



FIRST QUARTER 2023

FORECAST REPORT 104

NEW ZEALAND TRENDS IN
PROPERTY AND CONSTRUCTION

OFFICES AROUND THE WORLD

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Mauritius

Saint Pierre

Mozambique

Maputo

South Africa

Cape Town

Johannesburg

Pretoria

ASIA

North Asia

Beijing

Chengdu

Chongqing

Dalian

Guangzhou

Guiyang

Haikou

Hangzhou

Hong Kong

Jeju

Macau

Nanjing

Nanning

Qingdao

Seoul

Shanghai

Shenyang

Shenzhen

Tianjin

Wuhan

Wuxi

Xiamen

Xian

Zhuhai

South Asia

Bacolod

Bohol

Cagayan de Oro

Cebu

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OCEANIA

Australia

Adelaide

Brisbane

Cairns

Canberra

Coffs Harbour

Darwin

Gold Coast

Melbourne

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New Zealand

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Dunedin

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Palmerston North

Queenstown

Tauranga

Wellington

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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 104

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 Australia Report) and country specific reports.

KEY POINTS IN THIS ISSUE

The weakening in construction demand is becoming more apparent, although there remains a solid pipeline of construction work for the remainder of 2023. We expect construction activity to ease over the coming years, with some offset from the rebuilding we expect in 2024 in the wake of the severe weather events in early 2023.

Easing construction pipeline

Construction activity declined in the final quarter of 2022, driven by weaker residential construction. Consent issuance has eased in recent months, but from very high levels. There are signs the solid pipeline of construction is easing.

But building sector firms feel very downbeat

The latest NZIER Quarterly Survey of Business Opinion shows building sector firms remain the most downbeat of the sectors surveyed. Weakening demand and intense cost pressures are weighing on confidence in the building sector.

Signs of capacity pressures easing

There are signs that capacity pressures are easing, as the dampening in demand from higher interest rates gain traction in the New Zealand economy. Despite these developments, the RBNZ surprised by increasing the Official Cash Rate by 50 basis points in its April Monetary Policy Review. The larger than expected interest rate increase reflected the RBNZ's concern that inflation will remain elevated should rebuilding activity add to capacity pressures in the New Zealand economy.

Future outlook

Higher interest rates will continue to weigh on the construction outlook. Over the longer term, we expect migration-led population growth to support infrastructure construction demand.



BUILDING ACTIVITY TRENDS

Stats NZ Building Work Put in Place showed a decline in construction activity in the final quarter of 2022. This decline was driven by a 2.6 percent fall in residential construction, which was partly offset by 0.4 percent increase in non-residential construction. The decline in construction was also reflected in other activity indicators such as concrete usage. Concrete sales tend to move in line with construction activity, and the fall has been particularly marked in Auckland.

There are signs of an easing in the pipeline of construction work, although we still expect a solid pipeline for the coming year. Dwelling consent issuance is easing from high levels, particularly in Auckland where the annual number of dwelling consents issued have fallen to just below 21,000. Dwelling consent issuance in Canterbury has also fallen in recent months.

The fall in dwelling consent issuance over the past year has been concentrated in standalone houses. This reflects the shift in demand towards medium-density housing given the scarcity of centrally located land. However, consent issuance for townhouses and flats has also eased in more recent months.

Higher interest rates and tighter access to finance have dampened demand for housing, with house price declines in the main North Island centres of Auckland and Wellington particularly sharp over the past year. We expect the house price declines to broaden across the New Zealand regions. Lower house prices should further reduce the incentive for property developers to bring new housing supply onto the market.

The latest NZIER Quarterly Survey of Business Opinion (QSBO) also shows a further weakening in the

pipeline of construction work in the March quarter. The architects' measure of work in their own office shows a continued decline in the pipeline of housing and commercial construction over the coming year. A net 57 percent of architects expect reduced housing construction over the coming year based on the work in their own office, while a net 54 percent of architects expect weaker commercial construction. In contrast, there was a pick-up in the proportion of architects expecting an increased pipeline of Government construction work.

Recent announcements of the liquidations of building and construction companies, including Scarbro more recently, highlight the challenging environment firms in the construction sector are operating in. Cost pressures and the lumpy nature of construction projects often heightens the risk of cashflow crunches. Liquidations have flow-on impacts onto creditors who will likely miss out on getting paid and clients whose projects will not be completed.

We expect rebuilding in the wake of the damage from the extreme weather events will gather momentum from 2024 and contribute to construction demand. The extreme weather events over early 2023 have meant a reprioritisation of infrastructure investment given the damage to roading. Beyond the rebuilding, the investment focus for both the Government and private sector is also turning from climate change mitigation to climate change adaptation and building resilience.

There also remains robust demand for the construction of social housing from Kāinga Ora, with the \$3.8 billion Housing Acceleration Fund¹ including initiatives for Kāinga Ora to develop supporting infrastructure and work with the

private sector, iwi and Māori, not-for-profit sector and local government to deliver more affordable housing.

Even with this rebuilding activity and demand for social housing, we still expect overall construction activity will decline over the coming years. This decline will be driven by lower residential construction demand as the impact of higher interest rates gain traction in the New Zealand economy.

Building sector firms remain the most downbeat of the sectors surveyed in the latest NZIER QSBO. A net 76 percent of building sector firms expect a deterioration in general economic conditions over the coming months. Weaker demand is weighing on confidence in the sector, with building sector firms reporting a continued decline in output and new orders.

There are also other signs that the key concern for building sector firms is shifting from capacity pressures to one of weaker demand, with 64 percent of building sector firms reporting sales was the primary constraint on their business in the March quarter. This is well above the 20 percent of building sector firms reporting finding labour as the primary constraint on their business. Prior to this, labour shortages had become increasingly acute as the COVID-19 pandemic progressed, with over 57 percent of building sector firms reporting that as the main constraint on their business in June 2022.

Supply chain disruptions had also been a key concern for firms over the COVID-19 pandemic, but this looks to be largely resolved with only 2 percent of building sector firms reporting materials as the primary constraint on their business in the March quarter. This is well below the peak of 26 percent in September 2021, and adds to other signs that capacity pressures are easing in the construction sector.

1 <https://kaingaora.govt.nz/working-with-us/housing-acceleration-fund/>

BUILDING ACTIVITY OUTLOOK

The outlook for the construction sector is one of an easing in demand, but from very high levels. We expect the impact of higher interest rates and tighter access to credit will continue to weigh on construction demand. We have already been seeing signs of this easing in demand from the slowing in building enquiries and decline in new orders and output. Banks have become more cautious when it comes to lending for property, and there remains caution amongst businesses when it comes to investment in buildings.

The latest Real Estate Institute of New Zealand (REINZ) data on housing market activity shows a 14 percent decline in house prices nationwide over the year to February. The house price declines have been particularly sharp in Wellington and Auckland, although we expect a broadening in house price weakness across the regions over the coming year. This weakness in house prices should decrease the incentive for property developers to bring new housing supply onto the market, thus reducing housing construction demand.

Cost pressures in the building sector remain intense despite the easing in construction demand. A net 86 percent of building sector firms reported higher costs in the March quarter. However, only 46 percent of building sector firms increased prices, indicating the continued pressure on operating margins in the sector.

With signs of capacity pressures easing in the construction sector, we expect this will drive a moderation in construction cost escalation from current high levels over the coming years.

ECONOMIC BACKDROP

The New Zealand economy continues to face many headwinds. Cost pressures remain high, and higher interest rates look to be gaining traction in dampening demand. The latest NZIER QSBO shows some encouraging developments for the Reserve Bank, with a slight improvement in business confidence and signs of capacity pressures easing. A net 61 percent of businesses expect a deterioration in general economic conditions over the coming months – a pick-up from the record low levels of confidence in the previous quarter.

Although businesses still remain cautious when it comes to investment in buildings and plant and machinery, this caution lessened in the March quarter. Businesses are also feeling more positive about hiring, with a net 2 percent of businesses increasing staff numbers in the March quarter. Given businesses tend to be more cautious in times of heightened uncertainty, these developments suggest that even though demand is softening businesses are feeling more certain about the outlook ahead and planning accordingly.

Nonetheless, businesses have historically tended to hold off on committing to large scale projects heading into an election in mid-October, given the uncertainty over the formation of the next Government. This uncertainty will likely weigh on investment in building and infrastructure over the remainder of the year. We expect more clarity following the general election will see improved demand for building and infrastructure spend from 2024.

The global growth outlook is mixed, as markets grapple with a banking crisis and demand slows in the face of interest rate increases in the major economies. Expectations that major central banks are nearing the end of their tightening cycles are supporting confidence in the markets.

INTEREST AND EXCHANGE RATES

The RBNZ surprised markets by increasing the OCR by 50 basis points to 5.25 percent at the April *Monetary Policy Review* meeting, against widespread expectations of a 25 basis point rate increase. Interest rate expectations had fallen in the weeks leading up to the meeting given weaker data and slowing in monetary policy amongst other major central banks around the world.

The RBNZ acknowledged at its April meeting that economic activity has turned out weaker than its projections in February. However, the central bank highlighted its concern that the post-storm rebuilding will add to capacity pressures in the New Zealand economy and keep inflation higher for longer. This heightened the risk of longer-term inflation expectations becoming unanchored and a wage-price spiral developing.

Although the RBNZ has left the door open to further OCR increases, we believe the interest rate increases to date will be enough to bring annual CPI inflation back down towards its 1 to 3 percent inflation target band over the coming years. Given half of mortgages in New Zealand are

due for repricing over the coming year many of these households will be rolling off historically low fixed term mortgage rates of 2 to 4 percent onto significantly higher rates of over 6 to 7 percent. We expect households will further rein in discretionary spending in the face of significantly higher mortgage repayments. This lagged transmission of monetary policy onto broader economic activity heightens the risk of over-correction for the RBNZ.

Nonetheless, given the RBNZ has indicated it is resolute in bringing inflation down towards its 1 to 3 percent target band, we recognise the risk the central bank will hike the OCR again in its May *Monetary Policy Statement*.

Given signs that other major central banks are slowing the pace of their monetary policy tightening, the larger than expected OCR increase from the RBNZ is improving the yield attractiveness of the New Zealand dollar. This is supporting an appreciation in the currency, which we expect will continue over the coming months. We forecast the New Zealand dollar to track at around 65 cents against the US dollar over the coming years.

BUILDING INVESTMENT

Uncertainty over the economic outlook has driven caution amongst businesses when it comes to investment, and this is weighing on private sector demand for construction. However, the pick-up in investment intentions in the latest QSBO suggests this caution is ebbing. Nonetheless, we expect a continued divergence between slowing demand for residential and commercial construction and continued growth in Government spending on infrastructure construction.

The Australian New Zealand Infrastructure Pipeline shows 35 major infrastructure projects underway in New Zealand², including a Canterbury multi-use arena and asset sales of 2Degrees and Spark mobile telecommunications tower assets with commitments to build sites over the next ten years.

BUILDING CONSENTS

Over the past year, growth in non-residential construction demand continues to be driven by stronger demand for office and storage buildings. Supply chain disruptions during the COVID-19 pandemic led businesses to focus on bolstering the resilience of their supply chains. Meanwhile, demand for the construction of health facilities also increased over the past year, reflecting the effects of the COVID-19 pandemic and an ageing population. There was also growth in demand for alterations to social buildings.

This growth contrasts with the reduced demand for the construction of accommodation and industrial buildings over the past year.

² <https://infrastructurepipeline.org/charts/location-sector>



Building consents by sector

There was very strong growth in office construction demand over the past year, reflecting increased demand for both new office space and alterations. We expect earthquake strengthening requirements in Wellington will underpin demand for office alterations over the coming years. In contrast, higher interest rates and tighter access to finance should weigh on demand for new office building construction.

With signs that the supply chain disruptions that severely impacted businesses over the COVID-19 pandemic are being resolved we expect demand for the construction of new storage buildings will begin to ease.

The household sector face many headwinds. In particular, with half of mortgages in New Zealand due for repricing over the coming year we expect households will rein in discretionary spending in the face of higher mortgage repayments. This should drive a continued slowing in retail spending, and in turn weigh on demand for the construction of new retail outlets over the coming year.

Meanwhile, as tourism activity rebounds with the reopening of the international borders, we expect a recovery in demand for accommodation buildings over the coming years.

Building consents by region

Growth in non-residential construction consent issuance has been concentrated in Auckland, Waikato and Canterbury. Strong demand for the construction of office space and healthcare facilities drove the growth in non-residential construction consent issuance in Auckland.

Meanwhile, in Waikato stronger demand for storage buildings was a key driver of growth in non-residential construction consent issuance.

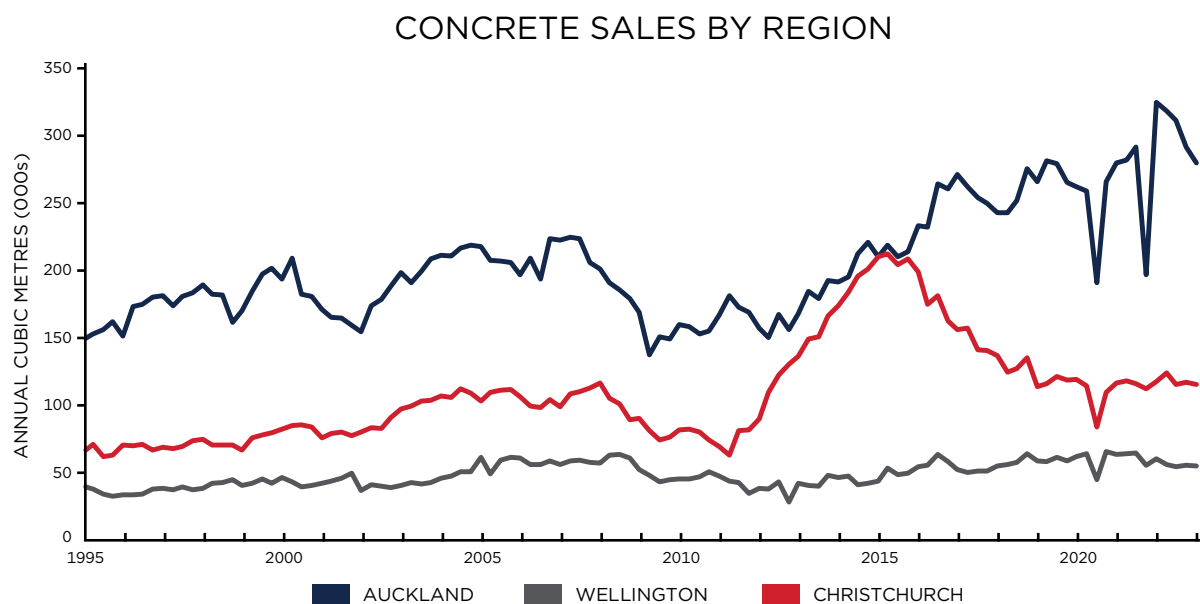
The growth in non-residential construction consent issuance in Canterbury was broad-based across many sectors, with particularly strong demand for social and storage buildings, as well as healthcare facilities and industrial buildings. This growth more than offset weaker demand for education and accommodation buildings in the region.

In contrast, non-residential construction consent issuance in Taranaki fell over the past year, largely reflecting weaker demand for healthcare facilities in the region.

FIGURE 1

Construction activity still strong in the second half of 2022

Annual cubic metres, 000s

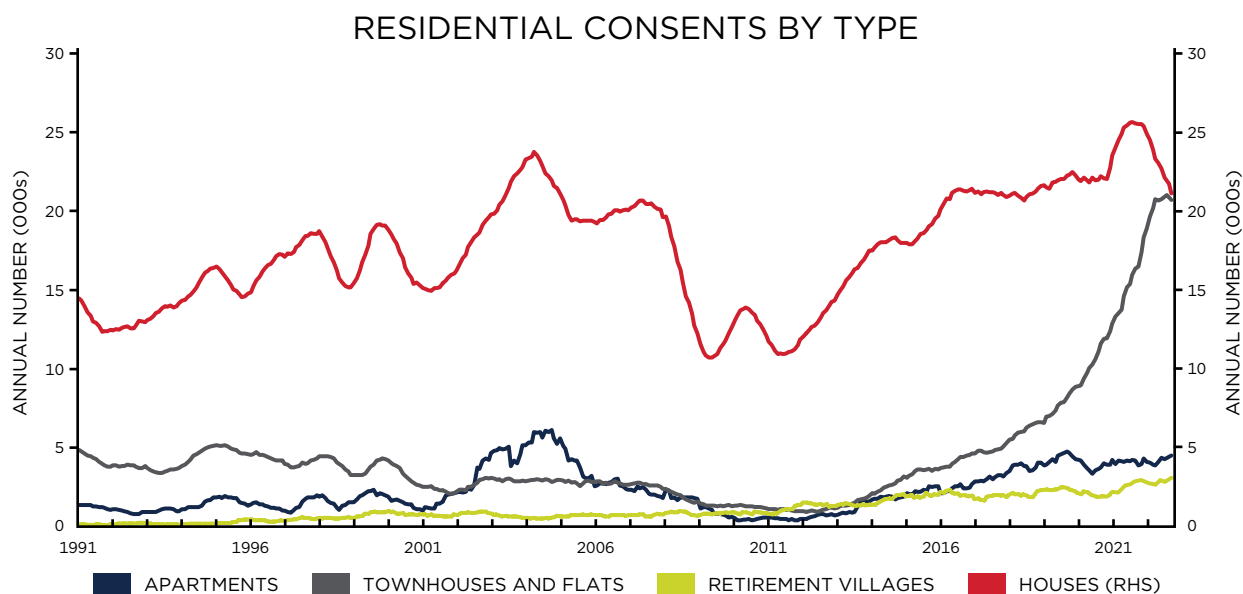


Source: Stats NZ

FIGURE 2

Easing demand for residential construction

Annual number of consents



Source: Stats NZ

FIGURE 3

Architects report softening pipeline of housing and commercial construction

Net % of firms

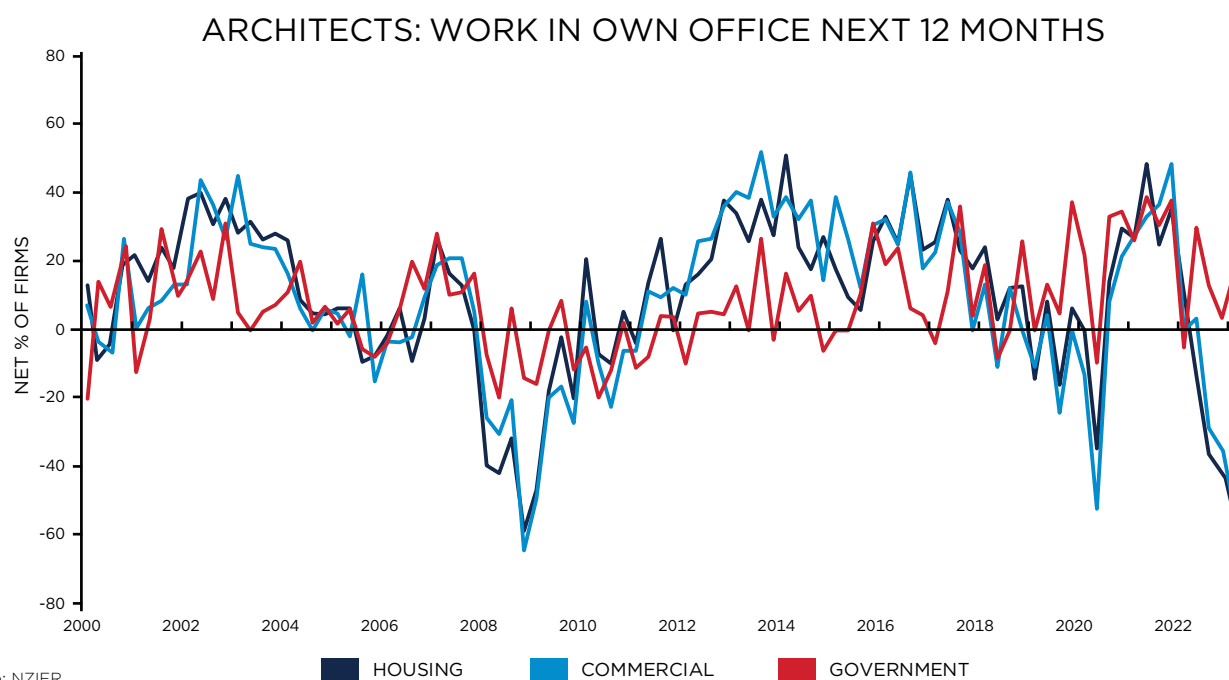


FIGURE 4

Building sector firms remain very downbeat

Net % of firms

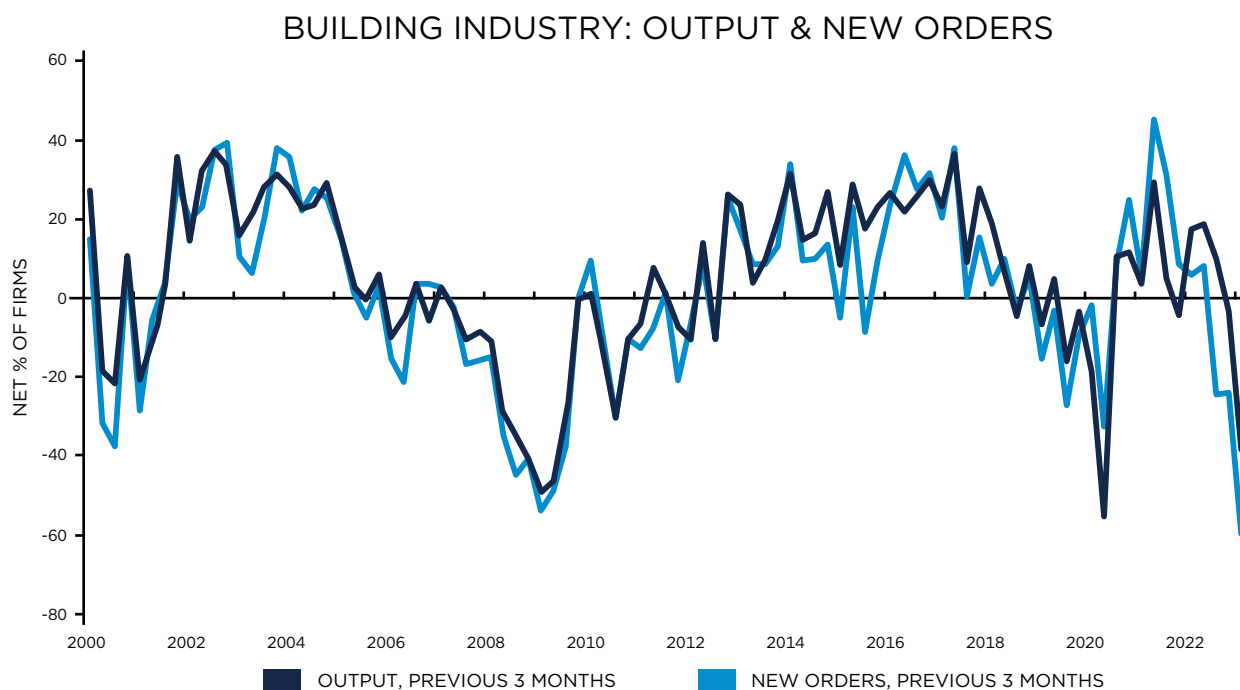


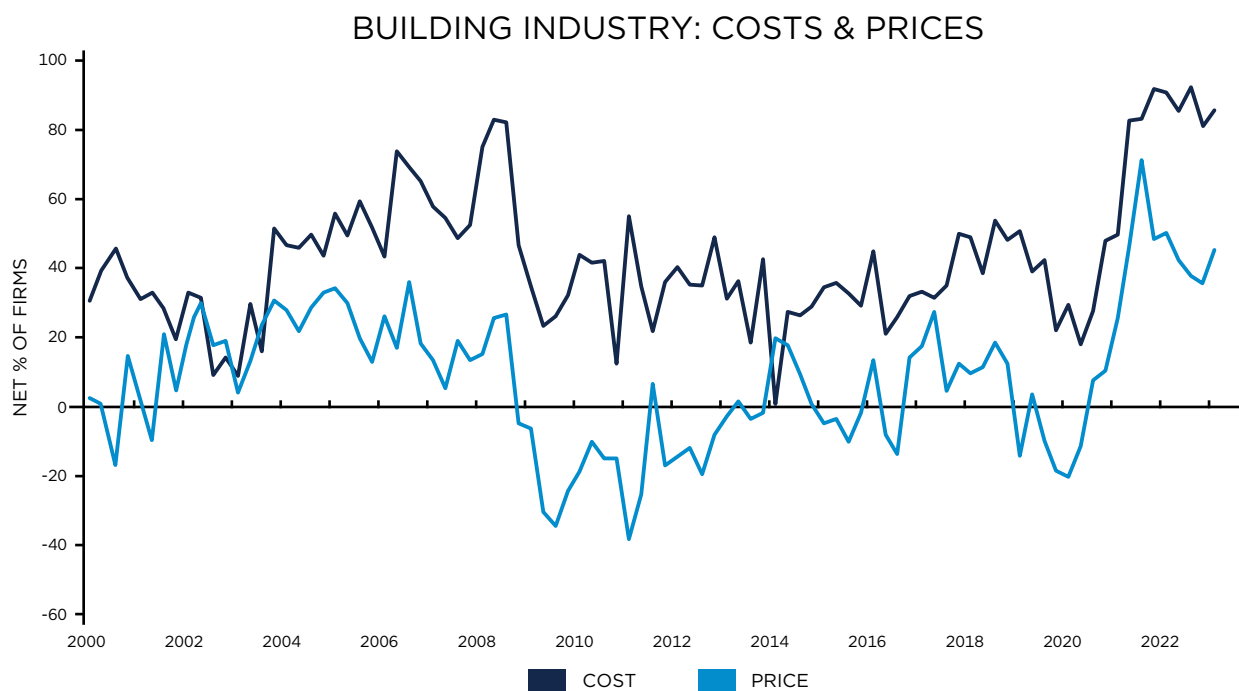




FIGURE 5

Cost pressures remain intense in the construction sector

Net % of firms



Source: NZIER

FIGURE 6

Demand for office space continues to lead the growth in non-residential construction demand

Change over year to February 2023

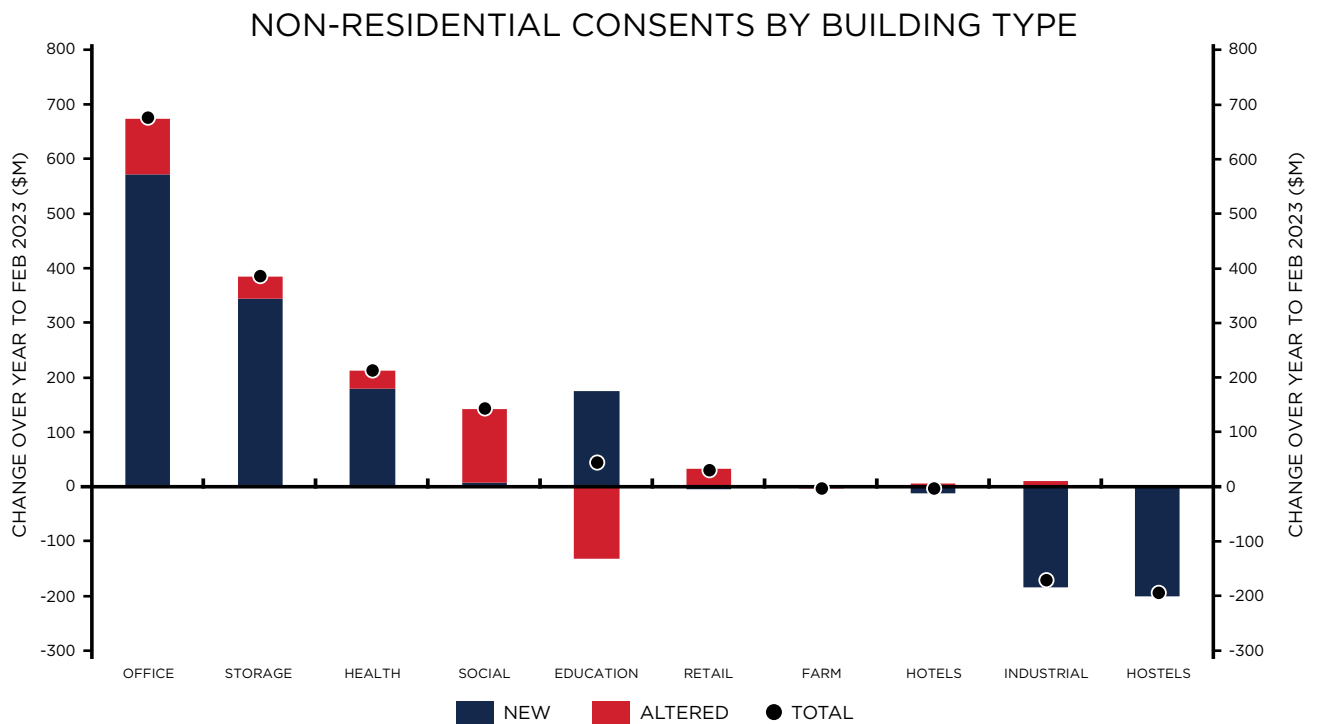


TABLE 1

Non-residential building consents by region and sector

\$m of consents for the year ending November 2022; 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	11.7	8.9	58.8	35.9	21.3	44.8	18.4	16.8	11.3	14.5
AUCKLAND	4.0	216.7	637.3	545.2	108.6	315.1	923.0	643.3	294.3	22.4
WAIKATO	6.4	9.2	120.0	124.9	109.8	62.4	101.4	315.4	191.5	76.4
BAY OF PLENTY	3.3	16.7	50.1	119.7	35.6	77.9	53.4	58.4	53.4	13.0
GISBORNE	0.7	0.2	1.1	9.7	30.0	3.0	3.9	6.3	12.3	3.1
HAWKE'S BAY	7.3	1.2	27.6	70.1	8.0	33.4	19.2	78.9	73.5	4.5
TARANAKI	0.0	7.8	4.1	11.4	8.9	6.3	20.6	13.7	37.4	16.6
MANAWATŪ-WHANGANUI	2.5	3.1	15.4	59.8	30.3	28.4	35.4	40.1	49.3	31.9
WELLINGTON	21.8	12.7	66.6	145.2	81.4	34.4	394.9	56.3	30.7	13.1
NELSON	0.0	0.5	5.6	11.6	1.0	22.0	6.7	2.4	3.6	0.1
TASMAN	2.8	0.1	4.2	31.8	1.7	4.5	3.8	10.0	21.8	4.8
MARLBOROUGH	2.5	0.0	0.8	5.0	2.8	22.5	1.9	3.8	34.7	6.4
WEST COAST	0.0	1.2	2.9	1.1	7.0	4.5	1.2	2.1	2.7	11.6
CANTERBURY	21.3	16.3	211.4	258.0	240.2	131.8	58.7	272.2	214.2	50.0
OTAGO	16.6	20.6	87.2	50.6	78.6	51.6	83.7	43.7	74.1	25.2
SOUTHLAND	1.1	4.8	5.0	9.0	5.6	11.4	21.6	8.9	39.8	22.2

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, and 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.

Non-residential construction cost inflation continued to ease on an annual basis in December 2022. The 1.8 percent increase in non-residential construction costs over the quarter saw annual

non-residential construction cost inflation moderate to just over 10 percent for the 2022 calendar year.

We expect construction cost inflation will continue to moderate from current high levels over the coming years. There are signs of capacity pressures easing in the construction sector, as the reopening of international borders help to alleviate labour shortages and supply chain disruptions are resolved. We expect this easing in capacity pressures will reduce cost pressures in the construction sector.

Nonetheless, we expect annual non-residential construction cost inflation to remain above 5 percent at the end of this year, given the high inflation environment of the New Zealand economy. Beyond 2023, we expect a continued easing in capacity pressures in the construction sector will drive annual non-residential construction cost inflation to below 3 percent in late 2026.

FIGURE 7
Non-residential building cost inflation
CGPI-NRB index, annual % change



Source: Statistics NZ, NZIER forecasts

TABLE 2**Non-residential building cost index³**

YEAR	QUARTER	INDEX	QUARTERLY % CHANGE	ANNUAL % CHANGE
2018	MARCH	771	0.8	4.3
	JUNE	780	1.1	4.4
	SEPTEMBER	790	1.3	4.6
	DECEMBER	799	1.2	4.5
2019	MARCH	807	0.9	4.6
	JUNE	813	0.9	4.3
	SEPTEMBER	831	2.1	5.1
	DECEMBER	843	1.4	5.4
2020	MARCH	849	0.7	5.2
	JUNE	850	0.2	4.5
	SEPTEMBER	851	0.1	2.4
	DECEMBER	859	0.9	1.9
2021	MARCH	862	0.4	1.6
	JUNE	889	3.1	4.6
	SEPTEMBER	905	1.8	6.3
	DECEMBER	925	2.2	7.7
2022	MARCH	951	2.8	10.3
	JUNE	985	3.6	10.9
	SEPTEMBER	1000	1.5	10.5
	DECEMBER	1018	1.8	10.1
2023	MARCH	1034	1.6	8.7
	JUNE	1048	1.4	6.4
	SEPTEMBER	1062	1.3	6.2
	DECEMBER	1074	1.2	5.5
2024	MARCH	1086	1.1	5.0
	JUNE	1097	1.0	4.7
	SEPTEMBER	1108	1.0	4.4
	DECEMBER	1118	0.9	4.1
2025	MARCH	1128	0.9	3.9
	JUNE	1138	0.9	3.7
	SEPTEMBER	1148	0.9	3.5
	DECEMBER	1157	0.8	3.5
2026	MARCH	1165	0.7	3.3
	JUNE	1174	0.8	3.2
	SEPTEMBER	1183	0.7	3.0
	DECEMBER	1190	0.6	2.9

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

³ Stats NZ has reweighted and rebased capital goods price indexes in the December 2022 quarter. The update includes structural changes to better align with the national accounts. As a result, there has been historical revisions to the index levels. This does not affect the percentage changes each quarter. Further detail on these historical revisions can be found at: <https://www.stats.govt.nz/methods/price-index-methods-updates-for-the-december-2022-quarter/>

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