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

2015 Major Projects Report Update

1. Overview – Key Messages

Welcome to this update to the 2015 Major Projects Report which provides a mid-term snap shot on the outlook for major engineering construction projects (>$100 million in value) and activity in Queensland.

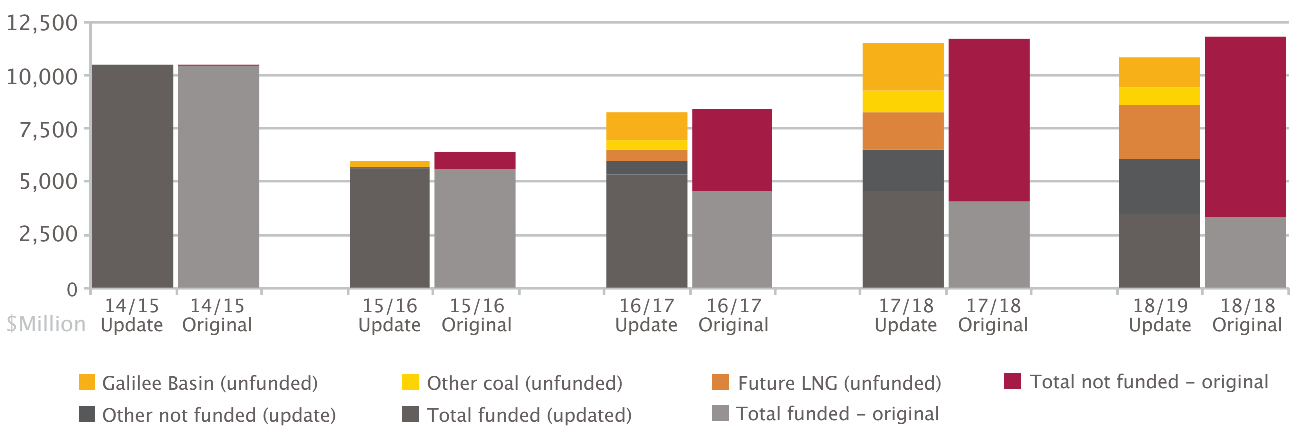
Since the 2015 Major Projects Report was released in March 2015, the outlook for major project work has worsened. Low commodities prices continue to threaten new resources investment while tight government finances at the State and Federal level has seen infrastructure projects delayed or cancelled from the QMCA Major Projects List.

While total major project work came out broadly as expected for 2014/15 (at just under $10.5 billion), projected total activity (the sum of funded and unfunded work) has been downgraded in each of the out-years to 2018/19. Work is still expected to slump dramatically through 2015/16 (to just under $6 billion), with prospects thereafter very much dependent on the commencement of new projects – whether publicly or privately financed.

On the positive side, funded work is now higher each year over the forecast period (compared to the original report) as key projects have achieved funded status through the year. However, more major projects will need to move to funded status to avoid further declines in major project work through the forecast period.

Meanwhile, very low commodity prices and 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.

Chart 1 – Major Projects Work Done Forecast 2015 Update vs 2015 Original Report



2. Queensland Major Projects Update

Overall, the revised Mid-Year forecasts for Major Project work still follow the path set out in the initial report. Valued at just under $10.5 billion in 2014/15, Major Project work done is anticipated to fall to $5.9 billion in 2015/16. Over the subsequent three years, Major Project activity is forecast to move higher, but this outcome very much depends on new investment in resources and non-resources projects, as illustrated in Chart 1.

Chart 1 highlights the Major Project outlook (including both funded and unfunded projects) has been revised down slightly across the forecast horizon between 2015/16 and 2017/18, with a more significant downward revision for 2018/19. Currently funded work continues to decline through the forecast period as existing projects are completed without enough new projects moving to funded status to maintain the funded level of work.

These outcomes are 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 several large projects from the list including the $6 billion Bus and Train (BaT) Tunnel and the $600 million Gold Coast Light Rail Stage 2 Projects – although it is recognised that revised forms of these projects may still emerge during the forecast period, particularly with the new State Government yet to release more details on its longer term capital works program. The $125 million Springdale to Blackwall Transmission Line project has also been removed given evidence that it will not be required until the mid 2020s at the earliest. On the resources front, the $400 million Paradise Phosphate project has also been removed from the list.
- Delaying the commencement of several projects in the list based on latest Budget information including:
  - The Port Drive Upgrade (Brisbane Ports), now expected to start construction in mid-2016 once the contract is awarded late 2015
  - The Mackay Bypass (State/ Federal Government) on the Bruce Highway, now expected to start construction in 2016/17
  - The Haughton River and Pink Lily Lagoon Upgrade on the Bruce Highway, shifted to start construction in 2018/19
  - The S1 Sewer Upgrade (Brisbane City Council) shifted to start in 2015/16 in line with the construction profile for the Kingsford Smith Drive Corridor.
- Adding the following new projects to the list:
  - $105 million Boundary Road Interchange (State / Federal Government) on the Bruce Highway with construction starting mid-2016
  - Scope for a new power station to provide baseload power in North Queensland – potential coming from coal, gas or renewable energy sources.
- Upgrading the construction values for the following projects based on revised budget information:
  - Gateway Motorway Upgrade North (GUN)
  - Warrego Highway Upgrade Program (WHUP)
  - Bruce Highway works packages
  - Peak Downs Highway – Eton Range
  - Townsville Ring Road – Stage 4
  - Reducing the civil allocation for the Cape York Regional Package (principally affecting projects for the Peninsula Developmental Road).

3. Opportunities & Risks

Given the dominance of major resources projects and exposure to global commodity prices, Queensland's engineering construction industry will remain highly volatile and subject to risks. As in 2014, the key downside threats to our base case include:

- Sustained low coal prices (both coking and thermal) which continue to threaten Queensland's status as a premier coal investment location. Here, the Galilee Basin thermal coal region remains the single biggest downward risk to the outlook, and these risks have deteriorated significantly further over the past six months. With thermal coal prices languishing at around US$60 per tonne, and renewed concerns over the long term global demand (and price) fundamentals, there is now a very high likelihood that Galilee Basin coal projects will not proceed over the next five years. As illustrated in Chart 1, this effectively takes $300 million off the table for related major project construction works (rail, port and mine) for 2015/16, rising to a peak of $2.3 billion in major project work by 2017/18. Overall, over $5 billion in major project work in the forecast is tied to Galilee Basin coal. Risks have also grown for other coal projects outside of the Galilee, with $2.3 billion in unfunded work across 10 other separate major coal projects.
- Lower oil prices which threaten the next round of brownfield LNG projects. Excess oil supply has seen prices fall more than expected over the past six months, now hovering at under US$50 a barrel compared to over $100 a barrel one year ago. This, combined with Australia's relatively high cost structure coupled with increasing competition from global sources poses a substantial risk to the next round of brownfield projects. The forecasts still assume one brownfield expansion to existing LNG facilities amounting to $4.3 billion in major project work through the forecast period, but this is now highly risky.

Opportunities on the upside still remain since our February report, including:

- The possibility of a stronger boost to public investment. While the State and Federal Budgets have not provided many new projects to the list, the recently released *Infrastructure Audit* by Infrastructure Australia (combined with the *Northern Australia Audit* released earlier in the year) highlight substantial and growing infrastructure gaps in Queensland, particularly in transport and regional water. While major projects are known and available, the challenge for Government will be to fund and finance development.
- The Australian dollar remains a wildcard. Further depreciation of the Australian dollar is expected during the forecast period which will assist the transition of the Queensland economy. In turn, a lower Australian dollar will boost US dollar profitability of Australian energy and resource projects, as well as projects which service agriculture, trade and tourism. This could help balance some of the downside risks for resources projects and potentially encourage new major projects to service other industries.

4. Implications

Major project work is projected to halve in Queensland through 2015/16 and substantial risks now surround the potential for a recovery through the forecast period. The downturn in construction work has already seen Queensland construction employment fall from a peak of 243,000 persons in early 2013 to just 207,000 persons by mid 2015 according to ABS data. Further falls in Queensland construction employment are forecast by BIS Shrapnel over the next two years as the resources investment boom continues to unwind.

Without new coal and gas projects, major project work will have very little growth through the forecast period, even if all currently unfunded works move to funded status, and construction employment will continue to decline. 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, this includes fast-tracking arrangements to fund and finance productivity-enhancing public infrastructure projects,** including the use of debt financing, capital recycling and facilitating private investment where possible.

Driving economic growth through a renewed public infrastructure investment push makes sense so long as the projects are selected on a transparent basis and pass a stringent cost-benefit test. In this context, the new State Government's establishment of *Building Queensland* which can provide independent advice and create a long term pipeline of priority projects is to be commended. **However, in an environment of excess industry capacity, historically low costs of capital, and strong private sector interest in infrastructure assets, there should be a renewed debate on the benefits of meeting infrastructure challenges sooner rather than later, 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 – as well as adopting the recommendations of the Productivity Commission and the Harper Competition Policy Review to reduce procurement and construction costs and improve industry competitiveness and productivity.

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 by 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.**