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Construction Market Update

State of Play, Australia Wide

September 2021

Construction Market Update: State of Play, Australia Wide

In this update, Slattery provides an overview of the construction market including the volume of work nationally, the pain points across various states, labour and supply chain impacts, and what this means for cost escalation.

The cost escalation forecast and what it means

Slattery is forecasting escalation averaging 4% per annum (with independent consideration for Tasmania) for the next 3 years with supply chain impacts currently posing the biggest risk to projects. This is mainly due to material costs and freight and exchange rate fluctuations driving up pricing and pushing out programmes.

In this current market, extensive financial due diligence of contractors and their subcontractors is critical. The key is to ensure that contractors and sub-contractors have the suitable financial capacity to deliver projects.

As an industry, we need to keep in mind that the closure of State and National borders are limiting the flow of skilled, unskilled, and seasonal migrant workers to Australia. This is creating a major skills shortage across the board which will have flow-on effects now and into 2022.

Disruption through 2020

In 2020, construction productivity decreased across most sectors due to health and safety issues relating to COVID-19 and the various lockdowns across the country causing major disruptions. To add to this, a number of projects had been completed before the pandemic hit and with a slow pipeline of work following behind it, this enforced the reduced activity in most sectors - the few exceptions being logistics, industrial, civil, and infrastructure.

Despite the hype and budget commitment, there continued to be limited market activity in the Government space – apart from transport infrastructure. The promised rollouts for social housing, health, and schools took some time to get to market.

With low margins and increased competitiveness, Slattery witnessed price reductions across the board – in some circumstances, north of ten subcontractor pricing per trade. The consultant space suffered also with limited opportunities in the market driving down fees.

As a result, many companies reduced staff numbers, or at the very least, put a freeze altogether on recruitment. With momentum now building in 2021, we are seeing the market shift.

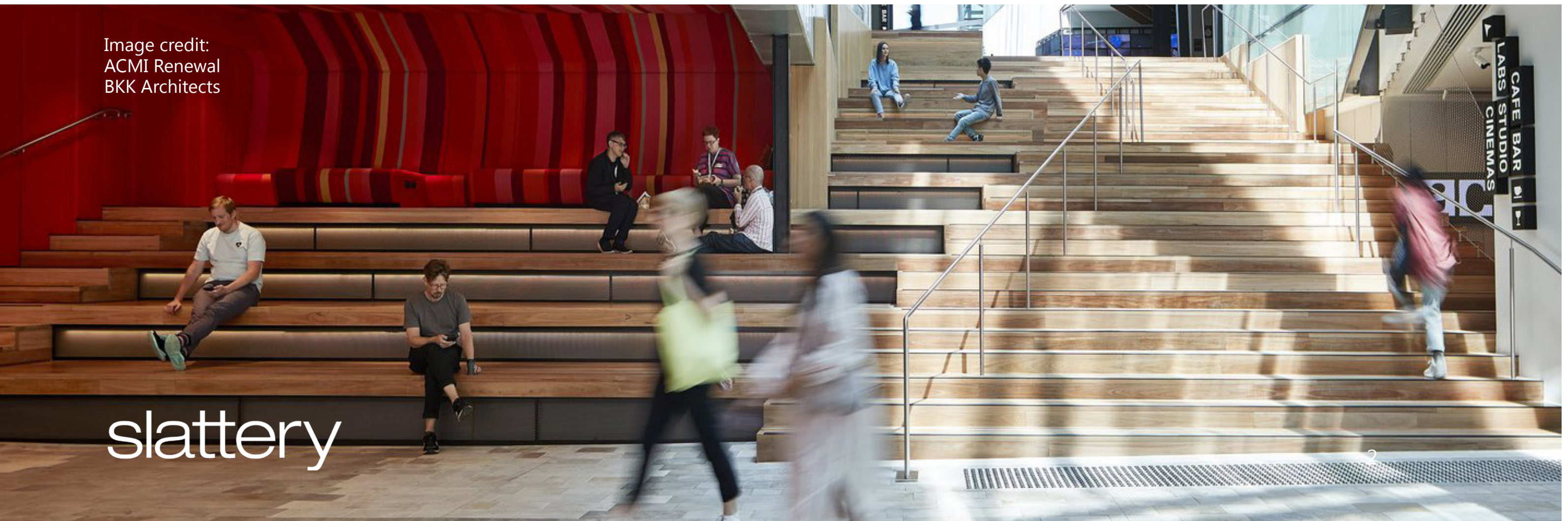

Image credit:
ACMI Renewal
BKK Architects

Construction Market Update
September 2021

Volume of Work

The ACIF Construction Forecasting Council Figures on the Value of Work Done [image one], provides an overview of the construction industry.

In the residential sector, there has been an uplift in residential building, driven by stimulus and short-term temporary support measures. This is unlikely to be sustained, with the stimulus soon ending, and reduced immigration reducing demand in the medium term.

For non-residential building, there has been a sustained decline from the peak in 2020 over the medium term. The forecasts foreshadow a drop in demand for new Offices, Retail, and Entertainment, with Industrial building activity plateauing.

Infrastructure construction is expected to grow by 5% in 2022, as expanded government infrastructure programs fully flow through into activity on the ground. Key areas for growth include rail and electricity supply.

Heavy industry including Mining is expected to increase significantly – growing by more than 5% per annum in the next 2 years, driven by expanded activity in coal, gas, and iron ore and newer areas such as hydrogen and lithium-ion. Mining has been the quiet achiever over the pandemic.

ACIF reports that the total volume of work of the 4 components mentioned, will peak in the current year, at $243.1B, dipping by 0.7% in 2022 and increasing by 1.9% again in 2023. The type of work is changing, with residential and non-residential being replaced with infrastructure and heavy industry.

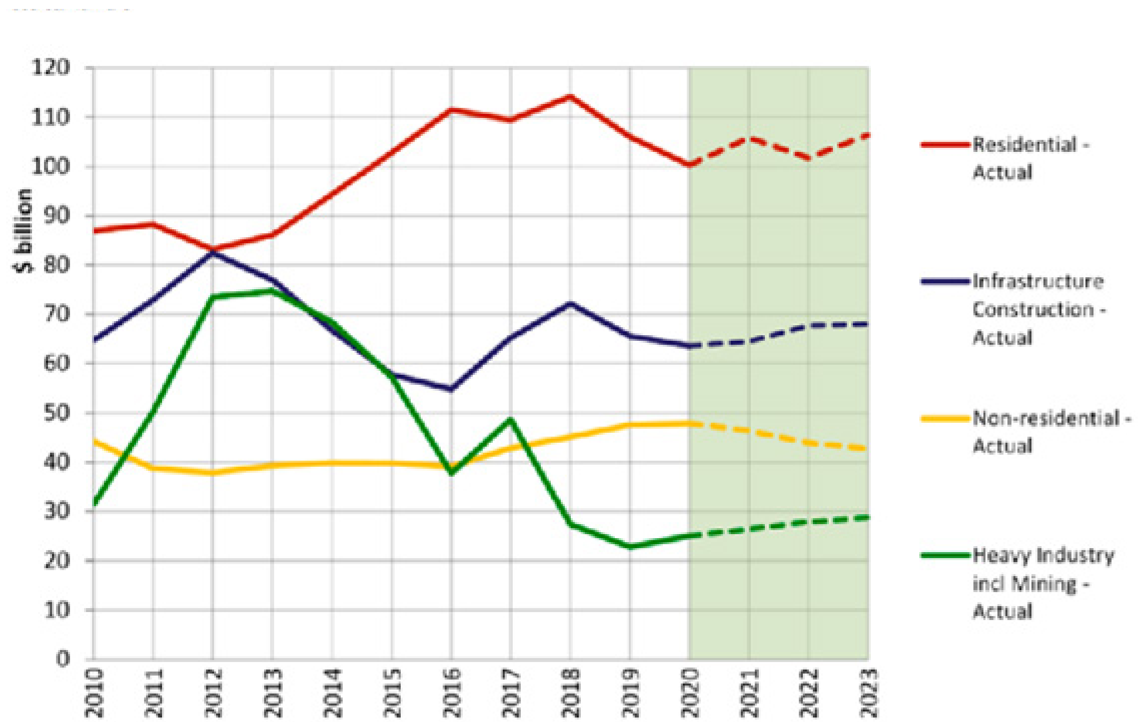

Image One:

ACIF CFC - Value of Work Done – Australia

Cost Escalation

After a relatively flat 2020, cost escalation is real and needs to be factored into budgets. Some of the drivers behind this are:

Material and supply chain impacts

- COVID-19 recovery programs intended to stimulate the economy have placed a huge amount of pressure on supply chains not only in Australia but globally.
- We have seen this within Steel, Joinery, Timber, Metalwork, Copper, PVC, Masonry, Reinforcement – just to name a few.
- COVID-19 outbreaks have led to congestion at major ports, compounding the supply issues and increasing freight costs. 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. The flow-on for the supply issues are delays to the program, resulting in increased preliminaries costs and loss of income as completion dates push out.
- Industrial action by the Maritime Union of Australia is impacting ports across Australia, with strike action at Sydney, Melbourne, Brisbane and Fremantle wharves, adding pressure to an already constrained materials supply chain.
- Another major impact is exchange rate fluctuations for materials supplied from overseas. The AUD was buying just over 57 US cents when COVID-19 hit in March 2020 and increased to a high of almost 80 US cents in February this year, and now back to circa 72 US cents. These fluctuations play havoc with tenders for imported materials, which can make up a large proportion of a tender.

Example : Steel production and the impact

- Over the past 12 months, steel production has reduced due to peak carbon emissions and disruption from COVID-19. Some reports say China has reduced steel exports by more than 50%.
  - In Australia, we import at least 30 percent of our steel supply, most of it from China. While both of Australia's large steel mills have kept their prices relatively competitive compared to the world market – this is changing.
  - Prices for steel from China have also been hit with export taxes and the recent removal of the manufacturer's tax rebate to compound the supply issues.
- While Slattery acknowledged some of these material rises last year, tender returns indicated that the full extent of price increases was not being passed on.
- Now, Slattery is seeing subcontractors and contractors qualifying their tenders for increases moving forward, for example, exchange rates or steel supply. However, projects that were locked in before these increases will be hit hard.

Labour rates and availability

- The impact of EBAs, although predictable is ongoing with roughly 3-5% Year on Year increases – this automatically guarantees escalation rates of around 2% per annum.
- The closure of State and National borders are limiting the flow of skilled, unskilled as well as seasonal migrant workers to Australia.
- Skilled labour shortages in Australia has been an issue for some time with an ageing population and investment in apprenticeships not keeping up with demand eg bricklayers.
- Slattery is seeing contractors using more tier 2/3 subcontractors in the current environment to stay competitive, which may have ramifications on solvency and quality.

Margins and competitiveness

- 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%.
- Contractors improved competitiveness by reviewing staff salaries, negotiating non-union EBA agreements where possible, and tightening programme durations.
- Trades were very competitive due to available capacity in the market and tenderers were taking on COVID-19 programme and cost risk.
- Slattery continues to see competitiveness in the trades and Contractors continue to bid for work outside of their core sectors to fill their order books, but we are seeing margins for both trade and head contractors return to pre-2020 levels.

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Construction Market Update
September 2021

Risks and mitigation strategies

Contractor selection

Slattery is consistently seeing Tier 2s being pushed up into the Tier 1 space, employing design management skills and taking a relationship-based approach. Tier 3s and below are incredibly busy due to the HomeBuilder stimulus – creating an impact on Tier 2s.

Contractors are starting to be more discerning about what they will tender on and good builders will become choosy in this market.

Slattery recommend seeking advice in relation to how to select the right tender list. Communicating and engaging with the builders to make sure they are interested first is key. Minimise project risks before-hand and make the tender package as attractive as possible.

Procurement selection

In Procurement, there are some distinct trends developing. Clients are moving away from ECI procurement unless there is significant programme drive. While Slattery note cost escalation impacts - contractors still need to fill their order books and on the back of a poor 2020 – will still be competitive.

With Design and Construct procurement methods, design management capability is a must within the contractor team. Projects that are documented appropriately prior to tender ensure better trade coverage and minimise risk pricing from subcontractors and head contractors.

Contractor and subcontractor performance

In this market, extensive financial due diligence of contractors and their sub-contractors is critical to ensure they have the suitable financial capacity to deliver projects. A major risk is insolvency. This is enhanced currently with low margins and changes to trade market pricing on projects locked in last year.

Our Forecast

Slattery is currently forecasting around 4% per annum for the next three years on the mainland. Tasmania is the exception currently with escalation peaking up to 12% in FY2022.

This will not be across the board and will affect projects differently.

The biggest impact will be on long-term projects. When a budget was set a few years ago and has only recently been given the go-ahead, it is important to review the base price for robustness – it's not simply a matter of updating for cost escalation.

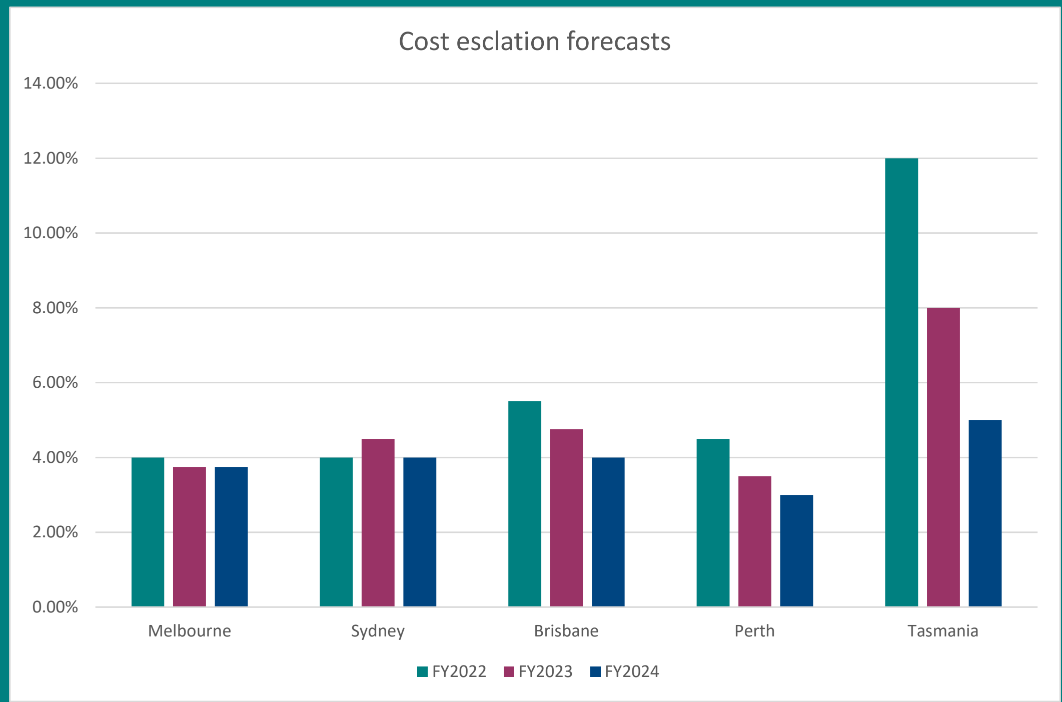

Image Two

Cost Escalation Forecasts

State by State Focus - Common Trends

Many impacts are common nationally, however each state is facing its own local impacts, opportunities and challenges.

Queensland

- There are supply issues for materials including steel, copper, timber as seen in other states. This is made more challenging with Sydney and Melbourne being prioritised by suppliers.
- Trade pricing remains competitive across several key trades including concrete, mechanical, and facades. Roofing trades are feeling the pressure of high volumes of work in both housing and industrial areas. Key finishes trades including plaster, paint, and joinery currently remain steady, but we anticipate these will increase in the latter half of 2021 due to the projects coming online.
- The construction market is heating up primarily due to migration increasing the demand for residential supply. This is affecting the Gold Coast & Sunshine Coast especially with the most activity seen for years.
- EBA agreements are influencing large-scale projects but in recent times non-EBA tier 2 builders have entered the market and are delivering projects up to $100m.
- The housing market is being driven by migration and infrastructure stimulus but we will see the residential boom convert to retail and industrial projects followed by schools and health. The Qld government will be trying to access federal funding to assist in the delivery.
- The Brisbane Olympics 2032 will drive investment and federal funding over the next few years
- More than other states, Queensland builders are forecasting significant escalation this year due to the future pipeline forecast and subsequent supply and demands.

New South Wales

- Upwards pressure on prices- Aluminium (facades & internal partitions), steel, reinforcement in particular. Some tender returns indicating escalation of 8-10% on structural steel and 35-40% on reinforcement.
- Border closure is affecting local supplied items – steel from Tamworth and windows from ACT for example.
- High rise residential returning - interest in BTR high, but BTS also starting to be considered again.
- COVID-19 restrictions - max site capacities currently at 50%, labour shortages compounded with many workers residing in hard lockdown areas.
- Skilled management staff are in high demand and there is a lot of headhunting for skilled staff which is driving up contractors wage costs and impacting preliminaries.
- Recent NSW CFMEU EBA agreements guarantee circa 10% increase in base labour cost rates over the next two years..
- Margins still under pressure – the key point in Sydney is that prices are going up, but builders still need to fill their order book. Short term, margins will continue to be squeezed to maintain cashflow.

Victoria

- Recent Environmental Protection Agency levy increases are being fully passed on to the client in most cases. Disposal rates are considerably higher, up 40% more in some cases. This must be considered when “dusting off” pre-pandemic feasibilities.
- There has been a significant increase in Build to Rent activity. Sophisticated players are now in the market and looking to begin construction in coming 12-18 months. This will impact tier 1 & 2 head and sub-contractors operating in this market.
- Recent COVID-19 restrictions introduced 25% staffing levels on site and a ban on all construction activity is now in place for 2 weeks. This has been and will continue to impact the critical path of most projects in delivery. The same restriction (25% rule) was a qualifying cause for delay in most commercial Contracts late last year.

Tasmania

- Several large-scale projects by the University of Tasmania in the north of the state will absorb a large percentage of market capacity through to the end of 2023. The roll-out of their program in the south of the state in early 2022 will then begin to put increased pressure on the southern market.
- Housing demand across all sectors is increasing with migration from VIC and NSW. With the State & Federal Government first home buyer grants being maintained, additional pressure and resultant price increases are forecast to continue for at least 24 months.
- Supply issues on steel and LVL timber products (as is also experienced in other states).
- Labour shortages will continue to be experienced with previous reliance on labour from other states not being possible due to national demand as well as ongoing uncertainty on COVID-19 travel restrictions.
- State government stimulus measures including a Headworks Holiday and the Building Project Support Program will trigger marginal projects placing increased pressure on an already extended market.
- Rumours of 30% cost increases over the last year continue to circulate. These levels are limited to small scale refurbishment projects (largely residential) and are driven more by opportunistic pricing than bona fide market drivers.

Western Australia

- Upwards pressure on prices – steel, reinforcement, joinery, timber for example.
- Skilled labour shortages – bricklayers, plasterers, etc.
- Strong pipeline of government work and housing affecting capacity.
- Longer lead times due to supply chain issues.

Construction Market Update
September 2021

Consultant Impacts

Consultants have not been immune from the effects of COVID-19, and in some cases are taking longer to recover. There are still reports of engineers and architects low-balling fees to lock in work. Many clients are becoming wary of low fees now and considering service level risks when low fees are offered. Other considerations:

- Fight for talent and the missing middle: Designers and engineers with 10+ years’ experience are becoming more difficult to find.
- Design competitions are losing attractiveness and firms are being more selective about which design competitions they go for, weighing up whether they have a good chance or not with such fierce competition and lack of key available resources in house.
- There continues to be collaboration between firms, particularly for large government contracts in Health, Infrastructure and Defence driven by firms lacking the right talent to bid for work. This means stronger bids, stronger competition but possibly less efficiencies across the board.

Innovation and Trends

Looking ahead, there are some exciting innovations and trends driving future delivery and design outcomes:

- Access friendly and gender neutral - with an ageing population, residential projects are considering flexibility in the design to allow disability access conversion. We’re also seeing gender neutral facilities in commercial and public buildings.
- Logistics – online shopping and last mile delivery will affect retail drop off areas and storage.
- Sustainability – greening buildings, embodied carbon, the cost of carbon in the future. Many of our clients have this high on their agenda. Other than the environmental costs, will we see levies on embodied carbon in new buildings?
- Wellness – more important than ever with the impacts of COVID-19 on mental health - mood lighting, nature sounds, outdoor entertaining spaces for workplace and hospitality, cycling promotion, carless cities, meditation rooms and openable windows!

Image Credit:
Victoria Pride Centre, Grant Amor Architects and Brearley Architects + Urbanists

If you would like further information or to discuss anything in this Construction Market Update, please reach out to any of our key state contacts below.

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Exsto and Slattery

Thank you to **Peter O'Donoghue from Exsto Management** for contributing to this Construction Market Update with on the ground knowledge of the market in Tasmania.

Exsto and Slattery have a well-established partnership, having worked closely together on major projects in Tasmania and nationally in Australia since 2017.

Together, we are a collaborative team of experts that understands the local market, its efficiencies and inefficiencies, the contractors capable, and the design teams involved with future projects.

Exsto Management was established in November 2012 following the acquisition of AECOM's Davis Langdon Tasmanian business.

With over 40 years of experience, a reputation as a respected provider of Cost and Project Management Consultancy Services has been continued with Exsto Management now a provider of whole of project advisory and management services to both the Private and Public Sector.

Exsto bring with them a strong reputation for providing a positive and valued contribution in delivering successful project outcomes.

Image credit:
UTAS Cradle Coast,
John Wardle Architects

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

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

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