A photograph of the Manukau Bus Station, a modern building with a large, angular, copper-clad roof and extensive glass facades. The station is set against a clear blue sky with light clouds. The foreground shows a paved plaza with yellow tactile paving and wooden benches.

THIRD QUARTER 2018

FORECAST REPORT 88

NEW ZEALAND TRENDS IN
PROPERTY AND CONSTRUCTION

Manukau Bus Station

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Palmerston North

Queenstown

Tauranga

Wellington

Cover: Manukau Bus Station, Auckland

Disclaimer: While the information in this publication is believed to be correct at the time of publishing, no responsibility is accepted for its accuracy. Persons desiring to utilise any information appearing in the publication should verify its applicability to their specific circumstances. Cost information in this publication is indicative and for general guidance only and is based on rates as June 2018. National statistics are derived from the Statistics New Zealand.

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 88

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

Broad-based decline in construction activity

Construction activity eased across the residential, commercial and Government sectors over the first quarter of 2018. We expect this easing in construction activity to be temporary given underlying demand remains strong, supported by the population surge in recent years.

Further slowing in net migration

Net migration continued to slow on the back of a reduction in the number of people moving to New Zealand from overseas. There are also tentative signs of net outflows to Australia, as the labour market across the Tasman picks up.

Auckland continues to lead non-residential construction demand

We expect a continued increase in construction workload over the coming years. Auckland continues to lead the strength in non-residential construction demand, driven by growth in demand for social and cultural as well as industrial buildings.

No urgency to lift interest rates

There is growing conviction that interest rates will be lifted globally, led by the US Federal Reserve. However, heightened uncertainty amongst businesses over the effects of new Government policies here in New Zealand adds to the case for little urgency for the Reserve Bank to start lifting the Official Cash Rate. With inflation remaining contained, we expect no change in the OCR until mid-2019.



BUILDING ACTIVITY TRENDS

Construction eased in the first quarter of 2018, driven by broad-based reductions across the residential, commercial and Government sectors. Despite this, the level of construction activity remains high. Underlying construction demand remains strong, but growth in construction is hampered by continued capacity and financing constraints in the construction sector.

Net migration continues to slow on the back of an easing in the number of people moving to New Zealand from overseas. The number of people leaving the country is also lifting, partly driven by the departure of people who had come into the country on temporary work and student visas in the past few years as the tenure of these visas comes to an end.

There are also tentative signs of net outflows to Australia, as improving job prospects across the Tasman encourages people to

leave. However, the net outflow of 180 people over the past year is well below the historical average net outflow of 16,000. We expect that as the Australian labour market continues to improve this would support further net outflows across the Tasman.

Concrete usage fell across many regions, including Auckland and Canterbury. This points to an easing in construction activity in these regions. These declines in the major regions contrast with the rise in concrete usage in the “halo” regions of Waikato and Bay of Plenty, indicating strengthening construction activity in these regions.

But we expect the population surge in recent years should continue to support demand for construction over the next few years. The NZIER Quarterly Survey of Business Opinion indicates a solid pipeline of construction, with

architects reporting increased work in their own office across the residential, commercial and Government sectors over the coming year.

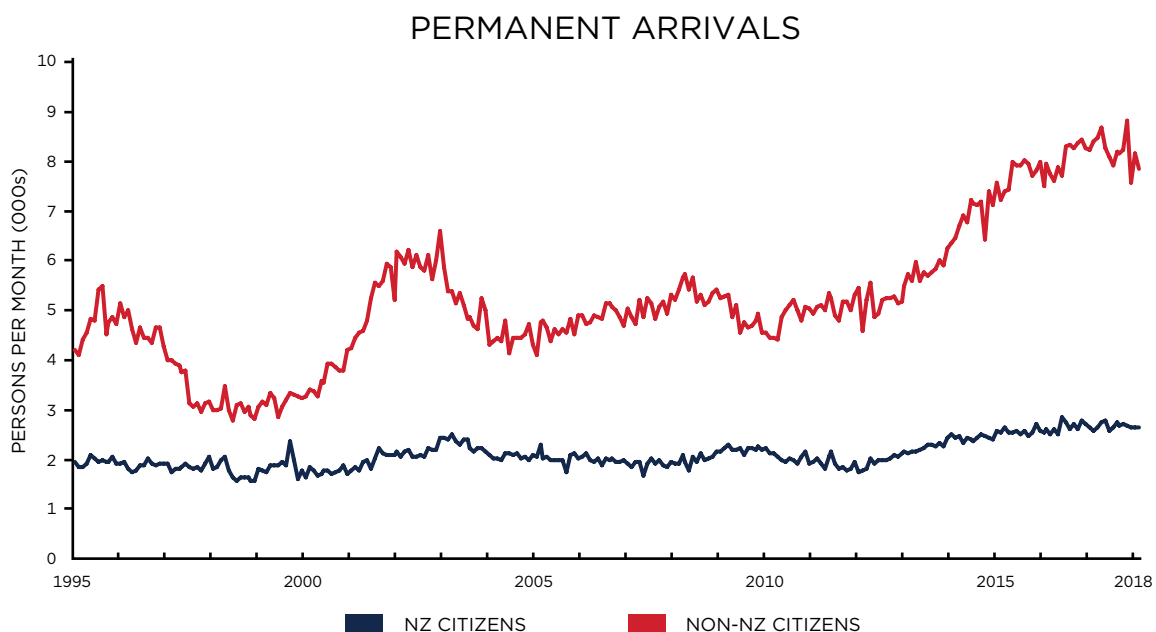
Capacity and financing constraints have weighed on construction activity, with some developments put on hold given they no longer meet feasibility criteria. However, the Government’s ambitious Kiwibuild plan to build 100,000 affordable dwellings over the next decade by underwriting the financing of housing developments will ease some of the financing constraints in the construction sector. This will likely see some developments brought forward over the next few years.

Nonetheless, capacity constraints remain in the construction sector. There is concern that labour shortages will become more acute with the slowing in net migration.

FIGURE 1

Less people moving to NZ from other countries

Permanent arrivals per month, seasonally adjusted



Source: Statistics NZ, NZIER

BUILDING ACTIVITY OUTLOOK

BUILDING ACTIVITY OUTLOOK

Underlying construction demand remains strong, with the pipeline of work solid. The surge in population in recent years has increased the demand for housing, with a shift towards demand for apartments and townhouses. This reflects the growing recognition that intensification of housing is required to meet the increased demand from population growth. We expect this trend to continue over the coming years, as the Government embarks on its ambitious Kiwibuild programme to provide 100,000 affordable dwellings over the next decade.

However, capacity and financing constraints in the construction sector will limit the extent to which activity can ramp up. Although demand is strong, the fragmented nature of the sector means that construction companies are grappling with low operating margins, labour shortages and difficulty accessing finance. Many smaller and mid-sized construction companies also face the challenge of cashflow issues, with delays in payment and completion of projects threatening their livelihood.

Plans by major construction company Fletcher Building to restructure and pull out of “vertical construction” work once it has fulfilled its existing contracts highlight the difficult conditions many firms in the construction sector are operating in. There remains a high degree of uncertainty in the wake of Fletcher Building’s exit from “vertical construction” work over who will have a sufficiently large balance sheet to lead the construction of high rise and commercial or Government buildings.

ECONOMIC BACKDROP

Businesses remain downbeat in the wake of the new Government taking office, likely reflecting pessimism about increased costs due to policy changes, such as the lift in the minimum wage. This pessimism is at odds with businesses’ own trading activity, which continues to hold up. Although businesses appear more circumspect about the future, there is renewed interest to invest in new capital equipment. With wage growth looking to pick up this is encouraging businesses to turn towards labour-saving technology to keep costs down.

Offshore, there remains downside risks to the global growth outlook. These risks stem from how the extensive amount of stimulus in the major economies, particularly the US, will be unwound. Tensions between the US and China, as well as renewed geopolitical issues in the Middle East, add to the global uncertainty.

Growth in the New Zealand economy is moderating, but demand still remains healthy. We expect annual growth to average around 3 percent over the next five years.

INTEREST AND EXCHANGE RATES

Inflation remains contained, with measures of core inflation stable. We expect the annual rate of inflation to rebound over the remainder of this year. In the near term this will be partly driven by the effect of the recent rise of global oil prices. However, over the medium term we expect underlying inflation to firm as the economy’s strong performance continues and capacity pressures become more widespread.

There is growing conviction that interest rates will lift globally, led by the continued monetary policy tightening by the US Federal Reserve. However, with inflation contained and heightened uncertainty over the new Government here in New Zealand, there remains little urgency for the Reserve Bank to start lifting interest rates. We expect the OCR to remain on hold until at least mid-2019.

We expect the New Zealand dollar to continue to weaken against the US dollar over the coming year as rising US interest rates reduce the yield attractiveness of New Zealand dollar-denominated investments.

BUILDING INVESTMENT

The NZIER *Quarterly Survey of Business Opinion's* architects' measure of own activity points to a solid pipeline of residential, commercial and Government work. The surge in population and tourism activity in recent years have increased demand for a wide range of buildings, including infrastructure.

BUILDING CONSENTS

Demand for social buildings is the top driver of growth in non-residential construction demand over the past year. Added to that, improved confidence in the agriculture sector is flowing through to a recovery in on-farm investment, with growth in demand for industrial and farm buildings as a result.

In contrast, demand for accommodation and office buildings have declined over the past year. The decline in consent issuance for new office buildings was broad-based across the regions, led by reduced demand in Auckland and Wellington.

Building consents by sector

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

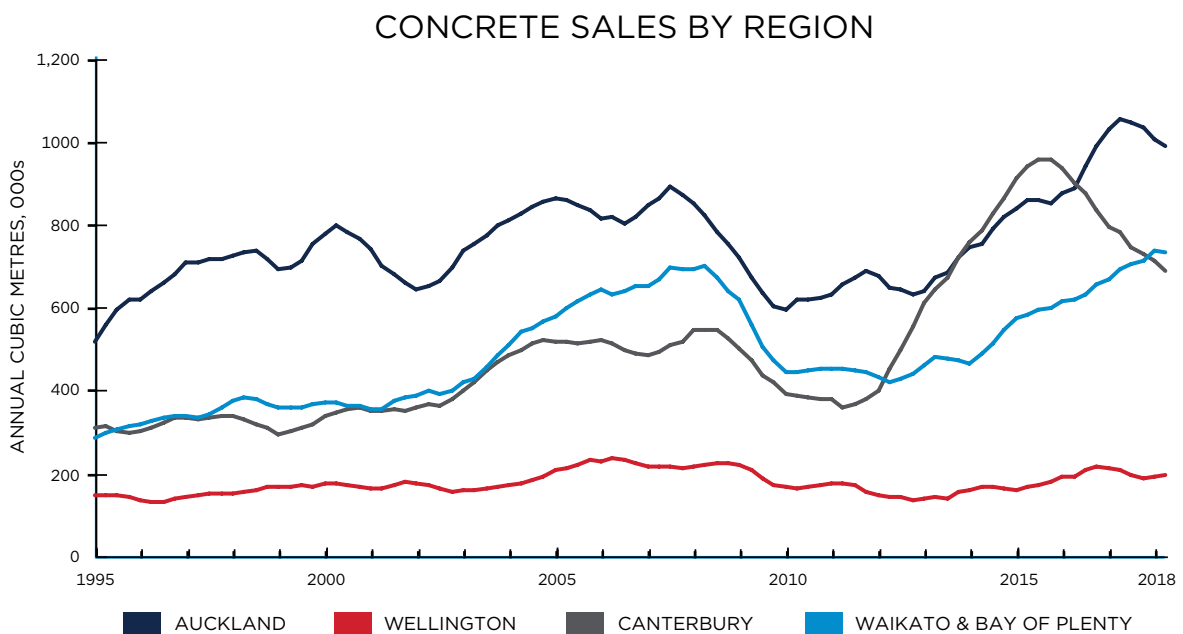
- Office growth to accommodate the higher number of white collar workers.
- New accommodation buildings in response to the continued high numbers of international visitors, as well as strong domestic tourism activity.

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

FIGURE 2

Construction activity falters in early 2018

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. The decline in demand for office buildings was offset by much stronger demand for social, cultural and religious buildings, as well as storage and industrial buildings. Although consent issuance for accommodation buildings fell over the past year, we expect a recovery given continued capacity pressures in the Auckland tourism sector.

Growth in non-residential construction demand in Waikato was broad-based, reflecting the effects of population growth and recovery in on-farm investment as dairy income improves.

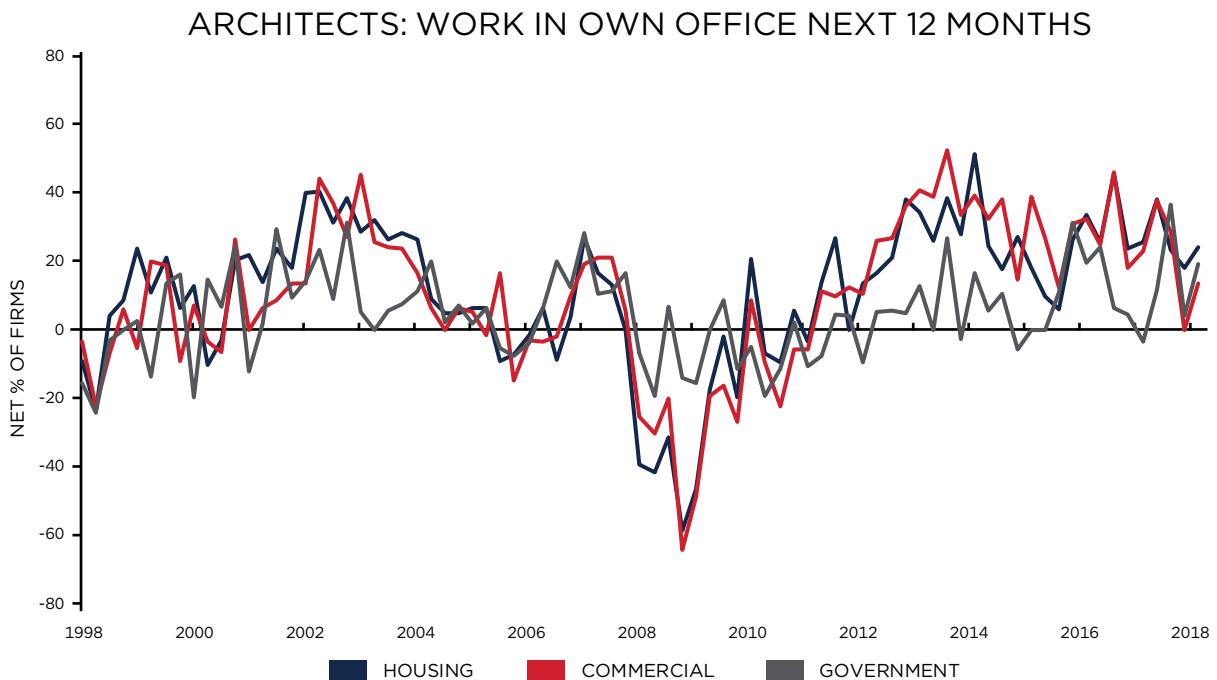
In contrast, there was a sharp drop in non-residential construction demand in Wellington, driven by reduced demand for new office space and

retail outlets. Pessimism amongst Wellington businesses in the wake of the new Government taking office has the potential to further weigh on investment in new commercial buildings over the coming year.

FIGURE 3

Solid pipeline suggests underlying demand strong

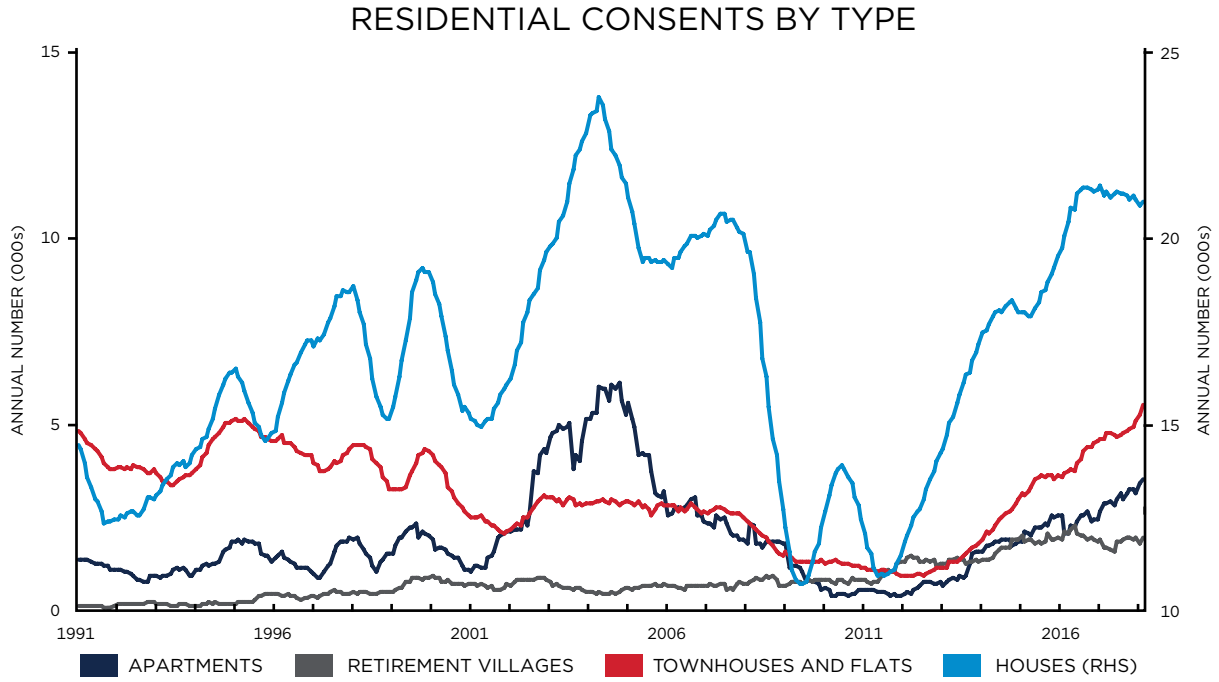
Net % of architects



Source: NZIER

FIGURE 4

Shift towards high-density housing

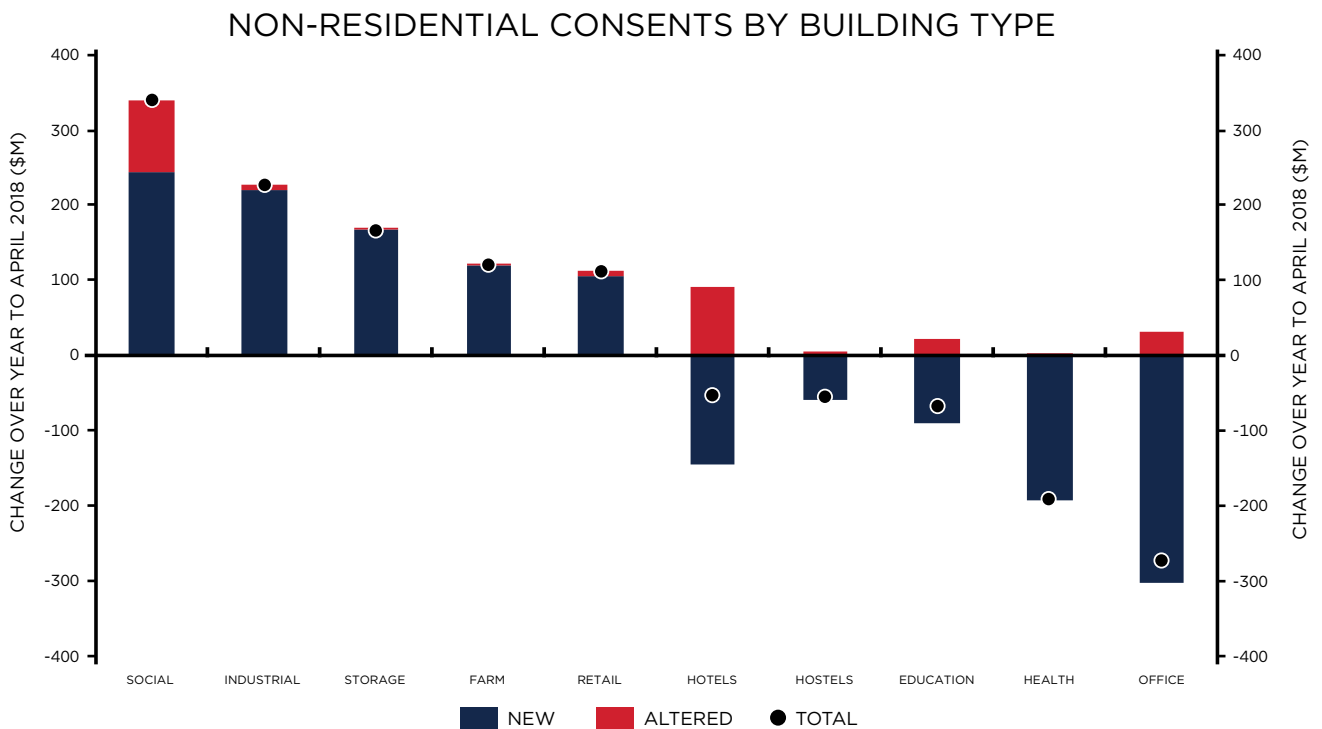


Source: Statistics NZ, NZIER

FIGURE 5

Demand for social and industrial buildings drives non-residential construction growth

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

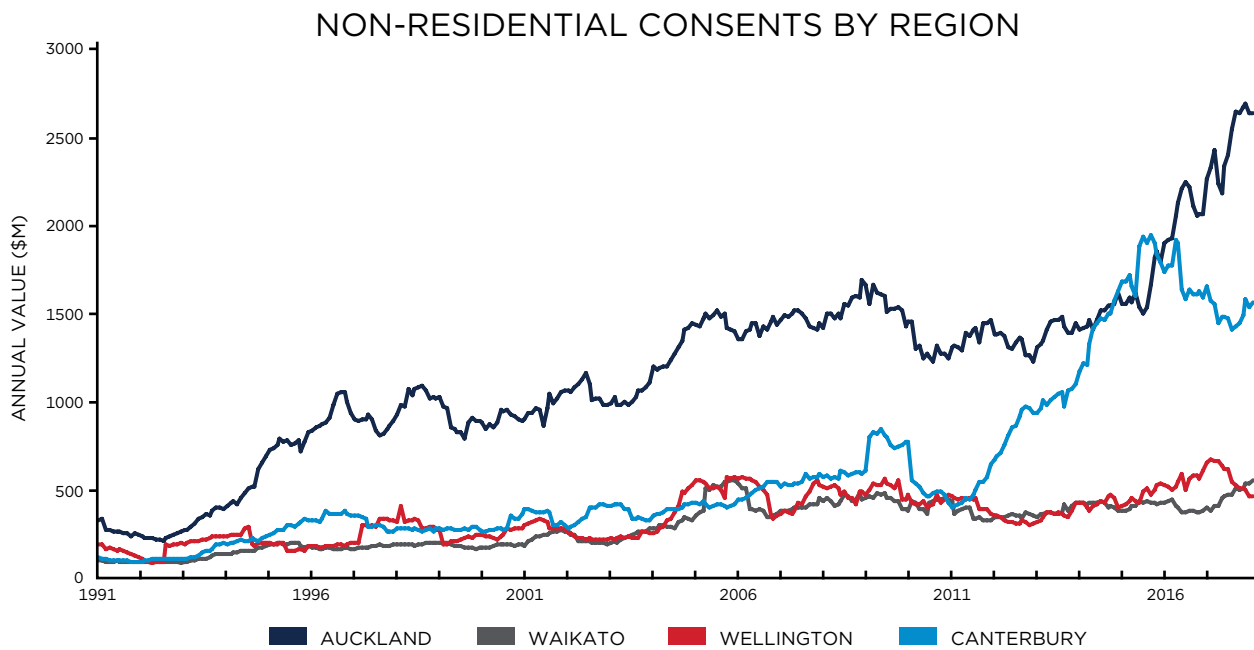


Source: Statistics NZ, NZIER

FIGURE 6

Non-residential construction demand continues to be led by Auckland

Annual value (\$ million)



Source: Statistics NZ

TABLE 1

Non-residential building consents by region and sector

\$m of consents for the year ending April 2018; 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	12.9	17.2	20.7	12.5	6.5	21.0	5.6	7.2	14.3
AUCKLAND	135.5	144.5	142.3	452.9	307.4	380.1	440.8	364.8	240.7	23.8
WAIKATO	3.1	12.1	60.9	64.6	27.1	47.0	66.1	55.5	125.0	93.2
BAY OF PLENTY	0.5	18.0	21.7	70.8	17.1	105.2	83.5	60.9	53.3	11.5
GISBORNE	0.0	0.1	0.0	3.8	1.5	1.7	2.3	2.4	1.2	2.7
HAWKE'S BAY	3.3	0.1	9.3	18.1	17.1	5.7	9.7	21.5	29.6	7.5
TARANAKI	0.0	0.8	2.0	21.3	3.5	11.1	13.0	10.4	22.5	29.0
MANAWATU-WANGANUI	1.0	2.3	17.5	61.9	9.0	26.0	12.8	23.4	30.8	17.0
WELLINGTON	0.9	45.3	43.9	81.9	61.1	52.3	114.2	17.9	38.5	7.6
NELSON	2.9	0.0	5.9	3.7	0.2	1.5	6.9	10.4	8.0	0.4
TASMAN	0.0	0.0	3.8	4.6	0.2	1.9	4.6	17.8	6.7	5.3
MARLBOROUGH	8.7	1.0	8.7	2.7	2.4	4.7	4.0	4.5	14.0	4.2
WEST COAST	0.0	9.1	0.3	2.1	0.7	1.9	1.0	2.3	1.5	3.0
CANTERBURY	18.6	81.3	139.0	255.1	254.5	203.8	189.4	202.5	118.4	98.0
OTAGO	1.3	32.3	24.7	33.8	21.5	41.9	54.5	18.2	28.9	25.4
SOUTHLAND	0.2	1.8	0.2	6.2	0.1	5.3	8.6	4.4	37.3	14.2

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 Second 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 lift to around 4.6 percent in early 2019 before moderating to 4 percent by the end of 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.

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	1664	0.8	4.3
	JUNE	1683	1.2	4.4
	SEPTEMBER	1704	1.2	4.6
2019	DECEMBER	1725	1.2	4.5
	MARCH	1743	1.0	4.7
	JUNE	1760	1.0	4.5
	SEPTEMBER	1776	0.9	4.2
2020	DECEMBER	1793	0.9	3.9
	MARCH	1809	0.9	3.8
	JUNE	1825	0.9	3.7
	SEPTEMBER	1840	0.9	3.6
2021	DECEMBER	1856	0.9	3.5
	MARCH	1872	0.9	3.5
	JUNE	1888	0.9	3.5
	SEPTEMBER	1904	0.9	3.5
2022	DECEMBER	1921	0.9	3.5
	MARCH	1937	0.9	3.5
	JUNE	1954	0.9	3.5
	SEPTEMBER	1971	0.8	3.5
	DECEMBER	1985	0.7	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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