



THIRD QUARTER 2021

# FORECAST REPORT 99

NEW ZEALAND TRENDS IN  
PROPERTY AND CONSTRUCTION

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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 99

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

Although the latest COVID-19 community outbreak has cast a shadow over the New Zealand economic recovery, the longer-term outlook remains positive. Just prior to the outbreak the rebound in activity had been strong, led by growing demand in construction. There remains uncertainty over how the pandemic will play out globally, and where it will settle, but momentum in the New Zealand economy should support a recovery in activity as containment measures and restrictions are relaxed.

### Momentum in the New Zealand economy before latest COVID-19 community outbreak

Over the past year, the New Zealand economy has been responsive to the unprecedented amount of fiscal and monetary policy stimulus, with wage subsidy and support payments, increased Government spending and low interest rates boosting demand across a wide range of sectors. The improvement in business and consumer confidence underpinned increased appetite for spending and investment.

### Strong demand, particularly for residential construction

Strong construction demand has led the New Zealand economic recovery. The pipeline of residential and Government construction work is particularly solid. Residential consent issuance continued to increase to new record highs, with the annual number of dwelling consents totalling over 45,000 for the year to July 2021.

### Acute capacity pressures drive up costs

The combination of strong demand and capacity constraints is driving a sharp increase in costs in the construction sector. Border restrictions are exacerbating labour shortages, with firms unable to hire workers from overseas to keep up with demand. Meanwhile, firms are finding it even more difficult to source building materials given continued COVID-related supply chain disruptions. In the near term, containment measures and restrictions have reduced firms' operating capacity, and this has affected the whole building supply chain.

### Higher interest rates on the way

Stronger demand has made it easier for businesses to pass on higher costs to customers by raising prices, and short-term inflation expectations have picked up. The Reserve Bank increased the OCR in response to rising inflation pressures, and indicated interest rates are likely to head up further over the coming year.

### Future outlook

The property and construction sector's longer-term outlook remains positive despite the uncertainty in the long tail in the latest COVID-19 community outbreak. However, there are some headwinds. Beyond the short-term disruption from lockdowns and social distancing restrictions, supply constraints will likely hamper the degree to which construction activity can ramp up despite strong demand. Strong construction cost inflation may also see some construction projects put on hold as they no longer become financially feasible.



# BUILDING ACTIVITY TRENDS

Strong demand for construction has led the recovery in the New Zealand economy over the past year. This bounce-back in demand has been particularly strong for residential construction, and consent issuance points to a solid pipeline of construction work for the year ahead. Growth in construction activity has been broad-based across the regions, but particularly apparent in Auckland reflecting the effects of strong population growth in the region over the past decade. Strong housing demand and house price inflation continue to encourage new housing to be built.

However, the latest COVID-19 community outbreak has renewed uncertainty over the economic outlook. Lockdown and social distancing restrictions have negatively affected activity on construction sites. On the supply side, capacity pressures had been evident in the construction sector even prior to the outbreak. The latest outbreak and containment measures and restrictions have exacerbated supply constraints, as the restrictions affect the supply of building materials across New Zealand.

Construction costs have risen sharply as a result of these acute capacity pressures in the sector. Continued border restrictions have limited the ability for building sector firms to bring in workers from overseas. Meanwhile, supply chain disruptions in New Zealand and abroad have made it even more difficult for firms to source building materials to carry out construction.

Congestion at ports around the world have driven up shipping costs, with strong demand for containers and container ships causing capacity constraints. Here in New Zealand, building materials manufacturers have had to either shut down or operate at a reduced capacity given lockdown measures and social restrictions. The extended period of time Auckland has spent in Alert Level 4 lockdown has had ramifications on the supply of building materials including roofing steel, insulation and plasterboard to other regions across New Zealand.

The latest NZIER Quarterly Survey of Business Opinion showed a moderation in these cost pressures in the September quarter, suggesting some of the supply constraints may be easing. Strong construction demand has made it easier for firms to pass on higher costs to customers by raising prices.

The NZIER showed 39 percent of building sector firms reported higher costs in the September quarter – lower than the 83 percent in the previous quarter. But the proportion of building sector firms raising prices continued to lift, with a net 49 percent increasing prices in the September quarter. The greater ease with which firms are able to put up prices is supporting a recovery in construction sector profitability.

The rebound in residential construction is particularly strong, with the annual number of dwelling consents issued for the year to July hitting a new record of over 45,000. This growth

is driven by a surge in demand for medium-density housing such as townhouses and flats. Although construction demand for standalone houses remains robust, we expect a continued shift in demand towards housing intensification over the coming years given prices and the shortage of centrally located land.

The pipeline of other construction work is also solid, particularly for Government construction work. The New Zealand Infrastructure Commission has estimated the infrastructure deficit in New Zealand at over \$75 billion<sup>1</sup> – this reflects its assessment of new and upgrade of infrastructure which is overdue. The infrastructure pipeline is ramping up, with the New Zealand Infrastructure Commission reporting an increase in the infrastructure pipeline from \$6.1 billion of projects in 2019 to \$61 billion in 2021. Much of this infrastructure spending is planned for the next two years, with per capita infrastructure spending in Auckland particularly high at almost \$17,500<sup>2</sup>.

How the reform of the Resource Management Act (RMA) evolves will influence the degree to which infrastructure construction can ramp up over the coming years. The reform will have to balance between supporting infrastructure development with a more efficient and responsive process whilst considering environmental constraints in New Zealand. Capacity constraints in the construction sector also have the potential to weigh on the degree to which construction activity can ramp up over the coming year.

1 New Zealand Infrastructure Strategy Consultation Document: He Tūāpapa ki te ora [https://www.tewaihanga.govt.nz/assets/Uploads/Infrastructure\\_Future\\_Forum\\_TeWaihanga\\_Presentation.pdf](https://www.tewaihanga.govt.nz/assets/Uploads/Infrastructure_Future_Forum_TeWaihanga_Presentation.pdf)

2 [https://www.tewaihanga.govt.nz/assets/Infrastructure-Quarterly/TeWaihanga\\_InfrastructureQuarterly.pdf](https://www.tewaihanga.govt.nz/assets/Infrastructure-Quarterly/TeWaihanga_InfrastructureQuarterly.pdf)

# BUILDING ACTIVITY OUTLOOK

Construction demand is very strong, but intensification of capacity pressures in the sector will likely hinder growth in the sector. In the near term, lockdown and social distancing restrictions is affecting the domestic supply chain of building materials. The effects of these disruptions on construction activity are likely to persist for the remainder of 2021 even as restrictions are relaxed in the New Zealand economy given the backlog of activity.

Added to that are continued global supply chain disruptions, as the COVID-19 pandemic affects production around the world.

The September quarter NZIER QSBO shows the shortage of labour in the building sector is at the most acute for the survey's history (going back to 1976). These supply constraints are driving up costs, but strong demand is allowing building sector firms to pass the cost increases on by raising prices.

The Capital Goods Price Index shows a sharp rise in costs across residential, non-residential and civil construction in June. The annual increase in residential construction costs has been particularly large at 6.9 percent for the year to June, reflecting where construction demand has been most strong. Residential construction cost inflation also tends to lead other areas of construction cost inflation. This reflects the fact that as non-residential and infrastructure construction tends to be larger in scale it takes a longer amount of time for activity to ramp up and capacity constraints to become apparent and start impacting on costs. As non-residential construction demand picks up, we forecast a further increase in non-residential construction over the coming year. Higher costs may see some construction developments put on hold as they no longer become financially feasible.

## ECONOMIC BACKDROP

Although the announcement on the 17th of August of the COVID-19 community outbreak changed the near-term growth outlook, the subsequent release of June quarter GDP indicated the New Zealand economy was on a solid footing prior to the lockdown. Stats NZ estimated New Zealand economic activity increased a robust 2.8 percent in the June quarter. While this growth precedes the discovery of the latest COVID-19 community outbreak, it nonetheless showed there was strong momentum heading into the lockdown.

The recovery in activity over the past year has indicated the New Zealand economy is resilient and responsive to stimulus, and we forecast a solid rebound in activity once restrictions are relaxed. Business and consumer confidence had been improving prior to the latest outbreak, and this was underpinning a recovery in spending and investment.

More broadly, inflation pressures have become more apparent. Annual Consumer Price Index (CPI) inflation jumped up to 3.3 percent for the year to June 2021, buoyed by higher food prices and housing-related costs and another significant increase in fuel prices at the pump. The current outbreak and greater transmissibility of the Delta variant mean that stringent containment measures will exacerbate the supply-side constraints. What is not as clear is the longer-term impact on demand, which will be a key influence on how persistent inflation pressures turn out to be. The strong bounce-back in activity over the past year suggest the New Zealand economy is resilient.

We expect the combination of acute capacity constraints and resilient demand will support annual inflation above the Reserve Bank's inflation target band of 1 to 3 percent over the coming year. From 2022, we forecast annual inflation to moderate back towards the central bank's inflation target mid-point of 2 percent as capacity pressures in the New Zealand economy ease.

## INTEREST AND EXCHANGE RATES

The Reserve Bank of New Zealand (RBNZ) in its October meeting increased the OCR in response to the increase in inflation stemming from both supply and demand side pressures, and the risk these pressures would flow through to a pick-up in longer term inflation expectations. We expect interest rates will continue to head higher over the coming year.

Focus overseas has also turned to when the major central banks would commence its tightening cycle, given signs of rising inflation pressures globally. The US Federal Reserve is expected to signal its timetable for tapering its quantitative easing programme in its meeting in late September, although its monetary policy settings are unlikely to change. The minutes from the latest Federal Open Market Committee (FOMC) meeting show the central bank remains focused on meeting its long-term employment and inflation targets, and it will not adjust its monetary policy settings.

The New Zealand dollar appreciated following the release of the strong New Zealand June quarter GDP result, but has since eased on the increased risk aversion in markets globally. We expect the NZD/USD will remain below 70 cents as uncertainty about the impact of the latest COVID-19 community outbreak on the outlook for the New Zealand economy weighs on our currency.

## **BUILDING INVESTMENT**

Consent issuance and the NZIER QSBO measure of architects' activity in their own office point to a solid pipeline of construction work for the coming year. Demand for residential construction is particularly strong, as the continued increase in house prices encourages new housing supply to come on board.

Uncertainty over how the latest COVID-19 community outbreak will evolve is weighing on business confidence and firms' appetite to invest in commercial buildings. This uncertainty will have a negative impact on non-residential investment over the coming year.

## **BUILDING CONSENTS**

The recovery in non-residential consent issuance reflects increased demand for industrial buildings and education facilities. However, lockdown restrictions will reduce construction activity in the near term, reflecting the direct impact on site operations as well as the indirect impact from supply chain disruptions.

## **Building consents by sector**

Consent issuance over the past year has been mixed across the sectors. Strong growth in consent issuance for industrial, healthcare and education buildings contrasts with weaker demand for retail outlets. The Government's focus on increasing infrastructure investment to support the New Zealand economic recovery is likely to be driving the stronger demand for industrial, healthcare and education buildings.

Lockdown has prevented people from shopping instore and accelerated demand for online shopping. Border restrictions continue to weigh on tourism activity, although the opening of the trans-Tasman quarantine-free travel bubble boosted retail spending in the June quarter. Border restrictions are likely to remain in place for the remainder of 2021 and potentially through 2022, and this should weigh on retail spending overall even as New Zealand households continue to make big-ticket purchases.

Although demand for office buildings has improved over the past year, the latest lockdown and restrictions has increased uncertainty about the demand outlook. As more white-collar workers adapt to working from home and activity-based working becomes more prevalent, this will potentially reduce demand for permanent office space.

## **Building consents by region**

Non-residential construction consent issuance increased across most regions over the past year. Growth in demand was particularly strong in Auckland, and was also robust in the Bay of Plenty, Hawke's Bay, Canterbury and Taranaki. Non-residential construction demand in Auckland grew across most groups, but was particularly strong for accommodation, education and storage buildings. For the Bay of Plenty, strong demand for industrial buildings drove the increase in non-residential consent issuance over the past year.

In contrast, non-residential construction consent issuance declined in Waikato and Otago over the past year, with both regions facing weaker demand for retail outlets.

The emergence of the more transmissible Delta strain of COVID-19 has introduced more uncertainty over the growth outlook, and borders are likely to remain closed for the remainder of 2021. A future with some degree of endemic COVID now looks almost certain. This should continue to weigh on non-residential construction demand in regions particularly exposed to international tourism such as Otago. These effects will likely remain until there is a broad-based relaxation of border restrictions.

We expect demand for non-residential construction to be concentrated in the North Island, reflecting where the infrastructure pipeline is also strongest.



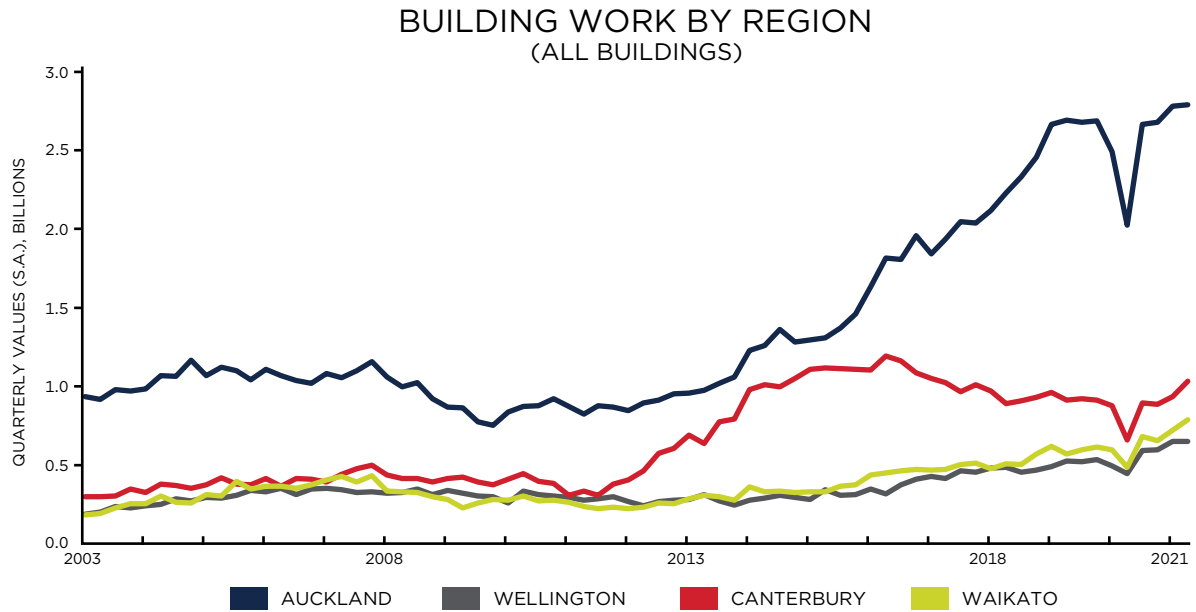




**FIGURE 1**

**Construction growth broad-based across the regions**

Quarterly values, s.a.

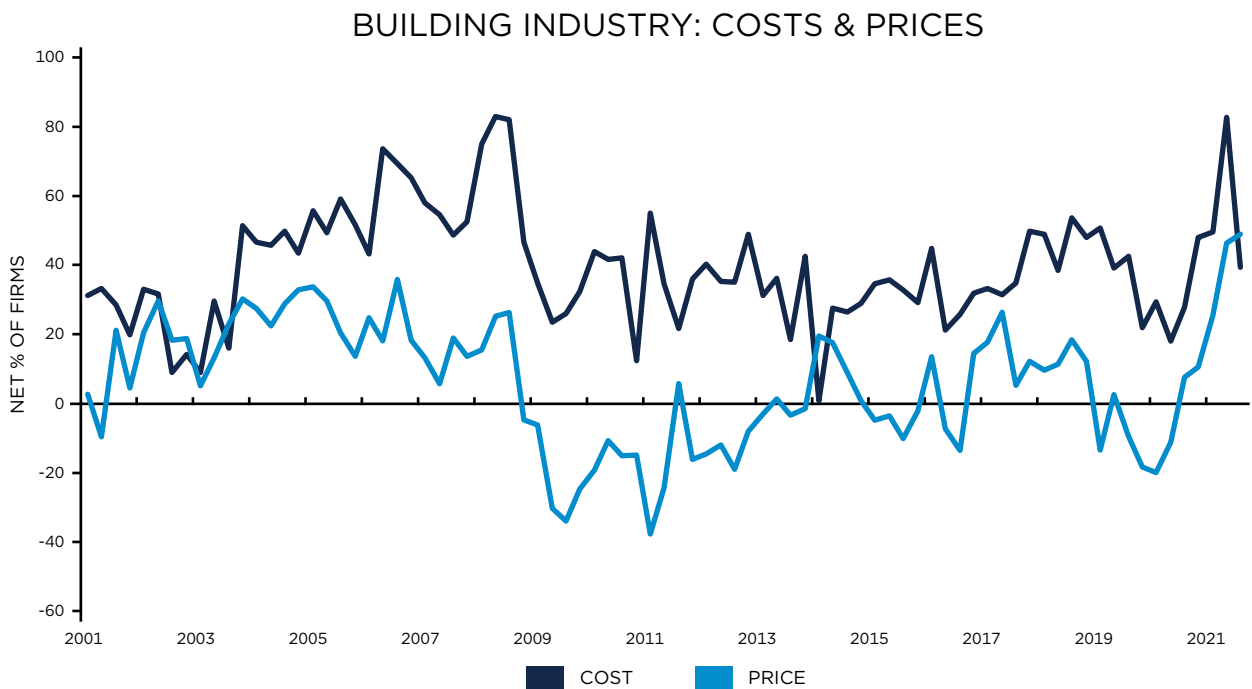


Source: Stats NZ

**FIGURE 2**

**Supply constraints push up construction costs**

Net % of firms

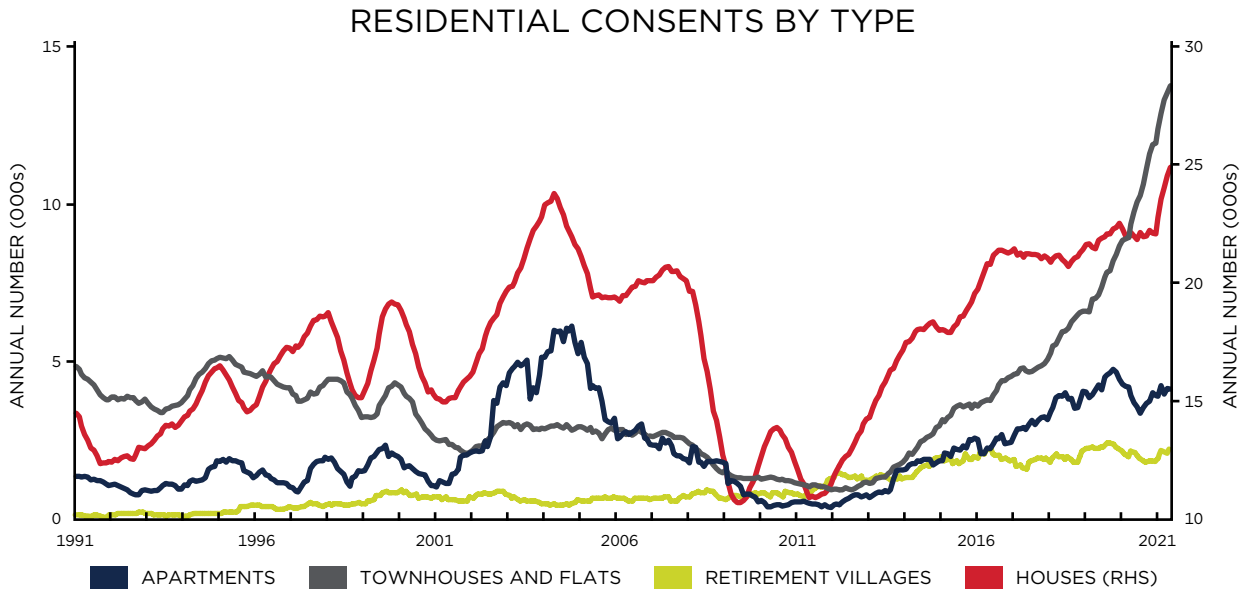


Source: NZIER

**FIGURE 3**

**Surge in demand for medium density housing**

Annual number of consents issued

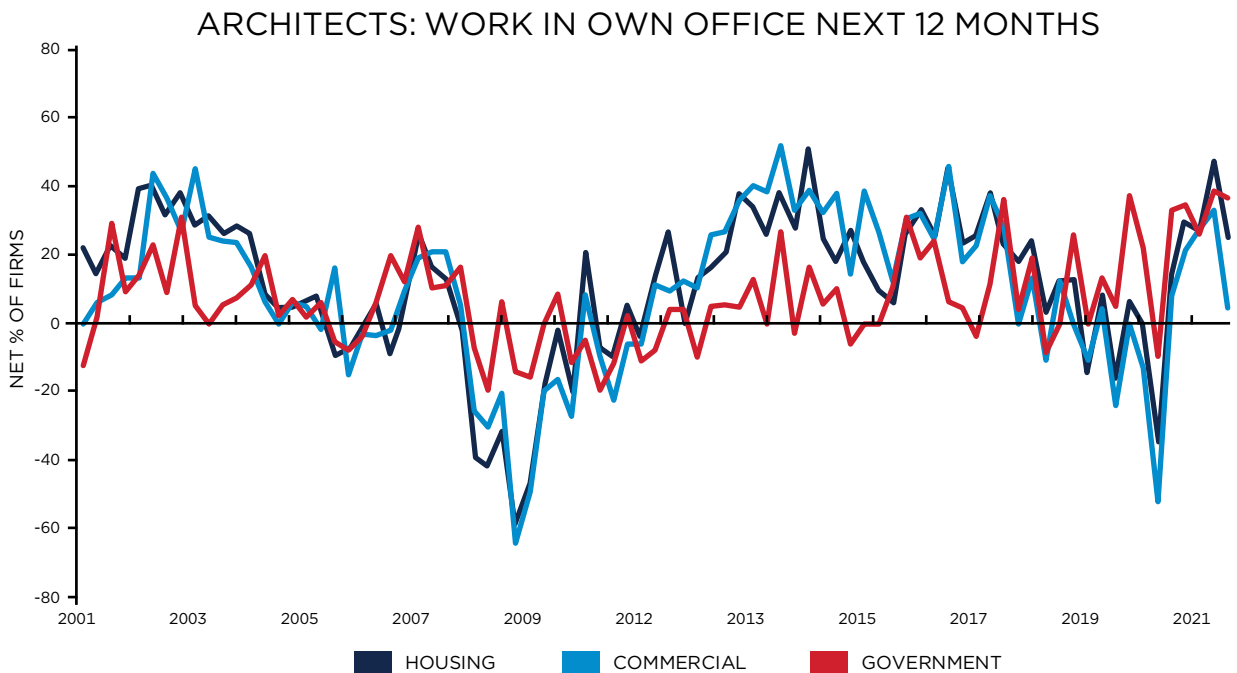


Source: Stats NZ

**FIGURE 4**

**Strong pipeline of construction**

Net % of firms



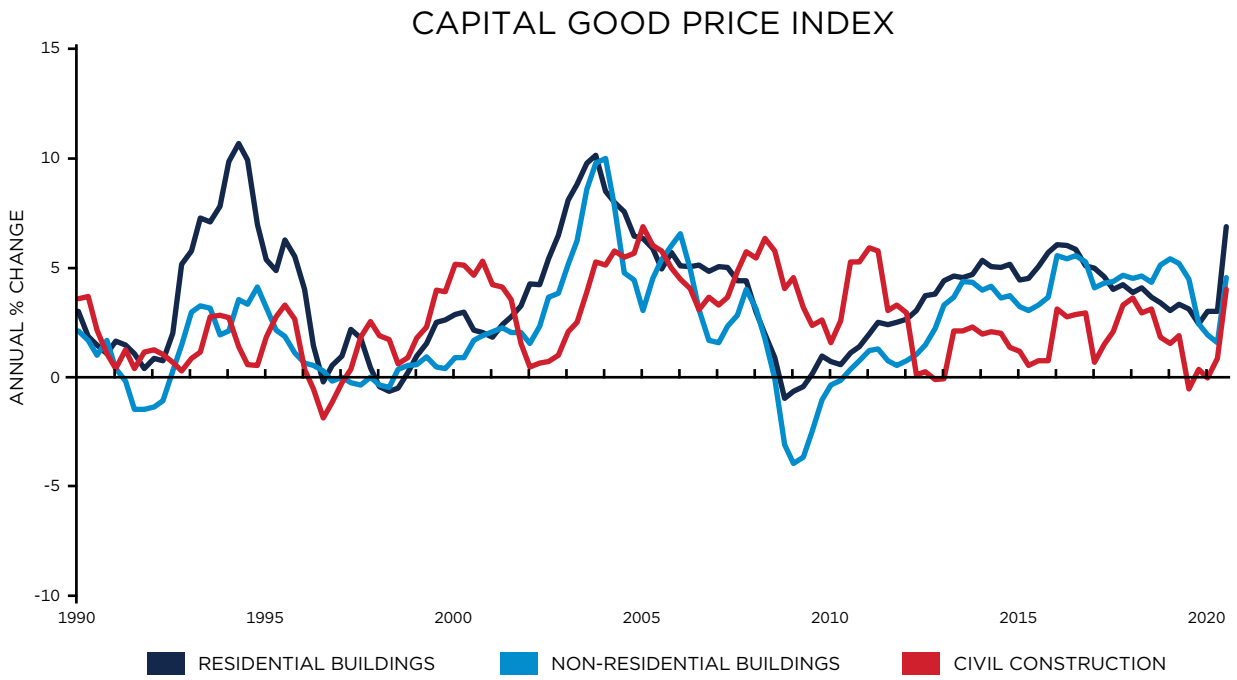
Source: NZIER





**FIGURE 5**

**Construction cost inflation picks up sharply**

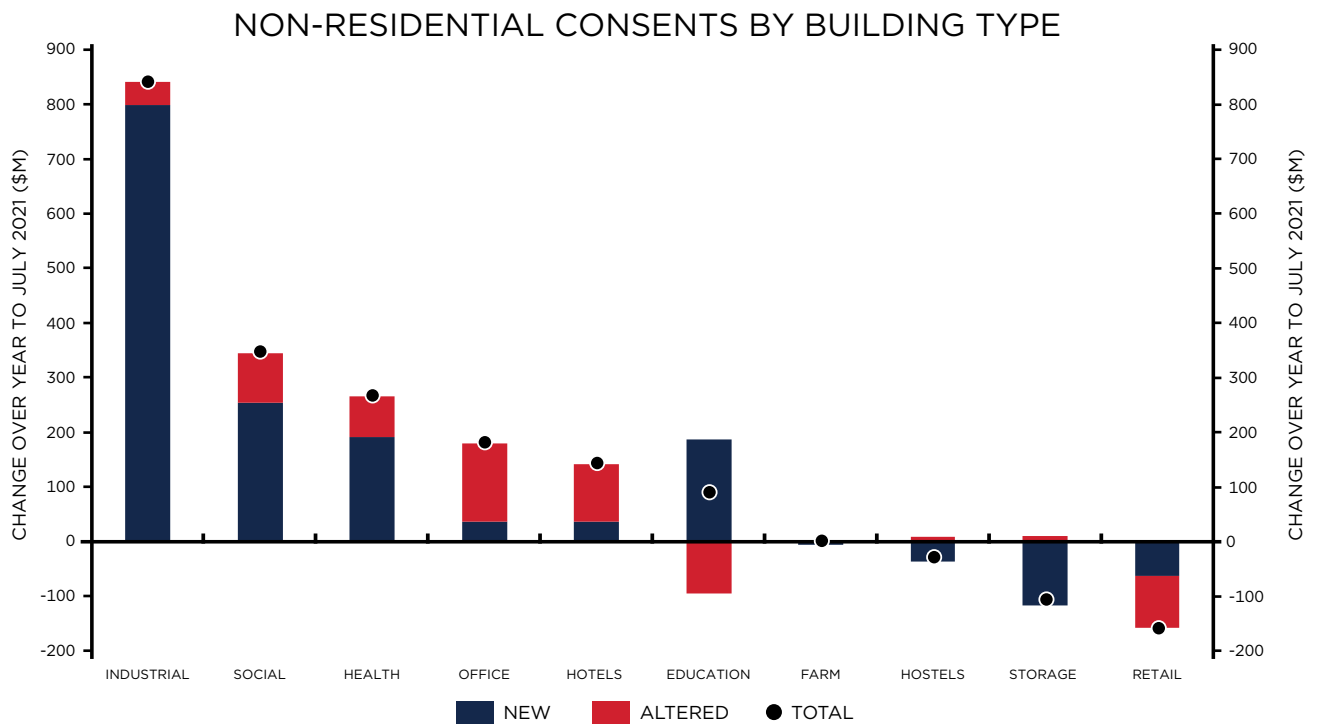


Source: Stats NZ

**FIGURE 6**

**Strong demand for industrial and social buildings**

Change over year to July 2021



Source: Statistics NZ, NZIER

**TABLE 1**

**Non-residential building consents by region and sector**

\$m of consents for the year ending December 2020; 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	0.0	2.2	7.2	31.1	25.7	40.2	43.9	21.8	19.8	18.4	
AUCKLAND	117.7	430.0	188.7	552.5	148.4	294.3	482.5	525.0	286.5	25.7	
WAIKATO	119.2	9.8	23.5	83.9	27.8	34.0	77.8	68.3	107.5	68.7	
BAY OF PLENTY	1.0	14.7	47.1	51.5	42.8	47.8	31.8	76.2	232.6	12.3	
GISBORNE	1.8	0.1	0.2	18.4	13.6	2.6	6.8	6.4	13.2	6.2	
HAWKE'S BAY	8.6	14.7	50.8	42.4	15.4	52.4	37.9	26.3	55.5	12.4	
TARANAKI	1.0	0.1	78.7	20.5	26.1	5.9	6.9	6.2	15.7	11.5	
MANAWATU-WANGANUI	1.1	4.7	8.2	47.9	19.5	28.3	17.2	28.8	92.3	16.1	
WELLINGTON	2.1	26.8	45.7	125.4	114.1	44.9	202.8	47.4	100.2	10.4	
NELSON	0.3	0.4	1.8	5.8	3.6	2.1	5.7	10.0	10.3	0.1	
TASMAN	0.1	0.8	0.1	3.9	10.4	19.1	1.4	4.1	7.6	4.1	
MARLBOROUGH	1.0	0.0	16.2	6.6	22.6	6.1	0.3	5.0	25.1	5.0	
WEST COAST	0.0	0.5	14.0	12.6	1.2	2.1	4.3	1.1	6.2	4.6	
CANTERBURY	36.0	56.1	145.8	206.9	109.2	72.2	68.1	124.2	91.7	39.0	
OTAGO	58.6	25.7	29.9	133.8	44.2	26.2	28.2	20.6	46.6	22.2	
SOUTHLAND	0.8	25.7	3.3	12.1	4.7	51.8	29.5	6.8	10.4	21.9	

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 Third Quarter 2021 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](http://www.rlb.com) or on request from any Rider Levett Bucknall office.

Non-residential construction cost escalation accelerated in the June 2021 quarter, as capacity pressures intensified in the sector. The 3.1 percent increase in non-residential construction costs brought annual inflation to 4.6 percent for the year to June 2021.

We expect non-residential construction cost inflation will be strong over the coming year, reflecting the perfect storm of strong demand and acute supply constraints. Labour shortages in the construction sector are unlikely to ease soon given continued border restrictions and the time required to train

the domestic workforce. We forecast annual non-residential construction cost inflation will peak at 10 percent by March 2022 as firms pass on rising costs given strong construction demand. This forecast peak is comparable to the previous peak of 10 percent seen in the 2004 building boom. We expect a faster moderation in cost escalation this time once border restrictions and supply chain disruptions ease.

## 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
2017	MARCH	1601	0.6	5.4
	JUNE	1618	1.1	5.5
	SEPTEMBER	1635	1.1	5.3
	DECEMBER	1656	1.3	4.1
2018	MARCH	1670	0.8	4.3
	JUNE	1689	1.1	4.4
	SEPTEMBER	1711	1.3	4.6
	DECEMBER	1731	1.2	4.5
2019	MARCH	1747	0.9	4.6
	JUNE	1762	0.9	4.3
	SEPTEMBER	1799	2.1	5.1
	DECEMBER	1825	1.4	5.4
2020	MARCH	1838	0.7	5.2
	JUNE	1841	0.2	4.5
	SEPTEMBER	1843	0.1	2.4
	DECEMBER	1860	0.9	1.9
2021	MARCH	1867	0.4	1.6
	JUNE	1925	3.1	4.6
	SEPTEMBER	1977	2.7	7.3
2022	DECEMBER	2018	2.1	8.5
	MARCH	2054	1.7	10.0
	JUNE	2080	1.3	8.0
	SEPTEMBER	2103	1.1	6.4
2023	DECEMBER	2125	1.1	5.3
	MARCH	2147	1.0	4.5
	JUNE	2169	1.0	4.3
	SEPTEMBER	2191	1.0	4.2
2024	DECEMBER	2212	1.0	4.1
	MARCH	2234	1.0	4.0
	JUNE	2255	0.9	4.0
	SEPTEMBER	2275	0.9	3.9
2025	DECEMBER	2295	0.9	3.7
	MARCH	2314	0.8	3.6
	JUNE	2332	0.8	3.4
	SEPTEMBER	2350	0.8	3.3
2026	DECEMBER	2368	0.8	3.2
	MARCH	2386	0.8	3.1
	JUNE	2404	0.8	3.1
	SEPTEMBER	2422	0.8	3.1
2026	DECEMBER	2440	0.8	3.1

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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