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Market Update

NSW construction market update: December 2020

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The unstoppable march of labour costs

Rising labour costs are a key issue to consider when planning any construction project.

Enterprise Bargaining Agreement (EBA) negotiations have recently occurred in NSW, between head contractors, sub-contractors, and the construction workers union around working conditions and rates of pay for construction workers. We explain below what this means for the construction projects in NSW which are affected by EBAs.

What is an EBA?

An Enterprise Bargaining Agreement (EBA) is a process of negotiation that occurs between the employer, employees, and their bargaining representatives (usually a Trade Union) with the specific goal of defining conditions of employment such as pay rates, working hours, etc.

Not all construction projects are impacted by union EBAs. Many smaller sized projects do not have CFMEU EBA labour on-site and instead use smaller head contractors & sub-contractors which typically use labour under the Building and Construction General On-site Award which is substantially lower than the CFMEU award. However, most of the larger projects undertaken will be using CFMEU labour which is the focus of this discussion.

In New South Wales, most builders have historically negotiated their EBA between the respective business and the CFMEU which is the largest union that represents construction workers.

Most EBAs lapsed in March 2019. Since then, the CFMEU has campaigned for new EBAs with both head and sub-contractors.

Cover Image: 32 Smith Street (GPT)
Below Image: North Shore Health Hub, St Leonards (Dexus)

CFMEU Proposed deal

The key terms the CFMEU are pursuing in their latest EBA are increasing:

- The hourly rate of labour by circa 7% effective from 1 July 2020 with a further 5% per annum (p.a.) increase up to 1 July 2023, and then a 3% p.a. increase thereafter until a new deal is agreed;
- The number of Rostered Days Off (RDOs) from 13 p.a. to 26 p.a. which includes 8 unpaid weekend days off. This would effectively close construction sites every second Monday;
- Superannuation contributions by 2.5% above the statutory guaranteed levy;
- Productivity allowance from $3.50 an hour to $4.00 an hour; and
- Casual loading increases from 25% to 35% and to 80% after 6 weeks.

What does this mean for Developers?

Based on the proposed changes Slattery estimates that the cost of labour could increase by circa 12% on a 56-hour working week (which is the typical working week on current CBD projects). In terms of program durations, we estimate that durations would increase in the order of 3-4%, in the absence of any increased site productivity.

Slattery has modelled the proposed changes for a $100m commercial project in Sydney with a 24-month construction program. We estimate the proposed changes would add approximately 5.2% to the total construction cost (+$5.2m) this is inclusive of additional program prolongation costs (Preliminaries) due to the increase in RDOs p.a.

Future annual increases in labour costs would then increase total construction costs by circa 1.7% p.a. to 1 July 2023 with total construction costs increasing by 1% p.a. thereafter.

Builders view

There appears to be significant resistance from builders to sign up for the new proposed terms. Many builders do not believe that the terms of the agreement are commercially sustainable, given the previous substantial gains achieved by the unions during the last round of EBA negotiations and considering the current impacts of COVID-19 on the wider economy.

Compounding the problem for the builders is the fact that site labourers will be remunerated higher than site management staff who work longer hours, take greater responsibility, and will expect to be remunerated at a higher level. A CW3 (Trade) worker working a 56-hour week currently would be on a package of approximately $171k per year inclusive of super, with the proposed changes this would increase to approximately $187k per year. For comparison, a foreman is on a package of $180-$220k, and a site engineer is on a package of $160k-$180k.

Builders feel the proposed changes will result in increases in costs at a time when work is drying up and could result in projects becoming unfeasible and not proceeding. This would further exacerbate falling workbooks for contractors and put jobs at risk. Also, builders concerns are that signing up to the union EBA terms could open the door to non-union builders who could exploit the significant gap in costs between union EBA and industry award rates of pay.

Data published from the Australian Bureau of Statistics supports the view of falling workload. The data shows an 8.1% fall in the value of all construction work carried out in NSW from September 2019 to September 2020.*

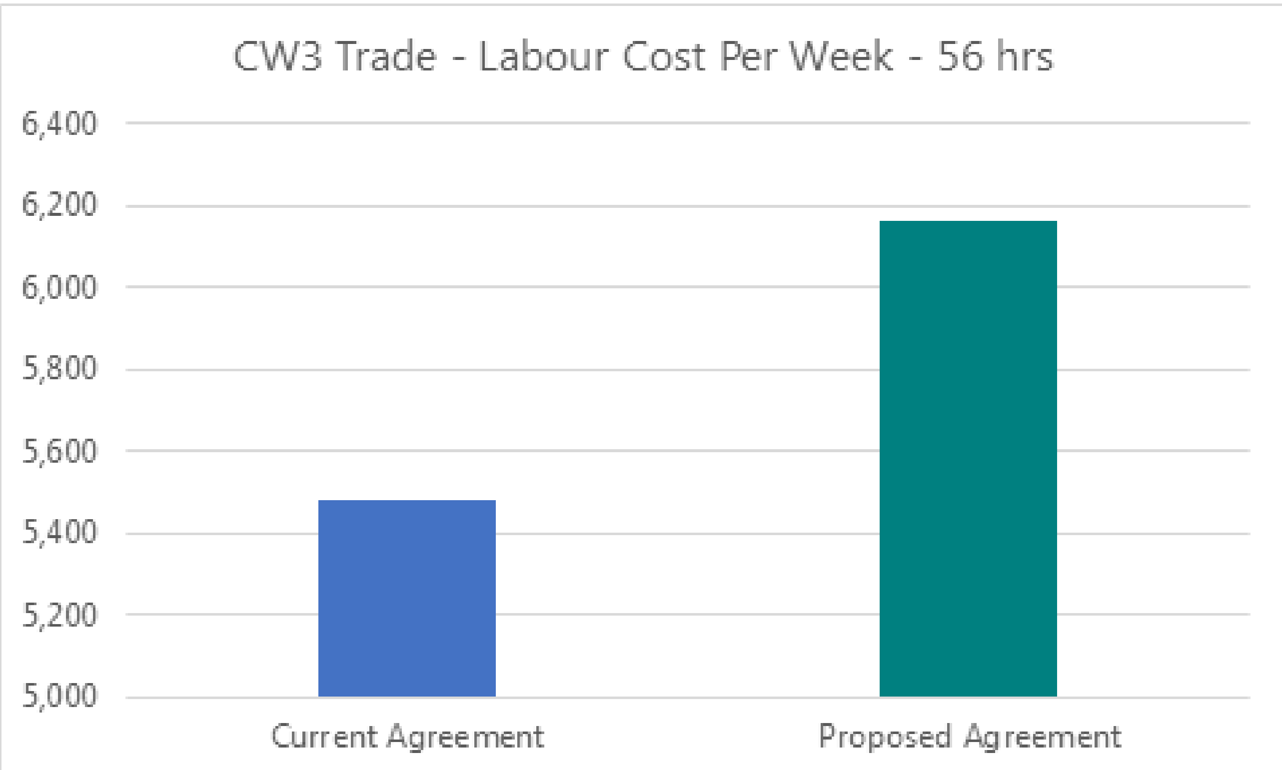
We are aware of many builders who have recently agreed on non-union EBA deals directly with their construction employees and several who are working towards negotiating similar deals with their employees.

Whilst the terms of the agreed non-union EBAs are not published, we understand them to be broadly in line with the existing EBAs. Especially in terms of RDOs and overtime allowances with circa 2.5% p.a. increases in labour cost. This would translate into a 1.8% increase in total construction costs or +$1.8m on our $100m commercial project in Sydney.

Conversely, we understand that at least one major builder and hundreds of major sub-contractors have already signed up to the Union EBA terms.

**Data provided from:*

https://www.abs.gov.au/statistics/industry/building-and-construction/construction-work-done-australia-preliminary/latest-release



Conclusion / Recommendations

At this stage, it is uncertain how the negotiations between the union and builders will play out. Though it is looking increasingly likely that the majority of builders will continue to reject the current terms of the union EBAs and seek to negotiate non-union EBAs directly with their workers.

There is little doubt that labour costs will increase and continue to do so, the question is by how much? Based on the above analysis we estimate the cost of construction for 2021 could increase anywhere from 1.8%-5.2% with costs further increasing by 0.9%-1.7% p.a. This depends on whether costs are on union EBA terms or contractor proposed terms.

So, what can developers and builders do to keep a lid on rising labour costs in a falling market?

There are many other elements that feed into the overall cost of a project including:

- material supply costs,
- contractor margins and overheads
- construction methodology,
- labour productivity levels, and
- labour pay rates.

An increase in labour costs does not automatically translate into increased costs for developers. We could mitigate labour costs by compressing margins, increase labour productivity, or reduce labour content on-site by using off-site manufacturing and prefabrication as part of the construction methodology. Due to COVID-19 builders and sub-contractors' margins are already compressed and have very little scope for further compression without putting the long-term security of the business at risk.

It is unlikely that site productivity levels will increase to help mitigate increased costs with the labour productivity index (LPI) of the construction industry of Australia showing falling levels of productivity since 2013.

Reducing labour content on-site in one area that we can look at. The opportunities to reduce labour content on-site include:

- Alternate structural frame (Structural steel, precast concrete, or timber frame rather than traditional insitu-concrete frame)
- Increasing use of prefabricated elements (Bathroom pods, services risers/ reticulation, unitised façade systems, prefabricated staircases, etc)
- Increased use of self-sufficient temporary works (Self-climbing screens, self-climbing jump forms)

Traditionally these alternate systems have come at a cost premium due to the much larger subcontractor supply chain for traditional systems in NSW. However, as labour costs continue to increase the gap in costs will narrow and alternative systems may become more cost-effective due to lower on-site labour requirements and faster construction programmes.

Taking all of this into consideration, we recommend that clients with projects in the early stages of design should investigate design options which could reduce on-site labour content and project programme to mitigate the exposure of the project to future labour cost increases.

Right Image: 32 Smith Street (GPT)

About Slattery

Slattery is a property and construction advisory firm specialising in quantity surveying, cost management, and early-phase project advisory, with an outstanding history spanning more than 40 years.

We work hand-in-hand with governments, institutions, and organisations as well as planners, developers, architects, and design teams on a broad range of property and construction projects.

A commitment to excellence and innovation, and an ability to become an integral part of the project team has earned Slattery the trust and respect of clients and project teams alike. Slattery adds value by taking control and ownership of the cost management process from the outset. We understand the importance to drive innovation and productivity.

We invite you to explore our knowledge sharing further at www.slattery.com.au/thought-leadership