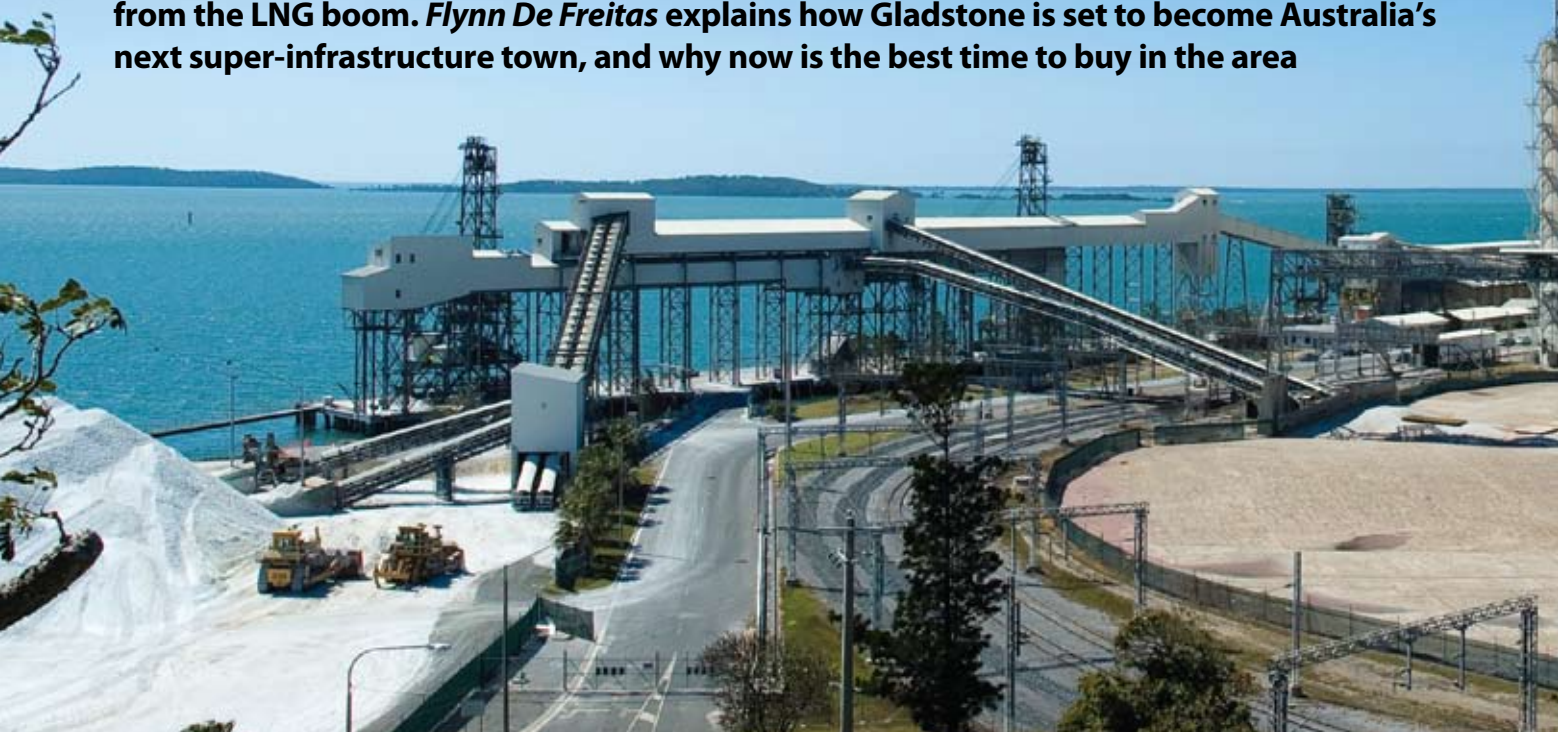


Gladstone: Queensland LNG boom town

With over \$51bn in LNG projects, Gladstone offers investors an opportunity to profit from the LNG boom. Flynn De Freitas explains how Gladstone is set to become Australia's next super-infrastructure town, and why now is the best time to buy in the area



Across Australia, there is one mining boom town that stands head and shoulders above the rest; one town with over a massive \$65bn in planned and committed infrastructure projects.

That town is Gladstone, a town of 30,000 on the mid-north coast of Queensland, just to the south of Rockhampton.

With nine planned or committed infrastructure projects over \$1bn in value, Gladstone is the classic example of an infrastructure boom town. The value of the town's projects has rocketed by 191% over the last two years to a breath-taking \$65bn (see Chart 1, right).

Gladstone can no longer be called just an infrastructure boom town. It has now joined the ranks of Karatha, Port Hedland and Dampier in becoming a true 'super-infrastructure' boom town.

However, unlike these WA super-infrastructure towns that boast median

house prices of \$800,000 to \$900,000 (or more) and 10% rental yields (ie, \$1,600–1,800 weekly rents), Gladstone represents true value for 'infrastructure spotting' investors. August 2009 median house values are at \$360,000, and unit values are at \$255,000, according to national property research firm Residex.

Before we go into detail on Gladstone's large infrastructure projects, let me outline 'infrastructure spotting' and how Gladstone fits each of the four key criteria perfectly.

Infrastructure spotting

Infrastructure spotting is the 'deliberate' investment by a property investor (or developer) in a small town with an impending billion-dollar or larger local infrastructure project.

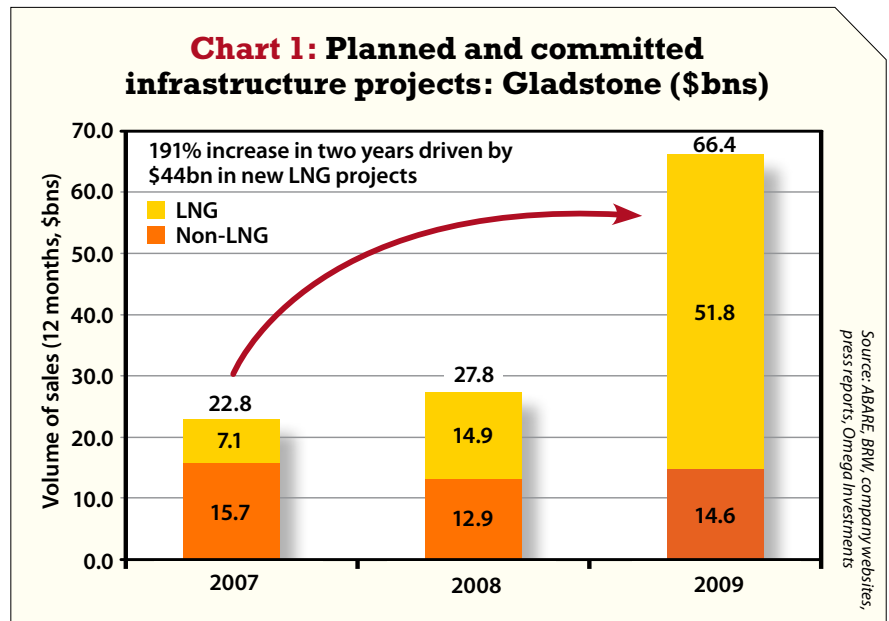
These projects are linked to the commodities boom driven by the expanding Chinese and Asian economies, and Australia's status as

one of the world's largest resource exporters. These projects enable mining and energy companies to extract more (ie, new mines or gas platforms), move more (ie, railways or pipelines), refine more (a new refinery), condense more (a new LNG train) and ship more (ie, a new port).

The projects all have several things in common: a huge injection of cash into the local economy; thousands of cashed up workers on \$100,000 plus salaries; limited housing supplies; and smart investors who have seen this all before and are looking to invest in boom towns before everyone sees the opportunity.

Battered but ready to roar again

The global economic crisis has provided the ultimate litmus test for the 'stronger for longer' commodities boom theory, which argued that global commodity demand was driven by China and other Asian countries' internal growth



criteria that identify upcoming infrastructure boom towns. Below I explain these five criteria, and Gladstone satisfies them.

1. Less than 30,000 population

Infrastructure towns have to be small, with a population of less than 30,000. It is imperative that the project fundamentally changes the economic climate of the town. Any larger than 30,000 and the impact of a new project on housing demand and rental yields becomes relatively marginal.

Gladstone is right on the 30,000 mark, but as its infrastructure projects will bring in many thousands of workers, the town satisfies the first criteria comfortably.

2. Billion dollar project

Projects need to be at least \$1bn or more in size. Smaller projects may still have a material impact on a town, but this is usually only the case when the town is quite small.

Well, \$65bn in planned and committed projects sees Gladstone easily fly past this criterion!

3. Large peak workforce

The new project's 'peak' workforce should also equate to 5–10% of the town's normal population. This ensures a massive jump in rents when the workforce comes into town and quickly exceeds the 'normal' stock of available accommodation.

The peak workforce for six of Gladstone's planned and committed infrastructure projects all exceed 5% of the town's population, and the numerous other projects in aggregate also equate to approximately 10%. As Table 1 shows (see page 28), if all of Gladstone's projects occurred simultaneously (hypothetically speaking) it would require about 21,000 workers during the peak construction phase!

4. Approved project status

Finally, the project must have attained 'approved' project status – that is, all required state and federal government approvals have been formally granted. This occurs in the very last phase of the 'feasibility' stage of the infrastructure spotting cycle (see Chart 2 on page 28).

With all environmental and government approvals granted, all that remains is the Financial Investment Decision (FID), which is the point the project enters into the lucrative 'confirmed' stage of the cycle. This is when house prices can jump 10–20% overnight, as investors rush into town.

Five Gladstone infrastructure projects have already received full approvals or entered into the 'confirmed'/'commenced' phase. Numerous other projects have also submitted their Environmental Impact Statements (EIS) and are now waiting for governmental approvals, so they can proceed to FID.

rather than just the US economy. After the darkest days of the crisis, with the collapse of Lehman Brothers due to subprime housing woes and the global pull back in demand for commodities, it looked grim for many of these infrastructure projects. Many were shelved, and others were abandoned just as they started. Thousands of workers were been sacked.

However, one billion Chinese are one billion consumers who are want the 'Western' lifestyle that can only be provided by the commodities that nations like Australia export. The Chinese economy is growing again, and it looks like 'stronger for longer' is back with a roar.

Investment criteria and when to buy

Happy days are now returning to mining towns, and investors should bear in mind the four investment

Table 1: 2009 planned and committed infrastructure projects, Gladstone

Project	Commodity	Company	Status	Cap ex	Peak workers	Ongoing workers	Completion
Australia Pacific LNG	LNG	Origin/ ConocoPhillips	Feasibility (EIS to be lodged)	35,000	4,000	1,000	2014-15
Curtis LNG	LNG	BG Group	Feasibility (EIS submitted)	8,000	3,600	820	2013
Gladstone LNG	LNG	Santos/Petronas	Feasibility (EIS submitted)	7,700	3,000	250	n/a
Gladstone Nickel (Stage 1)	Nickel	Gladstone Pacific Nickel	Feasibility (EIS approved)	5,000	2,000	530	2012
Yarwun Alumina Refinery Expansion	Alumina	Rio Tinto	Commenced (on hold)	2,570	2,200	270	2012
Wiggins Coal Terminal (Stage 1)	Coal	Central QLD Ports Authority	Feasibility (EIS to be lodged)	1,400	500	130	2012
Wiggins Coal Terminal (Stage 2)	Coal	Central QLD Ports Authority	Feasibility (EIS to be lodged)	1,400	600	225	2016
Wiggins Coal Terminal (Stage 3)	Coal	Central QLD Ports Authority	Feasibility (EIS to be lodged)	1,000	480	300	2020
Gladstone Nickel (Stage 2)	Nickel	Gladstone Pacific Nickel	Feasibility (EIS approved)	1,000	1,700	200	n/a
Fisherman's Landing LNG	LNG	LNG Ltd/Arrow/Shell	Feasibility (EIS approved)	570	120	32	2012
Australian Iron and Steel Project	Iron Ore	Boulder Steel	Pre-feasibility	536	700	750	2011
Shell CGS to LNG	LNG	Shell	Pre-feasibility	n/a	2,500	200	2013
Boyne Island Smelter (Stage 2)	Alumina	Rio Tinto	Confirmed (on hold)	495	n/a	n/a	2012
Boyne Island Smelter (Stage 1)	Alumina	Rio Tinto	Commenced (on hold)	385	n/a	n/a	2011
QAL Refinery Expansion	Alumina	Queensland Alumina Ltd	Announced	100	n/a	n/a	n/a
Total				65,156	21,400	4,741	

Super infrastructure town

Gladstone doesn't just qualify as an infrastructure boom town – it is the equivalent of a world record holder. It has over \$65bn in infrastructure projects that will employ a peak workforce of about 21,000 over the next five to 10 years (see Table 1, above).

The sheer magnitude and number of projects (15 in total) means that Gladstone is rightly classified as a 'super infrastructure town', which will struggle to cope with the enormous influx of future workers.

This, of course, means booming house prices. Vacancy rates will hit zero, and rents will escalate as the various projects move through their respective infrastructure spotting cycles.

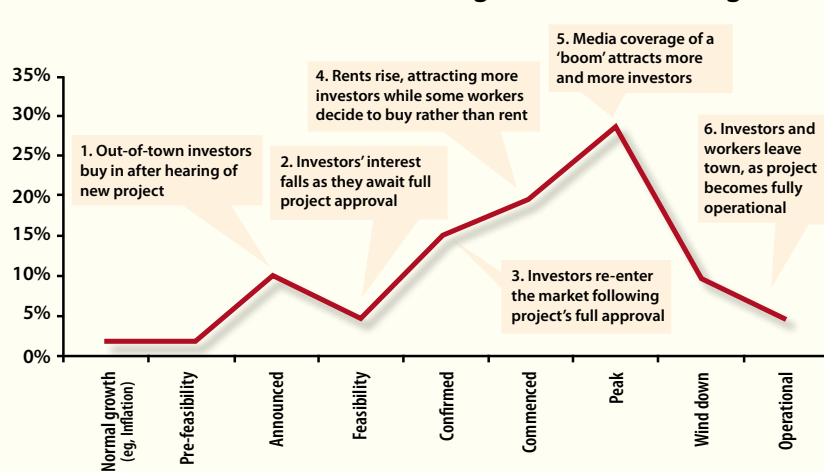
The number of projects in Gladstone will almost certainly ensure that the town will be in the 'peak' stage (see Chart 2, right) of a particular project at any given time. There simply will not be enough workers or accommodation to build more than two or three major projects at any one time.

But this town is no stranger to booms. Twice in the last ten years house prices have hit 20% or higher annual growth rates as the town went through various infrastructure spotting cycles (see Chart 3, right).

Why now is the time to buy

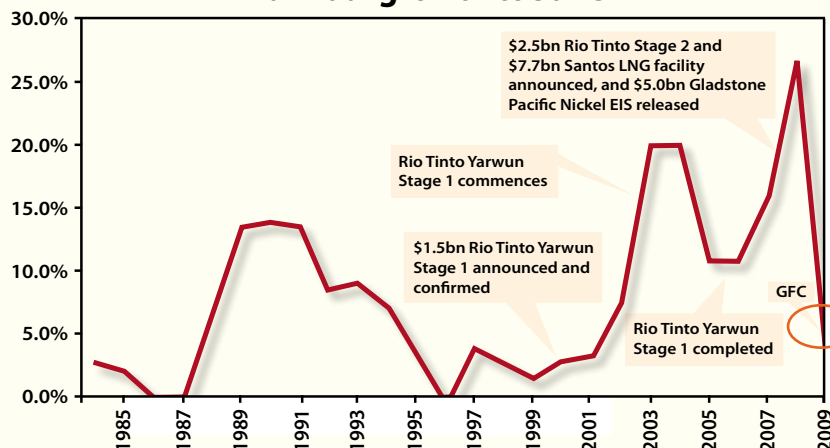
What is now so exciting is that, according to the national property research firm Residex, growth in median house values

Chart 2: Six stages of growth
Infrastructure towns — when to get in and when to get out



Source: Omega Investments

Chart 3: Gladstone median house values, annual growth to June



Source: Residex

ground to a very abrupt halt in 2009 as uncertainty reigned during the financial crisis. The median house price is now an affordable \$360,000.

Indeed, Rio Tinto deferred its huge \$2.5bn Yarwun Alumina Refinery expansion project that was to employ over 2,200 workers, and then sacked 700 of its workers from the existing Yarwun refinery.

This has created a window of opportunity for investors to buy now, while sentiment is weak. Planned and committed infrastructure projects have soared from approximately \$28bn to \$65n over the last year (see Chart 1 on page 27).

LNG boom town: Projects currently underway

The charge in new infrastructure projects has been led by massive liquid to natural gas (LNG) projects that have recently appeared. Their proponents have raised billions of dollars in capital and sold billions more in 'off-take' contracts to key LNG buyers. These multi-billion dollar projects, know as Australian Pacific LNG (APLNG), Curtis LNG (CLNG) and Gladstone LNG (GLNG) cumulatively amount to an amazing \$50bn in proposed capital expenditure – and there will be 10,600 workers during peak construction!

1. APLNG

By far Gladstone's largest infrastructure project, the proposed APLNG is a

monster \$35bn LNG plant and is Australia's second largest infrastructure project. APLNG will tap into huge coal steam gas (CSG) reserves in the Surat Basin (some 450km away) to extract LNG, which will be piped to an LNG facility in Gladstone. The LNG will then be shrunk to approximately 1/600th of its size in huge cooling and condensing facilities called 'LNG trains'.



Source: Bechtel Corporation

Three to five LNG trains are planned for APLNG, from which the LNG will be loaded onto more than 60 super tankers a year bound for Japan, China and South Korea.

The construction of the five LNG trains is expected to take over four years, with the peak workforce forecast to reach 4,000 workers.

Significantly, the LNG facility will employ 1,000 workers once operational – the equivalent of about a 10% increase in Gladstone's population (assuming each worker belongs to an average family of three people).

This project alone will transform Gladstone into an economic

powerhouse, with future LNG sales likely to rival the \$50bn Gorgon LNG project (Australia's largest infrastructure project – see page 22 for more) situated on the remote Barrow Island in WA.

Following the September 2009 ConocoPhillips (a major US energy company) \$9.6bn 50% investment into the APLNG project, Origin (the proponent of APLNG and one of Australia's largest energy companies) now has a) the cash and b) the expertise (through ConocoPhillips) to construct the LNG facility.

With the project's financial side now essentially locked in, attention is focused on the outcome of the EIS submitted in late 2009. Both state and federal environmental approvals are expected in early 2010, clearing the way for FID by the end of 2010.

Consequently, the project is in the final phase of the 'feasibility' stage of the infrastructure spotting cycle.

2. CLNG

At \$8bn, CLNG is Gladstone's second-largest infrastructure project, and boasts a peak workforce of 3,600.

Similar to APLNG, CLNG intends to pipe gas from the Surat Basin to Gladstone, where it will be processed by three LNG trains.

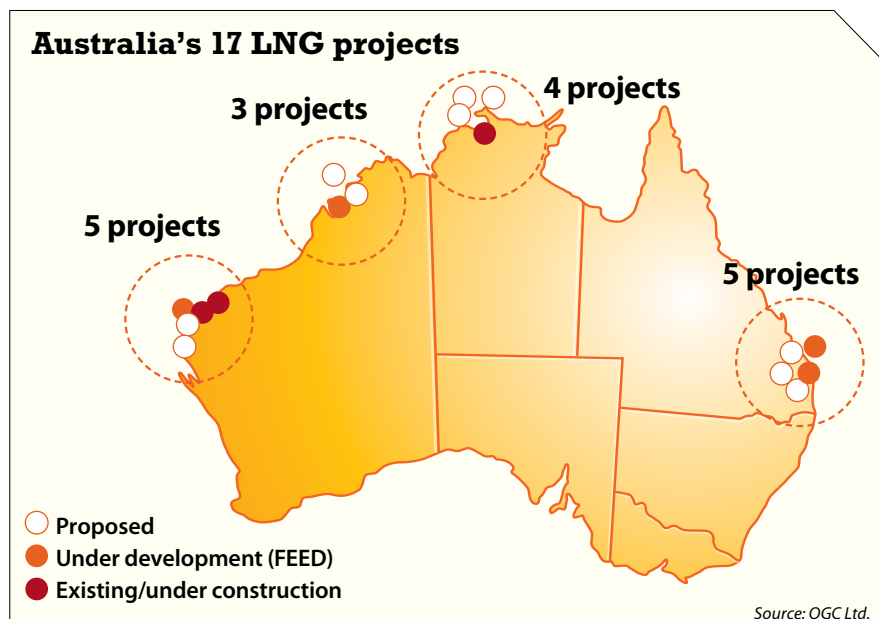
The proponent of CLNG, UK-based BC Group is one of the world's largest LNG producers and invested \$5.6bn in October 2008 to acquire the then project proponent Queensland Gas Company.

BC Group has also signed a 100% 'off-take' agreement (ie, to purchase LNG when produced in the future), which has substantially increased the probability of the project proceeding.

BC Group submitted its EIS in July 2009, and once the EIS is granted, the company expects to make the FID for the project in mid 2010. Construction is expected to start by the end of 2010.

3. GLNG

The Australian-based energy company, Santos, has led the development of GLNG, Gladstone's most progressed LNG project. With a proposed capital expenditure of \$7.7bn and peak workforce of 3,000 (see Chart 4 on page 32), GLNG will see three LNG trains built over a three-and-a-half-year period. Subsequent trains may also require a similar construction period and employ





of 2,500) means that it is highly probable that the various proponents will seek to amalgamate the projects.

This would be a logical outcome, given concurrent construction of any of the three key LNG projects would struggle to attract sufficient workers. This would lead to cost escalations as they compete with each other for workers. Huge costs savings would also exist in reducing duplications in the LNG facilities, and the hundreds of kilometres of gas pipelines necessary to transfer gas from the Surat Basin.

Amalgamation will be a good outcome, as it would make the FID easier. The financial returns of one or two 'super' LNG plants would be better than the current standalone projects. Hopefully, this would also reduce the time to FID and commencement of construction – and a boom in house prices!

Other Gladstone projects

While the LNG projects are currently in the limelight, Gladstone has numerous other projects in the wings. These include the \$5.0bn Gladstone Nickel project, the \$3.8bn multi-stage expansion of Wiggins Coal Terminal and the \$2.6bn Yarwun Alumina Refinery expansion (see Table 1 on page 28).

All these projects will have to compete for workers (pushing salaries sky high) and for space to house them (pushing rents upwards). About 1,000–2,000 workers camps have been proposed, but thousands of workers will need to live in Gladstone. This means that another property boom is on the horizon.

Investment options

With depressed prices, investors are spoilt for choice in Gladstone. Broadly, there are three options: new apartments; new house and land packages; and established properties. Each have their benefits and potential drawbacks, which are discussed below.

1. New apartments

New units are generally more appealing to the typical mining town construction worker, who is most likely in their early 20s (with or without a partner) and earning \$100,000 a year. They want to live in new, low-maintenance apartments that are within walking distance of the town centre.

Thousands of workers will need to live in Gladstone. This means that another property boom is on the horizon

peak workforces of approximately 1,800.

The project's EIS was submitted in March 2009 and is expected to be approved by early 2010, with FID to be made in mid 2010.

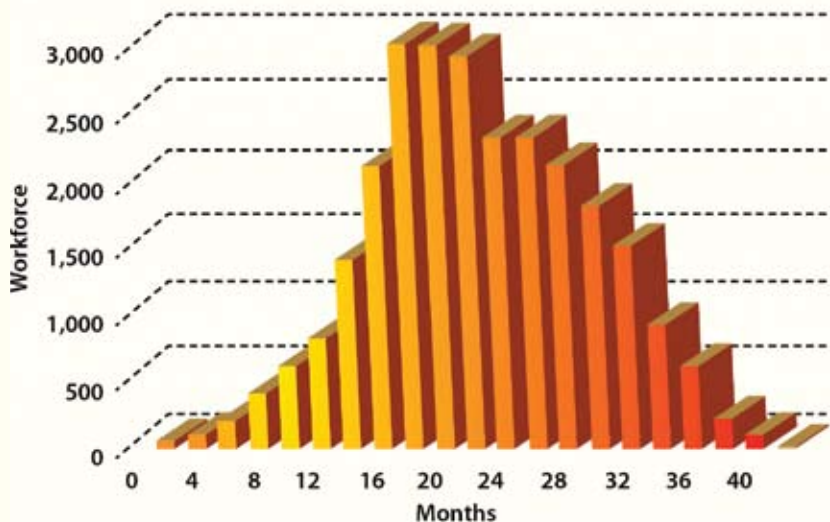
GLNG is the most likely LNG project to proceed, following the May 2008 investment of US\$2.5bn in the project by Malaysia's national oil company and the world's third-largest LNG producer, Petronas. Origin is now debt-free (ie, not under any pressure from the financial

crisis) and sold an off-take contract to Petronas in June 2009 for 100% of the first train's LNG capacity for 20 years. This removed substantial financial risks from the project.

Amalgamation of LNG projects

The mammoth size of the three key LNG projects in Gladstone and the fact there are another two LNG projects also on the cards (including Shell's uncosted project that will employ a peak workforce

Chart 4: Required construction workforce, Gladstone LNG project



Source: Santos

There are plenty of unit offerings in Gladstone, including the G80 apartment complex which is a 10 minute walk from Gladstone's CBD and close to the town's marina.

Expected to be completed in late 2010, G80 will hopefully come onto the rental market just as projects begin to commence and hundreds – then thousands – of workers stream into town. Investors will also have the option of putting apartments into a 'letting pool', which will be managed by the onsite manager.

Priced between \$289,000 and \$400,000 (average of \$350,000), the two-bedroom apartments are expected (in today's market) to rent at approximately \$380 a week (ie, just over a rental yield of about 5%).

A quick scan of rental properties in other super infrastructure towns such as South Hedland and Karatha shows that similar apartments (if anything is vacant) rent out for \$1,200 per week and are selling for \$600,000 or more!

Benefits

Firstly, new apartments will have high depreciation benefits, which will provide investors with attractive tax benefits in the first year or two until rents are super charged by workers coming into town as projects begin to be constructed. First year depreciation benefits for G80 are about \$11,000.

Secondly, newer apartments generally have lower vacancy rates than older apartments, because they provide tenants will more than just a place to stay. Tenants (particularly those with higher incomes) want the latest European appliances, a pool, community areas such as BBQ facilities, and security-controlled entrances.

Finally, there is less maintenance and repairs required for new apartments. This makes them a convenience and cost-effective investment.

Considerations

Like any investment, investors need to be mindful of several things when buying a new apartment.

Firstly, any 'strata titled' property will have body corporate fees that can potentially be quite substantial and reduce returns. Body corporate fees for G80 are \$2,400 a year (or approximately \$46 a week).

Secondly, some developers look to 'pack in' as many apartments as physically possible into an apartment development to maximise returns. Often, your tenants will be expected to live in studios or one bedroom apartments that are 40m² in size (slightly bigger than your regular double car garage).

This means that the apartments are often destined to only ever be rented rather than bought (at higher prices) by owner occupiers.

Finally, the quality of the builder/developer is very important. With an existing property, investors can arrange an inspection from building inspectors such as Archicentre, who will ensure buyers are fully informed of any potential problems. With new buildings, this is a little more problematic – particularly when buying off the plan. New property is covered by the builder's warranty but actually enforcing this (especially for 'minor' but ugly/annoying defects) can be quite time-consuming and frustrating.

2. New house and land packages

There exists substantial demand for house and land packages (H&L packages) within Gladstone. Indeed, over 40% of existing dwellings are detached houses and 50% of households have at least one child.

That all means that during the next infrastructure boom (remember, Gladstone has had booms before), thousands of workers are going to be looking for a house to rent or buy.

Well paid employees, like their younger co-workers who prefer apartments, are going to be looking for new houses that have all the 'mod cons'. A big block of land, room for the kids and a large driveway for the boat (Gladstone has one of the highest boat ownership rates in Australia) will be in high demand.

New H&L packages range from \$350,000 for a three-bedroom home to over \$500,000 for a four-bedroom home with separate lounge and family areas.

An example of a new H&L package is The Curtis, built by building group Racey Constructions. Priced from \$466,000, this 214m² (plus 27m² of patio and porch) three-bedroom house features two-bathrooms, separate



Source: www.g80.com.au

family and meal areas, lounge, double lockup garage, and undercover outdoor living area.

Benefits

The benefits of buying a H&L package include those found with new apartments (ie, depreciation, lower vacancy rates, less maintenance) plus five other additional benefits that I will discuss below.

Firstly, houses offer flexibility in fixtures, finishes and designs. An new apartment is effectively a 'take it or leave it' proposition for buyers with limited options to customise, but a buyer of an H&L package has extensive options.

For instance, buyers have a choice of fixtures and finishing that cover everything from wall colours, flooring (eg, tile, wood, carpet), Enviro Glass (scientifically proven to lengthen the life of soft furnishing such as curtains and carpets), insulation, specially-treated housing frames to protect against termites, and so on.

Secondly, buying brand new means you are covered by an extensive range of warranties. The house will come with a six-and-a-half-year structural warranty. With some builders (like Racey Constructions) there is the potential for a one-year cosmetic warranty for internal finishes (eg, paint, flooring etc). All the

appliances are also covered with brand-new factory warranties.

Your investment will also comply with the latest building and safety regulations. For instance, older homes may have asbestos fibres (expensive to remove), poorer construction methods or generally inferior building material now surpassed with new materials.

Thirdly, you are actually buying 'land' (rather than the 'air space' that comes with strata-titled apartments) and land appreciates while buildings depreciate. Consequently, over time an investor might enjoy higher capital gains from houses rather than apartments.

Growth in unit values has broadly tracked houses, albeit with a tendency to overshoot on the up and down side (See Chart 5 on page 35).

Fourthly, houses are not affected to the same extent as apartments should a 'distressed seller' (or sellers) dump their property at a firesale price. In a large block of apartments, valuers will base all valuations (for refinances or purchases) on 'comparable sales'. One or two distress sales can taint an entire complex.

Conversely, each house in an estate has many points of difference (eg, house size, façade, floor plan, land size etc) and for an individual investor to be affected by distress sales, sellers will have to have had nearly identical properties.



Finally, investors get 'more for their buck' by buying a house rather than an apartment. For example, an investor might pay \$400,000 for a 100m² apartment, or \$4,000/m². In comparison, buying a \$400,000 house that is 200m² equates to \$2,000/m² plus land!

Considerations

Investors need to be aware of three considerations in buying a H&L package.

A new H&L package will be more expensive than a new apartment or an existing property. This means a larger deposit and higher loan repayments.

Investors will receive lower rental yields compared to a new apartment. This is because of the lower entry price and the fact that tenants are willing to pay relatively more rent (per square metre) for the convenience of an apartment.

When buying a H&L package it is imperative that you look at some of the houses that the builder has already constructed. Just like buying an established property, once you are happy with the design and serious about purchasing, organise a building inspection of a previous property they have built. Also, you should ask for references from happy homeowners.

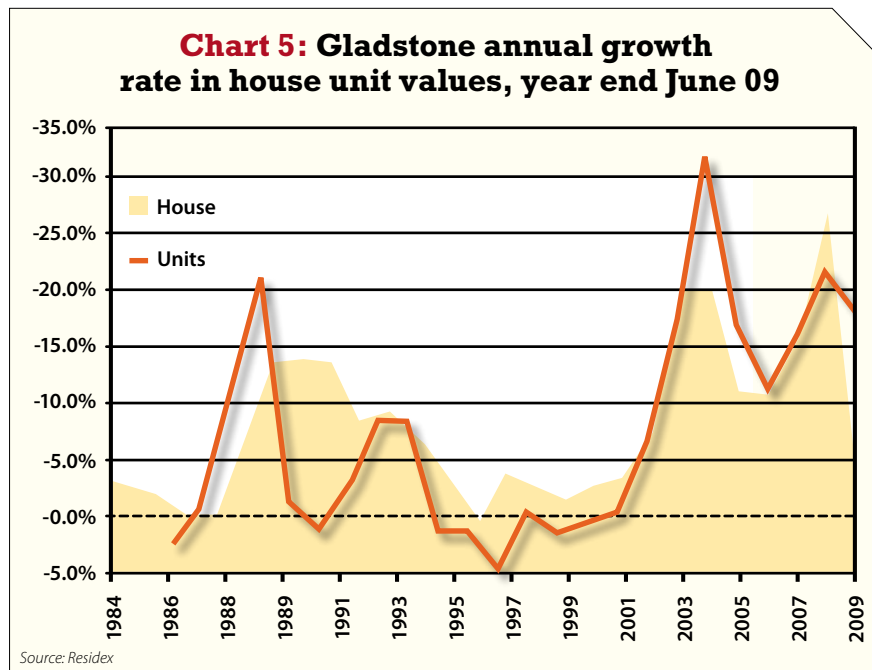
3. Established properties

'Bright and shiny' appeals to some investors, but others can not go past buying an existing property.

Benefits

Investors benefit three ways when buying existing property.

Existing property is cheaper than new, all things being equal. Granted, existing



waterfront properties will probably trump a property that is 4km down the road in the new estate. But when you compare apples with apples, existing properties are cheaper.

This means a smaller deposit, lower repayments and potentially higher rental yields (as new properties often don't command the rents to compensate for the higher purchase price).

You also know exactly what you are buying (provided you obtain a property report and pest inspection). There won't be any problems nine months down the track when the property has been constructed.

Finally, existing properties are generally in 'proven' areas that have shown consistent capital growth and are likely to do so in the future. Newer

properties in newly developed areas can consequently carry a degree of 'speculative' risk that investors need to assess and understand. 🏠

Flynn De Freitas is the principal of Omega Investments, a boutique firm specialising in residential property investment in regional mining towns. Utilising his training and



experience as a former management consultant and investment banker, he has developed an extensive knowledge and understanding of towns exposed to the commodities boom. For investment opportunities please visit www.omegainvestments.com.au.