

Creating Resilience

# Sharp rise in construction cost inflation to persist

LOCAL RESPONSE  
AUSTRALIA

CBRE RESEARCH  
JUNE 2022



## Construction costs have increased sharply

Costs in construction have spiked in recent months, driven by inflation, economic stimulus and supply chain challenges, impacting on material availability. The increase in construction costs is putting pressure on the development pipeline, margins and timelines. Materials have seen price increases in part due to the following:

### Global infrastructure building stimulus

Global COVID government stimulus has resulted in unprecedented levels of capital for large infrastructure projects. This has pushed the prices of raw materials higher. This demand should stabilise as construction starts in the US slow and stimulus is wound back.

### Residential Construction Boom

The HomeBuilder scheme and low interest rates have seen a surge in domestic residential construction driving demand for materials. Much of this development is still underway maintaining demand for materials in the near term.

### Supply Chain Disruption

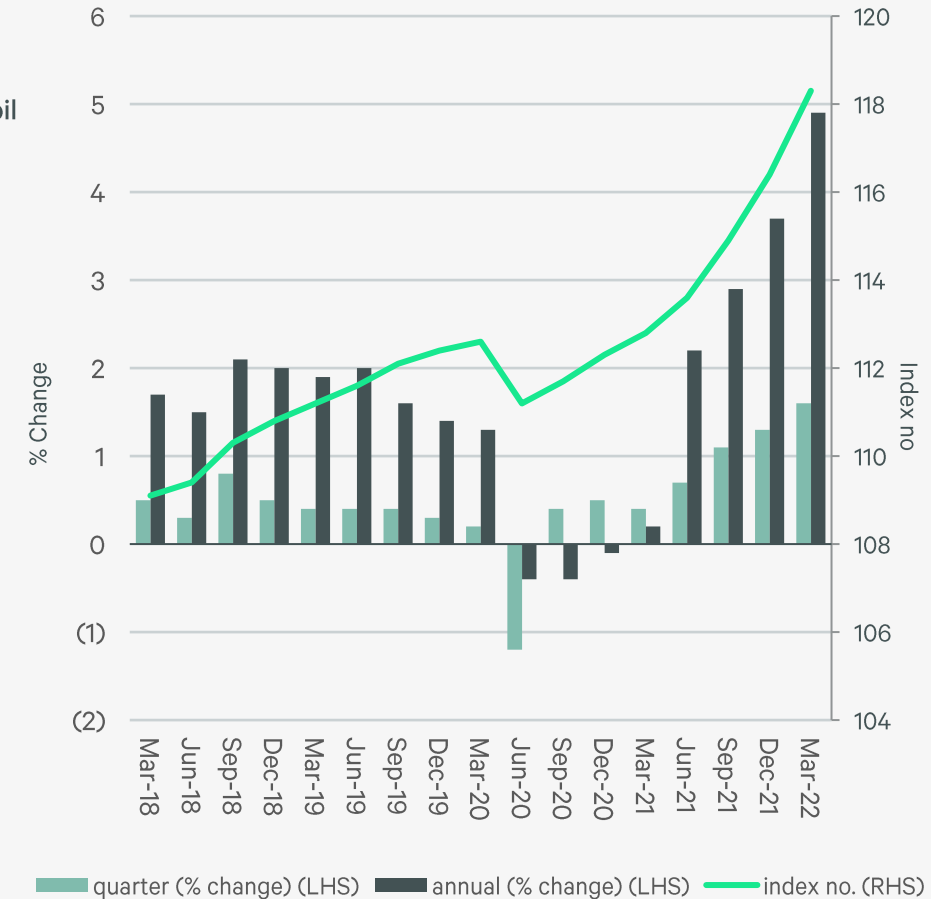
Supply chain delays have impacted material availability pushing up prices. The COVID Zero strategy in China is causing delays in ports placing increased pressure on freight costs and reliability.

### Oil Price Increases

Global crude oil prices have increased ~62% y-o-y. This has seen transport costs surge which are being passed on to buyers.

FIGURE 1

**Final Demand - Construction materials, crude oil and skilled trade shortages drove increases**



Source: ABS CBRE Research




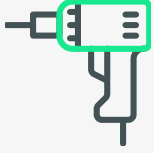
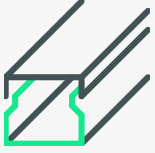

## Australian construction costs have risen sharply over the past 12 months

Australian construction prices have seen considerable growth between Q1 2021 and Q1 2022 as shown in Figure 2.

According to Turner & Townsend, price increases were recorded across all key material and staffing indicators. The sharpest increase was structural steel which increased by 39.5% per tonne followed by plasterboard which increased 35.3% per sqm.

The cost of labour also spiked with the average cost of a site foreman increasing 11.5% per hour and a group one tradesperson increasing 14.0%. Main contractors margin movement was 24.7%.

FIGURE 2  
Australian key price indicators - % change Q121 – Q122

		
<b>11.5%</b>	<b>14.0%</b>	<b>12.4%</b>
Site Foreman / hr	Group 1 Tradesperson	Concrete 32 MPa / m <sup>3</sup>
		
<b>35.3%</b>	<b>39.5%</b>	<b>24.7%</b>
Plasterboard 13mm thick to stud wall / sqm	Structural steel / tonne	Main contractors margin movement

Source: Turner & Townsend

## Construction cost inflation should peak in 2022

According to Turner & Townsend, building cost inflation is expected to moderate in 2023. Supply chain delays will persist into early 2023 but will begin to improve.

It is anticipated that the bulk of cost escalations have now been built into project pricing, particularly for building materials and subsequently, further price increases will be more modest.

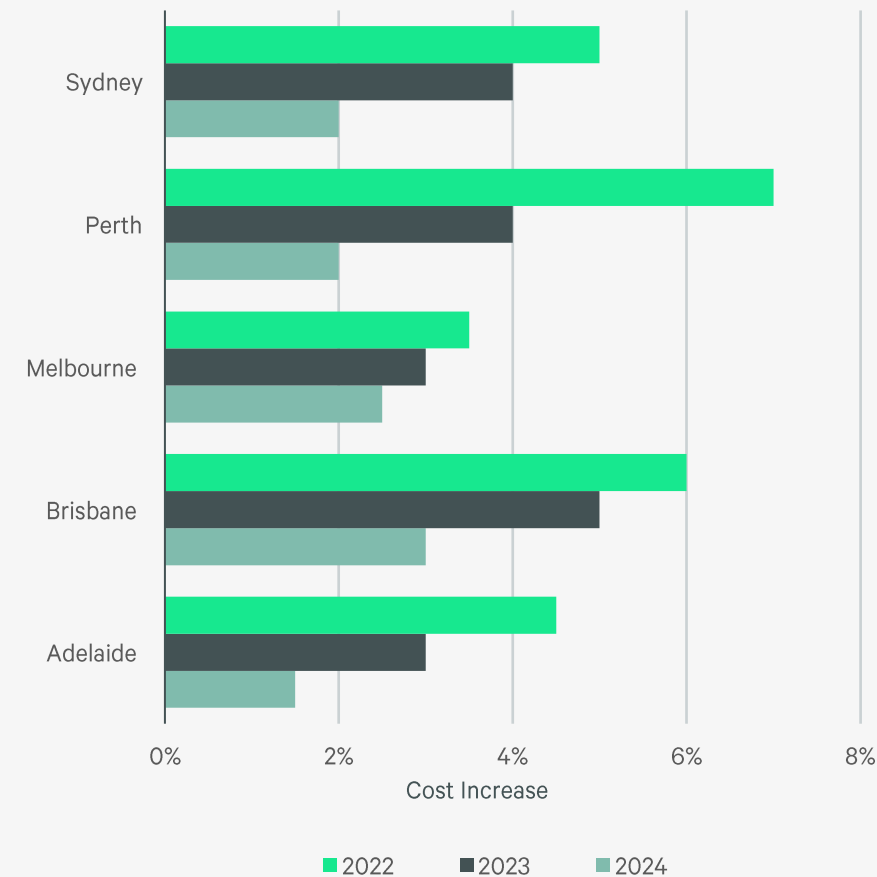
Cost increases from 2023 onwards will be largely driven by increased wage costs. Although migration levels will pick up in 2023, recovery in labour supply may take some time and as a result, wage growth will still be reasonably high which will drive construction costs.

## Perth and Brisbane to see the greatest increase to costs in 2022

The Perth market is expected to see the highest level of cost inflation in 2022 with prices increasing 7% y-o-y (Figure 3). This is in part due to a significant infrastructure pipeline contributing to the demand of materials. Furthermore, labour supply has been constrained by border closures and competition from the mining sector driving wages up.

The Brisbane market has a significant forecast increase in costs in 2022 (6.0% y-o-y) driven by a surge in population growth fuelling a boom in residential construction while a number of major infrastructure projects, including the Cross River Rail and Queens Wharf, are placing pressure on demand for materials. Recent reconstruction works to repair flood damage has also driven up material costs. Continued population growth and infrastructure development for the 2032 Olympics is likely to see the high costs persist.

FIGURE 3  
Cost Escalation  
Forecast by City  
2022, 2023, 2024



Source: Turner & Townsend

## Tight labour market adds pressure to timelines and costs

Labour shortages have been a significant factor in cost increases. Job vacancies in the construction sector increased to 35,200 vacancies in February 2022. This has made sourcing labour for projects challenging resulting in some delays and placing upwards pressure on wages.

According to the ABS, wages in the construction sector have increased by 2.5% y-o-y and 0.5% q-o-q to March 2022. Continued labour shortages are expected to see this number increase across 2022. Subsequently, this will put pressure on longer dated (2023/24) construction costs.

The a number of commercial building workers have enterprise bargaining contracts, which have kept wages relatively locked-in at present. The most recent Attorney-General's *Trends in Federal Enterprise Bargaining Report*, Average Annualised Wage Increase (AAWI) showed wage growth in private sector enterprise agreements approved in Q4 2021 was 2.7%, and the industry with the highest AAWIs was construction (4.0%). As these contracts come up for renegotiation, it is anticipated that there will be a sharp increase in wage growth.

The recent *Hays' FY23 Salary Guide* report listed the top five roles employers need to fill in the construction sector:

1. Contract Administrators
2. Estimators
3. Project Managers
4. Site Managers
5. Project Engineers

The report states that 93% of Australian respondents believe skill shortages will impact operations or growth. Subsequently, 88% of employers have offered higher salaries than planned.

FIGURE 4  
Construction Job Vacancies



Source: ABS, CBRE Research

Construction Job Vacancies (Feb 2022) Source: ABS

35,200

Construction Wage change (y-o-y) Source: ABS

2.5%

Proportion of Australian construction workers in a union Source: ABS

9.9%

## Cost is slowing volume of new building starts however HomeBuilder program will keep residential pipeline elevated

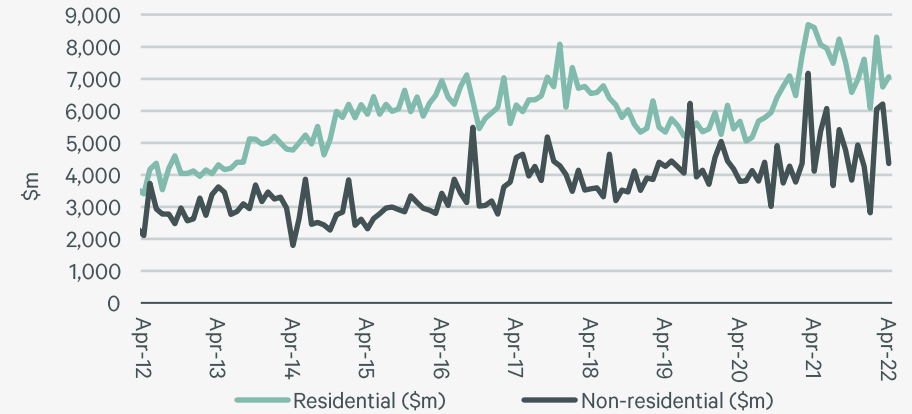
The amount of new residential and infrastructure construction will remain elevated in the near term with a number of major projects already underway. Homebuilder applications had surged to 75,000 nationally ahead of the lowering of the grant amount from January 1. The final tally exceeded 135,000 applications nationally with Victoria the most active (Figure 6).

The majority of recent construction contracts have priced in cost rises which will mitigate risks to developers. Although material costs are expected to moderate in 2023, renegotiated EBAs will drive the costs of unionised labour over the next 24 months. Subsequently it is the cost of labour that will be the key driver of construction cost increases from 2023 onwards.

Once the current development cycle is complete, interest rate hikes may help to slow consumption levels and new construction starts. ABS building approval data in April 2022 (Figure 5) showed a slowdown in approvals with the seasonally adjusted estimate for total dwellings approved falling 2.4%. The value of private sector houses rose 0.5%, while private sector dwellings excluding houses fell 6.1% while the value of non-residential building approved fell 30.0%.

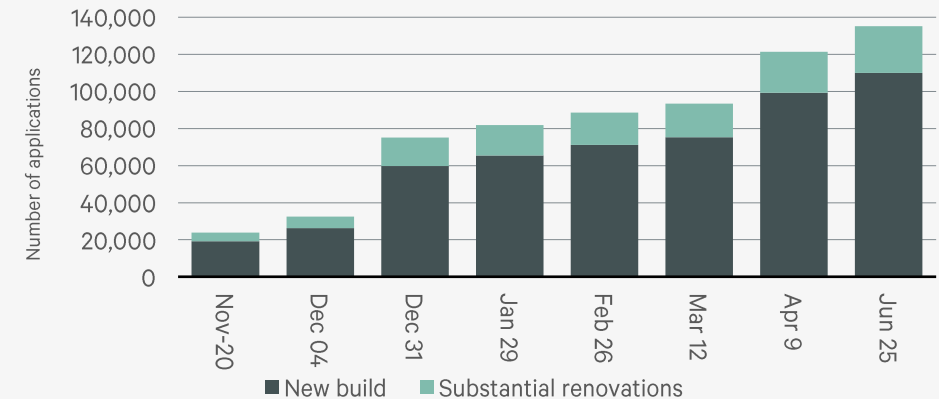
The Performance of Construction Index (PCI) is a composite indicator designed to provide an overall view of activity in the construction sector. May PCI fell to 50.4 from 55.9 in April. This indicates stability in activity across the construction sector following three months of positive conditions. According to the Ai Group, builders reported concerns around increased costs, combined with higher interest rates as dampening customer demand subsequently, new orders fell significantly in May.

FIGURE 5  
Value of Building Approvals (\$m)



Source: ABS, CBRE Research

FIGURE 6  
Number HomeBuilder Applications



Source: Australian Federal Government

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CBRE's construction report harnesses data from Turner & Townsend, a global professional services company and CBRE subsidiary specialising in program management, project management and cost consulting across the commercial real estate, infrastructure and natural resources sectors.

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