

Rebuilding Australia

Volume 3: A COVID-19 Action Plan for the Construction Sector

May 2020



MASTER BUILDERS
AUSTRALIA

Message from the President & CEO



The Australian construction sector, comprising both commercial and civil construction, links the activities of our day to day life. Whether it is the office, schools, industrial estates, hospitals, or retail outlets right through to our roads, rail, and airports, construction provides the essential components of our built environment for economic and community activity in Australia.

COVID-19 has placed pressure on the construction industry in two ways.

The first being delays which impact on contractual commitments. Delays have been experienced due to some supply shortages (supply shortages are short term and have not been as acute as initially anticipated) but more significantly through the productivity impacts of slower work to implement social distancing and hygiene practices on site. Slower work to ensure the safety and well being of those on site is paramount and is better than no work, but it has resulted in delays. Master Builders has welcomed the flexibility provided by some jurisdictions to enable construction activity to be extended but nevertheless delays have continued, placing pressure on the supply chain to meet contractual demands.

The Federal Government, as a client, is doing the right thing by negotiating with head contractors to enable extensions of time and we implore private clients to do likewise. If clients are being unreasonable, we are of the view that government intervention will be required to ensure that there is not an unreasonable adverse impact on one party to a contract due to unforeseen events from COVID-19.

The second pressure point, yet to reach its peak, is the rapid decline in private sector investment, particularly in commercial building. Economic downturns result in a decline in building activity. There is generally a six month lag from the time of a downturn to the impact on the building and construction industry, which Master Builders forecasts to be hardest hit in quarter-four of this calendar year. A forecast decline for 2020–21 of around 15 per cent will place jobs at risk, compounding already high unemployment rates.

Master Builders is advocating for governments and long-term institutional investors to fill this gap in private sector investment in the short-term to protect jobs, stimulate the economy and ensure we have the built environment for the future.

In volume three of Rebuilding Australia we outline the problems, the opportunities and our recommendations to governments on how best to rebuild Australia through the construction sector.

Simon Butt
President

Denita Wawn
CEO

Construction Sector Action Plan



Environmental Scan

Up until recently, construction building activity across Australia was at a record high. It was buoyed by the favourable mix of low interest rates, strong employment creation and fast population growth.



Based on the experience of the early 1990s, our worst case scenario would see the national unemployment rate peaking at 12 per cent in the aftermath of the COVID-19 crisis with the building and construction industry's share of total employment in the economy falling from 9.1 per cent currently to just 6.0 per cent at its lowest. Were this to happen, approximately 464,300 jobs would be lost directly in the construction sector. A further 171,600 jobs could be shed in those sectors of the economy that rely most heavily on construction activity including professional services and the supply of materials.

Of the 1.2 million people currently employed in the construction industry, about 404,000 are directly engaged in commercial and civil construction.

Commercial Sector Scan

During the 2018–19 financial year, the volume of commercial building work done is estimated to have reached to \$43.3 billion — an increase of 1.5 per cent on the previous year’s already strong performance.

The COVID-19 crisis fundamentally changes prospects for commercial building. For sectors of the economy dependent on discretionary spending, such as travel and overseas tourism, the short term pipeline of new building projects is likely to decline severely. The general hit to the economy resulting from COVID-19 will also hurt sections of commercial building activity like those related to retail and offices. For building work in the education, health and aged care sectors, an expansion of government led projects could improve their short term prospects.

Master Builders updated its forecasts for commercial building activity at the end of April 2020 to take account of the dramatic changes in the economic environment over recent months. Having previously projected that commercial building work would total \$47.3 billion in 2019–20, we now believe that total activity is more likely to be around \$44.7 billion. The biggest hit to commercial building is likely to take place in 2020–21 with activity forecast to decline to \$38.6 billion, a fall of some 13.6 per cent compared with the previous year. Commercial building is projected to shrink further during 2021–22, bottoming out at \$38.0 billion before embarking on a slow recovery as economic activity starts to revert to its long term trajectory after the worst of the COVID-19 crisis has passed.

While our updated forecasts represent our best estimate of what is likely to happen, there is a real risk that economic conditions could turn out to be considerably more difficult. Should such a worst-case scenario eventuate, commercial building activity could drop by around 50 per cent from its recent peak — a similar scale of reduction to what happened during the prolonged economic recession in Australia during the early 1990s.

There are 459 projects in Master Builders’ reports on the current pipeline of potential commercial building projects in Australia. Most of these projects, 314 (68 per cent) are private sector funded projects, 108 (23 per cent) are public sector projects and 37 (8 per cent) are public private partnerships. 43 per cent of all projects cost more than \$50 million, 24 per cent are under \$50 million and the cost of 33 per cent of the projects is unknown.

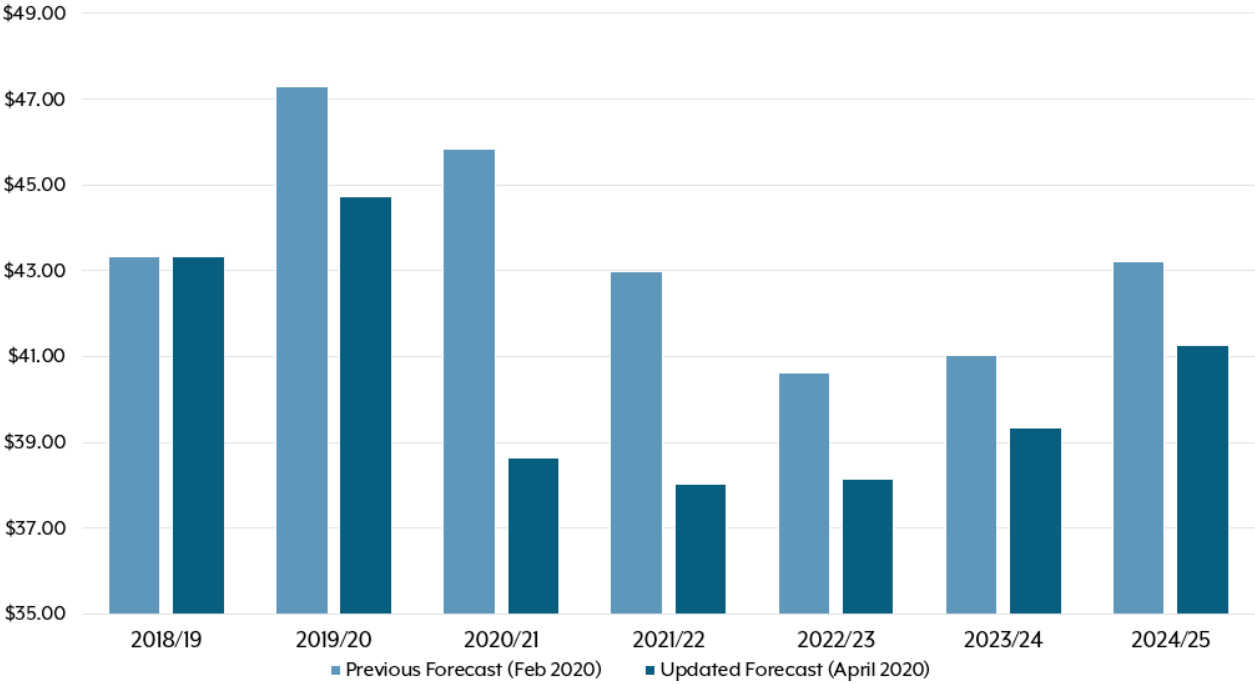
Private sector led projects are going to be hardest hit especially in activities like tourism, recreation, and entertainment. These sectors have particularly poor prospects given the combination of enforced closures and restrictions on travel as well as the reduced willingness of consumers to engage in non essential expenditure. The public sector dominates important areas of commercial building, such as health and education. Prospects for government stimulus are more likely in these areas given government controls. Increasing investment and fast tracking public sector projects could offset the loss of private work, and extending the government guarantee for working capital loans to projects above \$50 million could reduce the impact of financial risk from COVID-19 thereby softening the impact on commercial activity.

Stimulus investment in construction projects could also require a process for apprentice employment and training/re-training as conditions for funding to help boost employment numbers and redeploy people who have lost jobs.

Other areas where government could take the lead in stimulus funding are cladding rectification and asbestos remediation. Buildings requiring rectification were identified in the state and territory cladding audits and projects on government asbestos remediation lists could be fast tracked with government stimulus to prop up commercial activity and provide employment opportunities.

Project delays expected from the COVID-19 crisis will add to project costs and can lead to serious breaches of contract terms, such as liquidated damages. The contractual clause to align and manage risk in project delivery is through liquidated damages. The dollar value of this is agreed at the signing of the contract. For projects already under construction COVID-19 related risks were not estimated. Where there is delay the contractor bears the cost of damages. Unforeseen COVID-19 related costs will be substantial. Immediate responses to fast track contracts and manage the treatment of liquidated damages will soften the scale of cost increases, decrease disputes and minimise business closures.

Commercial Building Activity in Australia: Comparison of Previous and Updated Master Builders Forecasts to 2024-25 (Billions of Dollars)



Civil Sector Scan

The Federal Government funds large and small projects in partnership with state, territory and local governments across Australia through its \$100 billion, 10 year pipeline of funding that broadly translates to around \$10 billion a year in funding from the Federal Budget.

More than 30 programs exist at the federal level to implement funding commitments in relation to freight routes, urban congestion, northern Australian road infrastructure, road safety, inland and urban rail, water infrastructure, regional community infrastructure, mobile telephone infrastructure, energy infrastructure, city deals and business planning.

Master Builders reports on the status of engineering and civil construction activity identify 464 projects in the pipeline of work across Australia that are designated as either fully committed, under consideration or possible. Of these projects:

- Only 26 (5 per cent) are fully committed to and the numbers are nearly equally split between public and private funded projects.
- There are 290 projects (62 per cent) which are under consideration and 148 (31 per cent) that are described as being 'possible'.
- 22 per cent of these projects are in the \$500 million to \$1 billion cost range and 8 per cent are valued at less than \$50 million.

The Infrastructure Australia Priority List identifies a smaller pool of projects at different stages of development and delivery. This includes 147 nationally significant infrastructure proposals, with six high priority projects, 17 priority projects, 36 high priority initiatives and 88 priority initiatives. This provides all levels of government with an evidence-based list of infrastructure investment opportunities for the near, medium, and longer term. New projects are added to the Priority List after assessment of project business cases and the Priority List is also reviewed and updated as evidence based proposals for nationally significant initiatives move through the stages of development and delivery.

Latest results from the Australia Bureau of Statistics for the December 2019 quarter indicate that the volume of engineering construction work done across Australia during the final three months of last calendar year dropped to an 11 year low. The figures also show that the volume of engineering construction dropped by some 8.0 per cent compared with a year earlier. Of the \$89.3 billion worth of engineering construction work done during 2019, \$35.6 billion (40 per cent of the total) was completed on behalf of the public sector. This high proportion means that an expanded portfolio of government-led projects would have a significantly positive impact on activity in the engineering stream of the construction industry.

These statistics demonstrate that there are plenty of projects in the pipeline of works that are not being delivered fast enough. The collective efforts of federal, state, and local governments need to be improved in relation to planning and procurement to ensure faster delivery of these projects. A model that has worked well in a crisis environment is the bushfire recovery collaborative procurement model that uses a head contractor to manage planning and procurement of work using local contractors and skilling and upskilling of workers to fast track the rebuilding process.

The range of programs at the federal level creates layers of a red tape and bureaucracy that should be consolidated into a more streamlined model for approving and delivering projects across all levels of government.

All stimulus funding commitments should prescribe local contracting, faster payment times, apprentice numbers and training requirements.

Details of Master Builders Proposed Stimulus Measures for Commercial Building and Engineering/Civil Construction Sectors

COMMERCIAL & CIVIL

BARRIER TO ACTIVITY	STIMULUS MEASURE	DESCRIPTION OF MEASURE
Increased cost risk from project delay.	Fast track contract payments and offer time and cost relief on projects.	<p>The Government has taken the lead in defence contracts and this should be extended to apply in all contracts. Additional measures in place include:</p> <ul style="list-style-type: none"> • Accelerating payments to Australian suppliers by making payment as soon as possible after their invoice has been approved for payment by Defence, irrespective of the contracted payment terms; • Reinforcing to prime contractors the important role their Australian subcontractors play in ensuring prompt payment across the supply chain; and • Providing appropriate relief to contractors in circumstances of demonstrated adverse effects as a result of the COVID-19 crisis on the supply of labour, equipment, materials or services required to meet current contractual obligations. <p>For projects that receive future stimulus investment, the government should introduce accelerated procurement processes that standardise and simplify tender processes; employ local contractors and deliver government funded training. Models used for bushfire recovery have been successful and are worth considering for COVID-19 recovery.</p>
Increased cost risk from project delay.	Effectively manage enforcement of liquidated damages.	<p>Government may consider mandating a temporary industry code or similar. This would operate to require parties to a building contract for building works to, when faced with a COVID-19 delay or other contractually significant event, explore all possible solutions thoroughly and genuinely as a precondition to taking conventional legal steps seeking enforcement of a particular contractual legal right.</p> <p>Governments may also consider a range of options to address COVID-19 delays through a combination of initiatives involving legislative change, financial support, and taxation relief for the commercial construction sector.</p>

BARRIER TO ACTIVITY	STIMULUS MEASURE	DESCRIPTION OF MEASURE
Access to finance.	Extend the government guarantee for working capital loans to businesses with a turnover of above \$50 million.	Extending this measure will expand the reach of working capital financial relief from banks and other financiers to more businesses in the construction sector.
Inadequate project pipeline of work.	Establish a dedicated COVID-19 recovery and rebuilding process for the shovel ready pipeline of work.	<p>The New Zealand Government has established a construction accord between government and industry. It is being utilised during the COVID-19 crisis to maintain and fast track projects, keep cash flowing in the sector, ensure a fair and consistent approach to contractor costs, provide additional financial and other support to employees and business owners, and specify health and safety guidelines for working in the COVID-19 environment.</p> <p>Governments should establish a process for COVID-19 recovery procurements similar to the bushfire recovery which simplifies procurement, allows for contract innovation through a collaborative process involving managing contractors and local contractors, specifies apprentice subsidies and funds training.</p>
Government charges.	Introduce a flat company tax rate of 25 per cent.	Currently company tax rates range between 27.5 and 30 per cent based on annual turnover. The company tax rate for businesses with an annual turnover of less than \$50 million is 27.5 per cent and will reduce to 25 per cent in 2021–22. For all other businesses it remains at 30 per cent. The government should fast-track planned tax cuts for businesses with a turnover of up to \$50 million and revisit relief for big business.

SPECIFIC TO COMMERCIAL

BARRIER TO ACTIVITY	STIMULUS MEASURE	DESCRIPTION OF MEASURE
Inadequate project pipeline of work.	Increase and fast-track investment in government institutional infrastructure (education, health, aged care, and defence).	<p>Any barriers or risks that might prevent these projects from continuing should be removed.</p> <p>A 5 per cent increase in funding for institutional infrastructure may reduce some of the financial risk to projects and encourage more activity. Master Builders is seeking more investment from industry superannuation funds in these types of critical infrastructure.</p> <p>Governments should establish a process for COVID-19 recovery procurements similar to the bushfire recovery which simplifies procurement, allows for contract innovation through a collaborative process involving managing contractors and local contractors, specifies apprentice subsidies and funds training.</p>
Inadequate project pipeline of work.	Provide funding for cladding rectification for audited buildings requiring rectification in affected states and territories and for asbestos removal for projects on the National Asbestos Exposure Register.	For cladding rectification, governments should apply a version of the Victorian model across the country that is fully funded by government, but does not require an increase in building permit levies to partially fund the cost of the program. Currently the Victorian Government has established a \$600 million grant program, with building permit levy increases covering 50 per cent of the cost of the program.
Government charges.	Relax all land related development charges.	<p>Incentivise development activity through a waiver or a substantial reduction in infrastructure charges for a defined period. This incentive would need to be enough to overcome the development risk of starting a project now, rather than waiting for the crisis to pass and for certainty to be restored to the market.</p> <p>The Gold Coast City Council's Construction Kickstart in 2012 (following the Global Financial Crisis) provided a 100 per cent discount on infrastructure charges for projects substantially commenced within a six-month period and completed within three years.</p>
Access to finance.	Get clients to accept surety bonds in lieu of bank guarantees. These do not require companies to tie up equity for bank guarantees.	<p>Surety bonds help overcome rationing of credit by financial institutions. Contractors can take on more projects without being restricted by security requirements.</p> <p>A surety bond allows greater financial flexibility, by allowing an organisation to leverage its capital base (i.e. better utilisation of your balance sheet), thus enhancing working capital and opportunities to improve liquidity. Surety bonds remove the need to have contingent liability (i.e. lazy capital) on your balance sheet.</p>

SPECIFIC TO CIVIL

BARRIER TO ACTIVITY	STIMULUS MEASURE	DESCRIPTION OF MEASURE
Inadequate project pipeline of work.	Fast-track delivery of the existing pipeline of work.	<p>The collective efforts of federal, state, and local governments need to be improved in relation to planning and procurement to ensure faster delivery of these projects.</p> <p>A model that has worked well in a crisis environment is the bushfire recovery collaborative procurement model that uses a head contractor to manage planning and procurement of work using local contractors, faster contract payment times and skilling/upskilling of workers.</p>
Inadequate project pipeline of work.	Reduce red-tape.	Consolidate the range of project appraisal processes and programs at the federal level that create layers of a red-tape and bureaucracy into a more streamlined model for approving and delivering projects across levels of government.



www.masterbuilders.com.au