REVIEW OF AUSTRALIAN CONSTRUCTION MARKET CONDITIONS

NOVEMBER 2013

The change of Federal Government in September appears to have renewed optimism in the construction sector across most States. Although both Federal and State Government spending remains tight, private investment in both building and infrastructure looks set to take up capacity in these sectors.

Whilst we expect tendering conditions to remain tight for the next 6 to 12 months as both tier 1 and 2 contractors look to fill their order books for the remainder of 2013 and into 2014, the market appears to have turned with consultants and contractors expecting an improved activity in 2014.

The residential sector, especially at the lower end investment grade and first home developments, is ramping up into the New Year with most of our offices reporting an increase of work in the feasibility and pre-contract phases as developers act to capitalise on both the tight tender market and the low cost of finance.

AI Group in its October *Performance of Construction Index* reported growth in the construction sector for the first time since 2010. With activity in the house and apartment building sectors increasing for a second consecutive month, index levels for both sectors are at their highest since the commencement of the survey in September 2005.

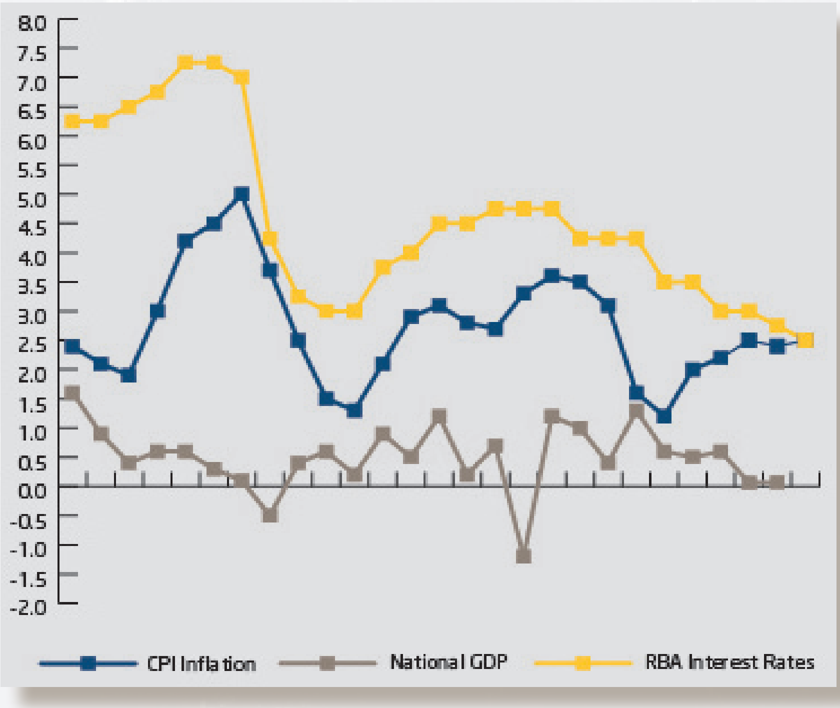
This renewed activity is not likely to impact upon residential construction costs overall, however it is expected that in some trades labour costs will increase as skill shortages, combined with the low throughput of apprentices since the GFC begin to impact on the capacity of trades to respond to increased demand.

Federal Government infrastructure budgets, as committed during the election campaign, have now been allocated with the Eastern States and Western Australia being the main beneficiaries. These budgets, combined with State allocations for major infrastructure projects, have created a pipeline of work for tier 1 engineers and contractors for the next decade. Major upward pressure on costs is not expected as most of the work will be absorbed by current capacity. However, tunnelling costs may increase as demand for TBM operators from Melbourne's East West Link, Sydney's North West Rail Link and Brisbane's Legacy Way push up labour rates, which can already account for up to 40% of tunnelling costs.

Overall the renewed optimism in the market is yet to be realised and fierce tender pricing is expected to continue until tier 1 contractors begin to fill their order books for the coming year. Pressure remains in the tier 2 sector to cut costs and absorb increases in labour and materials and we expect tight tendering conditions to continue until some of the major contracts come into the market in the first quarter of 2014. We expect National average tender price escalation for 2014 to trend below 2.0% with an increase to 2.5% for 2015 and 2016.

NATIONAL ECONOMIC INDICATORS

- GDP expanded 2.3% from June 2012 through to June 2013 averaging a quarterly increase of 0.58% each quarter for the same period.
- CPI rose 2.2% over the year ending September 2013. This compares with a rise of 2.0% through the year ending September 2012. The downward trend seen between June 2011 and September 2012 appears to have halted with inflation currently trending around 2.3%.
- The Australian dollar (AUD) traded at parity with the US Dollar (USD) throughout 2012. The AUD has generally remained below parity with the USD in 2013 and as of November 2013 was at approximately $0.93. Recent commentary from the Reserve Bank of Australia (RBA) suggests that the AUD is set to fall against the USD. In a 21 November 2013 speech the RBA Governor Glenn Stevens said the AUD is "currently above levels we would expect to see in the medium term". He went on to suggest that, if need be, the RBA is prepared to influence the AUD lower. This would likely involve the RBA selling Australian Dollars and buying foreign currencies.
- The seasonally adjusted Australian unemployment rate has increased by 0.2% since our previous report. The rate is currently 5.7% in the ABS October 2013 data.
- Since the beginning of the 2013 calendar year, the RBA reduced the official cash rate by a total of 50 basis points. The RBA's current Cash Rate is 2.5%.



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

NATIONAL CONSTRUCTION INDICATORS

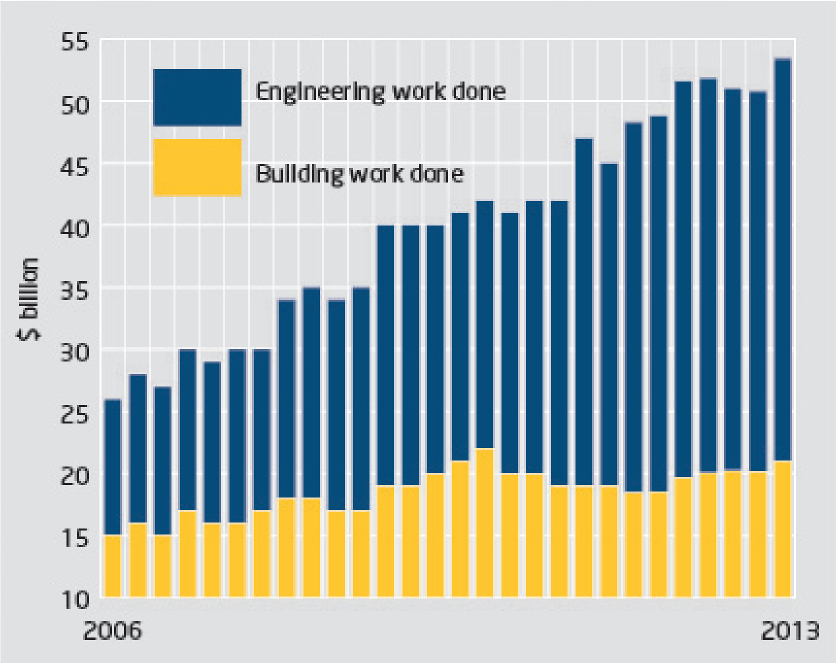
In the 12 months preceding October 2013, in nominal terms, the total value of construction work done increased by 4.1%. This compares with 8.1% for the same period one year earlier.

In the 12 months preceding October 2013, in nominal terms, the seasonally adjusted estimate for 'building work done', comprising residential and commercial works, increased by 8.7%. This compares with -0.8% for the same period one year earlier. In the 12 months preceding October 2013, the seasonally adjusted estimate for 'engineering work done' increased by 1.3%. This is a stark decrease in comparison with the same period one year earlier which saw 'engineering work done' increase by 14.2%.

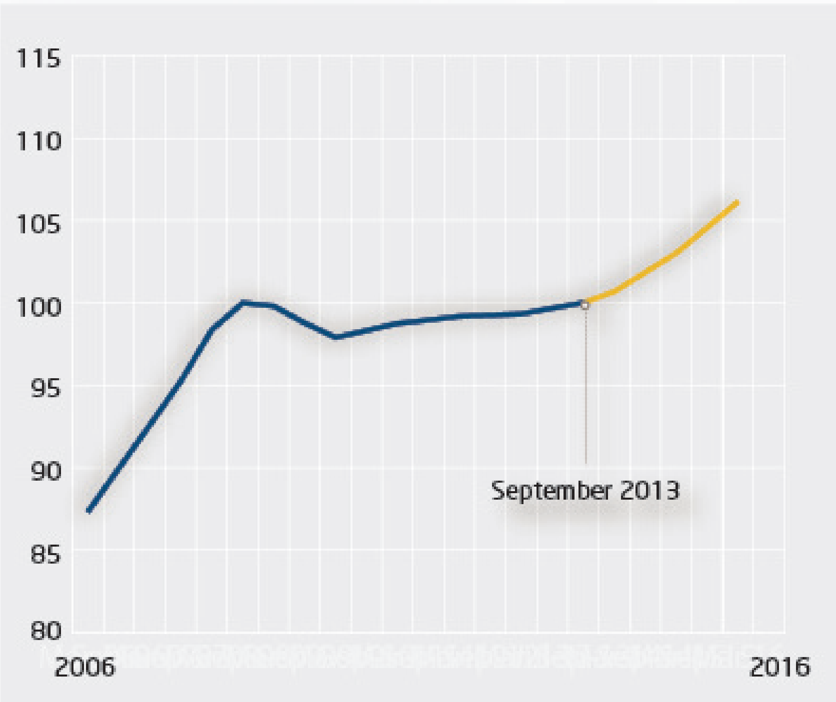
Notwithstanding, the September quarter in isolation has seen a notable nominal increase in the total value of construction work done of 5.2%. In the same period the value of 'building work done' recorded a nominal increase of 3.9% and the value of 'engineering work done' recorded a nominal increase of 6.1%.

Of the 'total construction work done' in the amount of $207,089 million during the 12 months preceding October 2013, 'building work done' represented 39% of total construction work done while 'engineering work done' represented 61%. The share of 'building work done' and 'engineering work done', as a percentage of the total construction work done, is continuing to trend relatively flat and has done so since the September 2012 quarter. This trend follows a rise in the proportion of 'engineering work done' compared with value of 'building work done' which began in the September 2010 quarter and ceased in the September 2012 quarter.

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 Commentary

NEW SOUTH WALES

The New South Wales building industry shows signs of improvement in certain sectors, with housing construction increasing for the first time in three years. Demand continues to rise in the Sydney and CBD rental markets and residential sales volumes continue to increase. The number of projects proceeding to tender across all sectors has increased with projects previously on hold now in the development and design process, however tender prices remain competitive. The non-residential sectors have improved marginally, with continued investment in health and aged care along with the major universities ongoing building delivery/campus improvement programmes.

A number of major tenants have, or are still re-considering options regarding new premises and new tenancy fitouts; with buildings such as 8 Chifley Tower, 200 George Street and the three major commercial towers at Barangaroo attracting tenants. This in turn will create a large quantity of various grades of existing office buildings/space requiring refurbishment to attract new tenants.

$30 billion of major infrastructure is planned to be completed over the next seven years, with support and financial commitment from both State and Federal Governments. This is expected to increase demand and hence price for materials and labour in this sector. Projects in the NSW State Government's Long Term Transport Master Plan include the South West Rail Link which is in the construction phase and the North West Rail Link Tunnelling package, which has been awarded with the Station Viaduct and Operating Train System packages to follow. Sydney Light Rail is expected to commence work in 2014, The M1 to M2 link has moved to stage 3 of the unsolicited proposal process and the WestConnex business case is underway. All major infrastructure contractors are either involved or looking to secure positions on these projects. Overseas contractors have been invited to participate in an effort to introduce more competition. The pressure these companies place on internal resources will see salaries rise which will impact on the overall direct costs of projects.

The resource related sectors remain sensitive to demand from external markets and uncertainty remains regarding expansion of the proposed coal seam gas projects.

Increased confidence should see continued investment within the construction sector for the next six months, allowing for the normal Christmas and January slow-down. We are projecting average cost escalation of 1.25% for 2013, 3.0% for 2014 and 4.0% for 2015 and 2016.

The South West Rail Link (Glenfield to Leppington Rail Line) (1) is in the construction phase. One of a number of projects in the NSW State Government's Long Term Transport Master Plan.

Tower Melbourne (2), which has commenced construction, is an indication of the improved residential sector in Melbourne.

Images courtesy of Transport for NSW and CEL Australia.

VICTORIA

Confidence in the Victorian construction sector continues to improve as overseas investment in major residential projects continues to boost the local market. The State Government's commitment to a number of major infrastructure projects including the East West Link, the Port of Hastings and the Western Interstate Freight Terminal over the medium to long term is also lifting confidence as the tier 1 engineers and contractors position themselves to secure a portion of the work. Melbourne Airport's pledge to spend near $1 billion on implementing its masterplan over the next 24 months, including the new Southern Precinct, will absorb some capacity in both the tier 1 and tier 2 sectors across both building and infrastructure.

There are numerous large CBD and inner suburban residential tower proposals in the early stages of cost planning, and mixed-use concepts for more substantial suburban sites are also being considered.

Various projects nearing the end of design development and approaching the tender stage have manifested in a large demand for Builder's Quantities to mitigate tendering risk and facilitate uniform subcontractor feedback.

Work in hand together with new enquiries continues to span all construction sectors as well as infrastructure generally. The underlying capacity across the industry reported in our July 2013 report remains and tender results in all market tiers remain competitive. This is qualified for the period up to January/February 2014 when a number of major projects will be tendered and awarded. Subject to the commencement date of these projects, there is still expected to be underlying demand in the tier 1 and tier 2 sectors.

Subject to the strength or decline in value of the Australian dollar, we currently assess cost escalation through 2014 at 2.0% increasing to 2.5% in 2015 and to 3.0% in 2016.

1

2

QUEENSLAND

Tender prices are on the move in South East Queensland. With the recent uplift in residential, commercial and retail construction activity it is likely that the extremely competitive pricing by Tier 1 and Tier 2 contractors seen over recent years will ease. Subcontractors that had been tendering at cut throat levels for several years are now reporting improved orders and are adjusting pricing levels and margin expectations accordingly.

Since trading at parity with the US Dollar throughout 2012, the value of the Australian Dollar against the Greenback and other foreign currencies has dropped significantly and it is expected that imported materials, equipment and components such as structural steel, curtain walling, lifts, travelators, tiling, stone, sanitary ware and tapware etc will increase putting further upward pressures on tender price escalation.

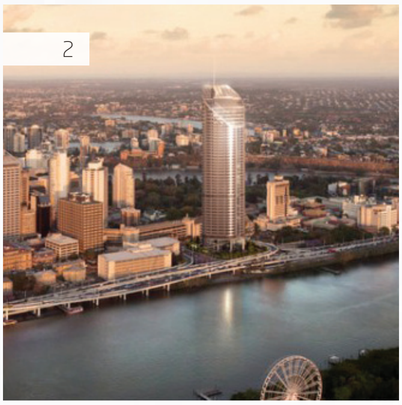
In our July Review, we noted that there were significant pressures on construction costs due to increases in material and labour costs as well as further uplift on labour costs as a consequence of the changes in January of this year to the *Building Code 2013 (Federal Code)* under the *Fair Work (Building Industry) ACT 2012 (Cth)*. In the build up to the Federal election, and in the ensuing weeks, the media is now reporting an uplift in confidence and potential returning investment in construction (outside of engineering/ infrastructure/ resources). Confidence in property investment appears to be on the increase with significant uplift in development applications in the Gold Coast, Logan City and around South East Queensland.

The Queensland State Government has recently announced discounted royalty incentives for mining companies first to open up in the Galilee basin. This may see renewed investment in the coal mining sector in Queensland in the next 18 months.

We continue to predict tender price escalation trending higher towards 2014 and 2015 with forecast levels rising from the current 2.0% to rates in the order of 4.0% per annum in the years 2015 / 2016.

The further development of QIC's Robina Market Hall (1) and construction of One William Street (2) is indicative of the renewed activity in Queensland's retail and commercial sectors.

Images courtesy of Buchan Group and cbus Property Group



SOUTH AUSTRALIA

We have witnessed a two speed economy in Adelaide for some time. Whilst the general construction industry is still suffering from a lack of demand, a few major Government projects such as the New Royal Adelaide Hospital and the Adelaide Oval redevelopment offer some opportunities and are creating periodical "hot spots" in certain trades. The construction sector, coming off a depressed base, looks well positioned for a resurgence in activity, as projects proceed beyond the due diligence and feasibility phases to project planning and implementation.

In the past 24 months Adelaide has had one of the deepest and most rapid falls in construction pricing throughout the country. During last year, tender return prices fell by as much as 20% in certain sectors compared to pricing levels 12 months previous. Following pressure from Master Builders Australia, in 2012 the State Government adopted a policy of open tendering (rather than its tradition of selective tendering) and, coupled with the dearth of private work, this resulted in unsustainably large tender fields and cut throat pricing.

This extreme level of competition has subsided to a degree during 2013 partly in response to the returning private sector construction demand. Developers now appear to be responding to these lower pricing levels with a view to taking advantage of competitive costs. Examples of this include the proposed future proofing and expansion of retail centres and upgrading and improvement works to privately held built assets.

We predict minimal tender escalation for 2014 with a rate of just 1.0% rising to 2.0% for 2015 and 2016.

WESTERN AUSTRALIA

The continued slowdown of the resources sector in Western Australia, coupled with the recent credit rating downgrade of the State's finances by Standard and Poor has eroded market confidence. The long term effects of the latter has yet to be borne out. It is however expected that the WA State Government will rationalise spending on various projects and consider the sale of State assets in order to realign the State budget. While the State Government will undergo a balancing of the books exercise, it is still committed to delivering major projects. These include the new Perth Stadium and a 2013 – 2014 expenditure of $7.5 billion on various projects, namely roads, health, education and infrastructure. However it is worth noting that a recent survey of WA businesses indicated a substantial decline in business confidence, in regard to the performance of the WA economy over the next 12 months. Again the slowdown of the resources sector is one of the main contributing factors to this negative sentiment.

Within the construction sector we continue to see aggressive tendering. It would appear that any increase in material and labour costs from subcontractors and suppliers is being absorbed by head contractors. In addition, tier 1 and 2 contractors are reporting that considerable discounts are being offered by subcontractors on projects which have a start date late 2013 to first quarter 2014.

Despite uncertainty in the local market due to the slowdown in mining activity and the loss of WA's triple A credit rating, we still expect to see strong activity in various sectors over the coming year.

The hospitality sector continues to grow strongly with a number of new hotels of various grades proposed for the Perth metropolitan area. This interest has been spurred on by relatively high room and occupancy rates within the Perth Metropolitan area, which is a direct result of a very limited local stock of hotel rooms. Conversely, hotel occupancy rates within regional WA have posted their first decline in 4 years.

Retail investment appears to have gained momentum, with a considerable amount of work being priced or in the pipeline.

The residential market continues to grow strongly, stimulated by low interest rates and population growth. The market has responded to this apparent undersupply in housing stock, with a considerable number of units under construction in Perth. This growth is mostly evident in the first time buyers section of the market, and is flowing through to the mid-level market. The upper end of the residential market remains relatively lethargic.

We project average escalation of 0.6% for 2013, 2.5% for 2014 and 3.2% for 2015.

ACT

Following the result of the federal election there remain concern about domestic economic conditions and the decreasing demand for office space which is suppressing confidence in the ACT property industry. Along with South Australia, the ACT continues to have the lowest confidence sentiment of all the mainland states or territories, though this has improved slightly from the previous quarter.

Despite a small improvement in industry confidence, there generally remains a negative outlook for the construction industry as a whole with a neutral view of the property in particular, reflecting the soft economic outlook for ACT.

Tier 1 contractors are continuing to bid for smaller projects attempting to match the levels of the tier 2 market with all tender pricing remaining extremely competitive.

It is anticipated that tender prices will continue to be keen for the remainder of 2013, with a forecast for cost escalation expected to be at 0.5 to 1.0% for the next 24 to 36 months.

TASMANIA

The Tasmanian economy continues to struggle in the face of dramatic cuts to GST revenue, high unemployment and low population growth. Recent State and Federal Government funding announcements have however buoyed sentiment in the construction sector.

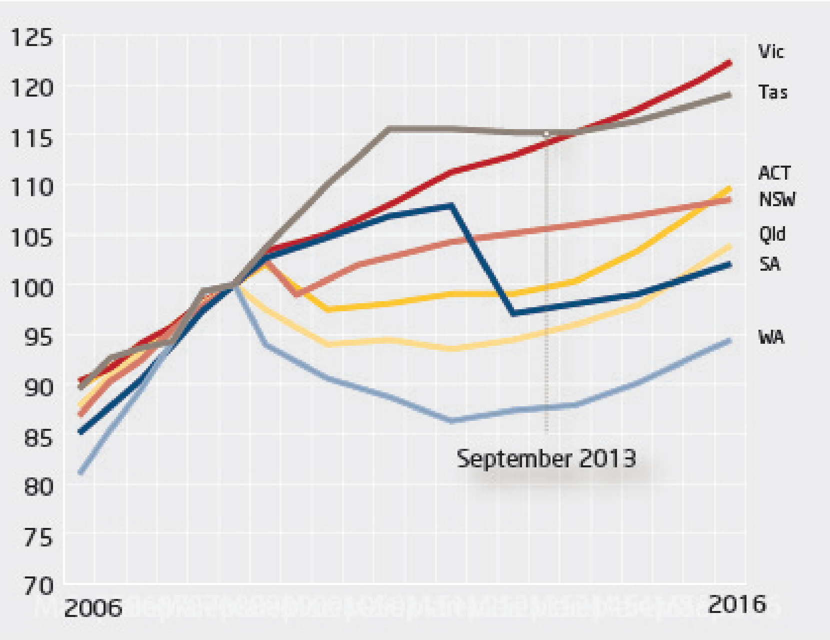
Federal Government funding for the Economic Growth Plan for Tasmania includes a $100 million commitment for infrastructure projects across the state with $38 million to expand Hobart International Airport. This is in addition to the $400 million already committed for the Midland Highway upgrade. The impact and timing of this funding on the local construction sector is yet to be fully understood, but based on previous experience it is likely that the mainland contractors will secure head contractor works packages with local contractors undertaking subcontracts. Whether this will impact on the overall tender market remains to be seen.

The State Government's recent announcement of a doubling of the Home Builders' Grant to $30,000, the most generous scheme in the Country, offers some hope for the residential housing sector and the Tasmanian economy in general as migration of mainland first home buyers taking up the grant is anticipated.

Tender margins are still extremely tight and we anticipate cost escalation in the order of 1.0% to 1.5% for 2014 and 2015 rising to 2.0% for 2016.

The Federal Government budget commitment of $38 million for the redevelopment of Hobart International Airport (1) forms part of a $100 million Economic Growth Plan for Tasmania

Tender Price Escalation Forecasts Regional Market Summary



	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%	1.6%	0.8%	1.0%	0.6%	0.0%
2014	3.0%	2.0%	2.0%	0.9%	1.0%	2.5%	1.0%
2015	4.0%	2.5%	4.0%	1.0%	2.0%	3.2%	1.5%
2016	4.0%	3.0%	4.0%	1.0%	2.0%	3.0%	1.5%

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

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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..