



Department of  
Building and Housing  
*Te Tari Kaupapa Whare*

# When will the building recovery pick up speed?

**Building and Construction Outlook**  
**June quarter 2010**

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## Key themes – June quarter 2010

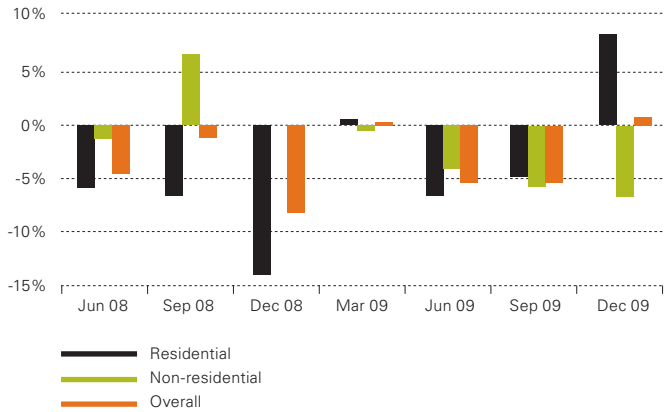
- **The key trends identified in our previous quarterly report were confirmed in the March quarter.**  
Housing consents rose tentatively from a low base and non-residential consents continued to weaken. Recent data showing a rise in residential activity in the December 2009 quarter supported the view that we have passed the bottom in the homebuilding cycle.
- **The industry remains cautious about the outlook for the residential sector.** Although consents rose in the March quarter, the growth trend flattened. Demand was held back due to lack of certainty regarding domestic economic recovery, concerns about rising interest rates and uncertainty surrounding potential changes to the tax treatment of investment property. Despite a lot of pessimistic commentary most businesses exposed to the residential sector are still reporting higher levels of activity than a year ago.
- **The non-residential outlook has worsened over the past six months.** The downward slide in non-residential consents has continued, as a result of high vacancy rates in key commercial sectors and a lack of development finance. There are early signs that the recent stimulus from publicly funded building is coming to an end; public non-residential consents were down 12% for the March quarter compared to 2009.
- **The leading indicators still point to a rise in construction activity in 2010,** although the pace of the recovery was slow and patchy through the first half of the year. Property investors appeared to be waiting on the sidelines until details of tax changes in the May 20 Budget were announced. With the outlook for employment now improving and New Zealand's projected shortage in housing increasing, the fundamentals for an upswing in homebuilding are still in place.

## Turn in the residential cycle confirmed

- Construction activity data for the December 2009 quarter confirmed the turn in the residential construction cycle. Activity levels rose 7.4% following two years of either flat or negative growth. The alterations and additions market was particularly strong, rising 12% in the quarter.
- The non-residential sector is now in decline after being a consistent source of strength over the past five years. Industry feedback suggests the downward trend will continue over the balance of 2010, as one-off public projects roll off and private commercial activity is dampened by high vacancy rates in key commercial sectors and a shortage of finance.
- As we indicated last quarter, the biggest concern currently facing the industry is that the residential recovery will not be strong enough to boost a construction industry which is still picking itself up from the 2008-09 downturn. This is still a risk in the short term. Residential consents rose 32% compared to the March quarter last year, but they are well below mid cycle levels and companies in the building supply chain are still under pressure.
- Given New Zealand's healthy net migration inflows over the past year, a more significant increase in the housing stock is overdue. Despite the current inertia in the market, the underlying drivers of demand should continue to give the industry confidence in the long term outlook.

**FIGURE 1**

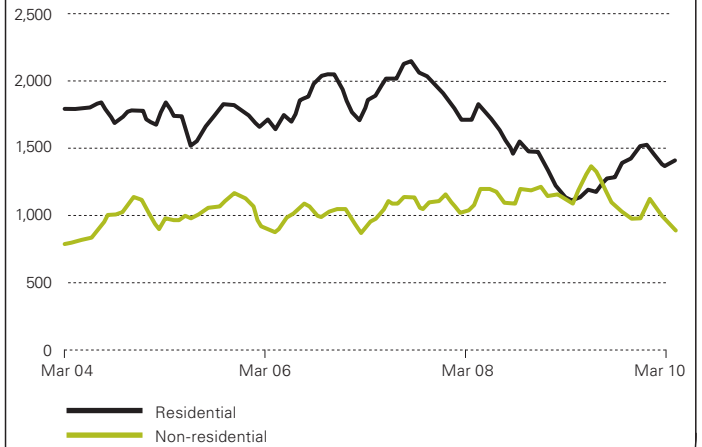
**CONSTRUCTION ACTIVITY (SEASONALLY ADJUSTED, QUARTERLY CHANGE)**



Source: Statistics New Zealand

**FIGURE 2**

**VALUE OF CONSENTS – ROLLING QUARTERLY \$M**



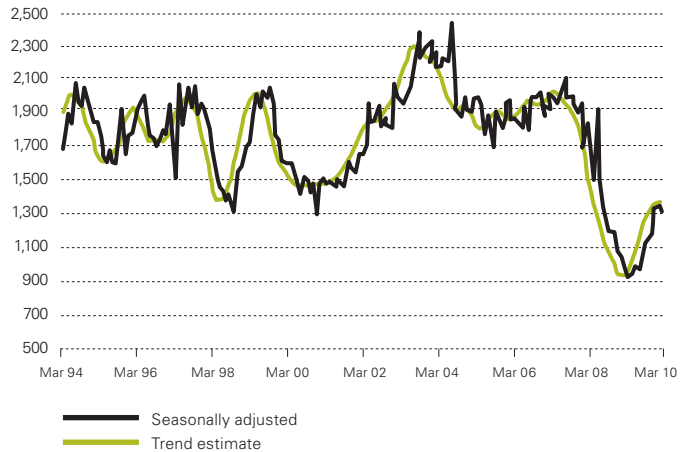
Source: Statistics New Zealand

## But the recovery is slow

- The estimate of trends for housing consents continued to rise in the March 2010 quarter: it is now beginning to level off. Feedback from the homebuilding industry indicates that the level of customer enquiry dropped away in February-March, meaning consents are unlikely to rise significantly in the June quarter.
- Although consents are tracking well ahead of last year, the annualised rate of approximately 16,500 for the first three months of 2010 is well below the average over the past 15 years (23,700). A common view among industry participants is that uncertainty surrounding potential tax changes in the May Budget held back property investment in the short term.
- The outlook for the New Zealand economy has generally improved in the year to date – the drop in the unemployment rate in the March quarter was a particularly encouraging sign. Thus, there is potential for homebuilding activity to gather momentum in the second half of the year.
- The Budget removed the ability to claim depreciation on most residential and commercial properties and tightened tax rules for loss attributing qualifying companies and qualifying companies. The impact of these changes will become apparent over coming months. Initial reaction from commentators was that the changes affecting residential properties were anticipated and will not have a major impact on the sector; though the change affecting commercial properties was unexpected.

**FIGURE 3**

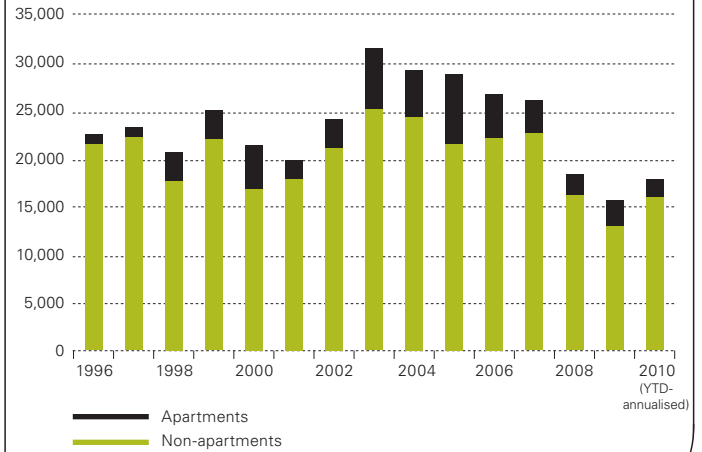
**MONTHLY NUMBER OF DWELLING CONSENTS  
(EXCLUDING APARTMENTS)**



Source: Statistics New Zealand

**FIGURE 4**

**ANNUAL NUMBER OF DWELLING CONSENTS**



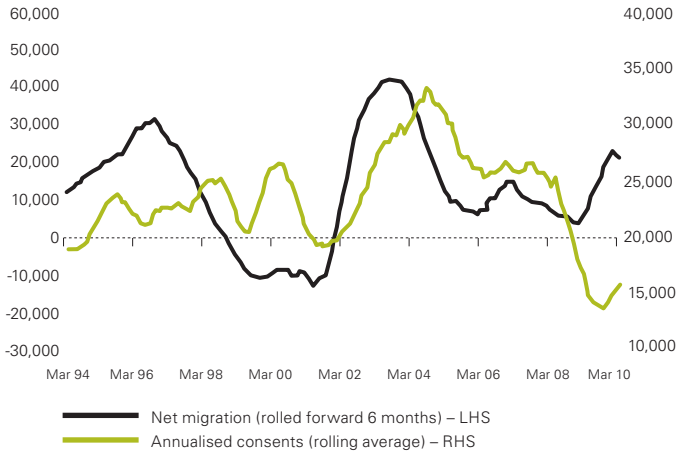
Source: Statistics New Zealand

## Net migration still supportive

- Net migration inflows remain at healthy levels but the rate of growth is slowing. March 2010 was the first month in over a year that net long-term arrivals dipped below 1,000 on a seasonally adjusted basis. Statistics New Zealand's estimate of trends has been in decline since November 2009.
- As we noted in the March quarter report, the recent surge in migration has been primarily driven by fewer departures rather than more arrivals. This could quickly reverse if global economic conditions improve and New Zealanders seek offshore job opportunities again. There are early signs of this occurring, with long-term departures rising off their lows in the March quarter.
- Even if net migration levels fall back from the current rate of 21,400 per year towards the 10-year average of 12,000, most economic forecasters believe New Zealand needs to build at least 20,000–25,000 houses per year to keep pace with its population growth. One such forecaster, BIS Shrapnel, estimates that New Zealand's underlying demand is for 29,000 new houses per annum over the next two years. This suggests the present level of homebuilding is unsustainably low and a backlog of work is steadily accumulating, particularly in high population growth areas like Auckland.

**FIGURE 5**

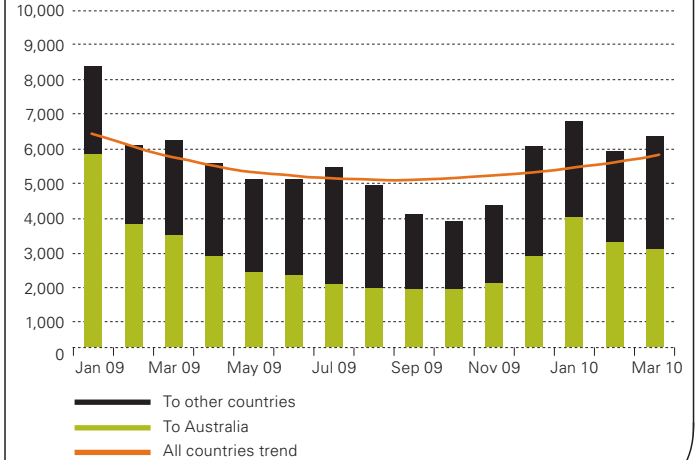
**NUMBER OF HOUSING CONSENTS VS NET MIGRATION**



Source: Statistics New Zealand

**FIGURE 6**

**PERMANENT AND LONG-TERM DEPARTURES (SEASONALLY ADJUSTED)**



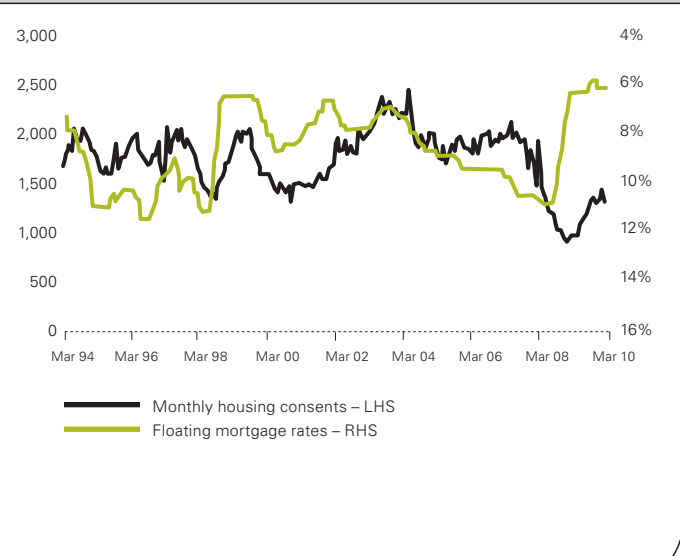
Source: Statistics New Zealand

## Interest rates poised to rise

- Floating mortgage rates have stayed low. They stand at just over 6%, broadly in line with where they sat a year ago. Fixed rates have also levelled out but at much higher levels, particularly for terms of three years or more.
- Early in the year there was some debate over whether the Reserve Bank would postpone raising interest rates until late July. Better-than-expected employment data for the March quarter and the Bank's recent commentary on the strength of global growth has all but ended the debate, and the strong consensus among economists is that cash rates will begin to rise from June.
- Although higher rates are on the horizon, home affordability has continued to improve in recent months. The latest Massey University Home Affordability Report reported that weaker demand from property investors and an increase in residential listings helped boost affordability by 3.9% for the February 2010 quarter. The report also warned about the risk of higher interest rates in 2010 and the potential impact on future affordability.

**FIGURE 7**

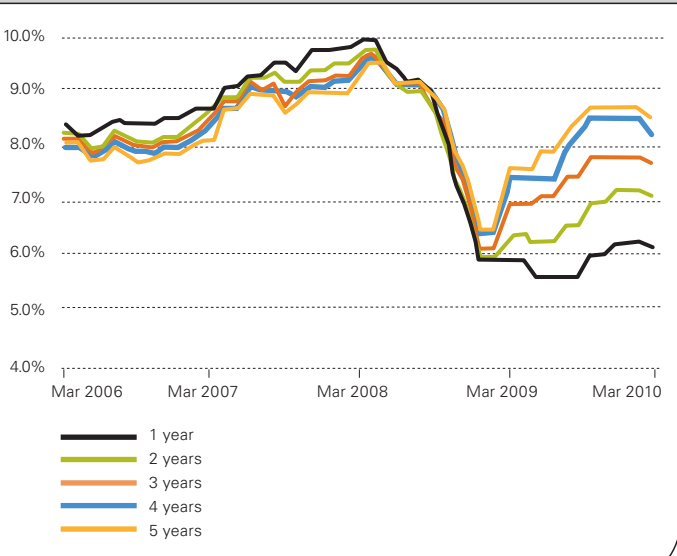
**MORTGAGE RATES VS NUMBER OF DWELLING CONSENTS**



Source: Statistics New Zealand and Reserve Bank of New Zealand

**FIGURE 8**

**FIXED MORTGAGE RATES BY TERM**



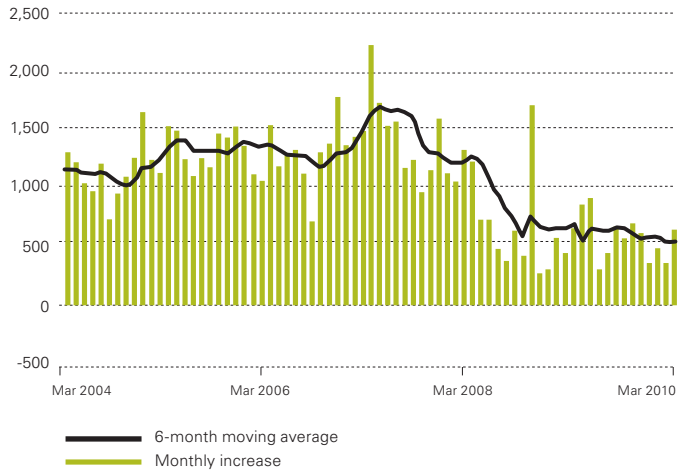
Source: Reserve Bank of New Zealand

## Bank lending falls further

- There is still no sign of a recovery in the home lending market, despite the continued improvement in affordability. It is true that banks tightened their lending criteria post the global financial crisis, making it more difficult to secure a mortgage, but the weakness in home lending appears to be more a consequence of cautious consumers than the banks' actions.
- Speculation about tax changes in the Budget reportedly dampened demand from property investors in recent months. Whether this signalled a structural shift in the market, or simply a short-term anomaly, remains to be seen.
- The unexpectedly sharp dip in the unemployment rate – from 7.1% in the December 2009 quarter to 6.0% in the March 2010 quarter – could foreshadow an increased appetite for household debt. There is potential for pent-up demand to be released if the employment outlook continues to improve and home loan approvals could stage a recovery in the second half of 2010.

**FIGURE 9**

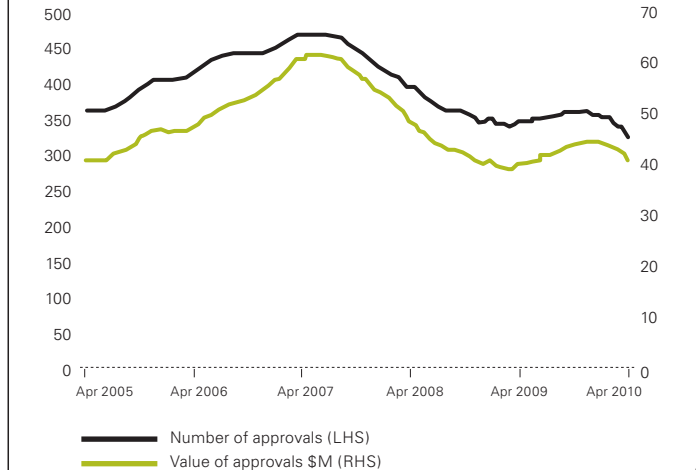
**MONTHLY INCREASE IN HOME LENDING (\$M)**



Source: Reserve Bank of New Zealand

**FIGURE 10**

**HOME LOAN APPROVALS (ROLLING ANNUAL FIGURES)**



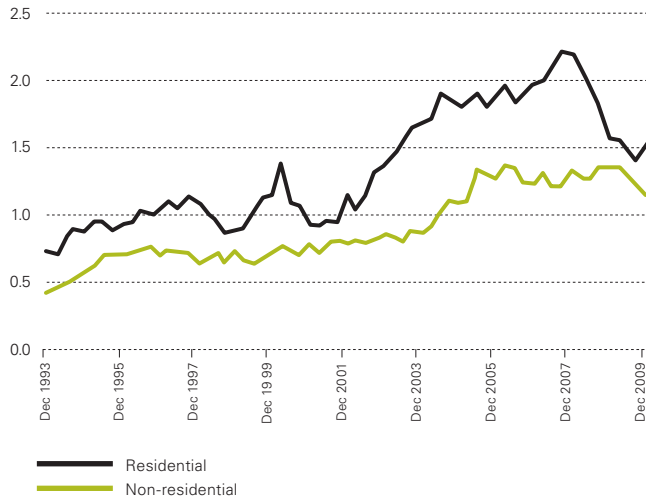
Source: Reserve Bank of New Zealand

## Non-residential in decline

- The non-residential sector is now in decline, with activity levels falling 12.6% during the last two quarters of 2009. Consents for the March 2010 quarter were the lowest since the June quarter 2004 and conditions in the sector are predicted to get worse before they get better.
- The development finance market has not yet recovered from the collapse of the mezzanine finance sector. The major banks are unlikely to plug the gap while vacancy rates in the key commercial sectors – office, retail, industrial – remain high.
- Government spending continues to underpin the sector to some extent, as shown by the consent numbers in the graph, below right. All of the categories that have experienced growth over the past year – hospitals, social buildings, schools – are heavily weighted towards the public sector. However, there are signs of this stimulus coming to an end, with public non-residential consents down 12% for the March quarter versus a year ago.
- Non-residential construction is typically a lagging indicator, so despite increasingly positive signs for the wider New Zealand economy, there is unlikely to be another sustained increase in commercial construction until 2011 at the earliest.

**FIGURE 11**

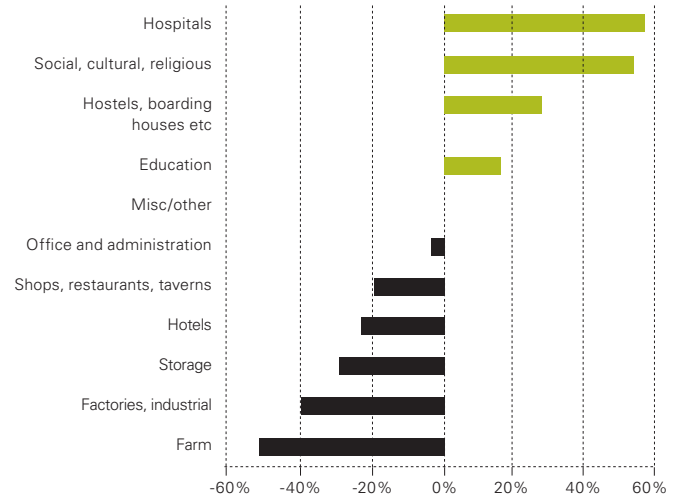
**CONSTRUCTION ACTIVITY (BILLION \$) SEASONALLY ADJUSTED QUARTERS**



Source: Statistics New Zealand

**FIGURE 12**

**NON-RESIDENTIAL CONSENTS ANNUAL CHANGE, 12 MONTHS TO MARCH 2010**



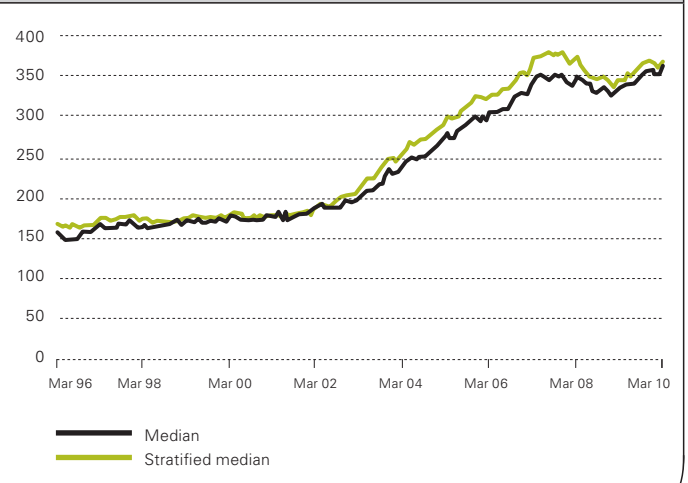
Source: Statistics New Zealand

## House prices holding up

- The property market has quietened in recent months following a brief flurry of activity in late 2009. Median prices in the March quarter were up about 6% on a year ago but sales were down 5%; early indications from the market suggest this sluggishness has carried through into the June quarter. The consensus among real estate agents is that uncertainty surrounding tax changes in the May 20 Budget was a significant factor in the market cooling off. Buyers adopted a wait-and-see approach – particularly at the low end of the scale.
- In the last quarter of 2009, real estate agents were saying that there was no shortage of buyers but a shortage of stock. This changed dramatically in the New Year, as the market flooded with new listings and buyers largely sat on the sidelines. It is significant that prices barely moved despite the big increase in supply, suggesting that at least some vendors were testing the water rather than firmly committing to a sale.

**FIGURE 13**

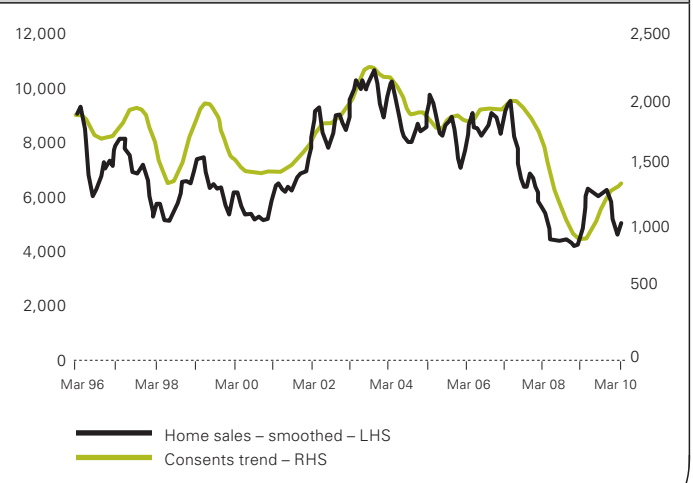
**NEW ZEALAND MEDIAN HOUSE PRICES (THOUSANDS \$)**



Source: Real Estate Institute of New Zealand

**FIGURE 14**

**MONTHLY HOME SALES VS NEW DWELLING CONSENTS**



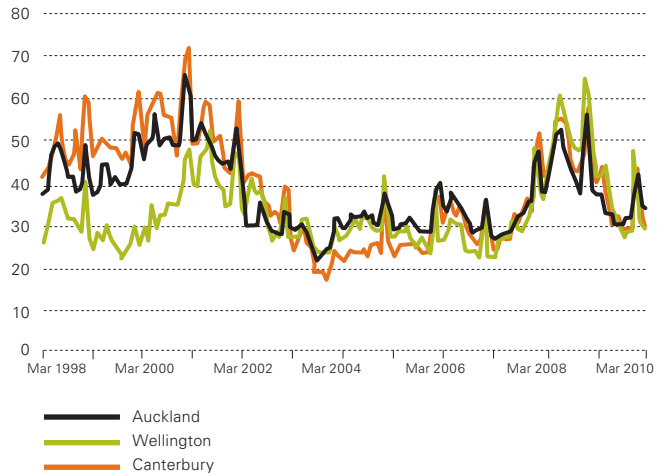
Source: Real Estate Institute of New Zealand

## Home sales unpredictable

- There was some brief media noise in January about a looming property collapse when home sales fell to their lowest level since 1992, and median days to sell jumped from 33 to 43. This only highlighted the pitfalls of reading too much into one month's data. Subsequent months saw home sales recover and the median days to sell drop down to 35, comfortably below the 10-year average of 38.
- House prices have risen in all three major markets in the first three months of 2010, supporting the popular real estate agents' view that properties in sought-after locations are still fetching good prices. While no one is suggesting that the boom times of 2003-07 are on the horizon again, it is worth noting that in the 12 months to March 2010, home sales were up 25%. However, these sales are rising from a very low base, as are consents in the homebuilding sector, and any cyclical upswing is likely to be considerably slower this time around.

**FIGURE 15**

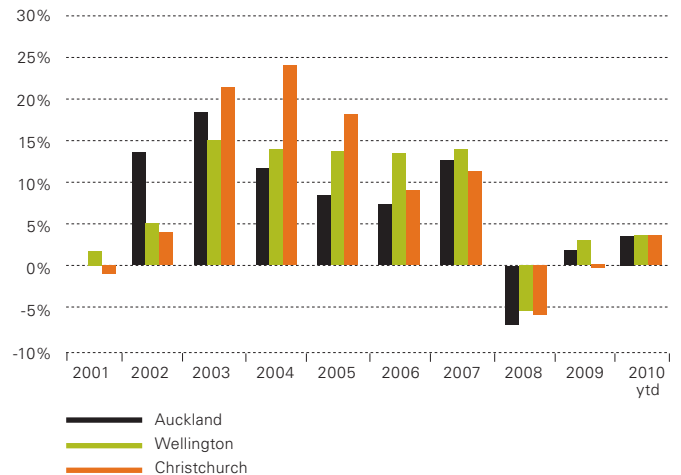
**MEDIAN DAYS TO SELL**



Source: Real Estate Institute of New Zealand

**FIGURE 16**

**STRATIFIED MEDIAN HOUSE PRICES (ANNUAL CHANGE)**



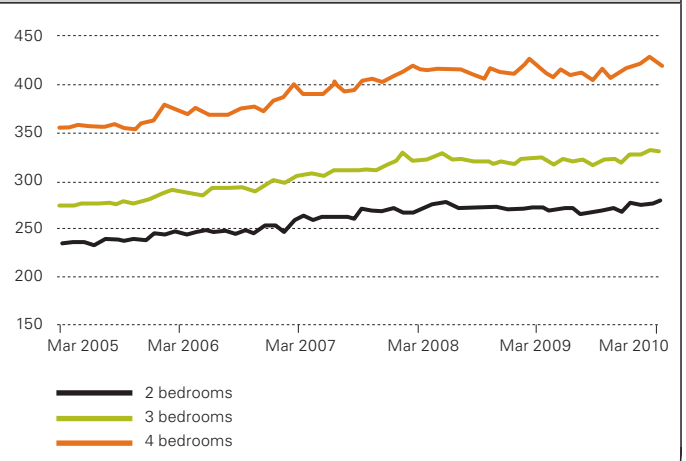
Source: Real Estate Institute of New Zealand

## Rents remain stable, but increases expected

- The apparent supply-demand imbalance in New Zealand's housing market has not yet resulted in upward pressure on rents. This is nothing new, however, since rents have generally tracked inflation for the past decade regardless of what has been happening in the wider housing market. Many economists believe this is because investment property owners are primarily interested in the long-term capital gain on property, rather than maximising short-term yield.
- Wellington was the only major market we track to record any significant rise in average rents over the 12 months to the March quarter 2010. Some markets – notably North Auckland and Christchurch – have actually seen average rents decline.
- Changes to the tax treatment of investment property may change the game in the rental market, making landlords more focused on maximising pre-tax cash flows. Property managers are reporting that demand for rental properties continues to strengthen, therefore the market might be able to accommodate more significant rent rises over the balance of 2010.

**FIGURE 17**

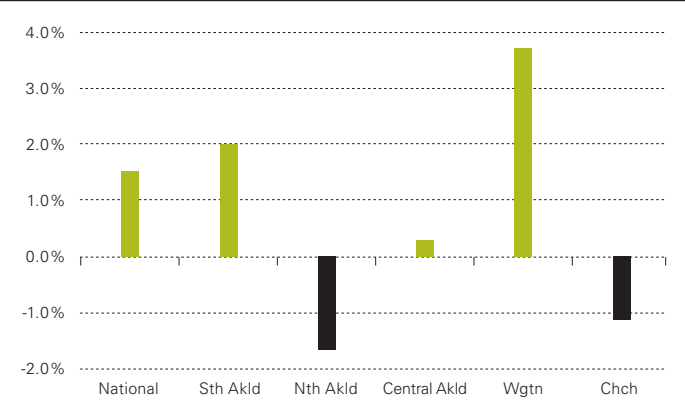
**AVERAGE NEW ZEALAND WEEKLY RENTS (\$)**



Source: Department of Building and Housing

**FIGURE 18**

**MEDIAN RENT INFLATION – MARCH QUARTER 2010 VS MARCH QUARTER 2009**



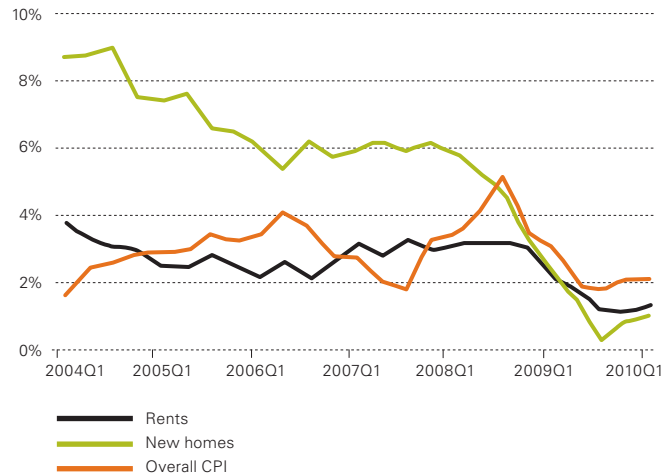
Source: Department of Building and Housing

## The cost of homebuilding set to rise

- Since the residential collapse in 2008, homebuilding costs have not kept pace with inflation. The sharp drop in demand reduced the ability of builders to push through price increases, and the cost of homebuilding subsequently levelled out. While demand is still relatively weak, cost pressures are beginning to build again.
- Timber prices have been rising since late last year as greater demand for export logs puts pressure on the local supply chain. Steel prices are also on the way up and, with margins already tight in the industry, homebuilders may have little choice but to pass these increases on to buyers.
- Subcontractors continue to report pressure on margins and intense competition for jobs. Rising materials costs are likely to keep a lid on margins for the foreseeable future, especially set against a backdrop of weak demand.

**FIGURE 19**

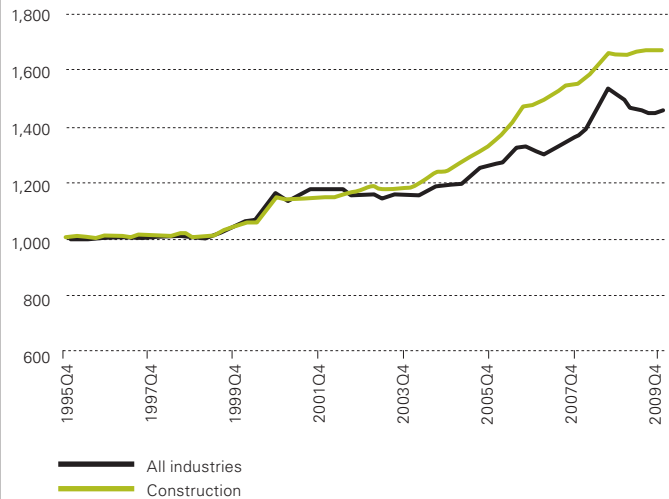
**CPI – HOUSING COSTS**



Source: Statistics New Zealand

**FIGURE 20**

**CONSTRUCTION INPUT COSTS – PPI**



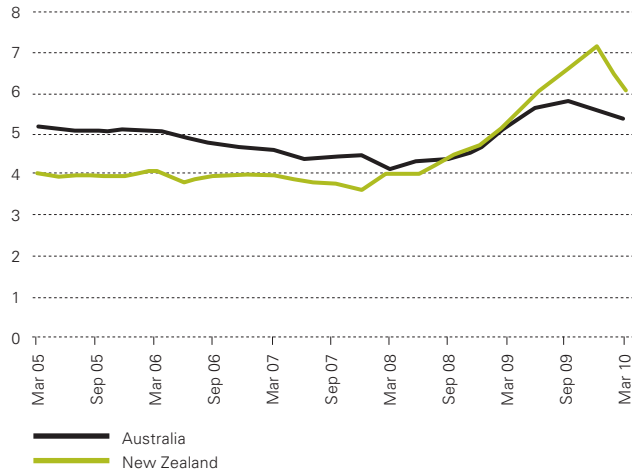
Source: Statistics New Zealand

## An encouraging fall in unemployment

- There were a number of factors supporting a residential construction recovery in the latter half of 2009 – namely, strong net migration levels, relatively low interest rates, and stabilised homebuilding costs. The one glaring negative was the unemployment rate, which peaked at 7.1% in the December 2009 quarter (from 4.6% a year earlier).
- The muted response in demand to the positive drivers mentioned above highlights the importance of employment expectations in the homebuilding equation. The argument is that even if financing is cheap and building costs are low, people don't sign up for mortgages if they fear they could lose their job in the near future.
- The unemployment rate dropped sharply to 6.0% in the March quarter, catching most economists off guard. It is welcome news for the homebuilding industry in two key ways. First, it should encourage greater confidence among homebuyers who have been sitting on the sidelines. Second, it helps keep skilled construction labour at home, which is particularly important given the strong employment opportunities in Australia. Although it is very early days for the recovery, there are signs that the construction industry is beginning to hire again; the number of employees rose from 170,000 to 177,000 over the past two quarters.

**FIGURE 21**

**UNEMPLOYMENT RATE  
(SEASONALLY ADJUSTED %)**



Source: Statistics New Zealand and Australian Bureau of Statistics

**FIGURE 22**

**EMPLOYMENT INDEX  
(1997 = 100)**



Source: Statistics New Zealand

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