



Department of
Building and Housing
Te Tari Kaupapa Whare

Is the recession nearly over for the building industry?

**Building and Construction Outlook
March quarter 2010**

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Key themes – March quarter 2010

- **The slump in residential building activity has bottomed out.** Housing consents have been rising from a low base since the June quarter 2009 and this will feed through to higher activity levels in 2010.
- **The industry remains uncertain about the strength and sustainability of the residential recovery.** Many companies in the building supply chain believe the recent rise in consents is an inevitable response to a prolonged period of weak activity rather than a return of confidence in the sector. There is also some concern that the key factors supporting current demand – strong net migration and low interest rates – may begin to unwind in 2010.
- **The non-residential sector is showing signs of weakness** after providing a solid base to the construction sector over the past four years.

Development finance has dried up, and it is difficult to make a case for new investment when vacancy rates in commercial, retail and industrial property are steadily rising. With private development in decline, ongoing public spending on infrastructure will become increasingly important to companies involved in project design and heavy construction.

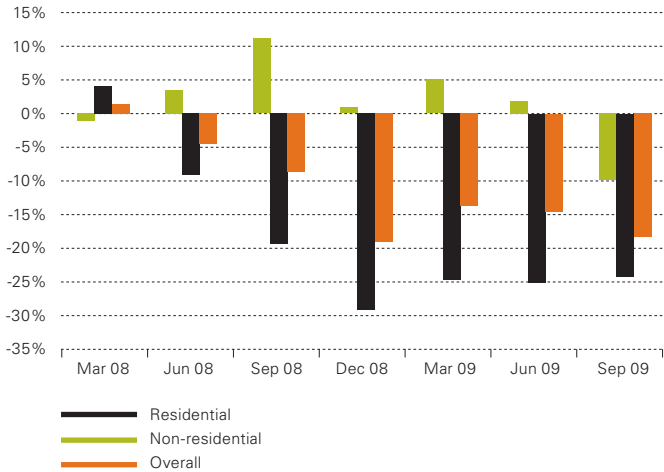
- **Total building activity should rise in 2010** if annual housing consents recover towards the 20,000 level, which most industry commentators believe is the minimum required to meet New Zealand's basic housing needs. Even if progress is slow and housing consents only reach 18,000 by year end 2010, this would still represent a 25% increase on 2009 levels. Therefore, while construction activity in 2010 is likely to fall short of the levels seen in 2005–07, we should at least see an improvement on 2009.

Trends are reversing

- Until recently, the sharp fall in residential activity over the past 18 months has been partially cushioned by a resilient non-residential sector.
- However, this trend has the potential to reverse in 2010. Residential activity is likely to continue improving from a very low base, while non-residential activity is showing early signs of tapering off. This shift is beginning to show through in consents data (see Figure 2).
- The biggest concern currently facing the industry is that the residential recovery will not be strong or long enough to boost a construction industry already under pressure. The residential sector represents 60-65% of the total building market on a mid-cycle basis (note, we have excluded engineering construction – roads, power stations, etc – due to a lack of reliable data). At present, residential building is contributing only 50% of the total building market, and while this percentage is likely to improve in 2010, without a tailwind from a healthy non-residential sector, prospects for overall building activity appear subdued.

FIGURE 1

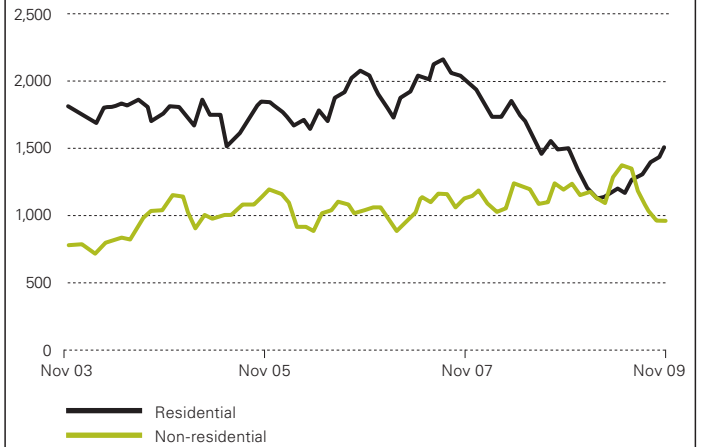
QUARTERLY CONSTRUCTION ACTIVITY (ANNUAL CHANGE)



Source: Statistics New Zealand

FIGURE 2

VALUE OF CONSENTS – ROLLING QUARTERLY \$M



Source: Statistics New Zealand

Homebuilding activity likely to rise into 2010

- There is little doubt that the worst of the 2007–09 housing downturn is now behind us. The trend estimate for housing consents has been rising since the June quarter 2009, which fits with recent feedback from the industry – ie, volume homebuilders have experienced higher levels of phone calls and website enquiries since the middle of the year, and distribution outlets are reporting greater levels of confidence amongst trade customers (beyond normal seasonal fluctuations).
- Given the positive movements in leading indicators, we expect homebuilding activity to rise through the first half of 2010 as the market satisfies the demand that has been building up over the past 6–12 months.
- However, we would stress that very few industry participants are expecting another boom period in 2010 (ie, new housing levels of 25,000+). Unless there is a more significant improvement in economic conditions and consumer confidence, a modest recovery appears to be the most likely scenario.

FIGURE 3

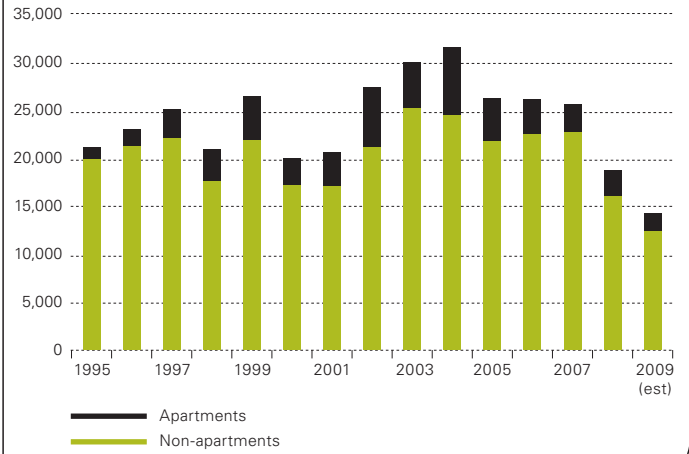
**MONTHLY NUMBER OF DWELLING CONSENTS
(EXCLUDING APARTMENTS)**



Source: Statistics New Zealand

FIGURE 4

ANNUAL NUMBER OF DWELLING CONSENTS



Source: Statistics New Zealand

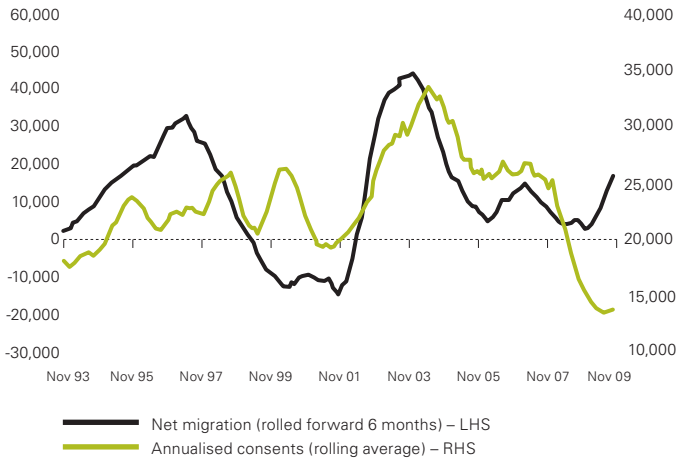
Net migration is playing a part

- Net migration inflows put pressure on the existing housing stock. November 2009 was the 10th consecutive month that net long-term arrivals exceeded 1500, pushing the annual rate above 20,000 (versus a 10-year average of 12,000).
- From Figure 5, we can see that annual net migration levels of 10,000+ are broadly associated with annual housing consents of 20,000–25,000 per annum, using a 6-month lag.
- The recent surge in migration has been driven by two main factors – fewer New Zealanders leaving for the UK and Australia, coupled with an increasing number of returning ex-pats.

While this trend could quickly reverse if global economic conditions improve and New Zealanders seek offshore job opportunities again, the strong migration figures in 2009 to date suggest a supply-side response is already overdue (particularly in Auckland, which has experienced the bulk of the influx).

FIGURE 5

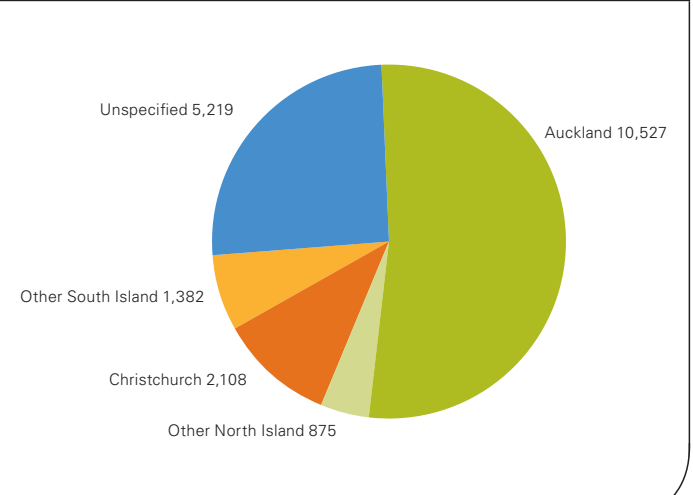
NUMBER OF HOUSING CONSENTS VS NET MIGRATION



Source: Statistics New Zealand

FIGURE 6

NET MIGRATION INFLOWS BY REGION (YEAR TO NOVEMBER 2009)



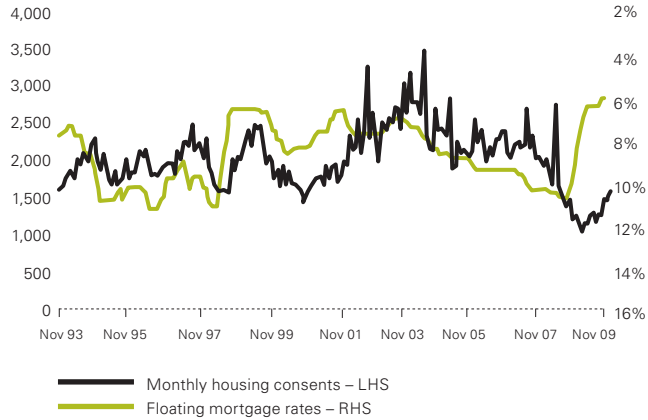
Source: Statistics New Zealand

Lower interest rates have aided affordability

- Floating mortgage rates have fallen sharply in recent times, with average rates now hovering at 6.0% versus 8.7% in November 2008. Shorter-term fixed rates are also significantly lower, but there is a steep step-up to fixed terms of three years or more, where interest rates are broadly in line with historical averages (see Figure 8).
- The overall fall in interest rates has boosted home affordability measures. The latest Massey University Home Affordability Report for the November 2009 quarter showed that relatively flat wages and an increase in house prices were more than offset by the fall in mortgage rates. As of November 2009, affordability had improved 20% over the previous year.
- However, expectations are that recent price pressures and a shortage of global credit will put upward pressure on interest rates in 2010. These concerns are currently being reflected in long-term mortgage rates.

FIGURE 7

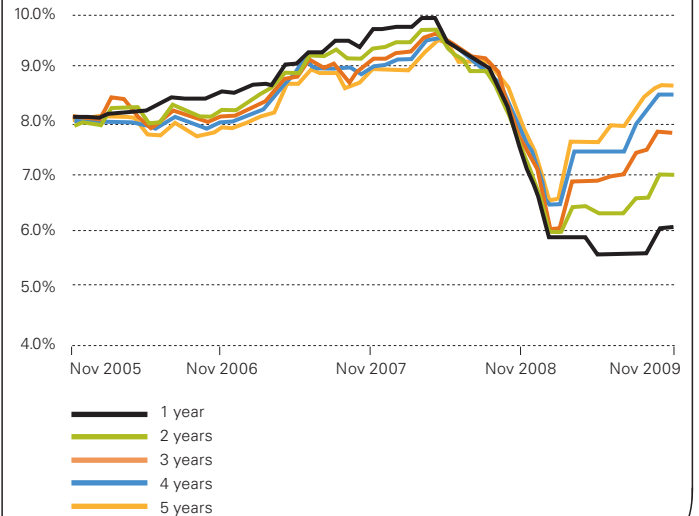
MORTGAGE RATES VS NUMBER OF DWELLING CONSENTS



Source: Statistics New Zealand and Reserve Bank of New Zealand

FIGURE 8

FIXED MORTGAGE RATES BY TERM



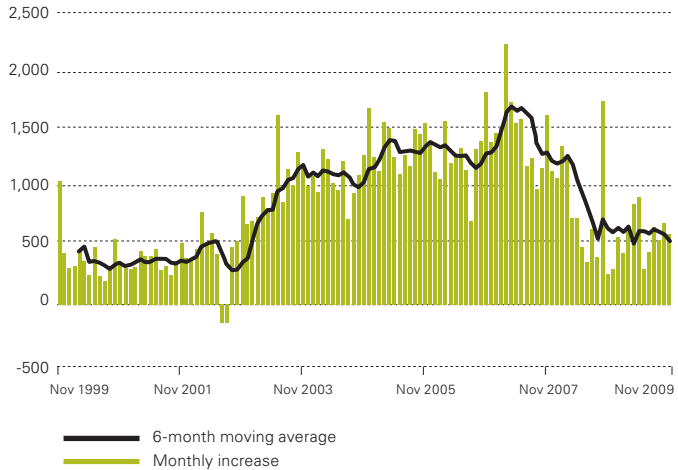
Source: Reserve Bank of New Zealand

But bank lending remains subdued

- Improvements in affordability have not yet filtered through to a meaningful increase in mortgage lending. Among the reasons cited for the muted consumer response are:
 - banks tightening their lending criteria and minimum deposit requirements
 - uncertainty over the economic outlook and job security
 - few listings and limited available housing stock, especially in high-demand areas like Auckland and Wellington.
- Home loan approvals have picked up modestly since March 2009, indicating there are buyers waiting in the wings if the number of listings increases. However, approvals are still running significantly below the levels seen during the last housing boom in 2005–2007.

FIGURE 9

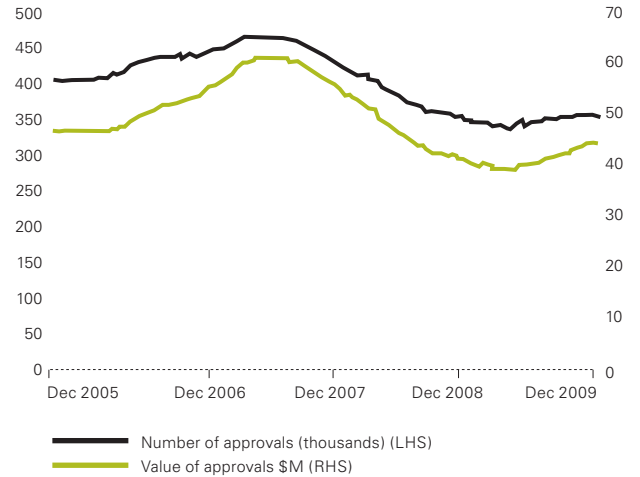
MONTHLY INCREASE IN HOME LENDING (\$M)



Source: Reserve Bank of New Zealand

FIGURE 10

HOME LOAN APPROVALS (ROLLING ANNUAL FIGURES)



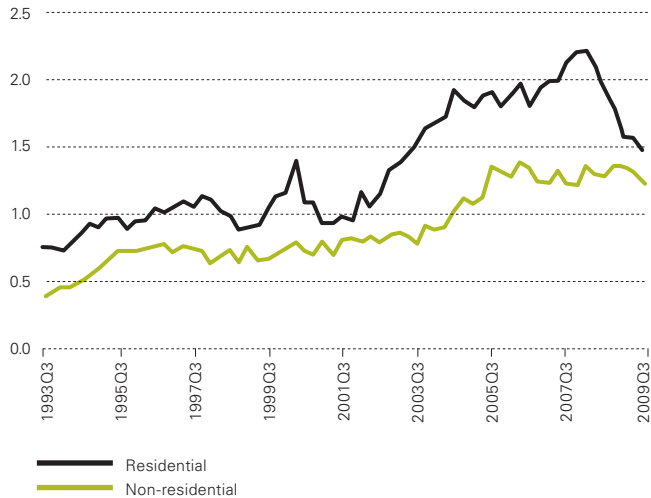
Source: Reserve Bank of New Zealand

Non-residential activity has held up well, until now

- Until recently, the sharp fall in residential activity has been cushioned by a resilient non-residential sector.
- Non-residential activity is holding up at \$1.2–\$1.3 billion per quarter, where it has roughly sat since 2005. These are still very healthy levels, considering the 10-year average is closer to \$1 billion per quarter.
- Public sector spending has played a big part in propping up non-residential activity recently, particularly in areas such as education, health, and social and cultural buildings (eg, construction related to the 2011 Rugby World Cup).
- Government spending will continue to underpin the sector to some extent, but possible declines in key categories directly linked to the business cycle – notably hotels, offices, retail, and industrial – could make it difficult for non-residential activity to remain at the \$1.2–\$1.3 billion per quarter mark in 2010.

FIGURE 11

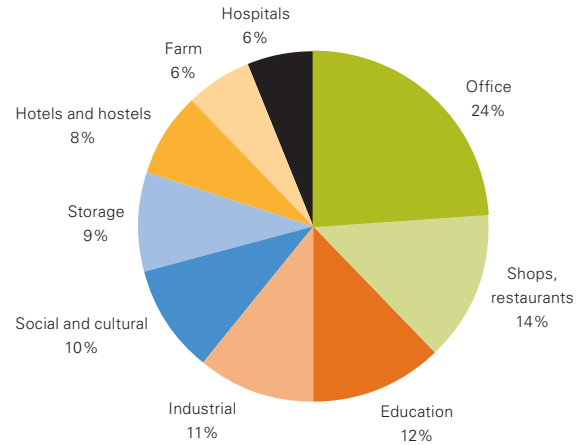
CONSTRUCTION ACTIVITY (\$B) SEASONALLY ADJUSTED QUARTERS



Source: Statistics New Zealand

FIGURE 12

NON-RESIDENTIAL CONSTRUCTION BY SECTOR (VALUE OF CONSENTS - LAST 10 YEARS)



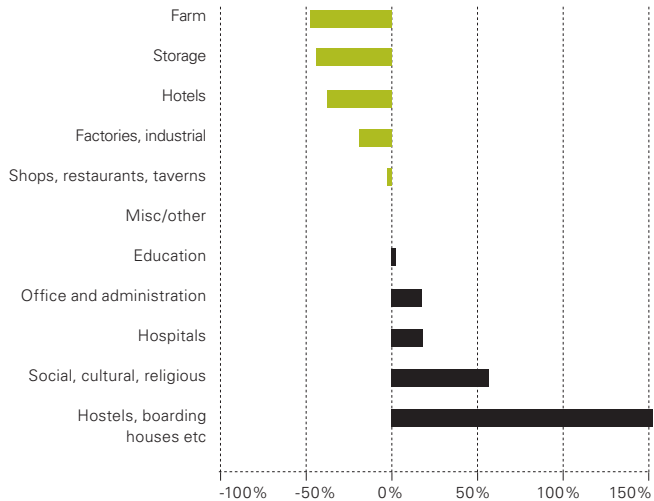
Source: Statistics New Zealand

Conditions could get tougher in 2010

- There are typically long lags between a non-residential project gaining consent, then breaking ground, and finally reaching completion. As a result, the healthy non-residential activity levels New Zealand experienced in 2008 and early in 2009 were the result of projects approved well before the economic downturn.
- These projects have largely drawn to a close, and the value of non-residential consents in the 12 months to November 2009 is now flat on the same period a year ago. Furthermore, with development finance drying up, vacancy rates in the office sector increasing, and the economy still suffering from the effects of the global downturn, there is concern that consents will decline more sharply through 2010.
- From Figure 13, the biggest concern is the dip in consents for large sub-categories related to the private sector – industrial buildings, shops and restaurants, hotels and storage. Given that office construction is also expected to struggle over the next two years due to a number of recently completed developments coming onto the market, the non-residential sector will be increasingly reliant on publicly funded buildings to keep its order books full.

FIGURE 13

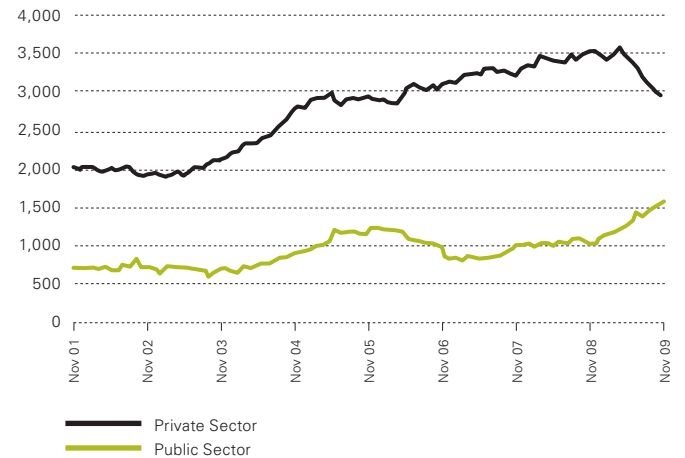
**NON-RESIDENTIAL CONSENTS
ANNUAL CHANGE, 12 MONTHS TO NOVEMBER 2009**



Source: Statistics New Zealand

FIGURE 14

**NON-RESIDENTIAL BUILDING CONSENTS
(ROLLING ANNUAL VALUES) (\$ MILLIONS)**



Source: Statistics New Zealand

House prices and sales are creeping off recent lows

- House prices have resumed their upward trend in recent months. While the downturn following the 2007 peak gained a lot of media coverage, it is important to note that:
 - house prices were only in decline for approximately 14 months, following more than 15 years of relatively steady increases
 - the current stratified median house price of \$367,000 (as at December 2009) is less than 4% below its 2007 peak of \$381,000.
- Real estate agents indicate there is no shortage of buyers, but a shortage of stock. Therefore, the intense competition amongst buyers for available homes has helped keep average prices at reasonable levels. The test for prices will come when sales volumes increase and buyers and sellers are more evenly matched. This will most likely occur over the next 12 months, as new construction increases and the housing stock rises (note the correlation in Figure 16).

FIGURE 15

NEW ZEALAND MEDIAN HOUSE PRICES (THOUSANDS \$)

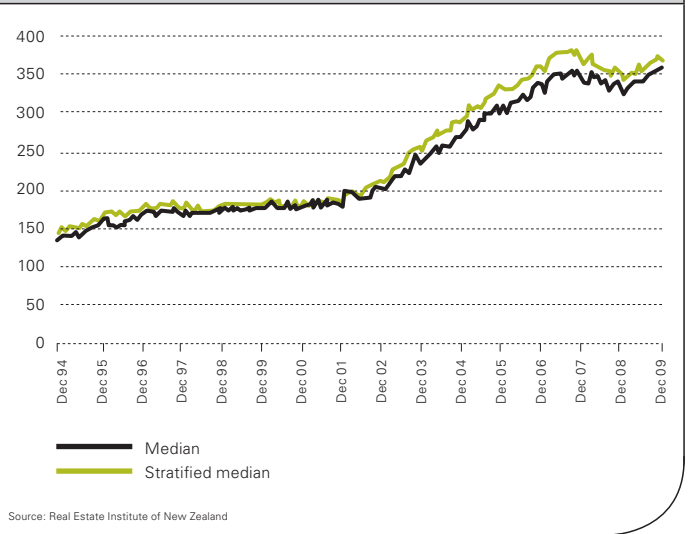
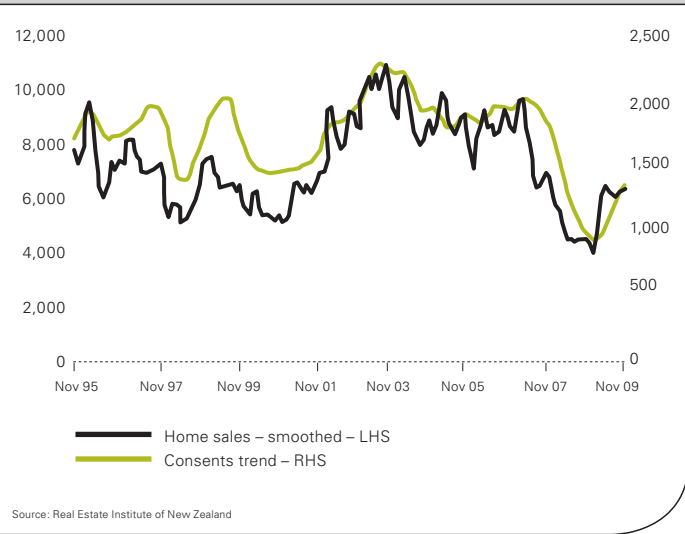


FIGURE 16

MONTHLY HOME SALES VS NEW DWELLING CONSENTS

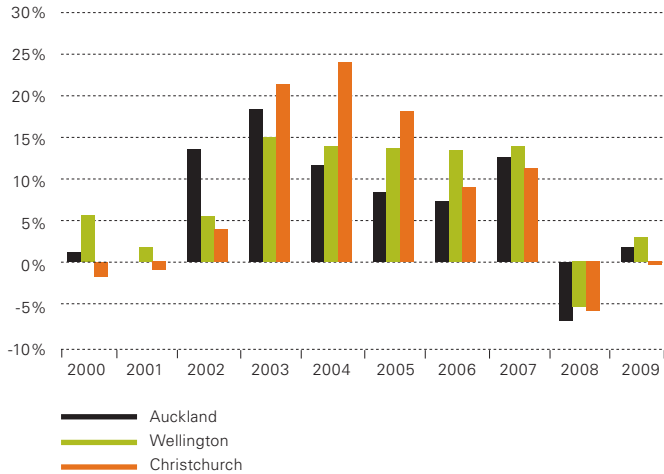


Auckland and Wellington leading the way

- The house price drop in late 2007–2008 has been largely recovered. According to Real Estate Institute of New Zealand (REINZ) monthly data, Wellington and Auckland house prices experienced slight increases in 2009 while Christchurch was flat. The main centres have also picked up in terms of the number of sales and the median days to sell – both strong indications that the housing market has regained much of its lost confidence. In December 2009, houses took less than 30 days to sell in the three main regions versus 43 days a year earlier.
- The number of homes sold was strongest in Auckland, with transactions up 46% in the December 2009 quarter versus a year ago. Wellington sales were up 32% and Canterbury rose 25%. However, as with the homebuilding sector, sales are increasing from a very low base. With summer already upon us, real estate agents have expressed concern about the lack of listings. We would also note that very few people in the industry are expecting a return to the 10%+ per annum house price growth experienced in 2003–07.

FIGURE 17

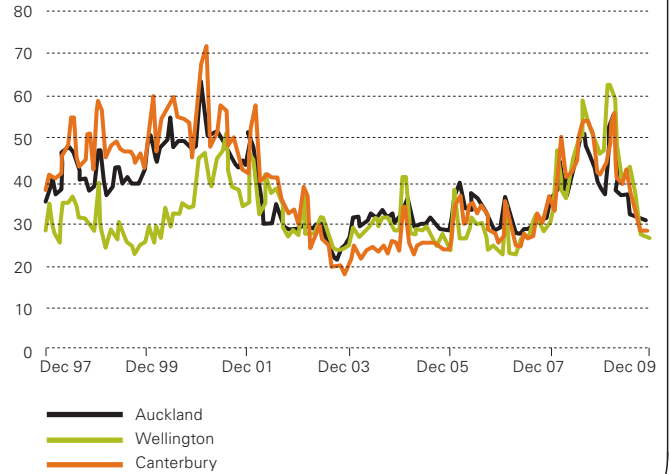
STRATIFIED MEDIAN HOUSE PRICES (ANNUAL CHANGE)



Source: Real Estate Institute of New Zealand

FIGURE 18

MEDIAN DAYS TO SELL



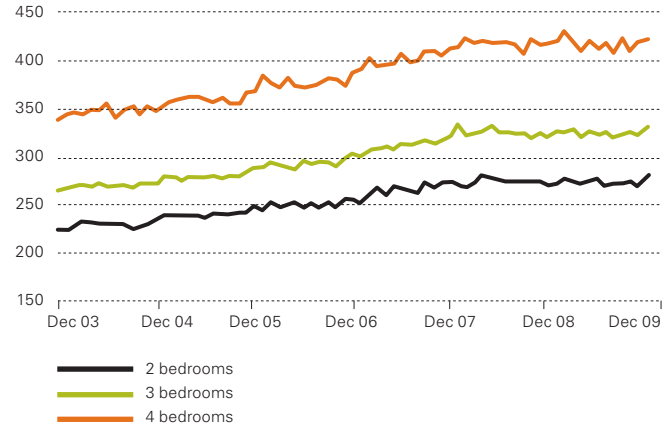
Source: Real Estate Institute of New Zealand

Rents stable, despite perceived housing shortage

- While it has been widely acknowledged that the severity of the recent housing slump has led to a supply/demand imbalance, to date this has not been reflected in rental data.
- Conventional wisdom suggests that a housing shortage would lead to increased demand for rental properties, and a subsequent lift in average rents. However, rents have been relatively flat across much of the country, including Auckland which has seen the biggest influx of new migrants. Only Wellington has seen a significant rise in average rents over the past 12 months.
- We would caution against using rental data as a guide to the supply/demand dynamics in the housing market. Imperfect information, lags between supply changes and price negotiations, and other peculiarities of the landlord-tenant relationship mean that rental prices have tended to reflect the rate of inflation rather than housing cycle peaks and troughs.

FIGURE 19

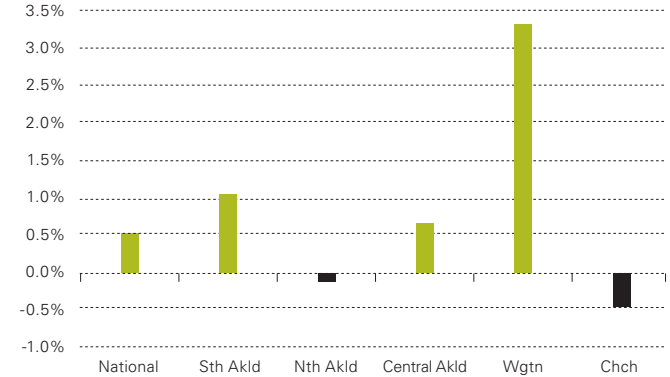
**NEW ZEALAND WEEKLY RENTS
(MEAN \$'S)**



Source: Department of Building and Housing

FIGURE 20

**MEDIAN RENT INFLATION 12 MONTHS
TO DECEMBER 2009 VS 2008**



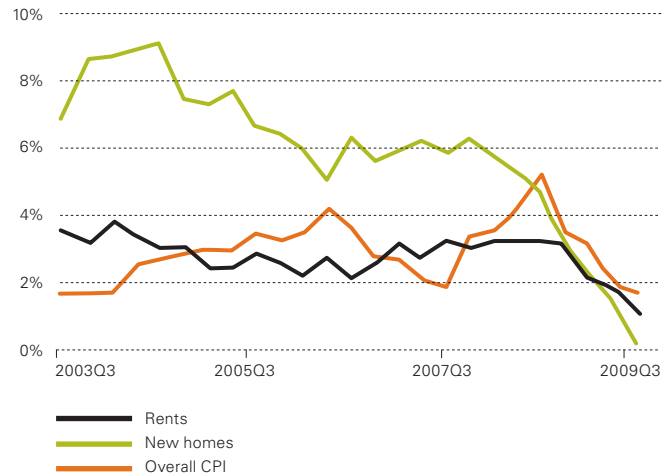
Source: Department of Building and Housing

The cost of homebuilding has levelled out

- Homebuilding costs are no longer rising at above the rate of inflation. The sharp drop in demand has meant there is still spare capacity in the industry, even with the exit of some smaller players, and the tender process is more competitive than it has been for several years as builders chase a smaller amount of work.
- Subcontractors are certainly backing up this claim of an increasingly competitive environment, reporting tough trading conditions and intense margin pressure.
- From the March quarter 2009, it is apparent that input prices for residential buildings have been levelling out following strong increases from early 2005 to late 2007. However, recently there have been reports of higher timber prices pushing up construction costs again. If we also see higher demand in 2010 and a subsequent tightness in the labour market, the static period for housing costs may be short-lived.

FIGURE 21

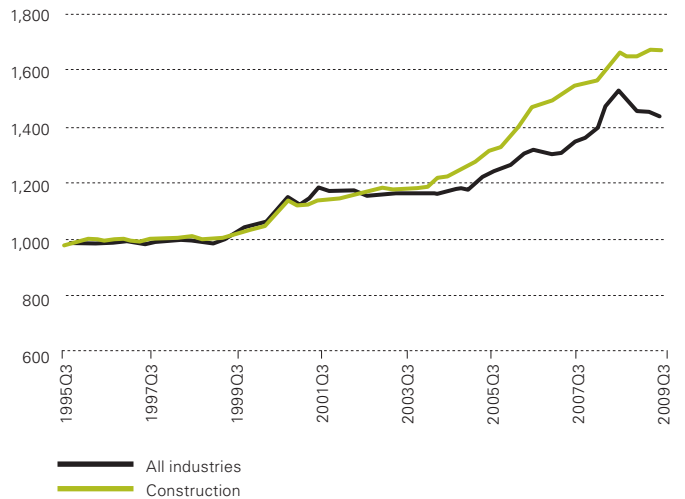
CPI – HOUSING COSTS



Source: Statistics New Zealand

FIGURE 22

CONSTRUCTION INPUT COSTS – PPI



Source: Statistics New Zealand

Construction employment has now fallen 10%

- Construction industry employment outpaced the wider labour market during the housing boom, peaking in late 2006 at 190,000 employees (8.8% of the workforce).
- The economic and housing downturn has seen industry employment fall 10% from 2006 to just under 170,000 employees currently, reducing construction's contribution to 7.9% of the workforce. While this is a significant drop, it should be remembered that housing consents fell 58% over the same period.
- There are two main reasons why the severity of the homebuilding sector has not been reflected in employment numbers. First, there has undoubtedly been a transfer of workers between the residential sector and the (more stable) non-residential and non-building sectors.

Second, hours worked per employee have been falling, suggesting that some managers/owners have been finding ways to reduce labour costs without resorting to lay-offs.

- The employment outlook in 2010 will largely depend on the residential sector recovery, and whether it can reach trend levels of around 20,000 new houses over the next 12 months. If not, there could be additional pressure on sector employment.

FIGURE 23

EMPLOYMENT INDEX (1997 = 100)

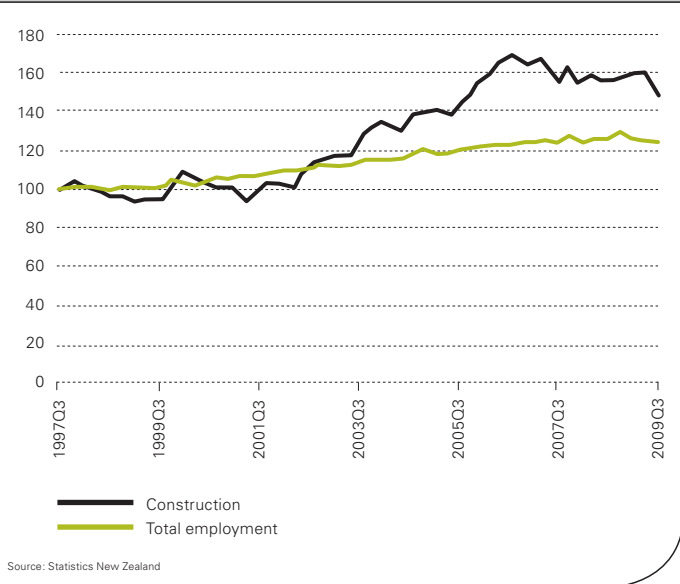
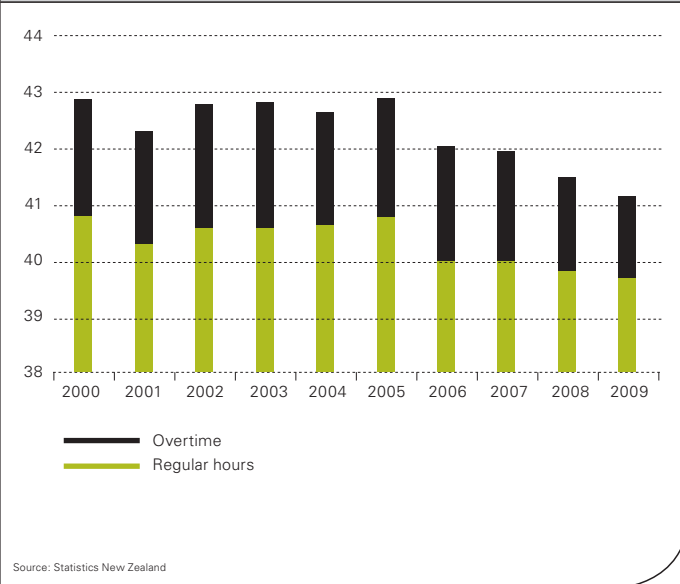


FIGURE 24

AVERAGE WEEKLY HOURS CONSTRUCTION INDUSTRY

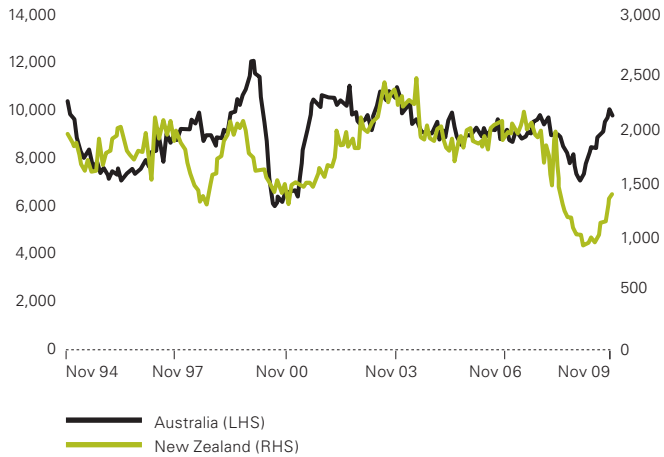


Australia's relative strength is a risk factor

- Australia's economic strength could threaten the New Zealand construction industry in two key ways. First, Australia's housing recovery is further progressed than New Zealand's, which could attract more skilled labour over the Tasman. Second, a strong Australian economy is likely to have an adverse effect on New Zealand's net migration flows – an important driver of new housing demand.
- The single biggest factor behind the recent strong net migration numbers has not been a surge in long-term arrivals, but rather a substantial drop in Kiwis heading offshore (down 21% in the year to November 2009). This could change quickly if overseas employment prospects improve relative to New Zealand, especially in Australia which is the destination for approximately 55–60% of New Zealand migrants.
- New Zealand's unemployment rate has increased to more than 7% for the first time since 1999, well ahead of Australia's rate which fell to 5.5% in the December 2009 quarter. If these trends continue, there is a risk that New Zealanders will head over to Australia in increasing numbers in 2010.

FIGURE 25

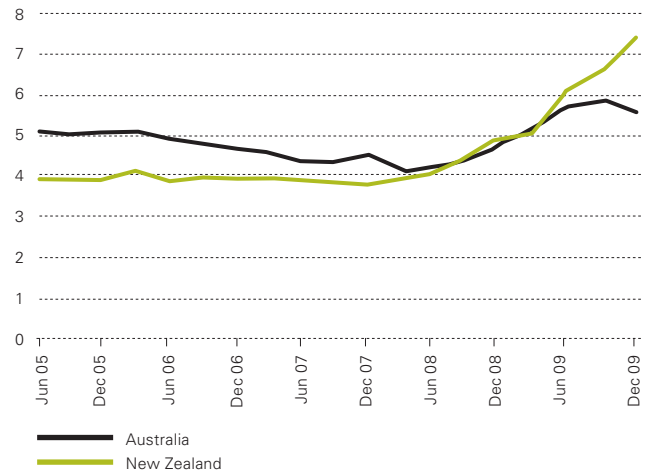
**MONTHLY NEW HOUSING CONSENTS
(SEASONALLY ADJUSTED)**



Source: Statistics New Zealand and Australian Bureau of Statistics

FIGURE 26

**UNEMPLOYMENT RATE
(SEASONALLY ADJUSTED %)**



Source: Statistics New Zealand and Australian Bureau of Statistics

Notes



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