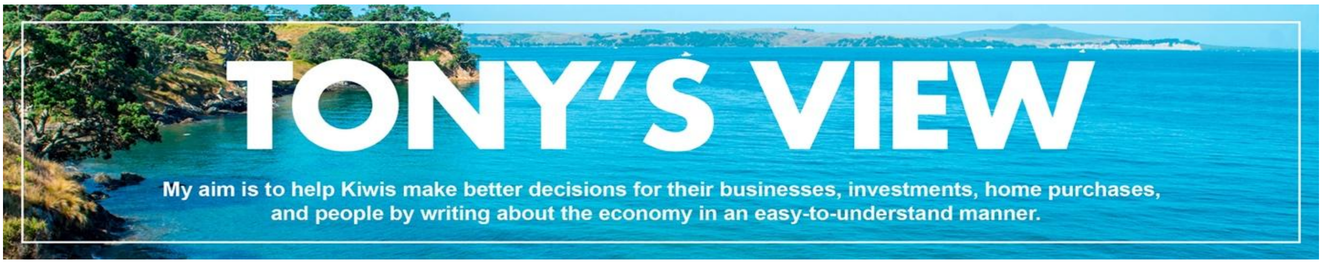


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ISSN: 2703-2825 27 March 2025

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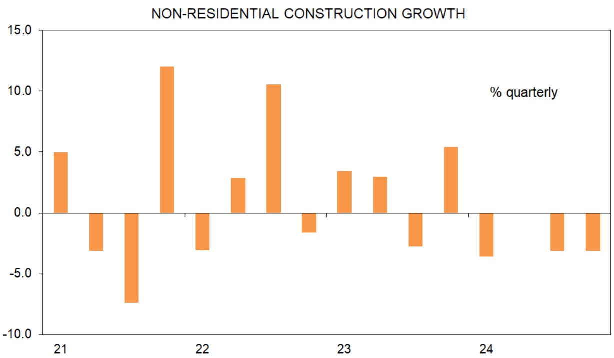
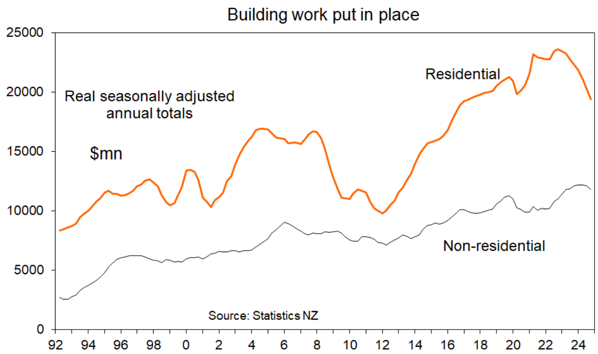
# Bottoming of the commercial building cycle

How are things looking with regard to commercial construction? First, the data tell us that weakness has been dominant recently. The volume of non-residential construction work undertaken fell by a large 9.5% in the December quarter last year which is quite a contrast to the surprisingly strong 0.7% growth recorded for the economy overall.

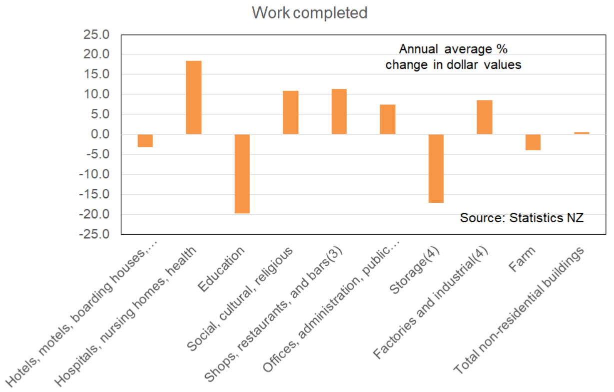



This decline followed smaller falls in the previous two quarters and means that construction of things like hotels, schools, shops, restaurants, factories, warehouses, offices etc fell all up by 2.7% last year whereas the economy shrank by 0.5%.

So, it is fair to say that the sector has well under-performed over the past year. But as the following graph shows using data from 1992, this sector does not tend to run through the same cycles as residential construction does. The recent decline of 2.7% is actually very mild compared with the 12.9% fall in house building.



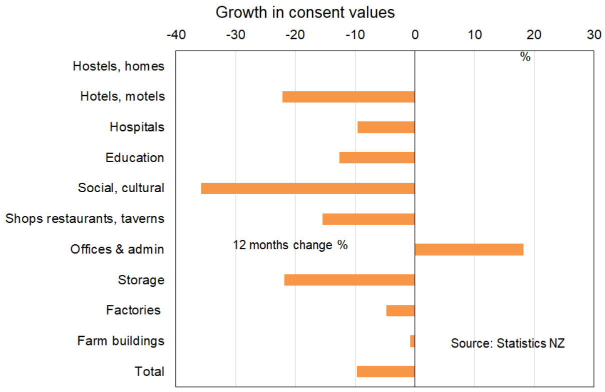

We don't have work done in volume terms for different types of buildings, but we do in dollar terms and the changes in 2024 from 2023 are shown here.


Greatest weakness has occurred for education buildings and storage facilities – which is a tad surprising considering the strong focus on logistics in recent times. Greatest 2024 strength was in the health sector.

To get a feel for what lies ahead we can look at the data on values of consents issued for different buildings reported by Statistics New Zealand.

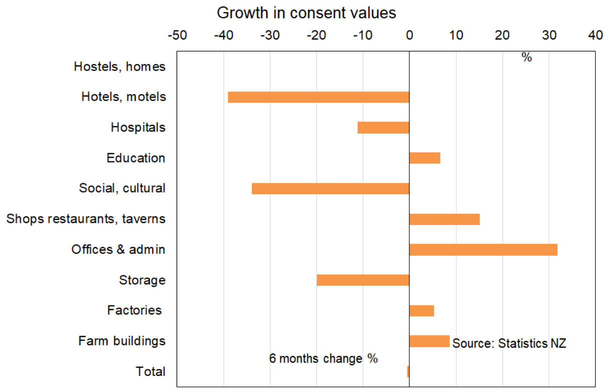
I have stripped out the 142% rise for the top category of hostels, boarding homes etc. as it distorts the picture, and the category is the smallest of all at $191m for the year to January versus $8.9bn across all non-residential building types – just 2.1%.



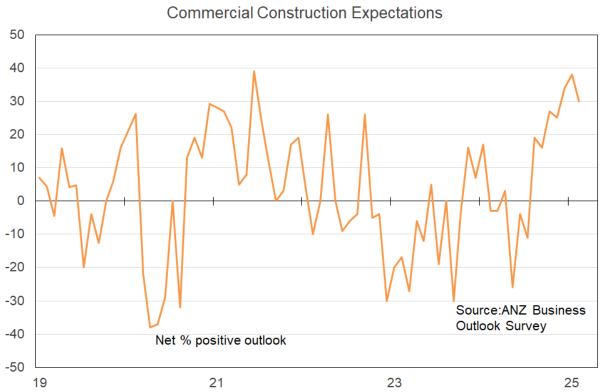

We can see that in the past year there has been good growth in the value of consents issued for offices and admin buildings. But for all other meaningful categories declines have occurred.

I can try and weaken the poor outlook implication by looking at the three months to January versus a year earlier and noting growth of 0.8%. But these numbers are highly volatile and at the individual category level such a comparison would be unwise.

But if we do this for the past six months we get a smell of growth for offices, shops, factories, farm buildings, and education facilities. Again I have removed the hostels category which shows growth of 283% as it messes up the picture.



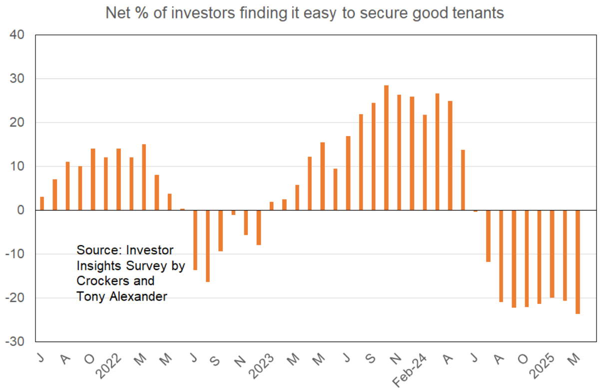

For now the prospects for commercial construction look muted. However, in the ANZ's Business Outlook Survey for February a net 30% of businesses in the construction sector said they expect higher levels of activity in the next 12 months compared with a net 3% a year agio saying they expected things to worsen.


So, we have probably about reached the bottom of the cycle for the non-residential construction sector. An upturn beckons of uncertain magnitude, but I suspect some upside risk exists as businesses increasingly think about how to boost productivity and streamline their logistics.

## Rental market in favour of tenants

This week I have released the results of my March survey of existing residential property investors undertaken with support from Crockers Property Management. The key things people might usefully note include the fact that a record net 24% of landlords say it is hard to find a good tenant.

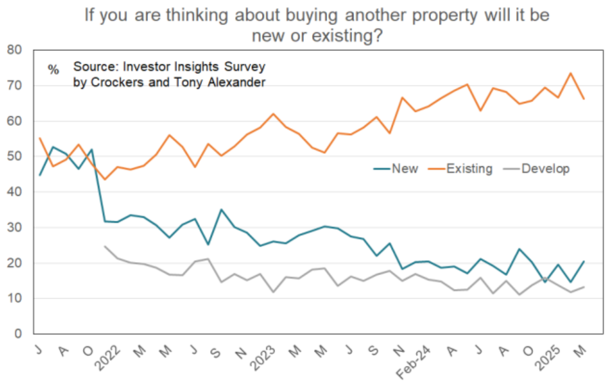



A year ago a firm net 27% said it was easy. So, the nationwide rental market has been turned on its head over the past year, probably because of two things.

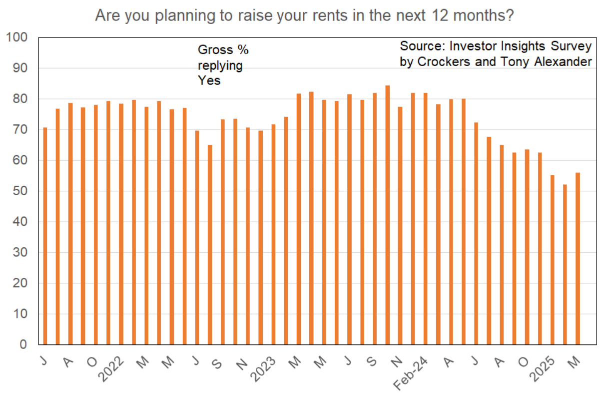
First, net migration has changed strongly since the record net gain of 135,000 people in the year to October 2023. The annual gain now is 32,000 and looks like plateauing.

Second, there is an over-supply of townhouses in Auckland and Christchurch and some developers have put a part of their unsold stock into the rental pool.

Another key point to come out of this survey is that interest from existing landlords in purchasing a new-build or undertaking a development themselves remains low. The following graph shows this in the form of the decline in the blue and grey lines.



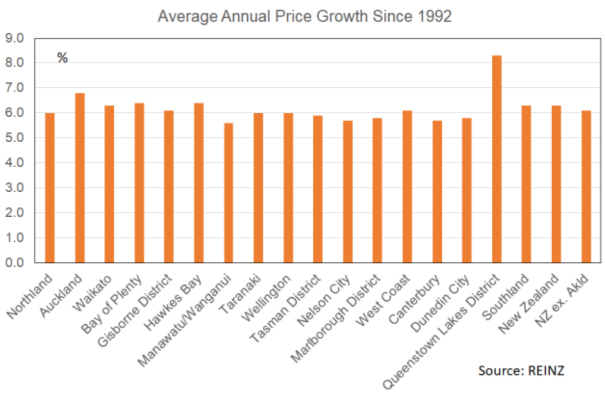

Finally, it looks like many landlords have yet to adjust their rent rise expectations to the shift in the market. What I think is a relatively high net 56% still say they plan raising their rents. Good luck.




## Corrected number

Two weeks ago here I penned a small piece discussing the average nationwide increase in house prices since 1992. I referred to prices rising on average by 7.2% per annum but that is actually how many times prices in 2024 were a multiple of where they were in 1992. The average rise per annum has been 6.3% a year and not 7.2%. Going forward to 2057 the average rise will be closer to 5.5% than 6.3% I suspect because of things like

-the absence of a three decade decline in interest rates
-greater regular supply of new-builds
-greater availability of land,
-introduction of DTIs.



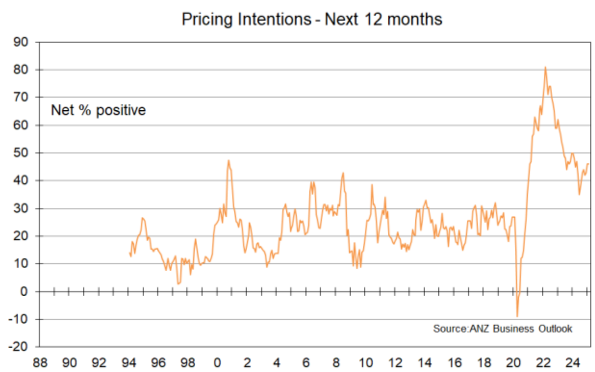

The table I printed a month back showing average price gains per annum nationwide and for all the regions was correct and I repeat it here.

| | Average annual rise in prices 1992-24 |
|---|---|
| Northland | 6.0% |
| Auckland | 6.8 |
| Waikato | 6.3 |
| Bay of Plenty | 6.4 |
| Gisborne District | 6.1 |
| Hawkes Bay | 6.4 |
| Manawatu/Wanganui | 5.6 |
| Taranaki | 6.0 |
| Wellington | 6.0 |
| Tasman District | 5.9 |
| Nelson City | 5.7 |
| Marlborough District | 5.8 |
| West Coast | 6.1 |
| Canterbury | 5.7 |
| Dunedin City | 5.8 |
| Queenstown Lakes District | 8.3 |
| Southland | 6.3 |
| **New Zealand** | **6.3** |
| NZ ex. Akld | 6.1 |


## If I were a borrower, what would I do?

I still have a lot of my attention directed towards the ANZ's monthly Business Outlook survey measure of business pricing plans. As repeatedly noted here for many months the high net proportion of businesses saying they plan raising their prices within a year is cause for concern.

On average since inflation started averaging 2.3% in 1992 a net 26% of businesses have said they plan boosting their prices. That measure now stands at 46% having seemingly bottomed out this cycle at 35% in the middle of last year.

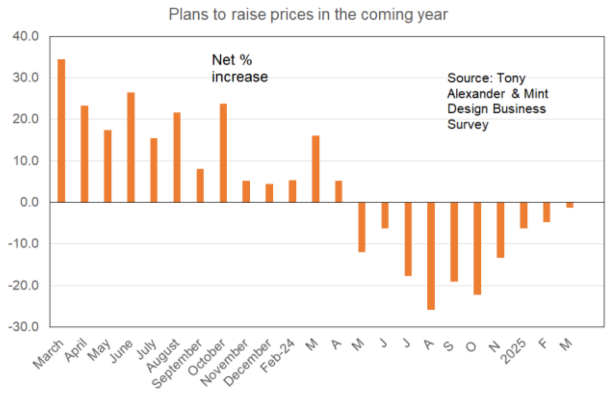



With any luck this trend back up for the past few months is simply the last gasp of cost pressures being brought to bear in management plans. But this hope is somewhat challenged by the net 70% or so of businesses who say they expect their costs to go higher.

The key here is this. If cost pressures remain strong and margins under pressure when extra customers start coming through the door we will see a potentially quick rebound in inflation.

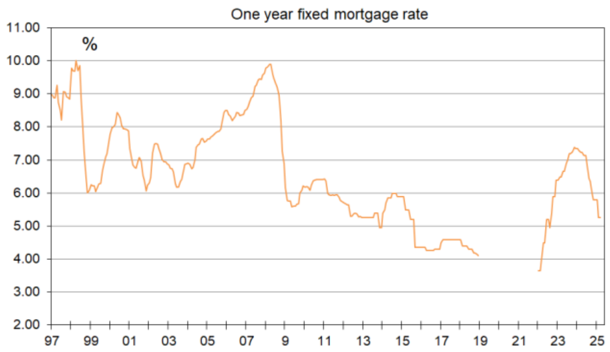
At this stage the outlook for customer flows is not particularly strong so the cyclical recovery in inflation is not imminent. There remain a few quarters yet for businesses to boost their productivity in order to handle the cost rises which have occurred and those yet to come.

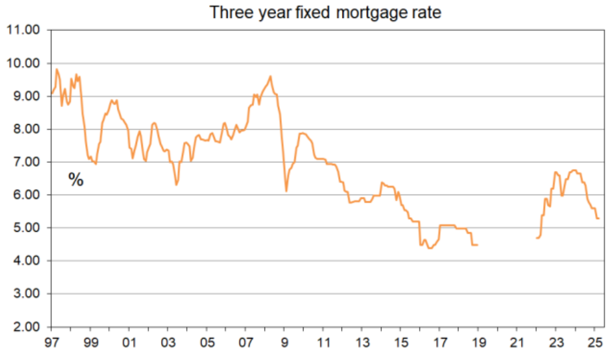
But the trend highlighted in my monthly survey of businesses with Mint Design is not good. Very slowly fewer businesses are indicating they have no plans to cut prices or hold them steady.

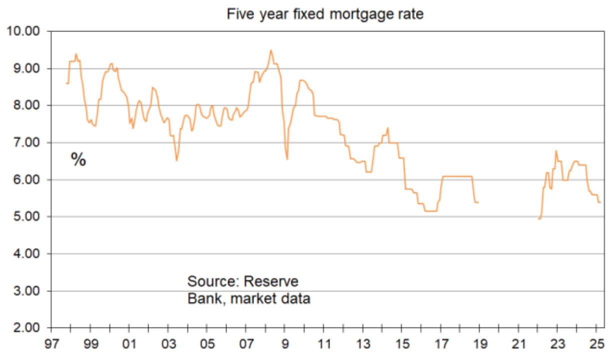



If I were borrowing at the moment, I would probably fix two years at 4.99% but might wait a bit in case the 4.99% three year rate were to return again.

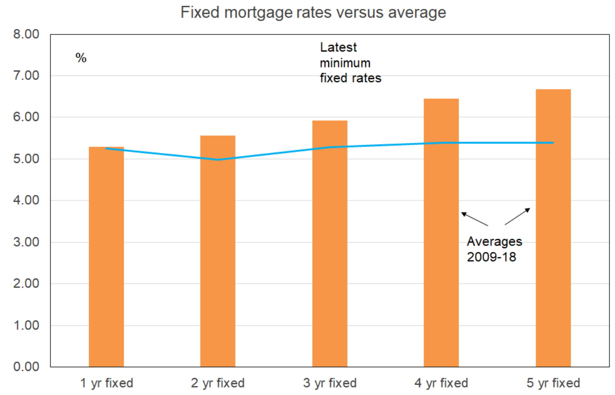
These three graphs show mortgage rates since 1997 excluding the period of deflation worries (2019) and the pandemic.



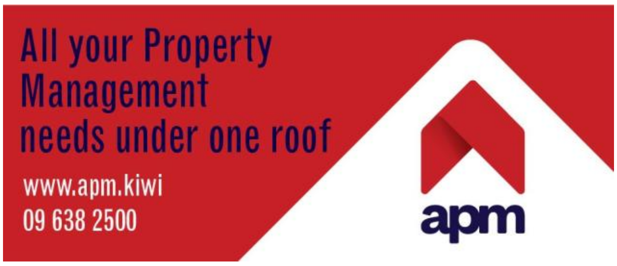




This graph shows how current rates compare with averages from 2009-19.




To see the interest rates currently charged by major lenders go to www.mortgages.co.nz

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