FORECAST REPORT 80

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

THIRD QUARTER 2016

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RIDER LEVETT BUCKNALL

Rider Levett Bucknall is an independent, global property consultancy, providing advice focused on the cost, quality and sustainability of the built environment. It has over 3,500 staff operating from more than 120 global offices.

The firm's philosophy is to combine global best practice with local know-how, utilising the latest cost data and innovations to deliver full property solutions for clients across a number of sectors. Services provided include Cost Consultancy and Advisory.

FORECAST 80

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

AUCKLAND CONTINUES TO LEAD THE WAY IN CONSTRUCTION GROWTH

Construction demand continues to strengthen across both residential and non-residential sectors, led by Auckland.

STRONG POPULATION GROWTH CONTINUES TO BOOST HOUSING DEMAND

There are tentative signs migration is starting to moderate, but the effects of strong population growth over the past year continues to flow through to housing demand.

NON-RESIDENTIAL CONSTRUCTION DEMAND BOOSTED BY STRENGTHENING HOUSEHOLD SECTOR

Population growth and robust household spending drive non-residential construction demand. Highest sustained inflation profile since mid 2000's.

FURTHER CUT IN INTEREST RATES POSSIBLE

The Reserve Bank is growing increasingly concerned about the reacceleration in the housing market, but the subdued inflation outlook suggests scope for another interest rate cut. Further changes to prudential requirements on banks cannot be ruled out.

BUILDING ACTIVITY TRENDS

Strong population growth continues to underpin construction demand. Both residential and non-residential construction grew strongly in the first quarter of 2016. We expect construction will continue to be a key driver of economic growth in the New Zealand economy over the coming years, underpinned by strong migration-led population growth and low interest rates.

There are tentative signs net migration is moderating, but the effects of the phenomenal population growth we have already seen will continue to boost demand across a wide range of sectors. The effects are particularly evident in increased demand for education buildings and retail outlets.

Reflecting the key influence of population growth on construction demand, Auckland continues to lead the way in activity. However, demand is broadening, with halo regions such as Waikato and Bay of Plenty benefitting from the spill-over of strong population growth in Auckland.

Housing supply continues to ramp up in Auckland, with around 9,500 dwelling consents issued in the region over the past year. However, with Auckland net migration rising above 31,000 over the past year suggesting at least 10,000 additional dwellings would be needed just to keep up with demand from net migration itself.

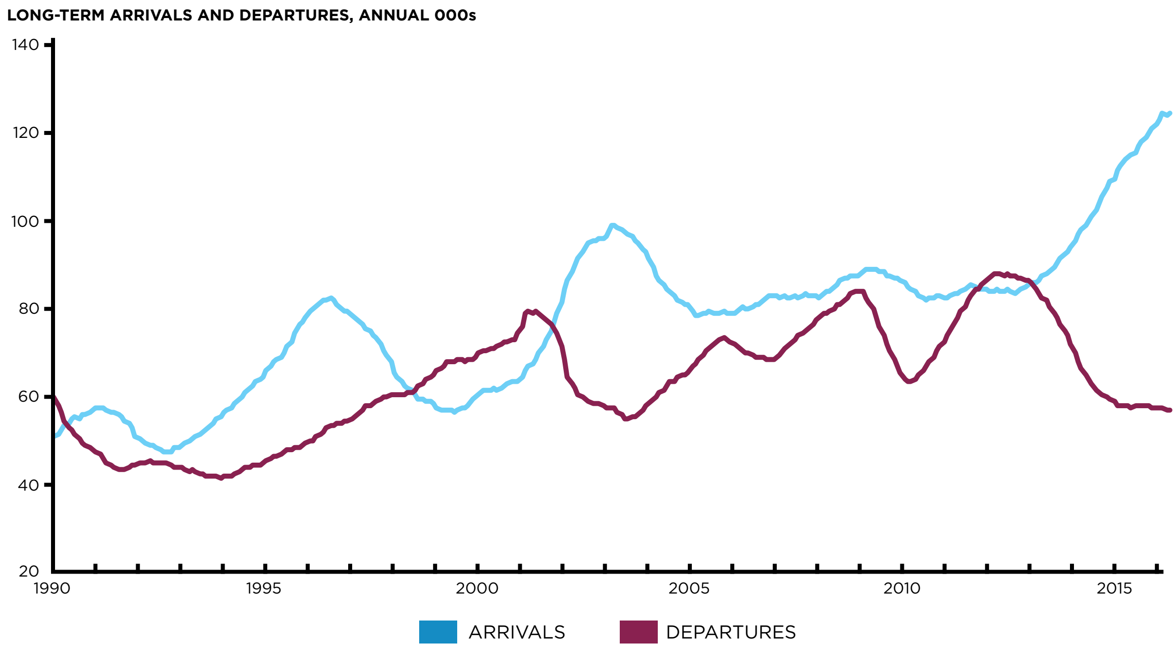
Despite the easing from 2015 highs as the housing part of the earthquake rebuild starts to wrap up, construction activity in Canterbury remains at a historically high level, and net inflows into the region should continue to underpin relatively strong residential construction demand over the next few years.

Demand remains strongest for standalone houses, with consents issued for apartments easing in recent months following a marked lift over the second half of 2015. Meanwhile, demand for other multi-unit dwellings such as townhouses remain steady. There is growing recognition that more high-density housing will be required to meet Auckland's increased housing needs, but the extent to which the region can intensify will depend on the zoning plan decisions made over the coming year. Central government has clearly signalled its dissatisfaction with the ability of Auckland Council to deliver sufficient land to meet demand and has issued a draft National Policy Statement under the RMA designed to make all councils, but Auckland in particular, to place greater emphasis on accommodating urban growth in its planning decisions. It has not ruled out further legislative changes, which seem to have cross-party support in Parliament.

Non-residential construction demand continues to strengthen, but the outlook is mixed across the sectors and regions. Demand is rising in tourism-intensive regions such as Auckland, Wellington and Otago, in contrast to the weakening demand in the dairy-intensive regions as farmers rein in spending in the face of reduced income.

FIGURE 1

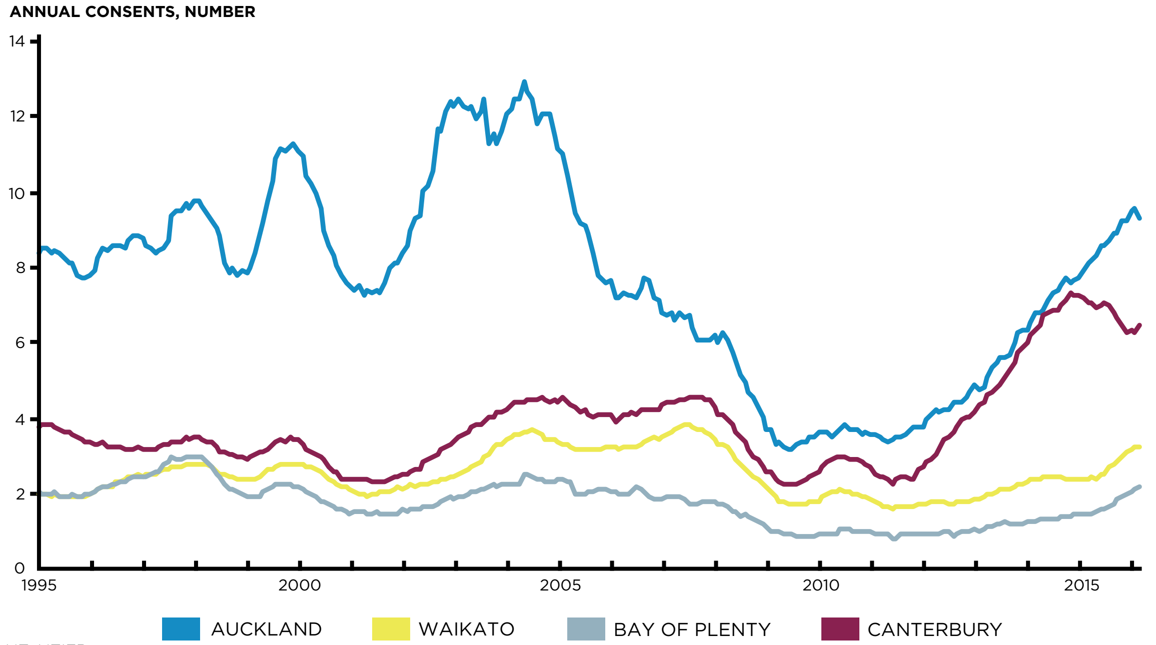
STRONG NET MIGRATION UNDERPINNING CONSTRUCTION DEMAND



Source: Statistics NZ, NZIER

FIGURE 2

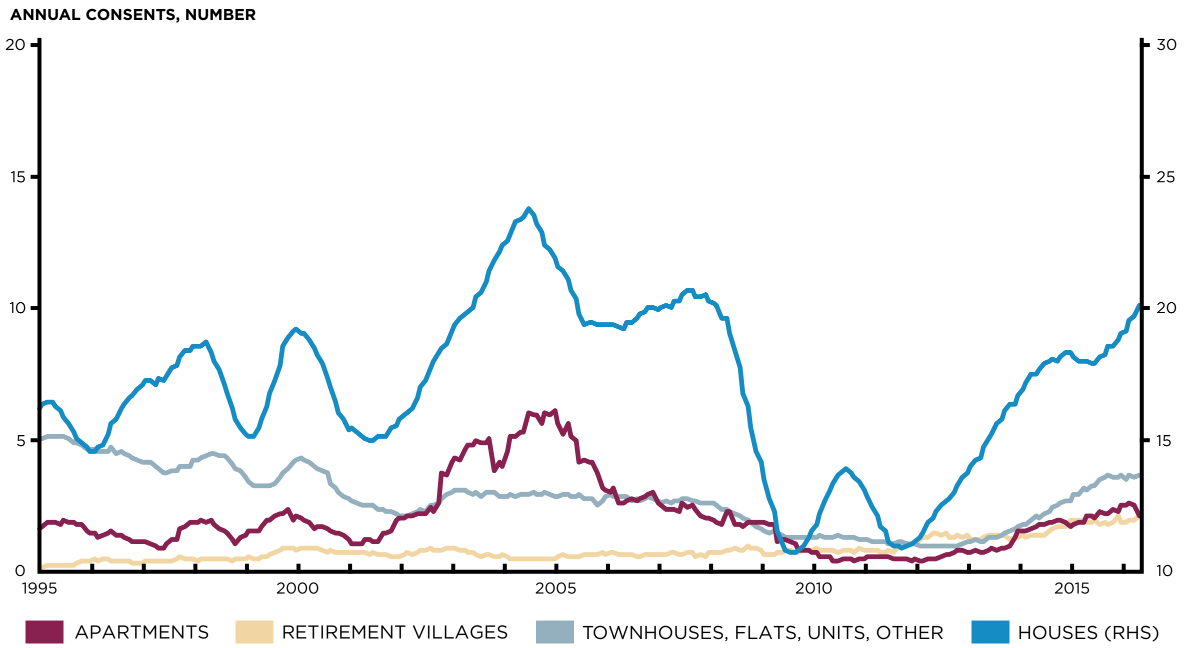
RESIDENTIAL DEMAND RAMPING UP IN AUCKLAND AND THE HALO REGIONS



Source: Statistics NZ, NZIER

FIGURE 3

SURGING DEMAND FOR STANDALONE HOUSES



Source: Statistics NZ, NZIER

BUILDING ACTIVITY OUTLOOK

ECONOMIC BACKDROP

The New Zealand economy showed decent momentum in the first quarter of 2016, despite volatility in the financial markets at the beginning of the year. Construction was a key driver of economic growth, as strong population growth boosted demand for residential, non-residential and infrastructure construction. Demand in the services sector also remains robust, reflecting the strengthening household sector.

Reduced dairy incomes continue to weigh on the rural parts of the New Zealand economy, but improving prospects in other commodities such as horticulture, seafood and viticulture is providing some offset. We expect the New Zealand export sector will continue to diversify from dairy to other commodities over next year. Nonetheless, we expect a continued reduction in on-farm spending by dairy farmers given the slower than expected recovery in dairy incomes will weigh on business investment over 2016 and 2017.

Meanwhile, tourism remains a standout, having overtaken dairy as our top export earner. Lower fuel prices have increased flight capacity, with the growing number of long-haul flights meaning more tourists are staying in New Zealand for longer and spending more. The tourism boom has boosted activity and injected income into many regional economies.

Uncertainty over the global growth outlook continues to present downside risks. In particular, the Chinese economy continues to slow as it transitions from investment-led to consumption-led growth. Policymakers have taken steps to support growth given the rocky nature of the transition, but reforms will be needed for the longer term sustainability of the Chinese economy.

INTEREST AND EXCHANGE RATES

The Reserve Bank held the Official Cash Rate (OCR) at 2.25% in June, and expressed heightened concern at the reacceleration in the housing market in wake of its OCR cut in March. Despite reasonable momentum in the New Zealand economy, inflation remains weak with annual inflation at just 0.4% for the year to March 2016 – well below the Reserve Bank's 1-3% target band. The subdued inflation outlook suggests scope for another cut in the OCR given the Reserve Bank's focus on returning headline inflation to the 2% mid-point of its inflation target band. Lower interest rates will undoubtedly pour further fuel on the housing market fire. The Reserve Bank does, however, have other tools in its arsenal that can be used to mitigate risks to financial stability caused by imbalances in the housing market. In its latest Financial Stability Report, it noted it is closely monitoring developments to assess whether further financial policy measures would be appropriate.

The New Zealand dollar has rebounded on the back of data showing a reasonably robust outlook for the New Zealand economy. Adding to the upward pressure on the New Zealand dollar has been increased uncertainty over when the Federal Reserve will lift its policy rate given more recent signs of fragility in the US labour market. Uncertainty over whether Britain will choose to leave the European Union added to volatility in exchange rate markets.[1]

BUILDING INVESTMENT

Demand for non-residential construction continues to strengthen, and a solid pipeline of work remains with population growth underpinning strong demand for education, buildings and hospitals.

BUILDING CONSENTS

Non-residential building consent issuance has eased in recent months, following a lift over late 2015. Despite the easing, non-residential construction demand is solid, buoyed by population growth and low interest rates.

The average value per square metre consented has lifted back to levels last seen in 2010, suggesting a lift in construction costs.

[1] See Do you think you're better off alone? Impacts of Brexit on New Zealand - NZIER Insight 60 for our take on what Brexit might mean for New Zealand.

BUILDING CONSENTS BY SECTOR

Education buildings, hostels and retail outlets were the top three drivers of growth in non-residential issuance over the past year, reflecting the effects of strong population growth. The increase in construction of education buildings reflects a mix of new construction and alterations. Overall, the majority of non-residential consents issued over the past year continue to be for new building construction rather than alterations.

There has been a particularly marked decline in alterations of office buildings over the past year, following growth over 2014.

In contrast to the increased demand for education buildings, hostels and retail outlets, the weaker rural sector has reduced demand for farm and industrial buildings. With the dairy farm payout the upcoming season likely to be below the average break-even for the third straight season, dairy farmers are paring back on investment.

Demand for new office buildings has eased over the past year. However, we expect the low interest rate environment will support demand for new developments including office and retail space. Strong population growth underpin many of the longer-term trends:

- Office growth to accommodate the higher number of workers.
- Public sector spending on education buildings, along with rebuilding activity.
- Capacity constraints in the tourism sector will drive demand for new accommodation buildings.

FIGURE 4

NON-RESIDENTIAL CONSTRUCTION COST LIFTING AS DEMAND IMPROVES

Source: Statistics NZ, NZIER

Spark Data Centre, Auckland

BUILDING CONSENTS BY REGION

The diverging outlooks of the tourism and rural sectors drive non-residential demand across the regions. The upbeat mood of the tourism-intensive regions is in sharp contrast to the downbeat mood of the dairy-intensive regions, and points to a mixed outlook for the various regions.

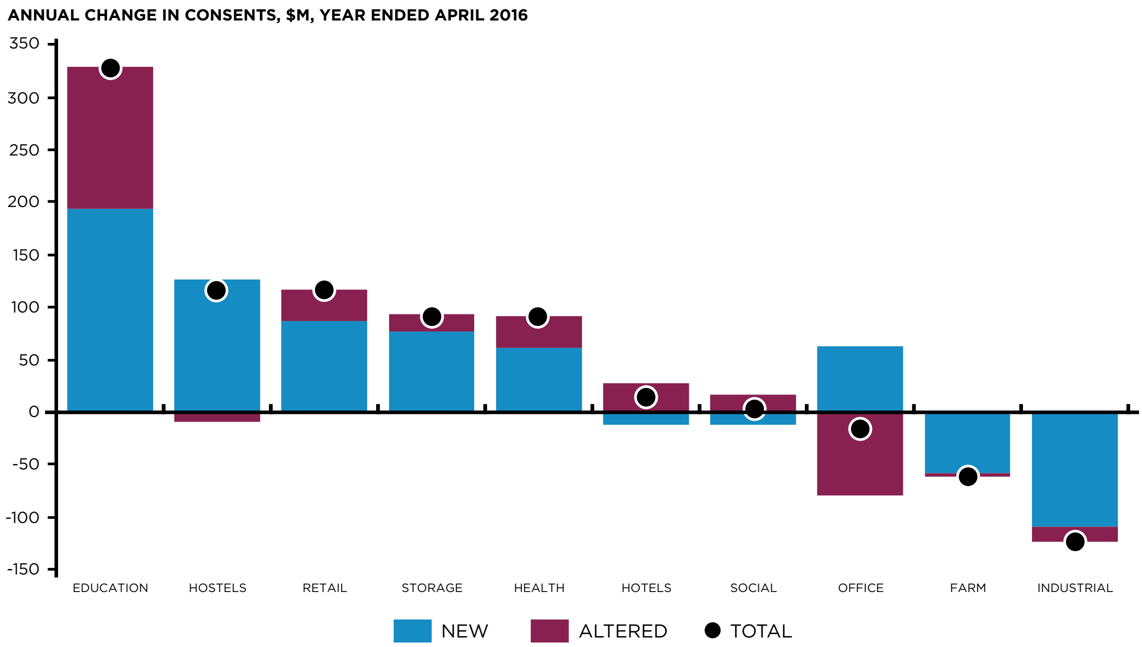
Non-residential demand remains strong in Auckland, and the region continues to lead the way in growth in non-residential consent issuance across a broad range of sectors including accommodation, retail and office buildings. As the largest recipient of tourist income, the surge in international visitors over the past year has boosted demand in Auckland. We expect non-residential demand will remain strong in the region over the next few years.

Non-residential demand is also picking up in Wellington, Waikato and Bay of Plenty, reflecting the increased number of people going to those regions to live and visit. Canterbury also saw an improvement in non-residential demand on the back of demand for education buildings following weakness over late 2015. Although the residential part of the earthquake rebuild is wrapping up, there is still a large amount of non-residential building to be done. We expect the level of non-residential construction will remain high in Canterbury over the next few years.

In contrast, regions exposed to the dairy sector such as Taranaki and Southland have seen reduced demand for non-residential construction over the past year as farmers rein in spending. Although reduced dairy income will continue to weigh on non-residential demand, we expect as demand for other New Zealand commodity exports grow non-residential demand in the rural regions will recover.

FIGURE 5

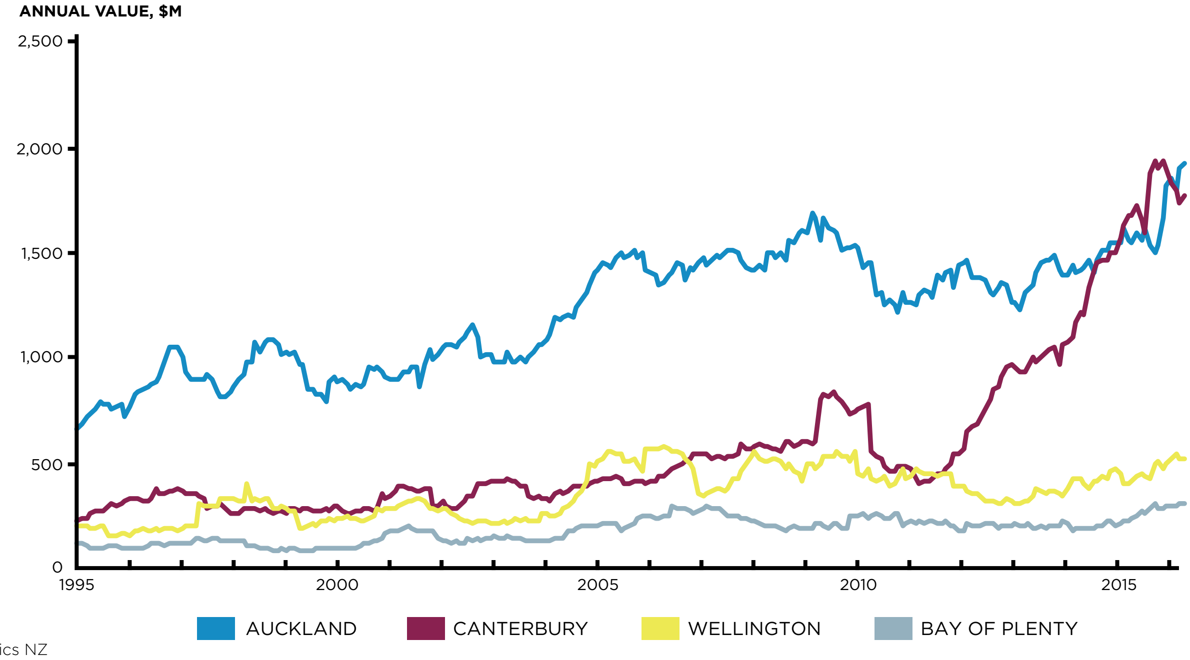
STRONG POPULATION GROWTH DRIVES NON-RESIDENTIAL CONSTRUCTION DEMAND



Source: Statistics NZ, NZIER

FIGURE 6

NON-RESIDENTIAL CONSENTS LED BY AUCKLAND



Source: Statistics NZ

TABLE 1

NON-RESIDENTIAL BUILDING CONSENTS BY REGION AND SECTOR

$M OF CONSENTS FOR THE YEAR ENDING APRIL 2016; RED COLOUR SHADING FOR DECLINE IN CONSENTS FROM PREVIOUS YEAR

	SECTOR									
REGION	HOSTELS, PRISONS ETC	ACCOMODATION	HEALTH	EDUCATION	SOCIAL, CULTURAL, RELIGIOUS	RETAIL	OFFICE	STORAGE	INDUSTRIAL	FARM
NORTHLAND	7.7	1.7	1.4	13.9	6.5	10.4	8.4	6.3	4.0	8.7
AUCKLAND	185.1	57.4	142.4	306.4	91.8	294.1	415.6	275.2	125.7	26.5
WAIKATO	3.4	9.4	29.1	53.4	49.7	92.0	45.9	33.1	61.1	58.5
BAY OF PLENTY	0.6	2.1	32.1	32.8	22.5	77.9	47.3	58.4	24.8	11.5
GISBORNE	0.0	0.1	0.1	6.6	1.4	3.2	2.9	0.5	12.2	2.3
HAWKE'S BAY	0.6	2.3	0.7	21.2	10.6	14.8	18.5	19.9	15.1	8.1
TARANAKI	0.0	2.4	9.5	12.8	7.7	8.2	11.9	8.0	12.2	31.5
MANAWATU-WANGANUI	0.1	0.3	11.8	22.1	14.3	17.4	17.3	13.4	12.4	13.1
WELLINGTON	1.6	8.7	50.4	169.0	30.0	37.7	172.5	15.3	26.9	5.0
NELSON	0.0	0.4	0.3	2.7	4.7	5.0	1.7	4.0	6.2	0.0
TASMAN	0.0	1.2	0.1	2.5	3.7	6.1	4.2	4.2	1.2	3.6
MARLBOROUGH	0.0	4.9	4.2	4.8	2.4	4.2	2.6	12.7	10.3	3.0
WEST COAST	0.0	1.1	2.2	2.5	4.3	1.2	0.9	2.2	9.1	5.0
CANTERBURY	12.5	37.6	230.4	416.5	136.9	205.9	376.2	216.2	85.4	50.7
OTAGO	5.3	28.1	24.4	53.1	18.2	46.7	29.8	18.8	20.4	12.6
SOUTHLAND	2.0	0.7	5.3	3.6	2.7	18.2	5.8	8.9	14.0	12.6

Source: Statistics NZ, NZIER

33 Bowen Street, Wellington

BUILDING COSTS

The Capital Goods Price Index for Non-Residential Buildings (CGPI-NRB) provides an official measure of cost movements in the sector. The CGPI-NRB excludes GST. The rate of increase in the CGPI-NRB can be used as an indicator of cost escalation.

The CGPI-NRB is a national average across all regions and building types. We therefore advise caution in applying the increase in the CGPI-NRB as an indicator of cost escalation for specific building projects.

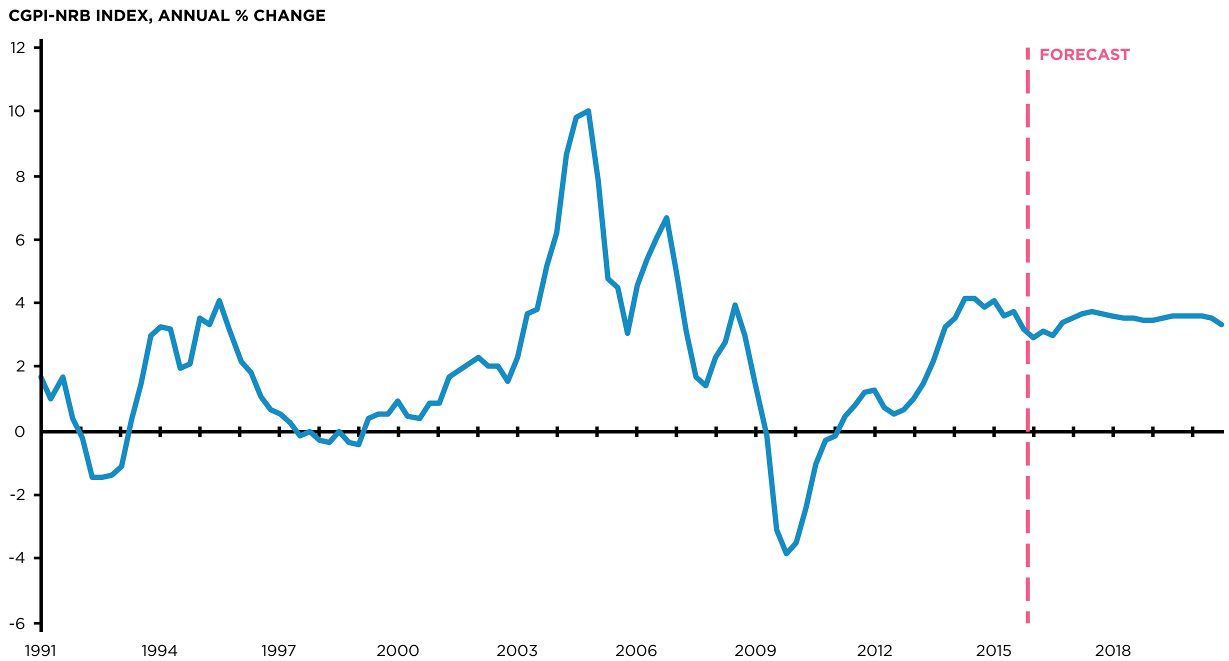
The Rider Levett Bucknall Second Quarter 2016 Oceania Report provides local regional comment and tender price relativity between the main New Zealand and Australian centres. This publication is available at www.rlb.com or on request from any Rider Levett Bucknall office.

Construction costs increases have moderated more recently following solid growth over 2014, but there are differences across the regions. While resource and capacity constraints have eased in Canterbury, they are more acute in Auckland.

NZIER forecasts construction cost inflation to average below 4% a year over the next three years. This will be the highest sustained inflation in the sector since the construction boom of the mid-2000s. NZIER does not expect the inflation to be as high as the mid-2000s given 1) the low inflation environment limits the extent to which rising costs can be passed on, and 2) strong net migration is helping to mitigate skills shortages in the building sector.

FIGURE 7

NON-RESIDENTIAL BUILDING COST ESCALATION



Source: Statistics NZ, NZIER forecasts

TABLE 2

NON-RESIDENTIAL BUILDING COST INDEX

YEAR	QUARTER	INDEX	QUARTERLY % CHANGE	ANNUAL % CHANGE
2010	MARCH	1336	-0.1	-3.5
	JUNE	1336	0.0	-2.4
	SEPT	1336	0.0	-1.0
	DEC	1333	-0.2	-0.3
2011	MARCH	1334	0.1	-0.1
	JUNE	1342	0.6	0.4
	SEPT	1347	0.4	0.8
	DEC	1349	0.1	1.2
2012	MARCH	1351	0.1	1.3
	JUNE	1352	0.1	0.7
	SEPT	1354	0.1	0.5
	DEC	1358	0.3	0.7
2013	MARCH	1365	0.5	1.0
	JUNE	1372	0.5	1.5
	SEPT	1383	0.8	2.1
	DEC	1402	1.4	3.2
2014	MARCH	1413	0.8	3.5
	JUNE	1429	1.1	4.2
	SEPT	1440	0.8	4.1
	DEC	1456	1.1	3.9
2015	MARCH	1471	1.0	4.1
	JUNE	1480	0.6	3.6
	SEPT	1494	0.9	3.8
	DEC	1502	0.5	3.2
2016	MARCH	1514	0.8	2.9
	JUNE	1526	0.8	3.1
	SEPT	1539	0.8	3.0
	DEC	1553	0.9	3.4
2017	MARCH	1568	0.9	3.5
	JUNE	1582	0.9	3.7
	SEPT	1596	0.9	3.7
	DEC	1610	0.9	3.7
2018	MARCH	1624	0.9	3.6
	JUNE	1638	0.8	3.5
	SEPT	1652	0.9	3.5
	DEC	1666	0.9	3.5
2019	MARCH	1681	0.9	3.5
	JUNE	1696	0.9	3.5
	SEPT	1711	0.9	3.6
	DEC	1727	0.9	3.6

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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