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FORECAST 61

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

JUNE 2011

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0508 ASK RLB

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Cover: Wellington harbour, New Zealand

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

FORECAST 61

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** Reconstruction of Canterbury is slow and may not accelerate until 2012. At the peak of the reconstruction there will be capacity constraints and a lift in inflation in the construction sector. The bulk of the reconstruction will be in residential and infrastructure segments, while commercial work is likely to be spread over a long period.
- **Building activity** The non-residential building sector stabilised in March 2011 at soft levels. Building work put in place rose 2.7% over the March 2011 year.
- **Building consents** Building consents, which lead work done by around 12 months, have fallen by 12.0% over the past year. Activity will soften as a result. The main drivers are high vacancy rates, a slowing economic recovery and delays in Canterbury reconstruction.
- **Building investment** Non-residential building investment will contract by 18% over the March 2012 year before recovering from 2013. Investment activity may rebound sooner if delays in reconstruction for Canterbury are mitigated.
- **Building confidence** Building confidence declined as activity levels remain soft. Delays in Canterbury reconstruction and weak building consent levels suggest that confidence will remain subdued.
- **Building costs** Non-residential building costs have broadly stabilised over the last year and fell only 0.1% over the March 2011 year. Weak domestic demand for construction was the main driver. However, construction costs will accelerate as the rebuilding programme builds up. This may coincide with a broader cyclical upturn and create capacity shortages. There is considerably uncertainty around the outlook on the ultimate size and timing of the Canterbury rebuild.

2011 Winners Property Council Rider Levett Bucknall Property Industry Awards 2011, page 17.

RLB Intelligence

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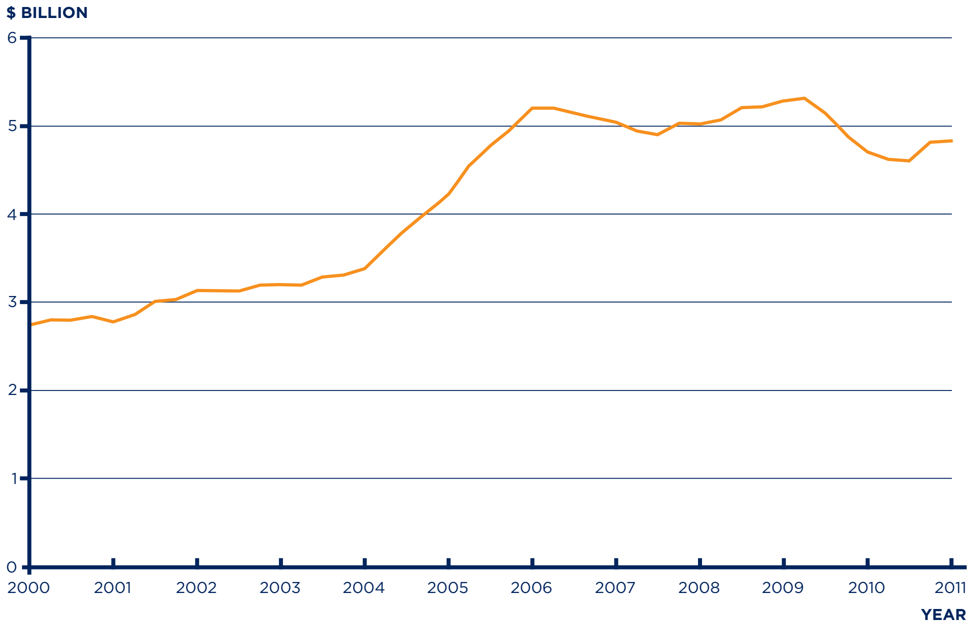
FIGURE 1

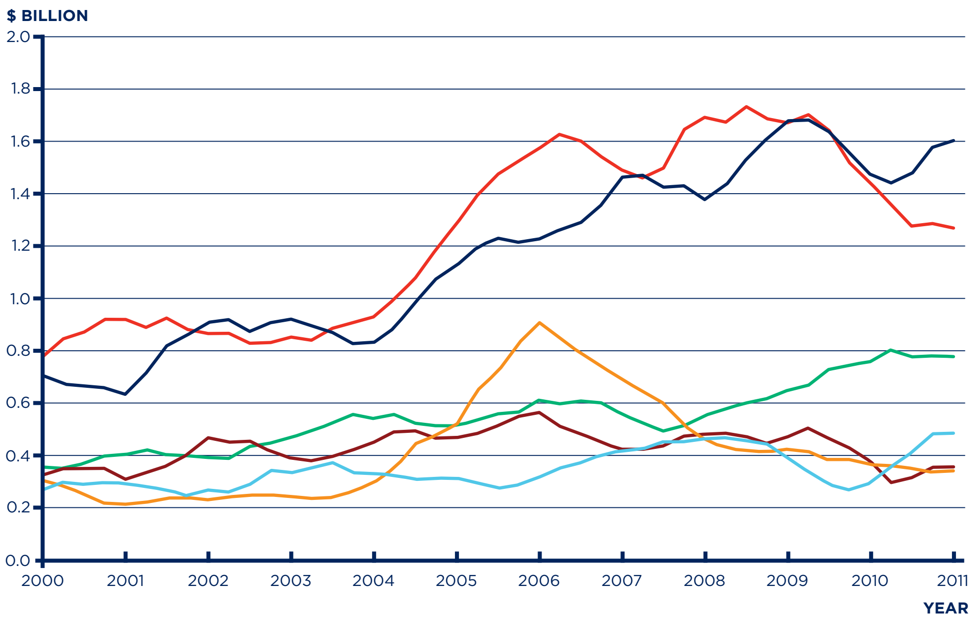
ANNUAL NON-RESIDENTIAL BUILDING WORK PUT IN PLACE



Source: Statistics New Zealand

FIGURE 2

ANNUAL NON-RESIDENTIAL BUILDING WORK PUT IN PLACE BY SECTOR



COMMERCIAL
MISCELLANEOUS
EDUCATION
FACTORIES AND INDUSTRIAL
HOTELS AND BOARDING HOUSES
HOSPITALS AND NURSING HOMES

Source: Statistics New Zealand

BUILDING ACTIVITY TRENDS

Non-residential building construction stabilised in the March quarter, following a brief rebound in the December 2010 quarter (Figure 1). The value of non-residential building work put in rose 1.6% in the March 2011 quarter compared to the March 2010 quarter. The increase was driven by work on hotels and boarding houses and miscellaneous buildings[1] . Construction work worth $4.834 billion took place in the year to March 2011, increasing 2.7% from the previous year. Residential building work has slowed again, following a brief recovery through the middle of 2010. Residential values fell 6.5% in the March 2011 quarter compared to the March 2010 quarter, but were up 4.8% over the year ended March 2011.

Performance in non-residential construction is varied across sectors. Work on commercial buildings declined 12% (year ended March 2011), hotels and boarding houses 7% and factories and industries buildings 5%. Growth in other sectors was positive with miscellaneous buildings rising 3% over the previous year. The stabilisation in non-residential construction is due to one sector offsetting other declines. Work on hospitals and nursing homes rose 65% over the past year. Work on education buildings grew a modest 3%, and is likely to ease further as government spending tightens.

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

New Lynn Station, Auckland

BUILDING ACTIVITY OUTLOOK

ECONOMIC GROWTH AND BUILDING INVESTMENT

The economy is in a soft patch, but the outlook is for a more gradual but sustainable recovery over coming years. The Canterbury earthquake and spikes in food and fuel prices earlier in the year weighed on economic growth. Emergency interest rate cuts by the RBNZ, and signs of a resumption in house sales and business lending suggest a broadening recovery will develop later this year. This will be supplemented with the Canterbury reconstruction programme, likely to be in full force by mid-2012. NZIER expects economic growth of only 0.3% in 2011 but rebound to 3.7% in the 2012 calendar year.

Non-residential construction activity has been surprisingly strong. Recent activity has been in health and Rugby World Cup (RWC) related projects. These appear to be nearing the end. Underlying weakness in consents is yet to be fully translated into activity. We continue to expect weakness in non-residential building construction through 2011, before a recovery begins in 2012. NZIER expects non-residential building investment to fall 18% over the March 2012 year, before recovering by 8% over the March 2013 year.

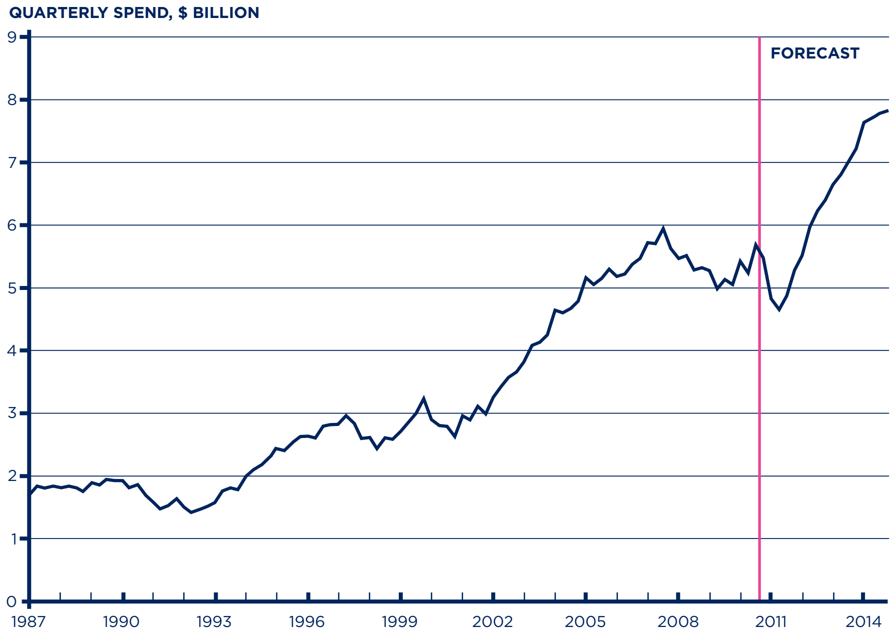
Canterbury reconstruction has been slow and is likely to be further delayed. Significant reconstruction activity may not be apparent until mid-2012. The rebuilding programme in Canterbury is likely to be large for residential, but spread over many years for non-residential buildings. Total residential construction activity will be around $8b over the next 3-5 years. This will draw significant resources (materials and labour) to Canterbury and is likely to raise construction sector inflation.

Construction of commercial buildings in Canterbury may take some time. There will be some $3b of work done, but it may be over a decade. The net impact on the sector is likely to be relatively small on an annual basis, but construction costs may rise quite sharply. There is little evidence that the earthquake is impacting on other regions in a significant manner.

The May Budget is not expected to have much of an impact on the non-residential construction sector, except in Wellington. The government announced it intends to reduce spending, which will have a significant impact on the Wellington regional economy and demand for new space.

FIGURE 3

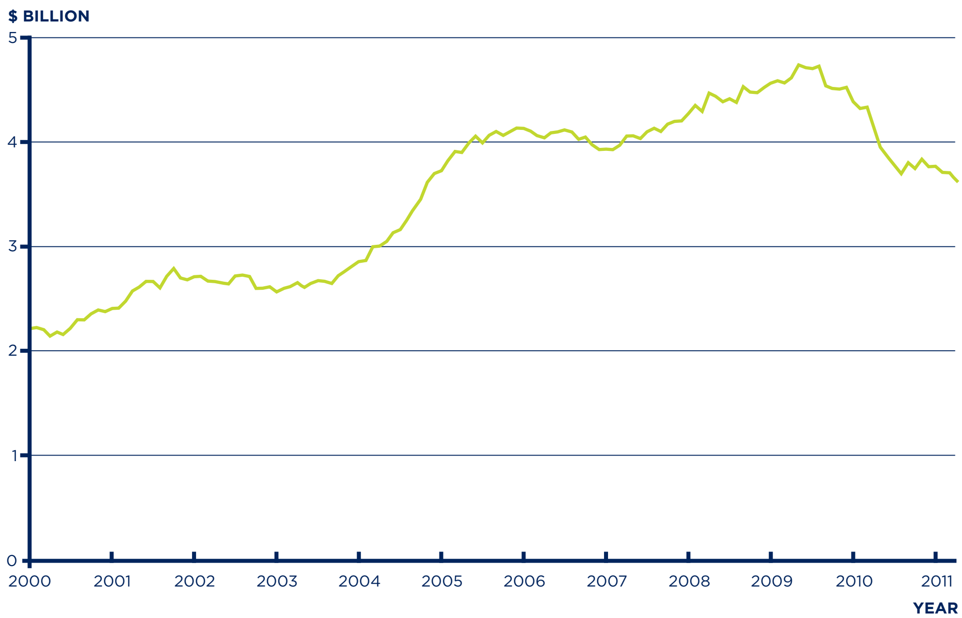
CONSTRUCTION ACTIVITY



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, but medium term pressures are building. Annual consumer price inflation was 4.5% in March 2011, largely due to the GST increase and other policy changes. Firms have continued to absorb escalating costs in ever thinner margins. These are likely to be gradually passed on to consumers as demand rises. Producer input prices increased 5.3% while output prices rose 4.2% over the March 2011 year.

The RBNZ left the Official Cash Rate (OCR) unchanged in June after a 50 basis point cut to 2.50% in March 2011. We expect the RBNZ to raise interest rates from early 2012 to curb inflationary pressures. However, this will be contingent on a strengthening economy. Economic conditions remain subdued, but inflationary pressures will emerge from a loss of capital in Canterbury and tightening capacity as the economy slowly recovers.

The NZD remains elevated and in a holding pattern. Strong agricultural commodity prices, weakness in major economies and sovereign credit concerns continue to support the NZD. We expect the NZD will remain elevated over the next year and depreciate gradually thereafter.

BUILDING CONSENTS

Non-residential building consents have eased after a period of consolidation (Figure 4). Non-residential consents are typically seen in actual work done around a year later. So, movement in building consents are a good leading indicator of future activity levels.

Non-residential consents have stabilised in recent months, after steep declines through 2009 and 2010. Consents in the month of April 2011 were 22.9% lower than April 2010. In annual terms, consents fell by 12.0% to $3.633 billion over the year to April 2011.

The floor area of non-residential building consents, which is a good indicator of volumes, fell 4.4% over the year to April 2011 (Figure 5). The value of consents has flattened as the average value and floor area is stabilising.

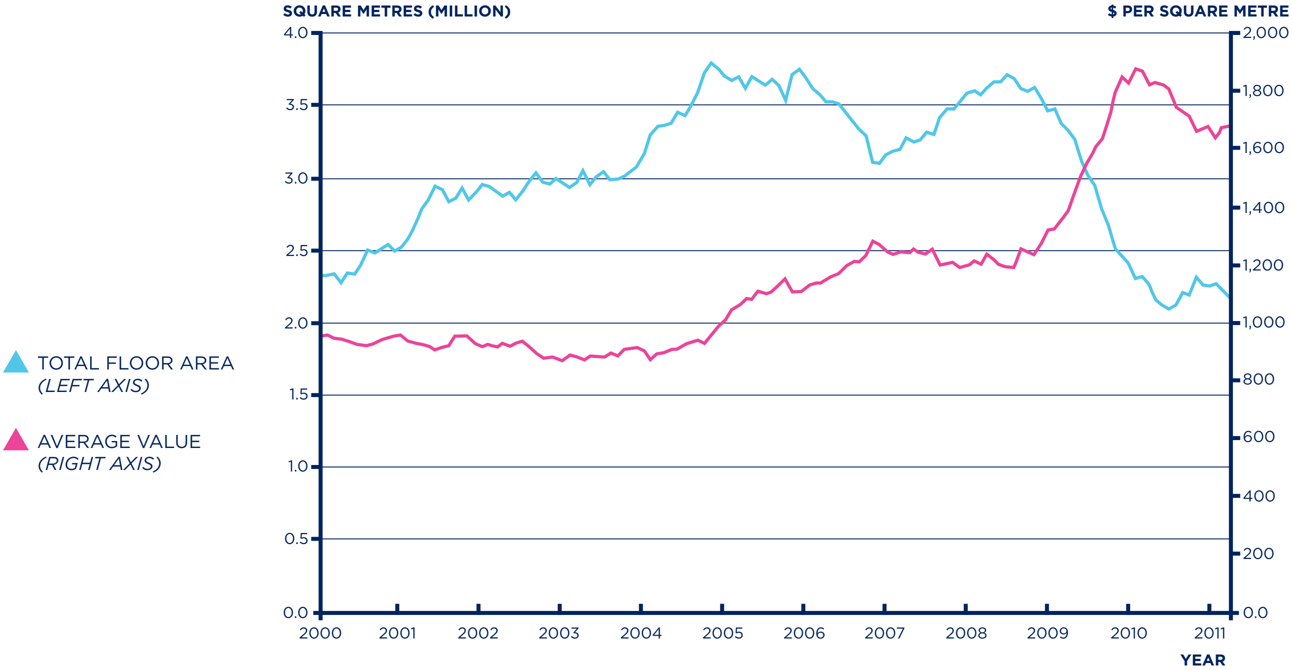
Residential consents fell 6.6% in the year ending April 2011. Consents in the April 2011 month fell sharply (26.3%) compared to April 2010. Residential consents remain at very soft levels.

CONSENTS BY SECTOR

Consents are generally trending lower and indicate weakness in actual construction work done over the year ahead. Growth in consents varies wildly by sector. Total consent values are declining, but signs of growth are emerging in some sectors. Miscellaneous building consents have surged, but remain a small fraction of overall consents. Factories and industrial buildings and shops restaurants and taverns are also growing strongly from a low base. Other sectors look bleak. Hostels and boarding houses, office and administration buildings, social, cultural and religious buildings, storage buildings, hotels and motels and hospitals and nursing homes have plunged from year-ago levels. Education and farm buildings declined slightly over the previous year.

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 APRIL 2011

SECTOR	ANNUAL VALUE ($ MILLION)	SHARE OF TOTAL (%)	ANNUAL CHANGE (%)
EDUCATION BUILDINGS	684	18.8	-1.6
SHOPS, RESTAURANTS AND TAVERNS	544	15.0	17.5
OFFICES AND ADMINISTRATION BUILDINGS	500	13.8	-35.3
FACTORIES AND INDUSTRIAL BUILDINGS	479	13.2	43.3
SOCIAL, CULTURAL AND RELIGIOUS BUILDINGS	451	12.4	-35.7
HOSPITALS AND NURSING HOMES	276	7.6	-34.3
STORAGE BUILDINGS	239	6.6	-9.2
FARM BUILDINGS	171	4.7	-0.5
HOTELS AND MOTELS	113	3.1	-11.6
HOSTELS AND BOARDING HOUSES	95	2.6	-37.7
MISCELLANEOUS BUILDINGS	83	2.3	175.5
TOTAL	**3,633**	**100**	**-12.0**

Source: Statistics New Zealand

CONSENTS BY REGION

Consent values have been soft in most regions. Manuwatu-Wanganui became the growth centre of consents over the previous year, with a 32% increase in the total annual value of consents issued. Marlborough consent values have plummeted after a couple of soft months against large one-off health related consents the previous year.

As shown in Figure 6, the West Coast, Wellington and Taranaki saw modest growth rates. Downward trends continued in Auckland, Bay of Plenty, Canterbury, Gisborne, Marlborough and Southland.

Wellington was the only main centre to record an increase in consent values, due to a marked increase in floor area. The value of consents issued in Auckland fell 10% in the year to April 2011, even with total floor area rising a robust 10%. Wellington consent values rose 5% over the April 2011 year. This is due to a surge in floor area in Wellington rising 23% over the same period. The total value of consents issued in Canterbury plunged 28%, with a marked 29% decline in total floor area.

The outlook remains soft due to soft domestic conditions and high vacancy rates in commercial properties. Investment intentions have stalled as profitability hinders firms' ability to invest. The short term outlook is soft but will be boosted in the medium term as demand returns to the economy and Canterbury reconstruction commences.

BUILDING INDUSTRY CONFIDENCE

In NZIER's April 2011 Quarterly Survey of Business Opinion (QSBO), the building sector – residential and non-residential building combined – remained soft in the March 2011 quarter. The general business confidence of the building sector improved with a net[2] 3% of firms believing conditions would improve on a seasonally adjusted basis (from a net 13% of firms believing conditions would deteriorate in December). The QSBO survey is dominated by the residential building sector.

A net 7% of firms in the building sector reported a decline in their own output in the March 2011 quarter, a slight improvement from December where 11% experienced a decline in output. Similarly, a net 13% reported declining new orders, compared with a net 11% deterioration in the December 2010 quarter. Firms are less optimistic for the June quarter. A net 8% expect declining output in the June 2011 quarter, and a net 9% expect new orders to decline.

Employment remains stable in the building sector and is expected to remain so, as Canterbury reconstruction is delayed. A net 1% of firms increased staff numbers in the March 2011 quarter. A net 2% of building firms expect employment to ease in the June 2011 quarter. Firms are experiencing escalating costs, but selling prices continue to decline.

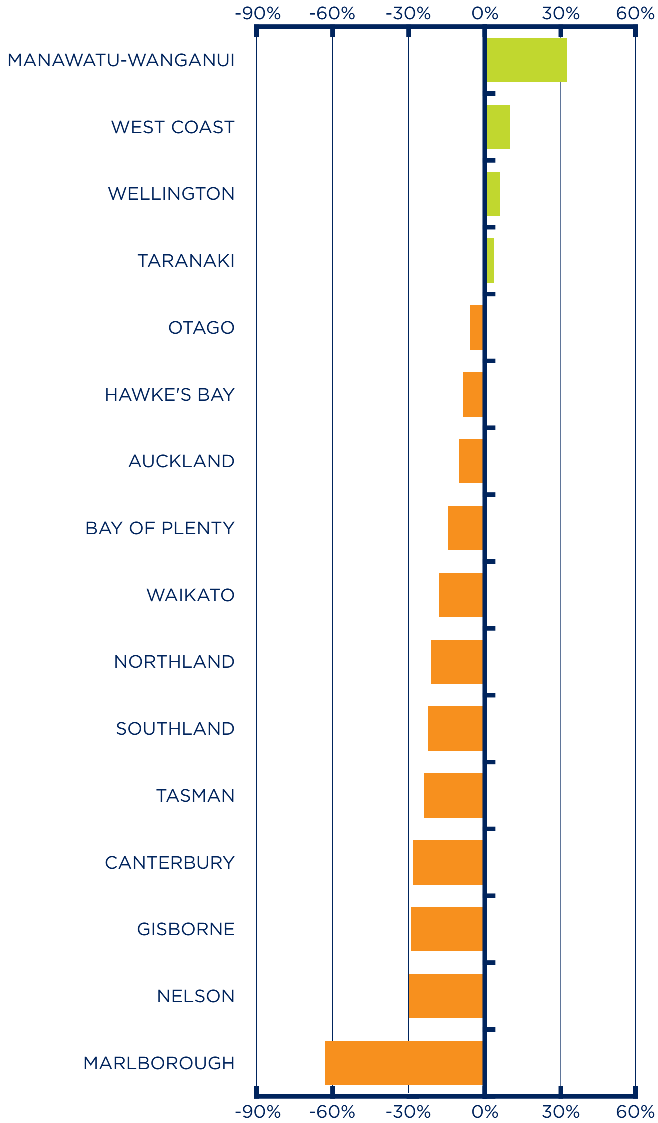
Of particular relevance to the non-residential building sector are building investment intentions. Building investment intentions have remained stable at -7% in the March 2011 quarter as reconstruction and general economic conditions have been slow. The indicator remains slightly above its long run average.

[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 6

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

AVERAGE ANNUAL PERCENTAGE CHANGE



Source: Statistics New Zealand

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. 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 June 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 slightly in the March 2011 quarter and was down 0.1% 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 remain moderate during 2011. Forecasts for future years have been revised upwards. These forecasts reflect the likely path of inflation in the sector, if the rebuild is done over a ten year period.

Construction sector inflation is set to accelerate sharply as the scale and timing of the Canterbury reconstruction becomes clear. It seems very probable that the rebuild will be in excess of $15 billion, over the next 5 to 10 years. If the rebuild starts early, it will coincide with a broader cyclical recovery in the economy supported by low interest rates. This will stretch the current capacity of labour and some materials. Annual cost inflation will accelerate over coming years. The size and timing of the Canterbury rebuild will have a large bearing on the future path of inflation in the sector.

Nelson Technical Hanger, Nelson

FIGURE 7

NON-RESIDENTIAL BUILDING COST ESCALATION

ANNUAL PERCENTAGE CHANGE IN THE CGPI-NRB

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 (%)
	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
	2011	MARCH	1334	0.0	-0.1
FORECAST		JUNE	1337	0.2	0.1
		SEPT	1346	0.6	0.7
		DEC	1357	0.8	1.8
	2012	MARCH	1370	0.9	2.7
		JUNE	1379	0.7	3.1
		SEPT	1387	0.5	3.0
		DEC	1395	0.6	2.8
	2013	MARCH	1405	0.7	2.6
		JUNE	1418	0.9	2.8
		SEPT	1433	1.0	3.3
		DEC	1448	1.1	3.8
	2014	MARCH	1464	1.1	4.2
		JUNE	1481	1.1	4.4
		SEPT	1497	1.1	4.5
		DEC	1513	1.1	4.5
	2015	MARCH	1529	1.1	4.4
		JUNE	1545	1.0	4.3
		SEPT	1561	1.0	4.2
		DEC	1576	1.0	4.1
	2016	MARCH	1591	1.0	4.0

Source: Statistics New Zealand, NZIER forecast

Wharewaka, Wellington

2011 WINNERS

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PROPERTY COUNCIL RIDER LEVETT BUCKNALL PROPERTY INDUSTRY AWARDS 2011

SUPREME AWARD

- Highbrook Business Park
  (Highbrook Development Limited)

EDUCATION AND ARTS

EXCELLENCE

- Albany Senior High School
  (Jasmax and Arrow International)
- Mangere Arts Centre Nga Tohu o Uenuku
  (Auckland Council, Creative Spaces and RDT Pacific)
- NMIT Arts and Media Building
  (Irving Smith Jack Architects Limited)
- Wintec House
  (Mainzeal Property and Construction Limited)

MERIT

- AUT AJ School of Education Building (Jasmax Ltd)
- AUT Lecture Theatres and Conference centre (AUT)
- AUT Manukau Building MC (Jasmax)
- Remarkables Primary School
  (Coffey Projects (NZ) Ltd)
- The Alan MacDiarmid Building (Jasmax Limited)
- TSB Bank Wallace Arts Centre The Pah Homestead
  (Auckland Council, Matthews and Matthews Architects Ltd, RDT Pacific, NZ Strong Group Ltd)

HERITAGE AND ADAPTIVE REUSES

EXCELLENCE

- Government House (Beca)
- The Supreme Court of New Zealand
  (The Building Intelligence Group)
- TSB Bank Wallace Arts Centre The Pah Homestead
  (Auckland Council, Matthews and Matthews Architects Ltd, RDT Pacific, NZ Strong Group Ltd)
- Wintec House
  (Mainzeal Property and Construction Limited)

MERIT

- AUT Manukau - Building MC (Jasmax)

COMMERCIAL OFFICE

EXCELLENCE

- Telecom Place (Beca and Mansons TCLM)

MERIT

- Asteron Centre (One Featherston Development Ltd)
- Order of St John National and Northern Regional Headquarters (Pragmatix Ltd)
- Pipitea House (Redwood Group Limited)
- The Slider Building (McDougall Reidy & Co Limited and Haydn & Rollett Construction Limited)

TOURISM AND LEISURE

EXCELLENCE

- Eden Park (Populous, Jasmax, RCP, Aurecon and Beca)

MERIT

- Don Rowlands Events Centre (Hawkins Construction)
- The Celestion Waldorf Apartments
  (Kalmar Construction Limited)
- Waitomo Glowworm Caves Visitors Centre
  (Hawkins Construction Limited and Davis Langdon)
- ZEALANDIA (Beca and Jasmax)

URBAN LAND DEVELOPMENTS

EXCELLENCE

- Highbrook Business Park
  (Highbrook Development Limited)
- Stage 1 Anselmi Ridge (McConnell Property Limited)
- Stonefields Stage Three
  (Todd Property Group Limited)

MERIT

- Hobsonville Point Stage One
  (Hobsonville Land Company and AVJennings)
- Karaka Lakes (Harrison Grierson)

RETAIL

EXCELLENCE

- Auckland International Airport (Beca, Auckland Airport, Ignite and S&T)
- The Plaza Shopping Centre (Kiwi Income Property Trust)

SPECIAL PURPOSE

EXCELLENCE

- Blue Water Black Magic: A Tribute to Sir Peter Blake (MPM Projects Limited)
- Government House (Beca)
- New Lynn Station (Beca, Fletcher Construction Company, NZ Strong Construction Ltd, Architectus)
- Papatoetoe Sports Centre (MPM Projects Limited)
- The Supreme Court of New Zealand (The Building Intelligence Group)

MERIT

- Aotea Square Redevelopment (Auckland Council)
- Christchurch International Airport – New Control Tower (Designgroup, Paris Magdalinos Architects Ltd)
- Invercargill High and District Courthouse (Arrow International Ltd, Ministry of Justice)
- Kerikeri Police Station (Mainzeal Property & Construction Limited)
- Northland Events Centre (RCP)
- Te Wharewaka (architecture+)
- Terminal Development Project (Beca and Wellington International Airport Ltd)

INDUSTRIAL PROPERTY

EXCELLENCE

- Lion Integrated Beverage Facility 'The Pride' (Lion Nathan and Beca)

MERIT

- D&H Steel Construction Facility (Clearwater Construction Ltd & ASC Architects)
- Nelson Technical Hangar (Aurecon and Mainzeal Property and Construction)
- Southern Spars Building (McDougall Reidy & Co Limited and Haydn & Rollett Construction Limited)
- The Laminex Distribution Centre (DNZ Property Fund Limited)

GREEN BUILDING

EXCELLENCE

- NZI Centre (Newcrest Group)

MERIT

- Ironbank (Samson Corporation Limited)

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