WT PARTNERSHIP

Review of Australian Construction Market Conditions - What Price Carbon?

September 2011

Australia is entering its slowest period of economic growth since the Global Financial Crisis with key factors being weak consumer spending, continuing weakness in residential and non residential building, a slow down in employment, disruption to production due to floods and the European financial crisis.

Activity in all major sectors of commercial and industrial construction is forecast to slow over 2011 to 2012. Dwelling approvals have fallen 15% over the year to June 2011 and approvals are now down 19% for the year. Dwelling starts in Queensland are the worst in the country demonstrating a slower than expected recovery from the floods and severe weather of early 2011.

The CPI rate rose to 3.6% in the first half of 2011 and is trending at levels higher than expected however the RBA has stated that there is no compelling case for an increase in the official cash rate and, at its September sitting, held the cash rate at 4.75%.

The recent Macromonitor survey of non-residential construction industry shows an overall slowdown. Construction in the industrial sector has been impacted by the strong Australian dollar and economic uncertainty has generally put a dampener on employment impacting on office construction. The survey forecasts a slight decline in new factory and office construction. Retail and warehouse construction is faring slightly better with positive but slowing growth. Construction in the education sector is forecast to decline as the Government Stimulus (including the BER) comes to a close.

Construction activity in the health sector is trending upwards with large projects recently approved or underway including the Royal Adelaide Hospital, the New Children's Hospital in Perth and the Comprehensive Cancer Centre in Victoria, The Centre for Obesity, Diabetes and Cardiovascular Disease, Sydney and the new Gold Coast Hospital. In NSW several other major health projects are due to commence in the next six to 12 months. Countering the downturn in non residential construction is the demand for construction resources in the mining sector which continues to attract resources from the traditional building organisations.

The construction industry continues to reflect Australia's 'two speed economy' and the industry is experiencing a divide between the traditional building sector and the engineering construction sector.

Labour and material cost increases continue to be the main cost pressures impacting on tender price levels. As part of the current national round of Enterprise Bargaining Agreements, we understand the CFMEU is pushing for a 5% to 6% per annum increase over the next 3 years and companies in Victoria agreed to 5% last month. Materials suppliers will continue to steadily escalate prices in accordance with CPI (as a minimum).

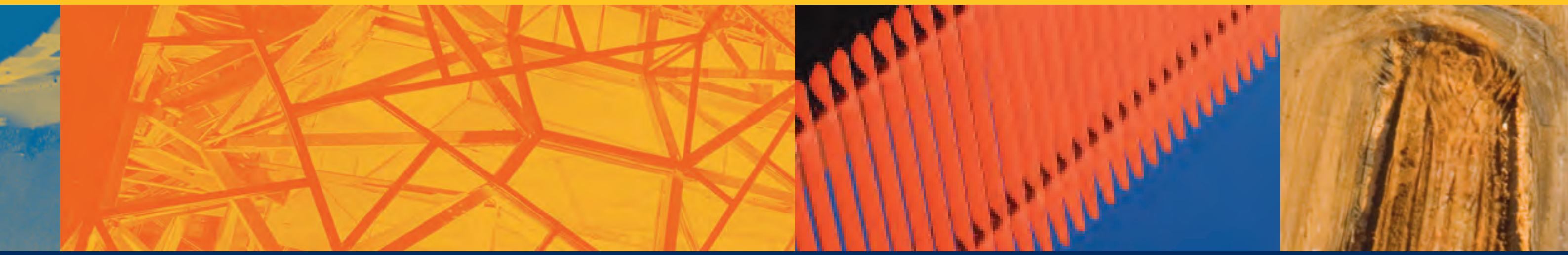
In addition to labour and material cost pressures, the industry faces the introduction of the Federal Government's Carbon Price Mechanism in 2012.

The carbon price will come into effect on 1 July 2012 and for the first three years will be at a fixed rate of $23/tonne, indexed at 2.5% per annum. From 1 July 2015, the fixed price will revert to a 'flexible' price scheme with a cap and floor. This flexible pricing scheme will be known as an Emissions Trading Scheme (ETS).

The Government has indicated that approximately 500 companies will be directly liable for the carbon price. For the construction industry, the majority of the cost impact will come from embodied carbon in the materials used for construction, the major contributors being concrete, steel and aluminium.

It is still unclear as to the extent to which the Tax will impact on outturn construction costs. Each specific project will need to be analysed on its own merits, taking account of project commencement date, project cash flow, material sources and the degree to which manufacturers will seek to pass on additional costs. WT Partnership's subsidiary WT Sustainability, detail in their report, *Carbon & Construction*, that the nett trade cost of construction will rise by approximately 0.35% to 0.70% as a result of carbon pricing, however this can only be better defined by specific analyses of each individual project.

The overall impact on the construction industry is as yet unknown but the Carbon Price Mechanism being introduced during a period when Australia's commercial construction recovery is slowing down after just one year of positive growth since the GFC.

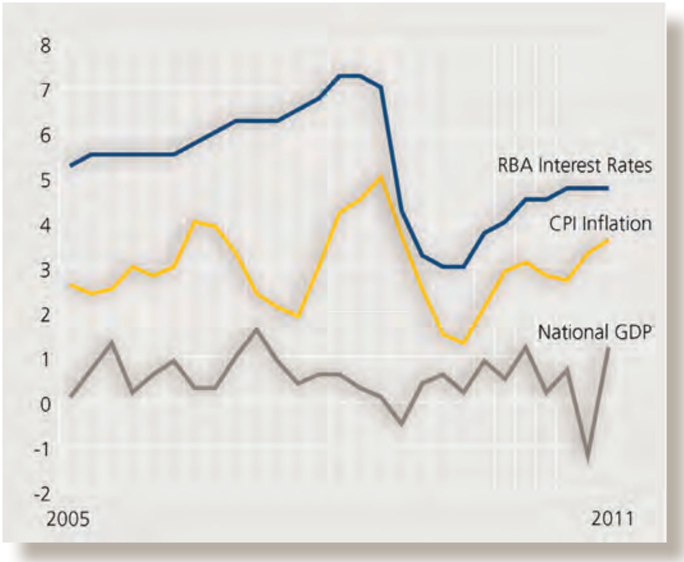


"In addition to labour and material cost pressures, the industry faces the introduction of the Federal Government's Carbon Price Mechanism in 2012."

National Economic Indicators

- The GDP expanded 1.2% in the second quarter of 2011 over the same quarter, previous year.
- CPI rose 3.6% through the year to the June quarter, compared with a rise of 3.3% through the year to the March quarter. Inflation in the June quarter was the highest level since the 2008 December quarter when inflation reached 3.7%.
- Having traded above parity throughout the year, in September the Australian dollar traded at a record low for the year of US$0.97.
- The seasonally adjusted Australian unemployment rate increased 0.1 to 5.3% in August.
- Official cash rate held at 4.75%.

AUSTRALIAN ECONOMIC INDICATORS



National GDP measure: seasonally adjusted quarterly % change

Source: RBA; ABS; Quarterly trend review on GDP, CPI inflation, RBA cash rate.

National Construction Indicators

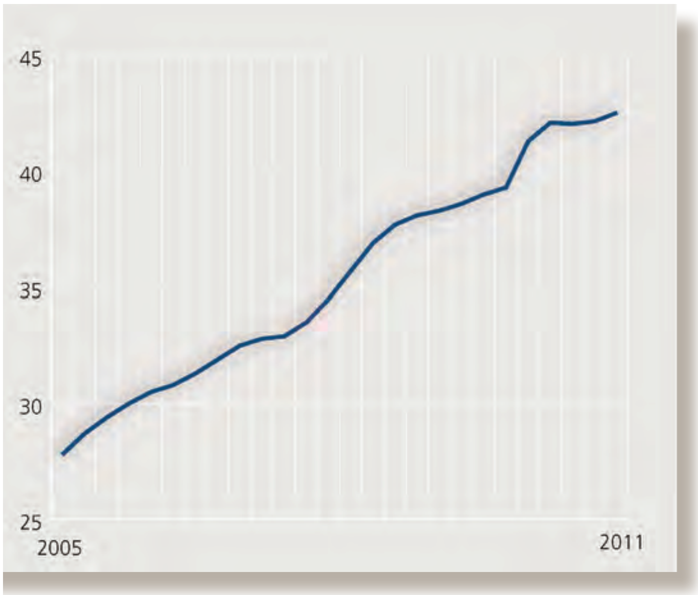
The ABS's trend estimate for total construction works done has increased by 1.1% to over $42.5 billion in the June 2011 quarter, rising for the second consecutive quarter after a decline in the December 2010 quarter. The seasonally adjusted estimate increased 0.7% in the June 2011 quarter.

Seasonally adjusted estimates for building work done declined by 3.4% to $20 billion in the March 2011 quarter and declined a further 4.9% to $19 billion in the June 2011 quarter. This fall was primarily due to a continued weakening in residential and non-residential building, falling 7.6% and 23.2% respectively since the June 2010 quarter.

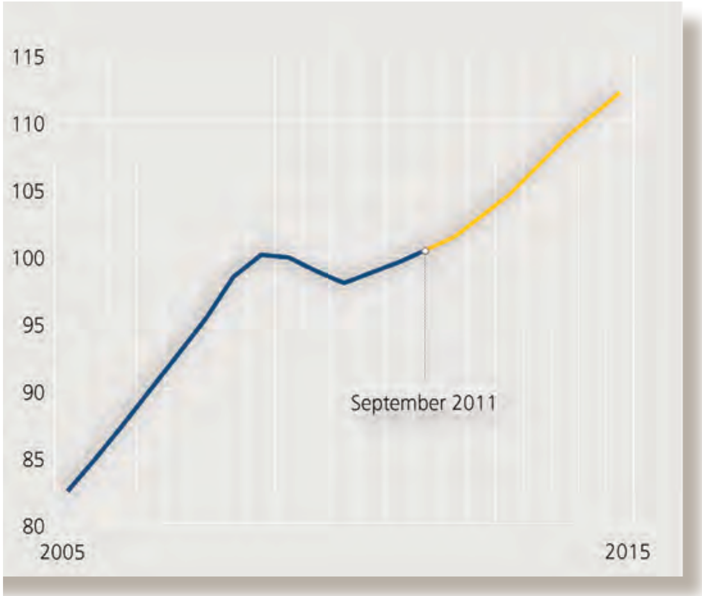
The seasonally adjusted estimate for engineering construction work carried out in Australia rose 5.9% during the June 2011 quarter following a 4.6% rise during the March 2011 quarter. The seasonally adjusted estimate for engineering construction work carried out in Australia has risen by 21.2% over the 12 month period between the June 2010 and June 2011 quarter.

The trend estimates should be read with caution as the fundamental behaviour of building activity may be affected by initiatives within Government stimulus packages as well as other developments associated with global economic conditions.

VALUE OF CONSTRUCTION WORK DONE IN AUSTRALIA ($ BILLION)



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).

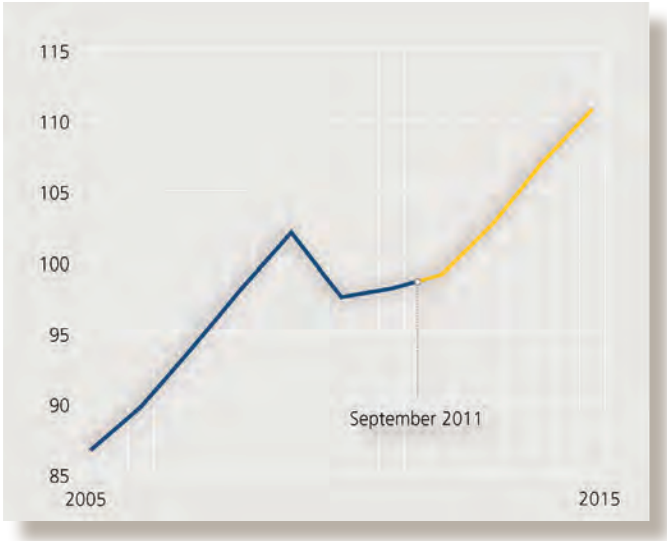
New South Wales

The general immediate post GFC recovery in the NSW construction industry continues at a pace slower than other states. The boost provided by Federal Government stimulus funding has now largely been absorbed. Forecasts by the MBA show that the total value of Building Construction Tasks in the next ten years is expected to be $547 billion and, in considering the shorter term, the Australian Construction Industry Forum's Construction Forecasting Council predicts steadily increasing levels of construction activity rising from $26.7 billion in 2011/12 up to $30.7 billion in 2014/15 (non residential and engineering work). Following the change in State Government, private sector confidence continues to grow with increased activity in the retail and commercial sectors. The market is also responding positively to the Government's backing of the Barangaroo development.

Emerging confidence and increasing private sector development will help to fill the void left by the culmination of the Federal Government funding stimulus but is not expected to have an immediate inflationary impact on tender price levels. We consider the NSW building construction market and the greater Sydney metropolitan region in particular, to be relatively static resulting in continued competitive tendering. We do however anticipate an upswing in activity from the second quarter of 2012 onwards which is likely to result in a steady increase in tender pricing levels. Materials suppliers will also continue to steadily escalate prices in accordance with CPI (as a minimum), and labour resource costs will be impacted with ongoing bargaining agreements, however trade contractors may have concerns about their ability to procure workload which is likely to partially negate some of these inflationary pressures.

On this basis, our 'predictions' for escalation levels over the next few years are around the 1% for the remainder of 2011 rising to 3.25% per annum in 2012 and 4.25% per annum in 2013.

TENDER PRICE ESCALATION - NEW SOUTH WALES



Following the change in State Government, private sector confidence continues to grow with increased activity in the retail and commercial sectors. The market is also responding positively to the New South Wales Government's backing of the Barangaroo development

Victoria

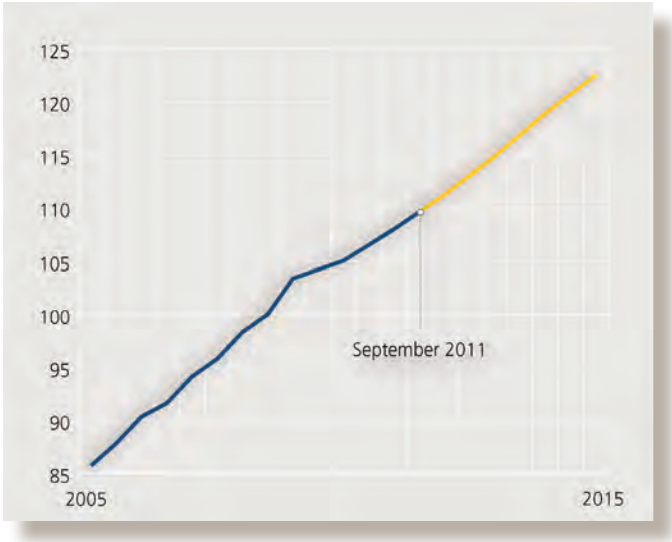
The tender market in Victoria is 'softening' relative to construction capacity and as a consequence tender pricing is generally keen across all sectors. This is despite the anticipated resolution of the new round of Enterprise Agreements, which will come into effect from 1 March 2012 for the ensuing four years.

The effect of the new Enterprise Agreements will be an across the board labour cost increase of approximately 5% per annum between 2012 and 2015. However, we expect these cost impacts to be somewhat moderated by increased competition in the market place over the next six to12 months and we will continue to monitor price competition.

We understand that some contractors are beginning to experience difficulty securing new work, and this is resulting in aggressive tendering and reduced margins across most sectors. Some sub-contractors, however, particularly structural, have a significant amount of work committed and are not expected to be in a position of having to cut prices to fill their order books.

We forecast tender price escalation to be in the range of 3.00 to 3.50% per annum average over the next three years 2012, 2013 and 2014.

TENDER PRICE ESCALATION - VICTORIA



"Notwithstanding that the statistical analysis of the MBA data suggests a relatively healthy market, there is a general view around Adelaide that although SA managed to avoid the worst effects of the GFC, it is nevertheless about to experience a dearth of work in the short to medium term."

South Australia

Construction activity in South Australia has remained at relatively healthy levels compared to New South Wales and Queensland. At the moment the market is dominated by a number of public sector projects with relatively little commercial construction activity underway when compared to three years ago. Notwithstanding that the statistical analysis of the MBA data suggests a relatively healthy market, there is a general view around Adelaide that although SA managed to avoid the worst effects of the GFC, it is nevertheless about to experience a dearth of work in the construction sector in the short to medium term. We believe this is more likely to present itself as a flat period however the uncertainty as to where the industry will be at the start of 2012 is creating a very competitive market. The Australian Industry Group *Australian Performance of Construction Index* contracted again in July 2011, continuing a contraction that has lasted 14 months.

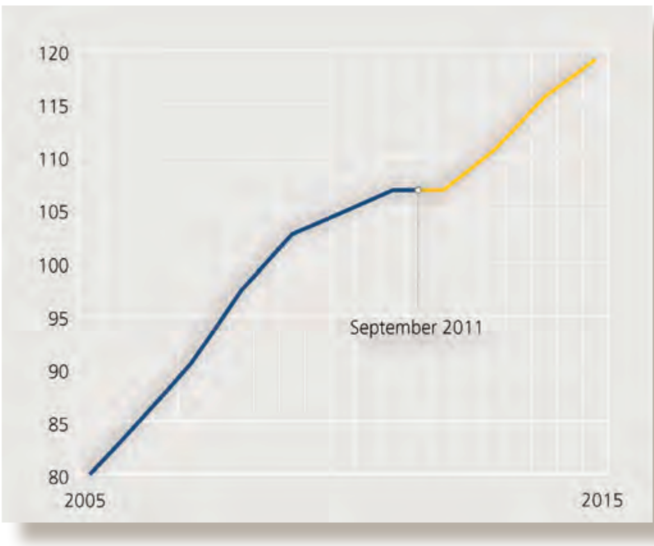
Activity in the engineering construction sector however is expected to ramp up in 2012 with the anticipated approval of BHP's Olympic Dam expansion project. BHP will invest $30 billion on the redevelopment of mine infrastructure at the site in the next five to 10 years before any return on investment is expected. Bulk earthworths and site preparations alone are expected to take five years. As a result of this project and the increase in mining activity generally the State is investing $2.6 billion in transport infrastructure upgrades to support predicted demands from employment and population growth. Major projects expected to begin in the short to medium term include a number of components of the North South Corridor such as the duplication of the 18.5 km Southern Expressway and the Northern Connector a 15 km freeway and 31 km rail line in Adelaide's north-west.

Upcoming large projects, such as the $2.3 billion New Royal Adelaide Hospital and the $530 million Adelaide Oval Redevelopment, may place a significant burden on the tier one trade contractor sector. However these large projects need to be viewed against the background of the changing political climate, with the Premier about to change, bringing the potential for suspension and review of the Capital Works Program. In the retail sector, construction activity has continued throughout the GFC, with large projects, refurbishment and redevelopment projects under construction or in planning.

The likelihood of a small number of extraordinarily large projects anticipated to commence on site during 2012 at a time when the commercial market remains flat and there is uncertainty over the Public Sector Capital Works Program, means that it is difficult to predict how the labour market will react over the medium term.

Overall, we consider the building construction market will remain relatively flat, with competitive tendering, and it is likely to remain so until the start of the procurement phases of the large projects referred to above. We forecast that there will be no tender price escalation for the balance of 2011 with prices escalating at levels of 3 to 4% per annum during 2012 and then 4 to 5% per annum during 2013.

TENDER PRICE ESCALATION - SOUTH AUSTRALIA



Olympic Dam - Image courtesy BHP

Queensland

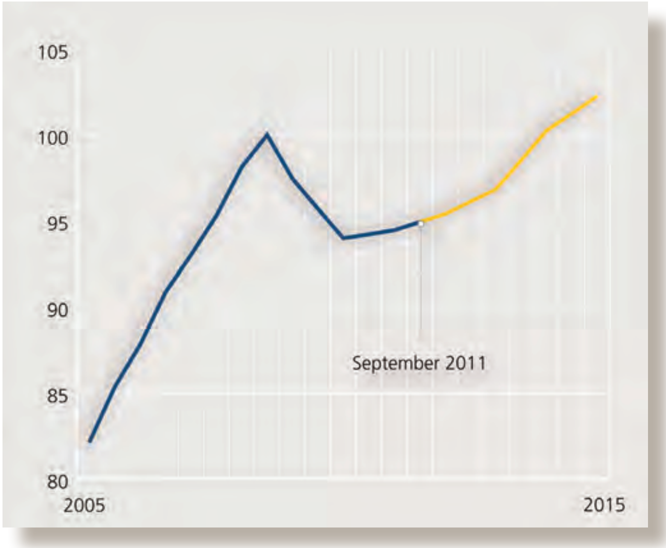
The current construction market in the South East Queensland region is flat with only a small number of large private commercial projects underway in addition to major health and infrastructure projects. Those contractors, of which there are many, that do not have health or infrastructure work are competing fiercely for jobs. The retail sector has fared somewhat better with a number of large projects underway and a large number of projects and expansions in the early development and feasibility stages. However this apparently healthy activity contrasts with the difficulties the shopping centre operators are experiencing in securing agreements for lease from specialty retailers and in securing major tenants. The residential market continues to falter with medium to high density projects currently underway struggling to achieve apartment sales as initially forecast. Securing finance continues to be a major hurdle.

As an indication of Australia's two speed economy, the resources and mining sector is providing major engineering construction projects throughout Regional Queensland whilst the downturn in construction in the South East corner continues. The resource and mining sectors' influence on the construction industry throughout Queensland is not limited to the major civil projects that dominate the headlines. The Brisbane office fitout market is being driven by the expansion of resource and mining companies headquarters. Brisbane has become a mining town.

The impact of the GFC on the Queensland construction industry was countered by the Governments stimulus initiatives. In particular, the BER Schools Stimulus Package assisted small to medium sized contractors maintain continuity of work post GFC. However, with the scheme now in its final stages the stimulus effect of the program has all but gone.

Overall, we consider the building construction market in SE Queensland to be very competitive at the moment, with fierce tendering. We expect tendering to remain very competitive leading into the first and second quarter 2012, with relatively low escalation and a potential 'window of opportunity' to lock in competitive prices during the later stages of 2011 as trade contractors seek to fill their order books and secure cash flow for the 2012/13 period. We forecast that tender price escalation for the remainder of 2011 will be around 1% increasing to 2% per annum in 2012 and then 3 to 4% at the end of 2013.

TENDER PRICE ESCALATION - QUEENSLAND



The demands of large engineering projects in remote locations are expected to continue to draw greater numbers of skilled works away from the already finite pool of labour available in the State.

Western Australia

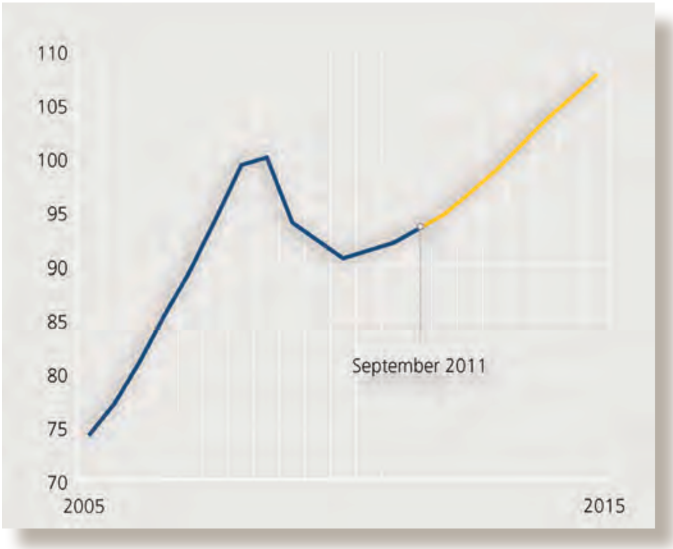
The financial boost to the Western Australia construction market flowing from the Federal Government's stimulus has now largely been absorbed with the BER coming to a close. Similar to Queensland, Western Australia is experiencing a 'two speed construction industry' with 'a sectorial divide opening up with strong engineering construction fed by the mining boom contrasting with a weak building sector caught in the slow lane of a post GFC economy struggling to transition to a private sector led recovery' (as described by the MBA). The demands of large engineering projects in remote locations are expected to continue to draw greater numbers of skilled works away from the already finite pool of labour available in the State.

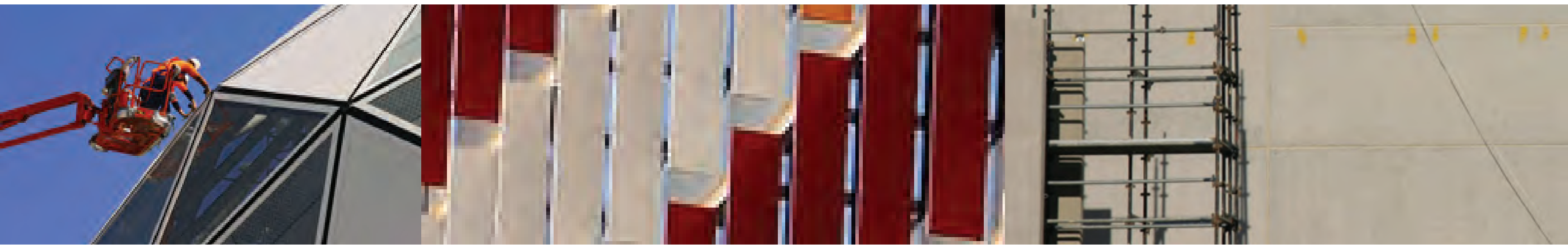
The MBA predicts a total value of building construction tasks in WA over the next ten years at around $502 billion with some $300 billion of this in the engineering infrastructure and resources sectors.

The Australian Construction Industry Forum's Construction Forecasting Council predicts steadily increasing levels of construction activity for the State due largely to the anticipated volume of large scale engineering works associated with major resources projects. This demand will impact on the residential and commercial sectors as many of WA's major main contract and sub contract organizations active in these sectors are also heavily involved in oil, gas and mining related construction.

We anticipate the increasing volumes of construction activity, particularly in the engineering sector, will see the perennial problems of lack of depth and resource in the WA construction market begin to drive up tender pricing in the coming years. It is anticipated that construction prices will again begin to show a market level of escalation however, it is not envisaged that tender price escalation levels will rise again to pre GFC levels in the short to medium term. On this basis, escalation is predicted to trend at 2.9% for 2011 increasing to 4.2% in 2012 and then 4.8% in 2013.

TENDER PRICE ESCALATION - WESTERN AUSTRALIA





Tasmania

In Tasmania, the construction market continues to be soft with tender levels in the current quarter demonstrating an increase in competition as builders strive to secure work in a tightening market. Private sector projects are largely on hold and Government stimulus funding is all but at an end. Wage increases resulting from the renegotiation of EBA's at the end of last year appear to have been countered by fierce competitive tendering.

We anticipate a further slowing in the construction market until some of the larger anticipated projects come on stream.

With further marginal contraction over the next two quarters, we forecast that tender price escalation will continue to trend at around 1% for the balance of 2011 increasing to levels of around 2.5% and 3% per annum for the years 2012 and 2013 respectively when larger projects currently planned enter the tender and construction phase.

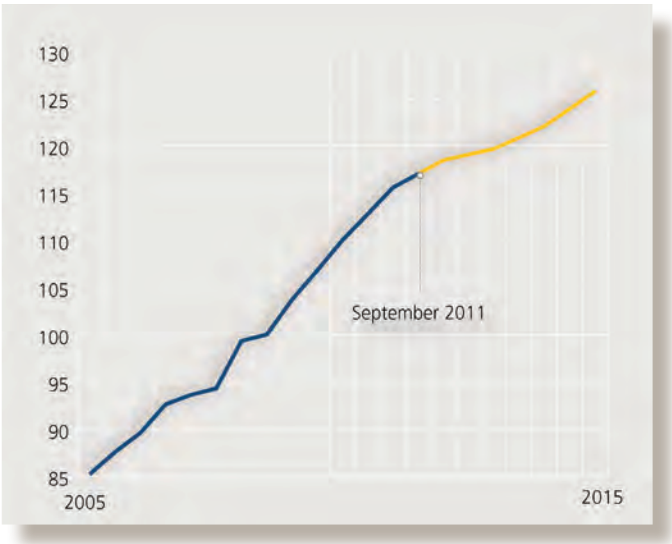
ACT

Currently in the ACT, residential construction activity remains strong with increased activity in response to the expansion of Canberra and creation of new suburbs. The tertiary education and schools sector is gaining momentum with upcoming tenders and continuing construction works at the major universities. Commercial office development is subdued due to vacancy rates of between 13 and 14%. New retail development is largely on hold as the market reacts to the turndown in activity. With the continuing redevelopment of the Canberra Hospital and 3 new health centres, this area of the market remains bouyant.

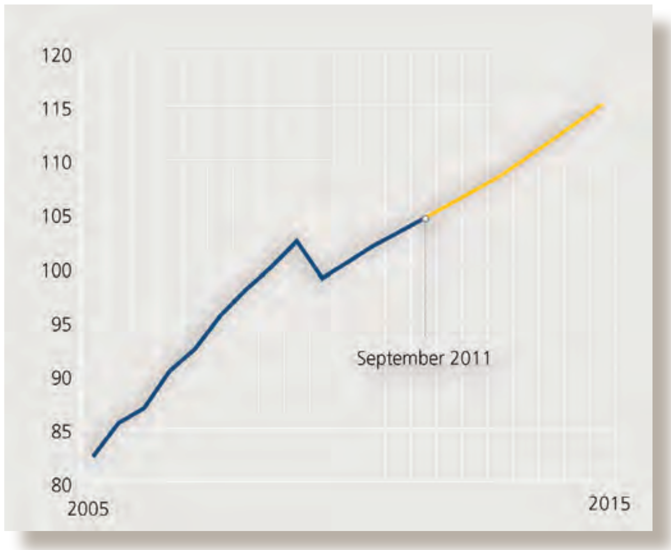
The ACT infrastructure program (valued at $1.55 billion over four years) continues to maintain demands on civil engineering resources.

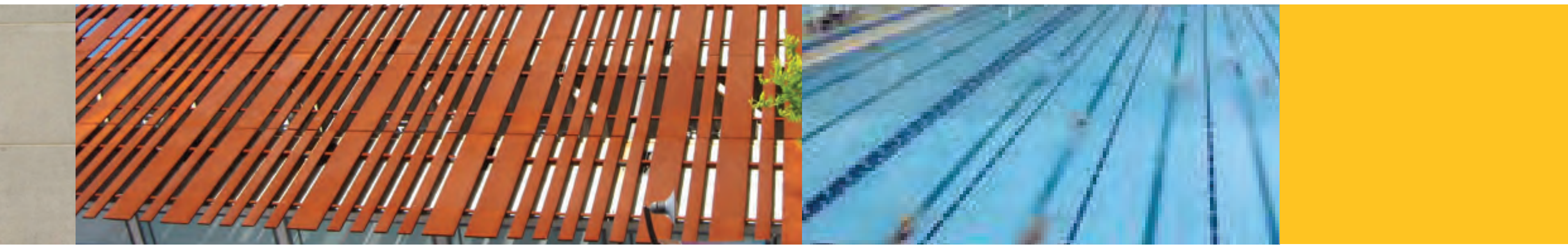
Cost escalation is be in the order of 2 to 3% each year through to 2013.

TENDER PRICE ESCALATION - TASMANIA

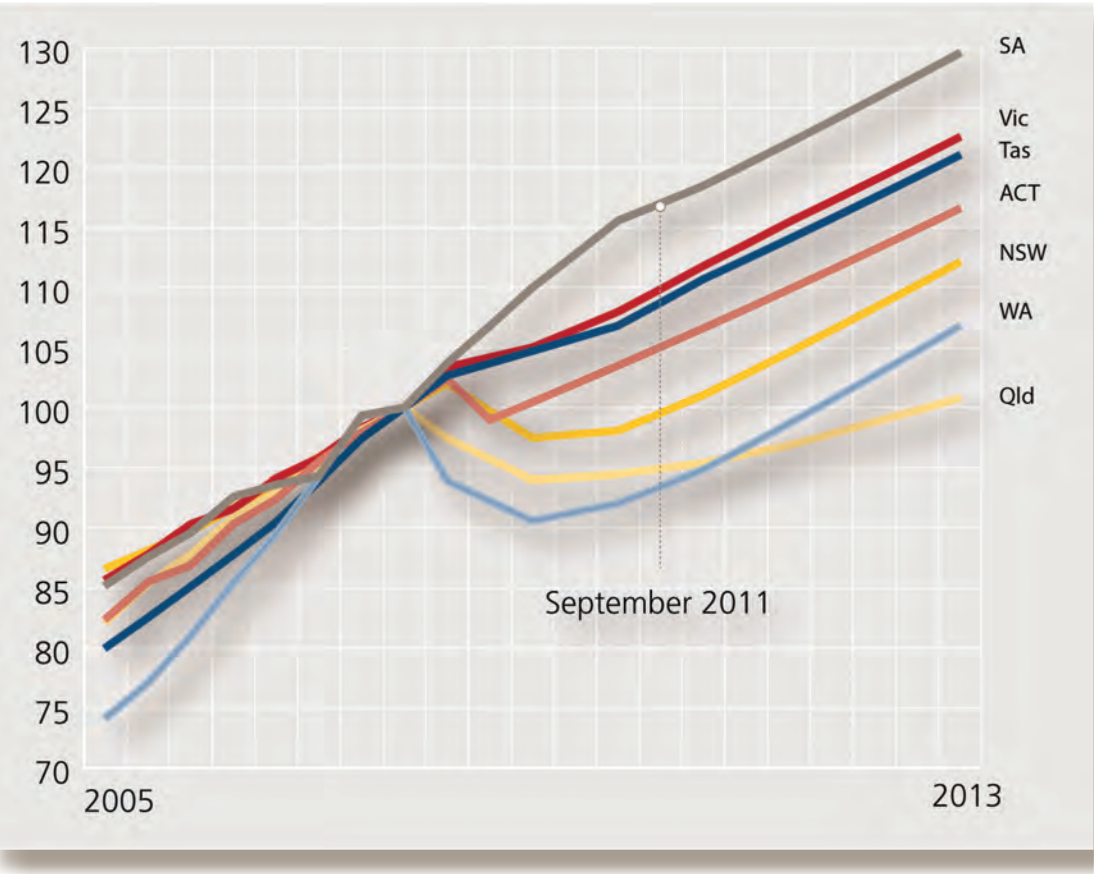


TENDER PRICE ESCALATION - ACT





Tender Price Escalation Forecasts
Regional Market Summary



	NSW	VIC	QLD	ACT	SA	WA	TAS
2005	3.5%	5.4%	6.9%	5.4%	6.4%	9.3%	5.1%
2006	4.6%	4.2%	5.9%	6.3%	6.3%	10.5%	4.5%
2007	4.6%	4.5%	5.5%	6.0%	7.6%	10.9%	6.1%
2008	4.0%	5.1%	-0.7%	4.6%	5.4%	-5.4%	4.4%
2009	-4.4%	1.6%	-3.6%	-1.9%	2.0%	-3.6%	6.1%
2010	0.6%	2.8%	0.5%	2.8%	2.0%	1.6%	5.1%
2011	1.0%	3.0%	1.0%	2.5%	2.0%	2.9%	2.5%
2012	3.5%	3.3%	2.0%	2.5%	3.5%	4.2%	1.0%
2013	4.3%	3.5%	3.5%	3.0%	4.6%	4.8%	2.0%

WT PARTNERSHIP

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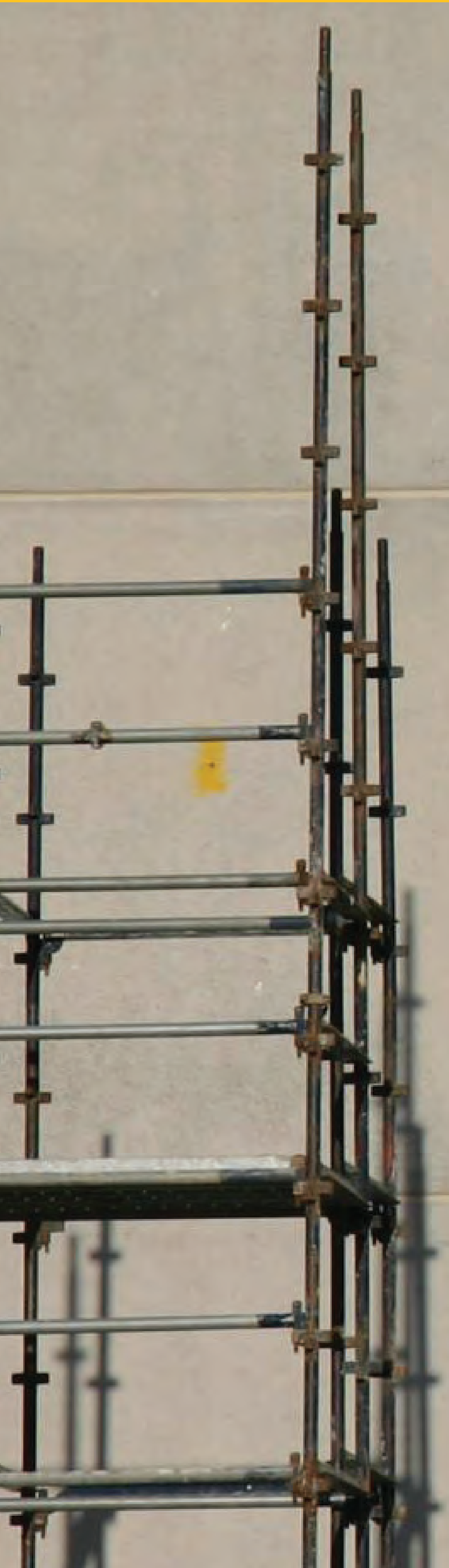
WT Partnership is wholly owned by the Principals of the Practice, who ensure that independent advice is solely aligned to our clients' desired project objectives.

WT Partnership draws on the collective experience, knowledge and capability of over 1,000 professional staff in 49 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.

On matters in relation to 'Sustainability' readers of this bulletin should also refer to WT Sustainability's publication ***Carbon & Construction.*** Click here to download your copy.

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. Clearly, it is very difficult to predict future escalation over the next few years given the current state of the international markets however, the above advice is offered for guide purposes only at this point. With the current uncertainties in the local, national and international arena, it is important to continually monitor the market and review escalation allowances.



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