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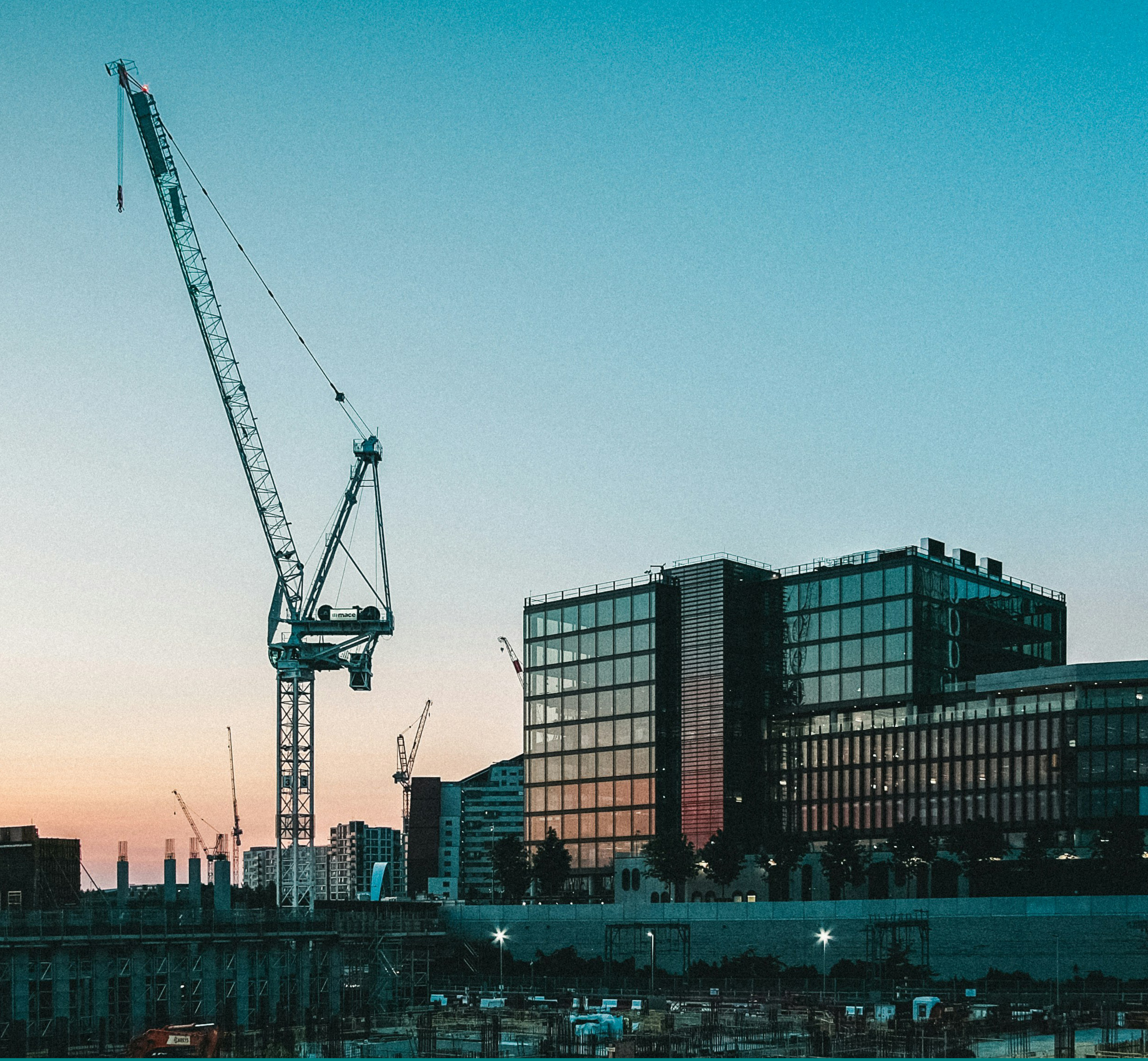
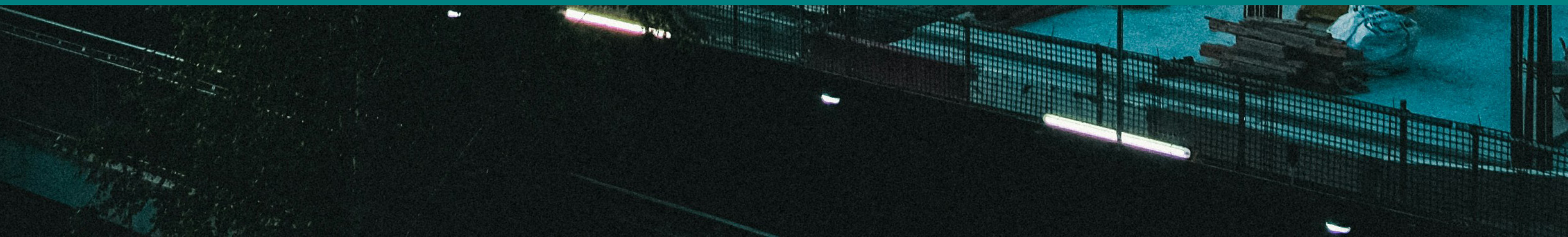


Slattery National Market Update

Balancing costs, building foundations

December 2023



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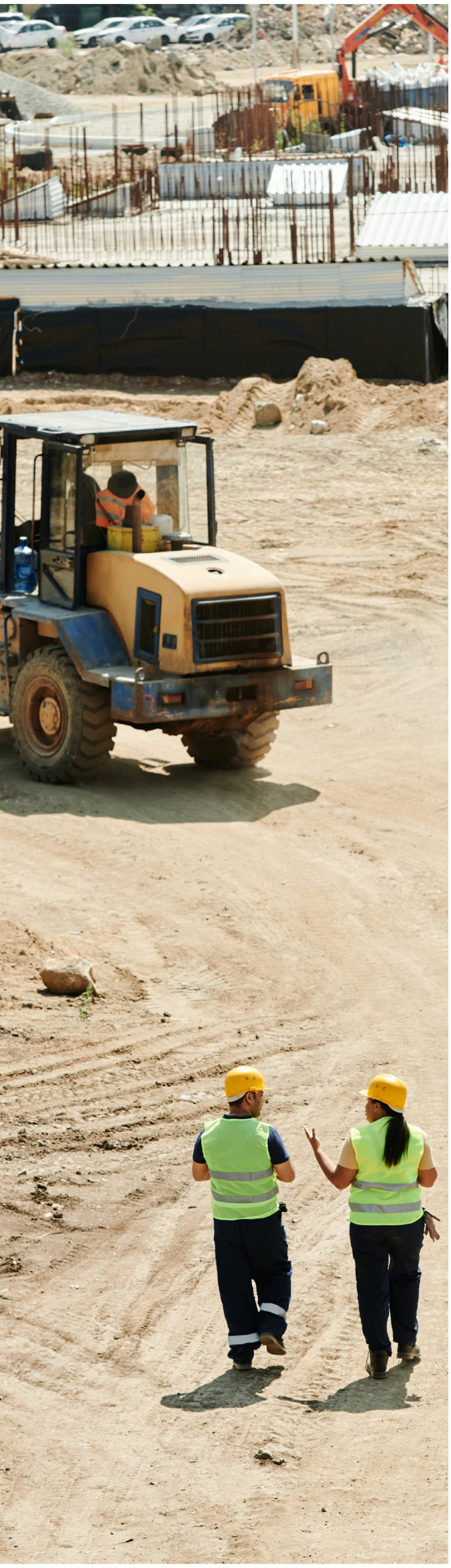

Balancing costs, building foundations

Inflation, interest rate hikes and insolvencies have been a consistent story over the course of 2023, but the biggest challenge ahead is labour costs, according to Slattery's latest Market Update.

The forecast

Slattery is forecasting an average of 4-6% per annum for the first quarter of 2024 in Australia's major markets, although variances can be expected in smaller and more remote cities. The national average does not apply consistently to all projects, materials or locations.

We expect the market to revert to the traditional long-term average of 3-4% per annum over the course of 2024. However, cost predictions can be precarious. Therefore, we recommend clients analyse their portfolio of projects to understand the impact of cost escalation and adopt appropriate mitigation strategies.

Overview

In this update, Slattery examines how Australia's construction market is responding to macroeconomic forces and market-specific issues. We cover primary cost pressures and provide a state-by-state commentary on the factors influencing costs.

City	2022	2023	2024 and beyond
Sydney	6-8%	4-6%	4-5%
Melbourne	8-10%	4-6%	3-4%
Brisbane	10-12%	6%	6-7%
Perth	10-12%	4.5-5.5%	4.5-5.5%
Adelaide	5-7%	4.5%	4.5-5%
Hobart	10-12%	8%	6-8%

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National overview

While inflation has eased, the Consumer Price Index for the September quarter sat at 5.4%. This is still above the Reserve Bank's target of 2-3%, prompting a Melbourne Cup Day rate rise. As interest rates hit a 12-year high in November, mortgage repayments as a share of Australian household disposable income leapt to a record level of 9.5%.

Australia recorded the sharpest falls in household disposable income in the developed world in 2023, according to the OECD. Reserve Bank analysis shows $181 million is being extracted from the economy each day in interest – $100 million more than the previous year.

Despite uncertain macroeconomic conditions, Australia's property sector is cautiously optimistic. The most recent Property Council survey, released in late September, found construction activity expectations were generally positive across all asset classes, with the exception of retail and office.

> "Given labour accounts for around 50% of most construction projects, and with labour at a premium for both trades and professional services, we expect industrial relations will be a hot topic and a cost lever in 2024."

Labour

The national unemployment rate of 3.7% sits slightly higher than the 3.6% recorded the previous quarter, but is nevertheless close to a 50-year low. Conditions have eased slightly, with the Australian Bureau of Statistics noting 28,800 vacancies for construction positions nationwide to August, down from 33,100 the previous quarter.

The latest Skills Priority List, published by Jobs and Skills Australia in October, shows that 36% of occupations assessed are in shortage. Technicians, trade workers and professional occupations have the highest shortages, particularly in regional and remote areas. Skills supply won't match demand until March 2025, according to Infrastructure Australia estimates.

Enterprise agreements posted average pay rises of 4% or more for 10 weeks straight from mid-July, according to the Fair Work Commission. The Construction, Forestry, Maritime, Mining and Energy Union (CFMEU) is currently bargaining for a 5% annual pay rise, which is likely to be 8% in the first year. This will add further wage pressures and see the gap between EBA and non-EBA projects widen in 2024.

Given labour accounts for around 50% of most construction projects, and with labour at a premium for both trades and professional services, we expect industrial relations will be a hot topic and a cost lever in 2024.

Materials

Materials cost escalation has eased over 2023, following record price increases in 2022. Prices for some materials, notably steel, have plateaued. Some cost increases have followed energy price hikes, but in general price increases are aligned with the volume of work in the market.

Sometimes global prices for materials will fall, but suppliers are reluctant to pass that on. What does that mean for projects? Escalation has eased – which means prices aren't rising as steeply as they were, but they won't go backwards. Developers expecting prices to retract as part of their assumptions are likely to be disappointed.

Insolvencies

The number of construction-industry insolvencies rose to 1,001 for the financial year, according to figures published by corporate regulator ASIC in November. Construction liquidations accounted for one third of the total 3,308. Last year, construction insolvencies reached a decade-high of 2,213.

CreditorWatch chief executive Patrick Coghlan told the Australian Financial Review in November that the worst of the insolvencies were over as loss-making fixed-price contracts wound up. CreditorWatch didn't expect failure rates to be "more than another five-to-ten per cent", although another interest rate increase would fuel further insolvencies.

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Key national impacts *cont.*

Infrastructure

The reality of cost escalation has hit home for governments, as budget blowouts put infrastructure projects and programs at risk. The Australian Government's snap strategic review of the $120 billion infrastructure pipeline found many of the projects promised were without merit or proper planning. Consequently the Albanese government slashed $7 billion in federal funding from 50 road and rail projects; although it did add $6.7 billion in extra funding for infrastructure projects already underway. Some residential developers have expressed hopes that this will free up capacity and reduce some of the competition for subcontractors.

Commercial

Average vacancies in Australia's office markets continue to trend upwards. The Overall CBD vacancy increased from 12.6% to 12.8% nationally, according to the most recent edition of the Property Council Office Market Report and non-CBD vacancies rose from 15.2% to 17.3%. Few projects are likely to commence without large tenant precommitments.

As commercial tenants in CBD markets continue their flight to quality, office owners are reappraising their portfolios. More than $6.1 billion was written down from the portfolios of Australia's real estate investment trusts (REITs) in FY23, according to analysis by the Australian financial Review. In response, REITs are turning their attention to alternative asset classes, including data centres, self-storage, build-to-rent (BTR) and co-living.

Residential

Australia added more than 563,000 people to the population in the 12 months to March 2023. Housing Australia suggests the gap between migration and homebuilding could see a shortfall of 175,000 dwellings by 2027. Rental vacancies are at sub-1% in some markets, and renters won't see a reprieve any time soon as the pace of apartment building slows. The supply pipeline of inner-city apartments dropped 8% year-on-year, according to JLL's Q3 Apartment Market Overview. Meanwhile, REITs are looking towards BTR. Governments have started to offer incentives. Analysts suggest, with the right settings, BTR could deliver 150,000 homes over the next decade.

Changing contractor models

The conversation about 'risk sharing' continues. Builders scarred by the 'profitless boom' are increasingly reticent about new Design & Construct contracts. There is a growing acceptance that unfair allocation of risk between parties is a significant contributor to project and contractor failure. Some builders are bringing services inhouse to better manage risk, while others are insisting on Early Contractor Involvement.

Sustainability

Many developers see sustainability as a differentiator today; but it will rapidly become a "ticket to play" as investors and regulators call on the industry to demonstrate its green credentials. The Australian Government is proposing to mandate climate reporting, based on the International Sustainability Standards Board's new framework, from 1 July 2024. ASIC chairman Joe Longo has said it will be the "biggest change to corporate reporting in a generation". This will require Australia's biggest companies to disclose their carbon emissions across a range of categories, including the Scope 3 emissions generated in their supply chains. This will have cascading implications for the construction industry, as Scope 3 is essentially embodied carbon.

NABERS, the National Australian Built Environment Rating System, is currently developing a framework to measure, benchmark and certify embodied carbon emissions. Informed by industry expertise, including from Slattery, NABERS expects to release the framework in 2024. The NSW Government has also mandated embodied carbon reporting as part of its new Sustainable Buildings SEPP (see our section on NSW for more).

A big shift is coming. Data collection is the first step, and companies across the construction industry can expect more questions about material quantities and their carbon impacts.

Image:
Indi Footscray
Footscray, VIC

Slattery is providing cost and carbon planning services - click to learn more about this BTR project

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State-by-state trends

Australia's construction costs are influenced by local constraints and challenges. Our 'around-the-grounds' covers some of the key costs in each market where Slattery and its partners operate.

New South Wales

In a volatile economic environment, the local construction industry continues to face cost blowouts, skills and materials shortages and significant government procurement challenges. Key factors influencing the market include:

- **A tight labour market:** With the cost of labour around 50% of most construction projects, skills shortages continue to cause headaches. The NSW-wide unemployment rate edged up slightly to 3.3% over the quarter, following its record low of 3% earlier this year. But the NSW Government has noted that skills shortages, compounded by interstate and international competition for the same resources, are an ongoing cost challenge.
- **Infrastructure update:** The 2023–24 Budget includes $116.5 billion in infrastructure investment over the next four years. The infrastructure program is shifting away from complex megaprojects, and towards schools, hospitals and roads. The NSW Government has committed $13.8 billion over the next four years to healthcare projects alone, and more than 100 capital works projects are underway.
- **Federal funding cut:** 17 NSW projects lost $3.5 billion in federal funding following the national infrastructure review. Some of this was redirected to top up existing NSW infrastructure projects, but NSW Treasurer Daniel Mookhey estimated the state would still lose $1.4 billion in funding.
- **Residential reframe:** The Minns Government's first budget allocated $2.2 billion for housing, critical infrastructure and better planning. In November, the NSW Government Architect introduced a "pattern book" for residential development, and an accelerated approval pathway for pre-approved designs. Some developers are on the hunt for new sites, but the market is generally cautious and capital is hard to attract. Amid the current economic uncertainty, and with the cost of money rising, few developers are willing to build speculative housing.
- **Quest for quality:** In November the Minns Government announced it would not allow quantity to come at the expense of quality, increasing the powers and resources of the NSW Building Commission to crack down on poor building practices.
- **Sustainable Buildings SEPP:** The new Sustainable Buildings SEPP came into force on 1 October 2023. This policy aims to help the NSW Government meet its net zero target by 2050. Developers must calculate and report on carbon emissions – both in operation and those generated upfront during design and construction. Large commercial buildings and certain state significant developments must also operate without fossil fuels by 2035. While these targets may sound distant, developers must demonstrate their intentions to achieve approval. Meeting these requirements is likely to come at a cost.

Pipeline visibility is hazy beyond the next six months, but a reduction in the volume of work doesn't necessarily translate into easing cost escalation. While we estimate costs will increase by 4-5% overall in 2024, we expect it to be closer to 6% in the residential sector and 7% for infrastructure.

Victoria

Following significant price hikes in 2022, the tender market stabilised across all tiers. But the next 12 months won't be smooth sailing for Victoria's property and construction industry, as infrastructure megaprojects reach practical completion and the project pipeline dries up.

- **Infrastructure axe falls:** Twelve Victorian projects have been de-funded following the federal review of the nation's infrastructure pipeline. The review recommended the $4 billion plan for faster rail between Melbourne and Geelong be abandoned, and cast doubt over the business case for the Suburban Rail Loop. The Victorian Government hopes the Commonwealth will contribute a third of the $35 billion needed for the first section – an increasingly unlikely outcome.
- **Residential ramp up:** The Victorian Government has committed to building 800,000 new homes, including 12,000 social and affordable dwellings, as part of a four-year, $5.3 billion Big Housing Build plan. But new data from the Department of Families, Fairness and Housing suggests this is ambitious, as just 394 new properties were added to the state's social housing stock over the last five years. The housing affordability challenge ahead is whetting the appetite of REITs in the nascent BTR asset class.
- **Relife and retrofit:** A range of market drivers are propelling the property market towards adaptive reuse of commercial offices: net zero targets and ESG imperatives, the higher cost of debt and protracted development approvals, the need to repurpose low-grade office stock and more. The City of Melbourne launched its Retrofit Melbourne Plan in October 2023 with a determination to reach its target of net-zero emissions by 2040. This includes a goal that all mid-tier commercial buildings are 'zero carbon ready' by 2040, with a plan to tackle embodied carbon. More than 80 buildings will need upgrades each year to reach this target; currently, the Council averages just seven.

- **Project pivots:** We are seeing a host of companies pivot to new sectors. Real estate investment trusts are looking at build-to-rent and co-living, for instance. Construction companies are moving from office development to renewable energy and infrastructure.
- **New models:** As contractors grapple with ongoing cost pressures, they are trying to recover that through their projects. As a consequence, contractor overhead margins are increasing. Procurement models are also changing; the move away from the Design & Construct model continues, as builders become more risk averse and look for a fairer share of risk.
- **Equipment cost crunch:** Most equipment companies continue to focus on infrastructure projects, which means any project that requires excavation will come with a cost premium.

Victoria faces evolving challenges, prompting a projection of cost escalation returning to the traditional long-term average of 3-4% per annum in 2024.

Queensland

Queensland's market can be characterised as the 'calm before the storm'. While there is more capacity in the market now, this is before billions of dollars of work shifts from numbers on a page to boots on the ground in 2024. Key local factors include:

- **Big Build:** A $20.3 billion capital investment in the 2023-24 State Budget – part of a $88 billion investment over four years – will support the delivery of the state's biggest transformational projects. This includes the 10-year $7.1 billion Brisbane 2032 venues infrastructure program, the Queensland Energy and Jobs Plan, and new health and transport facilities. As these projects hit the market, they will soak up skills.
- **Mega renewables project:** Queensland has committed $14 billion for a pumped hydro project on the Sunshine Coast. Money was also allocated in the 2023 state budget for the Pioneer-Burdekin project – hailed as the largest pumped hydro project in the world. The total cost for the two pumped hydro projects in Queensland is expected to top $30 billion.
- **Hospitals hit the ground:** Queensland Health has three new hospitals and nine major hospital expansions totalling more than $8 billion worth of capital works. These will come to market in 2024, and shovels will hit the ground in the second quarter.
- **Skills squeeze:** A shortfall of tens of thousands of skilled tradespeople and professionals continues to blow out project timelines and budgets, and potentially placing the ambitious Olympic Games program at risk. While trades and professionals – notably mechanical, electrical and hydraulics specialists – are needed to deliver the infrastructure for the growing state, their arrival exacerbates an already acute housing shortage.
- **Residential refresh:** We are seeing most private work stalling as construction costs and interest rate rises continue to bite. While residential work would usually account for around half of our order book, this has fallen to 25%. We are seeing several large developers pivot away from multi-unit residential development and towards social and affordable housing as government dollars flow in that direction.
- **Caution ahead:** Subcontractors are still wary of projects above the $50 million mark that they perceive to be risky. Many contractors are uninterested in bidding for private work while their books are full. Others, driven by fear of market insolvencies and rising wages bills, incorporate a substantial buffer on tenders.

For Queensland, it is business as usual – for now. But the next surge of projects is coming. As costs continue to rise by 0.5% per month in Brisbane, and up to 0.9% each month on the Gold Coast, we expect escalation to run at an average of 6-7% per annum over the course of 2024.

South Australia

Scarcity of skilled labour, a surge in government investment and strategic shifts in property projects have shaped South Australia's market over the last few months. While the market remains robust, key influences include:

- **Skills:** Demand for labour is the biggest challenge on construction projects. Attracting interest from trades is especially tough, and any job with a rushed program is struggling to find the skills to deliver. South Australia's construction labour market is currently at capacity, and Infrastructure Partnerships Australia predicts demand will reach 131.5% of supply by October 2024.
- **Government projects:** The South Australian Government has committed $21 billion to new and upgraded infrastructure over four years from 2023–24, and the Department for Infrastructure and Transport maintains a strong pipeline of projects. In the last quarter, a contractor was appointed to the $135 million Adelaide Aquatic Centre, for instance, and the $3.2 billion Adelaide Women's and Children's Hospital gained a tick of approval from the Commonwealth environment department in November.
- **Property pivot:** Large construction companies are pivoting to the defence sector as office work dries up. In mid-November, the federal and SA governments announced a new strategy to support the delivery of some of the nation's most complex defence projects. Other companies are looking to capitalise on spending in the justice sector.
- **Private sector projects:** Adelaide Economic Development Agency tracks a long list of investments, including the $1 billion One Festival Tower and $400 million Market Square, which are both under construction, and the $500 million Australian Bragg Centre, which is nearing completion.
- **Infrastructure cuts:** South Australia lost $400 million in federal funding for five road upgrade projects, as part of the Albanese Government's infrastructure review. But several other projects will proceed as planned, with the North-South Corridor allocated an additional $2.7 billion in funding.

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We expect cost escalation to sit at 4.5% per annum for 2024. With infrastructure projects ramping up towards the back end of 2024, this could increase beyond 5% per annum.

Tasmania

The Tasmanian construction market continues at pace, fuelled by large-value projects and government infrastructure programs that have been locked and loaded for some time. Influences of note include:

- **Labour squeeze:** As Tasmania draws from a limited labour pool, government and tertiary projects continue to drive demand for skills. Securing interstate talent – both contractors and consultants – is an ongoing challenge and can attract a premium of 35% or more.
- **State election:** The next Tasmanian state election must be held before Saturday 28 June 2025. While this is still some way off, the date will weigh on the state government's ability to spend.
- **Residential focus:** As cost-of-living pressures mount, the Tasmanian Government has sharpened its focus on tangible action around affordable and social housing. The most recent development, in November, was $50 million in federal funding, as part of the $2 billion national Social Housing Accelerator, for 110 affordable homes in Tasmania.
- **Stadiums Tasmania:** The Tasmanian Government has fast-tracked the $715-million multi-purpose stadium at Macquarie Point; the Australian Government has committed $240 million and the Tasmanian Government will contribute $375 million. The first round of tenders is underway and the project is gaining momentum. Meanwhile, the $200 million upgrade of the UTAS Stadium in Launceston continues to progress as the local council plans to hand over management to Stadiums Tasmania.
- **Private projects:** Several projects in the $50 million range are in the final stages of negotiation and value management. We expect some will break ground in the new year.
- **Renewable revolution:** Tasmania's renewable energy sector continues to grow – and this is an area of competition for traditional construction. The $3 billion Marinus Link high-voltage cable between Tasmania and Victoria, the state's equivalent to Snowy 2.0, promises to unlock hydro-electric power equivalent to 30,000 times Australia's biggest battery.

Constrained by its small labour market, we expect Tasmania to see cost escalation at approximately 8% per annum in 2024.

Western Australia

Construction material cost escalation has eased over 2023, however with labour costs still sky high, Western Australian construction teams shouldn't anticipate price reductions in 2024. Some of local factors influencing the WA market include:

- **Skills shortages:** Skills, always a challenge in Western Australia, are a constant focus for government policy and funding. In November, the WA Government expanded its wage subsidy scheme to attract more building and construction apprentices and trainees. This follows relaxed visa requirements to encourage more skilled migrants to the state.
- **Infrastructure funding shortfalls:** Five WA projects worth a total of $300 million face a funding shortfall after the federal government withdrew its support following the strategic infrastructure review. This includes a $200 million bypass highway around the town of Pinjarra and sealing the Marble Bar Road in the state's north. The Premier has said the WA Government will cover any funding shortfall.
- **Long lead times:** Residential projects that once took 12 months can now take 24; waits on materials have increased from six weeks to six months. Some project teams are taking longer lead times in their stride, and clients are more accepting of earlier 'deposit' payments. Others continue to find the market challenging to navigate, especially when a lag on materials, such as engineered timber, can slow down development programs by many months.
- **Insolvencies:** Several large-scale builders have gone down in 2023, with consequences not only for residential customers but for government projects, such as schools. We are seeing contractors moving away from a fixed lump sum as early contractor involvement becomes their preferred approach.
- **A geographical challenge:** The Perth-Peel metropolitan area is not just the world's most isolated city; it's also the longest. The city's sprawl presents infrastructure delivery challenges, not to mention liveability issues. Recent government incentives, including fee relief and a focus on inner-city affordable housing, are welcome but may have little impact without improved delivery appetite.

As Western Australia navigates a complex construction market, we expect costs to maintain a steady course, ranging between 4.5% per annum and 5.5% per annum in 2024.

> "With materials prices attaining equilibrium, the spotlight remains on labour costs. Understanding the nuanced dynamics of skilled shortages, rising wages and evolving contracting models in each market is vital for smart, strategic decision-making"
>
> **Sarah Slattery**
> CEO, Slattery

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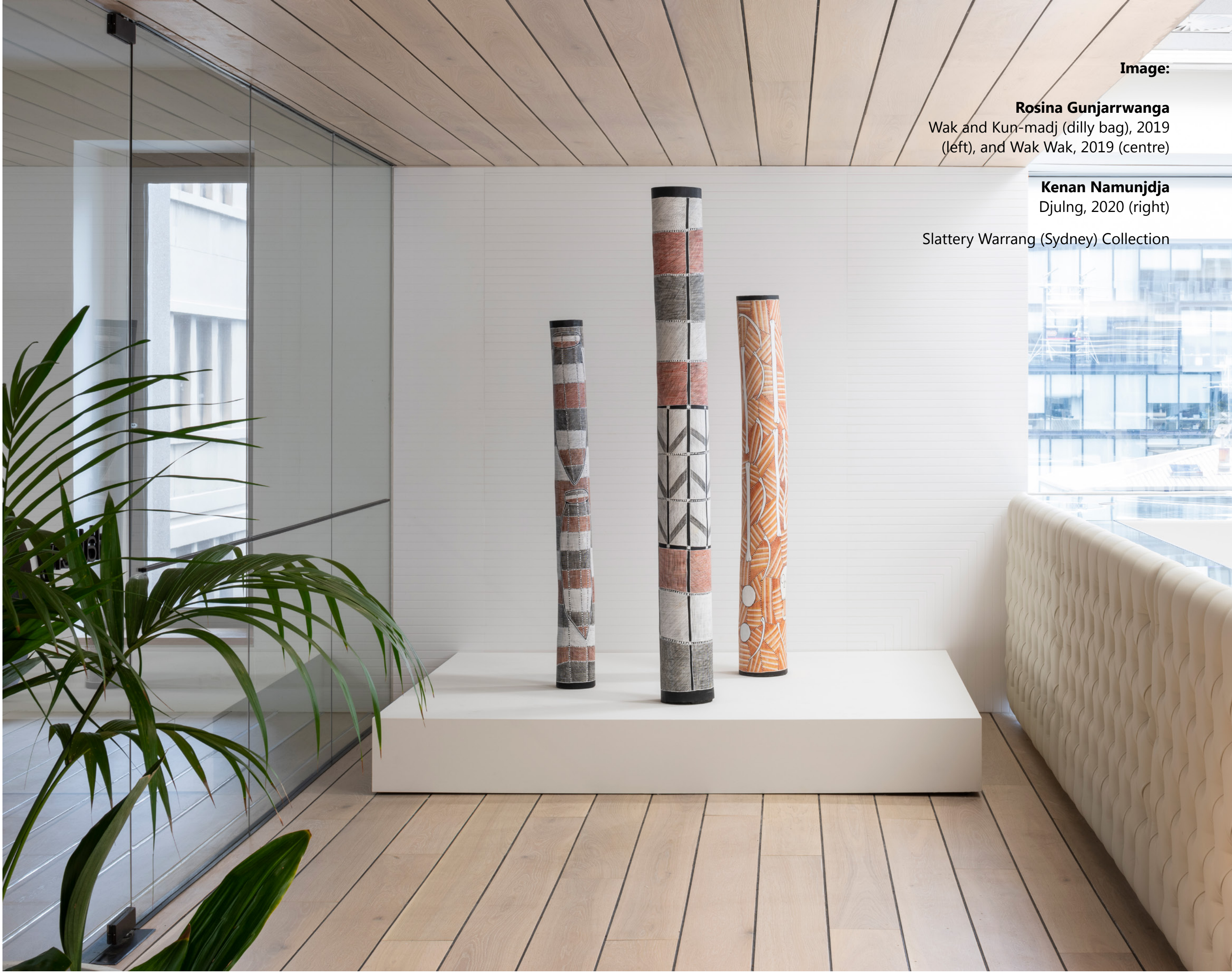

Image:

Rosina Gunjarrwanga
Wak and Kun-madj (dilly bag), 2019 (left), and Wak Wak, 2019 (centre)

Kenan Namunjdja
Djulng, 2020 (right)

Slattery Warrang (Sydney) Collection

About Slattery and our collaborators

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

Thank you to **Peter O'Donoghue, Director** from **Exsto Management** and **Travis Swigart, Managing Director** from **Chris Sale Consulting** for contributing to this Construction Market Update with on-the-ground knowledge of the market in Tasmania and South Australia respectively.

Image:
Powerhouse Parramatta
Parramatta, NSW

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