WT PARTNERSHIP

REVIEW OF AUSTRALIAN CONSTRUCTION MARKET CONDITIONS

JULY 2014

The WT Partnership *Review of Australian Construction Market Conditions*, March 2014, reported a revitalised private sector in the wake of consolidating mining and infrastructure activity. Recent Australian Bureau of Statistics (ABS) data has further substantiated this trend with the value of 'building work done', which excludes infrastructure and mining work, at an all-time high and increasing by the largest quarterly percentage since June 2010.

Conversely, the total value of infrastructure and mining works completed in the March 2014 quarter fell from the all-time highs recorded in the September 2013 and December 2013 quarters. The tender market has remained competitive throughout 2014 following the aggressive tendering seen during and prior to 2013. Sentiment and confidence appears to be improving throughout the construction industry, particularly amongst head contractors.

The latter half of 2013 and the first half of 2014 saw a steady and sustained increase in the number of projects progressing to tender. We continue to see very competitive tendering as contractors seek to firm up order books currently loaded with projects with very tight margins; a hangover from the aggressive tendering we have seen over the last few years.

Whilst Tier 1 contractors are tendering the traditional markets with projects exceeding $150 million they continue to find themselves up against increasingly capable Tier 2 contractors in the $50 million to $150 million market segment. This competitive market characteristic is placing pressure on subcontractors and is partly alleviating upward pressure on construction cost escalation.

We commented previously on the oversupply in the subcontractor market which was driving fierce competition at the subcontractor level. This market trend continued through the first half of 2014 with the exception of select trades. Consequently we have recently seen a number of financial collapses amongst subcontractors. With the number of tenders increasing and 'stretched' subcontractors 'going to the wall', we anticipate the subcontract market to consolidate over the coming years.

Enterprise Bargaining Agreements will continue to contribute to construction cost escalation into 2014 and beyond. However, it appears that industrial action within the construction industry has eased.

The private sector continues to improve into the second half of 2014. According to the ABS, the total value of building work done, which excludes infrastructure and mining work and broadly represents the private construction sector, rose 4.8% in the March 2014 quarter. The 4.8% quarterly rise has only been exceeded on three occasions in the past six years with all three occasions falling within periods of significant government stimulus initiatives such as the Building the Education Revolution program.

Our offices around the country continue to report significant and sustained activity in the multi-level residential apartment market. The solid and steady pipeline of work that this sector provides for contractors and consultants shows no sign of slowing as development applications and approvals continue to materialise along with very strong pre-sales underpinned by Asian capital.

The institutional retail sector continues to invest in new assets and the improvement of existing assets in response to the rejuvenated market. The renewed activity in the institutional retail sector and, to a lesser extent, the smaller regional and private retail centres, is providing long term cash flow for Tier 1 and Tier 2 contractors around Australia.

Despite a fall in activity over the last 18 months, the mining sector continues to absorb a significant amount of construction capacity. Demand in the mining sector is however forecast to continue its decline as projects progress from the construction phase towards operation and maintenance.

The tourism sector is forecast to improve in the medium to long term with Asian tourism, particularly from China, expected to increase significantly. As a result we are anticipating new development projects along with the revitalisation of existing assets to cater for the particular needs and wants of this specific market. The potential of this sector and its effect on construction activity, and in turn construction cost escalation, is evident in projects such as the 'mammoth' $4.2 billion mega-resort and casino project proposed in North Queensland.

In-line with our March report, we forecast increasing optimism and confidence for the balance of 2014 and into 2015. Key economic indicators continue to support this.

Data released by the ABS shows national GDP continuing its increase from the December 2013 quarter with a further increase in the March 2014 quarter. This upward movement in national GDP over the last six months comes after relatively flat growth since the September 2011 quarter. Inflation has also risen further from 2.7% in the December 2013 quarter to 3.0% in the June 2014 quarter.

In conclusion, contractors are forecast to continue competitive tendering strategies for the remainder of 2014. Nonetheless, tenders are not expected to be at the cutthroat levels seen prior to 2014 as contractors begin populating their order books with 'healthier' margins. However, given the capacity remaining in the broader subcontractor market we anticipate head contractors to continue to pressure subcontractors in order to maintain competitiveness. Whilst this is not sustainable in the long run we do not forecast significant construction cost escalation in the remainder of 2014. We expect national average tender price escalation through to the end of 2014 to trend in the order of 2.0% rising to 3.0% per annum for the next three years.

NATIONAL ECONOMIC INDICATORS

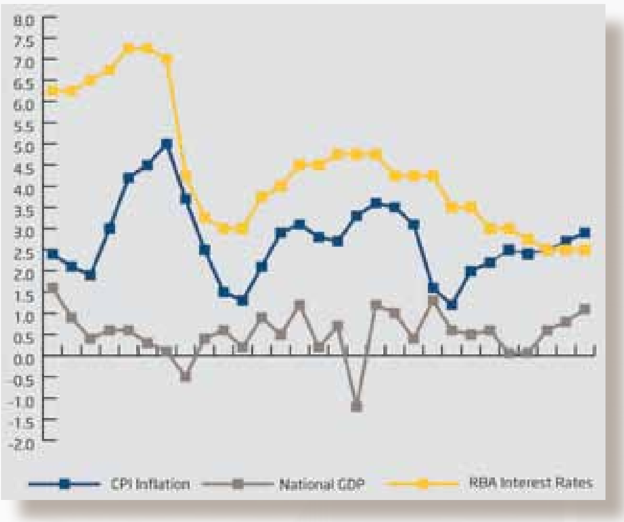
GDP expanded 3.5% from March 2013 through to March 2014 averaging a quarterly increase of 0.8% each quarter.

CPI rose 2.9% over the year ending March 2014. This compares with an average comparable rate of 2.2% since March 2012. The downward trend seen between June 2011 and September 2012 appears to have broken with inflation now at 3.0% off a low of 1.2% in June 2012 and equivalent to the average inflation rate pre-GFC (between December 2004 and March 2007).

The Australian dollar (AUD), which has ranged between US$1.11 and US$0.77 over the last 5 years, remains below parity. As of July 2014 the AUD was trading at approximately $0.94 against the US Dollar. Recently in a July 3 speech, the Reserve Bank of Australia (RBA) Governor Glen Stevens stated 'most measurements would say it (the AUD) is overvalued, and not just by a few cents'. He also predicted disruption in the AUD due to expected monetary policy movements in the United States.

The seasonally adjusted Australian unemployment rate has risen to 6.0% since our previous report, from lows of 5.0% at the peak of the 'mining boom'.

The RBA's current cash rate is 2.5% and has remained unchanged since August 2013 when it was reduced by 25 basis points. According to an index of swaps from Credit Suisse Group AG in Sydney, Traders are pricing in a 15 basis point cut in the RBA interest rate over the next 12 months.



National GDP measure: seasonally adjusted quarterly % change
Source: RBA; ABS; Quarterly trend review on GDP, CPI inflation, RBA cash rate.

NATIONAL CONSTRUCTION INDICATORS

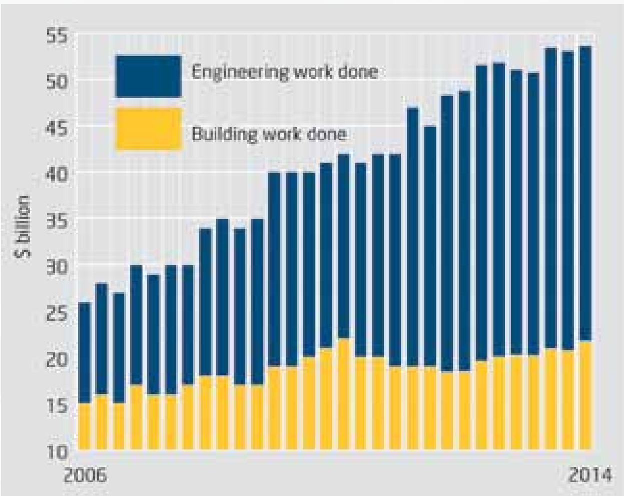
In the 12 months preceding March 2014, in nominal terms, the 'total value of construction work done' increased by 3.9% and, in terms of value, is at an all-time high.

In the 12 months preceding March 2014, in nominal terms, the seasonally adjusted estimate for 'building work done' (generally comprising private sector residential and commercial works) increased by 7.3%. This compares with an increase of 0.9% for the same period one year earlier. In the 12 months preceding March 2014, the seasonally adjusted estimate for 'engineering work done' (generally comprising mining and infrastructure works) increased by 1.8%. This represents a significant decrease in comparison with the same period one year earlier which saw 'engineering work done' increase by 25.0%.

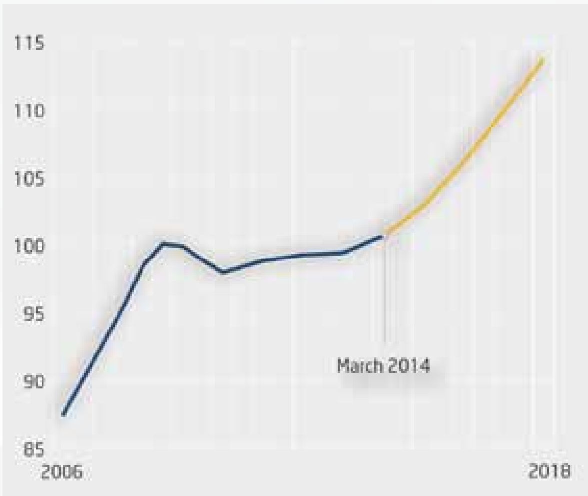
Following a quarterly decrease in the December 2013 quarter, the March 2014 quarter has seen a nominal increase of 1.0% in the total value of construction work done. In the same period the value of 'building work done' recorded a nominal increase of 4.8% and the value of 'engineering work done' recorded a nominal decrease of 1.5%. The overall value of construction work done for the March 2014 quarter is at record highs. Notably, in the March 2014 quarter, 'building work done' experienced its largest quarterly increase since the June 2010 quarter.

Of the 'total construction work done' in the amount of $210,922 million during the 12 months preceding June 2014, 'building work done' represented 40.0% of total construction work done while 'engineering work done' represented 60.0%. The share of 'building work done' and 'engineering work done', as a percentage of the 'total value of construction work done', is continuing to trend relatively flat and has done so since the September 2012 quarter. Notwithstanding, the share of 'building work done' as a percentage of 'total construction work done' has reached 40.0% for the first time since December 2011.

VALUE OF CONSTRUCTION WORK DONE IN AUSTRALIA ($ BILLION)



WT PARTNERSHIP TENDER PRICE ESCALATION FORECAST - AUSTRALIAN AVERAGE



The above graph index is set at 100 for September 2008. Recorded data and forecasts are based on tenders for large building construction projects (value $20 million to $300 million).

State By State Summary

NEW SOUTH WALES

Whilst the pipeline of potential projects has increased, only certain sectors, such as health, multi-level residential and aged-care are experiencing actual increased workflow. Adaptive re-use of existing C and D grade commercial space to both residential and hotel use is increasing as building owners see the need to re-position assets in the face of increased commercial vacancy rates as tenants look to relocate to Barangaroo, the CBD and North Sydney, leaving emptying lower grade stock behind. As the strong demand for residential apartment stock continues, conversion of these assets is a logical option for building owners.

The outer suburbs still have strong demand for industrial buildings and Western Sydney has huge expansion potential following the State Government's recent announcement for growth in commercial, retail, residential and associated infrastructure.

The demands being placed on the subcontract market, due to projects such as Barangaroo and The Sydney International Convention, Exhibition and Entertainment Precinct is placing pressure on pricing and competitiveness. Engineering services and structural trades are the first to show signs of price escalation. The immediate effect is on Tier 1 contractors as the resource pool diminishes due to demands from these major projects. There will be a knock-on effect for Tier 2 and Tier 3 contractors as skilled labour looks to secure positions on the more lucrative 'mega' projects and this will flow onto other trades increasing pressure on all sectors over the next 12-36 months.

Major infrastructure projects including road, rail and aviation (Sydney airport and the second airport) will see this sector buoyant for the next 6-10 years although foreign competition for these multi-billion dollar projects means local contractors have to maintain keen pricing in an attempt to ward off offshore competition.

Our forecasts for tender price escalation have been relatively conservative for the past few years and we foresee the remainder of this year to trend around 2.5% per annum increasing to approximately 4.0% per annum for the next 3 years.

VICTORIA

The number of construction projects tendered by Tier 1, 2 and 3 contractors in Victoria in the second quarter of 2014 was less than in the same period last year. However, the outlook for the second half of 2014 remains steadily optimistic.

Whilst there have been fewer projects tendered in number, the projects are more substantial in individual value which has concentrated demand on Tier 1 contractors and subcontractors with demonstrated 'larger project' experience. This in turn has resulted in contractors operating on the Tier 1-2 'cusp' to tender lesser value work than they have been in the last two to three years. This, combined with some Tier 3 contractors aspiring to tender larger projects has created new competition for sub $50 million construction projects.

Whilst recent construction tenders have remained competitive, the demands from large individual projects currently entering market, coupled with the value of the AUD could contribute to increasing construction cost escalation throughout Victoria.

In our Melbourne office enquiries continue, particularly for new larger scale mixed-use, residential and hotel schemes. Continuing off-shore investor interest as well as acquisition of metropolitan sites has introduced grander concepts and higher yields than previously envisaged.

The Federal and State Governments' announcement for large-scale infrastructure spending has raised expectations for short and long term port, rail and road projects generally. However, the Victorian election later in the year may influence planned and potential planning decisions. New retail and commercial project enquiries are being received with capital works programs also on the drawing boards.

In line with our first quarter 2014 advice, we foresee tender price escalation for the balance of 2014 at 2.5% per annum, increasing to 3.0% in 2015, 3.5% in 2016 and 3.25% in 2017.

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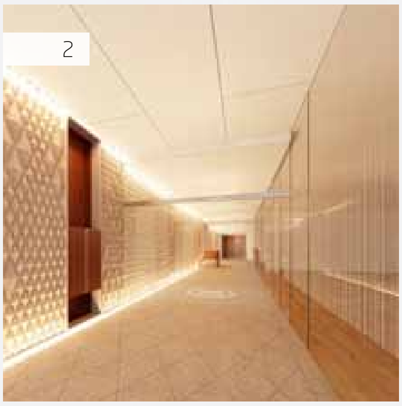

The recently approval EQ Tower (2) and the recently completed Sheraton Hotel on Little Collins Street (2) are indicative of activity in Melbourne's residential and mixed use markets

QUEENSLAND

The second quarter of 2014 has seen sustained activity in the South East Queensland tender market continuing from increases in the final quarter of 2013 and first quarter of 2014. Tender results continue to be competitive.

As per our previous report, confidence in South East Queensland continues to strengthen with strong sales in the residential sector and strong leasing, particularly in the retail sector. The activity in the Brisbane multi-level residential sector shows no signs of slowing with a number of projects in the construction phase and further projects entering the planning and tendering phase. Our Queensland offices have seen a marked increase in interest from financiers in the multi-level residential sector and smaller private developers entering this market sector.

The retail sector continues to grow with the institutional sector pressing ahead with major projects such as Grand Central Toowoomba, major refurbishment and expansion works at Robina Town Centre and the redevelopment of Pacific Fair. Expansion and refurbishment works are also underway in sub-regional and regional centres as investor confidence continues to strengthen. Private developers are also continuing to invest in small to medium retail as capital becomes more readily available and demand for stock from major retailers increases. Coles recently announced 31 new stores across the state.

The Gold Coast market is improving. The development revival on the Gold Coast could see as many as 1,700 new apartments entering the market within the next six to 12 months. The Commonwealth Games are less than four years away with works on the $500 million athletes village commencing recently and various venues for the games progressing to tender.

The tourism sector is also improving with market commentators expecting a significant increase in the Asian market as planned developments funded out of the region frequently hit local property headlines.

Construction activity in the mining and resource sector is expected to ease further from its highs over the coming years as construction of new major projects subsides and developments progress to production. However, this sector and its demands on material and labour resources is not to be underestimated given the number of significant projects still in the long-term pipeline. In addition, some of the resources currently employed in this sector will likely relocate to urban regions where there is increased public infrastructure spending.

With significant activity in the South East Queensland market, the forecast revival on the Gold Coast, improvements in the tourism market and continuation of mining and infrastructure works regionally, we forecast tender price escalation trending in the order 2.2% per annum for the remainder of 2014, rising in 2015 to 3.0% and to 4.0% in 2016 and 2017.

1. Continued expansion to Robina Town Centre is indicative of wider construction activity in the South East Queensland retail sector

SOUTH AUSTRALIA

Competitive construction costs coupled with growing demand and all time low interest rates are assisting feasibilities and fuelling a steady increase in optimism in the Adelaide market. It is commonly heard in the industry that 'this is the time to develop'. The competitive pricing levels of the past two years continue with the majority of contractors very keen to secure work in the latter half of 2014 and into 2015.

Construction of The Royal Adelaide Hospital (RAH) continues to dominate the Adelaide skyline but the majority of the trade contract works have been awarded to interstate companies primarily due to the large size of the project. Therefore, the RAH is not having, nor is expected to have, any significant impact on construction costs or trade availability in the South Australian Market.

There have been some head contractor and subcontractor financial failures in recent months including the electrical subcontractor on the RAH. This highlights the need for caution when assessing tenders particularly where subcontractor pricing amongst the tenders varies significantly. In purchasing sites based on 'builders prices' and in accepting tenders, caveat emptor should prevail.

Adelaide's three largest universities have significant projects scheduled over the next few years. These are being targeted by Tier 1 contractors with the Adelaide University project recently being awarded to Lend Lease.

The surge in confidence in the private sector is not reflected in the public sector with a 'tough' state budget handed down on 19 June. There are a number of projects planned to be tendered for design and ultimately construction in the next 12 months but not the usual quantity or size seen in previous years. In particular, a significant public project currently being tendered to three shortlisted bid parties is the South Australian Courts Redevelopment project. Despite award of the construction contract likely to occur in 2014, construction is not expected to commence until after the first quarter of 2015.

We forecast that the expanding private sector coupled with the contracting public sector will result in tender pricing escalation in the order of 1.25% per annum for the remainder of 2014, 1.5% and 2.0% for 2015 and 2016 respectively and then rising to 2.5% in 2017.

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2. Ongoing work on the Royal Adelaide Hospital has not impacted on construction costs in the Adelaide market.

WESTERN AUSTRALIA

The outlook for the Western Australian construction industry remains positive for the balance of 2014. Most sectors should grow as the construction industry reacts to steady demand. In our last report we reported our expectation of Tier 1 contractors re-gearing operations to specific projects with construction values from $40 million to $75 million and we now see this materialising.

From a tendering perspective, we expect the aggressive tendering and tight margins seen over the last 12 months to continue for the foreseeable future. Whilst Tier 1 contractors re-position themselves in the market, the Tier 2 and Tier 3 contractors' space is becoming increasingly competitive. One of the driving factors being the entry of a number of interstate based contractors into the Western Australian market. The initial effect of this was minimal however, we are now beginning to see these contractors gain traction in the local market, especially in the $20 million to $50 million market segment.

The resource sector which has dominated the Western Australian market for some time now, continues to realign from the construction phase to the production phase. The effect of this and Western Australia's dependence on this sector has yet to be fully realised on the state economy. As direct foreign capital investment for new projects declines, and given the resource sector's high sensitivity to numerous external market forces, this should continue to be a volatile sector for some time to come.

The outlook for the tourism sector remains positive over the medium term, with a number of hotel chains such as Hilton announcing intention to enter the Perth and Fremantle markets. We are of the opinion that the influx of new hotel operators in the Perth market will ultimately lead to a robust hotel refurbishment market, as existing operators seek to improve their product offering in order to remain competitive.

The retail sector continues to grow strongly with a number of projects progressing to construction. We expect this sector to be one of the cornerstones of the local construction industry over the medium term.

The commercial office sector is also very buoyant, with a large amount of 'A-Grade' office space either planned or currently under construction. Whilst there seems to be a relatively strong market for 'A-Grade' office space, 'B and C-Grade' office space may have difficult times ahead as this sector becomes a buyers' market. We expect to see a growing number of refurbishments as owners seek to reposition their assets in a challenging market.

In our previous report we mentioned our expectation of a tapering housing market during 2014. It would appear now that this is the case as much of the gains seen in the latter half of 2013 and beginning of 2014 have been lost. Regional Western Australia, especially those areas dependent on the mining sector, have seen a significant decline in residential market value. However, the high rise residential market in and around the Perth CBD area continues to grow strongly as developers react to demand for inner city living from both domestic and international purchasers.

We forecast tender price escalation of 2.0% per annum for the remainder of 2014 increasing to 2.8% for 2015 and 3.0% per annum for 2016 and 2107.

AUSTRALIAN CAPITAL TERRITORY

The ACT economy has slipped dramatically as cuts in the public service bite into business confidence. Even though the ACT has experienced growth in dwelling starts and employment opportunities, it remains weak compared to the rest of the nation in terms of business investment and construction work underway. However there are several major construction and infrastructure projects in the planning phase which are expected to move to tender phase towards the end 2014 and into 2015 including the Capital Metro, the Law Courts, Government office construction and fitouts and a proposed CBD residential project.

The ACT Government is attempting to lift market sentiment with recent announcements of concerted efforts to cut red tape and implement an overhaul to the local government tendering process to increase construction turnover. However, the likely loss of up to 6,000 government sector jobs from Canberra as part of the Federal Government's overall cut of 16,000 jobs, the ACT will be more heavily impacted than in other regions.

In addition to public sector job losses a further 0.25% efficiency dividend, and the abolition of 70 government agencies will all have an additional negative impact on the ACT economy, local businesses and subsequently the construction industry.

Overall, the subdued economic outlook for the ACT is expected to adversely impact construction expenditure.

We are forecasting marginal growth in construction activity in the ACT resulting in tender price escalation of 1.0% per annum for the balance of 2014, rising to 2.0% in 2015, 2.5% in 2016 and 3.0% in 2017.

TASMANIA

The general sentiment in the Tasmanian construction sector remains restrained. However, following years of relatively poor economic conditions, a recent Deloitte Access Economics Reports suggests that the State appears to have finally 'turned a corner'.

Our previous report mentioned the Federal Government's funding for the Economic Growth Plan for Tasmania. Part of this plan was the proposed $38 million extension of the Hobart International Airport. According to The Mercury Newspaper a 'letter of comfort' has been signed between the Federal Government and the Hobart International Airport to extend the existing runway by 500 metres. The paper also sighted comments from business leaders stating 'it was among the most significant steps the State could take to give the Tasmanian economy a 'quick boost'.

The proposed $400 million Midland Highway upgrade remains on track, with works due to commence this year.

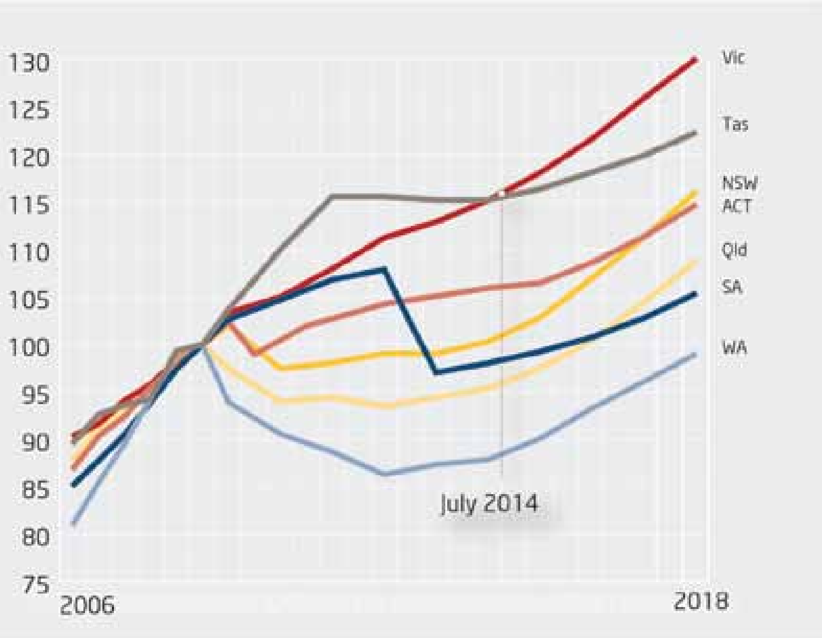
As general sentiment on the mainland improves and concerted efforts at both the Federal and State Government level to stimulate the economy continue, we believe the Tasmanian economy may be coming off its low point. The Tasmanian Government is also introducing a number of initiatives to help curtail unemployment in the State. Encouragingly, retail spending in Tasmania at April 2014 was almost 10% higher than the same time in 2013.

Inevitably as the broader economy improves the uplift will flow through to the construction sector in Tasmania. Bank of America Merrill Lynch Chief Economist Saul Eslake recently said '...Tasmania appears to be staging a recovery', and ANZ Chief Economist in Australia, Ivan Colhoun stating, 'I think for the first time we have got a glass half full view of the Australian and Tasmanian economy'.

As the Tasmanian economy stages a 'fight back', we anticipate construction activity to remain around the current levels throughout 2014 with tender price escalation in the order of 1.0% per annum followed by an increase to 1.5% in 2015 and 2016 then increasing again to 2.0% in 2017.

1. Upgrade works to the Midland Highway are on track to begin this year

Tender Price Escalation Forecasts Regional Market Summary



The above graph does not reflect the relative cost differential between the different States.

	NSW	VIC	QLD	ACT	SA	WA	TAS
2006	4.6%	4.2%	5.9%	6.3%	6.3%	12.0%	5.9%
2007	4.6%	4.5%	5.5%	6.0%	7.6%	10.9%	5.1%
2008	4.0%	5.1%	-0.7%	4.6%	5.4%	-2.8%	5.2%
2009	-4.4%	1.6%	-3.6%	-1.9%	2.0%	-5.7%	4.7%
2010	0.6%	2.8%	0.5%	2.3%	2.0%	-2.1%	4.1%
2011	1.0%	3.0%	-1.0%	1.5%	1.0%	-2.7%	0.2%
2012	0.0%	1.5%	1.0%	0.8%	-10.0%	-1.6%	-2.9%
2013	1.3%	2.0%	1.0%	0.8%	1.0%	0.6%	0.0%
2014	2.5%	2.5%	2.2%	0.5%	1.3%	2.0%	1.0%
2015	4.0%	3.0%	3.0%	2.0%	1.5%	2.8%	2.0%
2016	4.0%	3.5%	4.0%	2.5%	2.0%	3.0%	2.5%
2017	4.0%	3.3%	4.0%	3.0%	2.5%	3.0%	3.0%

The above indices reflect capital city CBD and metropolitan construction costs.

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WT Partnership is wholly owned by the Principals of the Practice, who ensure that independent advice is solely aligned to our clients' desired project objectives.

WT Partnership draws on the collective experience, knowledge and capability of over 1,250 professional staff in locations throughout Australasia, South East Asia, Central America, the United Kingdom and Europe to provide our clients with the right advice on all aspects of cost, value and risk to help them achieve optimum commercial outcomes.

CONTACT US

Adelaide

Sam Paddick
T: +61 8 8274 4666
E: spaddick@wtpartnership.com.au

Brisbane

Craig McHardy
T: +61 7 3839 8777
E: cmchardy@wtpartnership.com.au

Canberra

James Osenton
T: +61 2 6282 3733
E: josenton@wtpartnership.com.au

Gold Coast

Jason Thornley
T: +61 7 5591 9552
E: jthornley@wtpartnership.com.au

Hobart

Lee Deacey
T: +61 3 6234 5466
E: ldeacey@wtpartnership.com.au

Melbourne

Tim Roberts
T: +61 3 9867 3677
E:troberts@wtpartnership.com.au

Perth

Scott Parrott
T: +61 8 9202 1233
E: sparrott@wtpartnership.com.au

Sydney

Nick Deeks
T: +61 2 9929 7422
E: ndeeks@wtpartnership.com.au

Townsville

Jason Dixon
T: +61 7 4722 2760
E: jdixon@wtpartnership.com.au

WT Sustainability

Stephen Hennessy
T: +61 2 8197 9140
E: shennessy@wtsustainability.com.au

www.wtpartnership.com.au

Note on Applying Tender Price Indices

A number of project specifics should be considered when reviewing tender price escalation forecasts including, but not limited to, the procurement route, size, complexity, location and risk. Equally, the keenness of tenderers is important in terms of pricing and this will be driven by issues such as local market dynamics, workloads, hotspots and realisable margins. With the current uncertainties in the local, national and international arena, it is important to continually monitor the market and review escalation allowances. Clearly, it is very difficult to predict future escalation over the next few years therefore the above advice is offered for guide purposes only at this point..