

RLB | Rider Levett Bucknall

NEW ZEALAND TRENDS
IN PROPERTY AND
CONSTRUCTION

MARCH 2011



The very recent events of 2011 have driven home the importance of standing by our clients and our people. The Rider Levett Bucknall Christchurch office is located 200 metres from the Pyne Gould Guinness Building, which completely collapsed, so they know firsthand the devastation in the Christchurch CBD. Rider Levett Bucknall offers our sincere condolences and support to all of those affected by the earthquake in Christchurch.



Obviously, there will be activity following on from the recent devastating and tragic earthquake in Christchurch, but it has also been reported that we are likely to see a 1.5 per cent GDP drop this year with major rebuilding in Christchurch commencing in 2012 and a marked pick up in the industry over a 3-5 year period, due to this spike in the economy.



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Rider Levett Bucknall are independent property market and construction cost consultants with offices located globally.

FORECAST 60

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

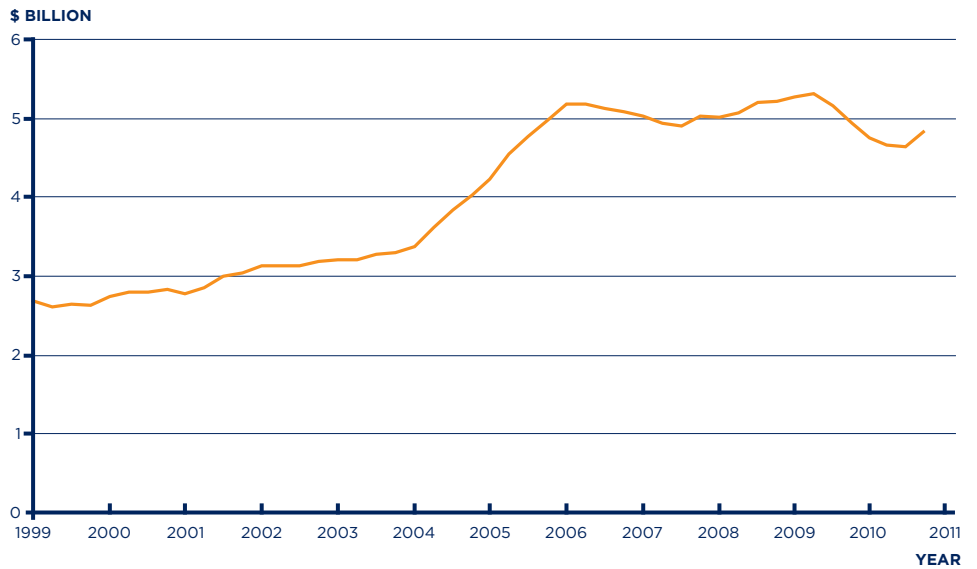
Forecast is supplemented by Rider Levett Bucknall's bi-annual construction market intelligence publications: the Oceania Report, International Report and Gulf Reports.

KEY POINTS IN THIS ISSUE

- **Canterbury earthquake** The disruption from the second earthquake will reduce building activity in the short term, but will kick start a massive reconstruction phase. Industry estimates of rebuild range from \$15b to \$30b and could take up to ten years to complete.
- **Building activity** The non-residential building sector rebounded in December 2010 from recent lows. Building work put in place fell only 1.6% over the December 2010 year.
- **Building consents** Building consents have fallen by 14.1% over the past year. Activity will soften as a result. High vacancy rates, a slowing economic recovery and disruption from the Canterbury earthquake are the main constraints.
- **Building investment** Non-residential building investment will contract by 10% over the March 2011 year, weaken further in 2012 and rebound sharply in 2013. Investment activity may rebound sooner if work for Canterbury reconstruction is fast tracked.
- **Building confidence** Building confidence has rebounded as new orders and output soared above long run averages. Softening economic conditions and building consents suggest that a recovery in confidence will be slow.
- **Building costs** Non-residential building costs have broadly stabilised over the previous year and fell only 0.3% over the December 2010 year. Weak domestic demand for construction was the main driver. Costs are starting to rise and Canterbury reconstruction may strain capacity in the building sector and boost prices in the medium term.

FIGURE 1

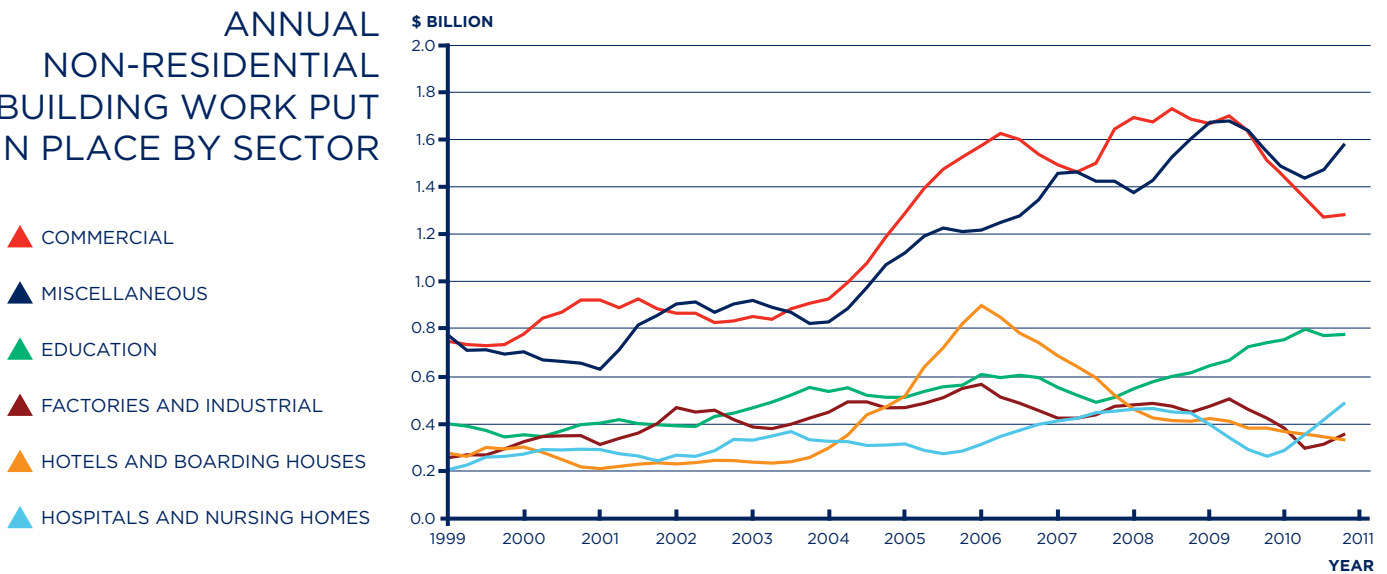
ANNUAL
NON-RESIDENTIAL
BUILDING WORK
PUT IN PLACE



Source: Statistics New Zealand

FIGURE 2

ANNUAL
NON-RESIDENTIAL
BUILDING WORK PUT
IN PLACE BY SECTOR



Source: Statistics New Zealand

BUILDING
ACTIVITY TRENDS

Non-residential building construction rebounded in the December quarter, following substantial declines since June 2009 (see Figure 1). The value of non-residential building work put in place soared 18.8% in the December 2010 quarter compared to the December 2009 quarter. The increase was driven by work on hospital and miscellaneous buildings¹. The large increase in activity is coming off recent lows. Construction work worth \$4.817 billion took place in the year to December 2010, down 1.6% from the previous year. Residential building work is recovering after a steep downturn. Residential values fell 3.1% in the December 2010 quarter compared to December 2009, but rose a respectable 6.5% over the year ended December 2010.

Performance in non-residential construction is varied across sectors. Work on commercial buildings declined 15% (year ended December 2010), hotels and boarding houses 13% and factories and industries buildings 17%. Miscellaneous buildings stabilised rising only 1% over the previous year (but farm buildings remain weak). The rebound in non-residential construction is being led by two sectors. Work on hospitals and nursing homes rose 80% over the past year – a substantial turnaround. Work on education buildings grew 5%, but is easing as the government tightens spending.

¹ A category encompassing social, cultural, religious, recreational and farm buildings.



BUILDING
ACTIVITY OUTLOOK

ECONOMIC GROWTH AND BUILDING INVESTMENT

The New Zealand economy faces another challenging year. The economic outlook has deteriorated in recent months. Summer retailing and house sales indicate weak domestic demand. Canterbury suffered a second damaging earthquake, which will create significant near term disruption and delay previously planned reconstruction activity. Growth expectations for the 2011 have been revised down sharply. NZIER expects economic growth of only 0.3% in 2011 but rebound to 3.4% in the 2012 calendar year.

The outlook for 2011 has softened due to the earthquake. Rising food and fuel prices will further dampen spending in early 2011, compounding an already slow economy. The reconstruction of Canterbury will boost construction employment, and there will be temporary hiring for the Rugby World Cup (RWC), but new hiring elsewhere in the economy will be slow. The second and more devastating earthquake has delayed reconstruction in Canterbury to later in the year.

The non-residential construction sector will contract sharply in early 2011, before a gradual recovery takes hold in later 2011. This will be boosted by reconstruction activity following the Canterbury earthquakes. Public sector investment is slowing from very strong levels during the recession. Fast tracked (roads, bridges, etc) and one-off RWC related projects are at or near completion. Public investment will be resilient but more modest over coming years. Reconstruction in Canterbury may boost activity significantly through 2011, but the extent of damage and potential displacement of other investment is not yet known. NZIER expects non-residential building investment to fall 10% over the March 2011 year, a further 26% in the March 2012 year before recovering by 11% over the March 2013 year.

The second Canterbury earthquake was another setback for the region. Latest government estimates suggest around \$15b of building and infrastructure damage. This has further delayed reconstruction from the initial earthquake as the focus returns to restoring infrastructure. Industry estimates reconstruction could take up to ten years to complete.

The full impact on the construction sector will depend on how much of the damage is repaired (as opposed to demolished) and over what timeframe. There is also the possibility of business failures, job losses and emigration from the region. This will reduce the amount of reconstruction required to return Canterbury to full operation. However, history suggests that cities are able to recover from major earthquakes, like Napier after the 1931 earthquake.

Additional demand may temporarily increase construction costs, but the extent remains unknown.

FIGURE 3

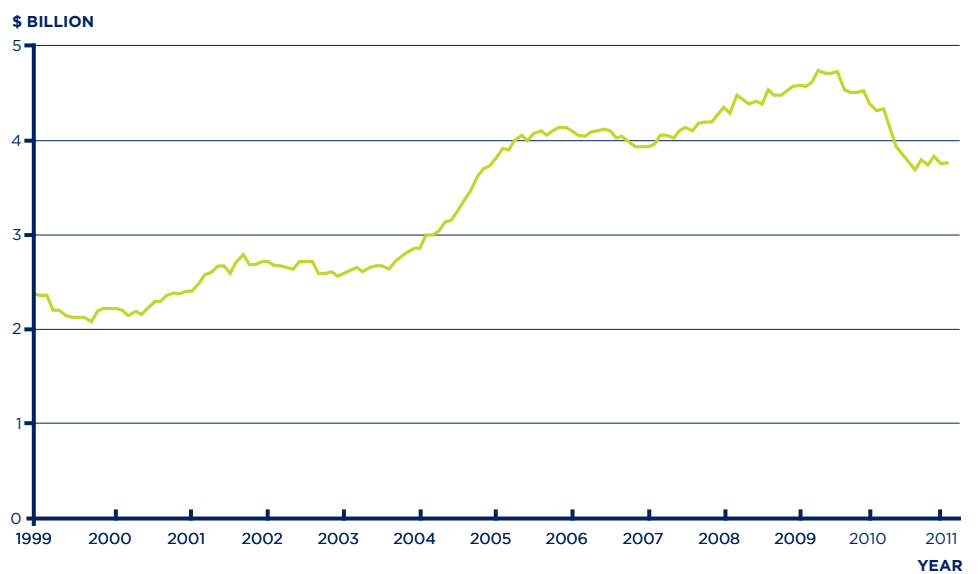
CONSTRUCTION
ACTIVITY &
CANTERBURY SCENARIO



Statistics New Zealand, NZIER forecast

FIGURE 4

ANNUAL
NON-RESIDENTIAL
BUILDING CONSENTS



Source: Statistics New Zealand

INTEREST RATES AND EXCHANGE RATES

Underlying inflationary pressures are subdued, with annual consumer price inflation at 4.0% in December 2010, largely due to the GST increase and other policy changes. Inflation has been concentrated in necessities. Core inflation excluding food, fuel and GST was closer to 1%. Producer input prices increased 4.4% while output prices rose 4.3% over the December 2010 year.

The RBNZ lowered the Official Cash Rate (OCR) 50 basis points to 2.50% in March 2011. The RBNZ will hold the OCR at low levels until more information is available on the impact from the earthquake. Economic conditions remain subdued, but inflationary pressures are emerging from food and fuel prices.

The TWI remains elevated. Rising commodity prices, the relative resilience of the banking system and the fiscal position have all contributed to relative strength of the NZD, but short-term fluctuations persist due to global factors. We expect the NZD to hold its value over the next six months.

BUILDING CONSENTS

Non-residential building consents have stabilised at low levels (Figure 4). While consents data are by nature very volatile between months, the month of January 2011 was 2.3% higher than January 2010. In annual terms, consents fell by 14.1% to \$3.769 billion over the year to January 2011. Over the same year, residential consents rose 8.0%, although January 2011 consents fell 18.6% compared to January 2010. Residential consents remain at very soft levels.

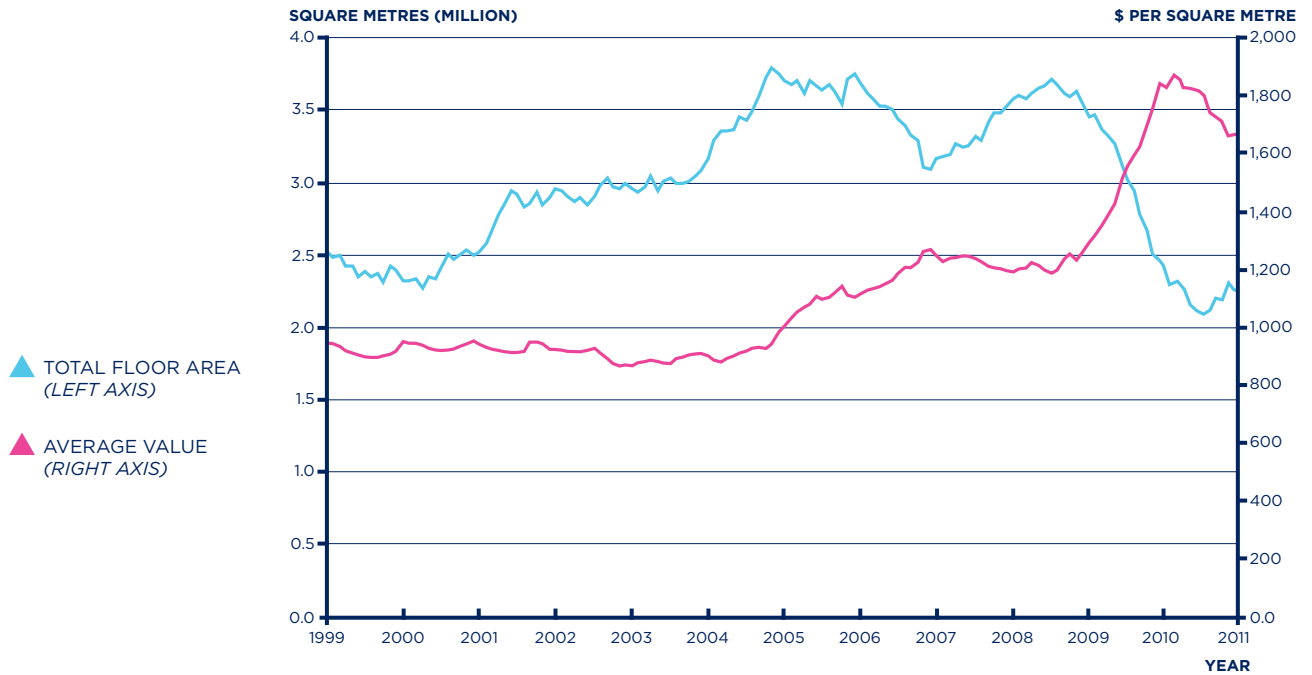
The floor area of non-residential building consents, which is a good indicator of volumes, fell 6% over the year to January 2011, as shown in Figure 5. The value of consents has stabilised as the average value and activity flattened.

CONSENTS BY SECTOR

Growth in consents varies wildly by sector. Total consent values continue to decline, but some sectors are showing signs of recovery. Miscellaneous building consents have surged, but remain a small fraction of overall consents. Factories and industrial buildings, shops restaurants and taverns and education buildings are also growing strongly. Hostels and boarding houses, office and administration buildings, social, cultural and religious buildings, farm buildings, hotels and motels and hospitals and nursing homes have plunged from year-ago levels. Storage buildings increased slightly over the previous years and hotels and motels are starting to rebound from current lows.

FIGURE 5

ANNUAL TOTAL FLOOR AREA AND AVERAGE VALUE OF CONSENTS



Source: Statistics New Zealand

TABLE 1

VALUE OF CONSENTS BY SECTOR IN THE YEAR TO JANUARY 2011

SECTOR	ANNUAL VALUE (\$ MILLION)	SHARE OF TOTAL (%)	ANNUAL CHANGE (%)
EDUCATION BUILDINGS	707	18.7	15.1
SHOPS, RESTAURANTS AND TAVERNS	532	14.1	18.3
OFFICES AND ADMINISTRATION BUILDINGS	526	14.0	-49.6
SOCIAL, CULTURAL AND RELIGIOUS BUILDINGS	513	13.6	-22.9
FACTORIES AND INDUSTRIAL BUILDINGS	483	12.8	22.8
HOSPITALS AND NURSING HOMES	323	8.6	-9.4
STORAGE BUILDINGS	263	7.0	0.6
FARM BUILDINGS	167	4.4	-12.2
HOTELS AND MOTELS	109	2.9	-11.7
HOSTELS AND BOARDING HOUSES	75	2.0	-70.2
MISCELLANEOUS BUILDINGS	71	1.9	87.4
TOTAL	3769	100	-14.1

Source: Statistics New Zealand

CONSENTS BY REGION

The West Coast region became the growth centre of consents over the previous year, with a 28% increase in the total annual value of consents issued. Gisborne consent values contracted the most as the previous year was boosted by a one-off \$18 million factory consent in November 2009.

As shown in Figure 6, Waikato and Northland regions also saw annual growth rates in double figures. Downward trends continued in Canterbury, Marlborough, Southland, Auckland, Hawke's Bay and Otago. Consents have flattened in Taranaki, Manawatu-Wanganui, Wellington and Nelson.

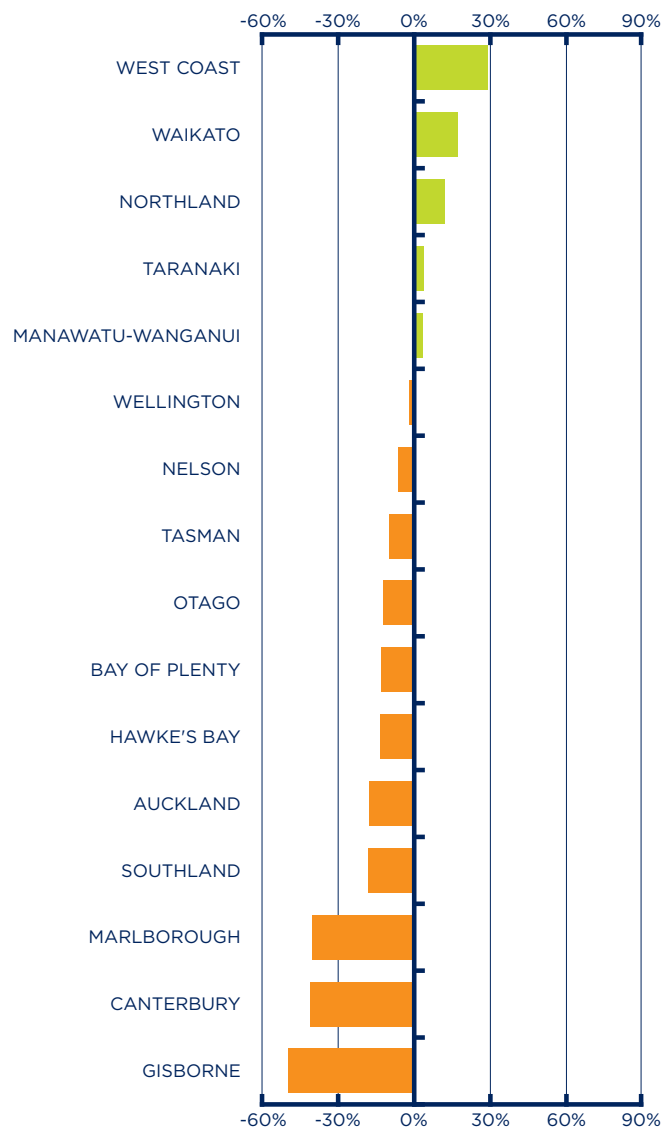
All three main centres recorded falls in consent values, but Wellington remains resilient with increasing volumes of floor area over the year to January 2011 compared to the previous year. The value of consents issued in Auckland fell 16% in the year to January 2011, but the total floor area fell a more modest 8%. Wellington consent values eased marginally down 1% over the January 2011 year. However, the floor area in Wellington surged 18% over the same period. The total value of consents issued in Canterbury plunged 40%, with a marked 18% decline in total floor area.

The outlook remains soft due to weakening domestic conditions and high vacancy rates in commercial properties. Investment intentions have stalled as profitability hinders firms' ability to invest. The medium term horizon is promising as demand returns to the economy combined with a boost from reconstruction in Canterbury.

FIGURE 6

ANNUAL GROWTH IN
VALUE OF CONSENTS BY
REGION IN THE YEAR TO
JANUARY 2011

AVERAGE ANNUAL PERCENTAGE CHANGE



Source: Statistics New Zealand

BUILDING INDUSTRY CONFIDENCE

In NZIER's January 2011 Quarterly Survey of Business Opinion (QSBO), the building sector – residential and non-residential building combined – showed signs of improvement in the December quarter. The general business confidence of the building sector increased with a net² 8% of firms believing conditions would improve on a seasonally adjusted basis (from a net 7% of firms believing conditions would deteriorate in September). Output and new orders rebounded sharply in the December 2010 quarter. The QSBO survey is dominated by the residential building sector.

A net 11% of firms in the building sector reported a decline in their own output in the third quarter of 2010, a substantial improvement from September where 29% expected output to decline. Similarly, a net 11% reported declining new orders, compared with a net 30% deterioration in the September 2010 quarter. Firms are optimistic and expectations have surged. A net 20% expect increased output in the December 2010 quarter, but only a net 4% expected new orders to increase.

Job shedding halted in the building sector and is expected to improve rapidly, due in large part to the Canterbury reconstruction. A net 2% of firms increased staff numbers in the December 2010 quarter, a large turnaround from the September quarter. A net 18% of building firms expect employment to further increase in the March 2011 quarter. Firms are experiencing easing costs, but have little ability to increase prices. A net 15% of firms reduced selling prices in the December quarter despite the GST increase coming into effect from October.

Of particular relevance to the non-residential building sector are building investment intentions. Building investment intentions have remained stable at -10% in the December 2010 quarter as the economy has been slow to recover. The indicator remains slightly above its long run average.

² The percentage of firms reporting general business conditions to have improved minus the percentage reporting business conditions have declined, after accounting for firms that did not provide a response.

FIGURE 7

NON-RESIDENTIAL
BUILDING COST
ESCALATION

ANNUAL PERCENTAGE CHANGE IN
THE CGPI-NRB

▲ MARCH 2011 FORECAST
▲ DECEMBER 2010 FORECAST



Source: Statistics New Zealand, NZIER forecast

TABLE 2

NON-RESIDENTIAL
BUILDING COST INDEX

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.

YEAR	QUARTER	INDEX	QUARTERLY CHANGE (%)	ANNUAL CHANGE (%)
2007	MARCH	1332	0.1	5.0
	JUNE	1334	0.2	3.1
	SEPT	1340	0.4	1.7
	DEC	1350	0.7	1.4
2008	MARCH	1363	1.0	2.3
	JUNE	1371	0.6	2.8
	SEPT	1393	1.6	4.0
	DEC	1390	-0.2	3.0
2009	MARCH	1384	-0.4	1.5
	JUNE	1369	-1.1	-0.1
	SEPT	1350	-1.4	-3.1
	DEC	1337	-1.0	-3.8
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
FORECAST 2011	MARCH	1335	0.1	-0.1
	JUNE	1338	0.2	0.1
	SEPT	1341	0.3	0.4
	DEC	1345	0.3	0.9
2012	MARCH	1350	0.4	1.1
	JUNE	1356	0.4	1.3
	SEPT	1362	0.5	1.6
	DEC	1370	0.5	1.8
2013	MARCH	1378	0.6	2.1
	JUNE	1387	0.6	2.3
	SEPT	1396	0.6	2.4
	DEC	1404	0.6	2.5
2014	MARCH	1413	0.6	2.6
	JUNE	1422	0.6	2.5
	SEPT	1430	0.6	2.4
	DEC	1437	0.5	2.3
2015	MARCH	1444	0.5	2.2

Source: Statistics New Zealand, NZIER forecast

BUILDING COSTS

The Capital Goods Price Index for Non-Residential Buildings (CGPI-NRB) provides an official measure of cost movements in the sector. The rate of increase in the CGPI-NRB can be used as an indicator of cost escalation. Note that this 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 March 2011 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.

According to the CGPI-NRB, average building costs in the non-residential building sector stabilised over 2010. The CGPI-NRB declined narrowly in the December 2010 quarter and was down 0.3% over the year. A subdued building sector and softening domestic growth have hindered price increases since September 2008.

NZIER's latest forecast of the annual percentage change in the CGPI-NRB is shown in Figure 7 and Table 2. NZIER expects building costs to start rising slowly from the March 2011 quarter. Forecasts have been revised downwards as economic activity has slowed, particularly in construction, resulting in a slower than expected recovery. Significant price rises will be delayed until building activity increases. Annual cost escalation should remain at moderate growth levels and flatten from 2013. The CGPI-NRB excludes GST. There is potential upside risk to cost escalation from additional work in rebuilding Canterbury and Japan. This may strain capacity in future years and raise prices for timber and steel, but much uncertainty remains to the extent and timing of the impacts from reconstruction.



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FORECAST 60