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Road construction activity to fall sharply

Will act as a drag on rising engineering construction work, with tight public finances and delays to next round of PPP projects to blame

Road construction – which has long been the largest infrastructure sector in Australia – is forecast to decline sharply after 2011/12, according to leading industry analyst and economic forecaster BIS Shrapnel. In turn, the weak roads outlook will be a drag on Australia's booming engineering construction sector, constraining overall growth in the market through to the middle of the decade.

According to BIS Shrapnel's recently released report, *Road Construction in Australia 2011 to 2026,* total road construction activity across Australia rebounded 11 per cent in real terms through 2010/11 to $16 billion. While activity is expected to remain near this level through 2011/12, the report forecasts a 20 per cent decline in road construction activity through the next three years to 2014/15.

This contrasts with a 30 per cent *increase* in non-road engineering construction activity across Australia forecast for the same period, driven primarily by mining and energy projects.

"Road construction faces a sharp squeeze on two fronts," explains Adrian Hart, study leader and senior manager of the Infrastructure and Mining Unit at BIS Shrapnel. "Primarily, we will eventually see sharp declines in privately funded road work as major toll road projects such as the Airport Link in Brisbane move to completion — with the next round of toll road projects still several years away due to financing constraints and issues around the traditional Public Private Partnership (PPP) model of infrastructure delivery.

"According to the new report, privately funded road construction activity is expected to fall from $5.3 billion in 2010/11 to $4 billion in 2014/15 (in constant 2009/10 prices) given the absence of new PPP-style toll road projects. This is despite a pick-up in other private road segments such as housing subdivisions, mining access roads and airport runways and aprons.

"Secondly, in the wake of the global financial crisis, we accelerated work on many of the publicly-funded road projects which underpinned the current five year Nation Building Program, formerly known as AusLink 2. While the next five year funding program is due to begin in 2013/14, we are yet to see the federal and state governments finalise a list of new major roads projects and bring them to the market for development."

According to Hart, recent changes in state governments combined with a general mood back towards fiscal consolidation will also dampen public investment in new roads over the next few years, despite funding promised for flood-related reconstruction in Queensland.

Says Hart: "Governments at the state and federal level have significantly increased funding for road construction over the past five years. Public sector funded work is now double what it was in 2005, mostly focused in large new highways and arterials projects. But this spike in work is unsustainable. State governments have now committed to improving their budget bottom lines and, in the case of the federal government, achieving a budget surplus by 2012/13. Some states are focusing on alternative transport projects, such as rail. This will make it difficult to maintain very high funding for roads projects."

According to the report, public funding for road construction is expected to fall from a peak of $11.6 billion in 2011/12 — mainly driven by flood reconstruction works — to $8.5 billion in 2014/15 as works under the current Nation Building Program move to completion and new projects get underway. However, this is still substantially higher than the previous trough of $4.9 billion in 2003/04.

Extent of decline can be avoided

Overall, road construction activity is forecast to decline 20 per cent from the 2011/12 peak over the three years to 2014/15, before recovering thereafter. However, the report acknowledges that the extent and duration of the decline could be reduced if work were to start earlier than anticipated on the next round of public and private sector funded major roads projects.

"Ideally, work on the next round of projects will come through quicker than we have forecast in the report," says Hart. "However, this will require more urgent action on the behalf of federal and state governments to establish the next set of Nation Building Program projects, as well as actively engaging with the private sector to encourage their involvement in their delivery."

Long term need for private and public sector provision of road infrastructure

In the longer term, BIS Shrapnel believes Australia will need to return to higher levels of road construction activity to fund major upgrades of the road network in order to handle ever-increasing freight demands and heavier axle loads, and to deal with chronic urban congestion issues in capital cities.

While Hart acknowledges that freight demands and congestion should be tackled primarily through a combination of higher investment in alternative transport systems including rail, as well as roads pricing initiatives, there will also be a requirement to invest in new road infrastructure in capital cities, including the completion of the orbital network in Sydney and new linking projects in Melbourne and Brisbane.

Says Hart: "Over the next few years, growth in Australia's infrastructure investment will be dominated by what is going on in the mining sector. By its nature, much of this work will be in the mining regions themselves, with relatively few developments in our capital cities.

"However, congestion and constraints to our freight transport systems in our cities will continue to get worse until new investment in capacity comes through. Given the size of the investment required, we will need to tap into the resources of both the public and private sectors to deliver effective solutions.

"Australia has seen large spikes in road construction activity in the past when the private sector has made a strong contribution — particularly in building large toll roads in Melbourne, Sydney and Brisbane over the past two decades. BIS Shrapnel expects that the next wave of urban toll road projects will need a mixture of public and private sector financing to go ahead, but only once existing disincentives for private investment are removed."

State-by-state outlook

New South Wales

Activity rebounded 36 per cent in 2010/11 to $4.5 billion as public spending on roads in New South Wales ramped up from already elevated levels. But activity is set to contract after 2011/12 due to the peaking of work on the M2 expansion and the completion of several major public projects. Another strong upswing is expected from 2015/16, underpinned by new private projects such as the M4 East and the F3-M2 Link.

Victoria

Road construction in Victoria posted sharp gains in 2010/11 with total construction rebounding to $2.6 billion. The jump in activity stemmed predominantly from further large state and federally-funded projects designed to alleviate congestion around Melbourne's urban centres. BIS Shrapnel is forecasting road construction activity to remain high in 2011/12 before falling back over the two years to 2013/14, as a dearth of new projects prevails and weaker private sector involvement continues in the absence of major toll road projects.

Queensland

In 2010/11, work done contracted to $4.9 billion despite strong fundamentals, as widespread flooding and Cyclone Yasi impacted negatively on the December 2010 and March 2011 road construction quarterly results. Following a flood-reconstruction boost in 2011/12, activity is tipped to contract sharply over the three years to 2014/15 as flood money dissipates, the Airport Link concludes and major publicly-funded projects begin to wind down.

Western Australia

The completion of the Perth to Bunbury Highway, combined with an easing of the private sector outlook, suggests that the historically high levels of work done in 2008/09 was unsustainable, and it will be a number of years before this peak is reached again. However, reasonably strong subdivision activity will help keep overall road construction around the $2 billion mark, which is still a strong level of activity for Western Australia.

South Australia

Activity moved higher in 2010/11 to $1.1 billion, driven mainly by the new South Road/Superway works. Road construction activity should remain elevated over the next two years, as the Southern Expressway duplication and Olympic Dam expansion-related works join the Superway activity, offsetting falling subdivision works. Declines are then expected through to the middle of the decade.

Tasmania

Roads construction in Tasmania is expected to fall back sharply in 2011/12, following a spike in National Building Program works through 2010/11. Activity should continue to soften over the three years to 2014/15.

Northern Territory/Australian Capital Territory

Road construction in the Northern Territory is expected to trend lower – but remain at a high level in historical terms – over the next five years. The Northern Territory government remains committed to historically high levels of infrastructure expenditure, in order to support employment and the general economy until the private sector recovers from its current lethargy. Meanwhile, work levels in the Australian Capital Territory will strengthen when the $288 million Majura Parkway project moves into a construction phase.

About BIS Shrapnel

BIS Shrapnel is Australia's leading provider of industry research, analysis and forecasting services. BIS Shrapnel helps clients better understand the markets in which they operate, through reliable and detailed market data, analysis of developments and drivers and thoroughly researched forecasts.

BIS Shrapnel compiles accurate, clearly explained and detailed information on industry sectors, markets and industries in which their clients operate. BIS Shrapnel provides market size and segmentation data, market shares, consumer attitudes and supplier reputation information, and regularly conducts both business-to-business and consumer research.

Over the company's 46-year history, BIS Shrapnel has built up a strong level of expertise and unique methodologies for forecasting.

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