

RLB|Rider Levett Bucknall

Rider Levett Bucknall **Forecast**₅₅

New Zealand trends
in property and construction

January 2010
Issue 55

This report was prepared by the New Zealand Institute of Economic Research (Inc.)
exclusively for Rider Levett Bucknall

No liability for errors of fact or opinion in this report whether or not due to negligence on the part of any Rider Levett
Bucknall office, their directors or employees or the New Zealand Institute of Economic Research, its contributors,
employees or the board of trustees.

© Rider Levett Bucknall 2010

KEY POINTS IN THIS ISSUE

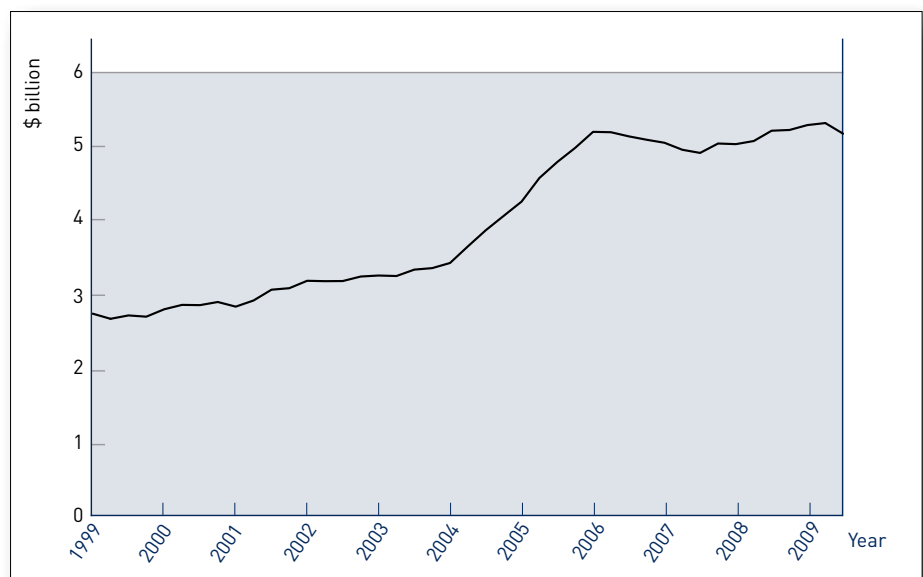
- **Building activity** After peaking in mid 2009, the value of non-residential building work put in place has declined, led by a reduction in the volume of building work available – numbers and sizes of buildings constructed – whilst the average value of this building work has held up.
- **Building consents** After peaking in the first half of 2009, issuing of non-residential building consents has slowed over the past six months. Consent volumes have fallen, whilst average values have risen, signalling less building work ahead, although of higher average value for the firms that secure it.
- **Building investment** Investment in non-residential buildings has fallen over the second half of 2009 and is forecast to drop further, before a gradual recovery over 2011 gathers pace over 2012. Again, the decline will be dominated by reduced volumes, with greater resilience in average values.
- **Building confidence** The building industry as a whole has, nevertheless, shown a leap in general business confidence. Firms' experience and expectations for their own business activity were more restrained, but also improving from recent lows.
- **Building costs** Large falls in the capital goods price index for non-residential buildings over the past two quarters reflect, to some extent, excess capacity and competitive pricing in the face of weakening demand, but also an improvement to the calculation methodology used by Statistics New Zealand. Average building costs are likely to rise a little over the next few quarters with increasing international commodity prices and a depreciating exchange rate. Cost escalation should remain relatively low for the next two years before accelerating over 2012, reflecting the downturn and subsequent recovery in building investment.

Building activity trends

The total value of non-residential building work put in place fell 0.9% over the three months July to September 2009, to 10.3% less than in the same quarter of 2008. This was led by a reduction in the **volume** of building work – numbers and sizes of buildings constructed – as opposed to the average **value** of this building work. The volume of building work fell 4.3% in the September 2009 quarter, following falls of 0.7% and 2.9% in the previous two quarters (seasonally adjusted).

In annual terms, the value of building work contracted 0.8% over the year to September 2009 to \$5.168 billion. This was the first decline in annual total since early 2008, although still only \$146 million (2.7%) below the highest point in the year to

Figure 1: Annual non-residential building work put in place



Source: Statistics New Zealand

June 2009, as shown in **Figure 1**. As above, this reflected less work available, even if its average value held up. The non-residential building sector is now almost the same size as the residential building sector, after the sharp drop off in house building (by 25.7% to \$5.938 billion over the year to September 2009).

For non-residential buildings, the sharpest contraction was in the value of building work on hospitals and nursing homes, which fell 36.5% this year, whilst work on hotels and boarding houses declined 8.2% and work on commercial buildings declined 3.9%. Bucking

the trend, work on education buildings grew 21.5%, due in part to government spending, and work on miscellaneous buildings¹ grew 7.0%, boosted by sports stadia and buildings for the justice system. These are the second and third largest sectors reported, after commercial buildings, so their continued growth should provide some relief in absorbing labour from other smaller sectors.

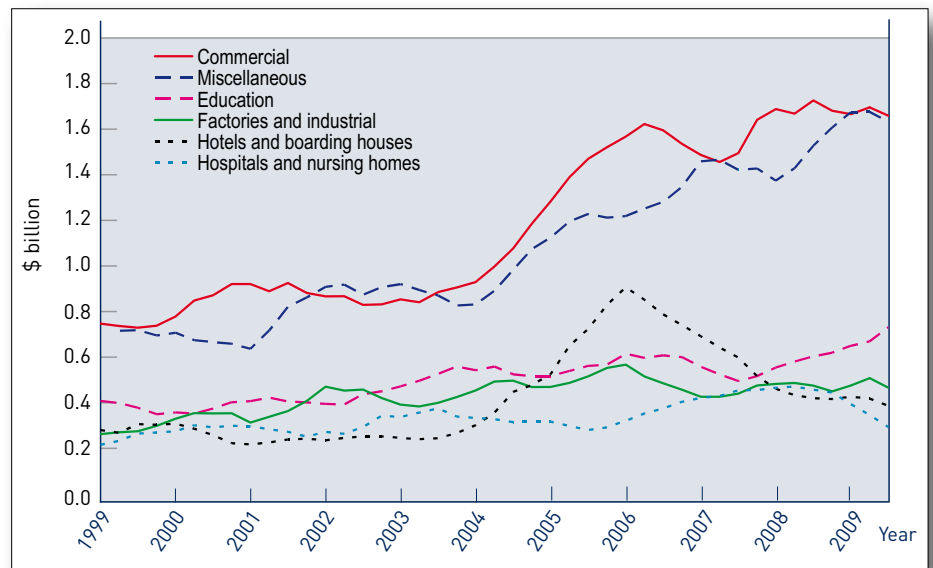
Building activity outlook

Economic growth and building investment

After five consecutive quarters of recession, the New Zealand economy at last stabilised with modest positive growth of 0.1% in the June 2009 quarter. The economy is expected to continue the climb out of recession, although may stumble a little over the next few quarters until it gains steadier footing. NZIER forecasts economic growth of 1.1% in the year to March 2010 and 2% to 3% per year thereafter, but the economy is likely to take until early 2012 to return to pre-recession levels of activity.

Historically, growth in non-residential building investment significantly lags upturns and downturns in the overall economy. Firms have cut back on their investment spending in the wake of weaker sales and profits during the recession and will be cautious about increasing investment again until they see sustained growth in demand for their goods and services and

Figure 2: Annual non-residential building work put in place by sector



Source: Statistics New Zealand

have exhausted their existing excess capacity. Investment in non-residential buildings has decreased over the second half of 2009. NZIER forecasts the total value of non-residential building investment to drop 12.2% over the March 2010 year and 10.5% over the March 2011 year, before a gradual recovery over the course of 2011 gathers pace over 2012. Like building work put in place above and building consents below, this will be dominated by reduced volumes of investment, with greater resilience in average values.

Interest rates and exchange rates

At its latest review on 10 December 2009, the Reserve Bank left the Official Cash Rate (OCR) unchanged at 2.5%. It expects to retain this rate until at least mid 2010, to assist the economic recovery. Annual consumer price inflation eased to 1.7% in September 2009 and is forecast to remain within the Reserve Bank's 1% to 3% target

band for the next two to three years. Producer price inflation not only slowed, but input prices actually fell 5.8% and output prices fell 2.1% over the year to September 2009, due to excess capacity and competitive pricing in the face of weak demand.

On a trade-weighted basis, the New Zealand dollar has strengthened over 2009, although mainly against the currencies of the USA and UK, which have seen harsher adjustment in their economies. There is some scope for the New Zealand dollar to appreciate further in the short run, due to mounting risk appetites, interest rate differentials and rising commodity prices. A significant depreciation is likely over 2010 and 2011, however, to correct external imbalances.

Building consents

The issuing of non-residential building consents has slowed over the past six months, after April 2009 recorded the highest ever value of consents issued in

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

a single month. \$4.514 billion of non-residential building consents were issued in the year to October 2009, just \$39 million (0.9%) more than in the October 2008 year and \$226 million (4.8%) less than the highest point in the May 2009 year, as shown in **Figure 3**. Again, the non-residential building sector is now almost the same size as the residential building sector, after the sharp decline in housing consents (by

24.3% to \$4.980 billion over the year to October 2009).

For non-residential buildings, consent volumes continued to fall, whilst average values continued to rise, as shown in **Figure 4**. The total floor area of buildings consented fell 26% over the October 2009 year. The average value per square metre of buildings consented rose 36%. Floor area consented reached its lowest annual total

since the beginning of 2001, but average value per square metre consented was the highest ever recorded. With a time lag of typically six to nine months between when consents are issued and building work commences, this signals less work ahead, although of higher average value for the firms that secure it.

Consents by sector

The two largest sectors – offices and administration buildings and social, cultural and religious buildings – continued to grow strongly, buoyed by development of Christchurch International Airport and preparations for the 2011 Rugby World Cup. The total value of consents issued for hostels and boarding houses more than doubled over the year to October 2009, with a leap in consents issued over February to May 2009 in the Auckland, Bay of Plenty and Manawatu-Wanganui regions. Growth in consents for education buildings and miscellaneous buildings slowed from recent highs, although the latter is smallest of the sectors reported and a residual category for buildings not covered by other sectors (e.g. public toilets and car parks)². Downward trends continued for shops, restaurants and taverns, factories and industrial buildings, storage buildings, farm buildings, hospitals and nursing homes and hotels and motels.

Consents by region

The Gisborne, Canterbury and Marlborough regions recorded the largest increases in total

Figure 3: Annual non-residential building consents

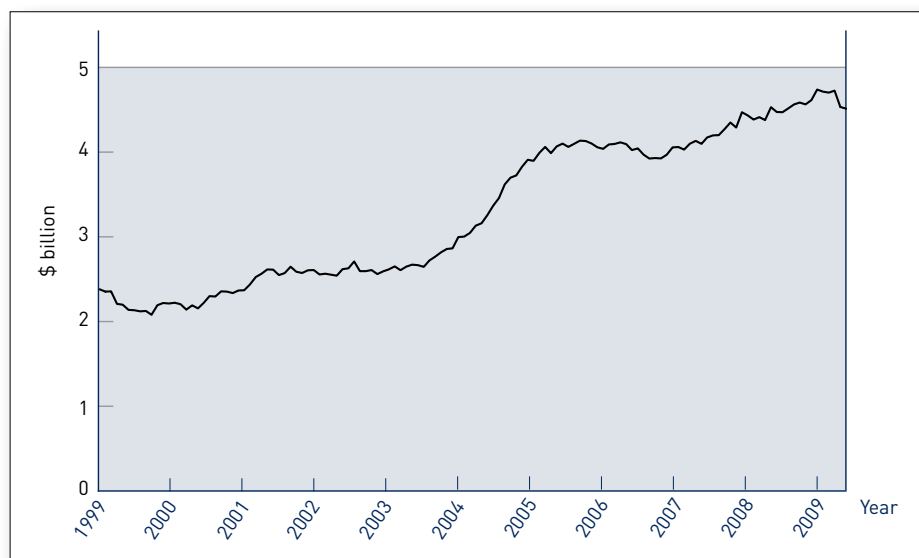
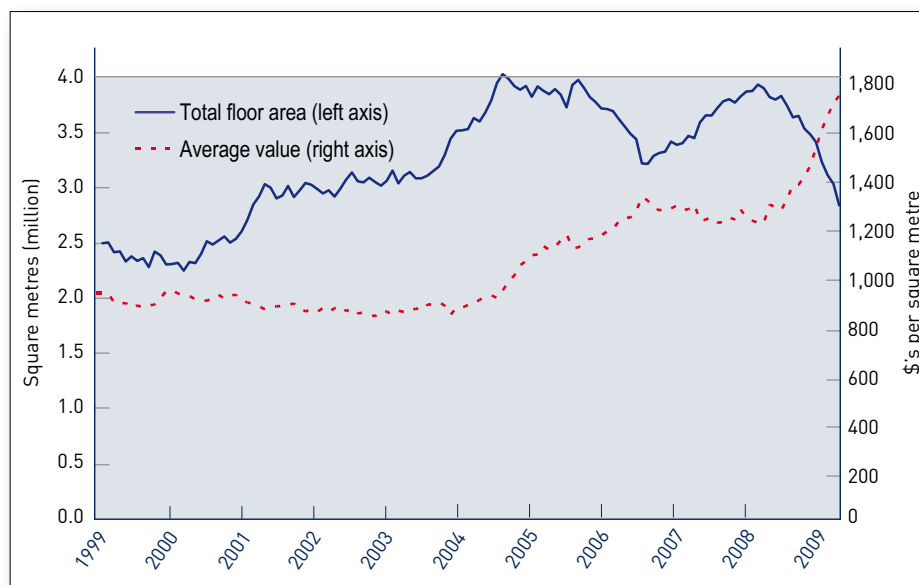


Figure 4: Annual total floor area and average value of consents



Source: Statistics New Zealand

² And, unfortunately, this is not comparable to the “miscellaneous buildings” category of building work put in place.

value of consents issued, as shown in **Figure 5**, whilst the West Coast, Northland and Taranaki regions recorded the largest falls.

For the three main centres, consents growth continued in Canterbury and accelerated in Wellington, whilst Auckland entered a downturn. Over the year to October 2009, consents grew 30% in Canterbury, up from a 1% decline over the October 2008 year, but slowing from the peak of 51% growth over the July 2009 year. Wellington experienced 15% growth in consents over the October 2009 year, also up from a 1% decline over the previous year. Despite recording its highest ever month in May 2009 and second highest in February 2009, Auckland had 1% fewer consents issued in the year to October 2009 than in the previous year. Vacancy rates for existing office and retail space in Auckland's central business district have risen and are expected to rise further over the coming year, delaying the need to build new space.

As nationally, these figures reflect a decline in the floor area of buildings consented and increase in average value per square meter, so indicate less work of higher value.

Building industry confidence

The building industry has shown a leap in general business confidence. Firms' experience and expectations for their own business activity were more restrained, but also improving from recent lows.

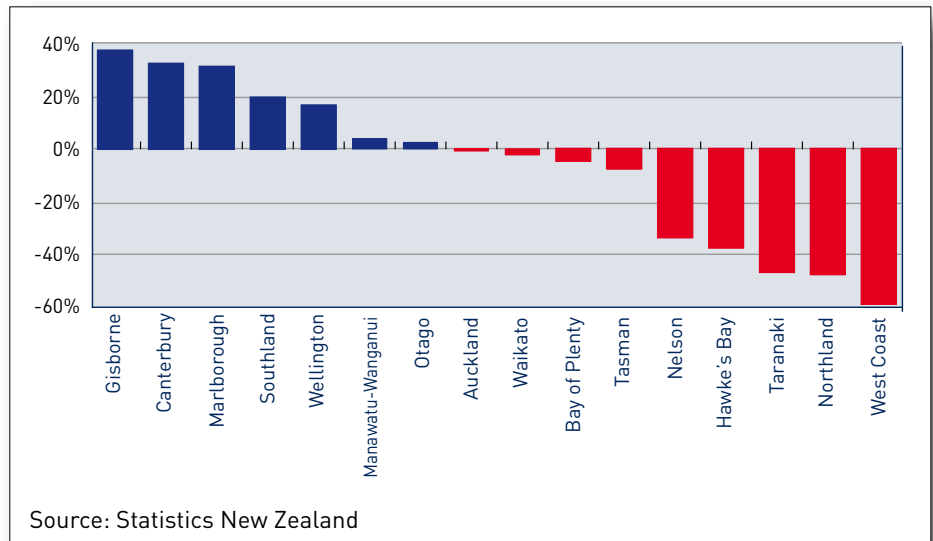
Table 1: Value of consents by sector in the year to October 2009

Sector	Annual value (\$ million)	Share of total (%)	Annual growth (%)
Offices and administration buildings	1,150	25.5	20.3
Social, cultural and religious buildings	628	13.9	64.0
Education buildings	601	13.3	1.3
Shops, restaurants and taverns	489	10.8	-5.2
Factories and industrial buildings	443	9.8	-14.5
Storage buildings	303	6.7	-32.7
Hostels and boarding houses	251	5.6	164.2
Farm buildings	230	5.1	-39.3
Hospitals and nursing homes	211	4.7	-31.9
Hotels and motels	139	3.1	-36.8
Miscellaneous buildings	70	1.6	25.0
Total	4,514	100	0.9

Source: Statistics New Zealand

Figure 5: Annual growth in value of consents by region in the year to October 2009

Average annual percentage change



Source: Statistics New Zealand

In NZIER's October 2009 *Quarterly Survey of Business Opinion*, a net³ 27% of firms in residential and non-residential building expected general business conditions to improve over the subsequent six months.

This was the first time since late 2006 that the net balance of firms has expected improvement, rather than deterioration, and was the highest net balance expecting improvement since early 2002.

³ The percentage of firms reporting their output to have fallen minus the percentage reporting their output to have risen, after accounting for firms that did not provide a response.

A net balance of 30% of building industry firms reported a fall in their own output in the third quarter of 2009, but this was a significant improvement from 48% and 47% in the first two quarters. A net 16% expected their output to increase in the following three months, the first time in two years that firms have expected an increase, rather than decrease. Similarly, fewer firms reported a drop in new orders and a net balance of 17% expected an increase in new orders in the three months to come.

Perceived cost pressures remained stable, with a net balance of 26% of firms both reporting average costs to have risen in the past quarter and expecting costs to rise in the coming quarter. The net balance of firms that lowered their selling prices rose from 30% to 34%, but only 5% expected to cut their selling prices in the following three months. The persistence of input costs relative to selling prices has squeezed profitability. One response has been more firms reducing staff numbers, a net 52% in the third quarter of 2009 from a net 45% in the previous quarter, although a net balance of 4% expected to increase staff numbers in the last quarter of 2009. A marked decline in overdue debtors has provided some relief.

Of particular relevance to the non-residential building sector are other firms' building investment intentions.

These remained negative, but less so than in earlier surveys. In the October 2009 survey, a net 16% of all firms economywide reported that they expected to reduce their investment in buildings over the following 12 months, showing steady improvement from a net 29% in the second quarter of 2009 and a net 46% in the first quarter of 2009.

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 publication *International Report* provides a tender price relativity between the main New Zealand, Australian and international centres. This publication is available at www.rlb.com or on request from any Rider Levett Bucknall office.

Recent trends

The CGPI-NRB indicated non-residential building costs to have fallen 1.4% in the third quarter of 2009 after falling 1.1% in the second quarter. Statistics New Zealand attributed the latest quarter's decrease to lower

labour costs and materials costs for steel reinforcing and structural steelwork in building warehouses, factories, shops and offices. Note, however, that Statistics New Zealand has altered its methodology for calculating the CGPI-NRB and transitioned to the new calculations over these two quarters. These new calculations align more closely with Rider Levett Bucknall's market observations.

As a result of the relatively large falls in these two quarters, the CGPI-NRB fell 3.1% over the year to September 2009. This was a particularly sharp drop, as highlighted in **Figure 6**, and the largest annual decrease since this series began in 1989. This reflects, to some extent, excess capacity and competitive pricing in the face of weakening demand, but also the improvement in calculation methodology used by Statistics New Zealand.

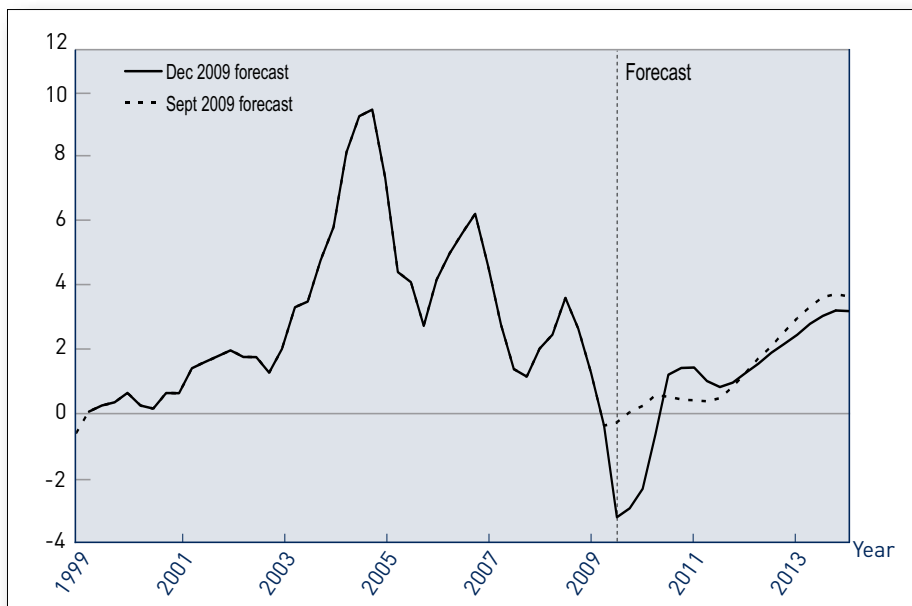
Forecast

NZIER's latest forecast of the annual percentage change in the CGPI-NRB is shown in **Figure 6** and **Table 2**.

NZIER expects building costs to rise a little over the next few quarters with increasing international commodity prices and a depreciating exchange rate. Cost escalation should remain relatively low for the next two years before accelerating over 2012, reflecting the downturn and subsequent recovery in building investment.

Figure 6: Non-residential building cost escalation

Annual percentage change in the CGPI-NRB



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 New Zealand, NZIER forecast

Table 2: Non-residential building cost index

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
Forecast	Dec	1351	0.1	-2.8
2010	March	1354	0.2	-2.2
	June	1363	0.7	-0.4
	Sept	1370	0.5	1.5
	Dec	1374	0.3	1.7
2011	March	1377	0.2	1.7
	June	1381	0.3	1.3
	Sept	1385	0.3	1.1
	Dec	1391	0.4	1.2
2012	March	1398	0.5	1.5
	June	1406	0.6	1.8
	Sept	1415	0.7	2.2
	Dec	1426	0.7	2.5
2013	March	1437	0.8	2.8
	June	1450	0.9	3.1
	Sept	1463	0.9	3.4
	Dec	1476	0.9	3.5
2014	March	1488	0.8	3.5



Auckland

t. +64 9 309 1074
e. auckland@nz.rlb.com

Wellington

t. +64 4 384 9198
e. wellington@nz.rlb.com

Christchurch

t. +64 3 365 0590
e. christchurch@nz.rlb.com

Palmerston North

t. +64 6 357 0326
e. palmerstonnorth@nz.rlb.com

Tauranga

t. +64 7 579 5873
e. tauranga@nz.rlb.com

Otago

t. +64 3 409 0325
e. otago@nz.rlb.com

Oceania

t. +61 2 9922 2277
e. enquiries@oceania.rlb.com

EMEA

t. +44 20 7398 8300
e. enquiries@emea.rlb.com

Asia

t. +852 2823 1823
e. enquiries@asia.rlb.com

Americas

t. +1 602 443 4848
e. enquiries@americas.rlb.com

www.rlb.com