SECOND QUARTER 2024

FORECAST REPORT 108

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

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Cover: University of Waikato, Tauranga Campus

CONFIDENCE TODAY INSPIRES TOMORROW

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With a network that covers the globe and a heritage spanning over two centuries, Rider Levett Bucknall (RLB) 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 108

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 publication, the Oceania Market Intelligence Update and other country specific reports providing timely snapshots of market conditions and construction cost movements around the world, via commentaries from Rider Levett Bucknall directors in key locations.

KEY POINTS IN THIS ISSUE

Construction demand remains weak, despite strong migration-led population growth. Higher interest rates are continuing their intended impact in dampening demand, but uncertainty over the new government's priorities and spending is weighing on confidence. The latest NZIER Quarterly Survey of Business Opinion (QSBO) shows the building sector feeling particularly downbeat.

Broad-based weakness in the pipeline of construction work

Construction activity remained weak in the December 2023 quarter, as a pick-up in non-residential construction was offset by a decline in residential construction. The NZIER QSBO measure of architects' activity in their own office points to a weak pipeline of construction across housing, commercial and government work.

Building sector firms feeling downbeat about conditions ahead

There has been a sharp drop in confidence in the building sector, with a net 54 per cent of building sector firms expecting a deterioration in general economic conditions over the coming months.

Weak demand weighing on pricing power

Cost and pricing indicators in the latest QSBO point to a mixed picture for construction cost inflation. While building sector firms report intense cost pressures in the March quarter, few were able to pass on higher costs by raising prices. This is driving a further weakening in profitability in the sector.

Future outlook

Although the near-term outlook for construction demand is weak, we continue to expect strong migration-led population growth will support construction demand over the longer term. Uncertainty over the broader impacts of the new government's plans including public sector cutbacks present some downside risk to the economic outlook and in turn construction demand.

BUILDING ACTIVITY TRENDS

Stats NZ *Building Work Put in Place* showed construction activity remained weak in the final quarter of 2023, as a rebound in non-residential construction was offset by a decline in residential construction. This likely reflects the continued impact of higher interest rates and tighter access to finance, with uncertainty over how long interest rates will remain high.

Although Auckland continues to lead the way in construction activity, there has been a plateau more recently. Nonetheless, Auckland continues to make up around 41 per cent of nationwide construction activity (on a nominal basis). The dominance of construction activity in Auckland reflects demand from migration-led population growth in the region. Meanwhile, Canterbury's share of nationwide construction activity has trended higher since early 2022.

Although there was a rebound in dwelling consent issuance in the February month, overall the trend remains one of weak residential construction demand. The annual number of dwelling consents issued eased further to be just over 36,200 for the year to February 2024. This weakness in residential construction remains broad-based across the building types. We expect demand for standalone houses will remain soft given the scarcity of centrally located land and increased development opportunities for medium density housing. Over the longer term, we expect intensification of housing to meet demand from strong migration-led population growth will drive a recovery in demand for apartments and townhouses.

The weakness in residential construction has also been broad-based across the regions. Residential construction demand in Auckland has fallen sharply since late 2022, with the annual number of dwelling consents issued totalling just over 15,200 for the year to February 2024 – 27 per cent below year-ago levels.

There has also been a marked decline in dwelling consent issuance in Wellington more recently, with consent issuance totalling just 2,300 over the past year. Uncertainty over the extent of cutbacks in the public sector will likely weigh on housing demand in Wellington for the coming year. Over the longer term, we expect the recovery in residential construction demand will be led by Auckland, reflecting the concentration of migration inflows in the region.

Although the latest NZIER QSBO indicates pessimism was broad-based across the sectors, the building sector was particularly downbeat. A net 54 per cent of building sector firms expect a deterioration in general economic conditions over the coming months, much greater than the overall net 24 per cent of firms feeling pessimistic across the sectors.

This pessimism reflects weak demand in the construction sector, with building sector firms reporting reduced output and new orders in the March quarter. This is weighing on pricing pressures in the sector, and the inability for firms to pass on higher costs by raising prices is driving a further deterioration in profitability in the building sector. A net 77 per cent of building sector firms reported weaker profitability in the March quarter. These results suggest a further slowing in construction cost inflation over the coming year.

Stats NZ updated its experimental building indicators series, which uses inspections and code compliance certificate data for a selection of building consent authorities to provide an estimate of construction timelines and completion rates. The latest update shows that the time taken from when a dwelling consent is issued to 1) final inspection and 2) issuance of code compliance certification has trended higher since 2020. Stats NZ estimates the average number of days from dwelling consent issuance to final inspection to be 533 calendar days at September 2022, while from dwelling consent issuance to code compliance certification is 569 calendar days in June 2022. However, the timeframe from the issuance of dwelling consent to first inspection, has fallen in recent quarters to be 163 calendar days in June 2023.

These results suggest the process for the construction of dwellings has been more prolonged in recent years, with delays likely over the COVID-19 pandemic period. However, there are emerging signs of an unwinding of these delays since late 2022. We expect that as capacity pressures in the construction sector continue to ease this should see further improvement in terms of the time taken to complete the construction of dwellings.

Tākina Wellington Convention & Exhibition Centre, Wellington

BUILDING ACTIVITY OUTLOOK

The outlook for construction is weak. This is reflected in the NZIER QSBO measure of architects' work in their own office. This measure shows what architects expect for the pipeline of construction for housing, commercial and government work specifically, based on the work they are undertaking in each of these areas in their own office. A positive result indicates architects expect an increase in the pipeline of construction work, while a negative result indicates architects expect a decline in the pipeline of construction work.

We will ask architects for their views on the pipeline of construction over the next twelve months, as well as the next two years. Based on the work in their own office, our latest NZIER QSBO shows an increasing proportion of architects expect a reduced pipeline across residential, commercial and government construction over the next two years.

However, non-residential consent issuance does suggest stronger demand in some regions. Although non-residential consent issuance fell sharply in Waikato over the past year, there was strong growth in consent issuance in the Bay of Plenty and Otago. For the Bay of Plenty, this reflects broad-based strength in demand including healthcare facilities and office buidings. Meanwhile, in Otago demand for healthcare facilities and accommodation buildings underpinned the increase in non-residential consent issuance. We expect the recovery in international tourism is likely to support continued demand for the construction of accommodation buildings in Otago.

Te Waihanga, the New Zealand Infrastructure Commission, reported in its *Pipeline snapshot* for the December 2023 quarter[1] infrastructure projects totalling almost $108.5 billion in value. The rebuild from the severe North Island weather events in early 2023 should support the pipeline of infrastructure projects over the coming year.

The $13.6 billion increase in the value of infrastructure projects in the pipeline over the December quarter reflects a combination of new infrastructure projects, increases in the value of existing projects, and new contributors to the pipeline. Transport infrastructure continues to be a dominant part of the pipeline, with the value of transport projects totalling $50.8 billion. Meanwhile, the value of water infrastructure in the pipeline totalled $19.9 billion.

In terms of projected spend over the coming years, $13 billion of infrastructure investment from the pipeline is expected to take place over 2024, while infrastructure investment for 2025 is expected to be $11.6 billion. Over the near term, infrastructure investment in the social sector, which includes community facilities and housing, is expected to dominate the pipeline.

ECONOMIC BACKDROP

The Stats NZ release of December 2023 GDP showed a 0.1 per cent decline in New Zealand economic activity for the quarter. Given this follows a 0.3 per cent contraction in GDP in the previous quarter, the result marked a technical recession for the New Zealand economy. More broadly, the impact of higher interest rates in dampening demand is becoming more apparent, and we expect economic activity will remain weak over the coming year.

The NZIER QSBO showed a net 23 per cent of firms reported a decline in activity in their own business over the March quarter. Weak demand is increasingly becoming the key concern for firms, with 59 per cent of firms reporting the lack of sales as the primary constraint on their business. In contrast, only 11 per cent of firms reported finding labour as the primary constraint on their business in the March quarter – well below the 43 per cent of firms reporting this being their primary constraint at the height of the COVID-19 pandemic in September 2022.

The combination of weaker demand and uncertainty over the new government's priorities around spending and public sector cutbacks is driving caution amongst businesses. A net 11 per cent of firms reduced staff numbers in the March quarter. There was also caution when it came to investment plans, with a net 14 per cent of firms planning to reduce investment in plant and machinery over the coming year, while a net 8 per cent plan to reduce investment in buildings.

We expect that with over half of mortgages due for repricing over the coming year, many households will continue to rein in spending in the face of higher mortgage repayments. This should drive a further slowing in economic activity.

1 https://media.umbraco.io/te-waihanga-30-year-strategy/y32ntapi/pipeline-snapshot-december-2023.pdf

INTEREST AND EXCHANGE RATES

Recent developments indicate higher interest rates are having their intended effect in dampening demand to reduce inflation pressures in the New Zealand economy. The key question is whether the Reserve Bank is confident this easing in inflation will be enough to return annual CPI inflation back to its 1 to 3 per cent inflation target band over the coming year. We forecast inflation to fall back to within the band over the second half of this year.

The RBNZ Survey of Expectations showed a further easing in inflation expectations, particularly with the easing in the two-year-ahead inflation expectations measure from 2.8 per cent to 2.5 per cent in the March 2024 quarter.

We continue to forecast the RBNZ will keep the OCR on hold until mid-2025 before it embarks on an easing cycle. Although inflation pressures are easing in the New Zealand economy, there is the risk of high inflation persisting for longer. These upside risks to inflation mean that the Reserve Bank will likely be cautious about easing too soon.

At its April Monetary Policy Review (MPR), the RBNZ reiterated its commitment to maintaining a restrictive monetary policy stance aimed at alleviating economic capacity pressures and returning consumer price inflation to its target band of 1 to 3 per cent.

The RBNZ's statement acknowledged the decline in the proportion of firms reporting difficulty in finding labour, suggesting a potential easing of pressure on the labour market. This shift in labour market dynamics and persistent global economic weakness have influenced major central banks around the world to exercise caution in easing monetary policy due to lingering inflation risks. The RBNZ remains vigilant in monitoring the domestic inflation outlook. Its latest decision to keep the OCR on hold reflects its policy goals of achieving its inflation target while navigating the evolving global economic conditions.

Meanwhile, we expect that currency movements will continue to be influenced by interest rate differentials. Global developments are particularly impactful on longer-term New Zealand interest rates, with attention in the United States centred on the Federal Reserve's potential policy rate adjustments. Recent data showing inflation over 3 per cent in the United States has delayed market expectations for Fed funds rate cuts while the European Central Bank (ECB) grapples with geopolitical uncertainty and inflation pressures. Market expectations suggest a potential policy rate cut by the ECB around the middle of this year.

BUILDING INVESTMENT

Businesses have become more cautious about investment, as uncertainty over the new government's spending plans and cutbacks in the public sector add to concerns about the extent of weakening demand in the New Zealand economy.

BUILDING CONSENTS

There was a sharp fall in consent issuance for education buildings for the year to February 2024. This decline was offset by increased demand for social, cultural and religious buildings and healthcare facilities over the past year. Growth in consent issuance for retail outlets and industrial buildings also contributed to the increase in non-residential construction demand over the past year. We expect the slowing in retail spending as households face higher mortgage repayments and a softer labour market will weigh on construction demand for retail outlets.

Over the longer term, we continue to expect strong population growth, and the ageing population will support demand for new healthcare facilities.

Building consents by sector

Social, cultural and religious buildings and healthcare facitilies led the growth in non-residental consent issuance over the past year. The increased demand for the construction of social, cultural and religious buildings largely reflected stronger demand in Canterbury and Wellington. Nationwide, the growth was driven by demand for both new social, cultural and religious buildings and alterations.

Meanwhile, the strengthenigng demand for healthcare facilities was broad-based across the regions except Auckland, which saw a substantial decline in demand for healthcare facilities. This weakness in Auckland was offset by stronger demand for the construction of storage and industrial buildings in the region.

Building consents by region

Over the past year, growth in non-residential construction consent issuance has been concentrated in the Bay of Plenty, Otago and Canterbury. In the Bay of Plenty, the strengthening in non-residential construction demand has been broad-based across healthcare facilities, office buildings, social buildings and retail outlets.

Growth in non-residental construction demand in Otago was also broad-based, with stronger demand for the construction of healthcare facilities, accommodation and office buildings.

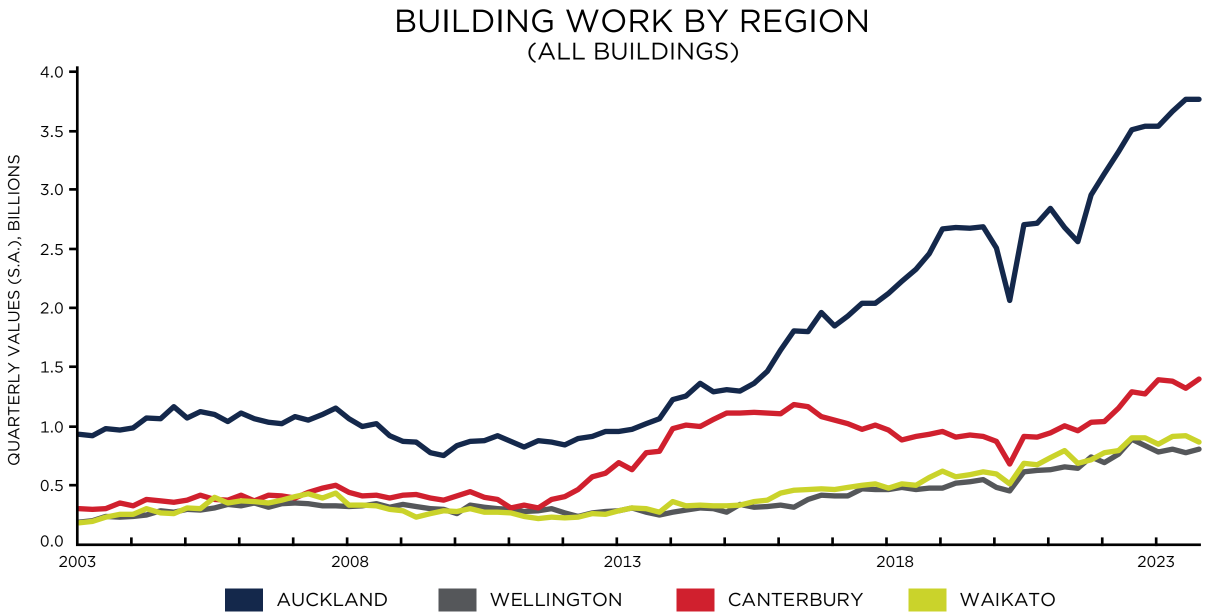
In Canterbury, increased demand for social, cultural and religious buildings was the key driver of stronger non-residential construction demand.

Ahutoetoe School, Auckland

FIGURE 1

Auckland continues to dominate construction activity

Quarterly values, billions

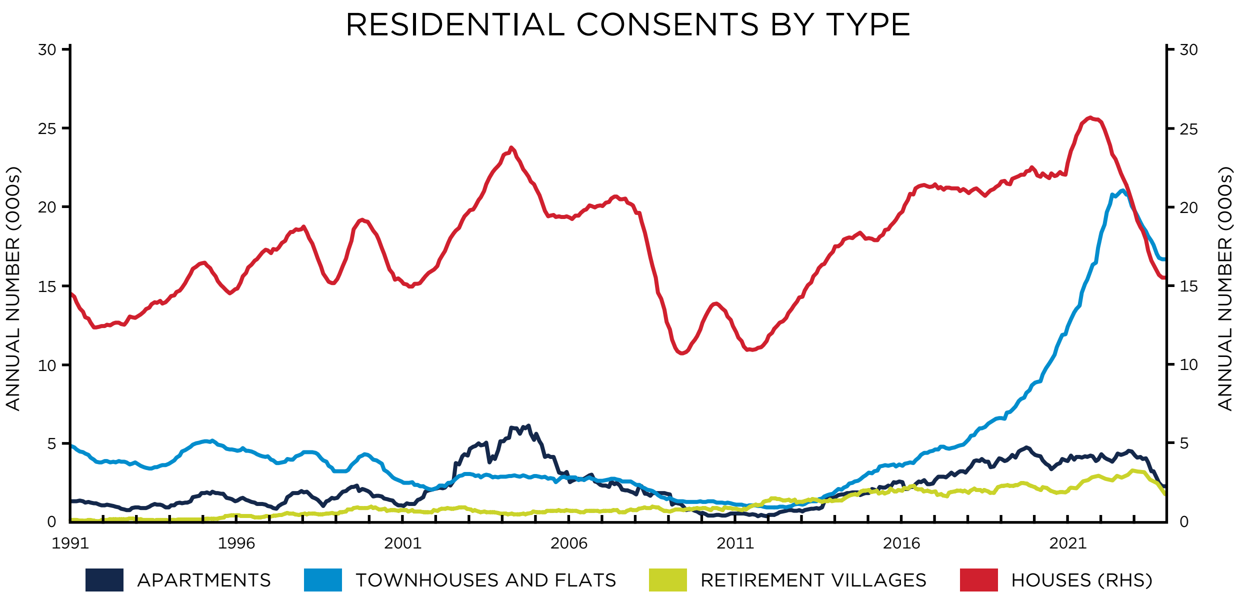


Source: Stats NZ

FIGURE 2

Continued weakness in the pipeline of residential construction

Annual number of consents

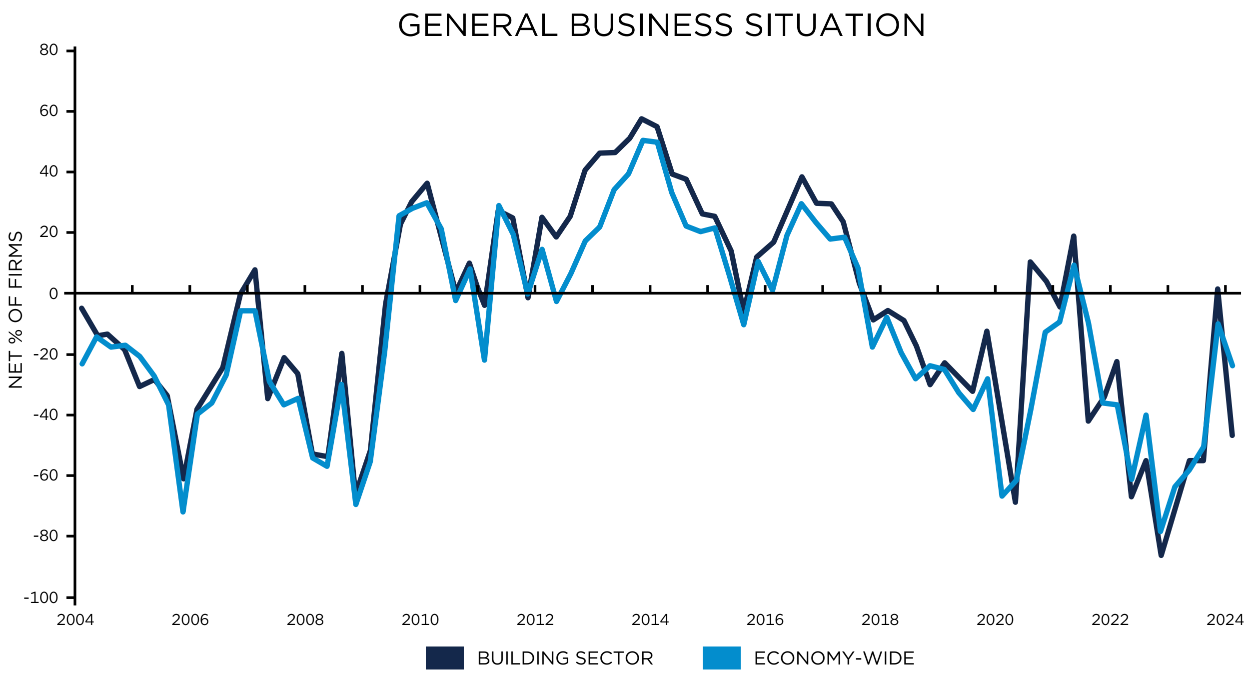


Source: Stats NZ

FIGURE 3

Building sector firms now the most downbeat

Net % of firms

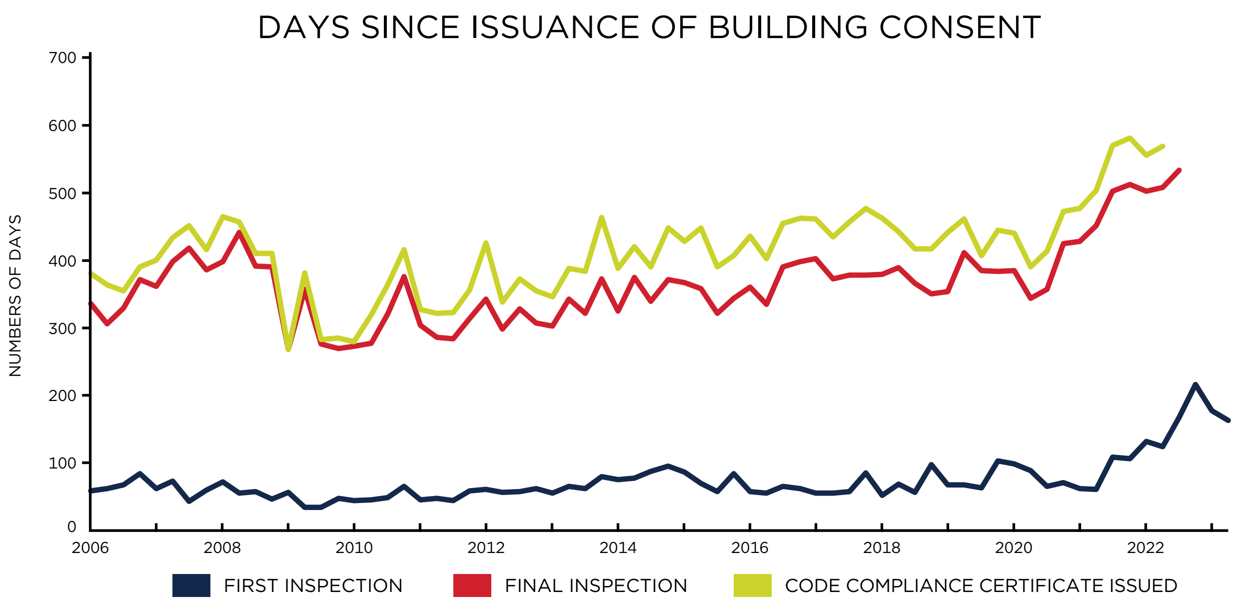


Source: NZIER

FIGURE 4

Construction delays over the COVID-19 pandemic looks to be unwinding as capacity pressures ease

Number of days since building consent issuance

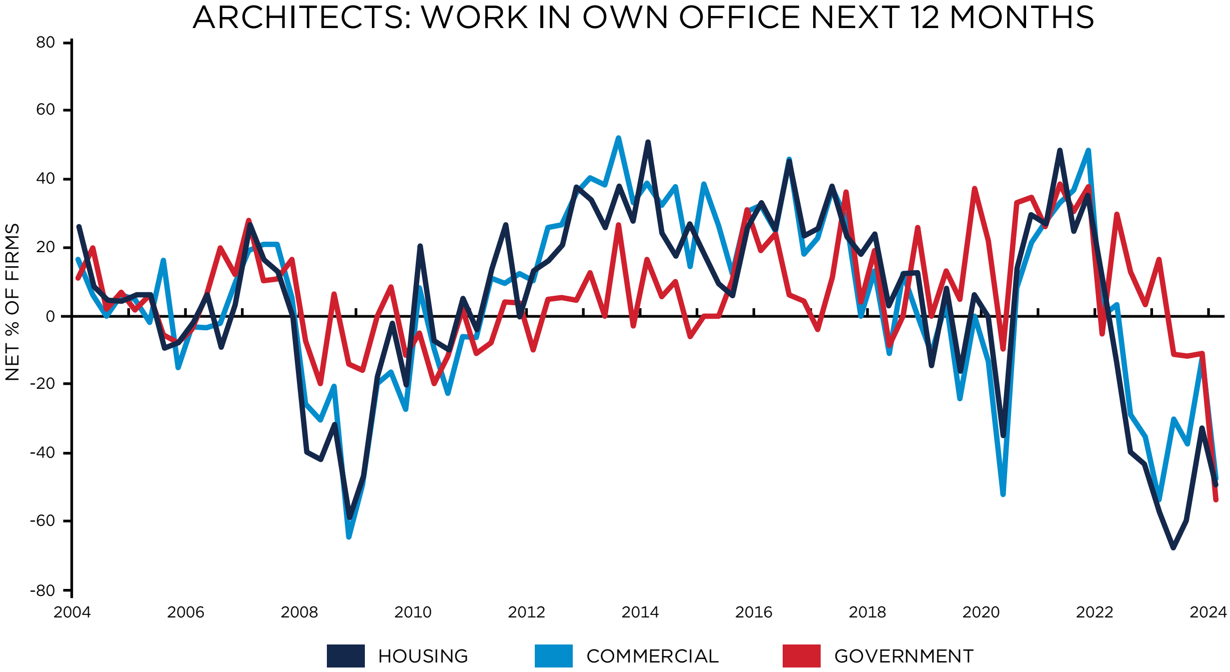


Source: Stats NZ

FIGURE 5

Broad-based weakness in pipeline of construction work

Net % of firms



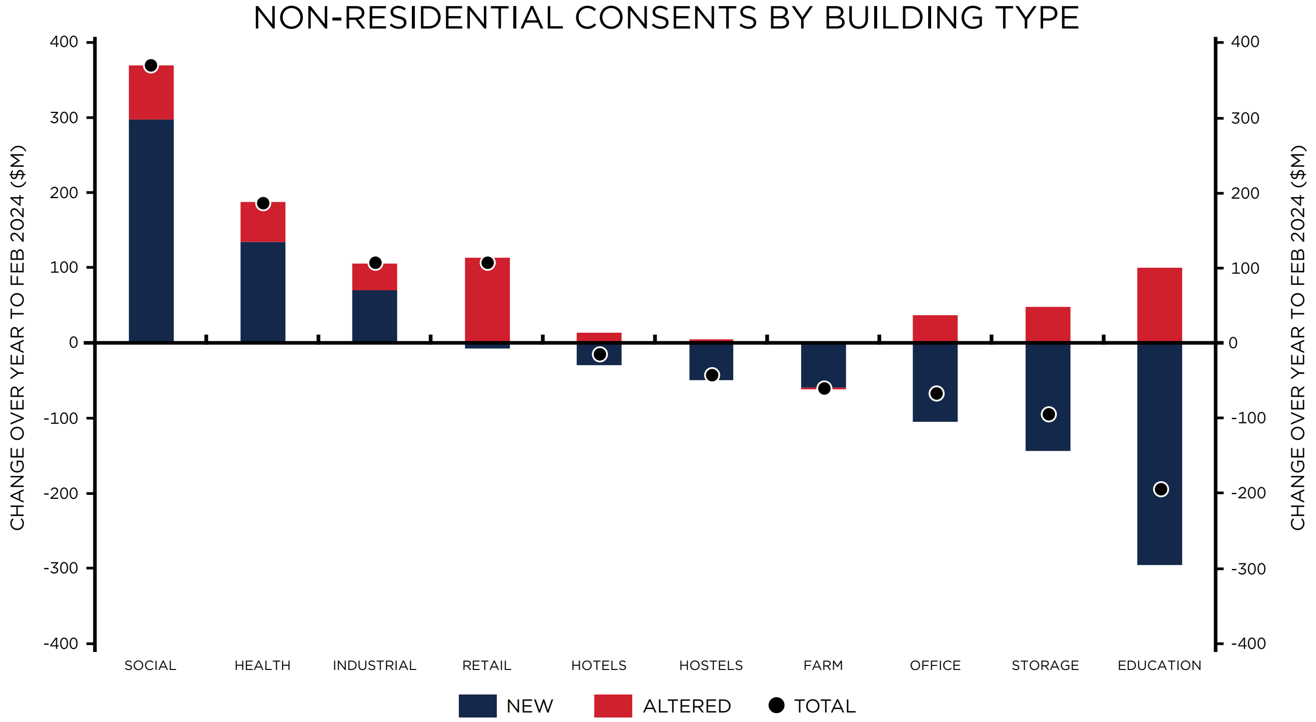
Source: NZIER

Christchurch Central Primary Birthing Unit, Kurawaka Waipapa

FIGURE 6

Demand for social and health buildings leads non-residential construction demand

Change over year to February 2024



Source: Statistics NZ, NZIER

TABLE 1

Non-residential building consents by region and sector

$m of consents for the year ending February 2024; red colour shading for a decline in consents from the previous year

	SECTOR									
REGION	HOSTELS, PRISONS ETC	ACCOMODATION	HEALTH	EDUCATION	SOCIAL, CULTURAL, RELIGIOUS	RETAIL	OFFICE	STORAGE	INDUSTRIAL	FARM
NORTHLAND	1.0	5.0	66.0	53.4	38.2	9.2	13.7	10.4	22.6	10.2
AUCKLAND	21.0	146.5	510.9	411.9	89.0	474.6	838.0	761.4	528.5	20.3
WAIKATO	7.9	8.6	164.4	61.6	38.0	52.3	79.0	152.0	135.9	52.7
BAY OF PLENTY	5.6	10.4	139.4	65.0	86.1	100.7	143.1	74.3	58.0	14.8
GISBORNE	0.9	0.3	31.7	8.4	14.0	1.4	2.5	1.1	0.3	1.6
HAWKE'S BAY	10.2	2.0	51.2	30.8	23.8	31.3	21.3	37.9	67.5	5.9
TARANAKI	0.0	0.2	3.3	16.8	50.3	12.5	13.6	11.0	12.4	15.2
MANAWATŪ-WHANGANUI	2.4	2.4	55.8	58.2	14.4	28.2	23.8	57.0	36.2	18.2
WELLINGTON	2.4	4.3	82.1	134.2	203.6	57.9	313.5	42.0	128.8	9.8
NELSON	0.0	0.1	14.4	7.9	3.6	2.7	5.7	1.7	9.3	0.0
TASMAN	3.1	1.1	2.8	10.4	3.5	5.1	7.2	11.8	23.6	4.4
MARLBOROUGH	0.8	1.5	6.8	17.9	0.7	4.8	3.1	1.6	36.6	6.2
WEST COAST	0.0	1.1	1.7	5.1	5.9	2.1	5.3	3.0	5.6	2.4
CANTERBURY	2.5	18.5	141.4	314.5	475.3	108.8	89.2	275.2	124.2	54.4
OTAGO	0.5	100.2	198.9	77.0	91.7	61.8	109.5	23.3	32.6	24.0
SOUTHLAND	0.3	2.5	15.1	19.6	2.4	6.8	11.6	13.2	29.2	14.4

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 2023, reflecting the easing in capacity pressures in the construction sector. The 1.0 per cent increase in non-residential construction costs over the quarter saw annual non-residential construction cost inflation ease to 5.7 per cent for the year to December 2023.

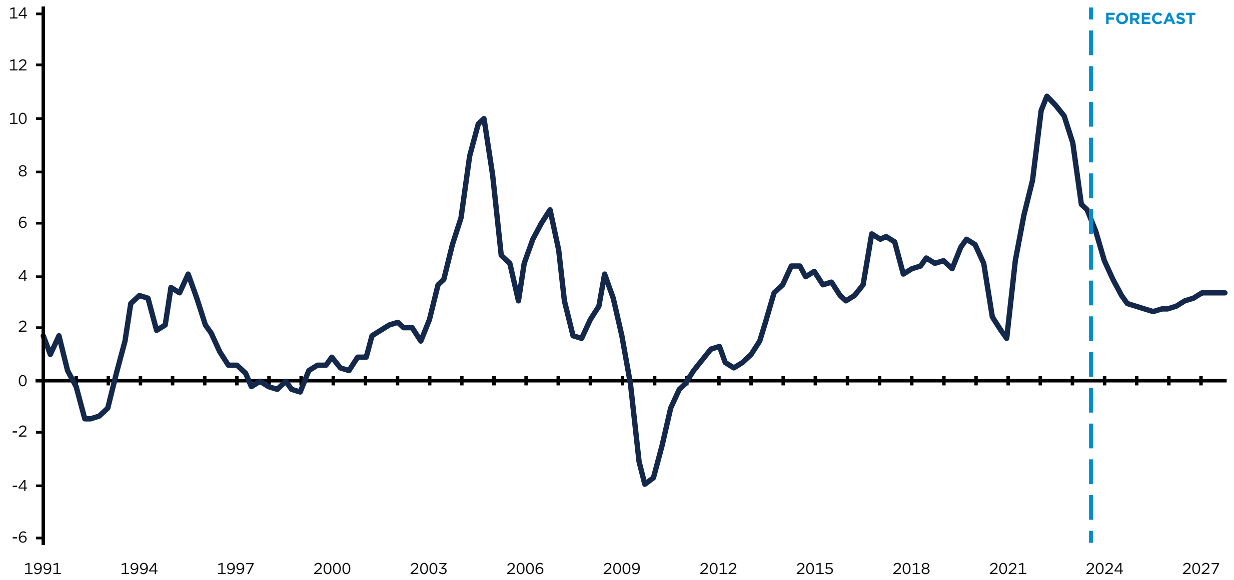
We expect construction cost inflation to continue to ease over the coming years, reflecting the continued easing in capacity pressures in the sector. Building sector firms report a further easing in labour shortages. The NZIER QSBO also indicates that weak construction demand is weighing on pricing pressures in the building sector. Overall, this supports our view of further slowing in construction cost inflation.

We forecast annual non-residential construction cost inflation to ease to below 3 per cent in 2025. Beyond that, we expect a recovery in construction demand will underpin a lift in construction cost inflation over the longer term.

FIGURE 7

Non-residential building cost inflation

CGPI-NRB index, annual % change



Source: Statistics NZ, NZIER forecasts

TABLE 2

Non-residential building cost index[2]

YEAR	QUARTER	INDEX	QUARTERLY % CHANGE	ANNUAL % CHANGE
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	1037	1.9	9.0
	JUNE	1052	1.4	6.8
	SEPTEMBER	1065	1.2	6.5
	DECEMBER	1076	1.0	5.7
2024	MARCH	1085	0.8	4.6
	JUNE	1093	0.8	3.9
	SEPTEMBER	1100	0.7	3.3
	DECEMBER	1108	0.7	3.0
2025	MARCH	1115	0.7	2.8
	JUNE	1123	0.7	2.7
	SEPTEMBER	1130	0.6	2.7
	DECEMBER	1138	0.7	2.7
2026	MARCH	1146	0.7	2.8
	JUNE	1155	0.8	2.9
	SEPTEMBER	1164	0.8	3.0
	DECEMBER	1174	0.8	3.2
2027	MARCH	1184	0.9	3.3
	JUNE	1194	0.8	3.4
	SEPTEMBER	1204	0.8	3.4
	DECEMBER	1214	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

2 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/

RIDER LEVETT BUCKNALL OFFICES

For further information please contact Grant Watkins +64 4 384 9198 or your nearest Rider Levett Bucknall office.

New Zealand

Auckland	+64 9 309 1074
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