A joint initiative of the Queensland Major Contractors Association and Construction Skills Queensland

2016 Major Projects Report Update

1. Overview – Key Messages

Welcome to the 2016 Major Projects Report (MPR) Update which provides a mid-term snap shot on the outlook for major engineering construction projects (>$100 million in value) and activity in Queensland.

The key message from the 2016 MPR remains intact – with both private and public investment in sharp decline, major project work in Queensland has been in freefall. From a peak of $18 billion in 2012/13, major project work fell 40% to $10.8 billion by 2014/15. During 2015/16 alone, it is estimated that major project activity fell a further 52% to just $5.2 billion, slightly below the forecast in the original report, as shown in Chart 1 below. Activity is expected to fall further in 2016/17.

The sharp decline in major project activity in Queensland mirrors the fall in broader engineering construction work done as captured by the Australian Bureau of Statistics in its quarterly Engineering Construction Survey (Cat. No. 8762.0). Over the year to the March quarter 2016 (the latest data available as at preparing this update), engineering construction activity in Queensland has fallen by 43% to just over $20 billion. The 2016 March quarter result alone showed a 40% decline compared to the corresponding quarter in 2015. This is easily the worst performance of all Australian states and territories during that time, as shown in Chart 2, and compares to growing activity in New South Wales, Victoria and South Australia, but illustrates again the massive, unsustainable, extent of the boom in engineering construction in Queensland in previous years.

Chart 1 – Revised Outlook for Major Project Work

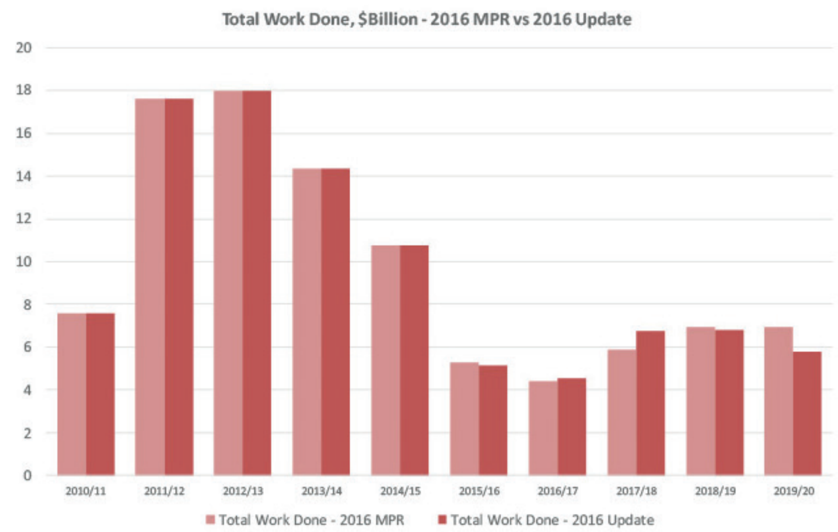

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Chart 2 – Engineering Construction by State, Annual Percent Change Year to March Quarter 2016

On the positive side, the outlook for major project work is now higher than forecast in the original 2016 MPR for both 2016/17 and 2017/18. The upgrade for 2016/17 mainly reflects slower than anticipated ramping up on major projects through 2015/16 and generally offsets the weaker outcome for that year. However, in this update, we now expect major project work to be significantly higher in 2017/18 (both relative to the previous year as well as what was previously forecast) given accelerated or new projects in the list (e.g. Ipswich Motorway Stage 1 and theNorth Coast Freight Rail Capacity) as well as higher forecasts for telecommunications (NBN) and electricity (renewables) works. We have also included the recently proposed Brisbane International Cruise Terminal to the list, although it is still to be assessed under Treasury's Market-Led Proposal (MLP) Framework and, as such, is still subject to risk.

However, longer term, the outlook for major project work has worsened considerably given the lack of committed funding to major projects (from both the public and private sector) and, particularly the lack of committed funding at the Federal level for construction of the Inland Rail initiative which accounted for over $1 billion in expected work by 2019/20 in the original 2016 MPR.

2. Queensland Major Projects Update

Overall, the revised Mid-Year forecasts for major project work still follows a similar path as set out in the initial report. Following a further decline in 2016/17, major project activity is forecast to move higher in 2017/18 and 2018/19, before a decline in 2019/20 as illustrated in Chart 1.

The revised outcome for major project work is the net result of the following adjustments to the QMCA Major Projects List based on recent State and Federal Budgets as well as news on private sector funded projects:

- Removing the Queensland Inland Rail projects from the list. Given that the 2016/17 Federal Budget only allowed for pre-construction funding in the forward estimates, just over $1 billion in major project work has been removed from the MPR to 2019/20. Given the extent of rail construction picking up in New South Wales, Victoria (and possibly Queensland with the Cross River Rail), Inland Rail construction works have now been delayed until after 2019/20.
- Accelerating the commencement or completion of several projects from the original list based on latest budget information including:
  - Ipswich Motorway Stage 1 (Darra to Rocklea) (accelerated commencement)
  - Kingsford Smith Drive Corridor (based on recent Brisbane Council election result) (accelerated commencement)
  - Charlton-Kingsthorpe duplication, Warrego Highway (accelerated commencement)
  - Cooroy to Curra (Section C), Bruce Highway (accelerated commencement)
  - Cooroy to Curra (Section A)), Bruce Highway (earlier completion)
  - Yeppen Floodplain South, Bruce Highway (earlier completion)
- Delaying commencement or ramping up several projects from the original list based on latest budget information including:
  - Toowoomba Range Second Crossing, Warrego Highway (delayed ramp up)
  - Sarina to Cairns, Goorganga Floodplain, Bruce Highway (delayed commencement)
  - Coomera to Helensvale Second Track (delayed ramp up, now underway)
- Cancelling other projects on the list including the Wyralong Dam Water Treatment Plant and Ceder Grove Connector given the relatively lower cost to supply water using existing facilities (including desalination)
- Adding new projects to the list from the latest budgets, including:
  - Inner City European Train Control System (ETCS) (although this project may not contain a high proportion of civil construction work)
  - North Coast Freight Line Capacity Upgrade
  - Brisbane International Cruise Terminal (although still under assessment)
- Upgrading forecasts to electricity and telecommunications (NBN) works based on recent project developments and ABS data.

3. Risks to the Outlook

Since the 2016 Major Projects Report was released in early March 2016, both the *environment* and *outlook* for major project work in Queensland – both through public infrastructure investment as well as private investment – has become more uncertain. While the near term outlook for major project work is slightly stronger, the lack of longer term project commitments sees a much lower projection for major project work by 2019/20 than forecast in the original report. Furthermore, a substantial portion of this major project work in the latter years remains unfunded.

Increasing risks for public infrastructure investment.

During 2016 the Queensland Government released both its State Infrastructure Plan (which outlined projects that could proceed as well as strategies to help fund them) and more recently the 2016/17 State Budget, which provided a clearer perspective of which projects had funding commitment. At the national level, the Federal Government released its 2016/17 Budget in early May 2016, outlining the path for funding of the Infrastructure Investment Program (IIP).

However, both the Queensland and Federal Government's commitments to infrastructure funding remain uncertain. At the State level, tight government finances remain a constant threat to future infrastructure funding. Without a clear plan to recycle capital from existing assets (through long term leases, as in New South Wales and Victoria) or increase borrowing for productive infrastructure investment, the State Government's infrastructure funding plan relies heavily on other, less predictable, funding mechanisms such as value capture, market led proposals, and an increased reliance on Federal funding for projects. The latter includes the IIP, new funding commitments from the recent election campaign (e.g. the Gateway Motorway/Pacific Motorway Merge Upgrade), as well as additional funding for water infrastructure through the $2 billion National Water Infrastructure Loan Facility.

At the Federal level, however, infrastructure funding uncertainty has also increased. The close Federal election result (and minority position of the Government in the Upper House) increases the risk that the 2016/17 Federal Budget (including the IIP) could face significant challenges if it is to survive passage through the new Senate. The 2016/17 Budget is yet to be passed, and there are no guarantees regarding longer term national infrastructure funding. A minority Government which must negotiate closely with smaller parties and Independents to pass the Budget and other legislation will likely result in greater politicisation in the choice of national infrastructure projects to fund (rather than choosing the most productive and sensible projects) and the levels of infrastructure funding overall. Meanwhile, the Northern Australia Infrastructure Facility (NAIF), charged with providing up to $5 billion in concessional finance to economic infrastructure projects in Australia's north became operational on 1 July, although there is no indication yet of what projects will achieve finance through this facility.

Uncertainty remains for resources investment.

Finally, while commodity prices have edged up from lows earlier in the year, there is still substantial uncertainty regarding the timing and magnitude of recovery in resources investment, which is the other key driver of major project work in Queensland. Here there has been progress with regards to two specific projects, Amrun and Dugald River, but the outlook for new investment across Queensland's two biggest resource sectors – coal and LNG – remain unclear. Prices for coal (both thermal and coking), while rising recently, are not expected to drive a major recovery in coal investment through the remainder of the decade, although Adani's multi-billion dollar plans for the Galilee Basin remain a wildcard. Meanwhile, LNG investment in Queensland has plummeted with the commissioning of all new LNG trains. Here, the opportunities are in sustaining capital works (and maintenance) in Queensland's coal seam gas fields (across the Surat Basin, Lower Bowen Basin and Western Queensland) to provide gas to feed the downstream processing trains. With more than 1,200 gas wells to drill each year from here, along with associated infrastructure, total capital expenditure may end up significantly higher than estimated in our original report.

Meanwhile, weaker global demand growth continues to threaten the pipeline of major project work in Queensland. With the bulk of future (unfunded) work dominated by Galilee Basin coal, other coal projects, and LNG expansions – which are now all subject to high risk – a greater onus is being placed on public infrastructure projects to support major project activity.

4. Implications

Major project work halved in Queensland through 2015/16 and is still set to worsen through 2016/17 as aggregated (private and public sector) investment troughs. While a recovery in major project work is expected to take placed over 2017/18 and 2018/19, there are renewed question marks over the sustainability of this recovery. Resources investment (and major projects work) is projected to gradually improve through the remainder of the decade, but much depends on the trajectory of public infrastructure investment to provide a sustainable base of major project work as the Queensland economy transitions from the resources investment boom.

Despite the projected contribution from the Amrun and Dugald River projects, resources investment is not expected to be the key driver of employment, growth and major project work in Queensland over the remainder of the decade. Sustaining capital works for CSG LNG is expected to pick up, along with new coal mines to replace depleting capacity elsewhere, but there is considerable uncertainty as to the timing and magnitude of the recovery. In this environment, it is paramount that Government and industry work together to ensure construction skills and capabilities are maintained in Queensland, and the economy remains sound. **Given current market conditions of weak domestic demand, excess industry capacity and historically low construction and capital costs, State and Federal Governments should boost productivity-enhancing public infrastructure investment,** financed through capital recycling (asset leases), debt and through recurrent savings, as well as facilitating direct private investment where possible. Queensland is now falling well behind other states, such as New South Wales and Victoria, who are funding their infrastructure programs through asset leases. In turn, the strong growth in work in these states over the next few years is expected to provide further challenges to Queensland contractors.

Driving economic growth through renewed public infrastructure investment makes sense so long as the projects are selected on a transparent basis and pass a stringent cost-benefit test. This will be the challenge given commitments made in the recent Federal election campaign, as well as the make-up of the new Federal Government post-election. In this context, it remains vital that the new Building Queensland authority provides robust, independent advice to ensure the most productive projects are chosen and, furthermore, works with State and Federal Governments to ensure a long term sustainable pipeline of priority projects. In our view, given recent funding uncertainties, this is the greatest challenge facing the construction industry in Queensland, and the greatest risk to the state's economic performance.

This means that there should be a renewed debate on the benefits of meeting infrastructure challenges sooner rather than later, and re-examining the best ways to fund them, leading to investment in projects that are both "shovel ready" and will deliver long term productivity gains. Such an approach has the broad support of economists, the Reserve Bank and international agencies such as the IMF. As these are national issues, not just issues for Queenslanders, there is also merit in increasing coordination between the Federal and State Governments in delivering sustainable funding solutions for infrastructure investment – including budgetary, debt and tax reforms.

In turn, in this very tough environment, it remains imperative for the major projects industry that it continues to promote sustainability, competitiveness, safety and high quality workplace outcomes through delivering on workplace efficiencies, encouraging innovation, and balancing wage demands with productivity gains. **A flexible, skilled and innovative construction industry will be vital in securing the next phase of growth in the Queensland economy.**