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FTMA Trussted Insight

THE OUTLOOK FOR BUILDING WORK IN AUSTRALIA

WITH TIM WOODS OF INDUSTRYEDGE

The outlook for building work in Australia

As building approvals fall, everyone worries over the future. In this analysis, we examine how much work is in the supply chain and find that its time for planning, not panic!

From Tim Woods at IndustryEdge

How much work is outstanding?

In the previous edition of Trussted Insight, one of the headlines was 'Pipeline of work has peaked'. That was wrong. Latest data shows us that far from having peaked, the pipeline of building work still to be done actually grew in the June quarter. At the end of June, there were 104,228 houses still to be built. Astounding.

Now, its true the pipeline of work on free-standing houses (that means they have been started but not finished) only grew by 925 houses over the quarter. But how was that possible, when approvals had fallen over the same period?

There are two main reasons.

The first is fairly obvious. Approvals don't become starts for a few months, so there will be a lag from when falling approvals occur, through to lower starts.

The data shows us that in the June quarter, starts fell by 260 houses, to hit their lowest level in seven quarters at 30,926, which is still 17% above the long-term average. So, a lot of new work was commenced in the June quarter.

The second reason is that completions **fell** in the June quarter, sliding by 6.3% to 28,898 completions. That is still about 3,000 houses more than the average quarterly completion rate, but it still comes as a surprise that completions did not increase, and in fact, it's a significant concern right now, which we'll discuss later in this piece.

Combined, what these factors mean is the pipeline of work still to be done expanded over the quarter, and thanks to the rate at which building is occurring – more on that later – it will take until early to mid-2024 for the pipeline to be built out, assuming there are absolutely no more approvals until then.

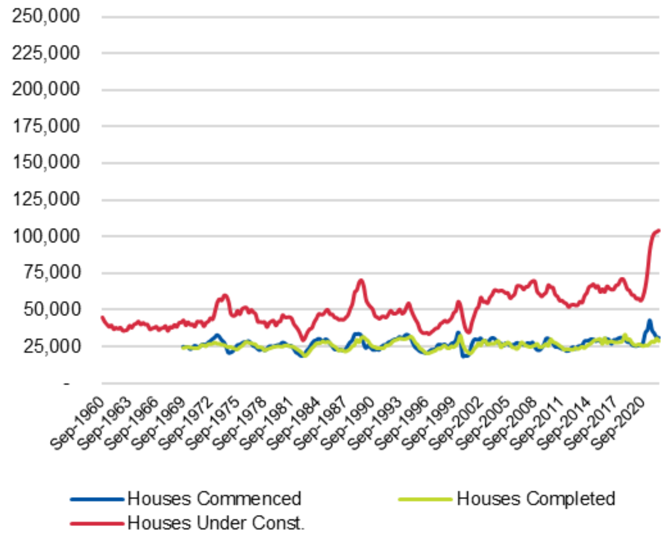
Putting the house pipeline in context

We asked, how could it have come to pass that less houses were built, right when the pipeline is so vast, and everyone is working their business as hard as it can go. To understand this, we turned to the detailed housing pipeline data.

Normally, we show the house pipeline chart a little differently, but bear with us here, because pictures can do most of the work for us.

First up, we can see the red line – Houses Under Construction – continued to grow and is at record levels, as we just outlined (chart next page).

Pipeline of Residential Building Work – Houses: SQ60 – JQ22 (Number)



Source: ABS and IndustryEdge

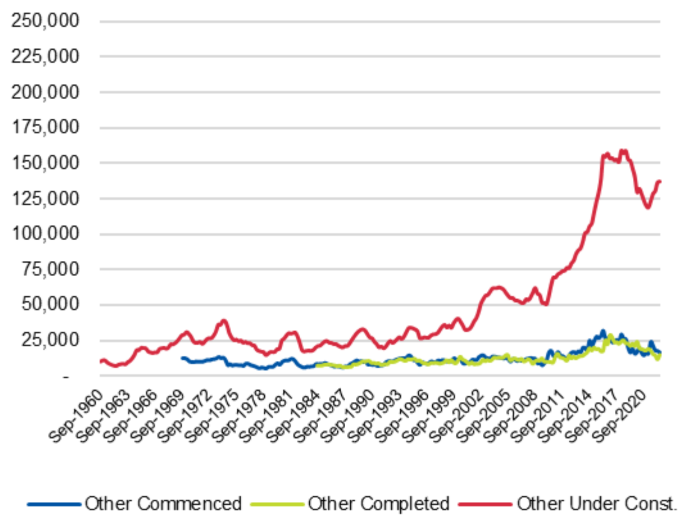
Second, we took a look at the pipeline, measured exactly the same way, for multi-residential dwellings – everything from townhouses to apartment towers. Now, look at the next chart! The pipeline of outstanding work on multi-residential dwellings has come off record levels, but at the end of June, totalled 136,896 dwellings!

How could this have arisen when multi-residential approvals have been slower than for houses?

The answer lies in the completion rates, which have crashed. In the June quarter, completions totalled just 15,129 dwellings. That was less than starts for the quarter and about 4,400 less completions than the long-term average.

Over the year-ended June, multi-res completions totalled just 57,439 dwellings (almost exactly half the rate for houses). If that rate continues, there is a total of about 30 months work in the multi-res pipeline, which would take until the end of 2024 to be built out, assuming there are absolutely no more approvals until then.

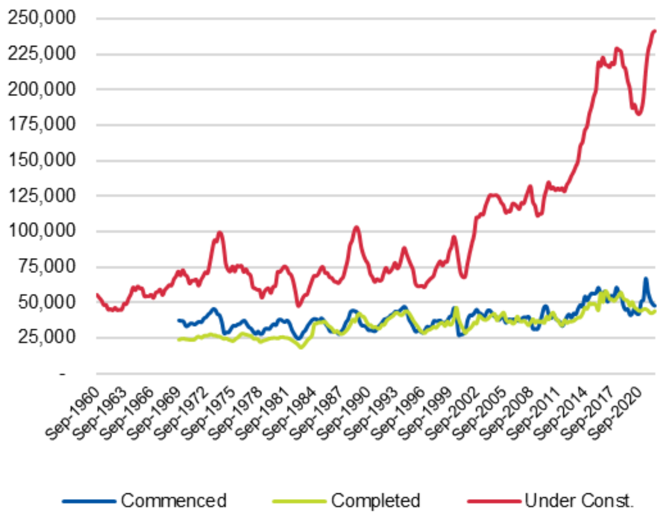
Pipeline of Residential Building Work – Multi-Res: SQ60 – JQ22 (Number)



Source: ABS & IndustryEdge

Unbelievably, there are greater than 32,000 more multi-residential dwellings in the pipeline, than there are houses. As the chart below shows, that means there was a mind-boggling aggregate pipeline of residential building work totalling 241,124 dwellings at the end of June.

Total Pipeline of Residential Building Work: SQ60 – JQ22 (Number)



Source: ABS & IndustryEdge

The growing size of the total pipeline is not new, as the chart shows. It has 62 years of data, and we can see the stellar lift in the total pipeline really occurred in the multi-residential boom that followed the GFC. It improved (here that means came down) for a while, but the final kicker has come with the pandemic.

It seems obvious that multi-residential properties take (on average) longer to build than houses. It turns out that is correct, in part because multi-residential dwellings are approved, built and completed as a group, not individually. Other factors include significant delays that can arise on apartment buildings and the delays in completing common areas and so on.

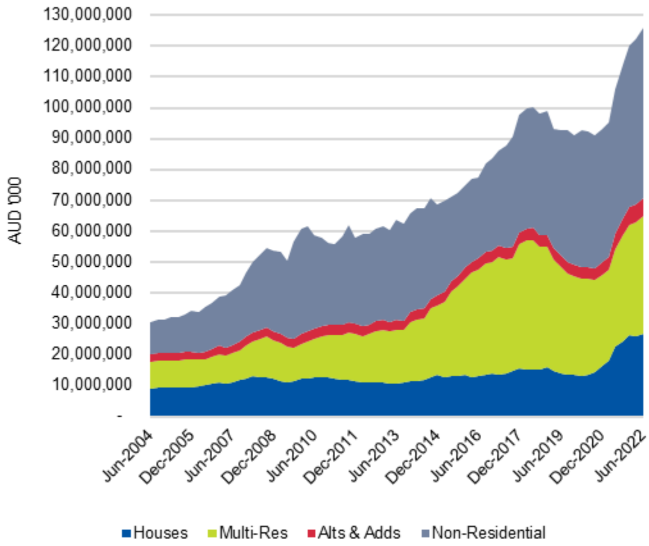
Before we get to the pace of house building however, there's still more to come on the pipeline of building work…

But wait, there's more…

Of course, the residential sector competes with other activities for labour, materials and supply-chain support. The most prominent of these is the 'other' construction sector, which includes health care, education sector, commercial and industrial building and of course, giant infrastructure projects.

In this chart (next page) we can see (by value) the total Australian building pipeline. At the end of June, it was valued at eye watering $126 billion, a clear record and up 18.9% on the prior year.

Total Pipeline of Building Work: JQ'04 – JQ'22 (AUD'000)



Source: ABS & IndustryEdge

The larger the construction sector's pipeline of work, the more significant the competition for resources in the supply chain.

Why is the pipeline still growing?

With about 246,000 dwellings to build and around $126 billion of total building work to complete, it is clear the Australian housing and construction economy is absolutely booming. At least, it would be if capacity matched demand.

The nation spent the pandemic complaining about the supply chain and bottlenecks and delays related to lockdowns, as though all problems start and end with supply and all demand is somehow virtuous. Some of the complaints were reasonable because supply delays were a factor causing profit-sapping delays.

Many complaints about supply were however misguided and missed the point: over-stimulated demand far outstripped the capacity of Australia's system of building work.

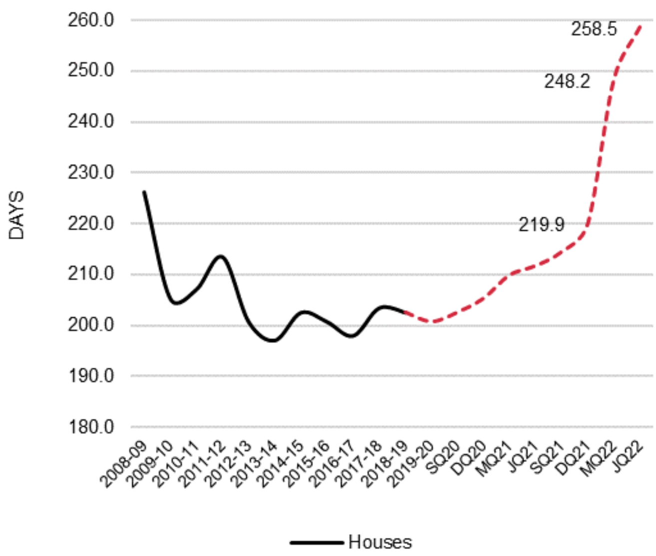
As an example, Australia's total residential building completions record was 57,810 in the December quarter of 2016. Over the pandemic, the nation has averaged about 44,000 completions, around 9,000 more than the long-term average. Pretty good going really, when consider how difficult supply, access to sites and availability of labour has been, and the absolute maximum that could have been achieved.

Meantime, we heaped more and more work into the pipeline as though we expected supply and supply chain capacity would suddenly gear up. That was never going to happen, and it is therefore little wonder the pipeline is at all-time highs.

The challenges in building the nation are not really diminishing. If in no other way, we can see this in the next chart, which shows the average time it is taking to build a house. In the June quarter, the build rate was its slowest on record, at an average 258.5 days (8.5 months).

Here, the chart's black line is annual data, and the red dotted line is quarterly data (chart next page). What is most alarming is how rapidly the average build time has changed over a single quarter by far more than in any year, including during the GFC.

Australia's House Building Rate: 2008-09 – JQ22 (Days)



Source: ABS, HireThinking* and IndustryEdge

* While the underlying data comes from the ABS, we are grateful for the work of Jim Houghton at HireThinking for the analysis, and for bringing this important data to the industry's attention

How much work is ahead of us and when will it run out?

Taking all the above – including the slow building rate – it now looks like there is about 24 months of work to be completed. To be fair, the pipeline of building work never completely evaporates. There is always a volume of work left to do.

As an example, over the last decade, the average number of houses in the pipeline at the end of each quarter was about 66,600 and about 127,100 multi-residential dwellings. So, in total, the average pipeline of work not completed has been about 193,700 dwellings over the last decade. As we have discussed, that is way higher than for the decade prior, but it is also way lower than the 241,000 dwellings in the pipeline at the end of June.

Link that to falling approvals, slow building rates and ongoing (but improving) challenges with materials and supply chains and we can imagine the pipeline working down to normal levels by the end of 2023 and softening in early 2024.

The question is, what will happen then?

The 2022 Federal Budget handed down in October provides some insights.

The role of the National Housing Accord in smoothing the work out

One of the most significant elements of the October 2022 Federal Budget was the announcement of the National Housing Accord, a new national agreement focussed on pursuing additional social and affordable housing. In many regards, the most significant element of the budget was not the focus on housing, but the emphasis on affordable housing and the regions.

It is worth unpacking the details, starting with the headlines:

- **'National Housing Accord'** a national agreement to pursue affordable housing
- **'Housing Australia Future Fund'** - $10 billion to build 30,000 new social and affordable dwellings[1]

[1] **Affordable housing** refers to rental housing provided at below market rent to qualifying tenants and is taken to be between 70% and 80% of the market rent.

- $350 million to build 10,000 further affordable homes over 5 years from mid-2024, to be matched by the States, to total 20,000 new dwellings
- **Target: total of one million new dwellings over five years from mid-2024**
- **Regional First Home Buyers Guarantee**, providing support for 10,000 buyers in regional areas, each year

A goal of one million dwellings would not be especially ambitious in normal times – Australia completed around 974,732 over the five years ended June 2022, for instance. However, the economic conditions are nothing like normal right now, and indeed, they were not over the last five years.

The nearly one million dwellings completed over the recent five years were fuelled by historic low interest rates, super-heated by the HomeBuilder grant and other 'gifts' and in a climate favourable for developers to release land and also, to build apartments.

By contrast, the next five years will see higher interest rates, labour shortages and materiel challenges, along with reduced incentive for land releases by those banking land or holding back on large multi-residential investments.

In that context, achieving a target of one million new dwellings over five years is a very strong signal to the market that just as the pipeline of work slows to a trickle, Government will be stepping in to support the housing sector by creating demand, not just pouring money into the hands of first home buyers, with all the inflationary impact that brings with it.

If the market delivers more than 200,000 dwellings per year, that will be a great result, and it is certainly possible. The key point here is that the National Housing Accord is designed to smooth out what could otherwise be a deep trough and it starts right about when we can expect the pipeline of working to be drying up.

Planning, not panicking – factor in higher prices!

There is a temptation, as the work slows, to 'buy' a forward order book, by lowering prices. It is true that new approvals are slowing and there will be less work to quote over the next year. In some regions, there will be significantly less work.

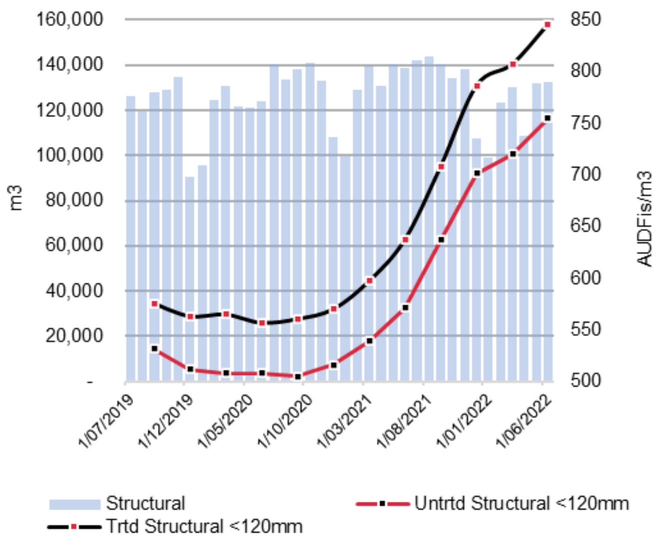
Fabricators need to be mindful that the slump in demand is likely to be quite short-lived. In part due to the pipeline of work still to be completed. In part due to the National Housing Accord. In part due to other factors we have not discussed in detail here: migration has opened up again, there is pent-up demand in some regions, Australia's economy is unlikely to tank the way the UK, others in Europe and the US certainly are capable of doing, energy costs are high thanks to Russia's war on Ukraine, as well as its timber being removed from many supply chains, and so on.

In a short downturn, where demand dials down from super-heated to stable, there will be few drivers for lower materials prices, including for timber.

The domestic supply chain is at capacity. The industry cannot saw more wood. It can sell all that it produces.

The chart below shows the quarterly weighted average prices of Australia's major sawn structural softwood products, both treated and untreated, along with the monthly sales volumes. This story is short: local prices are at record levels, with little prospect of dramatic falls because there is no immediate driver for much lower prices. Prices will moderate at some point, but with higher operating costs prevalent, it would be very risky to factor in a lower price.

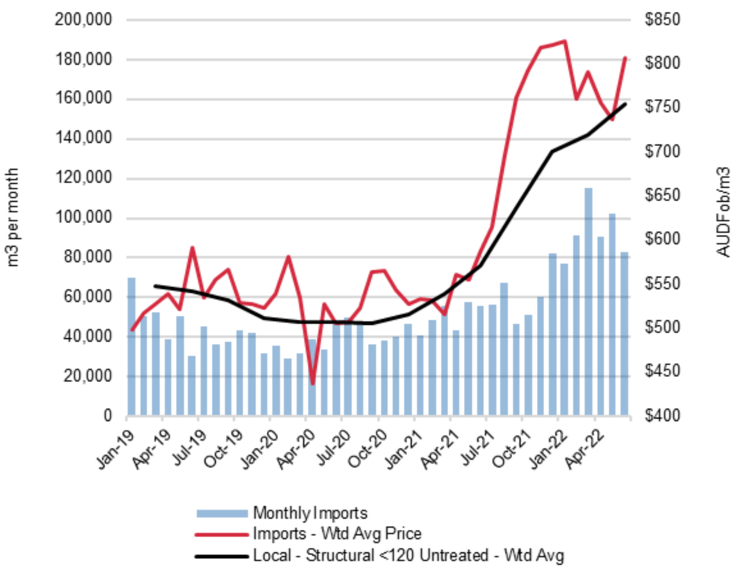
Local Sawn Structural Softwood: MQ19 – JQ22 (m3 & AUDFis/m3)



Source: FWPA and IndustryEdge

The situation is similar for imports, where the price response, as can be seen below, is linked to the volume response. Imports have done their job of providing core volume and lifting significantly as the 'swing' capacity to help meet demand in the market. That swing capacity arrived at higher prices. The black line overlays the local price, to show the similar trajectories on which local and imported prices have moved.

Imports of Sawn Softwood (Total): Jan '19 – Jun '22 (m3 & AUDFob/m3)



Source: FWPA and IndustryEdge

Moderation of import prices can be expected over the next year or more, but again, it would be brave to assume prices will fall to prior levels, given all the pressures on supply and supply chains and in the light of expectations of demand declining, but avoiding the crash.

Some careful planning is required right now, to ensure the prices we quote for future work reflect the work's value and the value of the materials we use.

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