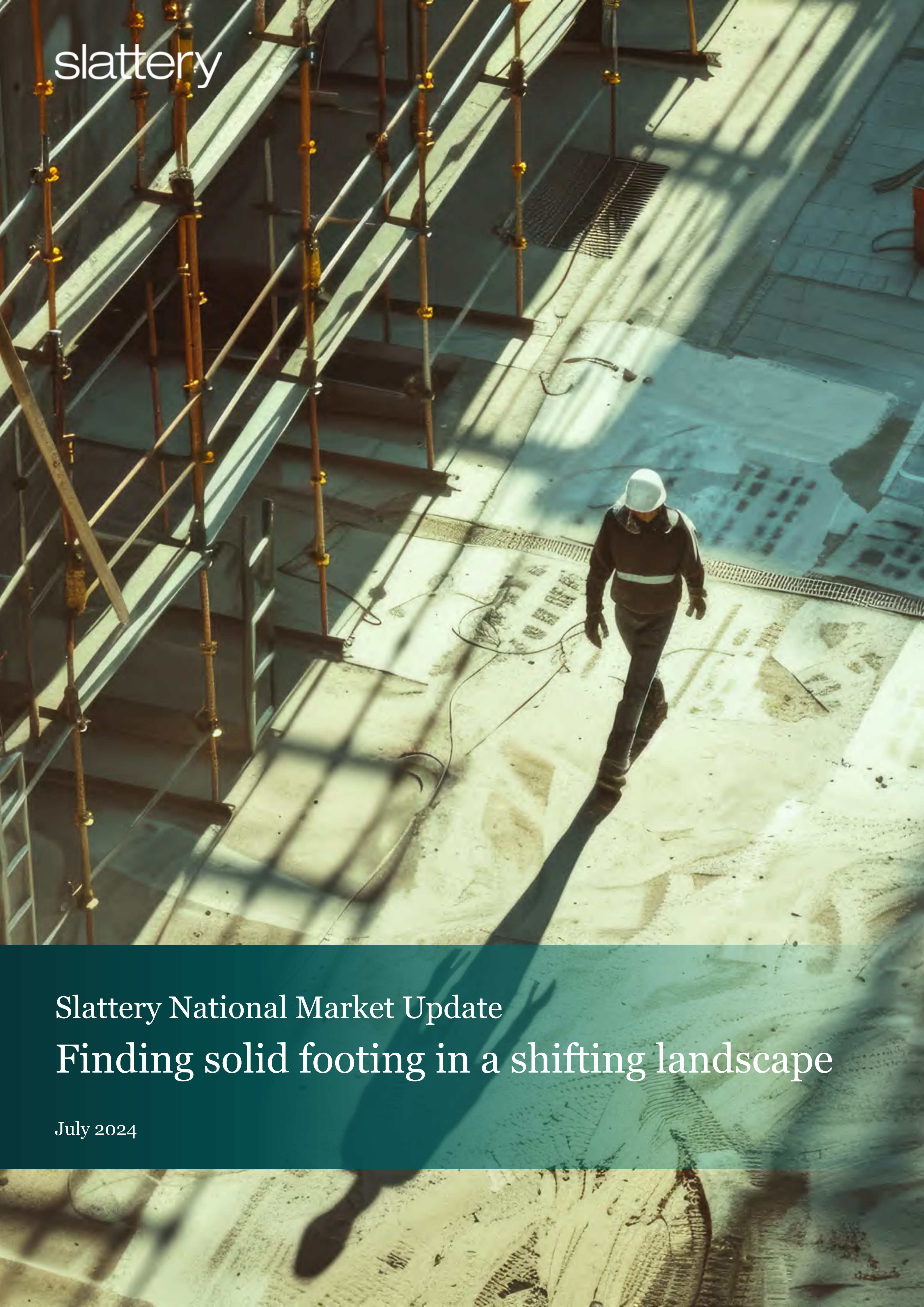

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Slattery National Market Update

Finding solid footing in a shifting landscape

July 2024

Finding solid footing in a shifting landscape

Construction sector activity has slowed as governments step back from public infrastructure spending, labour costs continue to climb and private developers steer clear of risky projects. But there are bright spots ahead on the horizon, as adaptable and innovative businesses pivot to take advantage of investment in defence, energy and future industries.

Overview

In this update, Slattery unpacks the macroeconomic forces and market-specific issues that influence costs in Australia's construction industry. We cover primary cost pressures influencing all markets, as well as state-by-state commentary. We also cover infrastructure cost pressures.

The forecast

Slattery's forecasts an average of 4-6% cost escalation per annum for the remainder of 2024. This forecast covers all of Australia's major markets, although this national average does not apply consistently to all projects, materials or locations.

Cost escalation can be unpredictable. Therefore, we recommend clients actively analyse their projects and portfolios to understand how costs may change as the market moves, and adopt appropriate mitigation strategies.

City	2024 forecast	2025 forecast
Sydney	4-5%	4-5%
Melbourne	4-5%	4-5%
Brisbane	4.5-5.5%	4.5-5.5%
Adelaide	4-5%	4.5-5.5%
Hobart	8%	6-8%
Perth	4.5-5.5%	4.5-5.5%

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National overview

Construction was the economy's weakest sector over the first quarter of 2024, with industry output falling sharply by 2.6%. This decline was driven by a 2.3% reduction in construction services, a 3.1% decrease in building construction, and a 2.6% drop in heavy and civil engineering construction.

Construction's poor performance translates directly to Australia's Gross Domestic Product, which grew by just 0.1%, according to the latest data from the Australian Bureau of Statistics.

Inflation hit a six-month high in June. The odds of an August rate rise are now one in three, according to investors and analysts, after annual inflation jumped to 4% in May, up from 3.6% in April. The inflation rate remains outside the Reserve Bank of Australia's target range of 2-3%. Meanwhile, the RBA has noted that highly leveraged mortgage holders are starting to sell; mortgage discharges are running at a record $40 billion per quarter as stretched owners offload property.

The global outlook remains "highly uncertain", according to the RBA, although both the Chinese and United States economies show signs of improving and some commodity prices are on the rise. Several central banks have relaxed their monetary policies but remain vigilant as geopolitical uncertainties, particularly those in the Middle East and Ukraine, continue to pose threats to supply chains.

Labour and skills

According to the most recent ABS data, annual wage growth across the economy was 4.1% to March 2024. Unemployment sits at 4.0%.

Australia's 1.35 million strong construction workforce cannot keep up with demand. Master Builders Australia estimates that replacing those exiting the industry and matching supply and demand will require at least 593,000 new workers over the next five years. Each of the 15 key occupation groups in the building and construction industry are in shortage. Skills squeezes inevitably push up the cost of projects.

According to MBA's April member sentiment survey, 66% of respondents said that sourcing workers was the biggest issue facing the building and construction industry. This was followed by regulation overreach (56%) and the cost of materials (49%).

The disparity of wages between government and private sector projects has left the private sector unable to compete, according to the Australian Constructors Association's latest sentiment survey.

Meanwhile, builders are starting to sign up to the CFMEU's new enterprise bargaining agreements, which include a 20% pay increase over four years in Victoria and 24% compounded over four years in New South Wales. CFMEU Queensland secured a 26% increase over five years. In some cases, contractors will be required to consult with the CFMEU when they engage subcontractors to ensure they are paid at least the CFMEU EBA rate.

The Fair Work Commission has "closed loopholes" which means labour hire contractors must be paid no less than the same pay rate they would receive under the employer's enterprise agreement. We have already seen this translate to increases in pricing.

Materials

Material costs in the Australian construction industry have been a mixed bag in 2024. Prices for structural materials like steel and timber have levelled off after a period of intense escalation, providing some relief to builders. However, costs for energy-intensive materials such as concrete and insulation continue to climb in line with rising energy prices. Masonry costs have also edged up, though their impact on large projects is minor. Price rises for materials now correlate with the level of activity in the market. We are slowly reverting to the historical annual escalation of around 3-4%.

Insolvencies

Construction continues to account for the largest single category of insolvencies on ASIC's database, with 27.1% of the 9,988 year-to-date total. This is slightly less than the 28.1% the previous year. Most of the insolvencies are now subcontractors with less consumer exposure.

Builders often face financial strain in rising markets, as costs escalate faster than prices they can command from customers. Subcontractors, on the other hand, are hit hard during market downturns as they struggle with insufficient cash flow to sustain their operations.

National overview *cont.*

Infrastructure

Estimating costs on large infrastructure projects means taking a long-term view, as projects may not commence construction for five years or more. This forward-looking approach can provide valuable insights into other sectors of the construction industry.

The general feel in the infrastructure sector is that 2024 is a time of transition.

Australia's public infrastructure pipeline, valued at $230 billion over the next five years, remains an ambitious undertaking and must be delivered alongside 1.2 million new homes, record spending on defence infrastructure and the renewable energy transition. Finding skills to deliver these competing priorities will remain a challenge for the foreseeable future.

The Australian Government's snap infrastructure review in 2023, in which 50 road and rail projects were canned, has had a cascading influence on market confidence. Overruns on previous projects are causing nervousness on new projects, particularly in Victoria where state debt is at record levels.

State government budgets have tightened, making business cases harder to justify and project approvals have slowed. The increased price of labour and materials are clear factors impacting decision making in the current economic climate.

Firms in the infrastructure space are pivoting from road and rail to energy and defence. Road and rail projects received relatively modest sums in the May Federal Budget. This included $3.25 billion for Victoria's North East Link, $1.9 billion for Western Sydney road and rail infrastructure, and $1.4 billion for METRONET projects in Perth.

In comparison, the Australian Government has earmarked $15 billion to encourage investment in green hydrogen production, is spending billions on renewable energy zones and 10,000 kilometres of new energy transmission lines, and is directing an additional $50 billion over the next decade to defence. These priorities will all require buildings and infrastructure – but most of this development will be in regional areas.

Money is more expensive than it was a year ago. The rising cost of capital has hurt commercial development, in particular. As the risk profile changes, more investors look to park their cash in bonds over buildings.

City-shaping projects, such as Sydney Metro and Melbourne's Suburban Rail Loop, will keep many people in work. But most of the big-ticket items in the years ahead will be in regional areas – and that has significant labour force implications. The short commute may be a thing of the past.

Construction of new airport infrastructure also continues at pace. With passenger numbers set to double in the next two decades, Melbourne Airport continues to embark on a significant program of construction across airfields, terminals and ground transport systems. Among the signs of the times, Perth Airport is investing $5 billion on a range of projects, including the precinct's first hotel. Brisbane Airport is funnelling $5 billion into 150 projects under the Future BNE banner in preparation for the Brisbane Olympic Games. Gold Coast Airport has unveiled plans for a new retail village, health and wellness hub and conference and tech centre as part of its 2024 Preliminary Draft Master Plan.

Commercial

Money is more expensive than it was a year ago. The rising cost of capital has hurt commercial development, in particular. As the risk profile changes, more investors look to park their cash in bonds over buildings.

This is particularly evident in the office market, where lack of demand is stifling new development. The January 2024 issue of the Property Council's Office Market Report shows national CBD vacancy now sits at 13.5% and non-CBD vacancy at 17.9%. Vacancy rates, combined with higher borrowing costs, continue to flow through to office asset values. Australia's largest landlords are responding by reshaping their portfolios, divesting assets and trimming their development teams.

Various types of 'big sheds' – whether industrial facilities, warehouses or data centres – are in strong demand. According to some estimates, more than $13.6 billion was directed towards data centre construction in 2023, equating to 150,000 sqm of space. Industrial buildings are particularly appealing to builders because they are fast to construct and pump businesses with cash flow.

Residential

Australia's population grew by 651,200 people (2.5%) over the year to 31 December 2023, and housing affordability remains a hot topic across the country.

The 2024 Demographia International Housing Affordability report ranked Sydney as the second least affordable market in the world, behind Hong Kong. Melbourne and Adelaide were also ignominious inclusions in the 10 least affordable markets of the 94 assessed.

A "staggering" 81% of respondents to the Australian Constructors Association's latest sentiment survey, published in June, said residential construction was either declining or stagnating. Regulation, planning approvals and costs continue to stifle development. The cost to build new homes has increased by 40% since pre-Covid, according to Master Builders Australia.

Adaptive reuse, built-to-rent (BTR) and co-living are all being touted as solutions but often do not achieve the margins necessary to take the risk. BTR currently makes up just 0.2% of the housing market, according to the Property Council. In comparison, 5% of UK housing stock is BTR, and 12% in the US. Recent legislative amendments recognise the role of BTR housing, but the Property Council says Australia does not have the "level pathway" needed to support the needed 150,000 new BTR homes by 2034.
We are seeing moderate to strong growth in aged care, retirement living and student accommodation. This is keeping some companies in work, although developments must still stack up with the cost of construction.

Sustainability

Australia's largest companies have earned a short reprieve as new mandatory climate disclosures have been delayed until 1 January 2025.

Initially capturing companies with revenues of $500 million or more, disclosure of climate risks, opportunities and impacts will sit alongside financial statements and will need to be signed off by an auditor. This new reporting requirement will ripple through the construction supply chain.

The federal government has flagged its intention to expand the Commercial Building Disclosure program, which currently requires every office more than 1,000 sqm to disclose its NABERS Energy rating at the time of sale or lease. Expanding the CBD program into other sectors is likely to drive a new wave of investment in energy efficiency.

Meanwhile, supply chain emissions are under scrutiny with NABERS, the National Australian Built Environment Rating System, piloting projects for the new embodied carbon rating tool. Informed by industry expertise, including advisory services from Slattery, NABERS will release the final tool later in 2024. This is likely to encourage the uptake of Environmental Product Declarations. EPDs will improve supply chain transparency and eventually become business-as-usual. In the short term, there will be an additional cost impost for trailblazers; but those trailblazers are also best placed to seize the competitive market advantage.

Slattery rates embodied carbon

Informed by industry expertise, including advisory services from Slattery, NABERS is developing a new embodied carbon rating tool to launch in 2024.

Click to read more and join the pilot program to see your project become one of the first buildings in Australia to have a NABERS Embodied Carbon rating.

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State-by-state trends

New South Wales

Soaring costs for labour and finance, together with a long list of development fees and charges, mean many projects are no longer feasible. Several local factors are influencing costs in New South Wales construction:

- **Government spending:** The state government's 2024-25 Budget Infrastructure Statement details $119.4 billion of investment over four years, with a "realignment" of the capital program to housing, schools, healthcare and essential services. More funds are being directed towards operations and compliance, especially in the health sector. More than $1.4 billion has been set aside to build new schools and bring existing education buildings up to current standards.
- **Extra taxes:** Taxes are now upwards of 50% of development costs in NSW. Increases in new taxes and development contributions over the last 12 months include the new water and wastewater infrastructure contribution, from 1 July, as well as increases to land tax, foreign investor surcharges and responsibility for the Emergency Services Levy (ESL). The Property Council warned has warned that the $4.7 billion cost transfer of the ESL from insurers to property owners, coupled with the $1.68 billion hike on land tax and foreign surcharges, will cripple the state's ability to deliver affordable housing.
- **Enterprise bargaining agreements:** Several builders, including Buildcorp, Aqualand and Roberts Co, have signed up to the CFMEU's new industry agreement in NSW, which includes pay increase of more than 22% over four years (7% in 2024, followed by three years of 5%). This represents the CFMEU's biggest wage rise nationally, according to the Australian Financial Review, at a compounded increase of 24%.
- **Skills squeezes:** The NSW unemployment rate has come off its recent low of 3.0% in June 2023 but remains below NSW Treasury's estimates of full employment (4.0%).
- **Planning bottlenecks:** Councils remain a significant roadblock to development approval. The average time for a development application to be determined increased from 83 days in the 2021/22 financial year to 107 days in 2023/24. Developers waited longer than 195 days for approval in some council areas.
- **Housing headaches:** The 2024 Demographia International Housing Affordability report ranked Sydney the second least affordable market in the world, behind Hong Kong. Undersupply continues to underpin rising costs. But few residential projects are coming to tender, and little rubber is hitting the road as residential developers struggle to make the business case stack up.

We expect a 4-5% annual increase across NSW, holding steady at that rate over 2025, before stabilising at the traditional rate of 3–4% per annum.

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State-by-state trends *cont.*

Queensland

Queensland's market is up and down; public sector work continues at pace while private sector projects struggle to get off the ground due to high costs and skills shortages. Key local factors influencing costs include:

- **Housing's catch 22:** The Sunshine State is hurting more from housing cost increases than any other state, according to fresh research from the University of NSW. Brisbane property prices have increased by 65% since 2020, almost double the Australian capital city average (34%). New tenancy rents also climbed faster than across the nation, rising by 45% over the same period. The State Budget locks in a record $2.8 billion in 2024-25 for housing. There is also a target to build 53,500 new social homes by 2046. To build these homes, Queensland will need to import skills; but importing skills worsens the already acute housing shortage.
- **New taxes:** A new Additional Foreign Acquirer Duty levy, plus an increase to the Foreign Land Tax Surcharge, were outlined in the 2024-25 Budget. These two tax increases are expected to raise $422 million over the forward estimates, applying to Australian based developers with 50% or more international ownership or investment.

The Property Council has said these taxes would be the "final nail in the coffin for Queensland's apartment stocks".

- **Hospitals ahead:** The Queensland Government is investing more than $14 billion in health infrastructure projects, including four new hospitals and 11 upgrades, adding 2,200 new beds around the state. These projects are beginning to break ground, putting pressures on the pipeline of labour once again. Queensland's public infrastructure pipeline was 30,000 people short in May 2024, according to Infrastructure Australia's Public Infrastructure Workforce Supply Dashboard.
- **Olympics obstacles:** Proposals for a new stadium captured headlines and head space last year, but commentary has moved on to whether the Brisbane games could become the "smallest summer Olympics in a century". As costs climb, organisers are looking to reuse as much infrastructure as possible, but commitments already include a $1.6 billion refurbishment of the QEII athletics venue in Nathan, $2.5 billion for Brisbane Arena aquatics centre, as well as Olympic athletes' villages Brisbane, Gold Coast and Sunshine Coast.
- **EBAs:** CFMEU Queensland secured a 26% increase over five years earlier this year. We are hearing cases where wage increases are extending to teams on the shop floor, not just those on site, which is in turn increasing costs in the Queensland market.
- **Risky business:** Subcontractors are cautious about taking on projects above the $50 million mark that they perceive to be risky. Taking on these jobs comes with a cost premium. This continues to encourage more developers to establish in-house services to keep a close eye on costs.

We expect any current market capacity to be short lived, as billions of dollars of public infrastructure projects begin to break ground. Costs currently sit at around 4-6%, but that disguises the reality that most costs are at the higher end and trending upwards.

South Australia

A steady stream of private and public projects, along with recent federal government announcements in defence and clean energy investment, continues to bolster a buoyant South Australian market. Key influences currently include:

- **Healthy public infrastructure pipeline:** The South Australian Government has allocated $25.6 billion over the next four years for public infrastructure. This includes $15.4 billion for the North-South corridor, $3.2 billion for the Women's and Children's Hospital, $1.5 billion in SA Water infrastructure upgrades and $498 million to expand the Flinders Medical Centre. Public infrastructure maintains a steady flow of work but also redirects resources and drives up costs.
- **City shaping projects:** The Adelaide Economic Development Agency's latest list includes Market Square and the Entrepreneur and Innovation Centre at Lot Fourteen, both $400 million projects. Several hotels are in the pipeline for Marriott, Hyatt and Wyndham Grand, reorienting the CBD towards a future as an 'experience district'.
- **Busy workbooks:** While the numbers on some projects, notably residential and commercial offices, can be challenging to stack up, many projects continue to move forward. Architects, planners and certifiers are all reporting plenty of work on their books.
- **Skills boost:** The 2024-25 State Budget includes record investment in skills funding. Money for training, education and skills development has been raised to $2.3 billion, in partnership with the Commonwealth. Measures include 160,000 training places over the next five years at TAFE SA and other training providers to bolster skills in defence, health, building and construction, clean energy and more.
- **New university:** Adelaide University was officially established under state legislation in March 2024, combining the strengths of the University of South Australia and the University of Adelaide. While this is unlikely to lead to additional projects, at least initially, it reinforces the strength of the state's higher education ecosystem.
- **Residential rollout:** In June, the state government announced two major housing developments in Adelaide's western and southern suburbs with over 1,900 homes at an investment of $576 million. This was followed by a $195 million joint contribution between the federal government and community housing providers to deliver 369 social homes. The quantum of residential housing is contributing to labour strains.
- **Future industries:** South Australia's role as a defence hub and producer of large-scale clean hydrogen both promise to supercharge the state's economy, while presenting labour implications for construction companies in competition for skills.

Cost escalation is expected to sit at 4-5% per annum over the remainder of 2024. This is driven mostly by rising labour costs, as the state forges ahead with ambitious infrastructure projects and innovative city-shaping initiatives.

State-by-state trends *cont.*

Victoria

Tighter budgets and evolving infrastructure priorities are changing the operating environment for construction, the state's largest employer. Some of the state-specific issues include:

- **Budget blows:** The Victorian state budget handed down in May was austere, with several big-ticket infrastructure projects – notably the Airport Rail Link – placed on ice. Treasurer Tim Pallas noted the government was "moderating the pace" of some big projects to allow "supply chains to catch up". The Budget papers revealed that the cost of construction has risen by 22% since 2021, a consequence of escalating prices for materials, labour and transportation. However, the state government's spending on infrastructure remains above the 10-year average.
- **Airport agreement:** Melbourne Airport has agreed to the state government's proposed above ground railway station, but funding is still $3 billion short.
- **EBA squeeze:** The CFMEU's new industry agreement in Victoria of 5% a year over four years, which is around 22%, was unveiled in late June. Tier One builders are yet to publicly sign on to the deal, according to the Australian Financial Review.
- **Project pivots:** Melbourne's office CBD vacancy rate of 16.4%, according to the Property Council, is forcing landlords to consider adaptive reuse, and alternative asset classes such as build-to-rent and co-living. Market watchers suggest the office market is reaching the bottom of the cycle and starting to "open the door" to new buyers.
- **PPP pursuit:** Public private partnerships have been synonymous with "economic" structures such as toll roads. In Victoria, more than $50 billion of PPPs have been carried out under the banner of Partnerships Victoria, including the $946 million Royal Children's Hospital redevelopment, the $1.8 billion Port Phillip Prison and the roughly $1.3 billion Victorian Comprehensive Cancer Centre. It is likely that this model will expand to new infrastructure types, notably schools, to remove them from the government's balance sheet.
- **Insurance increases:** The state government's public insurer has flagged an insurance premium hike of up to 65%. The Victorian Managed Insurance Authority (VMIA) announced the increase in domestic building insurance premiums in June, to take effect on 6 August. This will cover new single and multi-dwellings; premiums for structural renovations will increase by 20%.
- **Housing worries:** Victoria has the largest annual population growth of all Australian states. With the Victorian Government's target of target of two million new dwellings by 2051 falling further out of reach, the Victorian Premier is proposing to set new housing targets for local councils.

Market chatter suggests prices in Victoria have plateaued, and cost escalation is likely to sit at 4-5% per annum for the remainder of 2024 and beyond.

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State-by-state trends *cont.*

Tasmania

All eyes are on Tasmania as ambitious large-scale projects take shape. These state significant projects effectively insulate the Apple Isle's small market from the uncertainty rippling through mainland Australia. Notable cost factors currently observed in Tasmania include:

- **Certainty and confidence:** The cost of finance has led to a noticeable lull in mid-range projects. However, state significant projects, including the new stadium at Macquarie Point, Bridgewater Bridge, the $200 million terminal upgrade at Hobart airport, as well as hospital and justice buildings peppered across Tasmania, support certainty and confidence.
- **Stadium deal sealed:** Detailed concept designs for the proposed $1.5 billion stadium at are imminent, following Cox Architecture's appointment as lead design consultant. The stadium has attracted national interest, with many firms looking to get a slice of the pie and establish a new office in Hobart. The project's assessment approval deadline is 30 June 2025, after which time ground will break very quickly.
- **Renewables roll on:** The $3 billion Marinus Link high-voltage cable between Tasmania and Victoria promises to unlock hydro-electric power equivalent to 30,000 times Australia's biggest battery. Key contracts have been inked and the project inches closer to commencement. Experts suggest Marinus Link will attract industrial energy users to the state and encourage new construction activity
- **Commercial office optimism:** Hobart posted Australia's lowest office vacancy rate, according to the latest Property Council Office Market Report. National and international businesses are looking to set up shop near defence, agricultural, Antarctic, marine and other science opportunities.
- **Housing headaches:** Hobart is approving "record numbers" of inner-city apartment developments, according to Lord Mayor Anna Reynolds, but housing affordability is a growing concern. Just 15% of Hobart's housing stock are multi-unit, compared with 46% in Sydney and 34% in Melbourne. Housing availability has an impact on the ability for Tasmania to attract interstate skills.
- **Skills shortages:** Tasmania's biggest challenge is growing the talent pool and pricing in key trades reflects this. Labour costs require ongoing active management, but we are beginning to see interstate contractors offer competitive differentiation and win work accordingly. The increasing interest from interstate firms could stabilise local pricing and reduce exposure to disproportionate labour cost increases.

Constrained by its small labour market, Tasmania's cost escalation continues to hover at the 8% per annum mark. But now is a good time to hit a 'sweet spot' in the market. Many builders have space in their books, but pricing reflecting this capacity is expected to be short lived.

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Western Australia

It may be "business as usual" for Western Australia's construction sector, but labour costs and shortfalls in housing continue to pose significant challenges. Here are some key local factors shaping the WA market:

- **Economic strength:** The Commonwealth Bank ranks WA ahead of all other states on key metrics like unemployment, private sector growth and internal economic activity.
- **Minerals underpin optimism:** Iron ore prices have remained above the long-term average over the last 12 months, bolstering the state's coffers with mining royalties, boosting optimism and fuelling demand for commercial projects.
- **City-shaping projects:** New megaprojects have hit the headlines. This includes $5 billion at Perth Airport to develop a new terminal, runway and airport hotel, among other projects. The $3.8 billion megaproject at Burswood Point promises to become one of the largest urban development projects undertaken in Australia.
- **Government infrastructure agenda:** The WA Government's unprecedented $43.9 billion asset investment program includes a current $8.7 billion pipeline of public works projects.
- **Defence spending:** The federal Department of Defence plans to spend $738.1 million on works in preparation for AUKUS' arrival at HMAS Stirling, in support of nuclear submarines slated to arrive in 2027. The Cook Government spent $51 million in June purchasing a waterfront site in Perth's south to establish a slipway in preparation for defence-related infrastructure projects.
- **Skills boost:** Skills shortages remain an ongoing challenge, as construction competes with the mining sector. Australia's first TAFE Clean Energy Skills National Centre of Excellence was announced in June, with a joint investment of $70.5 million over five years from the federal and state governments. The centre will innovate training in solar, wind, hydrogen, batteries and grid integration.
- **Urgent housing demand:** The Master Builders Association has estimated that at least 55,000 extra workers are needed by the end of 2026 to meet demand for new housing. The Real Estate Institute of Western Australia says WA must maintain a long-term average of 22,000 builds annually to secure sufficient supply – a step change from the average 13,944 dwellings completed over the past three years.

We maintain our cost estimate increase of between 4.5-5.5% per annum for the remainder of 2024.

> "Construction plays a pivotal role in the future of our nation, underpinning the economy, employing around one in ten workers and laying the foundations for Australia's future. The industry's current obstacles won't be overcome by working in isolation. Our challenge is to come together to fuel industry innovation and allow ingenuity to shine to meet current and future needs of the Australian population."
>
> **David Martin**
> CEO, Slattery

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Slattery is a property and construction advisory firm specialising in quantity surveying, cost management, carbon planning and project control measures. We're at the forefront of providing knowledge and insights to the industry.

If you would like further information or to discuss anything in this Market Update, please reach out to:

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