Australia and New Zealand Construction Forecast 2019

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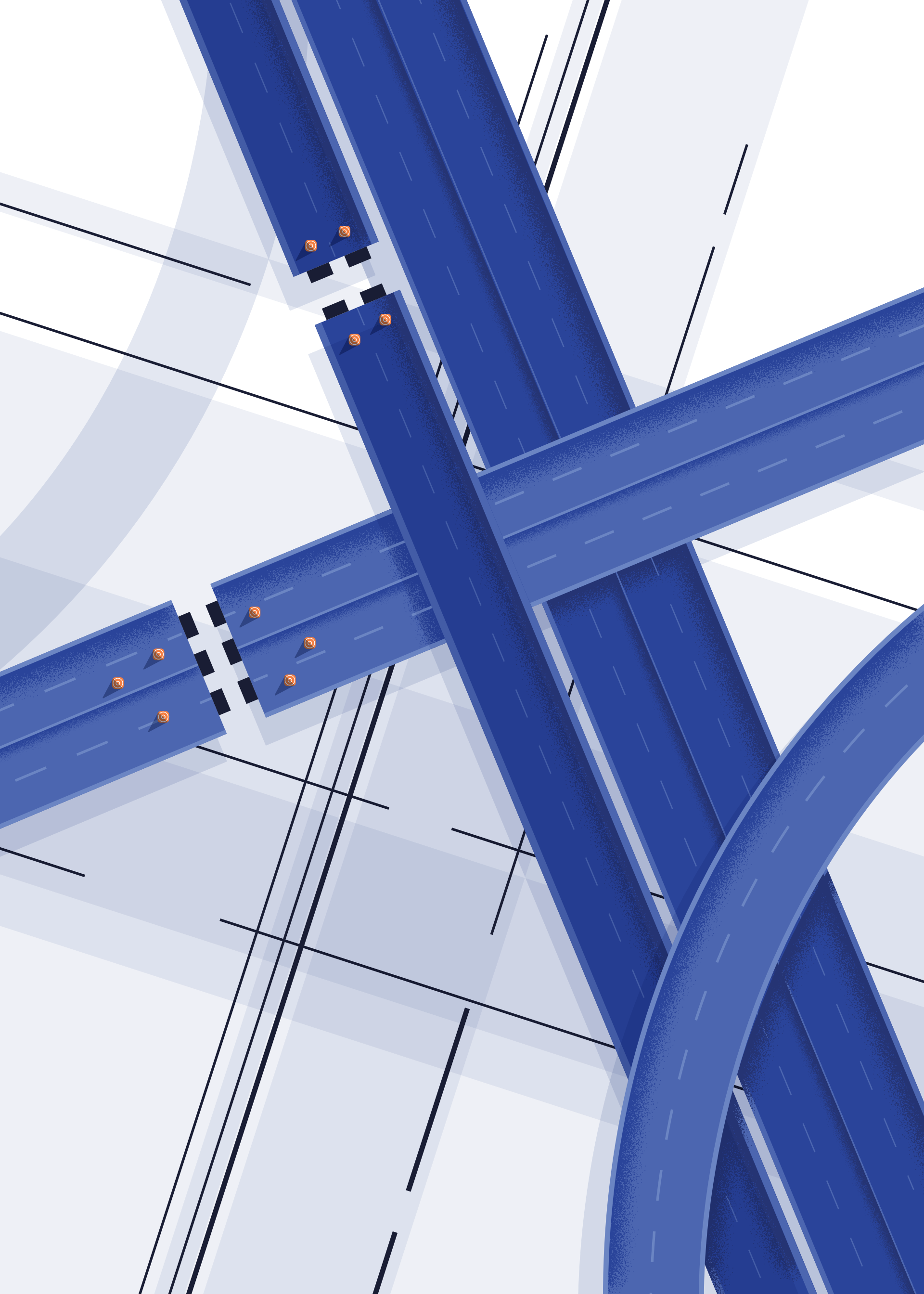

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Introduction

Across the board, economists are predicting a downturn in the market. Yet many still remain positive as we move toward 2019.

Hans Kunnen, Principal & Chief Economist at Compass Economics shared his forecast for the Construction Industry heading into the new year.

"There are some real positives for the construction industry in 2019. Interest rates should remain low, the population continues to grow and governments are spending on infrastructure.

Is it all upside? No. Residential building approvals are in decline. Banks are tightening their lending conditions, investors are being scared off by lower house prices and Chinese demand is falling due to restrictions on capital flowing out of China."

"Despite softness in the residential construction sector, activity will remain at historically high levels. The slack from residential construction should be taken up by government spending on social infrastructures such as schools, hospitals and correctional facilities.

"THE EXPANSION OF TRANSPORT INFRASTRUCTURE WILL SEE SPIN-OFFS IN COMMERCIAL CONSTRUCTION INCLUDING SHOPS, OFFICES AND WAREHOUSING."

“The expansion of transport infrastructure will see spin-offs in commercial construction including shops, offices and warehousing,” said Kunnan.

Morgan Stanley reports that they struggle to see improvement in any of the components over the next year, with pre-existing headwinds of net supply, an RBA on hold and sustained focus on lending standards, all independent of potential negative gearing/capital gains tax changes.

They also share news of a 10-15% peak to trough decline in real house prices, from 5-10% previously, which would mark the largest decline since the early 1980s.

It’s not just Morgan Stanley who see a drop when it comes to property forecasting. CoreLogic’s October 2018 figures found values had dropped by 2.7% across Australia in September, with Sydney home prices down 6.1 % and Melbourne down 3.4%.

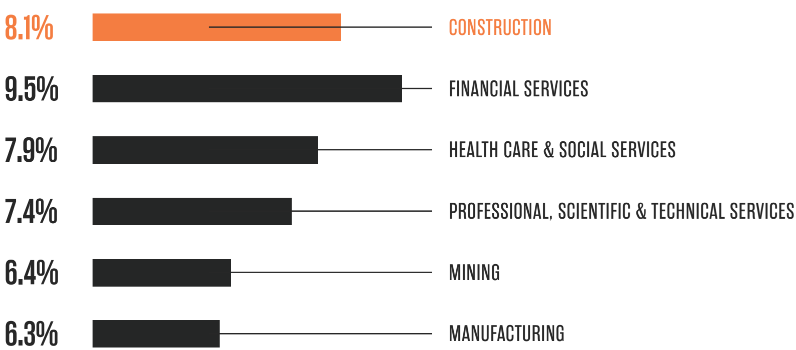
In October, ANZ announced its prediction that house prices would remain weak through to 2020, while in June, ANZ and Macquarie both predicted a Sydney house price fall of 10%.

02

A look at Australia's Economy as a whole

This is Australia's 28th consecutive year of economic growth. The International Monetary Fund (IMF) predicts that between 2019 and 2023 our economy will outperform every other major advanced economy. This impressive growth record is supported by Australia's strategic location within the dynamic Asian region, strong economic fundamentals and a portfolio of globally significant industries that represent future high growth opportunities.

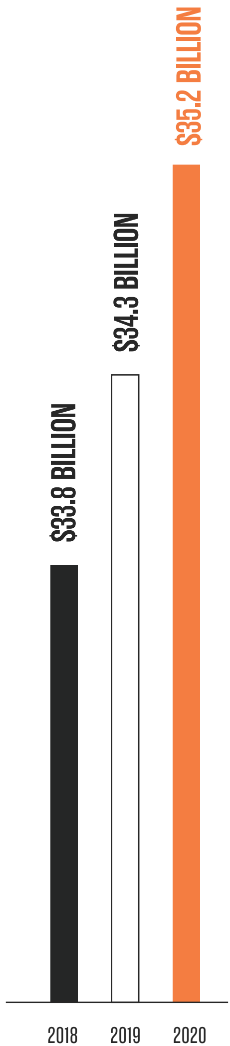
Despite some contrary perceptions, Australia's economy involves much more than Mining and Resources, with almost three-quarters of economic output generated by Service sectors:



There are now growing concerns for the Construction Industry, after years of stimulating the economy, as a slump in the apartment market hits home. According to BIS's Building in Australia 2018-2033 report, a weaker residential market will lead to an overall fall in construction of up to 10%.

GDP from Construction in Australia is expected to be AUD$33.8 billion by the end of the 4th Quarter 2018, according to Trading Economics global macro models and analysts expectations. Looking forward, Construction GDP is estimated to stand at $34.3 billion in 12 months' time. Moving into 2020, it is projected to trend around $35.2 billion.

All statistics show that construction has slowed recently and will be more modest for the next few quarters. However, the pipeline of building and infrastructure work yet to be done suggests that construction activity will increase through the forecast period. Machinery and equipment investment is also expected to pick up, consistent with ongoing economic expansion.



03

New Zealand Economy

New Zealand's Construction GDP is expected to be NZD$38.7 billion by the end of 2018, according to Trading Economics global macro models and analysts expectations.

Looking forward, they estimate Construction GDP to stand at $39.2 billion in 12 months' time. In the long term, Construction GDP is projected to trend around $41.5 billion in 2020, according to econometric models.

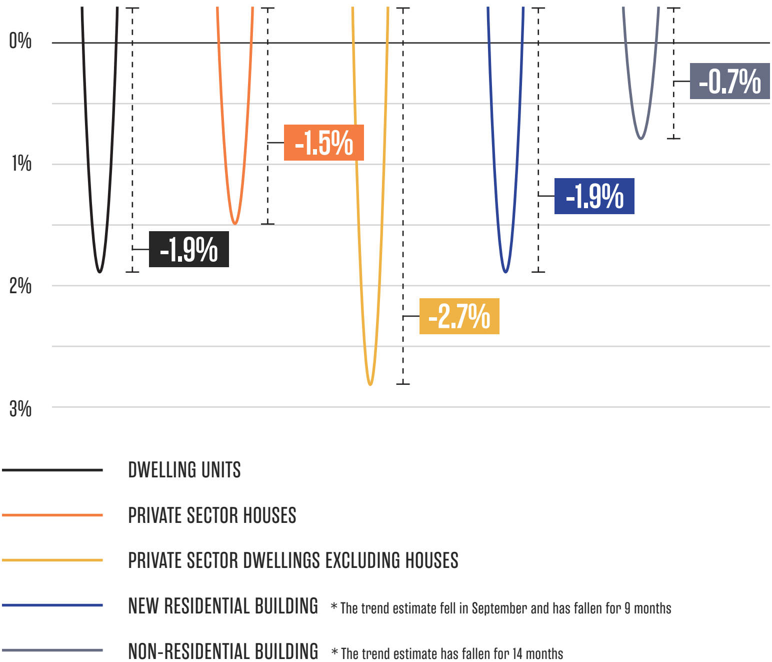
NEW ZEALAND'S CONSTRUCTION GDP

04

Building Approvals and The Domino Effect

Building approval statistics play a vital part in predicting what's to come in the near future and are a vital part of the construction cycle. September ABS figures show a decline across the board:

DECLINING TREND ESTIMATES IN CONSTRUCTION



Speaking to Procore, BIS Oxford Economics Senior Economist Tim Hibbert shared his prediction of a moderate downturn in the new year.

"WE ARE ALREADY SEEING THE EFFECTS OF THE DROP IN APARTMENT APPROVALS WHICH SEES INVESTORS LEAVE THE MARKET. FOLLOWING ON FROM APARTMENTS, WE ARE SEEING A DROP IN STAND-ALONE HOMES. THE COMMERCIAL SECTOR IS HOLDING ITS WEIGHT HEADING INTO 2019."

"Even with these forecasts, we could still see the market go either way... The market could soften given the strong population growth and elevated migration levels," he said. "We could also see a swing if there is a change in Government or Royal Commission."

A large majority of Australian household wealth and bank lending is concentrated in property and as such our government should do all it can to deter a complete crash in the system."

05

Unit Development

Over recent years, population growth and high median house prices have resulted in an influx of unit development in all major cities. In many areas, this increase has led to an oversupply, in turn causing median unit prices to drop.

Unit construction has recently surged in Sydney and Melbourne and to a lesser extent, in Brisbane. This new supply still needs to be absorbed by the market.

It seems many forecasts are in contradiction on whether the decline in unit construction will continue into 2019. The jury is still out on this one.

"THERE ARE SOME REAL POSITIVES FOR THE CONSTRUCTION INDUSTRY IN 2019. INTEREST RATES SHOULD REMAIN LOW, THE POPULATION CONTINUES TO GROW AND GOVERNMENTS ARE SPENDING ON INFRASTRUCTURE.

IS IT ALL UPSIDE? NO. RESIDENTIAL BUILDING APPROVALS ARE IN DECLINE. BANKS ARE TIGHTENING THEIR LENDING CONDITIONS, INVESTORS ARE BEING SCARED OFF BY LOWER HOUSE PRICES."

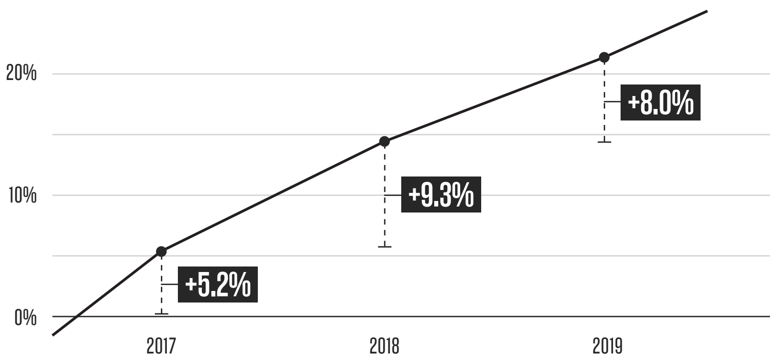
06

Non-residential Building

BIS forecasts that the value of non-residential building commencements will remain in positive territory, although it may slow down over the next two years.

AI Group has shared that after recovering by 5.2% in 2017, the total value of non-residential construction work is forecast to rise by 9.3% in 2018, followed by a further lift of 8.0% in 2019. They believe growth will be led by a strong pipeline of non-mining infrastructure work in line with the significant growth impetus from public sector spending on transport infrastructure projects.

VALUE FORECAST OF NON-RESIDENTIAL CONSTRUCTION



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Labour Market

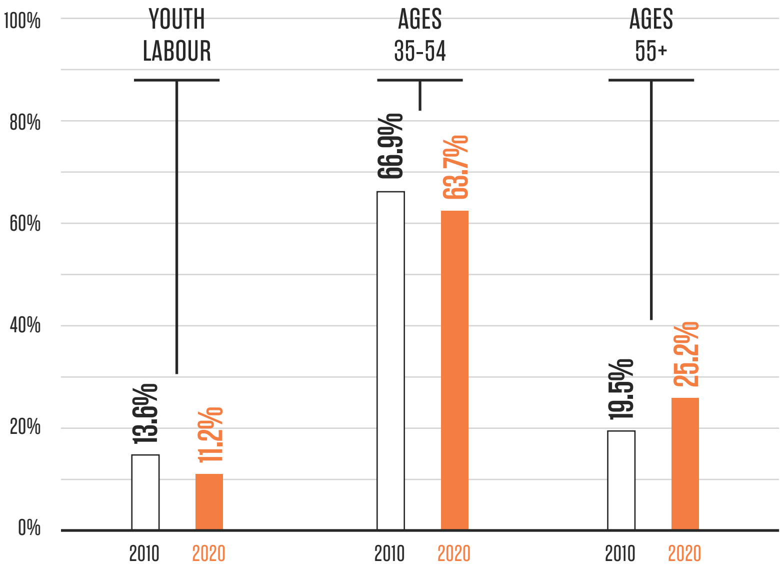
The latest data confirms the construction industry is responsible for 1.19 million jobs in Australia. That equates to a massive 9.5% of our workforce. If you include the additional 228,000 who work in property management, construction recruitment and real estate; the construction industry is the third largest employment sector next to retail and healthcare.

Over the past 5 years, employment in the industry has increased by 19.6%. The median age for workers in this industry is 38 years and median earnings are around $1,250 per week for full-time employees.

Given the drop in building approvals, there are concerns for the Construction Workforce.

According to ABS Trend Data, by 2020 it is expected that the share of the youth labour force will decrease from 13.6% in 2010 to 11.2%. The primary working age group (between 35 and 54) is projected to decline from 66.9% in 2010 to 63.7 in 2020. The share of workers ages 55+ is projected to jump from 19.5% in 2010 to 25.2% in 2020.

THE CONSTRUCTION WORKFORCE



2020 marks an important turning point, however, representing the last batch of baby boomers who will be entering the 55+ range and approaching the age of retirement.

It seems only a small amount of the 200,000 millennials entering the workforce each year are choosing a career in the building and construction sector. Heading into 2019 it is essential that construction companies begin to leverage the talent, skills and knowledge of the experienced and aging workforce to mentor and train younger generations who will soon be eligible for higher-level roles in construction.

08

A look at the Federal Budget 2019

According to the latest Budget, the Government is continuing to back businesses to invest and create jobs by:

+ Lowering taxes for small and medium-sized businesses as part of the Enterprise Tax Plan and seeking full implementation of the plan to ensure businesses remain internationally competitive
+ Extending the $20,000 instant asset write-off for businesses with a turnover of up to $10 million to apply in 2018–19
+ Investing $75 billion in transport infrastructure over the coming decade.

THE CONSTRUCTION INDUSTRY IS THE THIRD LARGEST EMPLOYMENT SECTOR NEXT TO RETAIL AND HEALTHCARE.

OVER THE PAST 5 YEARS, EMPLOYMENT IN THE INDUSTRY HAS INCREASED BY 19.6%. THE MEDIAN AGE FOR WORKERS IN THIS INDUSTRY IS 38 YEARS AND MEDIAN EARNINGS ARE AROUND $1,250 PER WEEK FOR FULL-TIME EMPLOYEES.

09

Transport

The Budget includes $24.5 billion for new, nationally significant transport projects and initiatives that benefit people and businesses in every State and Territory, building on existing projects such as the Melbourne to Brisbane Inland Rail project and Western Sydney Airport announced in last year's Budget.

These form part of the Government's $75 billion transport infrastructure investment over the next decade.

PwC Australia reports that urban transport networks are expected to see increased investment as the government's move to address population growth and increasing congestion in major cities.

The growing number of metropolitan rail and projects, such as the Cross River Rail in Brisbane, the Melbourne Metro and the Westconnex and M5 widening in Sydney, reflect this demographic shift.

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Green Design & The Future of Our Residential Market

Heading into 2019, the Green Building Council Australia (GBCA) is planning to develop a standard for Future Homes that marries the needs of home buyers with leading performance that will meet the challenges of the future. Currently, our residential sector accounts for 57% of carbon emissions from the built environment. GBCA endeavours to work with the industry to present better design options to reduce this figure.

Australia continues to lead the world's green building sector with further growth predicted over the next three years, according to a new global report. It indicates support for the green building sector is growing globally, with organisations across the construction industry shifting towards more sustainable materials and practices.

The report found 94% of Australian respondents are involved in green building projects and the majority (67%) report at least a moderate level of green activity, with 30% share or more of their work in the sector. Notably, 46% of respondents reported more than 60% of their projects were in the green building space, the highest of any country, and 64% expected by 2021 the majority of their work would be in green building.

11

Cloud-based Future

With more than half of prospective software buyers still using pen and paper and countless spreadsheets, a younger generation is influencing traditional-minded businesses to adopt technology. Already proving to be a necessity in the construction industry, we should expect cloud-based solutions to grow in popularity in the coming years.

2019 will be a time to build a truly collaborative environment with the opportunities provided by technology to ensure greater productivity and a competitive edge. With software such as Procore, teams can access all the information they need, with real-time updates and instant tracking.

Along with construction software, the adoption of advanced technologies like artificial intelligence, robotics and drones, the construction industry could see significant increases in productivity, cost savings and decreased work-related injuries.

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Conclusion

Business conditions are on the upswing and low wage growth and inflation are likely to temper any interest rate rises. The labour market is tightening and unemployment is expected to decline further as cities work to support population growth. Even weaker sectors such as retail are performing relatively well and there are several sectors that are well placed to serve as major engines of growth in future.

Australia's home-building pipeline is holding up stronger than expected and will add an extra $7 billion to the construction industry this year, the latest Australian Construction Industry Forum figures show.

While the country's $240 billion-plus construction industry will dip as the apartment-boosted home-building sector declines, the downturn has been pushed back, with peak forecasting group ACIF raising its expected output for the financial year to $99.5 billion from the $92.7 billion it predicted in its last forecast in May.

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