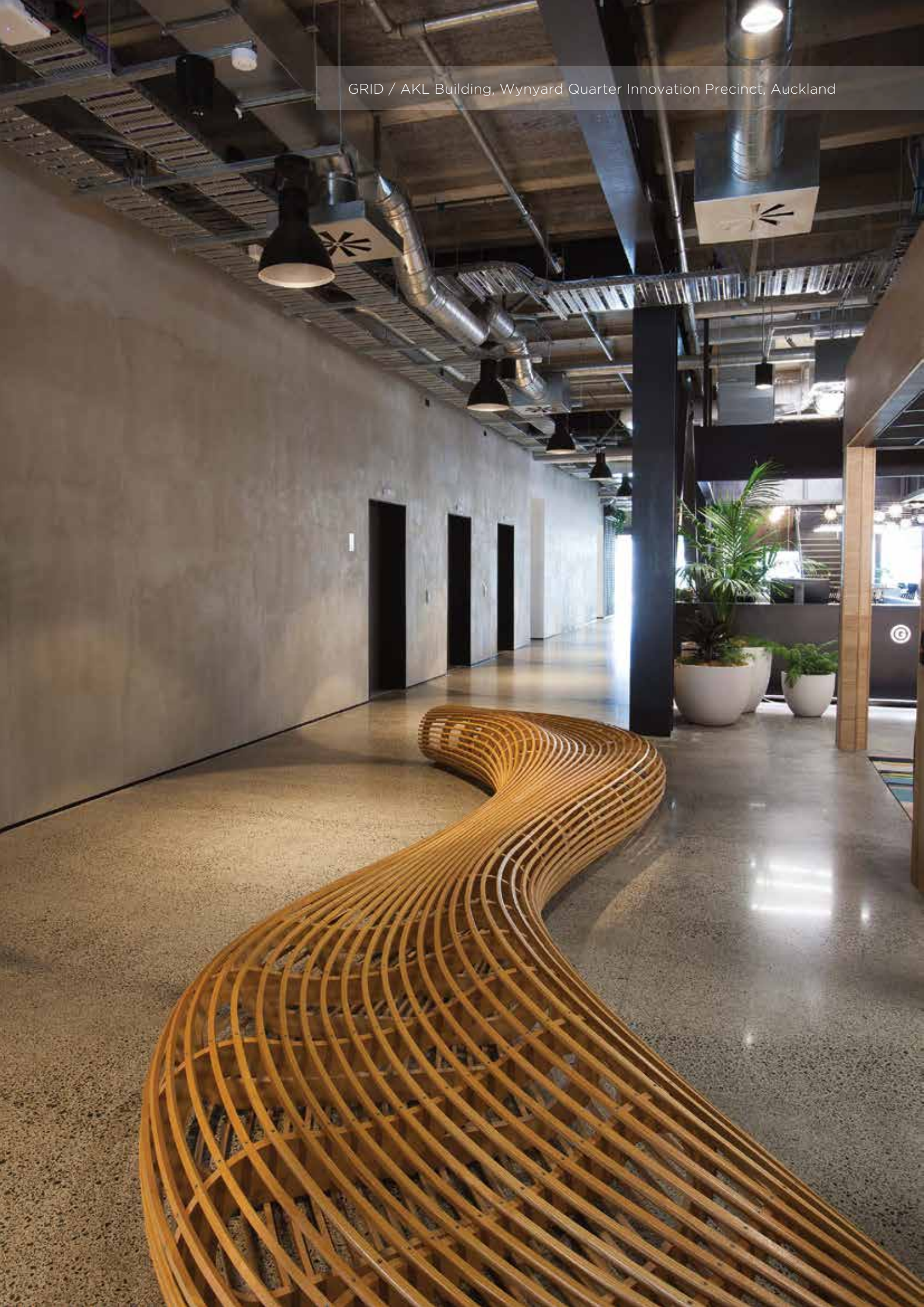
TABLE 1

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	2.9	15.2	16.7	15.6	11.5	4.7	13.0	5.0	7.7	13.5
AUCKLAND	162.8	233.7	141.8	419.0	230.3	352.1	547.3	359.3	196.8	25.0
WAIKATO	3.1	14.8	54.2	67.2	20.3	66.1	74.0	55.1	100.8	54.4
BAY OF PLENTY	0.0	18.0	31.7	73.1	19.7	78.6	85.0	44.6	53.5	11.4
GISBORNE	0.0	0.1	0.0	5.7	5.6	1.7	2.2	2.5	1.6	2.4
HAWKE'S BAY	5.2	0.3	15.2	15.4	14.6	6.7	6.8	28.5	25.5	6.3
TARANAKI	0.0	0.8	2.0	16.7	3.7	3.2	11.2	5.9	21.6	30.4
MANAWATU-WANGANUI	1.0	1.7	6.5	64.2	9.1	29.0	11.7	12.7	19.2	16.8
WELLINGTON	3.2	39.2	48.7	111.2	74.0	39.3	133.8	17.9	36.4	7.8
NELSON	3.0	0.0	1.1	3.3	0.2	1.8	29.3	12.0	6.0	0.4
TASMAN	0.0	0.0	0.9	4.4	0.2	1.0	3.9	6.4	6.5	5.6
MARLBOROUGH	7.8	1.0	8.7	5.3	2.3	1.4	2.8	4.9	13.0	3.5
WEST COAST	0.0	7.4	1.9	1.8	1.3	1.9	0.2	1.5	1.5	3.0
CANTERBURY	28.2	76.9	142.4	233.6	217.3	192.3	219.8	185.6	108.1	81.7
OTAGO	1.2	40.2	25.5	33.7	29.0	45.5	51.8	16.4	31.2	22.2
SOUTHLAND	0.2	2.2	0.2	5.1	0.1	6.9	6.6	1.3	37.1	14.3

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 First

Quarter 2018 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 peak at just below 5 percent before moderating to 4 percent by late 2019. Beyond that, we expect annual construction cost inflation to ease to around 3.5 percent in late 2020, as capacity pressures in the construction sector eases.

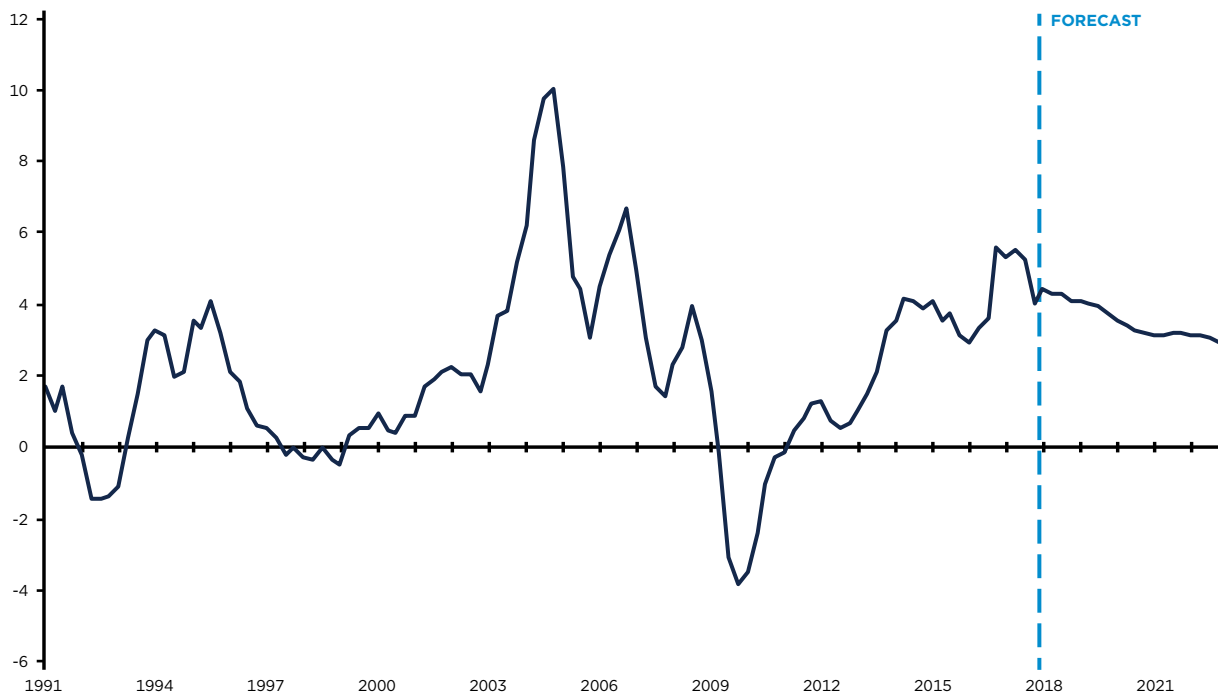
We expect an extended period

where construction cost inflation is elevated. The exit of Fletcher Building from the “vertical construction” sector increases the uncertainty over the degree of construction cost escalation, but large cost increases are likely to see a push-back in demand as developments no longer become financially feasible. This is likely to lead to a more protracted construction cycle. The lower inflation environment also limits the extent to which rising costs can be passed on quickly, and migrants are helping to alleviate 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
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	1650	1.3	4.0
2018	MARCH	1669	1.2	4.7
	JUNE	1689	1.2	4.7
	SEPTEMBER	1709	1.2	4.9
	DECEMBER	1729	1.2	4.8
2019	MARCH	1747	1.0	4.7
	JUNE	1764	0.9	4.4
	SEPTEMBER	1780	0.9	4.2
	DECEMBER	1797	0.9	3.9
2020	MARCH	1814	1.0	3.9
	JUNE	1830	0.9	3.8
	SEPTEMBER	1845	0.8	3.6
	DECEMBER	1860	0.8	3.5
2021	MARCH	1874	0.8	3.3
	JUNE	1889	0.8	3.2
	SEPTEMBER	1904	0.8	3.2
	DECEMBER	1919	0.8	3.2
2022	MARCH	1935	0.8	3.2
	JUNE	1951	0.8	3.3
	SEPTEMBER	1967	0.8	3.3
	DECEMBER	1981	0.7	3.2

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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