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Architects struggle with the strong dollar

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Architect Dylan Brady says it didn't take long to realise that his firm Studio 505 wouldn't be able to play the hedge fund game like big mining companies could. It took architect Dylan Brady about a year to give up on the currency game and realise he was a lousy forex trader.

From mid-2010 to late 2011, the director of Melbourne-based Studio 505 had been struggling to resolve the problem of a strong Australian dollar that slashed the profit he made on overseas work.

"All of the contracts we cut overseas when the dollar was at US80¢ were completely ruined," he says.

Studio 505 was started in 2002 by Brady and Dirk Zimmermann and by the mid-2000s it was doing most of its work in China, Malaysia and Singapore. For most overseas contracts, the firm set fees in US dollars. That was fine while the Australian dollar was worth about US80¢.

In mid-2009, however, the firm signed a fee agreement with the government of Wujin, a district in China's southern Jiangsu province, to design a cultural arts centre. At the time, the ¥500 million project would have paid the Melbourne-based architecture firm a fee of more than $1 million, Brady says. Within a year, however, the Aussie dollar had risen to US90¢, making the fee much less.

"We started haemorrhaging on it," Brady recalls. "We thought it must go down."

They were wrong. Despite a dip in mid-2010 back to US80¢, the Aussie dollar continued its rise.

"If we are sticking to our fee based in Australian dollars and then converting, it makes us less competitive than competitors in other counties," Australian Institute of Architects chief executive David Parken says.

While larger firms such as Cox Architecture have more options to deal with a strong Australian currency, smaller firms – most Australian architectural employers – do not. Studio 505, with 25 professionals, is a mid-sized firm that operates out of one office in Melbourne. Brady laughs as he recalls his firm's first attempt to deal with the falling value of its foreign payments in early 2010.

"We went to our banking institution and set about to try and hedge," he says. "We opened trading accounts in Singaporean and US dollars, which effectively meant we didn't have to realise any forex loss at the time. We thought we were being very clever. It's not."

As his firm opened the accounts, Brady's bankers mentioned that they were one of only a few firms to go down that route and that the only other companies to do so were large mining houses. He soon learnt the reason why. "They paid no interest. It wasn't something we could leverage against," he says.

The Aussie dollar's continued rise soon made him rethink the decision. By the end of 2010 it was at parity with the greenback and has largely stayed that way ever since. By late 2011 he had closed the accounts.

"I put together a spreadsheet that worked out how low the Australian dollar would have to go for us to have back the opportunity cost of the interest lost," he says. "The dollar had to drop to US62¢. We said, 'Are we convinced the dollar is going to drop to 62?' We're in the business of architecture, not money management. We abandoned our foreign currency account and [took] our losses. And we basically now when money comes in from overseas, we convert it at whatever the day rate is."

In some cases, the dollar prevents firms from getting work in the first place. Melbourne-based Andrew Maynard Architects did a large residential project for an Indian developer in 2009 and the same developer recently approached the firm about a similar project.

Director Andrew Maynard says he was willing to do the job – the housing component of a 50-hectare township master plan in Bangalore – for the same fee as four years ago but the dollar's rise from its then price of US62¢ has the developer worried.

"From their perspective, it's not the same fee," Maynard says. "They're freaking out about it."
He thinks he won't get the job, as he has no room to cut his rate.

"We can't wear losses like the big boys. We just have to get to a certain point and press the eject button."
Faced with a strong dollar that makes wages for Australian architects – the biggest component of any professional services firm – expensive on an overseas job, one option is to open an office overseas and hire local staff. Studio 505 contemplated doing this but decided against it.

"To open a wholly foreign-owned enterprise ... means you needed to be billing around $8 to $10 million per annum and getting that money out of China is then a whole other problem," Brady says. "It's not easy."
But it's not just a matter of money. "The intelligence and value-add comes from being here and working here," he says.

Studio 505 has reduced its profit margin slightly but it cannot compete solely on price, Brady says. "We have to rely on our innovation and creativity to be the value-add," he says. "We can't as designers be in a race to the bottom because then we're buggered anyway."

There are advantages. The strong Aussie dollar does mean Brady can travel to China each month to see clients and look for new business.

"It has given us extraordinary buying power in terms of our capacity to maintain regular travel to the countries we are doing business in. We are a service industry."

Cox Architecture has 400 professional staff spread across five Australian offices and Abu Dhabi. Director Alastair Richardson says the dollar's rise from 74 US cents to $US1.04 over the past five years means the firms US and European rivals can offer services at 20 per cent below what they normally would.

Cox had offices in Singapore and Beijing but closed them before global financial crisis hit. Richardson says the high dollar is spurring discussion among his fellow directors about opening regional offices once more.

"It's one of the elements that is certainly a point of discussion," he says. "We're having fairly serious board discussions over the next six months as to what, how and where we go with those particular thoughts."

Overseas expansion isn't a silver bullet, however. It carries its own pitfalls. Richardson says 90 per cent of Cox's doubtful and late payments are on overseas work, dating back in part to 2007 when projects collapsed and Middle Eastern clients stopped paying their bills.

"If we combine that with the currency issue and the fluctuating currency, we might have agreed to a fee three years ago which effectively, because of the exchange rate, has a 20 per cent or 30 per cent depreciation - and we haven't (even) been paid," he says.

The best safeguard for an Australian firm working overseas is to offer specialised skills, be they in hospital, transport or - in Cox's case - sports infrastructure design, Richardson says. Without that distinction, setting up local offices can be a tough call.

"If you're a generalised architectural practice and you are working in some of these markets, as soon as you set up offices locally, you are viewed as local architects, which forces your fees down to local market rates," he says. "But they're still expecting to see your experience, your Australian staff there."

The issues are big for both larger and smaller firms. Following its failed hedging strategy, Studio 505 now bills Chinese clients in yuan. Payments come in through a foreign exchange company that has accounts in both countries and pays into the firm's Australian account. It's not perfect but at least it is a way to get paid.

"Money coming at me is money coming at me," Brady laughs.