Navigating uncertainty

Understanding the dynamics of a volatile construction pricing market

August 2022

Cast

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The common themes impacting projects and the wider market

Recent levels of build cost inflation have been unprecedented and represent perhaps the most malign influence on long term prospects for the industry.

The drivers are multiple and conflated. We are seeing a complex interaction of ongoing Brexit fallout, the pandemic, the impact of the Ukraine conflict, the structural decline in labour availability and skills plus increasing regulatory burdens.

Combined with low / further declining productivity, this is now a toxic cocktail for businesses who either cannot raise prices or are locked into fixed price arrangements where input costs are rising rapidly.

Supply chain insolvency risks are high and increasing. Iterations required by clients in order to value engineer / re-design / re-procure projects due to viability pressures are impacting development programmes. We are seeing a marked reduction in projects committing to on-site construction starts.

Viability pressures coupled with delays in obtaining planning consent means that it is taking longer for projects to commence on-site.

TOP NEWS: UK construction sector slows in June as housing orders fall

Morningstar/Alliance News, July 2022

Post-COVID construction boom slowing to a stop

Construction News, June 2022

Britons face missing out on £11,500 of wage rises after Covid and Ukraine standoff inflicted the latest blows in two 'lost decades' for living standards – with a record squeeze this year

Mail Online, March 2022

Will Brexit shake UK construction?

Designing Buildings, The Construction Wiki

64% of the building materials used in the UK are imported from the EU

63% of the construction materials exported from the UK go to the EU

8% of the UK's construction workforce comes from the EU

The World's Economic Growth Engines slide into Recession

World Economics (online), August 2022

Example headlines, indicative only

Headlines

2022 and 2023 are likely to be years of stark contrast driven by wider economic events.

Cast current view on 2022 inflation

7.5% Q1-3
+ 2.5% Q4
10%

We are of the opinion that to date (3Q22) we have seen a 7.5% increase and there is a further 2.5% to come for the remainder of the year, i.e. 10% for calendar year 2022. Looking forward, we are of the opinion that there are three potential scenarios that could play out:

Scenario A

On-going economic fragility

The residual market inflation in early 2023 is driven by on-going price rises in labour and material / energy. This is negated by deflation in the latter part of the year as workloads reduce as a result of the current 2022 hiatus in construction commitment to site. This is due to viability issues and market pricing adjustments to secure orders. The overall calendar year inflation is zero for 2023 and 2% for 2024.

Scenario B

Stability returns and recession avoided

A long term recession will be avoided in 2022. UK political stability returns and the impact of the conflict in Ukraine subsides. Material prices normalise but the structural market shortages continue. The lack of capable industry capacity continues to drive inflation but at lower levels; 3% for 2023, 3% for 2024.

Scenario C

Global and UK recession

A global and UK recession takes hold in 4Q22 and economic and construction investment confidence weakens further. Demand reduction accelerates and build cost elasticity is greater with margins, costs and risk pricing all compressing quickly despite residual upward input cost pressure. This could potentially set a longer term inflation pattern for 2024 and beyond; -2% for 2023, 0% for 2024.

Headlines

In certain sectors and geographies, and irrespective of which of the three scenarios play out, we will see more stratified supply chain markets appearing.

There will be a flight to certain contractors and specialists with skills and relationships who will be busier. Others will be frozen out by the poor legacy of previous work or having to compete purely on lowest price and risking failure. This will lead to wider spreads of tender returns and will require good judgment to analyse and recommend contractors.

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There are regulatory burdens which are driving product based inflation (ie Future Homes Standard and Parts F, L, O & S in residential). These uplifts are outside of the quoted Scenarios A - C which are for 'like for like' market led movements.

Next year we could potentially see a spread of 5% between prices rising, staying static or reducing. We are of the opinion that we will see an increase in the early part of the year but this will then drop back by a similar percentage by the latter end of the year. Therefore what we have indicated in our most likely Scenario A is a flat line for 2023 on the basis that input costs are reducing and the need to win work is starting to influence tendering behaviour and sentiment.

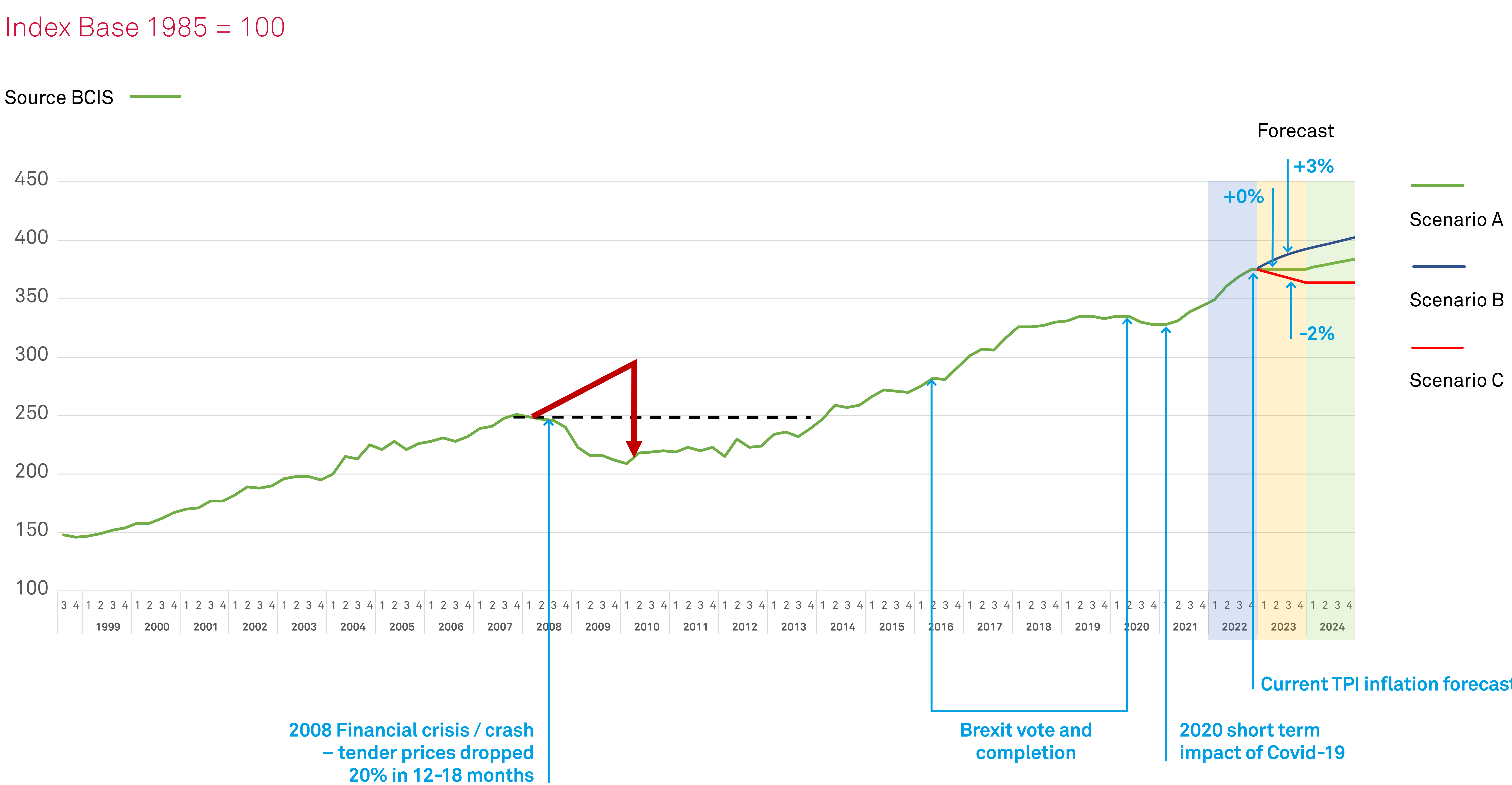
Consumer Price Inflation (CPI) rose to 9.1% in June 2022, from 5.5% in January 2022 – a 40 year high.

The Government's target inflation is 2%. The current inflation rate is well above this target (currently forecasted as 13%) and a number of tools are being used to bring it down. We have recently seen a rise in the Bank of England base rate.

2%

Food, petrol and gas prices are rising and continuing to be affected by macro-economic factors, though recently petrol prices have reduced slightly and may indicate growing exposure to potential profiteering which in turn will force deflation and reduce CPI.

Tender price indices July 2022



Cast and peers' view on TPIs

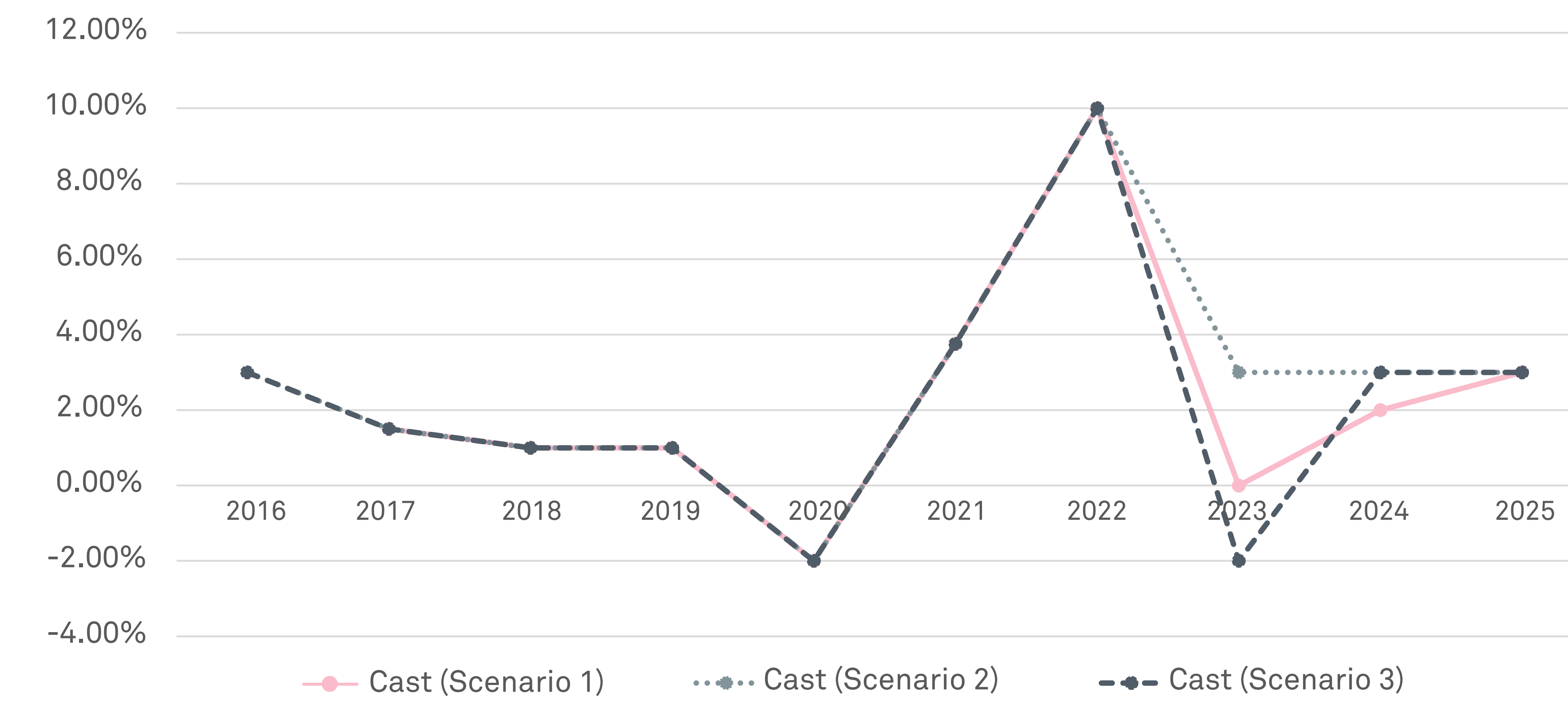
Tender Price Indices – Status Report (2Q22)

Year	Industry forecasts						Industry average (exc BCIS)	Cast	RICS BCIS
	Aecom	Arcadis	G&T	Gleeds	Mace	T&T			
2016	2.50%	1.00%	5.00%	0.00%	3.30%	0.00%	2.00%	3.00%	-0.40%
2017	3.20%	2.00%	2.50%	1.80%	2.50%	2.90%	2.50%	1.50%	1.10%
2018	2.70%	2.00%	1.00%	1.50%	1.00%	2.00%	1.70%	1.00%	1.50%
2019	1.90%	2.00%	1.00%	2.00%	1.50%	2.10%	1.80%	1.00%	0.90%
2020	-0.70%	-3.00%	-1.00%	*0.00%*	0.00%	-1.00%	-1.00%	-2.00%	-1.50%
2021	3.35%	6.00%	2.50%	6.00%	7.50%	5.50%	5.14%	3.75%	4.90%
2022	*6.60%*	10.00%	5.50%	7.00%	8.00%	8.70%	7.63%	10.00%	8.00%
2023	*4.15%*	3.00%	3.50%	3.75%	4.50%	3.80%	3.78%	0.00%	3.80%
2024	*3.25%*	4.00%	2.50%	3.50%	2.00%	3.00%	3.04%	2.00%	3.70%
2025	*tbc*	5.00%	2.25%	*tbc*	2.00%	4.00%	3.31%	*3.00%*	3.80%

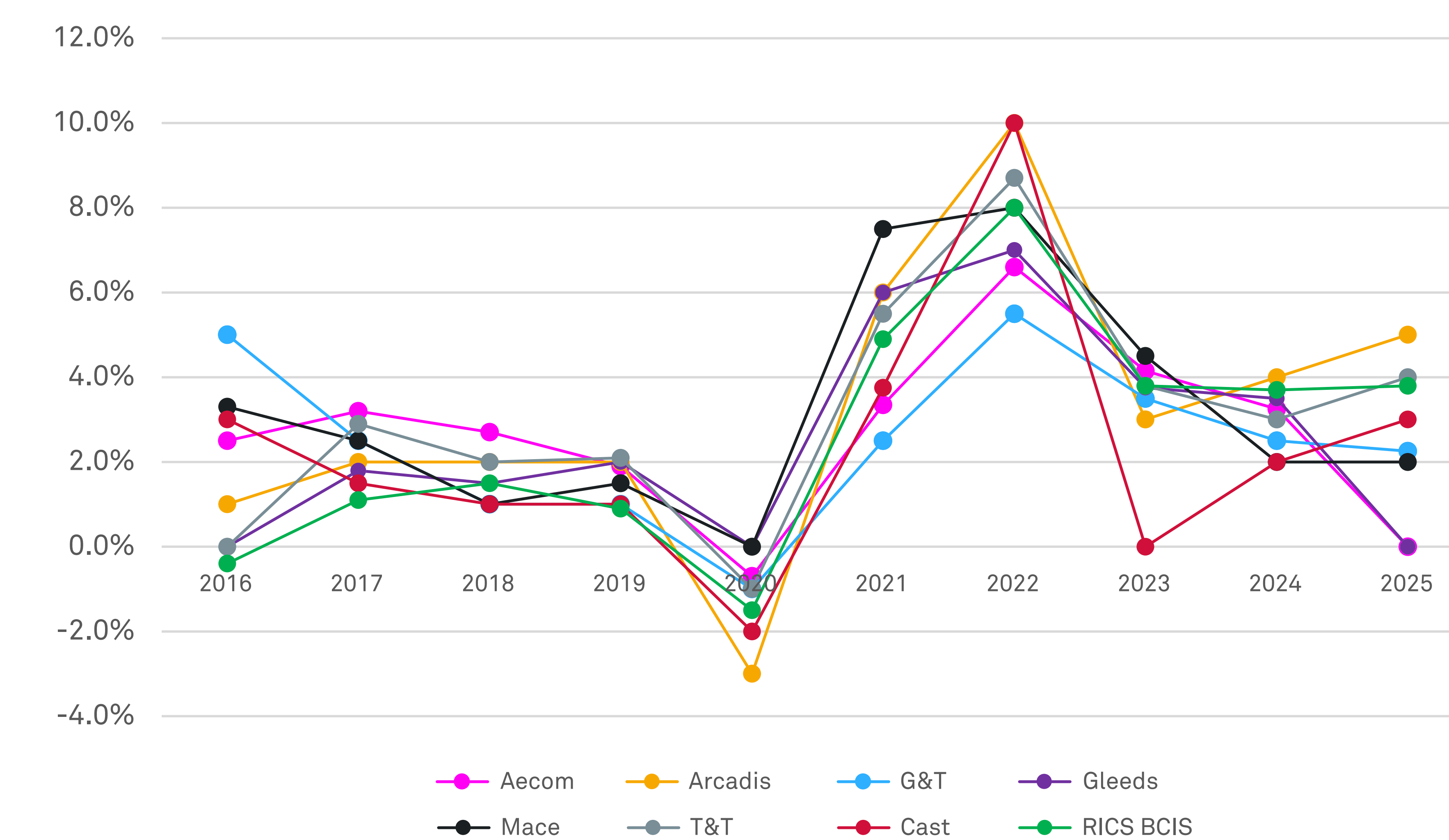
Sources

AECOM...................................... Market Forecast Q1 2022
Arcadis...................................... Market View Summer 2022 – The shadow of stagflation (London TPI)
Gardiner & Theobald .... Tender Price Indicator (Q2 2022) – (London TPI)
Gleeds....................................... Spring 2022 UK Market Report
MACE .... UK Market View Q2 2022 – More record material price growth
Turner & Townsend .... Tender Price Inflation Forecast Summer 2022
RICS.. BCIS All-in TPIs updated June 2022 (annual)

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



Overview of all TPIs



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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