



Rider Hunt

New Zealand trends in
property and construction

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Forecast₄₄

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Key points in this issue

- **Building activity**

Total annual non-residential building work put in place was \$5.1 billion in the year to September 2006, remaining close to the \$5.2 billion record high. Building work put in place grew most in the hospitals and nursing homes sector and declined in only the factories and industrial buildings sector.

- **Building consents**

The total value of consents issued in the year to November 2006 also remained stable, close to the record high of \$4.1 billion. This signals a continuing high level of non-residential building work to be put in place over the first half of 2007.

- **Consents by sector**

Consents grew most in the hotels and motels sector and hospitals and nursing homes sector. The miscellaneous buildings sector saw a significant decline after recent strong growth, but this is the smallest of the sectors reported. Consents continued to fall sharply in the hotels and boarding houses sector, after the mid 2005 surge in consents for prison projects.

- **Consents by region**

Consents data suggest that non-residential building activity in the near future is likely to grow most rapidly in Canterbury, West Coast, Taranaki and Marlborough and to contract most markedly in the Southland, Otago, Waikato and Tasman regions. Several of these are small regions, however, which can be significantly affected by just one or two large projects.

- **Building costs**

Pressure on non-residential building costs continued, with the Capital Goods Price Index for Non-Residential Buildings rising by 1.9% in the September 2006 quarter and 6.0% in the year to September 2006. Cost escalation is forecast to ease slightly from mid 2007, before rising again from early 2008 and declining again from early to mid 2009.

Building activity trends

Non-residential building work put in place rose slightly in the September 2006 quarter to \$1.3 billion, up 0.5% on the June 2006 quarter, but the second highest ever quarterly total after \$1.4 billion in the September 2005 quarter. As shown in **Figure 1**, the total for the year was down slightly, although remained close to the \$5.2 billion record high. In the year to September 2006, a total of \$5.1 billion of building

work was put in place, 7% higher than \$4.8 billion in the year to September 2005. This was the lowest annual growth since the year to March 2004, which might suggest that building activity had at last peaked, were it not for continuing high levels of consents signalling a high level of non-residential building work to be put in place over the first half of 2007 (see below).

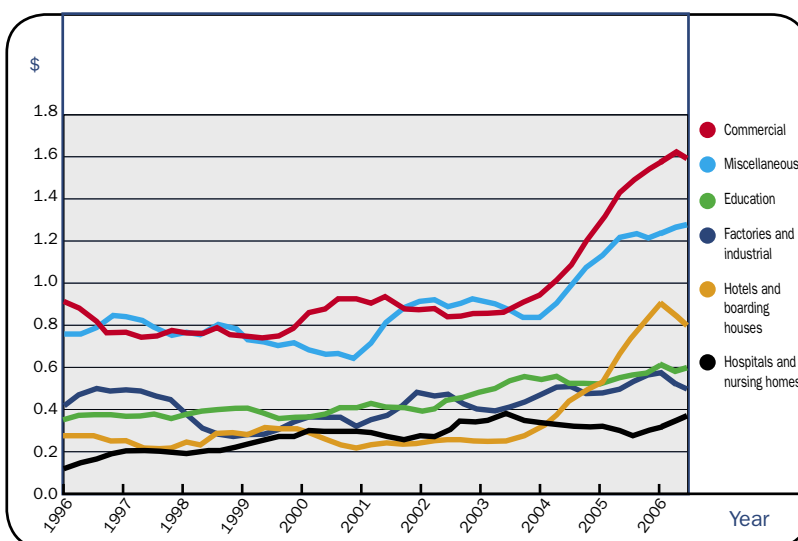
Figure 2 shows the annual value of building work put in place by sector. The factories and industrial buildings sector was the only sector to decline in the year to September 2006, with building work put in place falling by 6%. All other sectors saw higher levels of building work put in place in the year to September 2006 than in the year to September 2005, although lower than in the year to June 2006 in the commercial buildings sector and hotels and boarding houses sector. Each of these sectors grew 9% in the year to September 2006, the lowest annual growth in the commercial building sector since the year to September 2003 and the lowest in the hotels and boarding houses sector since the year to December 2003. At 4%, the miscellaneous buildings sector¹ also saw its lowest annual growth since the year to June 2004. Bucking this trend towards slowing growth was the hospitals and nursing homes sector, which grew at 34% in the year to September 2006. This compares with 18% growth in the year to June 2006 and represents a significant turnaround from a decline of 11% in the year to September 2005.

Figure 1: Annual non-residential building work put in place (\$ billion)



Source: Statistics New Zealand

Figure 2: Annual non-residential building work put in place by sector (\$ billion)



Source: Statistics New Zealand

¹ In data on building work put in place, miscellaneous buildings include social, cultural, religious, recreational and farm buildings.

Building activity outlook

Economic growth and investment

In the year to June 2006, real GDP grew by 1.9%, significantly lower than 3.1% in the June 2005 year. Economic growth is forecast to slow further to 1.5% in the year to March 2007, before rising to 1.9% in 2008, followed by an export-led recovery to 3.4% in 2009, 2.9% in 2010 and 4.1% in 2011.

Non-residential investment fell 5.3% in the June 2006 quarter, dominated by reduced investment in plant, machinery and equipment and transport equipment. Investment in buildings fared better. Capacity constraints have eased as the slowdown in residential building has freed construction resources for use in the non-residential sector. Consents, as shown

below, have remained high, indicating ongoing strong demand for building activity. Building investment is forecast to remain at or above the current level for at least the next four years.

Interest rates and monetary policy

In its January 2007 review, the Reserve Bank kept its Official Cash Rate (OCR), the benchmark interest rate, at 7.25%, where it has remained since December 2005. Inflationary pressures have eased in the short term, but remain a risk in the medium term, depending in particular on the resilience of household expenditure and the housing market.

Table 1 presents NZIER's interest rate forecast. NZIER predicts the OCR to remain at 7.25% for a few months more, before the Reserve Bank starts to loosen monetary policy from mid 2007 as the annual inflation rate returns to its target band of 1-3%.

Table 1: Interest rates (% per year, average for quarter)

Year	Quarter	90 day bank bill	10 year govt stock	First mortgage	Base rate
2005	March	6.9	6.0	8.8	11.2
	June	7.0	5.8	9.0	11.4
	Sept	7.0	5.7	9.0	11.8
	Dec	7.5	5.9	9.3	12.1
2006	March	7.6	5.7	9.5	12.3
	June	7.5	5.8	9.6	12.3
	Sept	7.5	5.8	9.6	12.3
Forecast					
2007	Dec	7.6	5.8	9.6	12.3
	March	7.4	6.2	9.3	12.0
	June	7.3	6.2	9.2	11.9
	Sept	6.9	6.2	8.8	11.5
2008	Dec	6.3	6.2	8.2	11.0
	March	5.8	6.2	7.7	10.5
	June	5.5	6.3	7.4	10.2
	Sept	5.6	6.3	7.5	10.3
2009	Dec	5.8	6.3	7.7	10.5
	March	6.3	6.3	8.2	11.0
	June	6.6	6.3	8.5	11.2
	Sept	6.9	6.4	8.8	11.5
2010	Dec	6.8	6.4	8.7	11.5
	March	6.5	6.4	8.4	11.1
	June	6.1	6.4	8.0	10.8
	Sept	6.1	6.4	8.0	10.8
2011	Dec	6.1	6.4	8.0	10.8
	March	6.1	6.4	8.0	10.8

Source: Reserve Bank of New Zealand, NZIER forecast

Figure 3: Annual non-residential building consents (\$ billion)



Source: Statistics New Zealand

Building consents

As shown in **Figure 3**, the total value of non-residential building consents remained stable, close to the high of \$4.1 billion per year, a level that has persisted since the year to June 2005. In the year to November 2006, over 17,000 non-residential building consents were granted at an average value per consent of \$233,000, a 2% increase in volume but 4% decrease in average value from the November 2005 year. The continuing high level of consents suggests a high level of non-residential building work to be put in place in the first half of 2007, given a time lag of typically six to nine months for trends in consents issued to feed through to work put in place.

Consents by sector

Table 2 shows the value of consents issued by sector in the year to November 2006².

The hotels and motels sector and hospitals and nursing homes sector continued to be the fastest growing, at 53% and 52% respectively. The largest sector, offices and administration buildings, saw growth of 22%, its highest annual growth since

the year to September 2005. In contrast, consents declined 30% in the miscellaneous buildings sector³, compared with growth of 141% in the November 2005 year. This was this sector's first year of negative growth since the February 2005 year, although this is the smallest of the sectors reported. Consents continued to decline sharply in the hostels

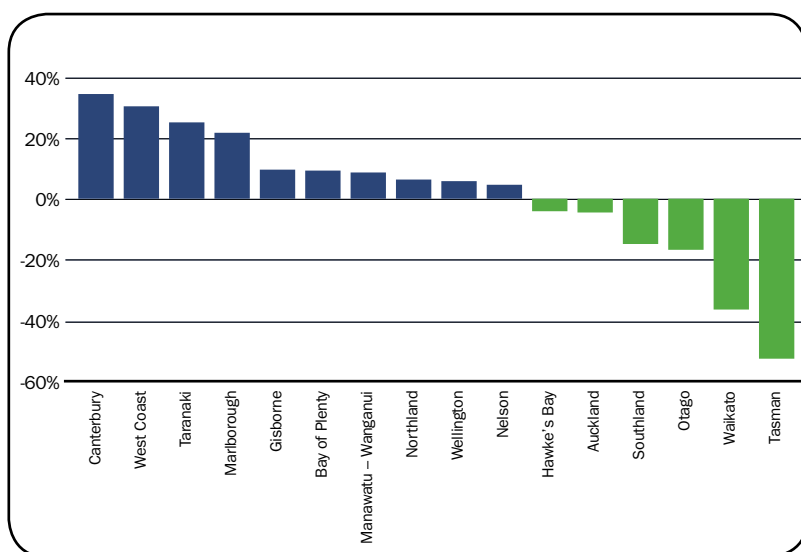
and boarding houses sector from \$459 million in the year to November 2005 to \$122 million in the November 2006 year, in the wake of the mid 2005 surge in consents for prison projects. Although modest, the 2% decline in the education buildings sector was this sector's first year of negative growth since the October 2005 year.

Table 2: Value of consents by sector in the year to November 2006

Sector	Annual value (\$ million)	Share of total (%)	Annual change (%)
Offices and administration buildings	763	19	22
Shops, restaurants and taverns	609	15	-11
Education buildings	444	11	-2
Storage buildings	443	11	6
Factories and industrial buildings	442	11	-10
Hospitals and nursing homes	328	8	52
Social, cultural and religious buildings	294	7	11
Hotels and motels	291	7	53
Farm buildings	192	5	4
Hostels and boarding houses	122	3	-73
Miscellaneous buildings	52	1	-30
Total	3,982	100	-2

Source: Statistics New Zealand

Figure 4: Annual change in value of consents by region in the year to November 2006



Source: Statistics New Zealand

Consents by region

Although Statistics New Zealand data on non-residential building activity are not available at a detailed regional level, data on consents issued by region can indicate likely areas of greatest future growth and therefore most pressure on labour and other resources. The change in value of consents by region shown in **Figure 4** suggests that, in the first half of 2007, non-residential building activity is likely to grow most rapidly in Canterbury, West Coast, Taranaki and Marlborough and to contract most markedly in the Southland, Otago, Waikato and Tasman regions. Note, however, that regional consents data tend to be very volatile month to month and, for small regions in particular, can be significantly affected by just one or two large projects.

The Auckland region, which accounted for 34% of the total value of consents, experienced a 4% fall in consents in the year to November 2006, compared with 9% growth in the year to November 2005. In contrast, Wellington consents grew by 6% in the year to November 2006, compared with a 7% decline in the November 2005 year. Canterbury saw consent growth rising from 0.4% in the year to November 2005 to 35% in the November 2006 year.

² These consents sector categories are unfortunately not equivalent to, and therefore not directly comparable with, the categories of building work put in place, illustrated in Figure 2 due to how Statistics New Zealand collects these data.

³ In consents data, miscellaneous buildings is a residual category for non-residential building construction not covered by other sector categories (e.g. public toilets and car parks).

Building industry confidence

Business confidence is measured in terms of reported expectations of changes in general business conditions over the next six months. In NZIER's December 2006 Quarterly Survey of Business Opinion, a net⁴ 7% of building industry firms stated that they expect business conditions to improve in the next three months. This is the first time that this confidence statistic has been positive since the December 2003 quarter. In the September 2006 survey, a net 15% expected business conditions to deteriorate over the subsequent six months.

A net 6% of building industry firms reported a fall in output in the December 2006 quarter, but a net 19% expect to increase output over the next three months to March 2007. A net 4% of firms reported an increase in new orders in the December 2006 quarter. Only a net 2% of firms reported that they had shed labour in the three months to December 2006 and a net 8% stated that they expect to increase staff numbers in the next three months. A net 65% of firms reported cost increases in the December 2006 quarter, whilst a net 18% reported raising their selling prices. For the next three months, fewer expect cost

increases but more expect to raise selling prices. On balance, a net 28% of firms reported a decline in profitability in the December 2006 quarter, but only a net 5% expect lower profitability in the March 2007 quarter.

These industry figures conceal a more optimistic outlook amongst building materials suppliers than building construction firms.

Building costs

This section focuses on movements in an official cost measure – the Capital Goods Price Index for Non-Residential Buildings (CGPI-NRB).

As indicated in previous issues of **Forecast**, Rider Hunt has been commissioned by Statistics New Zealand to provide detailed costing information on a range of model buildings, which will be updated each quarter. This work, which is part of Statistics New Zealand's review of the Producer Price Index, will provide more accurate information with which to calculate inputs that comprise the Capital Goods Price Index. This will lead to a more accurate indexation for the CGPI-NRB, which **Forecast** reports.

Readers should note that the CGPI-NRB, current and forecast

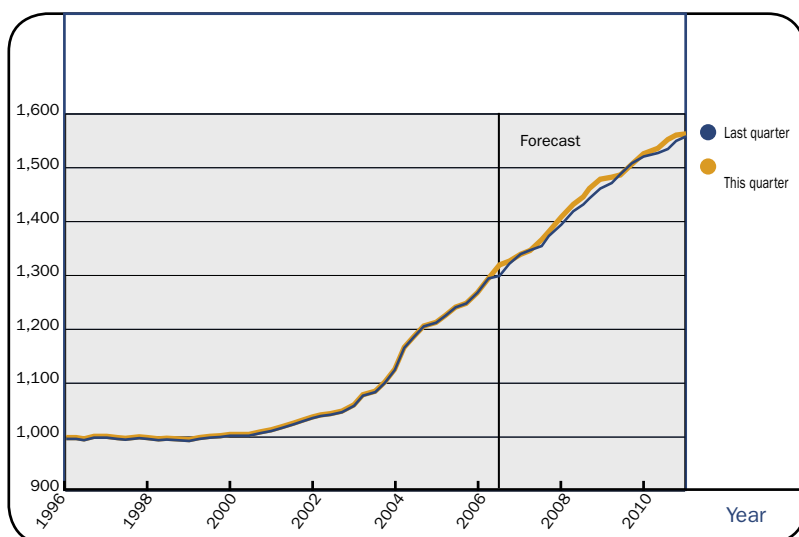
as reported below, is a national average, which does not differentiate between regions or building types. We therefore advise caution in applying the increase in the CGPI-NRB as a measure of cost escalation for specific building projects.

The Rider Hunt publication **Cost Commentary** provides a tender price relativity between the main New Zealand and Australian centres. This publication is available on request from any Rider Hunt office.

Recent trends

Pressure on non-residential building costs continued in the September 2006 quarter. The CGPI-NRB rose 1.9% in this quarter, compared with 2.0% in the June 2006 quarter and 1.7% in the March 2006 quarter. Statistics New Zealand attributes the latest quarter's increase to rising costs of construction services for commercial buildings. In annual terms, non-residential building cost escalation, as measured by the increase in the CGPI-NRB, rose from 5.4% in the year to June 2006 to 6.0% in the year to September 2006. This exceeds 4.5% in the September 2005 year, but remains well below 9.8% in the September 2004 year.

Figure 5: Non-residential building cost index (CGPI-NRB)



Source: Statistics New Zealand, NZIER forecast; index based to 1000 in September 1999 quarter

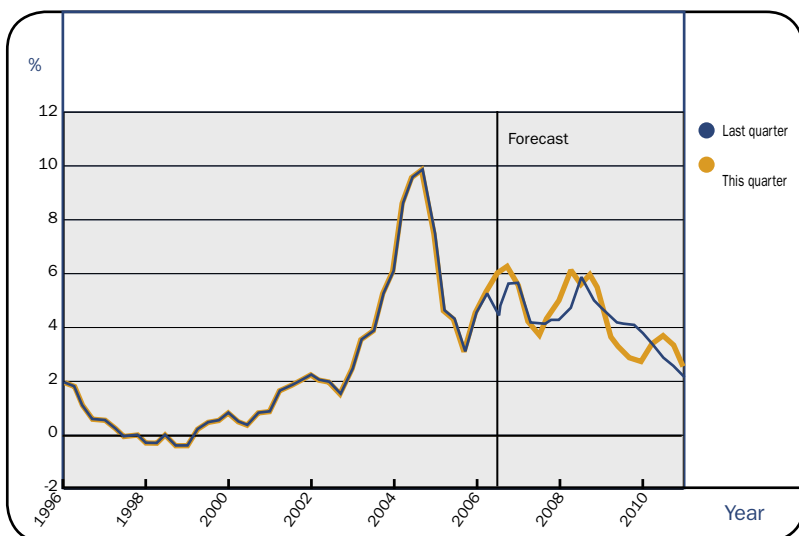
Forecast

Figure 5 shows our latest forecast of the CGPI-NRB and **Figure 6** its percentage change. See also **Table 3**. Note that in **Figure 6** the downward slope from the start of 2005 does not indicate that non-residential building costs fell (see **Figure 5**), but simply that they rose less than in late 2004.

We update our forecast each quarter as new data become available, including any revisions to the predicted size and timing of future changes in macroeconomic conditions. In this issue of **Forecast**, we have also extended the forecast period to 2011,

⁴ The number of firms expecting conditions to deteriorate minus the number of firms expecting them to improve or at least get no worse.

Figure 6: Non-residential building cost escalation (annual percentage change in the CGPI-NRB)



Source: Statistics New Zealand, NZIER forecast

Table 3: The CGPI-NRB

Year	Quarter	Index	Quarterly change (%)	Annual change (%)
Year	Quarter	Index	Quarterly change (%)	Annual change (%)
2005	March	1214	0.2	7.8
	June	1228	1.2	4.8
	Sept	1243	1.2	4.5
	Dec	1248	0.4	3.1
2006	March	1269	1.7	4.5
	June	1294	2.0	5.4
	Sept	1318	1.9	6.0
Forecast				
Dec	1327	0.7	6.3	
2007	March	1341	1.0	5.6
	June	1347	0.5	4.1
	Sept	1367	1.5	3.8
	Dec	1385	1.3	4.4
2008	March	1409	1.7	5.1
	June	1431	1.6	6.2
	Sept	1445	1.0	5.7
	Dec	1469	1.6	6.0
2009	March	1484	1.0	5.4
	June	1484	0.0	3.7
	Sept	1492	0.5	3.2
	Dec	1511	1.3	2.9
2010	March	1526	1.0	2.8
	June	1536	0.6	3.4
	Sept	1548	0.8	3.8
	Dec	1563	0.9	3.4
2011	March	1566	0.2	2.6

Source: Statistics New Zealand, NZIER forecast

although we highlight that longer run forecasts are less reliable and subject to greater change.

As shown in **Figure 5**, our latest forecast (Thick orange line) suggests slightly higher levels of the CGPI-NRB over most of the next four years than our previous forecast published in the October issue of **Forecast** (thin blue line). This is attributable mainly to changes in non-residential building investment, with revision of both historical data and forecast future changes, plus adjustment for higher actual than forecast cost escalation in recent quarters. As a consequence, our latest forecast suggests slightly higher cost escalation overall, with a later but more pronounced slowdown in 2009 and earlier resurgence in 2010, as shown in **Figure 6**.

Consents data, described above, suggest continuing high levels of building work put in place and strong demand for construction resources in the first half of 2007. Non-residential building cost escalation is expected to ease slightly from mid 2007, before rising again from early 2008 and declining again from early to mid 2009. At an average of 4.4% per year to 2011, this is well below the peak of 10.0% reached in the year to December 2004.

Not yet reflected in consents data or allowed for in our forecast of building costs are stadium construction and upgrading of sports grounds for the 2011 Rugby World Cup. We tentatively suggest that these could add 0.2 percentage points to forecast cost escalation in each of the four years to March 2011.

Notes: The current and forecast CGPI-NRB is a national average, which does not differentiate between regions or building types, and we therefore advise caution in applying the increase in the CGPI-NRB as a measure of cost escalation for specific building projects.

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