Running on Empty

Half-Year Australian Construction Market View

June 2024

Overview

Hopes for a construction recovery gained momentum during the early part of 2024. However, anaemic economic growth forecasts, continued high levels of insolvency, and a lack of commitment in terms of the forward pipeline suggest that the construction market could continue to run on empty for the rest of this year.

Is the CPI Target within reach?

The inflation outlook has changed dramatically since the start of the year. In December 2023 the monthly CPI indicator had fallen to 3.4%, from a peak of 8.4% the previous December. CPI has stayed around the same level since then, rising marginally to 3.5% in March 2024. The inflation target set by the Reserve Bank of Australia (RBA) is between 2% and 3%, with current forecasts suggesting that we will not move into this territory until the end of 2025. The good news is that, while inflation has not been falling as many would have hoped, it has stayed relatively consistent during the last few months.

However, and according to the RBA, a stockpile of savings and low unemployment rates have allowed households and businesses to withstand higher borrowing costs. The slight increase in March may give the RBA pause when it comes to announcing further rate cuts. The likelihood is that they will keep their powder dry and wait to see what happens until at least July before committing to any cuts. A touch of caution makes sense – particularly if you have a mind to see what else is happening in the world. Sticky inflation (essentially, inflation that takes longer than expected to come down) is evident in the US, where headline rates slowed by less than expected to 3.1% in January, impacted in part by rising wholesale prices. As a result of recent data, both the inflation outlook and expectations for speed and scale of rate cuts remain uncertain.

What is happening with overall sentiment?

For construction, there are signs that overall levels of sentiment are starting to decline – and in some sectors significantly so. The improvement in sentiment first seen in May last year gathered further momentum in the third quarter. However, this sharply declined in October demonstrating a level of volatility in market sentiment across the construction sector.

The latest data from AI Group advises that the Australian PCI indicator for construction rose by 5.5 points in March 2024 to land at -12.9. In overall trend terms, the construction sector has been in decline since mid-2023. Construction industry players have reported highly competitive market conditions, while new building projects have significantly decreased.

This is supported by the Arcadis 2024 Market Sentiment Survey, which highlights a dampening in overall sentiment from contractors. There is apparent frustration in the market in that there is a lot of promise but little actual commitment in terms of moving projects forward. The survey suggests that market outlook has reversed across most markets, with only New South Wales maintaining the same level of sentiment as last year.

This response makes perfect sense in housing, where expectations have been pared back significantly over the past 18 months. We are all familiar with the urgent need to build more homes, particularly with the challenges of affordability now turning into a full-blown housing crisis. According to the latest ABS data, the total number of dwellings commenced between the December 2022 and 2023 quarters declined by 6.4%. For the year through to March 2023, just over 175,000 dwellings were completed – with this being a decline of 0.7% on the previous year. Interestingly, "private sector other residential" (namely apartments) fell by 25.3%, indicating that project viability continues to be a perennial issue for the industry.

To meet current targets, Australia needs to build 240,000 dwellings each year. So, the 175,000 dwellings delivered between April 2022 and March 2023 is significantly behind this target. Dwelling completions have continued to decline since 2019, where we managed to deliver 218,000 dwellings – so in overall terms we are now delivering 24.5% less homes per year than we were at the start of the pandemic. Had we maintained the same level of construction delivery as we did in 2019, we would have delivered just shy of an additional 144,000 homes over the last four years. This demonstrates the scale of the issue at hand. Elsewhere in this report, our Zoom Into feature explores the issues surrounding the current housing crisis in more detail.

Commercial property has perhaps not performed quite as poorly as first feared, but there are still significant challenges in play, particularly with the "return to office" debate currently raging. Offices are still shedding value, but many investors believe that the bottom of the market is close.

Remarkably, the stock market in Australia experienced robust growth in 2023, with the total return landing at 12.42%. The counterfactual to rising share prices is evidenced by the fact that construction sectors are struggling to grow. The latest ABS data, for example, highlights that only 163,000 new homes were approved in 2023, 15% down on approval levels seen the previous year and 28% less than those seen in 2021.

Elsewhere, the risk from supply chain failure continues to grow. ASIC data shows that there were 2,546 construction-related insolvencies in 2023, a staggering 42% up on 2022 and 75% higher than the long-term trend since 2014. More are likely to follow, with many construction companies currently facing significant financial distress.

Weak construction data dents hope for a turnaround.

Paradoxically, and despite growing gloom last year, the latest data from the ABS reveals that the total value of construction work completed increased by 9% in 2023. This was the third consecutive year of growth – a remarkable achievement given the turmoil that clients and their teams have faced. Notably, the bulk of the growth in 2023 came from an increase in infrastructure and engineering work, up 5.2% in the year as building construction decreased. Weak recent new orders data highlights that many contractors and subcontractors face an uncertain 2024, showing signs that the market is slowing despite the boost seen the previous year.

The clear message is that any improvement to sentiment will take time to feed into the market. Although volume housebuilding could pick up quickly, with the right policies and measures put in place, the weaker state of the wider construction pipeline suggests 2024 will be much tougher than lead indicators like the PCI data suggests, with builders facing a slump in workload before new orders can be secured.

What might trigger a recovery?

Aside from falling interest rates (when this occurs), and with the lower cost of borrowing, what other metrics might help a recovery for construction?

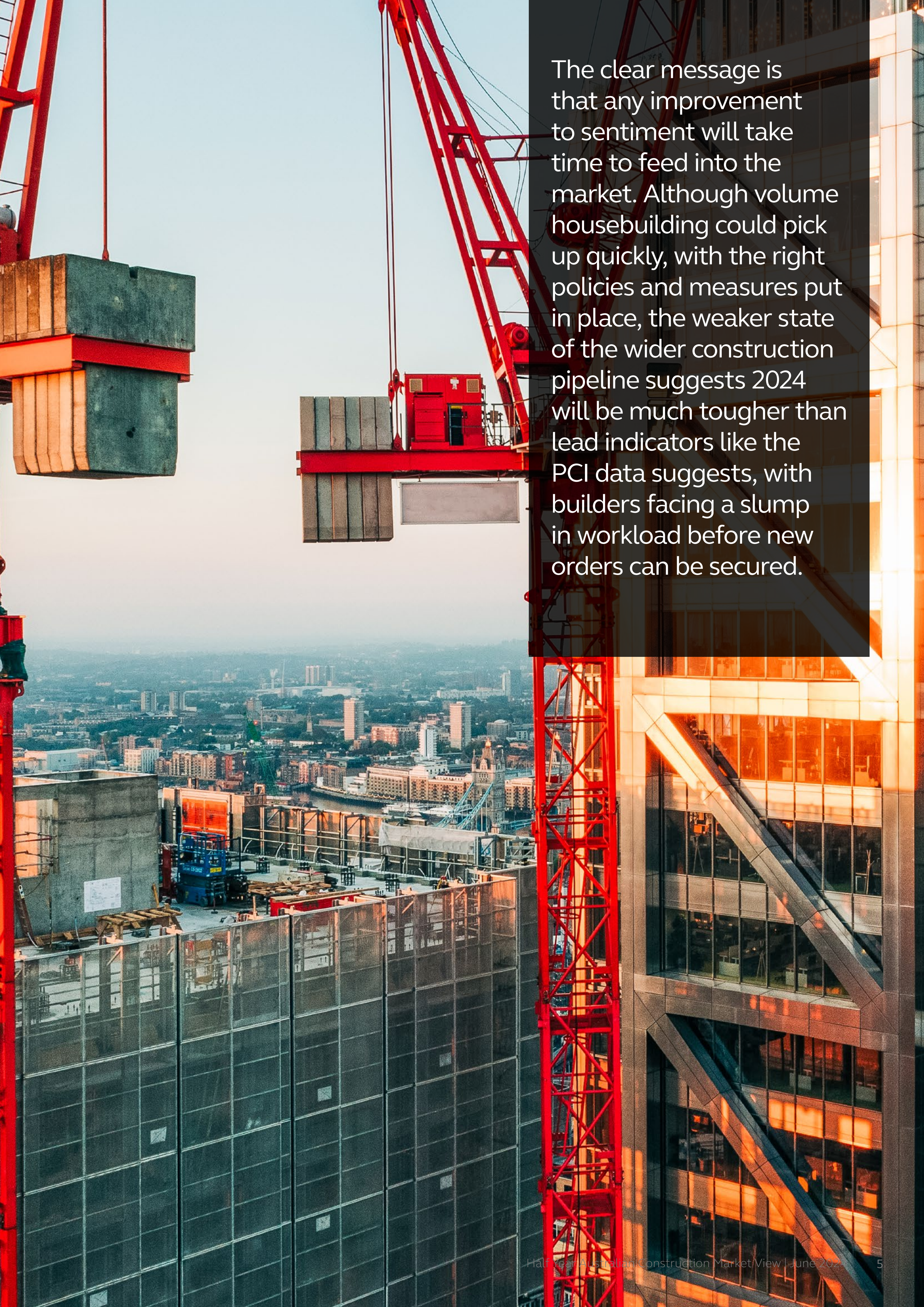
The 2024 Federal Budget has certainly taken aim at boosting the economy and driving a broader recovery. From an industry perspective, there is a significant commitment to housing with the budget investing an additional $6.2 billion in various housing initiatives, bringing the total investment since 2022 to $32 billion. States and territories will receive $1 billion to deliver new housing and invest in much supporting infrastructure. There is also $9.3 billion of funding for the new five-year National Agreement on Social Housing and Homelessness aiming to support vulnerable Australians.

Infrastructure also gets a piece, with the Budget providing $16.5 billion for new and existing projects over the next decade, with $4.6 billion allocated for new projects. This includes 14 projects that will create connectivity and infrastructure to the new Western Sydney Airport, Victoria's North East Link, Western Australia's METRONET, and Queensland's Direct Sunshine Coast Rail Line.

In response to the growing skills and labour shortage, and to strengthen the pipeline of workers in the construction and housing sectors, the government is providing $88.8 million for 20,000 additional TAFE and VET places in construction-relevant courses. The question is whether this is enough and whether it will be delivered quickly enough to address current shortages.

The growth in investment in energy transition is an obvious candidate for boosting a recovery, particularly given the priority now being given to net zero by many stakeholders. The 2024 Federal Budget allocates considerable funding to address Australia's clean energy transition. However, more needs to be done. Progress is well behind schedule, and the industry is in dire need of real certainty, allowing contractors to plan and invest accordingly for the future. Government spending is currently projected to increase substantially over the next five years but a lot of this is still waiting on real commitment. There is also the perpetual risk that any newly-elected government may change its priorities and delivery mechanisms.

In conclusion, while there is some evidence to suggest that an upturn in fortunes is on the cards, current levels of uncertainty together with weak new orders data means that clients and contractors are likely to be running on empty for some time to come.



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The Arcadis Forecast

2023 closed on a relatively disappointing note, with many projects stalling due to viability concerns. However, with lower inflation baked-in and (potentially) falling interest rates on the way, recovery should commence towards the end of the year. Can construction respond to this uptick, or will other factors hold some sectors back?

Introduction

In this section, as we highlight our analysis of new work, the slowdown has become more widespread. In our commentary on restarting the cycle, we focus on new headwinds that could slow down a nascent recovery. Finally, we look at mixed fortunes in the infrastructure sector that points to an emerging capacity crunch for networks including water and power transmission.

New work is thin on the ground.

Our Half-Year 2024 forecast has been compiled following a slow start to the first quarter. Our Year-End forecast, released in December 2023, anticipated that orders would remain strong – as they generally were at the mid-year mark, and this would continue to drive construction cost inflation. However, we have seen a dramatic shift in the last six months and a general slowdown in construction activity as projects have stalled and new tenders and commitments have failed to materialise. Client confidence is at a relatively low ebb and is probably the lowest it has been since the pandemic, with many developers being forced to restructure their businesses and teams.

Conversely, the forward pipeline across most states remains relatively strong – and has been the case for some time. However, the lion's share of this lies within the public sector and several project commitments have continued to be delayed and pushed to the right. This has had a significant impact on market confidence.

Typically, this kind of environment would favour the client – as construction costs fall to reflect an increasingly competitive market. However, this is far from the case as the industry continues to battle with several challenges that have been in place since the pandemic. In addition to this, contractors and their supply chain are being very selective in their project pursuits and risk averse in their pricing strategies. Dismal order books are more likely to trigger further contractor consolidation rather than it resulting in overly competitive bid pricing.

How quickly could the market recover?

There are plenty of early indicators of a potential turn in the cycle, but the shape of the forthcoming recovery remains uncertain. Contractors and subcontractors are choosing to focus on a smaller number of market segments where they can succeed in terms of both project winning and delivery. Construction markets are becoming more fragmented and as a result, clients have less leverage, even in a falling market. With less competition comes less downward pressure on prices, and potentially a continuance of above trend inflation.

Some factors point to a rapid take-up in work once conditions improve. A growth in refurbishment work in the commercial sector for example will deliver a program of work with a much shorter lead-in time than for traditional demolition-led new build schemes. Furthermore, there are many residential schemes that have been mothballed pending an improvement in market conditions and pricing. When the market does turn, these could restart quickly – absorbing available capacity before projects in design get through procurement.

By contrast, there are some time-specific factors that indicate that recovery might be stalled:

- **Elections**. A state election in Queensland as well as council and mayoral elections in New South Wales and Victoria, with Queensland and Western Australia already having had theirs, are due to take place in 2024 and will inevitably have an impact on the timing of funding and planning decisions. With funding tight, and significant ideological differences between the main parties, any change of political control is likely to result in a program of re-evaluation for public schemes which will trigger a further delay.
- **Regulatory change**. There are several proposed reforms for both regulation and legislation across most states and the impact of these reforms are still to be fully tested and understood. In Queensland, for example, recommendations were released in April 2023 that set out potential reforms to developer involvement in the construction process. Industry reception to these reforms has been mixed, with some commentators questioning their efficacy and others applauding them for fixing long-term issues. In New South Wales, amendments to building legislation, that are due to come into force later this year, will widen the liability of builders, developers, and certifiers among others. The wider net cast upon developers is particularly noteworthy. Any changes to regulation require a learning curve from industry participants – both clients and contractors alike – and any such learning curve is likely to potentially slow procurement and approval processes.

In summary, and even if an interest rate cutting cycle does start later in 2024, it will take considerable time for the benefits to trickle down into the construction supply chain.

Two speed recovery on the cards as energy transition starts to take off.

Infrastructure spend, and in particular public sector infrastructure spend, has been the big winner in Australia over the past ten years. Billions of dollars have focused on providing rapid growth on transport infrastructure, which has been exemplified in projects like Gold Coast Light Rail, Cross River Rail, Sydney Metro and Melbourne Metro. However, there is now a real terms reduction in public infrastructure investment on the cards. The practical implications are that workload in the transport sector will taper off, particularly on smaller schemes as finance is channelled towards transformational and nation-building investments.

By contrast, investment in new large-scale renewable energy capacity fell my almost 80% in 2023. There were several factors for this including grid bottlenecks, slow planning regimes, delays in obtaining environmental approvals, higher costs, and a constrained labour market. Last year's expenditure in the renewable energy sector slumped to $1.5Bn – down from $6.5Bn in 2022. The Clean Energy Council have noted that 2023 was the lowest level for new commitments to large-scale renewables, which is a lead indicator for future expansion, since records began in 2017.

However, and despite this backward step, the pipeline of work in renewable energy and key utilities over the next few years is significant. According to the ANZIP Infrastructure Pipeline, which is produced by Infrastructure Partnerships Australia, there are currently 98 prospective projects in the pipeline, equating to almost $250Bn of investment. In addition, there are 121 projects in the detailed planning and procurement stages (equating to about $150Bn) with a further 102 projects that have been announced (approximately $120Bn).

With the targets set for 2030 moving inexorably closer, it stands to reason that, despite recent challenges and headwinds, investment and delivery within the Australian energy transition sector will start to gather pace. This sentiment is reflected in the 2024 Arcadis Market Sentiment Survey, where more than 80% of responding contractors confirmed that the energy / power sector was a rising market.

We anticipate a 'K' shaped inflation trend for infrastructure, with inflationary pressures partially diminishing in rail and roads as workload eases off. Mega projects like Suburban Rail Loop will still face resource challenges, as will projects located in more remote areas, but smaller projects should become easier to deliver as capacity in second tier contractors increases. By contrast, we anticipate that networks including water and energy transmission and distribution will become increasingly exposed to inflationary pressures.

Materials – structural inflation coming to an end.

Material price inflation has continued to fall from the peak seen in 2022, and there are signs that we are now close to the bottom. Our latest Market Sentiment Survey, which includes a basket of goods analysis, indicates that there is still a great deal of material price volatility evident in the market, but the medians suggest that, overall, material price inflation is now closer to the long-term average. What we are sure of is that significant price deflation is not on the cards, and so it is highly unlikely that materials will fall back to pre-2022 price levels.

Latest data from the ABS records that suppliers are continuing to pass through increased input costs from higher energy prices for products such as aluminium windows and doors, and plaster products. Plaster products continue to see some of the highest pricing due to elevated input costs within the manufacturing process as well as low gypsum supply. Ceramic products, such as tiles, are also facing higher costs due to strong demand for finishes and higher import costs.

Markets and supply chains could be disrupted further by conflict in the Middle East, but so far this has not been the case. Container costs have risen, but these are marginal for light-side, non-bulky products such as electrical components, timber and board and small tools. Energy costs have remained stable or in the case of liquefied natural gas (LNG), have fallen to levels last seen in Autumn 2021. Distributors have sufficient inventory to deal with delivery delays. This means that, at least for now, the Australian construction sector is insulated from the impacts of global conflict. We therefore anticipate that material inflation will now largely revert to the long-term average.

Labour – diminishing capacity.

In 2023, the construction sector saw relatively modest wage growth equating to 4.1% for the year looking at the latest ABS data. The latest enterprise agreements are now largely locked – or soon will be – and there are growing signs that the impact on future construction costs could be significant and are no longer keeping in step with market dynamics:

- In New South Wales, trade unions have pushed for a 26% pay rise over the next three years. This includes an upfront 8% increase, which will likely impact already-priced projects.
- In Queensland, the new enterprise agreement has delivered a 5.9% pay rise backdated to July 2023, followed by a further 5.3% in 2024 and then 14.7% over the next three years to 2027.
- Negotiations are ongoing in Victoria and the outcome is still unclear. However, it is likely that increases will closely align with those of New South Wales. It is understood that many contractors are factoring an anticipated increase of 5% per annum into their pricing now and in readiness of the finalised EBA.

Signs of diminishing labour capacity continue to prevail. Our 2024 Market Sentiment Survey, produced in partnership with the Australian Constructors Associations, indicates that an average of 17% of contractors are struggling to secure professional services (architects, engineers, project managers etc), general labour, and Group 1 and 2 tradespeople and that capacity is a critical issue. Nearly all respondents agree, 74% in fact, that availability of skills and labour is a growing concern across most sectors.

2024 Forecasts

Markets have continued to perform weakly and below previous expectations. Low volumes of orders at the end of 2023 and the start of this year are generally consistent with our developing view that 2024 will mark the bottom of the cycle. As we highlighted in our commentary on the speed of recovery, we see some significant headwinds affecting the private sector – particularly residential – even as market conditions start to improve. Using this as a basis to inform our longer-term forecasts for the Buildings sector, we have also utilised the first quarter data from the ABS to support our 2024 forecasts:

- Sydney has already experienced construction cost escalation of 1.57% between December 2023 and March 2024. If this trend continues, then escalation is likely to top around 6.5% by the year.
- Victoria has had similar experience, with the first quarter data indicating an escalation increase of 1.14%. With major projects in the state likely to start gathering momentum in 2024, we anticipate a slightly higher escalation forecast of 5.4% for the year.
- Of the cities on the east coast covered by this Market View, Brisbane has experienced the highest level of escalation during the first quarter at 1.84%. Again, if this trend continues this would result in escalation capping out at more than 7% for the year. We anticipate that the state election that will be held in the latter part of the year will drive a considerable slow down in activity while the government moves into election mode – hence our more modest forecast of 5.2%.
- Perth is notoriously difficult to anticipate – and this is underlined by the first quarter results. Construction costs increased by 2.4% between December 2023 and March 2024, which is the highest of all the cities covered in this Market View. This is a significant shift, considering that escalation across the whole of 2023 equated to 3.8% (from a high in 2022 at 14.3%). At this stage, we have anticipated a spike of 7% for 2024, but will continue to monitor this situation as the year progresses.

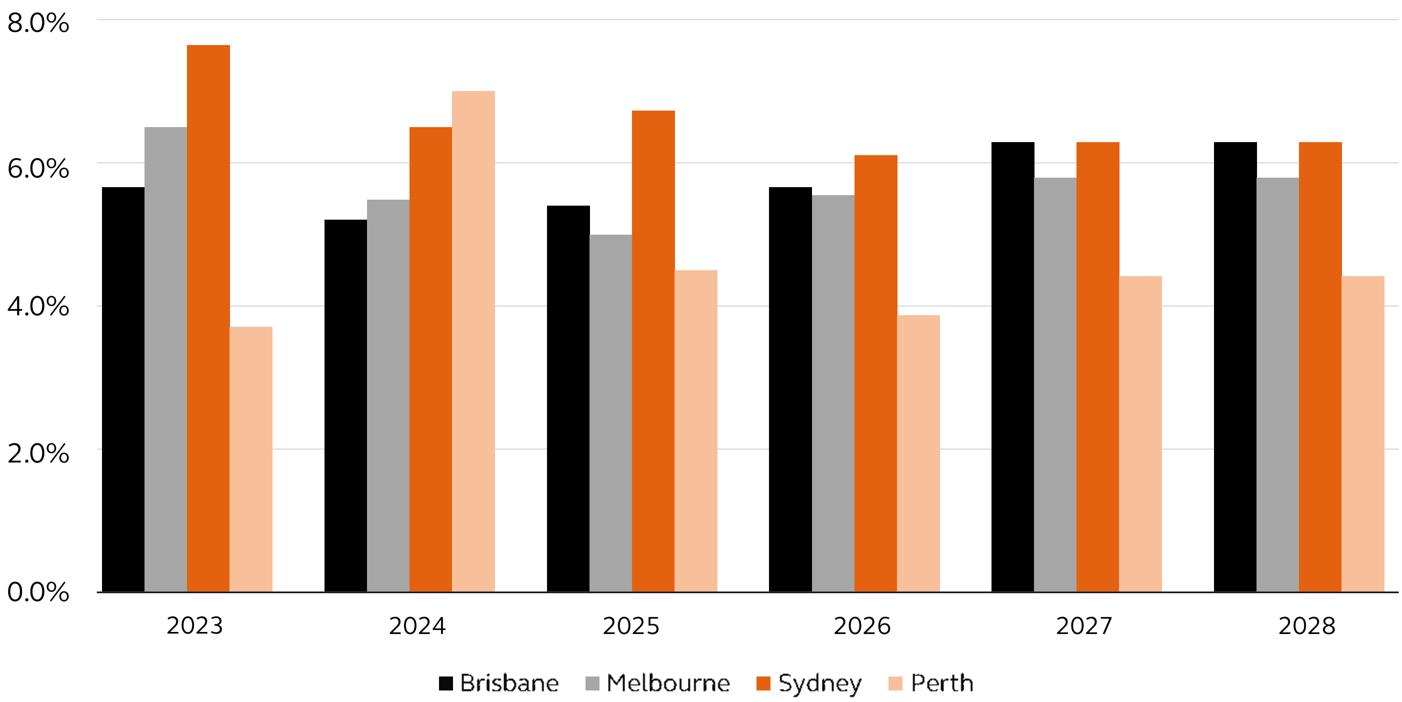
Our central case for the period 2023 to 2025 remains lowering levels of inflation, not deflation. But this will still be above long-term trends prior to the pandemic.

For infrastructure we are amending our forecast, considering weakening demand for transport projects as well as parallel growth in networks serving both power and water. These inflationary pressures are related to demand and scarcity rather than specific background inflation drivers. The wider range from 2027 onwards reflects the 'K' shaped inflation trend discussed in our infrastructure forecast. For certain projects, particularly HV transmission schemes, inflation is likely to be more than the average (metro-based) figures set out below.

Inflationary Factors	Deflationary Factors
Above-trend levels of workload in network infrastructure (anticipated).	Structural deflation from the end of 2023.
Supply chain consolidation and loss of industry capacity.	General economic slowdown.
Attitude to risk transfer.	Order book replacement in commercial and residential sectors.
Sector-specific demand for resources.	Attitude to work winning.
Wage increases due to trade union pressures	

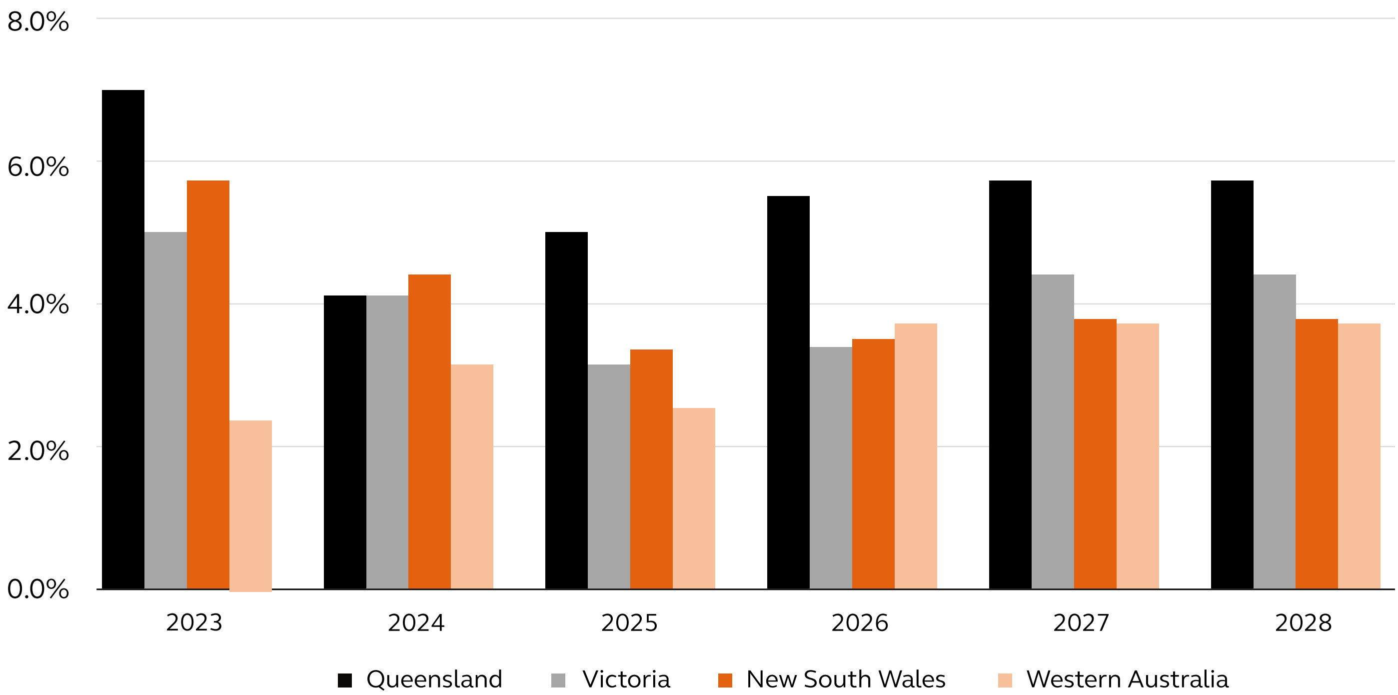
Arcadis Buildings Cost Escalation Forecast

	Brisbane	Melbourne	Sydney	Perth
2023	5.7% (6.9%)	6.5% (7.2%)	7.7% (5.9%)	3.8 % (4.8%)
2024	5.2% (7.8%)	5.4% (6.0%)	6.5% (5.0%)	7.0% (4.2%)
2025	5.3% (7.2%)	5.0% (5.4%)	6.8% (5.2%)	4.5% (4.8%)
2026	5.8% (7.9%)	5.6% (5.5%)	6.1% (6.4%)	3.9% (5.4%)
2027	6.2% (7.9%)	5.8% (5.5%)	6.2% (6.4%)	4.4% (5.4%)
2028	6.2%	5.8%	6.2%	4.4%
Total	**34.4%**	**34.1%**	**39.5%**	**28.0%**



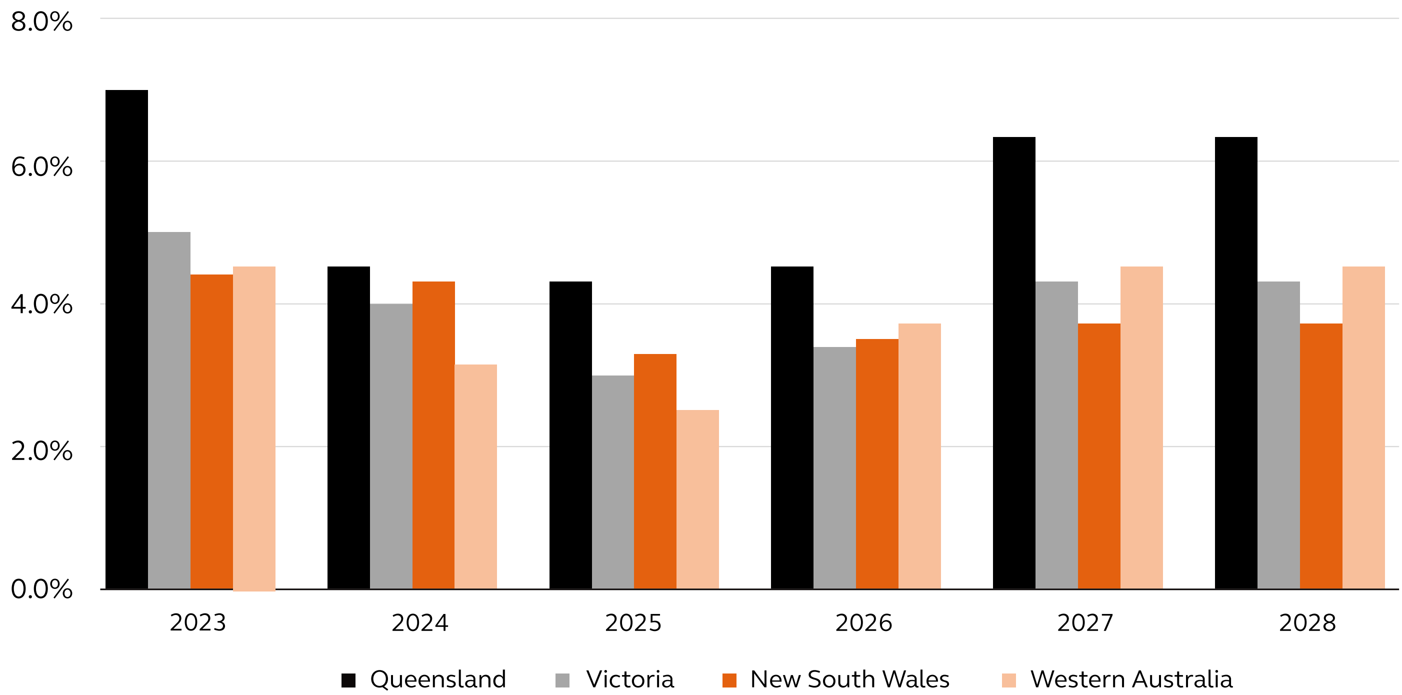
Arcadis Heavy Civil Infrastructure Cost Escalation Forecast

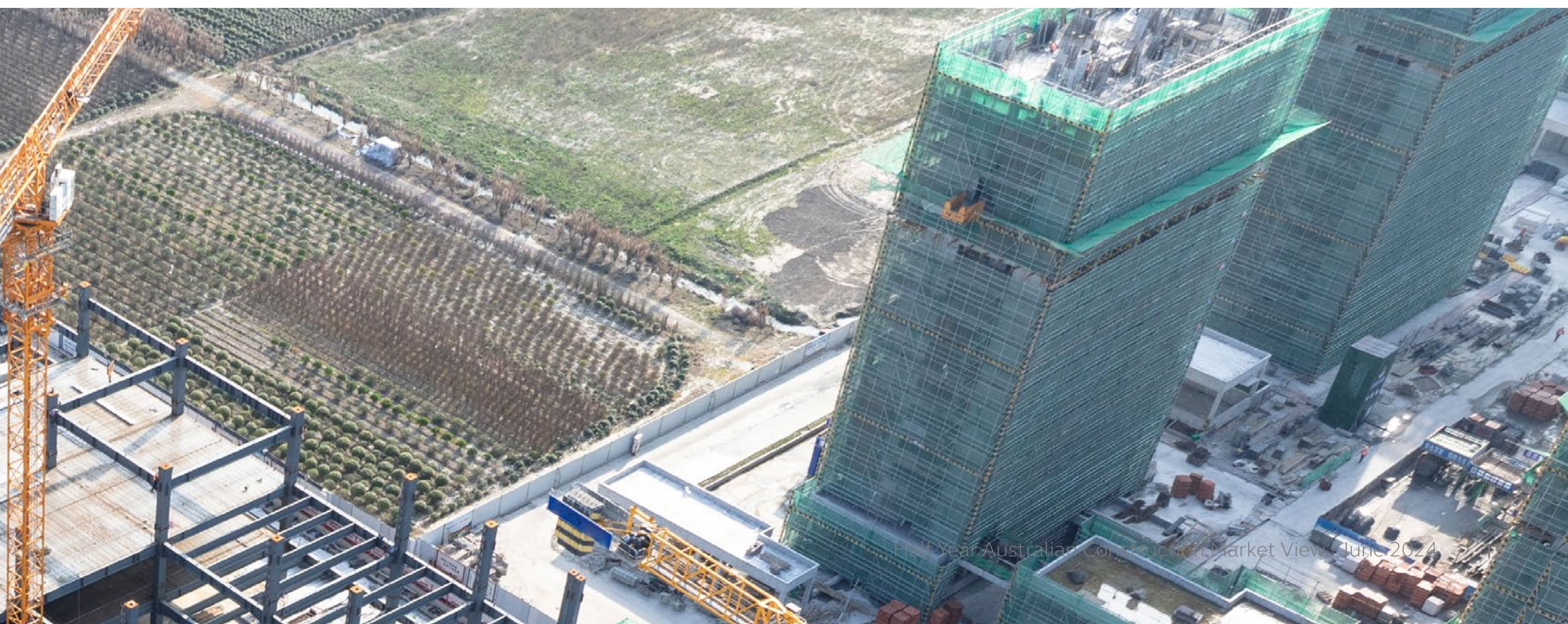
	Queensland	Victoria	New South Wales	Western Australia
2023	7.0% (9.3%)	5.0% (9.0%)	5.8% (9.1%)	3.3% (8.8%)
2024	4.1% (7.5%)	4.1% (7.2%)	4.3% (7.1%)	3.1% (5.9%)
2025	5.0% (5.8%)	3.1% (5.6%)	3.3% (5.4%)	2.5% (5.0%)
2026	5.5% (5.1%)	3.4% (5.0%)	3.5% (4.9%)	3.7% (4.2%)
2027	5.8% (5.1%)	4.4% (5.0%)	3.8% (4.9%)	4.5% (4.2%)
2028	5.8%	4.4%	3.8%	4.5%
Total	**33.1%**	**23.85%**	**24.0%**	**21.1%**



Arcadis Rail Infrastructure Cost Escalation Forecast

	Queensland	Victoria	New South Wales	Western Australia
2023	7.0% (9.2%)	5.0% (8.5%)	4.4% (9.1%)	4.5% (8.5%)
2024	4.5% (7.0%)	4.0% (6.8%)	4.3% (7.1%)	3.1% (8.2%)
2025	4.3% (7.2%)	3.0% (5.5%)	3.3% (5.8%)	2.5% (5.3%)
2026	5.5% (5.5%)	3.4% (5.5%)	3.5% (5.5%)	3.7% (4.2%)
2027	6.25% (5.5%)	4.4% (5.5%)	3.75% (5.5%)	4.5% (4.2%)
2028	6.25%	4.4%	3.75%	4.5%
Total	**33.8%**	**24.3%**	**23.0%**	**22.7%**





Bringing into focus: Construction markets by state

While there are many factors impacting the construction industry across Australia, each state continues to face local challenges as well as opportunities.

Queensland

- The last 18-months or so has built an incredible amount of optimism and industry confidence across the state. Ongoing investment in transportation and the health sector, a promising pipeline of projects supporting the state's energy transition and, of course, the 2032 Olympic and Paralympic Games. However, that optimism and confidence has now started to wane considerably as major decisions continue to be deferred and an increasing lack of clarity regarding the project pipeline for the 2032 Games. A state election in the latter part of the year will hardly help matters when it comes to project commitments and future vision.
- The good news from this is that there is now evidence of increasing market capacity, as well as more favourable tender responses – particularly at the subcontractor level. There has certainly been an overall level of improvement in tendering conditions, with pricing volatility markedly reduced. However, it will not take much for this capacity to be quickly absorbed, along with a swift return to pricing volatility.
- In terms of major projects, the first cab off the rank will be the hospital program. The Queensland Government is investing more than $14Bn in health infrastructure – project extensions and upgrades through to the delivery of new hospital assets. Many of these projects are due to commence construction in the latter half of 2024 – once GMP's have been negotiated and agreed. At this point, these projects will absorb any available capacity in the market, particularly in regional areas.
- Like most states, housing affordability – as well as availability – is an ongoing challenge. The Queensland Government released the Homes of Queenslanders plan in February 2024, which consisted of five pillars with an aim to deliver one million new homes by 2048. These pillars range from building more homes, faster, through to working towards ending homelessness. In addition to this, the government aims to deliver 53,500 new social homes by 2046 and, to meet this target, is providing $1.25Bn over the next five years to deliver 2,000 social homes every year from 2028. This is in addition to the $6Bn that has already been committed. This commitment is seeing some developers, who have historically played in the commercial sector, pivot towards this growing market.
- The skills crisis is only anticipated to grow, at least according to the latest report by Infrastructure Australia. More than 60,000 additional workers are required to deliver the current anticipated pipeline. This is supported by Arcadis' recent Construction Market Sentiment Survey, where respondents indicated that professional services and skilled tradespeople were becoming harder to source. So, the question remains – how can we build all of these houses with the supply chain and labour force that we currently have?
- The knock down and rebuild of the Gabba for the 2032 Games has been scrapped following a recent review of all the proposed venues. This is in favour of utilising and upgrading existing infrastructure and venues – at what will still be a substantial cost. The response to this U-turn has been significant, with the public largely divided on the matter. The industry response, however, has been loud and clear in that there are other – and perhaps better – options that should be explored further before any commitment is made. One thing is clear, 2032 is marching ever closer and progress needs to be made quickly in terms of what infrastructure will be prioritised and delivered.

New South Wales

- Viability issues continue to impact projects across the state, particularly in the private sector. Despite a relatively slower market when compared to previous years, construction costs continue to rise. In fact, Sydney recorded the highest level of escalation in 2023 of the four cities covered in this Market View. The forecast does not present a better picture and costs are not coming down any time soon.
- The latest Enterprise Bargaining Agreements that have been negotiated in New South Wales will increase labour costs by 26% over the next three years, which does not account for an immediate and upfront increase of 8%, which is anticipated to impact projects that have already worked through their tender processes.
- To put this into context, and depending on the type of asset, labour costs can equate to between 30% and 45% of the total construction cost. Therefore, on a $100M project in today's money, an immediate 8% increase in labour costs would equate to a 3.6% increase in construction costs alone – this is worst case and based on the labour component only. By the end of 2027, our $100M project will now cost in the region of $115.3M – equating to a 15.3% increase. At present, this scenario is only impacting projects that are delivered by the public sector. However, with a construction industry that is facing significant capacity constraints and a growing skills shortage, and if public sector investment remains in the ascendancy, it will not be long before this becomes the norm in terms of market pricing. The impact of this on the wider industry – just in terms of overall viability – cannot and should not be underestimated.
- Housing affordability has been the perennial issue in Sydney for some time now – and it is only getting worse with house prices increasing by more than 10% over the course of 2023. This coincides with a marked reduction in residential projects coming to tender – demonstrating that developers are struggling with the current challenges. According to the Urban Task Force, New South Wales will have to build more than 376,000 homes over the next five years to keep up with population growth. This equates to about 75,000 homes that need to be built each year. When you consider that less than 47,000 homes were delivered in 2023, you can start to appreciate the scale of the issue.
- To rub more salt in this wound, the Minns Government has confirmed that it will not meet its current housing targets of completing 75,000 homes per year due to rising construction costs, a lack of skilled labour, and higher interest rates. This means that growing pressures on affordability and declining home ownership will continue to impact the cost of living crisis.
- On a more positive note, the rezoning of more than 30 locations across the state, largely near transportation hubs and city centres, has meant that higher densities of residential development can now be delivered. At the same time, these sites will provide easy access to public transport, further reducing stress and congestion on the existing road network.

Victoria

- There is a significant transition currently underway in Victoria, which has been underlined by the recent 2024 State Budget announcement. As the government grapples with rising debt, there are some cuts to major projects – particularly in transport infrastructure. The $13 billion Melbourne Airport Rail Link project will be delayed by at least four years to 2033, while the Upfield Train line level crossing removal has also been delayed until 2030.
- On the flip side, this year's budget sees $1 billion invested to build 16 new schools which are expected to open in 2026, while a further 25 schools across the state will be upgraded. In addition, more than $900 million will be invested to upgrade Austin Hospitals existing emergency department while also delivering a new emergency department and additional beds at the Northern Hospital. $500 million will also be spent at Monash Medical Centre to increase its maternity care capabilities as well as adding more operating suites and intensive care beds.
- Unfortunately, plans to build community hospitals are now going to be reviewed and will likely be scrapped – despite these facilities being promised six years ago.
- The current target is to deliver 800,000 homes over the next ten years. In 2023, only 56,000 dwellings were delivered. In fact, the best year that Victoria had in the last decade when it came to delivering new homes was 2017. This was before the pandemic and during the previous housing boom, where more than 67,000 dwellings were delivered that year. Since then, completions have been falling by an average of 2,000 homes each year. With market capacity and housebuilders of a decent size dwindling, it is difficult to see how Victoria is going to achieve these ambitious targets.
- To increase home production, the federal government has halved the 30% withholding tax that is levied against foreign investment on Build to Rent (BtR) projects. The state government has made similar moves to try and move forward the current backlog in the BtR sector, but this is very much the tip of the iceberg when it comes to hitting current targets. That said, we are seeing several developers shift their focus towards BtR as well as social and affordable housing due to the incentives that are now in place for these sectors.
- The 'Big Build' infrastructure play remains Suburban Rail Loop. Expressions of Interest are now open for two contracts to deliver new stations at Box Hill, Burwood, Glen Waverley, Monash, Clayton, and Cheltenham. Tunnelling for SRL East is due to commence in 2026, with the contract awarded late last year, and the Tunnels North contract will be awarded later this year. SRL is much more than a transport project, with the intention that it will transform Melbourne into a city of vibrant precincts outside the main central business district, providing a combination of green space, greater housing options, and increased interconnectivity. Trains are anticipated to start running by 2035, but it will be sometime after that before the vision of these precincts is realised – and too late to influence the housing targets that have currently been set.
- Current levels of uncertainty across the construction market should ensure that cost escalation does not remain at the elevated levels seen during the last two years. However, this is only anticipated to be short term, particularly with labour costs set to soar at more than 20% over the next three years.

Western Australia

- Labour costs continue to be one of the most significant challenges for Western Australia – further underlying the constrained nature of the current supply chain. Despite this, market conditions remained relatively stable in comparison to other states, with building escalation last year falling below the long-term trend for the first time since 2020.
- Recent data by advocacy group Everybody's Home indicates that regional Western Australia has experienced some of the largest rental spikes in the country over the past year. This is starting to price people out of their communities and is a significant factor in the growing affordability crisis. The only way to really resolve this is to increase available housing supply. The Treasury department estimates that an additional 239,000 people would call the state home between 2024 and 2027 – meaning that a further 92,000 more homes need to be built. However, when overlaying current market capacity, the latest modelling shows that a maximum of 67,000 new homes can be delivered in this timeframe.
- Despite this growing level of demand, developers are struggling to get residential projects to stack up due to elevated construction costs. Large scale housing projects – including BtR and social / affordable housing schemes – are few and far between. To combat these issues, the state government launched a series of new planning reforms in March that promised to cut unnecessary red tape to streamline and accelerate the delivery of housing. This is a welcome move, but it is still too early to understand if these reforms are delivering the promised benefits. Regardless, it is unlikely that they will improve the challenges posed by excessive construction costs, lowering productivity, and market capacity constraints.
- One bright spot is that the WA government is investing $52.3M to encourage more apprentices into the building and construction industry. Milestone payments will be made to eligible apprentices after they complete training milestones, with a range of new initiatives funded in the 2024-25 State Budget to support and grow the construction workforce.

Zoom into: Is the housing crisis too big a problem for politics to crack?

The forthcoming National Housing and Homelessness Plan is likely to underscore the complexity of housing reform. It is expected to provide a 10-year strategy that will set-out a shared vision to inform future housing and homelessness policy in Australia. As we navigate through these challenging times, we must ask ourselves, can we anticipate a more favourable outcome?

How do you eat an elephant?

The holiday season may be a distant memory, but here's a timeless joke to consider: "How do you eat an elephant?" The answer, of course, is: "One bite at a time".

For the Hon. Julie Collins, the Minister for Housing and Homelessness, "one bite at a time" may also be a prudent approach to Australia's housing puzzle following the recent release of the State of the Housing System 2024. This is the first annual report by the National Housing Supply and Affordability Council and sets a baseline of understanding how the housing system is functioning and to forecast supply demand. This report comes after the National Housing Accord set an aspirational target of delivering one million, well-located homes over five years from mid-2024. This was amended further in August 2023, when the National Cabinet agreed to increase the target to 1.2 million homes.

When it comes to the Australian housing system, "one bite at a time" means a bottom-up focus on getting local plans in place and delivering against them. A bigger bite would comprise a much broader reform of the Australian planning system. This latest report certainly advocates for a more streamlined planning process to boost housing approvals.

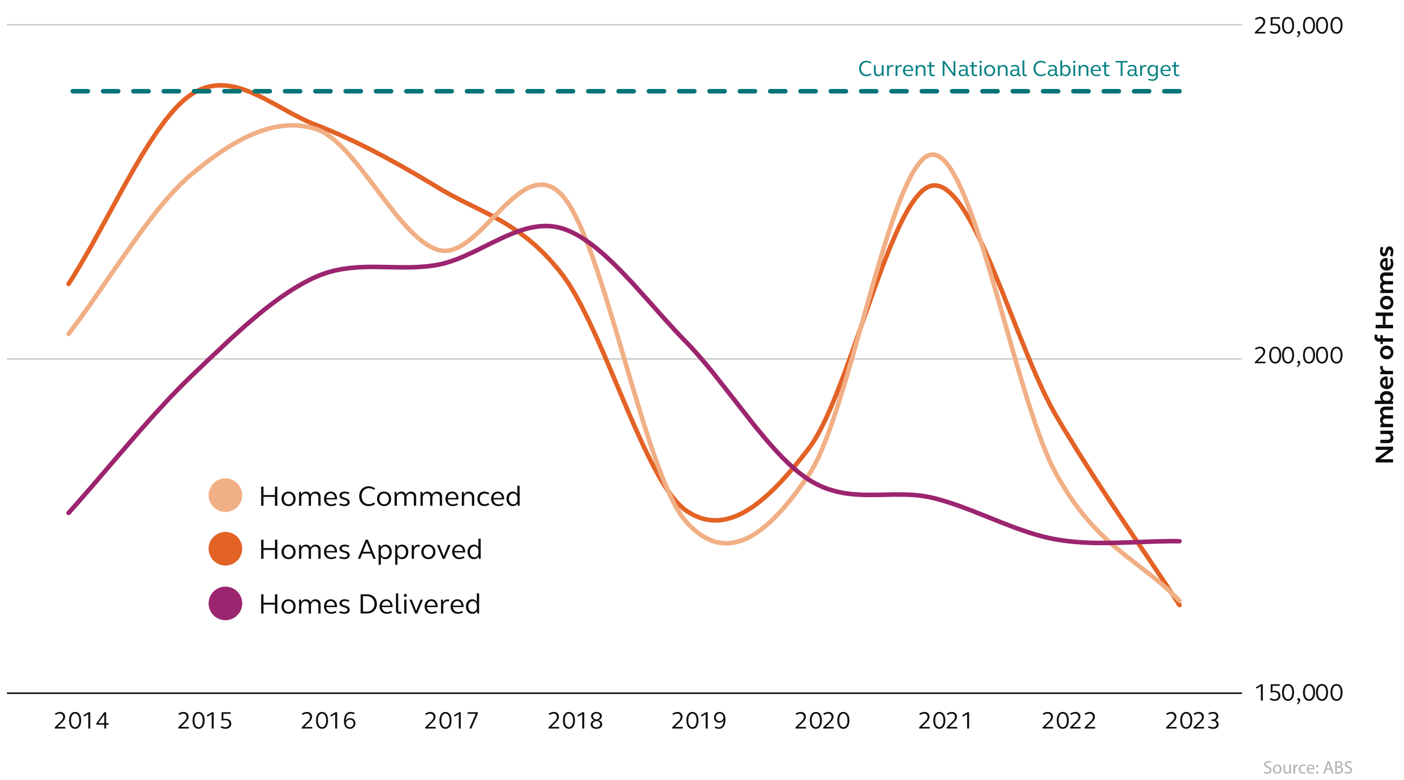
If we are to meet our extremely ambitious target of 1.2 million homes over the next five years, then planning reform is sorely needed. In 2023, a mere 163,000 dwellings were approved across Australia. The year prior faired a little better, but not by much, with 2022 approving 191,000 dwellings. The best year for approvals in recent times was 2021, where almost 226,000 dwellings were approved. The last time we got near this level of approvals was back in 2017. Between 2014 and 2018, dwelling approvals averaged 225,000 homes per year. Between 2019 and 2024 we have approved just 188,000 homes per year.

And yet, we need to deliver – that means build, not just approve – 240,000 homes every year for the next five years. If we look at the number of dwelling commencements over the past few years, we can paint a slightly different picture. In 2023, construction started on just 164,000 dwellings. This is the lowest number of dwellings commenced in a single year in the last 10 years. In the last five years, dwelling commencements equated to 935,000. In the five-year period prior (2014 to 2018, which concluded with the collapse of the apartment boom) commencements equated to 1.1 million homes.

Most commentators agree that the target set by the National Cabinet will not deliver the 240,000 homes required each year, but there is a more nuanced debate on whether an updated planning system will deliver better outcomes. The issue of better planning outcomes is very important, and it often gets obscured by arguments over annual housing targets. To be sustainable, a planning system relies on the consent of local people.

From a planning perspective – as well as sticking a spade in the ground – we have some way to go. And reform is desperately needed to provide new housing stock to the market. However, planning reform is only half of this particular elephant.

New Homes Approved, Commenced, and Delivered



Planning reform is only half of this particular elephant.

Getting more homes through the planning process is only part of this complex equation. The number of homes that have been delivered continue to underline and lay bare the challenges that the industry is currently facing. In the last five years, we have delivered an average of 182,000 homes each year. The previous five-year period fared better, equating to 204,000 per year – and yet 2017 to 2018 were considered boom years for apartment construction.

If we can reform the Australian planning system so that more homes are approved and work commenced (and there is a clear historical correlation between the two), then surely we will be able deliver more housing? And the answer to that question would, typically, be “yes”. In this particular case, the more accurate answer would be “not really”.

There are two aspects to this. The first is simply to do with the cost of construction and the values that can derived. The end sale prices, or the anticipated rents, are not covering the cost of land, the price of construction, finance charges, planning costs, and the plethora of government fees and taxes in between. The only way to combat this is to increase house prices – but there is a limit as to how far this can go. In a cost-of-living and housing crisis, where demand for new homes is beginning to dwarf the available supply, the last thing we need are even more expensive homes.

Based on our latest cost data, the construction cost alone on a new Sydney apartment is somewhere between $550,000 and $650,000. Add in the cost of land acquisition, finance, planning delays, and government taxes and it is difficult to see how the construction of new apartments can stack up, particularly when the median sale price across Sydney is $844,000, according to CoreLogic.

But the problem is deeper than just construction costs. There is a growing shortage of skilled tradespeople, which has certainly not been helped by rising industry insolvencies. This shortage is being compounded by substantially increased public spending on energy transition and transport infrastructure. Then there are the changes to the National Construction Code, which are intended to improve access and liveability on all new homes for those living with disabilities as well making housing more sustainable. But there is an additional cost for these new standards – and that is anticipated to be in the region of an additional $20,000 to $30,000 per dwelling.

While these new regulations have clearly been implemented with the best of intentions, it is adding yet more regulation and cost burden to an industry that needs far less. To get anywhere near the current target that has been set the industry will need to double its current capacity.

A "one bite at a time" approach in solving the housing crisis has so far focused the governments attention on increasing affordable housing and new housing infrastructure. We now need to quickly take a second bite and start to remove the barriers that are preventing us from physically building more homes.

The Federal Budget 2024 is set to have a significant impact on the housing crisis:

- The budget allocates an additional $200 million annually to the National Housing and Homelessness Agreement and $1.9 billion in concessional loans to community housing providers. This funding aims to reduce wait times for accessing social and affordable housing services, addressing a critical need in a strained sector.
- The government is making a further $1 billion available to states and territories to deliver new housing.
- An additional investment of $1.9 billion will increase the maximum rates of Commonwealth Rent Assistance by a further 10% to alleviate rental stress, which builds on the 15% increase already announced in September last year. This takes the maximum rate to over 40% since May 2022 (including indexation).
- The Budget includes funding for a new five-year, $9.3 billion National Agreement on Social Housing and Homelessness. This represents an increase of $423 million. Under the agreement, the Commonwealth will double its dedicated funding for homelessness services to $400 million a year.
- The government is targeting the $1 billion increase to the National Housing Infrastructure Facility to better support housing for women and children experiencing domestic violence and for youth. The funding is being rebalanced to provide more up-front grants to support states and territories and community housing providers to deliver more housing for these cohorts.

This is all welcome news and, while governments are doing what they can during these tumultuous times, they are still not addressing the fundamental issues of capacity and capability. Planning and zoning reforms will not help with these immediate challenges. Unless we can ease these constraints, delivering new homes or apartments will continue to be extremely difficult – and the housing and rental crisis will get far worse. A growing skilled labour shortage and an uptick in insolvencies across the construction industry have slowed the commencement of new builds, adding further pressure.

We are currently completing just over 170,000 new homes a year and for the first time in three years are commencing even fewer – culminating in the lowest level of dwelling commencements in the last decade, and declining approvals, which are also at the lowest level in 10 years, are signalling that things are only going to get worse.

This underscores the need for a targeted migration policy to address the growing skills shortage and meet the increasing demands for labour. Industry productivity, innovation and advanced manufacturing techniques can and should also play a role to improve efficiencies and quality. In this report we shine a Spotlight On the construction productivity puzzle that, like the delivery of new homes, has continued to decline significantly. By arresting this decline and enhancing productivity, existing industry output can be increased.

But the industry cannot solve these prevalent issues by itself – it needs support and intervention from the government. There are no easy solutions, and our politicians should know this. They should also recognise that public and industry support will be central to turning grand plans into reality. A “one bite at a time” approach in solving the housing crisis has so far focused the governments attention on increasing affordable housing and new housing infrastructure. We now need to quickly take a second bite and start to remove the barriers that are preventing us from physically building more homes.

Spotlight on: another brick in the wall – building beyond our construction productivity woes

In the world of construction, there is a paradox that is as puzzling as a mislaid brick in a well-planned wall. Despite rapid advancements in technology and construction techniques, Australia's construction industry seems to be stuck in a productivity pit. It's like we're trying to build a skyscraper with a spoon, with the sector delivering less at a higher cost compared to previous decades. And this issue is not confined to any single state but is a nationwide concern – it is very much a wall that we are up against.

The productivity paradox

Between 2011 and 2015, the industry was a bustling construction site, delivering an average of approximately $260 billion of work annually with a workforce of more than 1 million people. This translates to an average output of $258,000 per person. However, in the subsequent five years from 2016 to 2020, despite an increase in the workforce to an average of 1.15 million people (or 138,000 additional workers), the annual output per person employed plummeted to $209,000. It's like we have gone from building castles to stacking bricks.

Why the difference?

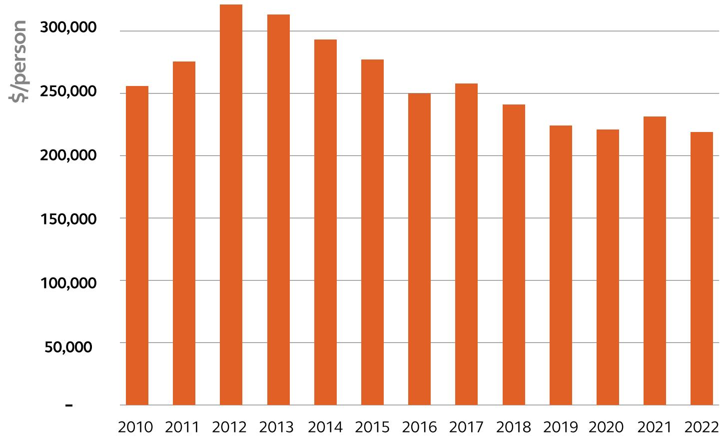
Well, this can partially be explained by the resources boom between 2012 and 2015. This period saw the substantial use and adoption of modularisation and other productive construction techniques. It was a time when we were building beyond the wall, so to speak. However, these methods have not been further deployed across the industry on any kind of scale.

The impacts of declining productivity

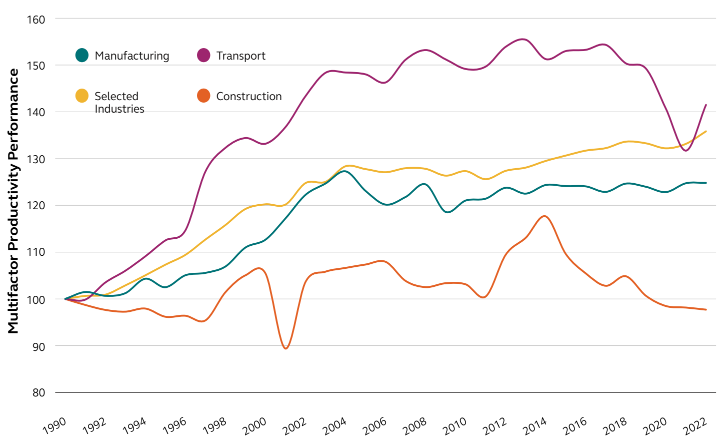
Productivity across the construction sector has been on a downward trend since 2014 and is now lower than rates recorded back in 1990. This decline is stark when compared to industries such as manufacturing, which, despite a slight decrease over the past five years, have seen a 30% increase over the same period. It's like comparing a well-oiled machine to a rusty old gear.

A recent report from the federal government sheds light on some concerning trends. It revealed that average labour productivity growth is currently at a 60-year low, showing a mere 1.1% increase from 2010 to 2020. Despite hopes pinned on technological advancements, the forecast for annual productivity growth over the next 40 years stands at a modest 1.2%. Economic growth is predicted to dip, averaging 1.4% in the coming years before an uplift to 2.3% by the end of 2025. The widening gap between wage and productivity growth since the early 2000s adds to the challenge of achieving value for money in the industry.

Annual Output / Productivity



New Homes, Approved, Commenced and Delivered



Challenges and Solutions

The construction industry is up against some tough challenges. With policies like the Best Practice Industrial Conditions (BPIC) in Queensland and the ongoing renewal of enterprise bargaining agreements nationwide, construction wages are on track to rise by more than 25% across most states over the next few years. However, on the flip side, productivity is likely to take a hit of around the same percentage due to the terms laid out in these policies and agreements. As a result, this shift could further impact the value-for-money equation in construction projects.

The impacts of this are already being felt across the industry. Anecdotal remarks from industry players indicate that some sites achieved less than ten days of productivity across January and February. In an environment where project cost blowouts are regular headline news, it is easy to draw a comparison between budget overruns and reducing productivity.

To put this into really simple terms, it is taking far too long to complete projects at a much higher cost than it has in previous decades. The data is compelling in telling this story.

The key areas impacting productivity in the construction sector include procurement, industrial relations, and the adoption of technology and new specifications. The impact of industrial relations on construction companies was loud and clear in the recent Arcadis Market Sentiment Survey, where 90% of responding contractors rated political changes (which include the current changing IR landscape) as being of major concern and significantly impacting their businesses.

Industry bodies such as Master Builders Australia, the Queensland Major Contractors Association, and the Australian Constructors Association have been advocating for change for some time now – all of it focused on improving profitability, reducing risk, and driving cost certainty. The industry is an eco-system, and yet it operates every step of the way like there are winners and losers. This is a zero-sum game, and a change of rules or playing conditions is desperately needed.

As an industry, we need to come to together to develop, champion, and integrate the solutions that we need to deliver the 1.2 million homes that are needed, enable and realise our energy transition, and continue investment in transport infrastructure. And the solutions are not new. We should stop waiting for the silver bullet that we think will solve our problems for us.

Fairer and standardised contracts that are fit-for-purpose. Equitable transfer of risk. Improved collaboration between all team members – and not just between the client and the contractor. Investment in the adoption of new technology and automation, as well as legislation to drive the growth of a manufacturing industry that can support Modern Methods of Construction (MMC) and Design for Manufactured Assembly (DfMA).

Without addressing any of the current issues, without improving construction productivity, it can and will continue to take longer and cost more to deliver buildings and much needed infrastructure.

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Contact

Matthew Mackey
Executive Director - Cost & Commercial
matthew.mackey@arcadis.com

Neil Gall
Director, Queensland
neil.gall@arcadis.com

David Ball
Director, New South Wales
david.ball@arcadis.com

Rebecca Hearn
Director, Victoria
rebecca.hearn@arcadis.com

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