

INFRASTRUCTURE
AND BUILDINGS
CONSTRUCTION
SURVEY

Sentiment

2H
2012

NEW ZEALAND

IN THIS ISSUE

Where is investment expected to increase?

Which sectors will see growth?

What will drive investment?

What are the key risks for the industry in 2013?

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THE REVIEW

A growing optimism is evident across several sectors of New Zealand's building and infrastructure industries, as found in our latest survey.

AECOM's survey of industry leaders and decision makers (our second for the infrastructure market, and eighth for buildings) combines, for the first time, the findings into one report, enabling comparisons between the sentiments in these two markets. Our research identifies many opportunities and challenges in the infrastructure and buildings markets, some of which are shared. Industry workloads, investment priorities and regional analysis are examined separately for each market, while a combined view of market pressure points and drivers offers an improved understanding of decision-making in New Zealand's construction industry.

This survey shows a more promising outlook for New Zealand's building construction market in 2013. Marginal improvements in workload expectations continue, even in areas outside of Canterbury.

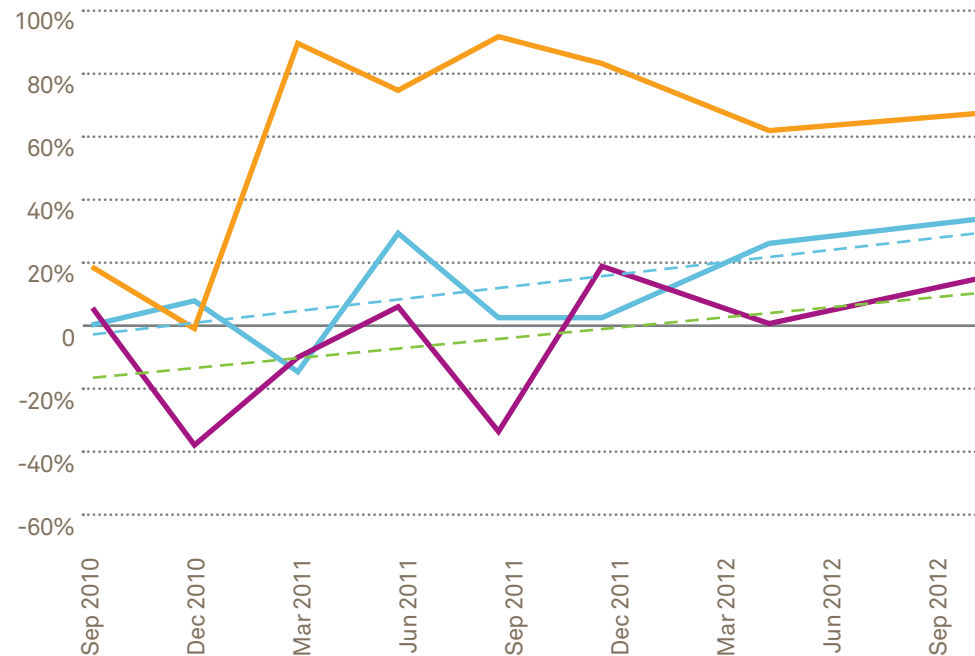
Views on the investment side of the industry — consisting of public authorities and private investors — have significantly improved for both the infrastructure and buildings markets, compared to our previous survey in May 2012. However, despite these anticipated improvements in workload, both markets remain cautious that not all prospects will translate into new projects in the near term.

Significant planning and scheduling of works is still required before many see a robust lift in project work. Meanwhile, the industry faces the conflicting pressures of rising costs and shrinking margins — a situation that could dampen the recent lift in sentiment if current infrastructure and local authority plans stall.

Workload expectations trend

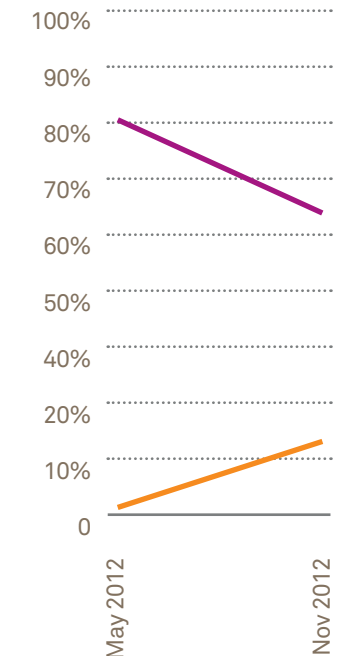
Buildings market 8th industry survey

Christchurch
Wellington
Auckland



Infrastructure market 2nd industry survey

Investment market
Delivery market



Note: Buildings market – based on a net measure of future workload expectations for the following 12 months. Infrastructure market – based on a net measure of expectations for the following 3 years.

KEY INDICATORS

INFRASTRUCTURE MARKET

Investment market expectations

13%

13 percentage point improvement in net investment expectations since May 2012 survey

Delivery market expectations

-18%

-18 percentage point fall in net workload expectations from the delivery market since May 2012 survey

Telecommunications anticipated to lead growth

63%

63 percent expect telecommunications to be the dominant infrastructure sector over the next 12 months

Roads viewed as a priority

35%

35 percent believe roads should be the number one infrastructure priority for the nation

BUILDINGS MARKET

Net expectations

8%

8 percentage point improvement in net workload expectations since May 2012 survey

Investment market expectations

50%

50 percent of the investment market expect increased expenditure in 2013, up from 14 percent in 2012

Public sector projects rise

28%

28 percent of projects are expected to be funded by the public sector in 2013, up from 16 percent in 2012

Existing buildings prospects

74%

74 percent nationally expect increased investment in existing buildings over the next 12 months

INFRASTRUCTURE MARKET

EXPENDITURE AND WORKLOAD EXPECTATIONS

There has been considerable disparity among the experiences of infrastructure industry participants over the past 12 months. Those delivering projects were polarised between improving and worsening conditions, with no consistent view of the market prevailing; 39 percent saw workloads increase, while 42 percent experienced declining workloads.

Looking ahead, there is a promising shift in the outlook for new project funding. Since May 2012, there has been an increase in investment market respondents expecting to introduce new capital — up from 35 to 42 percent.

Improvements in investment expectations are partially linked to the release of the Christchurch Blueprint — an important step towards delivering the rebuild (covered in detail on page 10).

Given the tight conditions in recent years, it is not surprising the delivery market remains optimistic the ‘only way is up’. Although positive expectations were pared back, they remain high — falling only 10 percentage points to 73 percent since the May 2012 survey.

However, respondent concerns associated with further declines in global financial conditions, the flow-on effects of reduced output from China, and the decline in Australian mining market investment, are beginning to weigh on expectations.

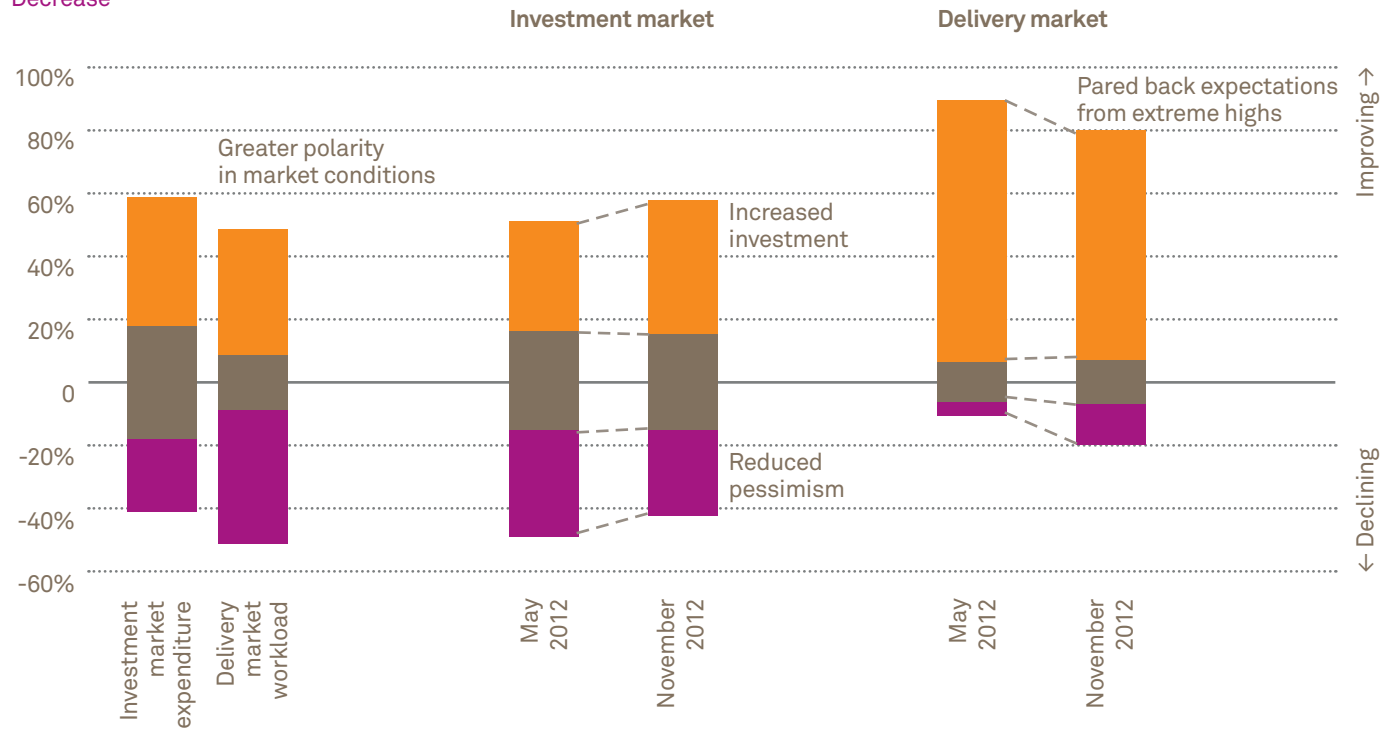
Infrastructure workload and investment expectations

Over the last 12 months

3 year expectations

Change in expectations between May 2012 and November 2012 survey

Increase
Steady
Decrease



WORKLOAD BY REGION



In general, projections across the infrastructure market are for moderate growth; however, there are hot spots to consider. Canterbury and the Upper North Island are expected to receive the lion's share of investment with 66 percent and 47 percent, respectively, anticipating increased workloads.

The Roads of National Significance project will take a considerable slice of funding, while investment in water and wastewater across the nation is also planned to rise.

Water infrastructure is a key focus of the National Infrastructure Plan, which aims to address several issues in the infrastructure sector. For example, water services are currently provided by a number of local authorities who face competing demands in terms of funding.

There will also be significant ongoing investment in the Ultra-Fast Broadband network. As in our May 2012 survey, this continues to rank as a major source of work across the regions.

The release of the Christchurch Central Recovery Plan (CCRP), including the Christchurch Blueprint Plan, has significantly improved local sentiment about land development, with positive workload expectations rising from 66 percent to 94 percent of respondents since our May 2012 survey. Some expect work to wind back in sectors such as energy as a result of this concentrated spending on road and land works, and the asset sales programme.

 Central Government's focus on asset management is helping to deliver 'more for less' and improve productivity within the sector. But this strategy needs a balanced, long term view that considers service provision, capital and operating expenditure. 

**Ian Martin, Regional Manager
Wellington, AECOM**



The CCRP significantly improved positive workload expectations for local land development with sentiment rising from 66 percent to 94 percent

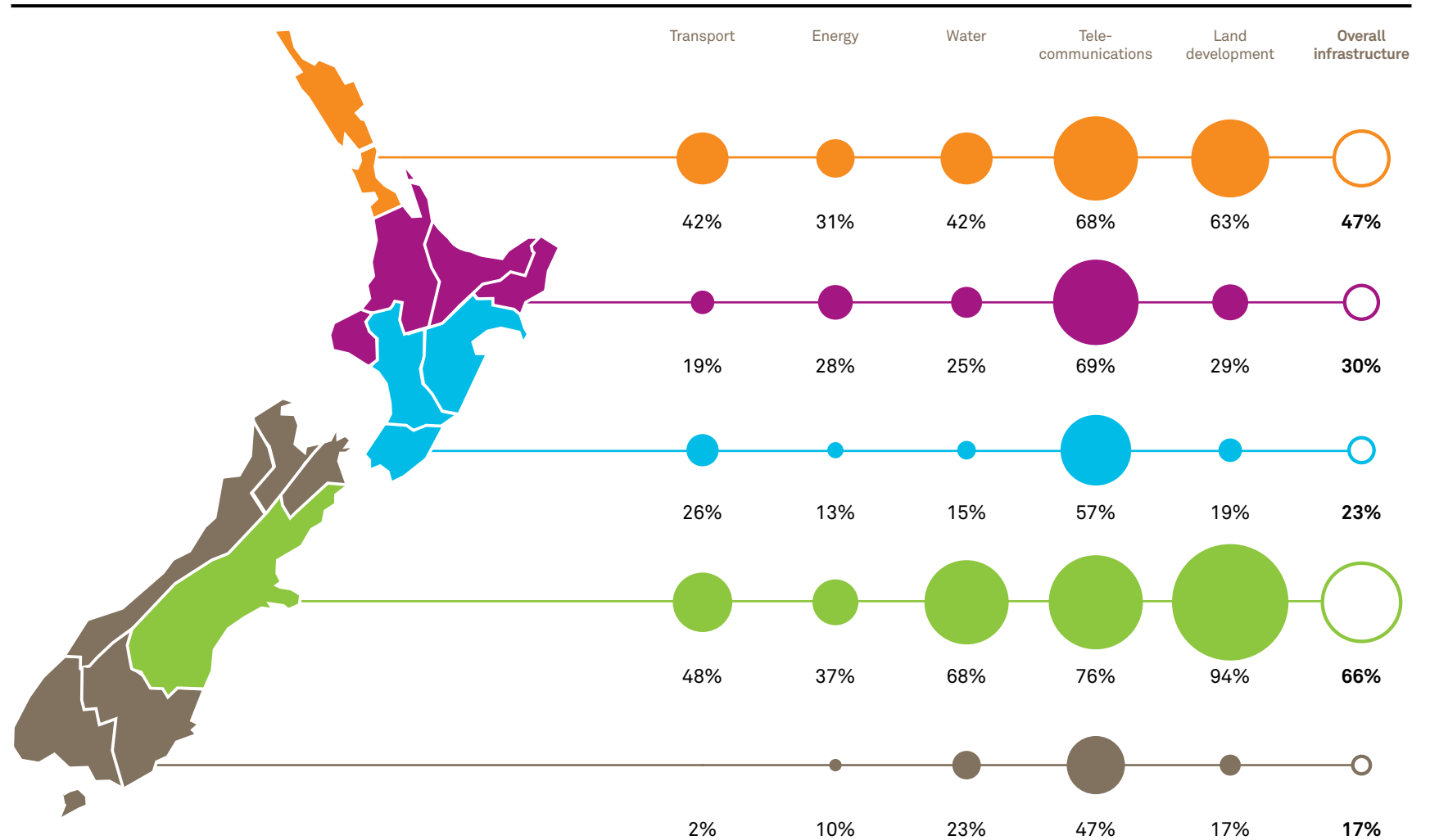
Proportion of respondents expecting increased investment by region

47%

47 percent of Upper North Island respondents are anticipating an increase in infrastructure investment

66%

66 percent of respondents in Canterbury expect increased infrastructure investment



📌 The Roads of National Significance is a substantial investment for the Central North Island; however, investment in other infrastructure remains subdued as local councils struggle with debt burdens and reduced council revenue from developer contributions. 📌

Craig Davidson, Regional Manager – Waikato & Bay of Plenty, AECOM

INFRASTRUCTURE PRIORITIES

The perspectives of the infrastructure industry — those who directly invest in or deliver projects — provide a valuable understanding, an inside view, of why certain investments would help keep the nation productive, beyond political imperatives or simplified payback assessments.

When respondents were asked what the nation's infrastructure priorities should be (if money was no object), three common themes were found: transport, place-making and infrastructure resilience.

Transport

Many saw room for improvement in the transport sector. The Roads of National Significance programme was expected to bring about greater efficiencies (and alleviate safety concerns), while rail investment was also seen as a key solution to improved freight operations, especially given its success in other countries.

Place-making

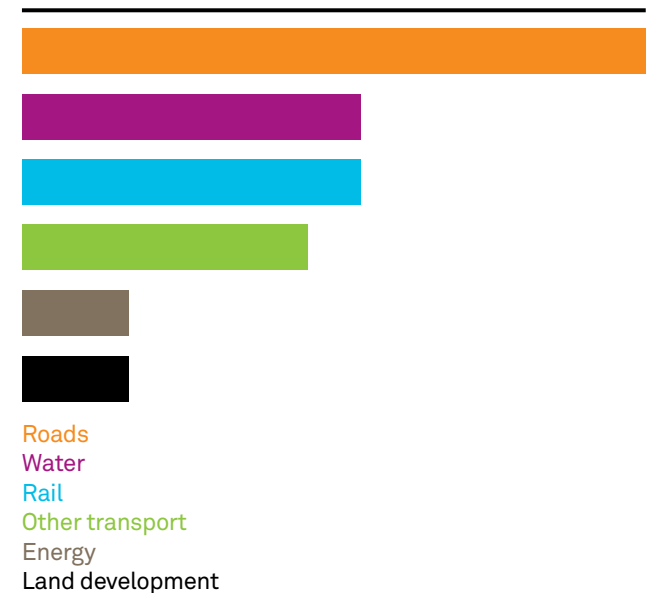
Respondents urged authorities to consider more integrated urban transport solutions that create a sense of place by actually reducing the amount of travel required by residents. This would lead to improved economic growth in more highly-populated areas.

Infrastructure resilience

Infrastructure resilience was a key concern for participants across all infrastructure asset classes, and is also a key priority in the National Infrastructure Plan.

There is a need to catch up on years of under-investment; effective drainage systems for waste and stormwater must be developed, while older bridges require strengthening for proofing against higher earthquake thresholds. This investment will help prepare the nation against the ongoing risk of environmental impacts.

Infrastructure priorities by sector



BUILDINGS MARKET

EXPENDITURE AND WORKLOAD EXPECTATIONS

The outlook for the buildings sector has improved significantly since our survey in the first half of 2012. Overall, respondents expecting increased building workloads jumped from 39 percent earlier in the year to 53 percent in our November 2012 survey.

Many are expecting an upturn in the near future, albeit from a very low base, considering recent work volumes. There are increased numbers seeing renewed interest in certain sectors, such as residential, education and health.

A notable shift has occurred in the investment market, with the proportion expecting an increase jumping from 14 to 50 percent compared to earlier in the year. In this case, many participants have shifted their view from a neutral outlook.

The delivery market continues to be more optimistic than the investment market about improving workloads over the next 12 months, with 55 percent expecting an increase. Expectations for the coming year exceed what was witnessed earlier in 2012. However, many respondents explained that “delays were preventing these prospects from being converted to bankable projects”. This is creating an environment of cautious optimism rather than bankable optimism.

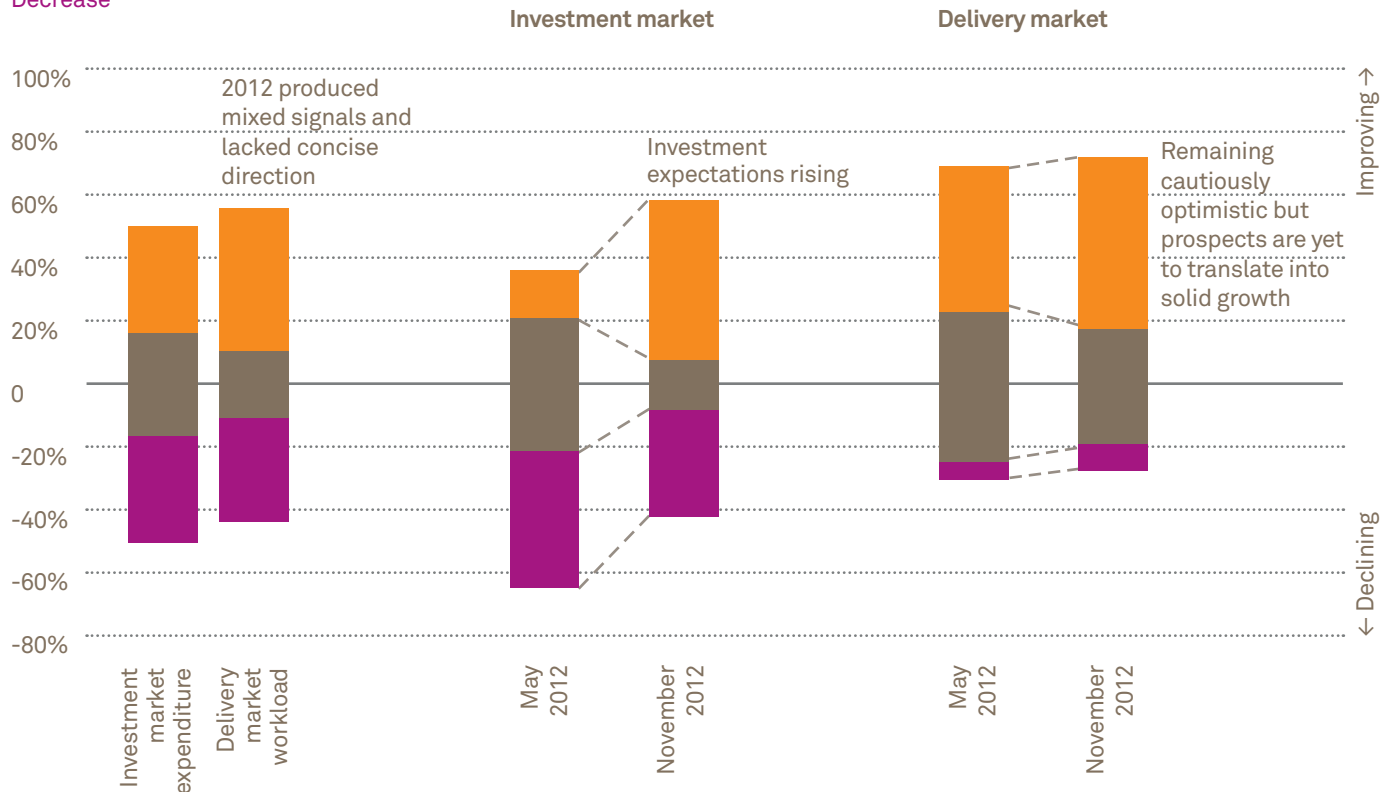
Buildings workload and investment expectations

Over the last 12 months

12 month expectations

Change in expectations between May 2012 and November 2012 survey

Increase
Steady
Decrease



Note: Measures of improving or declining expectations represent the proportion of respondent views on market direction – not the actual anticipated change in workloads.

WORKLOAD BY REGION AND SECTOR

An increase in optimism about public sector funding of projects is driving positive views in the buildings sector. Since May 2012, the 12 month projection for public sector investment has increased from 16 to 28 percent, although a notable proportion of this is likely to be associated with the release of the Christchurch Blueprint.

Beyond the Canterbury rebuild work, more than half of those from the North Island are expecting a rise in building sector work. The Lower North Island region is particularly optimistic about a positive shift — 40 percent are expecting building workloads to rise by more than 20 percent in the coming year.

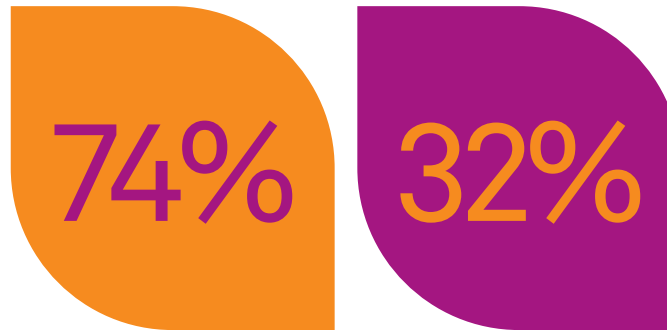
Meanwhile, there are other indicators of market strength, particularly in existing buildings and the residential market (for further details see the chart on page 9).

Existing buildings

Existing building work is expected to pick up considerably over the coming year; at a national level, 74 percent of respondents anticipate rises in this market.

Measures across the nation to deal with earthquake-prone building vulnerabilities mean some assets in the secondary commercial market will be given a new purpose or will require significant investment in remediation.

In contrast, there are few signs of any uplift in new office market developments and only 32 percent of respondents expect to see more investment in this area.



74 percent of respondents anticipate rises in existing building work over the coming year

Only 32 percent of respondents expect to see more investment in new office developments

Residential

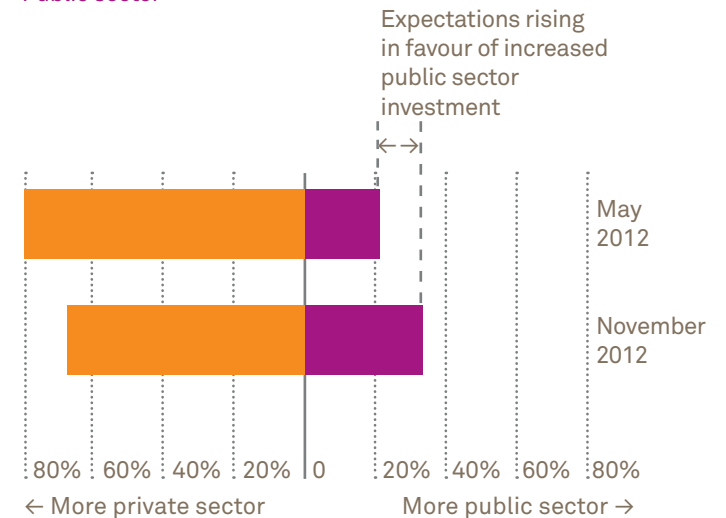
Auckland’s residential market continues to strengthen. The city’s house prices are up 7.2 percent this past year (according to Quotable Value), which is creating positive market conditions for new supply.

This momentum is reflected in the Statistics New Zealand new residential building consents which are up 31 percent in the year to November 2012, compared to the corresponding period in 2011. This trend will be aided by recent government measures to lower development costs and the favourable outlook for interest rates.

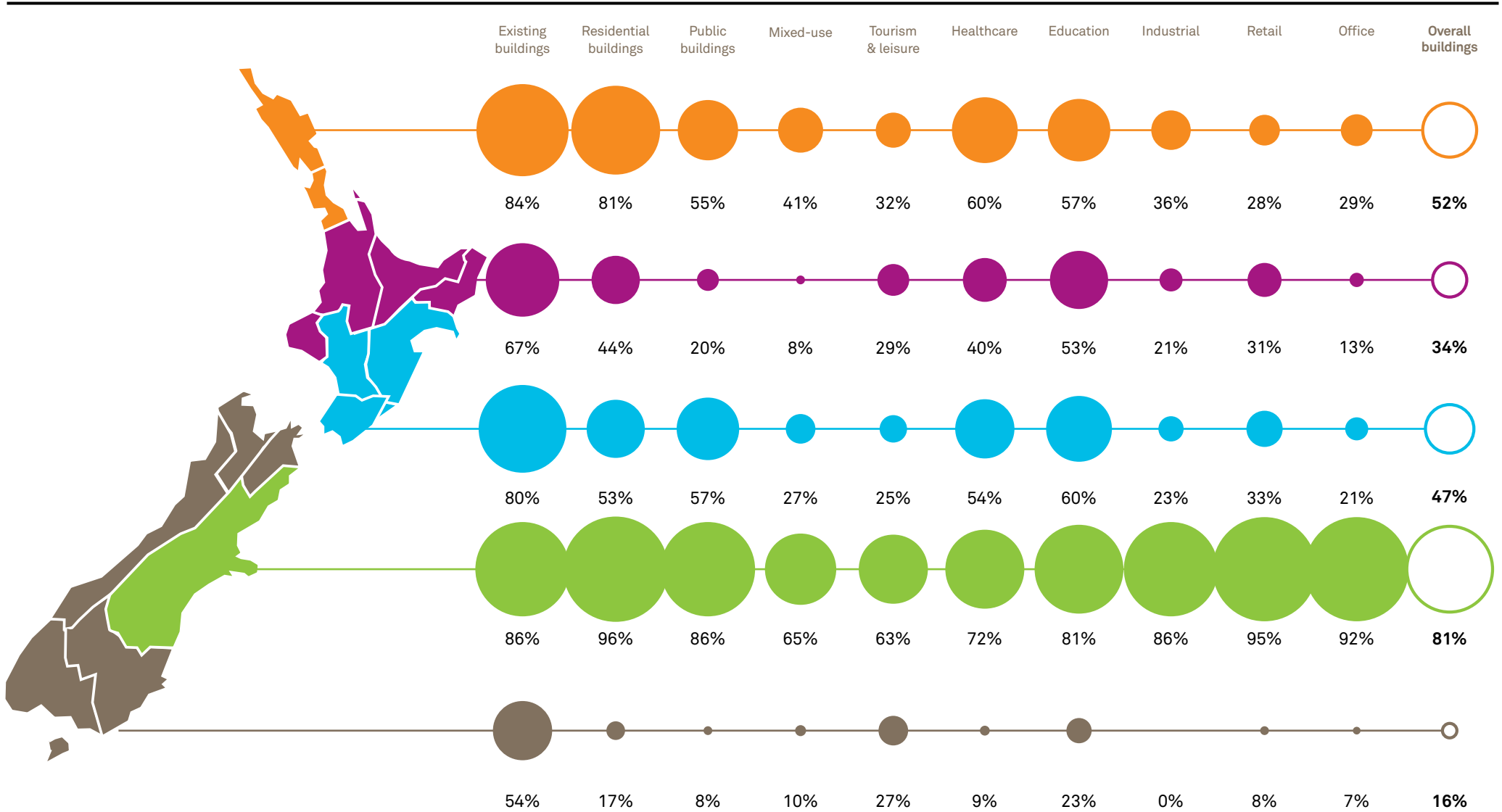
Investment expectations from the private and public sector

12 month projection

Private sector
Public sector



Proportion of respondents expecting increased investment by region



INFRASTRUCTURE AND BUILDINGS MARKETS

INVESTMENT DRIVERS

Canterbury

With a significant amount of demolition work now complete, construction activity in Canterbury is gathering pace, and will have a marked effect on the industry in the short to medium term. Consistently higher numbers of earthquake-related building consents are now being issued. This will see the number of projects entering construction ramp up from the start of 2013.

Total consent value for Canterbury building works up to November 2012 was \$748 million. This represents a doubling in the monthly value of consents since September 2011.

Despite indicators that the rebuild is gaining momentum, many roadblocks remain, including delays in completion of detailed damage reports, a lack of the required resources to assess ground conditions, land zoning restrictions and the wait for foundation repair guidelines.

Despite the continued rise in building consents, our observations of the market suggest that the time required to design, tender and then begin construction is likely to be more protracted than most survey respondents currently believe.

On the upside, commitments to the larger anchor projects are expected to improve market certainty and encourage other smaller developments to go ahead.

Progress is marked by the opposing forces of optimism to 'just get on with it', and a sense of being 'bogged down' in complicated processes involving multiple stakeholders. A number of respondents commented on this matter even though plans have now been set out in the Christchurch Blueprint.

A resilient attitude, however, continues to prevail despite the volume of work required to rebuild Christchurch. The complexity of circumstances surrounding the rebuild also means issues of value for money, probity and transparency must remain at the forefront of project procurement and execution processes.

Economies and exports

Investment continues to be constrained by global financial market fragility, and we expect it to remain sensitive to such fluctuations in the medium term.

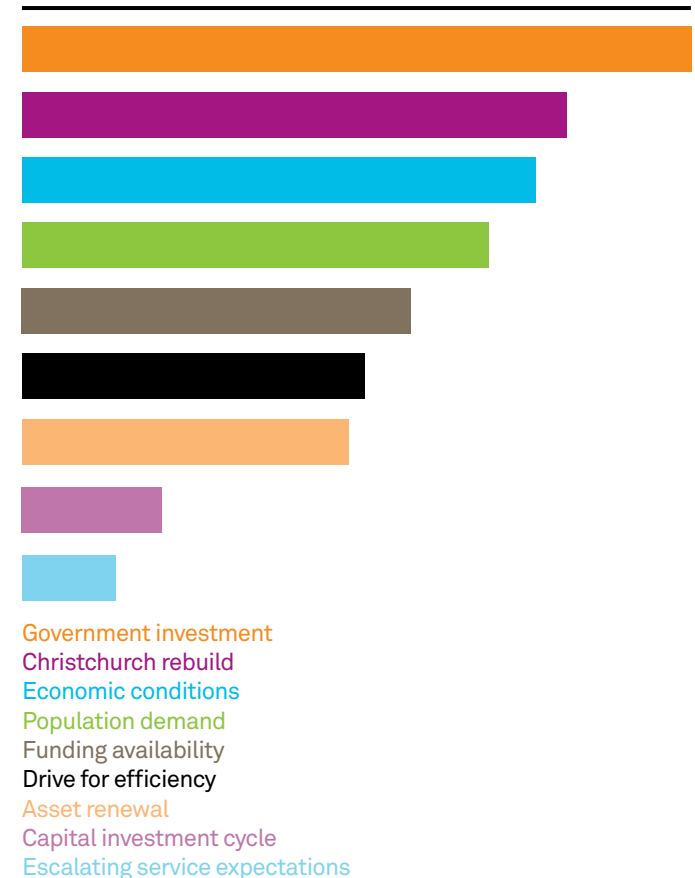
Earlier this year, the Government set a target to increase the contribution of exports to the economy from 30 percent of gross domestic product currently, to 40 percent by 2025. This export market push will encourage new investment in supporting infrastructure, despite recent erosion of export prices by the elevated kiwi dollar.

Population

Different parts of the country are also benefiting from migrating populations. Selwyn in Canterbury is the fastest growing territorial authority area in the country, with New Zealand Statistics reporting a 2.9 percent increase in the June 2012 year. Other areas such as Hurunui, Queenstown and Auckland have also grown, some as a result of residents leaving Christchurch.

These regions of growth will underpin the residential market's relative buoyancy which has been trending positively since March 2011, albeit from a very low base. This is translating into real growth for the sector, as seen in the rising value of residential building consents.

Relative strength of new investment drivers



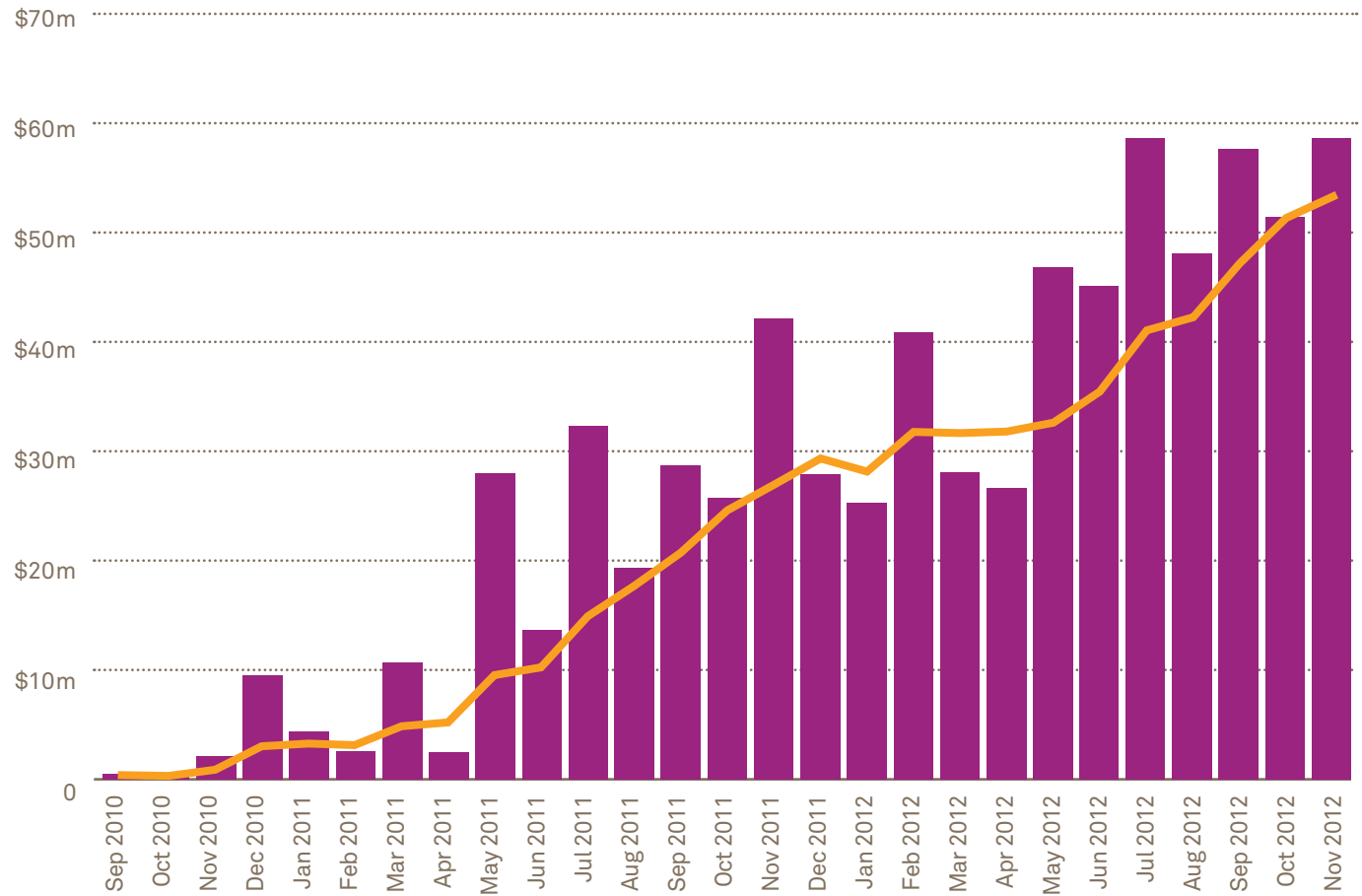
■ ■ A significant challenge to those involved in the rebuild will be the continuity of supply of professionals and tradespersons.

While anchor projects will ignite private sector redevelopment opportunities, their size and scale will draw on already limited resources and finance, and will require significant efforts to consolidate small land titles. **■ ■**

Nick Gorge, Director – Building Engineering, AECOM

Earthquake-related building consents continue to rise

6 month moving average
Monthly earthquake-related building consents



Source: Statistics New Zealand

FOREIGN INVESTMENT

There is notable resistance in the New Zealand market to offshore entrants. A significant proportion of respondents believe the level of openness is receding, although conversely, more also see the market becoming more attractive to foreign investors and suppliers.

Respondents were concerned about a tendency towards parochialism. One explained that a perception problem may be obscuring an understanding of where the benefits of this investment were flowing: "Some resistance to overseas investment where benefits are funnelled offshore rather than actually supporting growth in New Zealand".

Foreign investment represents an opportunity to leverage capital from offshore markets to deliver national project priorities. Addressing the gap between the perceived attractiveness of New Zealand as an investment destination, and the country's openness to being such a destination, would encourage greater future investment in the development of the nation.

Top drivers for foreign investment

- Larger transport projects
- Decreased spend in Australia
- Relatively high political and economic stability
- Easier to deal with authorities
- Earthquake recovery opportunities

Top barriers to foreign investment

- Resistance to offshore ownership
- Foreign exchange volatility
- Lack of local market knowledge and capability
- Willingness of public sector to look at new contracting methods
- Strong local competition with spare capacity

The introduction of PPPs into the New Zealand market addresses, in part, foreign investment opportunities. Continuous improvement of this investment and delivery model is viewed as a positive market direction and consistent with current government policy.

Dean Kimpton, Managing Director – New Zealand, AECOM

Perceptions of New Zealand's openness and attractiveness to foreign investment



INDUSTRY RISKS AND CHALLENGES

Uncertainty

Uncertainty is currently at play in many parts of the infrastructure and building industries. Many are cautious due to concerns about insurance, margin cutting to win work, and a lack of investment commitment.

In addition, over the next few years the industries will need to resolve how new levels of compliance can be incorporated into projects with limited budget flexibility.

Insolvency remains a significant risk for both industries. Many businesses have secured work at low margins and are open to being caught in an inflationary cost market with little or no capital reserves.

Skilled resources constraints

Resourcing remains a potential issue. An exodus of skilled workers across the Tasman continues to affect the construction sector and other industries. Statistics New Zealand figures show that in the year to June 2012, more than 17,600 aged between 20 and 29 moved to Australia — of those people, 14 percent were technicians and trades workers and 11 percent were professionals. Overall, permanent or long-term migration from New Zealand rose 9 percent in the year to June 2012.

Furthermore, in the South Island, firms have been indicating increased difficulty finding suitably skilled labour, suggesting a mismatch between the region's unemployed and the skills required in the area.

Declining quality

The challenges of sourcing a skilled workforce also highlight the ramifications of inadequate training and the subsequent long-term risks posed to build quality.

Survey respondents suggested that inadequate repairs to earthquake-damaged houses could lead to long-term problems of a similar nature to the ongoing leaky buildings crisis. The recent Supreme Court judgment on this issue (in favour of the owners of the Spencer on Byron in Takapuna) found that local authorities owed a duty of care to owners of all buildings, regardless of whether they are residential or commercial. This has created a risk of possible litigation from commercial owners that could be traced to resourcing quality.

The government is also faced with a considerable bill to fix problem sites in the education sector. It is likely to cost between \$1 billion and \$1.5 billion to repair or replace school buildings affected by the leaky buildings problem. It is estimated that 273 schools have at least one building affected by this issue.

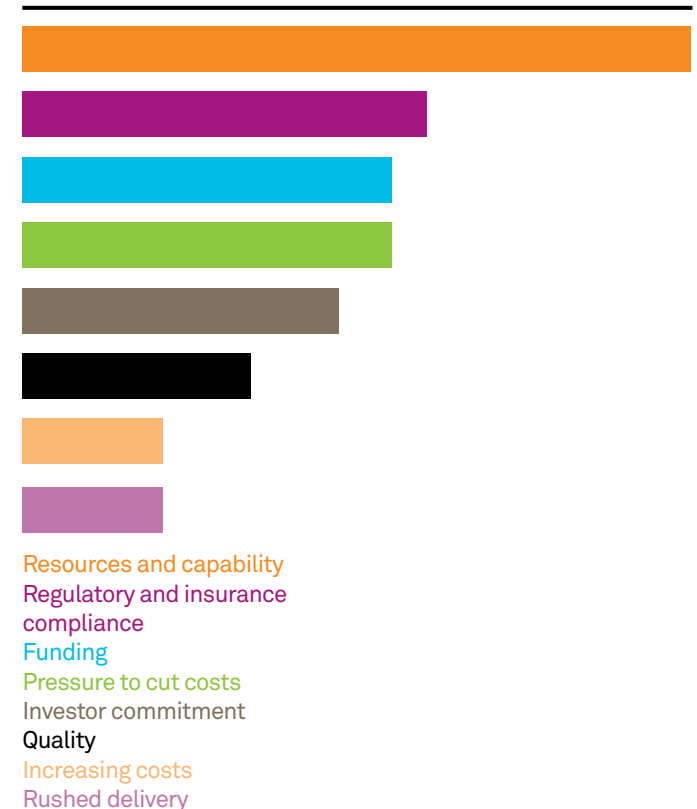
Declining productivity

There is a sense in the industry that productivity gains are being held back by 'old' practices in design and delivery.

New technologies and processes offer solutions to improve productivity in order to cope with tighter budgets, more challenging project demands and strained resources.

Respondents emphasised the opportunity for wider adoption of Building Information Modelling and improved collaboration on project delivery through integrated project teams to deliver better, more efficient, project outcomes.

Top risks - medium term



Since the onset of the Global Financial Crisis, reduced workloads have resulted in increased competition and subsequently tighter margins.

As the Christchurch rebuild programme gathers pace, industry profitability is expected to improve. However, the rate of improvement will remain closely tied to progress in the region, which could be limited by the economic viability of commercial projects.

Trevor Hipkins, Director – New Zealand, Davis Langdon, an AECOM company

COST PRESSURES

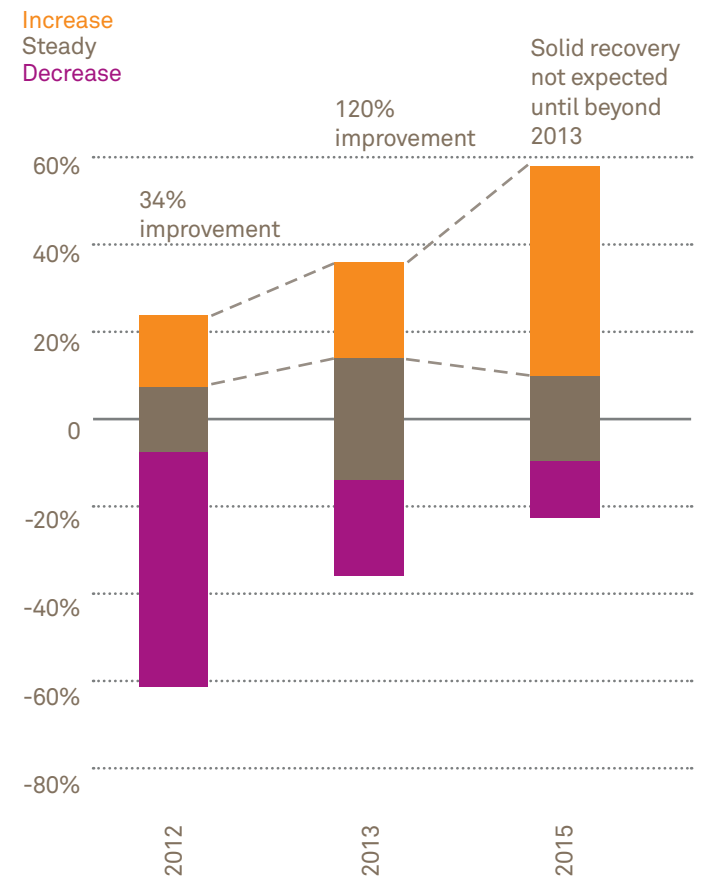
Industry profitability is not expected to rebound over the next year. Further margin tightening is likely in some parts of the industry, while others will hold steady. The general sentiment is one of tough business conditions. More than half of our respondents have seen margins depleted to negligible levels over the past year.

Projections for 2013 offer little improvement despite anticipated increases in workloads. Most anticipate that the industry will have to wait until 2015 before a notable improvement in profitability occurs.

While businesses are under duress from shrinking margins, they have also had to deal with rising costs over the last 12 months in addition to further anticipated cost increases.

Christchurch, not surprisingly, is expected to witness price escalation in the vicinity of 10 percent to 14 percent over the coming year, as professional and trade-based services and materials are brought to capacity.

Industry profitability faces a protracted recovery while costs continue to rise



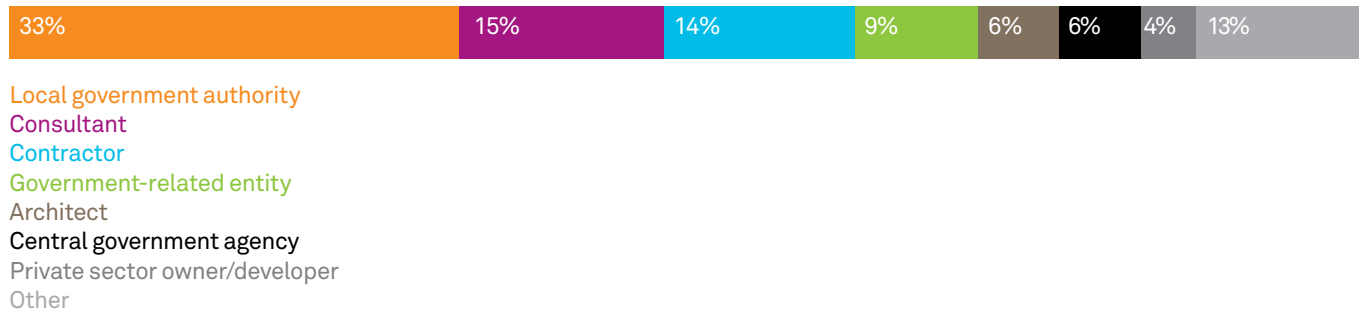
SURVEY SAMPLE – A BROAD VIEW

Profile of respondents

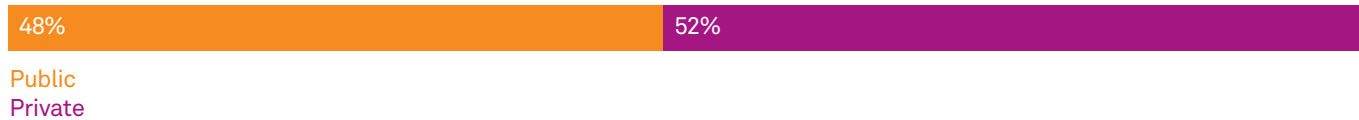
Respondents by location



Respondents by industry role

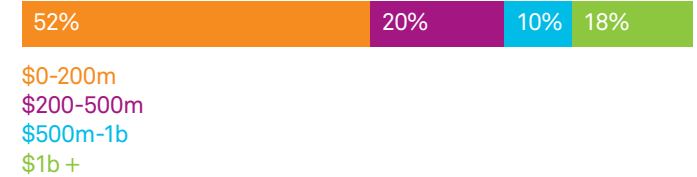


Public vs private respondents

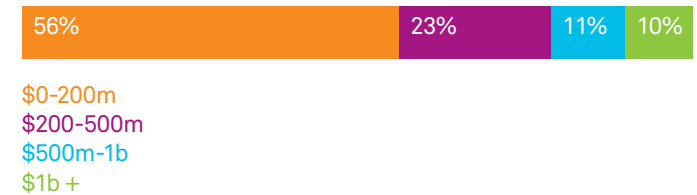


Market values

Investment market respondents by turnover*



Delivery market respondents by revenue#



*Representation from private and public organisations that invest \$15.8b in buildings and infrastructure annually.

#Representation from private and public organisations that deliver \$18.4b in buildings and infrastructure annually.

Note: Annual estimates may include overseas operations in addition to New Zealand projects.

CONTACTS AND RESEARCH

This report is part of our suite of regular industry publications:

- *New Zealand Construction Sentiment Survey – Building and Infrastructure*
- *Australian Infrastructure Construction Sentiment Survey*
- *Australian Building Construction Sentiment Survey*
- *Market Pulse.*

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