



The finance sector's viscosity is inhibiting the flow of property development

The Queensland development industry (according to Tourism Potential) is the second largest contributor to the State's GDP (11.9%) and the fourth largest industry by employment (9.3%). As a result of the industry's significant size, any volatility is exaggerated throughout the wider economy; for example if the development industry was to suffer a 20% down turn a direct 2.4% decrease in the State's GDP would result. These figures do not take into consideration any possible external flow on effect.

Queensland is currently in the grips of an economic downturn, as a result of the Global Financial Crisis. The majority of Queensland's media focus, in regard to the current economic situation, has been on the mining industry and the impact that a drop off in demand from our large trading partners is having on the minerals sector.

The primary catalyst to the Global Financial Crisis is the increased viscosity of the global finance sector, which has filtered through to all the corners of the earth. Banks are becoming far more risk averse and commercial money is becoming more expensive. The direct result of this is that finance is becoming increasingly scarce which has put a virtual halt on property development globally but also in Queensland.

Chart 1 below illustrates the total level of new commercial finance commitments (approvals) for Queensland (left hand axis) and also the level of new construction finance commitments (approvals) for Queensland (right hand axis). Both lines are highly correlated as illustrated by the trend lines and indicate that both construction finance and total commercial finance are subject to the same external influences, rather than purely being subject to micro level industry specific changes.

From the Australian Bureau of Statistics data THG have determined that construction finance has accounted for an average of only 7% of total finance over the last 10 years, and as such, any construction industry specific changes in the demand for construction finance have a very limited influence on the level of total finance commitments.

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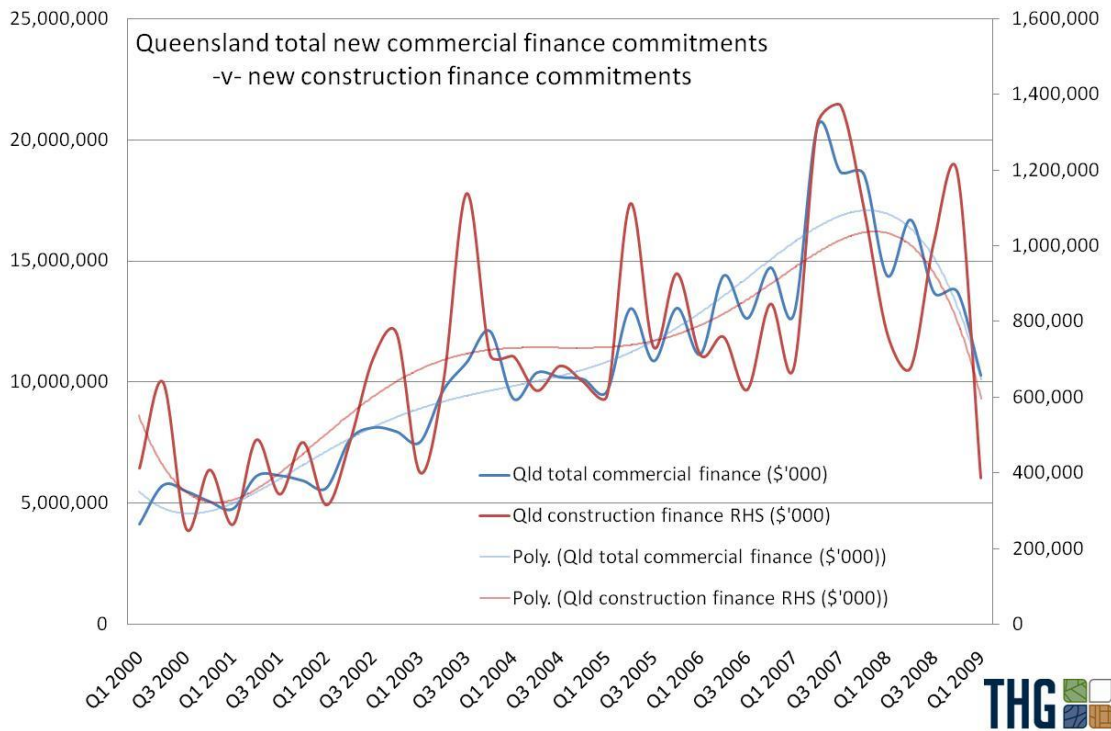
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Chart 1



Source: ABS and THG May 2009

Chart 1 illustrates the dramatic drop off in the level of new finance commitments from a peak in mid 2007 to date. This is a direct result of the global finance crisis. From a peak of \$20.5 billion in Q2 2007, total commercial finance in Queensland has decreased to \$10.2 billion - 50% of its peak value. Construction finance has followed a similar but more severe trend; from a peak of \$1.3 billion in Q3 2007, construction finance has decreased to \$0.4 billion in Q1 2009 a mere 28% of its peak value.

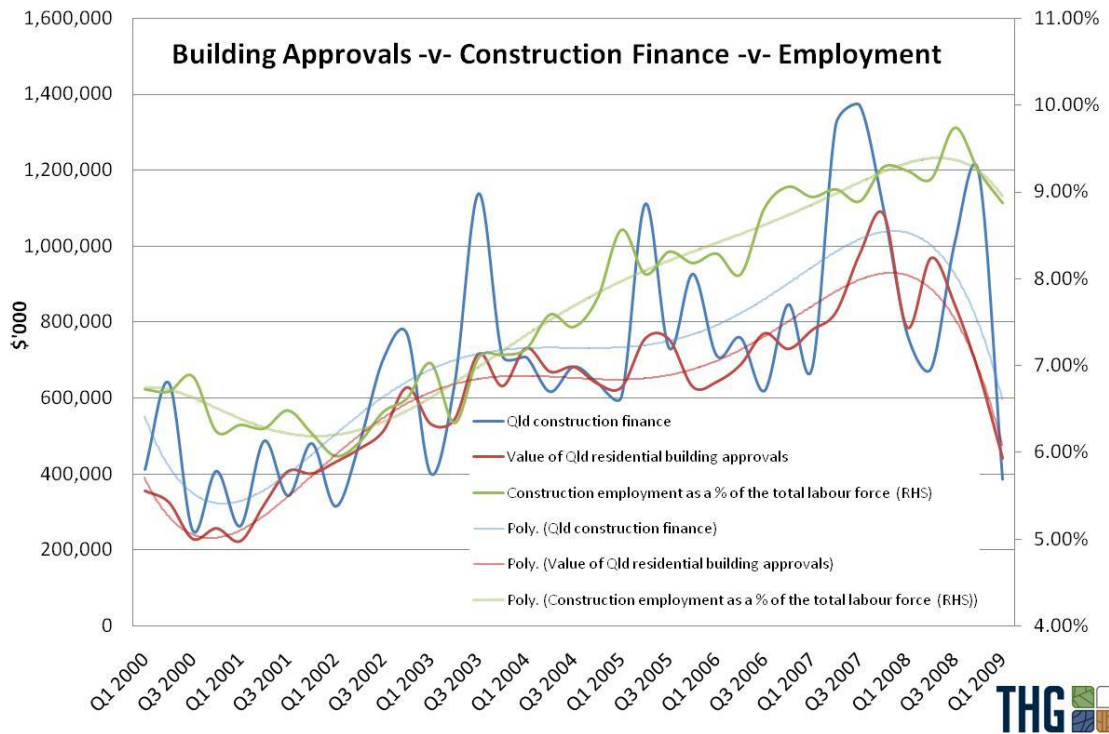
The inability of developers and builders to access finance is having a direct impact on the property industry and the broader economy.

Chart 2 below illustrates the correlation between Queensland's new construction finance commitments, the value of building approvals and the level of construction employment in Queensland. The Chart highlights the high correlation between these variables and the labour market's lag of finance and approvals (the trough in employment early this decade lagged the trough in finance and approvals by circa 15 months).



As Chart 1 above has illustrated Queensland's level of construction finance has dramatically decreased by circa \$1.16 billion since Q2 2007. The value of residential building approvals has decreased by \$643 million from its peak in Q4 2007. As employment lags approvals and finance and given the substantial downturn in both approvals and finance, it is very likely that construction industry employment faces significant decreases in the short to medium term.

Chart 2



Source: ABS and THG May 2009

According to The Urban Development Institute of Australia, Queensland Division's commissioned report by Tourism Potential, titled 'Economic Impact of the Development Industry in Queensland, 2007/08', every \$1 million in turnover generated by Queensland's development industry either creates or sustains 2.8 direct and 4.5 indirect full time equivalent jobs.



If we apply the employment multiplier to the decrease in the level of construction finance, it reveals that to date the downturn in activity, as a result of the high levels of viscosity in the finance sector and the increased risk aversion of the banks, has resulted in a loss of 2,760 direct jobs or 7,200 jobs in total.

If we use the new construction finance commitment figure to arrive at a total development figure by applying an equity contribution from the developer or other lenders of 30% and a developer's margin of say 20% the picture becomes a little more dire. However this is possibly more realistic as the figures above are purely based on the finance amounts. A reduction in finance of \$984 million reveals a reduction in development value of circa \$1.5 billion which reveals of total loss of employment of almost 11,215 jobs from the peaks in activity of mid 2007.

The ABS statistics on the number of people employed in the construction industry in Queensland reveal that over the last three quarters 16,643 people have lost construction jobs in Queensland alone. This figure is of particular concern as it exceeds estimates based on market multipliers and reveals the uniqueness of the current economic downturn and the adverse impact it is having on the construction industry in Queensland.

The impact that a decrease in development activity will have on Government revenue is also alarming in the face of an increasing budget deficit. The Urban Development Institute of Australia, Queensland report referenced earlier also reveals that every \$1 million worth of property development directly generates \$44,700 in direct and indirect taxes and the flow on effects generate \$95,100 in direct and indirect taxes. The decrease in development activity which we have derived from the decrease in new construction finance commitments has likely resulted in a decrease in total tax revenue of \$215 million to date.



Conclusions

Based on THG's research and analysis the Global Financial Crisis and the subsequent unavailability of construction finance domestically, have slashed development activity by circa \$1.5 billion. The reduction in development activity to date in Queensland, alone equates to a loss of employment of 11,215 jobs and a loss of Government revenue of \$215 million. Employment figures as a lag indicator of finance and approvals means that the majority of these job losses are yet to crystallise. However the ABS is reporting construction job losses in Queensland to date of over 16,000 jobs.

Many commentators are predicting that the worse of the economic downturn is in front of us. If this is the case and we are to apply the current average quarterly level of decrease in development activity forward for another four quarters, equating to a reduction in activity of \$877 million, we arrive at a loss of a further 6,408 jobs and \$123 million dollars in lost Government revenue.

If we apply the current trend in job losses per quarter (8,300 people), as reported by the ABS, over the next 12 months we arrive at an additional 33,200 job losses from the Queensland construction industry.

The full quantum of job losses from the construction and development industry in Queensland as a result of the Global Financial Crisis is as yet unclear as the labour market lags the major indicators by circa 15 months, but from the data available to date, it is likely that the job losses will range from in excess of 17,600 to possibly as high as 49,800.

The loss in Government revenue also looks as though it will exceed \$338 million, if as many expect, the market continues its current downward trend for the next 12 months.

The fact that the majority of job losses are yet to be felt means that there is still an opportunity to legislate to increase the liquidity of the finance sector and decrease some of the bureaucratic cost impositions placed on the property development sector.

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