Testing construction industry resilience

The implications of economic and geopolitical volatility

February 2024

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Executive summary

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February 2024

2023 saw the UK construction industry face significant headwinds. In the light of the disastrous 2022 mini budget, the true time lag from the impact of interest rate rises, declining consumer and investment market, and ongoing political uncertainty meant that the construction sector only really saw the full impact of these events later in 2023.

As we head into 2024, unfortunately the outlook remains difficult for construction. Although it is only in recent days that the UK economy has formally been classified as being in recession, the reality is that the construction sector overall has been in output decline throughout 2023 with a 12% fall in all new work. Declines in new housing has been a major contributor to this and this sector has seen output fall over 20% since October 2022. This fragile market looks set to continue into 2024.

The economic forces have conspired with continued dysfunctionality in the UK planning system, leading to ongoing risk and barriers, to bringing development forward irrespective of whether it is viable to proceed with. It increasingly looks like planning and housing delivery will be a manifesto battleground in the upcoming election and the industry must hope that this leads to a more positive outcome for development and construction.

The manifestation of all of this turmoil has been another cyclical ‘hollowing’ out of the industry. Supply chain insolvencies have rocketed, cashflow pressures have intensified and the usual routine of boom/bust business interruption has returned to the industry after over a decade of relative stability.

The massive material and energy cost volatility seen over the last 2-3 years has subsided but there remain pressure points driven by geopolitics, now extending to the Middle Eastern region and China, in addition to Ukraine.

There are also ongoing issues with core supply and demand economics, especially a lack of construction skills, or more particularly competence, as we enter a new period of regulatory compliance and higher technical standards. Although there has been some political wavering on climate change commitments, it is unlikely we will see any major reversal from the carbon reduction trajectory. The industry needs to continue to prepare to deliver better and differently if it is to be fundable and investible in the future.

In terms of construction pricing dynamics, input wage inflation is persistent and although this is under downward pressure as workloads and even trade and management employment levels drop, in reality this is likely to become a much bigger future problem when the industry returns to growth.

Contractor boardroom pricing sentiment is highly fluid at the moment. Many are seeing the fate of others who are failing all around them. Companies want to price for increased margin and greater de-risking, but in a market which still demands risk transfer and best price, the harsh reality is that this is more easily said than done. Downward tender adjudications are increasing in order to secure order books. Where this is cancelling out previous opportunism and price gouging in the supply chain then this is a welcome return to normality. It may be the case that buying work is used just to secure turnover and also with an attempt to cascade price reductions downwards to those that can least afford them. This is a recipe for future pain as we have seen so many times before.

It is disappointing to see a return to unintelligent blanket supply chain cost reduction strategies, from some major names in the housebuilding and contracting sectors, without accompaniment by specific waste reduction or productivity improvement strategies to enable cost savings. Simply demanding bottom line cost reductions without attacking the huge sources of waste in the industry continues to be a lost opportunity which requires a much greater strategic focus on productivity led innovation spanning client brief formulation, design, procurement, and physical delivery.

The above backdrop has therefore created further risks to future industry capacity and capability. The key issue now for the development and investment market is how to enable capital investment to be made whilst bucking the trend of increased risks from this declining construction sector resiliency.

Some may decide to sit and wait for the result of the general election later in 2024. However, the reality is that most real estate businesses need to continue to plan, invest, and deliver routes to revenue despite these challenges.

Development and investment viability has, over the last 2-3 years, mostly been impacted by construction cost inflation. However, it is now increasingly suffering from the cumulative impact of regulatory shifts, interest rate movements, changing end user trends and downward market valuation, and income pressures.

2024 will be a time for reflecting on new real estate market trends. This will mean investment in new development and repurposing existing assets has to increasingly reflect what is likely to be a changing market. Asset product definition is shifting in the residential and wider commercial sectors. The processes necessary to optimise the planning, design, and delivery of those assets is shifting and the measures necessary to manage an increasingly fragile construction supply chain require much more thought.

As always, with challenge comes opportunity and that is the approach we are taking at Cast in ensuring our clients have the insights to make informed decisions and out perform the market.

Macro-economic overview

In the residential sector, economic uncertainty and rising mortgage costs have stalled housing market activity, leading to a 50% reduction in starts in the 12 months following the September 2022 mini budget. Developers are focusing on existing sites instead of opening new ones. However, there remains a fundamental need for private rental housing and more sub-market affordable delivery.

Sterling

Sterling was one of the best-performing G10 currencies against the dollar in 2023, with a gain of about 5%.

FEB 2023	FEB 2024
£1:$1.20	£1:$1.26

Markets

As of February 2024, the FTSE 100 index stood at just under 7,700 points, significantly recovered from the slump post the 2022 mini budget. There remains volatility in market sentiment linked to geopolitical events, Bank of England interest rate decisions and inflation rate announcements.

FTSE 100 OCT 2022	FTSE 100 FEB 2024
6,860	7,664

Consumer Price Index

The Consumer Price Index has reduced significantly from its peak in October 2022 showing the impact of interest rate increases during the period.

OCT 2022	FEB 2024
11.1%	4.0%

Gross Domestic Product (GDP)

The UK has just officially entered a technical recession after a second consecutive quarter of GDP shrinkage in October to December 2023. Overall 2023 growth was 0.1%.

OVERALL 2023 GROWTH	Q4 2023 GROWTH
0.1%	-0.3%

Bank rate

In January, the Bank of England voted by a majority of 6-3 to uphold its benchmark interest rate at a 15 year high of 5.25% for a fourth consecutive time.

AUG 2022	AUG 2023 – JAN 2024
1.75%	5.25%

Construction market overview

Construction market conditions deteriorated in the later part of 2023 as the delayed lag affect of the 2022 mini budget finally manifested in reduced order books. This continues to be a feature of the early part of 2024's market with contractor nervousness about what lies ahead. Despite this, the market is complex with certain contractors gaining increased market share despite an overall market size reduction. The market is becoming increasingly discerning on price point, capability and relationship trust which is creating 'winners and losers' in the supply chain.

Output

Year on year construction output from December 2022 to December 2023 confirms the downward pressure on the industry mostly led by a reduction in new housing output.

NEW WORK
-12.6%

REPAIR & MAINTENANCE
+12.2%

New orders

Total construction new orders fell over 20% during 2023, mainly driven by new housing contraction. This is the main leading indicator of impact from the 2022 mini budget which will also impact 2024 construction levels.

JAN - DEC 2023
-20.9%

DECREASE IN TOTAL VALUE OF CONSTRUCTION NEW ORDERS

Insolvencies

A sharp rise in construction insolvencies in the last 2 years has meant there is a renewed focus on supply chain stability. 4,317 construction insolvencies were recorded in the 12 months to October.

DEC 2022 - DEC 2023
+4,378

RISE IN INSOLVENCIES

Materials

The material price index for 'All Work' decreased by 2.3% in November 2023 compared to the same month the previous year. This followed a decrease of 2.1% in October 2023 compared to October 2022.

DEC 2022 - DEC 2023
-2.0%

MATERIAL PRICE DECREASE

Labour

The shortage of skilled tradespeople in the construction industry is reaching unprecedented levels, and this trend is expected to persist. A government review of the Construction Industry Training Board, due to be published later in 2024, is likely to indicate a worsening shortfall in competent workers. The last Construction Skills Network report indicated a near-term shortfall of 225,000 skilled workers by 2027. The longer-term prognosis is likely to be much worse.

225,000

EXTRA CONSTRUCTION WORKERS NEEDED BY 2027

Source:
Data published by the UK government & ONS; S&P Global / CIPS UK Construction PMI; current market and GDP data from: www.statista.com www.tradingeconomics.com as well as data, market perceptions and research contained within PQS quarterly forecasted reports.

Market influencers in 2024

Challenges can lead to opportunities to focus on moving away from the norm to generate positive results. It will require the adaptation of efficient processes and procedures. Innovation will be key. Companies need to collaborate, innovate, and adopt a sustainable approach to meet these demands as well as retain their employees.

Geopolitics

Red Sea attacks

The situation is continuing to escalate causing major shipping disruption (15% of global seaborne trade passes through the Red Sea). Although 75% of UK construction products are manufactured in the UK or Europe, supply chains are international with many components and materials coming from China.

Middle East conflict

As the conflict continues, the threat of increases to crude oil prices remains high. The UK is a big importer of oil – high energy prices as a result of oil price rises could undermine the efforts by the Bank of England to bring inflation under control, keeping interest rates higher for longer.

Ukraine-Russia conflict

The effects on construction material and energy prices caused by the invasion have subsided but are still being felt. Prices in many cases are substantially higher than before the pandemic in January 2020.

Domestic politics

In 2024 voters will go to the polls in markets accounting for 54% of the global population and nearly 60% of GDP. This will generate regulatory and policy uncertainty in the short- and medium-term. UK pre-election periods also traditionally lead to a drag in decision making, particularly at local authority level – lengthening planning processes and construction start dates.

Key elections

- Mayoral and London Assembly Elections: May 2024
- UK Mayoral Elections: May 2024
- European Parliament Election: June 2024
- UK General Election: Based on Rishi Sunak's 'working assumption' this is now most likely to be held in the last week of November 2024
- US Elections: November 2024

UK economic recovery

The timing and pace of the UK's recovery from its current recession will be key to the health of the real estate and construction markets. Clearly this is linked to both international and domestic politics. However, it will also depend on winning the battle with inflation, allowing interest rates to reduce and consumer confidence to return which is vital for the housing market and development financing.

Regulatory impact

As a result of recent changes to the Building Safety Act, 2024 is likely to see new types of claims and the courts will be asked to recognise new liabilities across the construction industry. There is also a significant labour force implication linked to competence, not just for installing tradespeople, but also clients, designers, managers, and indeed approved inspectors. This could create an artificial bottleneck in delivery.

The Bank of England base rate

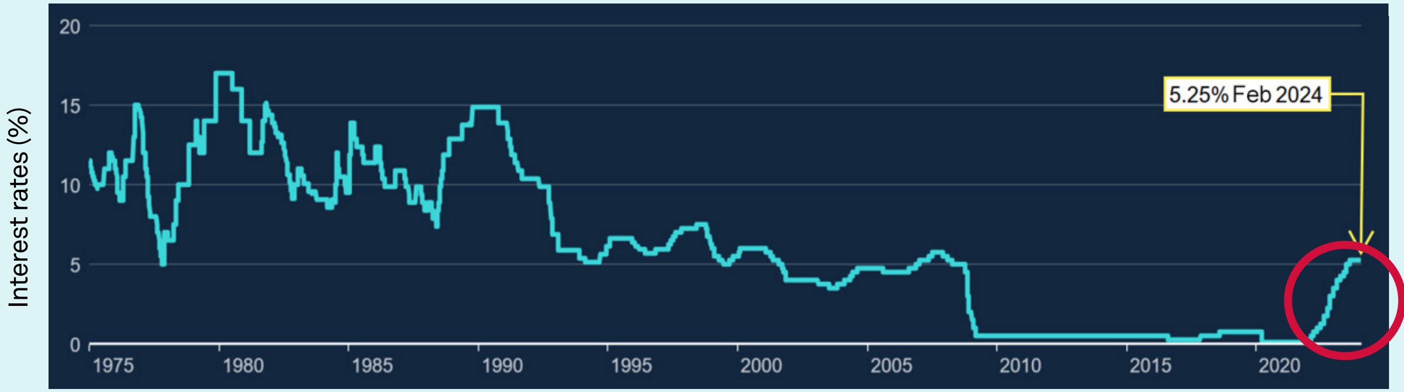
The Bank of England Monetary Policy Committee met at the end of January 2024 and agreed to maintain the base rate at 5.25%. However, the committee was split in their views. Two members wanted to increase the rate by 0.25% and one voted to reduce by 0.25%, which is the first time since the pandemic that someone has voted for a reduction.

Investors are of the opinion that the Bank will begin cutting rates in the middle of the year, with a target reduction to just over 3% by 2026, though other factors outside the UK could come into consideration.

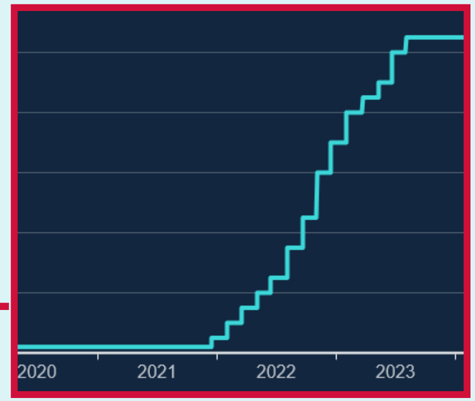
Current official bank rate:

5.25%

as of 1 February 2024



Source: Bank of England



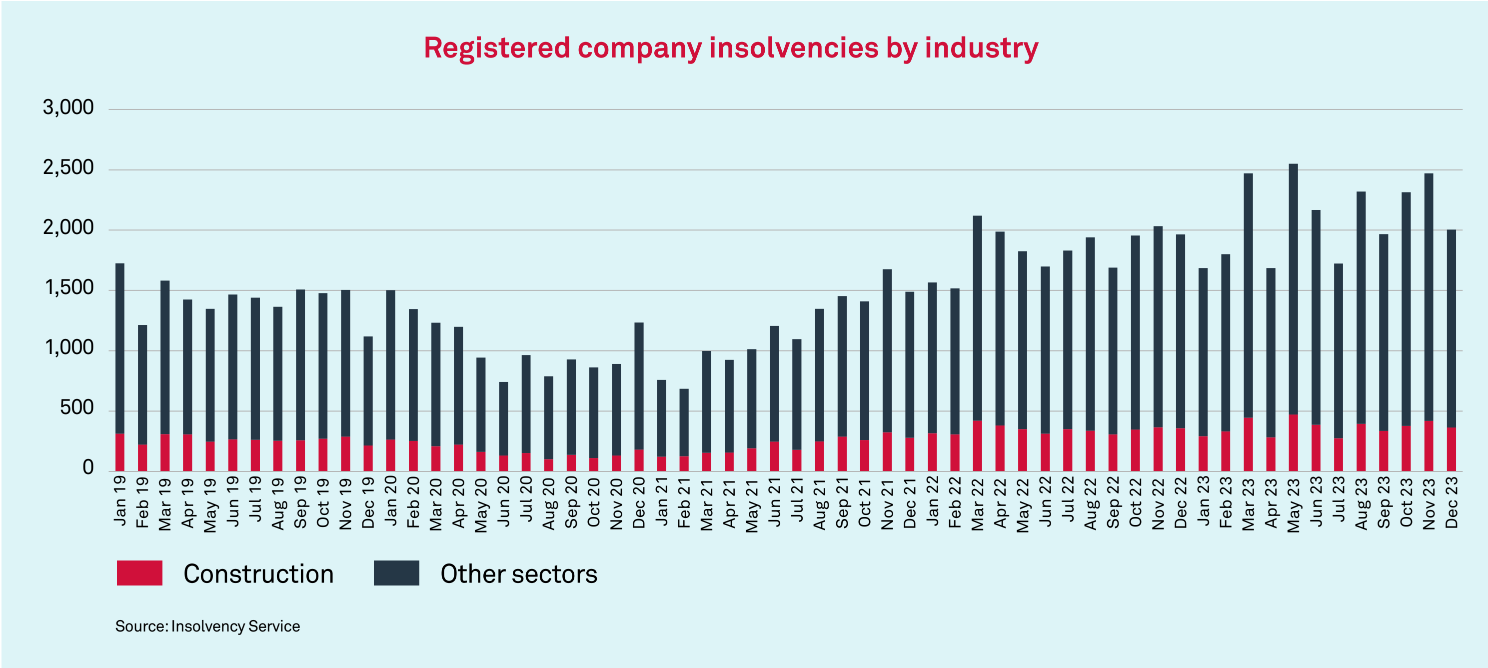
Source: Bank of England

Construction insolvencies

According to the Insolvency Service, construction firms accounted for 18.2% of all insolvencies in England and Wales in 2023, with 4,378 businesses failing in total.

Some of the notable firms that have recently gone into administration:

- Readie Construction (February 2024)
- MNCN (October 2023)
- MJ Lonsdale (October 2023)
- Buckingham Group (September 2023)
- Henry Construction (June 2023)
- Tolent (February 2023)



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Nearly 6,000 construction companies close to collapse

31 Oct 23 The number of UK construction companies reckoned to be in critical financial distress has jumped 46% in the past three months.

FINANCIAL TIMES

UK construction companies go under at fastest rate in a decade

Gill Plimmer August 24 2023

CN Construction News

Construction insolvencies up 36 per cent on pre-pandemic levels

20 DEC 2023 | BY IAN WEINFASS

Construction building materials and components tracker

The supply chain pressure experienced in 2023 has subsided with material prices on the whole now steadily falling, especially steel and timber. Construction buyers reported the biggest fall in purchasing costs for 14 years in November 2023.

	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Trailing Growth Rate 12 month	3 Month
Aggregates															
Gravel, sand, clays and kaolin – incl. aggregate levy	143	143	143	142	143	142	142	143	149	151	150	150	149	4%	-1%
Bituminous mixtures based on natural and artificial stone	140	140	140	140	148	148	147	144	144	144	144	144	142	2%	-2%
Cement and concrete															
Cement	134	138	143	144	141	141	141	141	140	140	140	140	140	4%	0%
Ready-mixed concrete	135	137	138	138	136	146	147	151	154	151	149	154	155	15%	3%
Pre-cast concrete products	169	169	172	177	179	180	180	180	180	179	178	178	178	6%	-1%
Concrete reinforcing bars (steel)	200	193	185	185	186	184	173	165	159	156	154	152	151	-24%	-3%
Timber and joinery															
Imported sawn or planed wood	174	162	166	162	163	167	160	158	158	157	158	157	153	-12%	-3%
Imported plywood	140	131	128	130	129	132	132	131	130	130	131	133	128	-8%	-1%
Particle board	161	162	153	150	153	148	149	149	146	143	145	138	138	-14%	-4%
Builders woodwork	157	158	157	157	157	156	158	158	160	160	159	158	158	1%	-1%
Metal Products															
Fabricated structural steel	199	188	187	188	193	195	187	178	167	161	159	155	155	-22%	-3%
Doors and windows (metal)	147	146	148	149	149	149	152	151	172	172	173	173	173	18%	1%
Screws etc	119	132	139	142	142	143	136	136	136	136	136	136	136	14%	0%
Other builders' ironmongery	127	127	128	128	128	128	129	129	128	128	128	129	129	1%	0%
Central heating boilers	139	139	139	139	139	143	143	143	143	147	147	147	147	6%	0%
Taps and valves for sanitaryware	150	150	150	151	152	152	152	153	155	155	155	155	155	4%	0%
Metal sanitaryware	119	119	119	120	120	122	122	124	124	124	124	124	124	4%	0%
Plastic products															
Pipes and fittings (rigid)	136	136	136	138	145	143	143	141	140	138	138	139	138	1%	0%
Pipes and fittings (flexible)	141	141	142	143	143	143	143	143	143	143	142	143	174	24%	22%
Sanitaryware	136	136	137	138	139	140	140	140	140	140	140	140	140	2%	0%
Doors and windows (plastic)	157	157	160	160	161	161	164	163	164	164	164	165	165	5%	1%
Other building materials															
Insulating materials (thermal or acoustic)	186	187	189	195	198	198	197	197	193	194	193	193	193	4%	0%
Paint (aqueous)	134	134	127	127	133	133	132	137	137	137	137	137	137	2%	0%
Paint (non-aqueous)	132	132	132	132	136	136	131	137	136	135	131	130	129	-2%	-4%
Electric water heaters	110	108	111	112	111	114	114	115	115	117	117	117	117	6%	0%
Kitchen furniture	143	144	146	148	149	149	155	156	157	157	160	160	160	12%	2%

Historical data (2015=100)

Source: ONS: Building materials and components: monthly statistics (Dec 2023), published 10.01.2024

Top 5 annual increases

- Pipes and fittings (flexible)
- Doors and windows (metal)
- Ready-mixed concrete
- Screws etc
- Kitchen furniture

Holding steady

- Builder's woodwork
- Pipes and fittings (ridged)
- Bituminous mixtures

Top 5 annual decreases

- Concrete reinforcing bars
- Fabricated structural steel
- Particle board
- Imported sawn or planed wood
- Imported plywood

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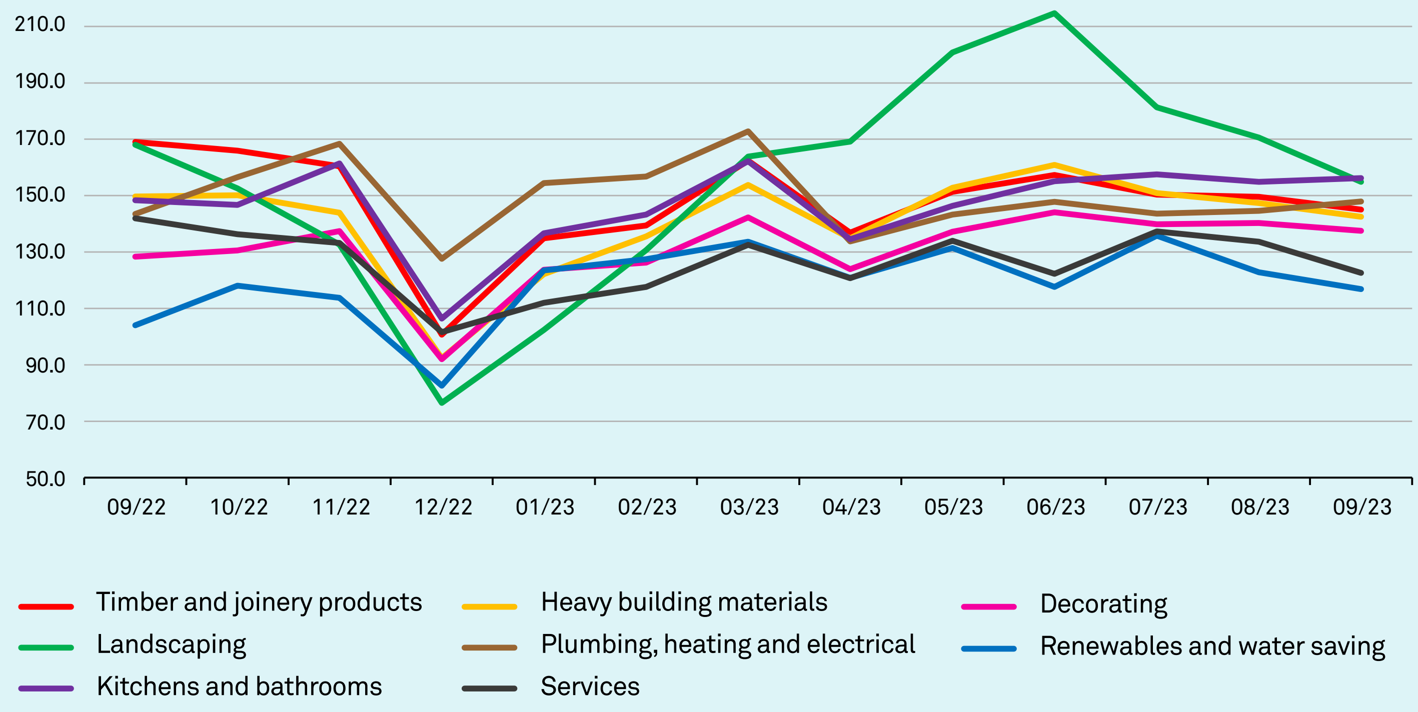
The Builders Merchant Building Index (BMBI)

Total builders merchants value sales were down -5.7% in November 2023 compared with the same month last year. Volume sales were -12.1% lower with prices up +7.2%.



Source: GfK's Builders Merchants Total Category Report – July 2015 to September 2023

Top 3 annual increases

- Renewables and water saving
- Decorating
- Kitchens and bathrooms

Top 3 annual decreases

- Timber and joinery products
- Services
- Landscaping

Heavy building materials:

- Aggregates
- Blockwork
- Brickwork
- Cements
- Insulation plastering
- Lintels etc

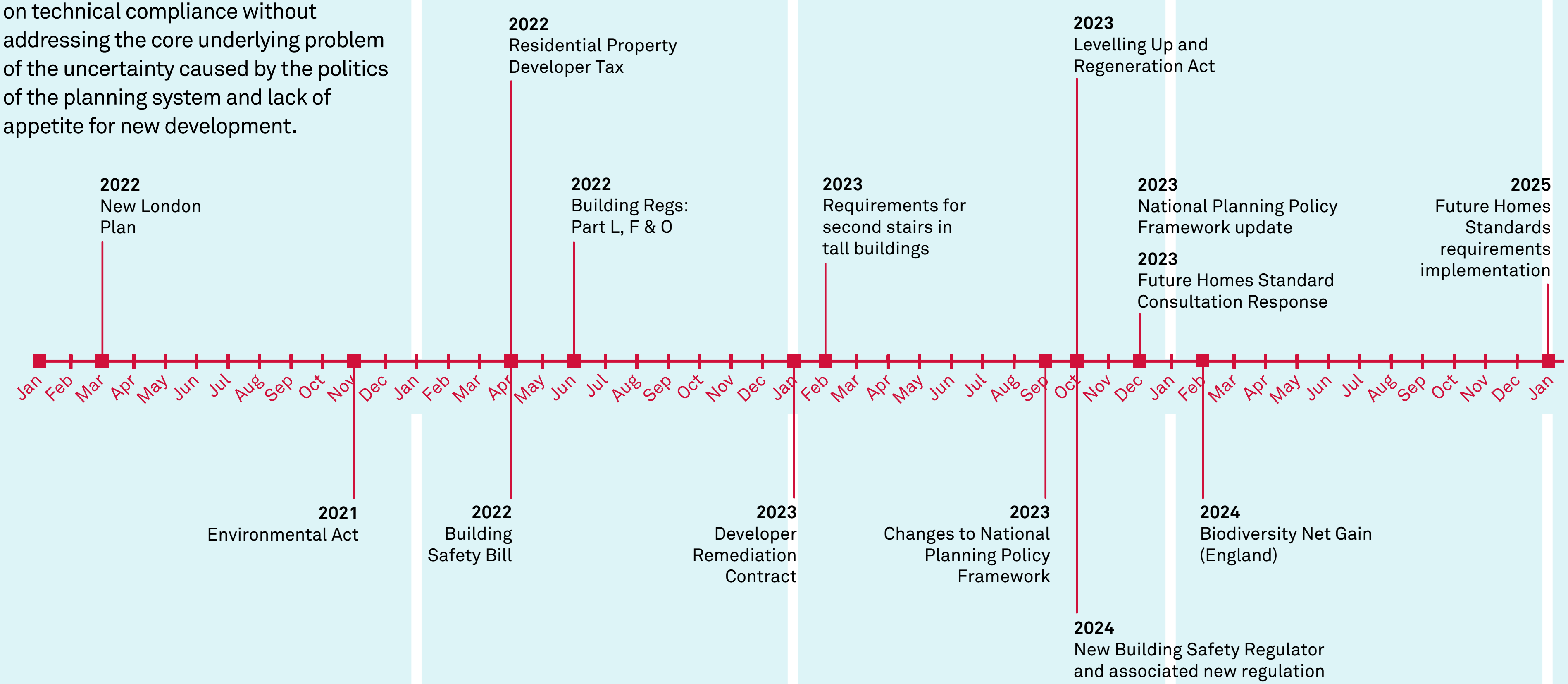
Services:

- Tool hire/hire services
- Other services

Recent planning and regulatory changes

The rapidly shifting regulatory and policy environment over the last few years has had a substantial impact, affecting confidence and impacting decision making. Following a decade of relatively minimal regulatory changes impacting the construction sector, the advent of the Building Safety Act is probably the biggest single regulatory disruptor the industry has seen in a generation.

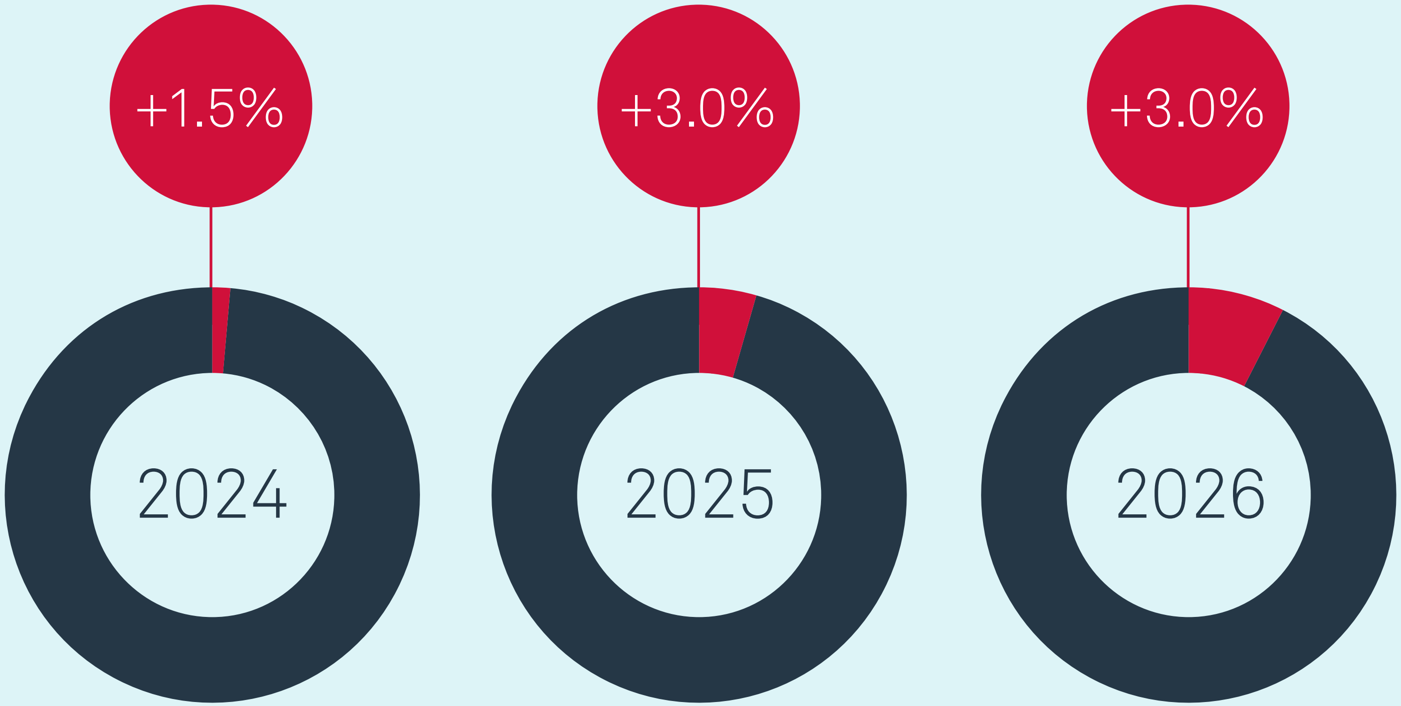
In the background, changes to planning have been ongoing. Some of these changes have increased the burden on technical compliance without addressing the core underlying problem of the uncertainty caused by the politics of the planning system and lack of appetite for new development.



Forecast movement in Tender Price Indices (TPIs)

Supply chain pressures experienced in 2022 and 2023 have tapered, however due to the challenges of the economic and geopolitical environment set out in this document, the outlook remains uncertain.

The supply chain will be looking at opportunities to convert their pipeline opportunities. Cast's view is that all in TPI inflation for 2024, focusing on the residential and mixed-use sector, will be 1.5% (2.0% previously). This does not include for the impact of the multiple regulatory changes set out on page 10.



Cast and peer group views on TPIs

Cast's view is that all in TPI inflation for 2024, focusing on the residential and mixed-use sector, will be 1.5% (2.0% previously). This does not include for the impact of the multiple regulatory changes set out on page 10.

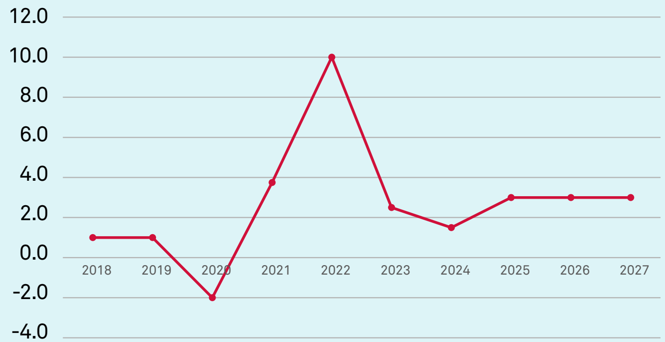
Tender Price Indices (TPI) – Status report (Q4 2023)

Year	Industry forecasts						Industry average (exc. BCIS)	Cast	RICS BCIS
	Aecom	Arcadis	G&T	Gleeds	Mace	T&T			
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	3.6%	2.0%	3.3%	4.8%	3.0%	3.7%	3.4%	2.5%	5.2%
2024	2.0%	1.5%	2.3%	3.8%	2.0%	2.7%	2.4%	1.5%	2.1%
2025	3.3%	3.5%	2.5%	3.8%	2.5%	3.0%	3.1%	3.0%	3.3%
2026		4.0%	2.5%		3.0%	3.5%	3.3%	3.0%	3.5%
2027		4.0%			3.5%	3.5%	3.7%	3.0%	3.7%

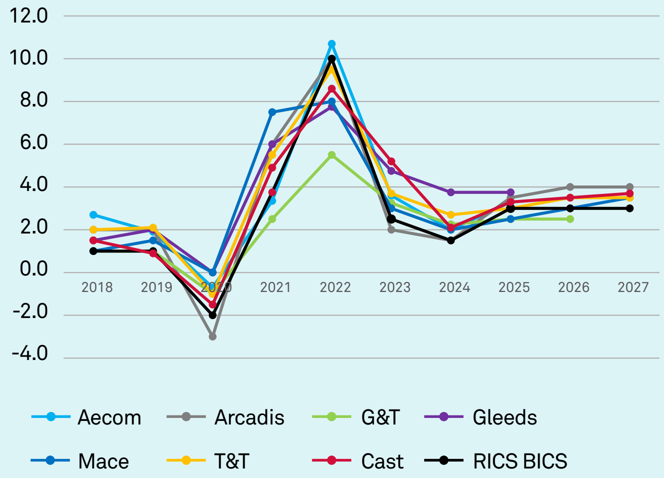
Sources

Aecom ....Market forecast: Why firms will feel the pressure in 2024 (January 2024)
Arcadis ....Market View Winter 2023 – Waiting for growth (December 2023)
Gardiner & Theobald ......Tender Price Indicator (Q4 2023) – London TPI
Gleeds ....UK Construction Market Report 4Q 2023
Mace.............................UK Market View Q42023
Turner & Townsend.........UK Market Intelligence Report – Preparing to Pivot (December 2023)
BCIS..............................BCIS All-in TPIs updated November 2023 (annual)

Cast TPI

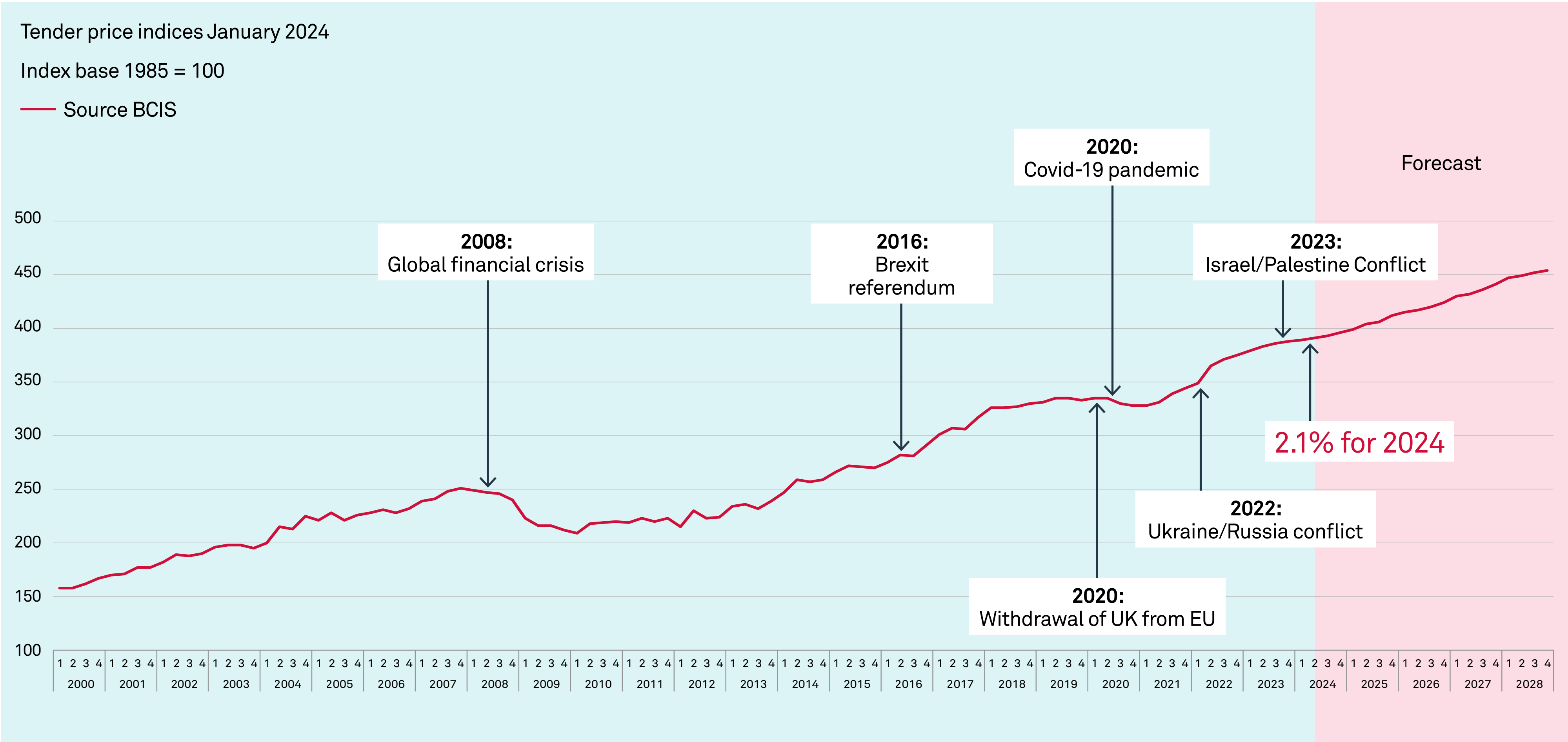


Overview of all TPIs



Long-term Building Cost Information Service (BCIS) TPIs

The below chart provides a snapshot of how key events have impacted inflation over the last 23 years.



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