A construction market in flux

Facing up to the challenges of the construction market

August 2023

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Cast

Contents

The current market context

In January 2023, I wrote my annual year opening market commentary entitled [*Opportunism to survivalism*]. Six months on, it seems that stark forecast of a serious shift in the construction sector's outlook has played out. We are seeing growing rates of supply chain failure, a perfect storm of fixed price liabilities crystallising against falling order books, preventing cash flow from bailing out loss making businesses. This trend has extended across specialists into major main contractor businesses. The recent failure of Henry Construction Projects Ltd typified the tightrope walked between what was perceived as a user friendly competitive contractor to an unsustainable business with contract compliance and balance sheet issues.

The reduction in order books is now working its way through the construction supply chain. Major projects such as HS2 have either been cut back by government spending or are mired in planning and approval delays.

The residential sector is holding up the construction sector overall performance. However, there is no counter-cyclical buffer supported by current government policy and expenditure programmes. This means construction output is already technically in recession.

The outlook for residential investment and development is more challenging than at any time since the Global Financial Crisis, with a broken housing market mechanism, high build cost inflation and a faltering sales market linked to mortgage rate hikes. These all risk even less supply coming forward for both sale and rent.

To predict the construction tender market now, contractors need to focus on supply chain market intelligence, general solvency and health, input cost shifts and over-arching sentiment linked to hunger for work and order book status. Contractors that adhere to the principles of being scrupulous and selective must either remain steady and resolute or relent and potentially reduce margins and resistance to risk.

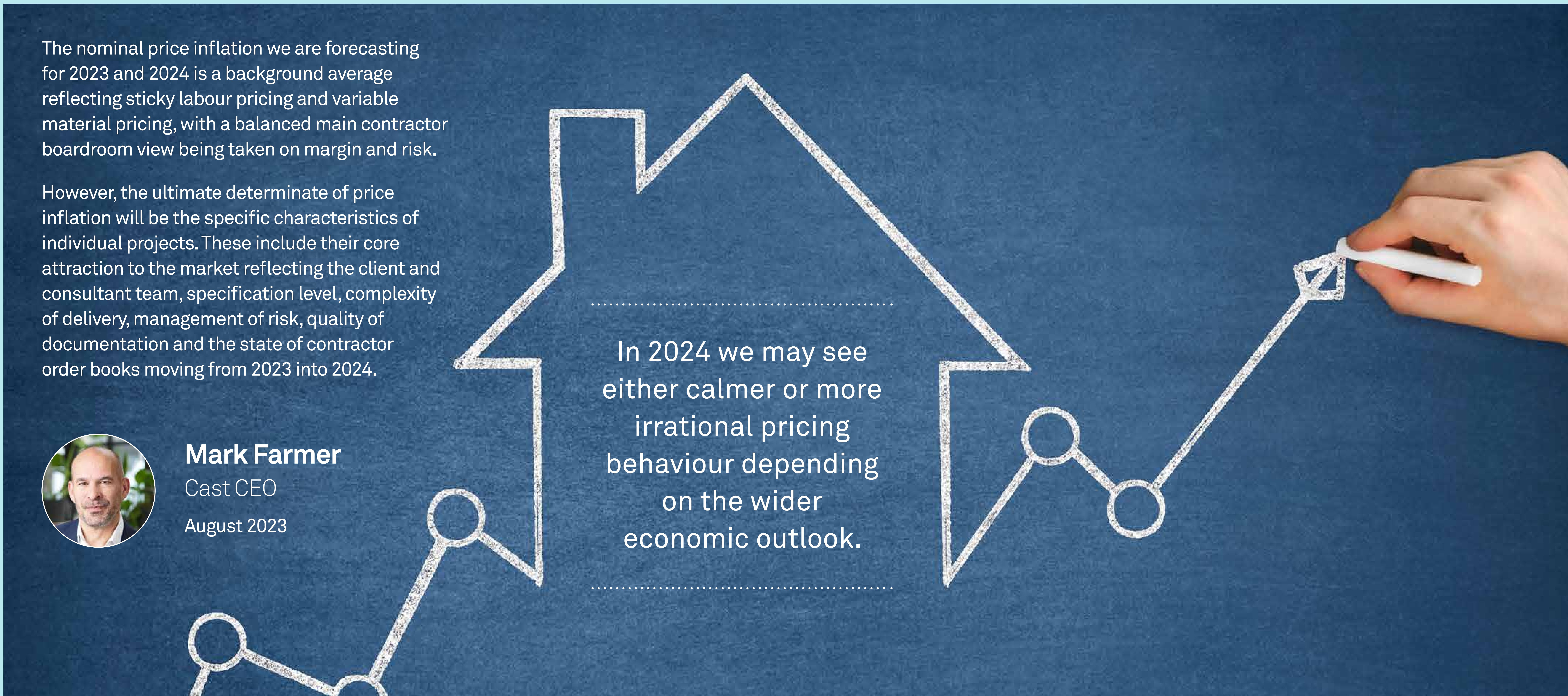
The contracting market at tier one and specialist contractor level is starting to diffuse into a spectrum of strategic and tactical responses. Clients and their teams will need to fully understand what the right price is to deliver the right outcomes.

The failures of Legal & General Modular Homes and ilke Homes highlight the need for robust business plans underpinned by resilient pipelines with capital investment which can withstand market cyclicality and planning related risk.

Main contractors and housebuilders are now actively seeking out solutions to the structural labour scarcity crisis.

The shape of input cost movement is conflicting at the moment, with labour prices remaining high in areas where there are still legacy projects on site, and material prices normalising after huge uplifts.

Re-forecasting with a razor sharp focus to create a robust business plan



The nominal price inflation we are forecasting for 2023 and 2024 is a background average reflecting sticky labour pricing and variable material pricing, with a balanced main contractor boardroom view being taken on margin and risk.

However, the ultimate determinate of price inflation will be the specific characteristics of individual projects. These include their core attraction to the market reflecting the client and consultant team, specification level, complexity of delivery, management of risk, quality of documentation and the state of contractor order books moving from 2023 into 2024.

In 2024 we may see either calmer or more irrational pricing behaviour depending on the wider economic outlook.

Mark Farmer
Cast CEO
August 2023

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Headlines

The country narrowly avoided going into recession in the first part of 2023. Inflation remains at a 30 year high and inflation rates are still rising. Construction output volumes contracted, driven by softer demand for housing which has been impacted by increased costs.

Rates are higher than we have recently been used to

Consumer Price Inflation index (CPI) is currently 7.9% which has come down from 10.1% in March. The Bank of England target is 2%. The Government is supporting the Bank of England's strategy of increasing interest rates to stem inflationary pressures.

This will present challenges for investment and purchase decisions as well as increase the risk of insolvencies. The current base rate has recently been increased to 5% which is concerning news for people seeking mortgages and existing mortgage owners. This will be reviewed again in September 2023.

Consumer Price Inflation Index (CPI)

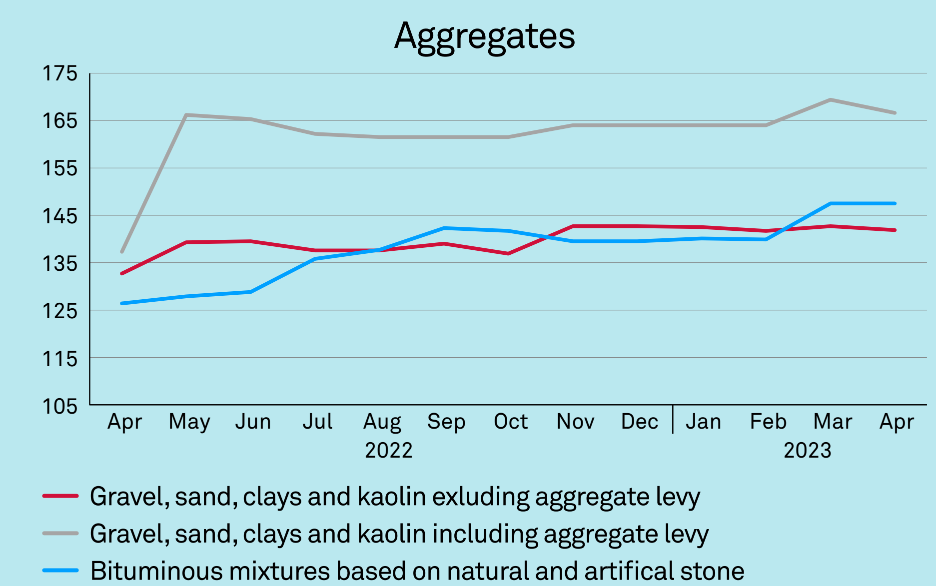
March 2023	June 2023	Bank of England target
10.1%	7.9%	2.0%

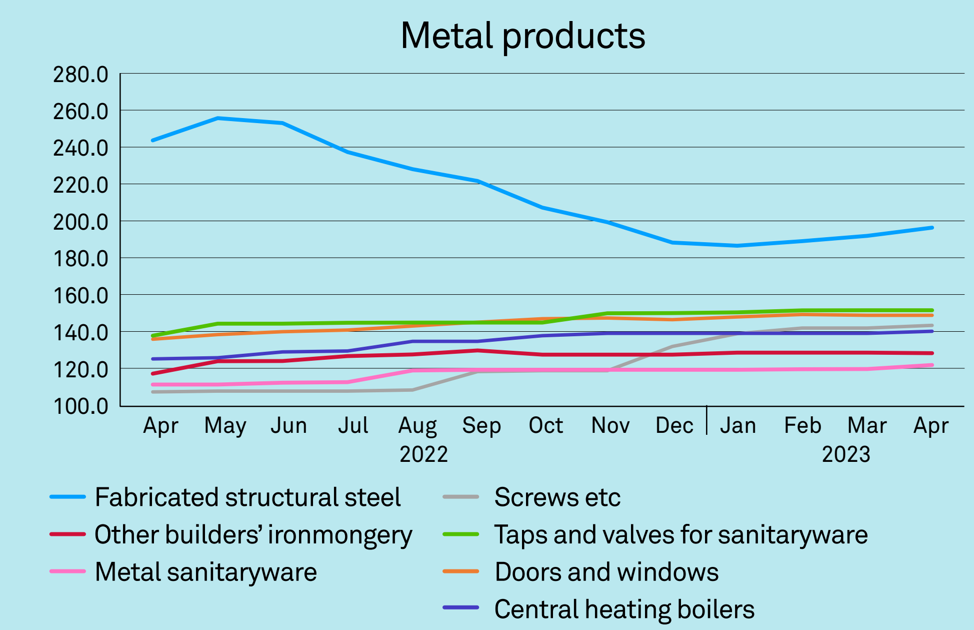
Interest base rate

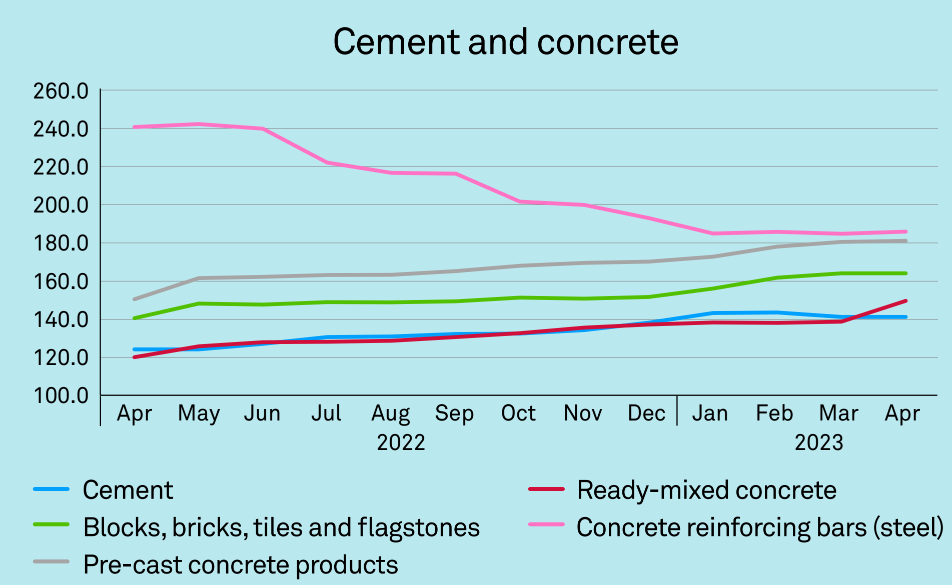
June 2022	December 2022	August 2023
1.25%	3.5%	5.25%

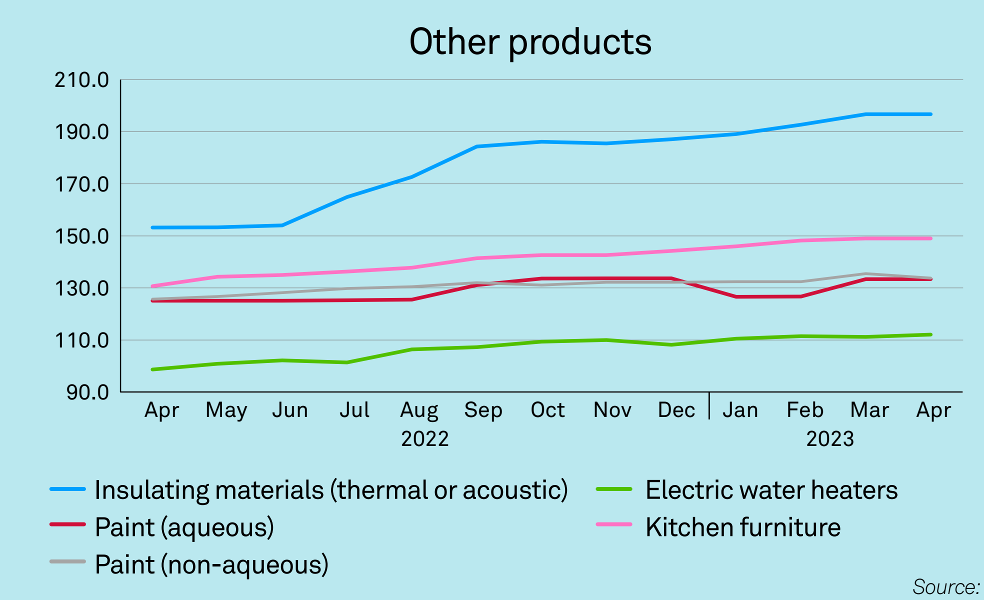
Movement in materials costs

The sharp rise in materials seen in 2022 has tapered off. However, there are still pockets of materials such as insulation, concrete and aggregates that are experiencing slightly higher than normal increases. Some of the material supply issues that were apparent in 2022 have been resolved. This is especially the case for bricks stock which are now more readily available due to stockpiling, thus reducing delivery times and any incurred extra costs.









Source: ONS

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Headlines

The construction and property market has been significantly impacted by the rise in inflation and interest rates including labour shortage, insolvency, energy prices and investment.

Regulatory changes

In a previous edition we highlighted that regulatory changes are adding to the inflation burden (i.e Future Homes Standard and Parts F, L,O and S in residential, fire safety, secondary staircases, and EVAC lifts). A recent study undertaken by Cast suggested that this could add 5-7% on to project cost. The Building Safety Act (BSA) will also present challenges in terms of project delivery and completion. Contractors will be looking at ways to mitigate the risks that may arise from delayed gateway sign offs.

Labour

A labour and skills shortage is still a major concern which is impacting business's ability to tender and complete projects. The UK workforce has reduced by 11% since 2019, continuing a long running trend. The industry is struggling to attract and retain skilled workers which has been a factor in project delays and wages increases. There are over 40,000 vacancies.

Cost of renting

According to a recent report by Zoopla, the cost of renting is at its highest for a decade and rental inflation has run at double digits for the last fifteen months. There is a shortage of rental property which is driving this increase. Weakness in the sales market due to interest and mortgages rate rises means that this is likely to continue into the last quarter of 2023. There are also signs of stress from renters with lower incomes due to the increase of the cost of living.

Insolvency

The price increases that were seen in 2022 have continued at the start of 2023 to some degree. The supply chain has suffered due to entering into fixed price contracts and/or are being squeezed to maintain project viability. Insolvencies are increasing and now more than any time we need to be aware of any tell-tale signs of duress. During May 2023 we have seen some well established companies become insolvent.

Energy prices

Energy prices have stabilised. Brent crude oil prices reduced at the end of 2022 and have remained steady in the first quarter of 2023. In contrast, OPEC recently announced a cut in oil production by nearly 1.2m barrels a day, which pushed oil prices up by 5.31%. This in turn does not assist the Government in its quest to swiftly reach its inflation target. However, with energy prices stabilising, from 1st July 2023, Ofgem will cut the price cap to £2,074 (from £3,280) for a dual fuel household. As a result of the Government's energy price guarantee which was set at £2,500, households will only see a reduction of 17%.

Ukraine/Russia conflict

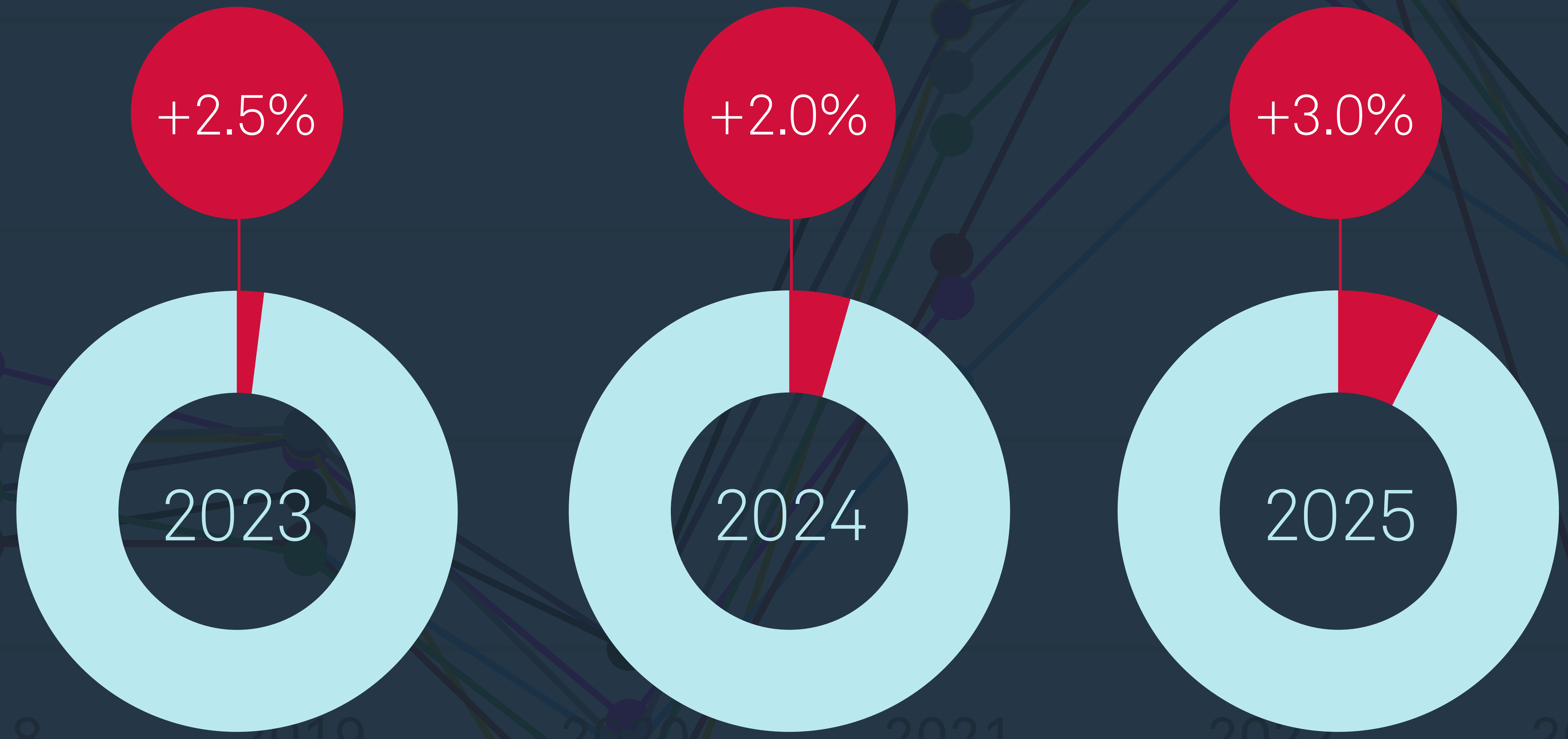
The continuing conflict in Ukraine and Russia leaves the construction industry and the wider global market susceptible to unpredictable volatility.

Investment

Tighter financing conditions are impacting the market. The end of a decade of 'cheap money' has hindered investment decisions, which will have direct impacts on project viability, demand, and ultimately, workload. We are seeing some projects being delayed, especially those that were marginal. When inflation influences are factored into appraisals, it pushes projects into instability. This will result in more distressed assets and potential opportunities for others.

Forecasted movement in Tender Price Indices (TPIs)

The prospect of recession is still evident. Pressures on labour costs and certain materials, combined with regulatory changes will influence an inflationary increase, however this will be dampened by reduced opportunities to market. For the 2023 residential sector we are of the opinion that we will see a 2.5% raise in tender prices, with a further 2% in 2024, and 3% in 2025.

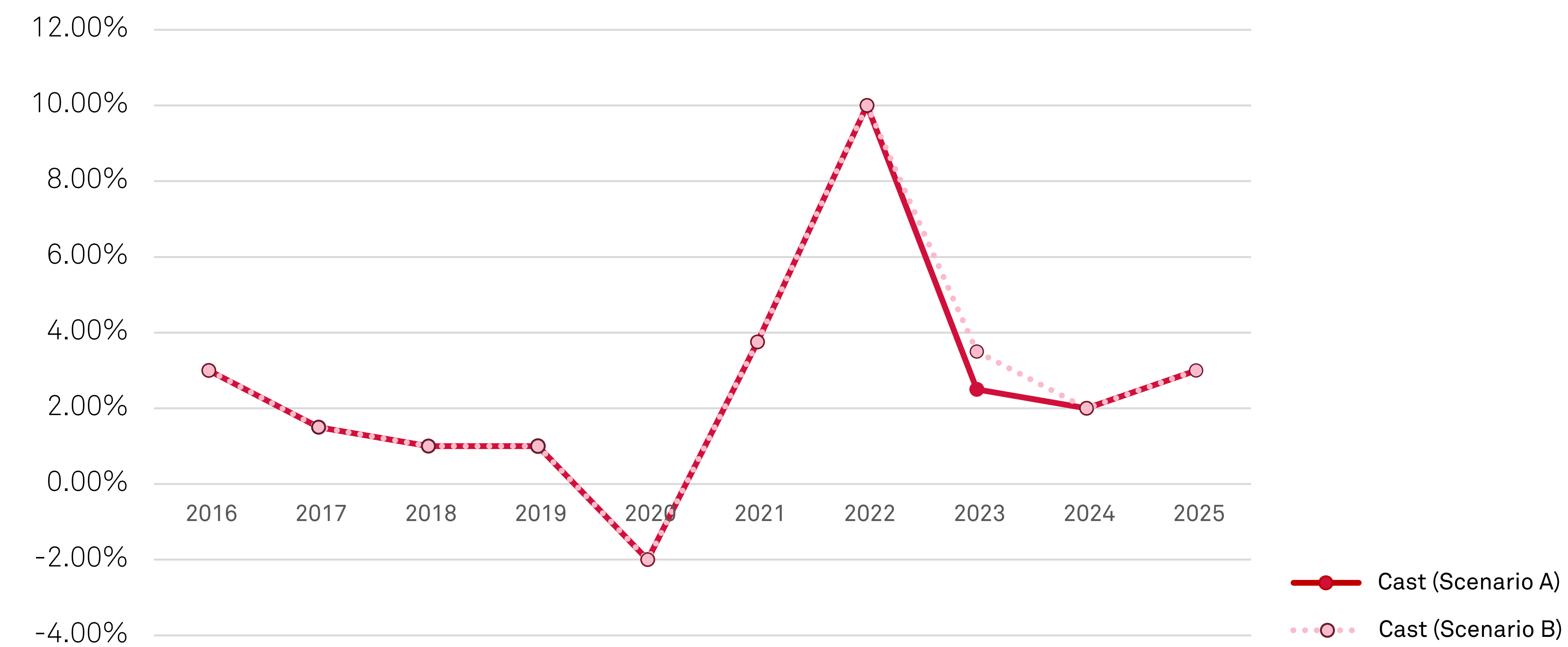


Cast and peers' view on TPIs

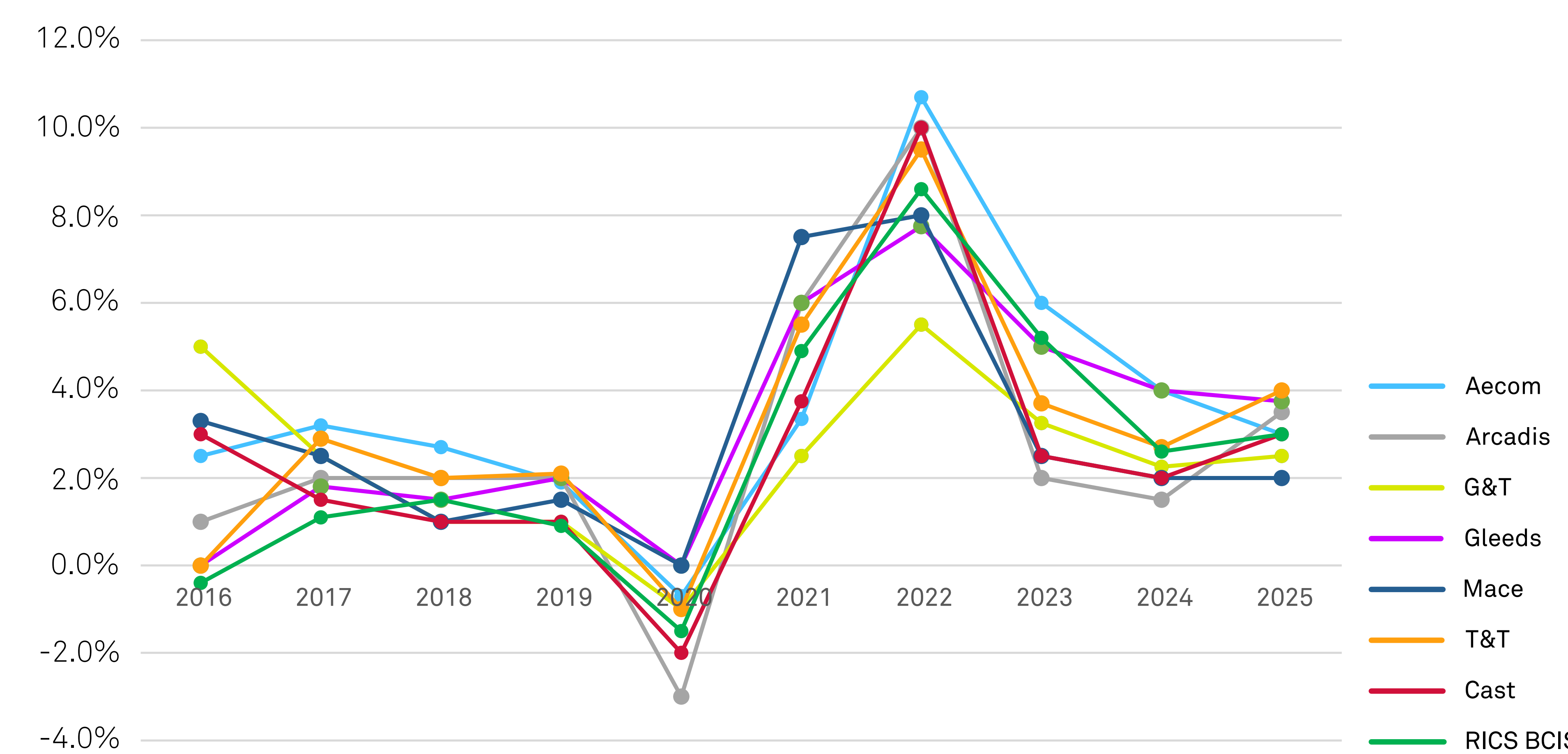
Tender Price Indices – Status Report (Q3 2023)

Year	Industry forecasts						Industry average (exc BCIS)	Cast	RICS BCIS
	Aecom	Arcadis	G&T	Gleeds	Mace	T&T			
2016	2.5%	1.0%	5.0%	0.0%	3.3%	0.0%	2.0%	3.0%	-0.4%
2017	3.2%	2.0%	2.5%	1.8%	2.5%	2.9%	2.5%	1.5%	1.1%
2018	2.7%	2.0%	1.0%	1.5%	1.0%	2.0%	1.7%	1.0%	1.5%
2019	1.9%	2.0%	1.0%	2.0%	1.5%	2.1%	1.8%	1.0%	0.9%
2020	-0.7%	-3.0%	-1.0%	*0.0%*	0.0%	-1.0%	-1.0%	-2.0%	-1.5%
2021	3.4%	6.0%	2.5%	6.0%	7.5%	5.5%	5.1%	3.8%	4.9%
2022	10.7%	10.0%	5.5%	7.8%	8.0%	9.5%	8.6%	10.0%	8.6%
2023	*6.0%*	*2.0%*	*3.3%*	*5.0%*	*2.5%*	*3.7%*	*3.7%*	*2.5%*	*5.2%*
2024	*4.0%*	*1-2%*	*2.3%*	*4.0%*	*2.0%*	*2.7%*	*2.8%*	*2.0%*	*2.6%*
2025	*3.0%*	*3-4%*	*2.5%*	*3.8%*	*2.0%*	*4.0%*	*3.2%*	*3.0%*	*3.0%*
2026		*4.0%*	*2.5%*		*3.0%*	*4.5%*	*3.5%*	*3.0%*	*3.0%*
2027		*4.0%*				*4.5%*			*3.3%*

Cast's view informed by taking the central trajectory of two possible TPI scenarios



Overview of all TPIs



Sources

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Arcadis .... Summer 2023 – Into the slow lane
Gardiner & Theobald .... Tender Price Indicator (Q3 2023) – (London TPI)
Gleeds .... UK Construction Market Report 2Q 2023
MACE.. UK Market View Q4 2022
Turner & Townsend .... UK Market Intelligence – Stagnation to strength 8th June 2023
RICS... BCIS All-in TPIs updated June 2023 (annual)

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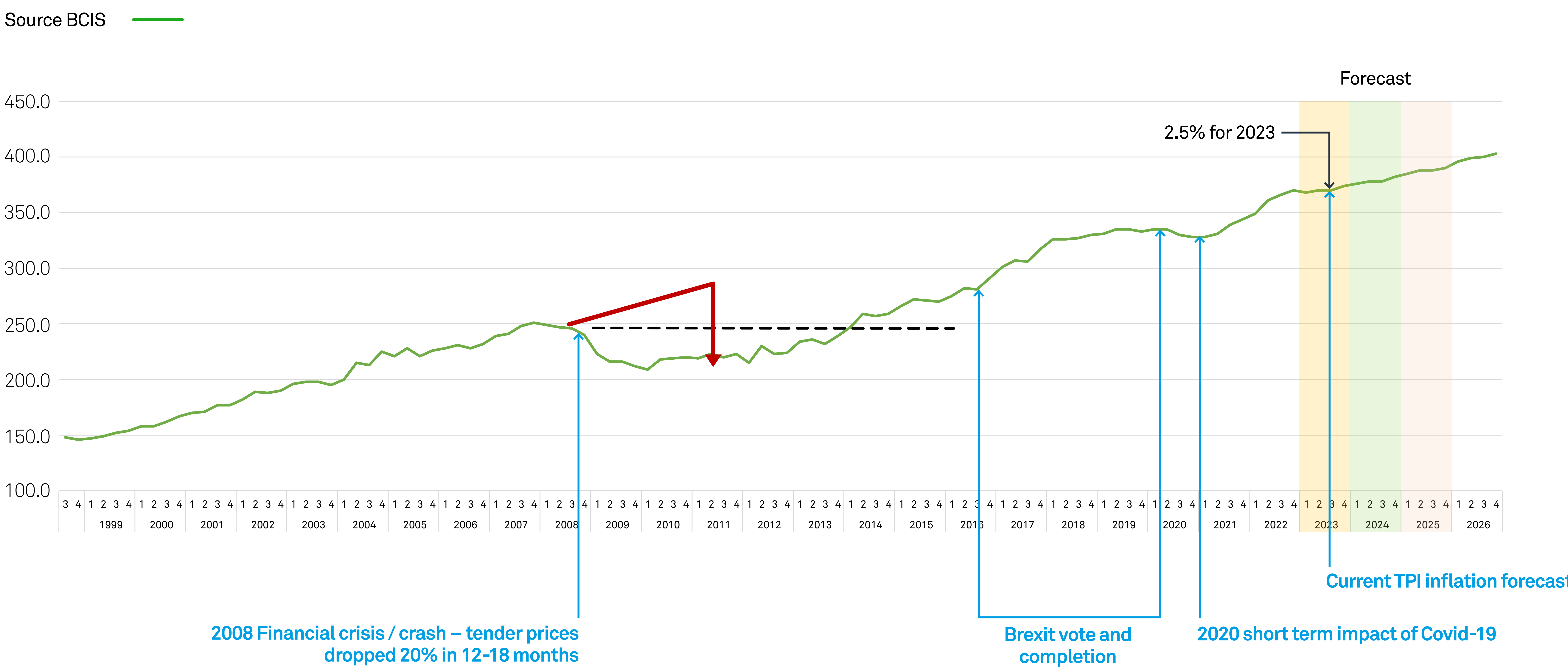
Tender price indices August 2023

Index Base 1985 = 100



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Overcoming the challenges

The construction industry faces a range of challenges including a shortage of skilled labour, rising costs, and increasingly stringent regulations. So how can these challenges be overcome?

1 Encourage innovation

The industry has been slow to adopt new technologies and processes, but there are now many innovative solutions available that can help us to increase efficiency and reduce costs. Increasing a project's PMV (Pre-manufactured Value) can enhance project predictability, lead to higher standards in health, safety and quality with significantly less environmental impact. The emerging use of AI has been recognised by many to improve efficiency and productivity. Encouraging the adoption of these technologies can help to overcome many of the challenges facing the industry.

2 To invest in training and development

As previously stated, there is a shortage of skilled labour throughout the industry. Investing in training and development programmes can help to address this by providing workers with the skills they need to work effectively in the industry. Adopting Modern Methods of Construction (MMC) and new technology can alleviate some of the labour pressures.

3 Adopt sustainable practises

The construction industry is a major contributor to carbon emissions, so adopting sustainable practises is essential. This can include using renewable energy sources, reducing waste and designing buildings that are more efficient.

4 Collaboration with other stakeholders

Collaboration between different stakeholders in the industry, including architects, engineers, contractors and suppliers can help to overcome many of the challenges facing the industry. By working together, stakeholders can share knowledge, expertise, and resource in order to find more effective solutions to common problems.

5 Address regulatory changes

The construction industry has been subject to a range of regulations. Complying with these is time consuming and expensive. The full impacts of the BSA are still not known. Addressing many regulatory challenges from the outset can help to streamline processes and remove wastage costs.

6 Develop flexible and collaborative procurement strategies

Collaborative procurement strategies that are flexible and specific to a project's needs are a distinct advantage, addressing areas such as risk and waste among others. Early engagement with the supply chain can help to de-risk design and reduce waste.

Overall, the key to overcoming the challenges facing the construction industry in the UK is to adopt a collaborative, innovative and sustainable approach that emphasises training and development, investment in new technologies and processes and a commitment to meeting regulatory requirements.

Contact us

Cast is a specialist construction consultancy providing solutions for developers, investors, policymakers and the supply chain. We are focused on helping deliver great homes and places viably whilst also addressing bigger economic, societal and environmental challenges.

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