



slattery

# Market Update

VIC Construction: July 2021

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The pandemic made 2020 one of the more disruptive years for the Australian construction industry in recent memory. This is especially true in Victoria, where the extended state-wide lockdown and on-site restrictions during 2020's second wave resulted in reduced productivity.

Although the construction industry was deemed an essential service in Victoria, there was a sharp decline in construction activity due to uncertainty around the COVID recovery timeline and a general lack of confidence. On a positive note, the latest forecasts reveal that the Australian construction market has and will continue to recover in 2021.

## Predictions

We expect to see upwards pressure on pricing due to margins returning to 'normal' levels. In addition, global supply shortages of key construction materials including steel, timber and copper, and annual EBA rate increases will affect prices.

These increases, on the back of reduced pricing and the end of JobKeeper mean that financial checks and due diligence on head contractors and key trades will be paramount to the success of projects over the next **12-24 months**.

## Tender Market

A desire to ride out the pandemic saw sharp declines in tender sums driven by reduced opportunities, resulting in margins as low as 0.5 – 1.0%. Recent feedback indicates the market is beginning to heat up. Margins are starting to recover to normal levels, particularly in the fit-out space, however this is not yet being seen across all tiers of the market.

Contractors are continuing to bid for work outside of their core sectors to fill their books and are targeting profit through letting gains. Considering all the factors above, we anticipate increased labour and material prices will become evident in trade pricing and margins will return to pre-pandemic levels over the next 6-12 months.

## Cost Escalation

Despite reduced margins across most areas of the market, the following factors are placing upward pressure on prices:

### Enterprise Bargaining Agreement (EBA) rates

Current EBAs have locked in 3% annual pay rises until 2023. This represents cost escalation in the order of 1.5-2% per annum. The next pay rise is due to come into effect from March 1, 2022, as per the four-year EBA between CFMEU and Victorian Master Builders Association.

Cover Image: 199 Normanby Rd, Southbank (Capital Alliance)

## Steel/iron ore supply rates

Global production for steel ramped down in anticipation of lower global demand due to the pandemic. Steel manufacturers worldwide are now struggling to scale up their production to catch up with higher than anticipated global demand. Material shortages are creating significant supply cost increases, with suppliers indicating reinforcement costs up in the order of 35% since the start of 2021, with all other structural steel products seeing similar increases. To counter this escalation risk, steel subcontractors are beginning to qualify their pricing with cost escalation clauses.

## Copper supply rates

Electrical services, AV equipment and pipework prices are seeing increases related to uplift in the supply rates for copper, which have recently increased by approximately 15-20%.

## Timber shortages

Australian timber supplies have been stunted by bushfires in recent years, resulting in local shortages and the need to import timber from overseas. Compounding the issue, global stimulus has resulted in unprecedented housing construction, particularly in the US.

Unfortunately, Australia is well back in the queue for European timber supply. Market feedback indicates cost increases in the order of 30-35% for raw materials are beginning to flow through to general carpentry, formwork and joinery trade pricing.

## Contaminated soil

EPA Victoria have indicated the levy on Category C soil disposal is set to increase from 1 July 2021. Current disposal rates of \$110-140/t at the subcontractor level are set to increase to \$170/t, with further annual increases forecast for 2022.

## Supply chain disruption

International shipping remains a significant risk due to port closures and difficulty securing space in containers. Market feedback indicates shipping times from China have increased from 28 to 40 days, and the cost per container has approximately doubled from pre-2020 levels.

## Other trades

Despite the above increases, competitive pricing remains across several key trades including structure, mechanical services and facades. Key finishes trades including plaster, paint and joinery currently remain steady, but due to material cost increases we anticipate these will increase in the latter half of 2021.

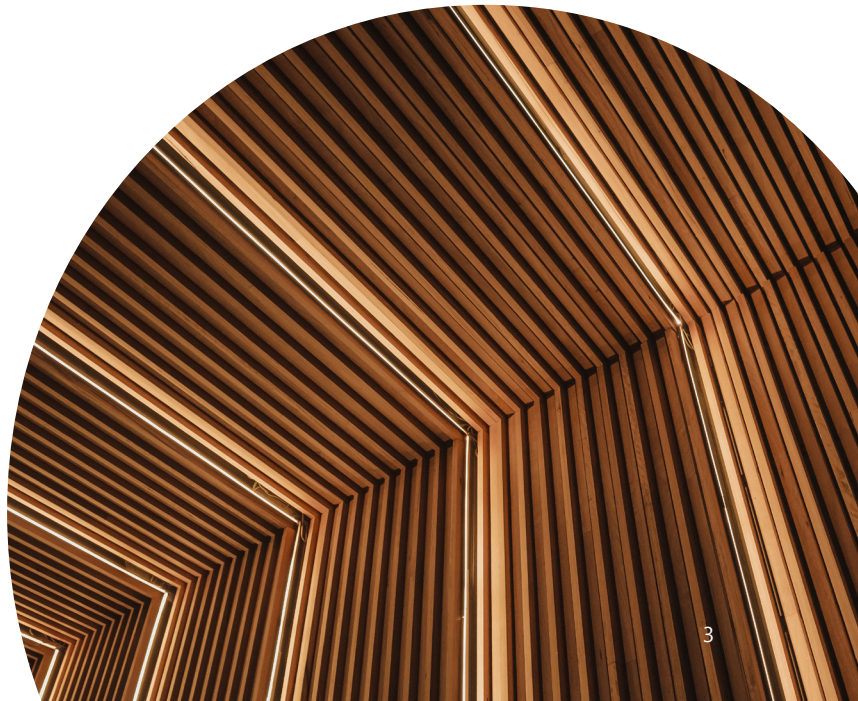
## Margin

Although material costs across the board appear to be on their way up, only select trades are currently reflecting this in their pricing, while many others appear to be absorbing these increases. As books begin to fill up, we expect margins at both trade and head contractor levels will return to pre-2020 levels.

## Case Study

We have undertaken a case study analysis on a recently tendered \$55M residential project which indicates cost escalation of 4.3% for year FY2021-22, based on known and forecast increases to margin (1%), labour (1.7%), materials (1.6%).

Case Study	Tender - % of contract sum	Escalation in cost	Project impact
Preliminaries & Margin	19.3%	5.2%	1.0%
Structure & Shell	31.1%	5.6%	1.7%
Fit-out	28.6%	3.3%	0.9%
Services	21.0%	3.1%	0.7%
<b>Total</b>			<b>4.3%</b>



## What does this mean for your project?

While the above issues sound concerning, they need to be considered in the context of whole of project pricing.

Labour makes up approximately 60-70% of construction costs, meaning the 3% p.a. increase in EBA rates represents cost escalation in the order of 1.5-2% p.a. Anticipated material cost increases outlined above will result in cost escalation in the order of 2-4% p.a. Margins are on the way back up, but are still well below levels seen throughout 2020.

Slattery is forecasting escalation across most commercial scale building projects of 3-4.5% for FY2021-22, and 3.5-4% p.a. thereafter, noting that different sectors will be impacted more or less heavily based on their exposure to material fluctuations and the level of activity in each area of the market.

### Contractor selection

Due to reduced pricing throughout FY2020-21, which is now beginning to show signs of rebounding, selecting the right contractor will be crucial for the success of projects over the next 12-24 months. Although competitively priced tenders are always a significant deciding factor, the following considerations should be made:

- Time commitment and capacity
- Sector coverage and trade pool
- Ease of doing business with the contractor

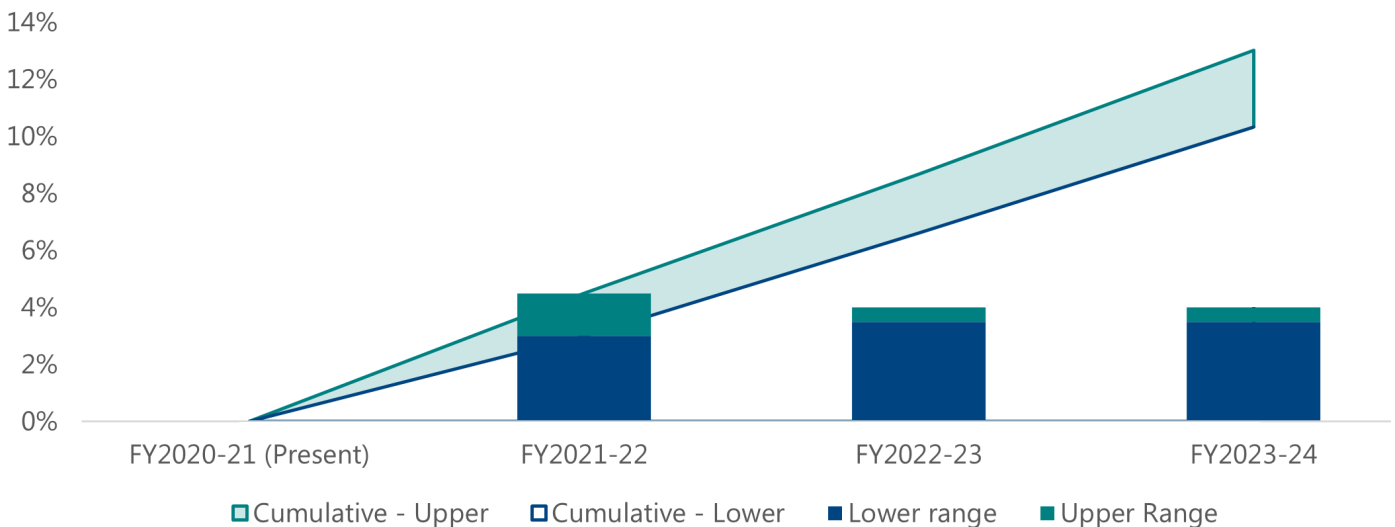
### Subcontractor performance

Market feedback indicates increased use of Tier 2 and 3 subcontractors on larger projects, with head contractors receiving greater coverage (upwards of 10 prices for key trades). Tier 1 subcontractors continue to remain busy, driven by government stimulus in infrastructure and health. Due to liquidity pressures resulting from reduced margins throughout 2020 and the end of JobKeeper, due diligence and financial checks on key subcontractors will be critical. For clients, understanding who contractors are considering for key trades at tender stage will be critical in this transition period.

### Procurement risk

Understanding your contractor's supply chain for key trades including structure, façade and overseas procurement/long lead time items will be crucial for project success and program management. We recommend this is factored into the tender process, with schedules outlining which trades and suppliers are being considered and included in RFTs.

## Forecast Cost Escalation





## 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](http://www.slattery.com.au/thought-leadership)

## Slattery Carbon Planning

Slattery is proud to be the first Quantity Surveying firm in Australia to launch a Carbon Planning service.

This new service is available in conjunction with Cost Planning to assist our clients in achieving their Net Zero and sustainability targets. The focus of the carbon plan will address and educate clients on the embodied carbon of their current and future developments.

Read more about Slattery's Carbon Planning offering at [www.slattery.com.au/carbon-planning](http://www.slattery.com.au/carbon-planning)



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