Construction Market Report

Q3 2022


Fulkers
Bailey
Russell
Big enough to cut it,
small enough to care.

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Executive Summary.

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This report summarises our findings from reviewing the current state of the construction industry and is for the sole use of the recipient. It is important to note that the assessment of inflation is based on historic data and forecasts which have been used for guidance only.

The wider economy has been experiencing a great deal of turbulence over the last number of years. This stretches back to UK leaving the European Union via Brexit, the pandemic caused by COVID-19, spiralling energy costs, the war in Ukraine, and now inflationary cost pressures coupled with rising interest rates which is being used as a mechanism to curb inflation.

Despite this, the construction market remains buoyant and there is still a great deal of activity and future planning. However, as we approach double digit inflation, the viability of projects comes under even greater scrutiny as previously anticipated margins are no longer deliverable.

Projects that are currently underway and are subject to a fixed price contract have some contractual protection from a clients point of view. However, on the flip side, contractors are being pushed to make operational efficiencies in order to deliver projects within budget.

We have been reporting the impact of material costs throughout recent issues. We are now seeing wage pressures starting to affect business' and this can be widely seen in the public sector as the number of labour strikes is on the increase. However, the number of people in full time employment remains at an all time high, whilst the number of vacancies rose to approximtely 1.3m. The labour market (and the weather) is very hot at the moment.

Interest rates have increased for the sixth time in a row, and are now sitting at 1.75% in August 2022. This had increased from 1.25% in July 2022 and this half point percentage increase was the largest for 27 years.

The UK inflation rate hit 10.1% in July. This was the highest rate of inflation since 1982. Current Bank of England predictions indicate inflation topping out at 13% later this year.

We can expect interest rates to increase further as the Bank of England looks to curb the inflation rate.

The Bank of England is also anticipating a recession later this year, and this could lead to a period of stagflation. This was reported in the last edition of our Construction Market Report and is further detailed in this edition.

Inflation Review.

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2 Inflation Review.

It is important to note that the assessment of inflation is based on historic data and forecasts which have been used for guidance only.

2.1 Tender Price Index

A review of tender prices shows an increase of 8.8% over the 12 months to Q3 2022. This is the highest rate of yearly tender price change since 2015 and 2016, when the post-financial crisis construction recovery was in full swing. Elevated rates of price inflation will continue in 2022, as acute input cost pressures afflict the economy and construction sector.

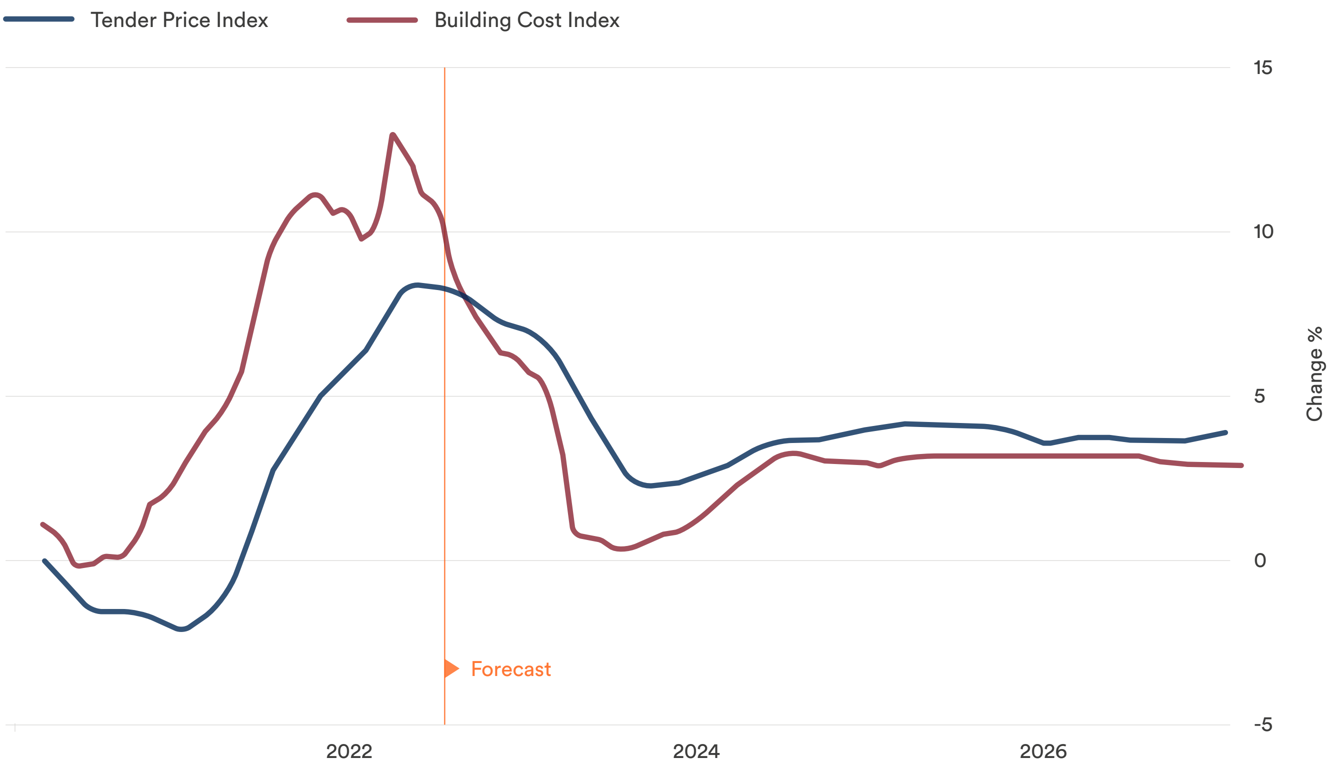
2.2 Building Cost Index

A composite measure of building input costs increased by approximately 12.5% over the year to July 2022. Global and domestic supply chain issues, along with improved demand, have contributed to strong inflation trends. Inflation trends are pervasive across global, domestic and local supply chains.

2.3 Consumer Prices Index

The Consumer Prices Index rose 10.1% in the 12 months to July 2022, up from 9.4% in June. Rising prices for food and non-alcoholic beverages, compared with falls a year ago, resulted in the largest upward contribution to the change in CPI.

Tender Price and Building Cost Index



Data Source: BCIS

2.4 Labour Prices

Labour rates continue to rise steadily, reflecting robust workforce demand and a very high number of construction vacancies. An aggregate measure of site trades recorded a year-on-year change of 3.2% between Q1 2021 and Q1 2022. This calculation includes some carry-over effects from 2020, so a comparison against a pre-pandemic year sees a 2% increase versus Q4 2019. Wage pressure is not likely to fade, unless there is a significant adverse change in workload trends or output over 2022.

More generally, the rate of change for average earnings across the country is now negative once adjusted for quickly rising consumer price inflation. This fell by 3% in the last quarter and will mark the third period in the last decade where earnings adjusted for inflation were falling.

2.5 Tender Price Forecast

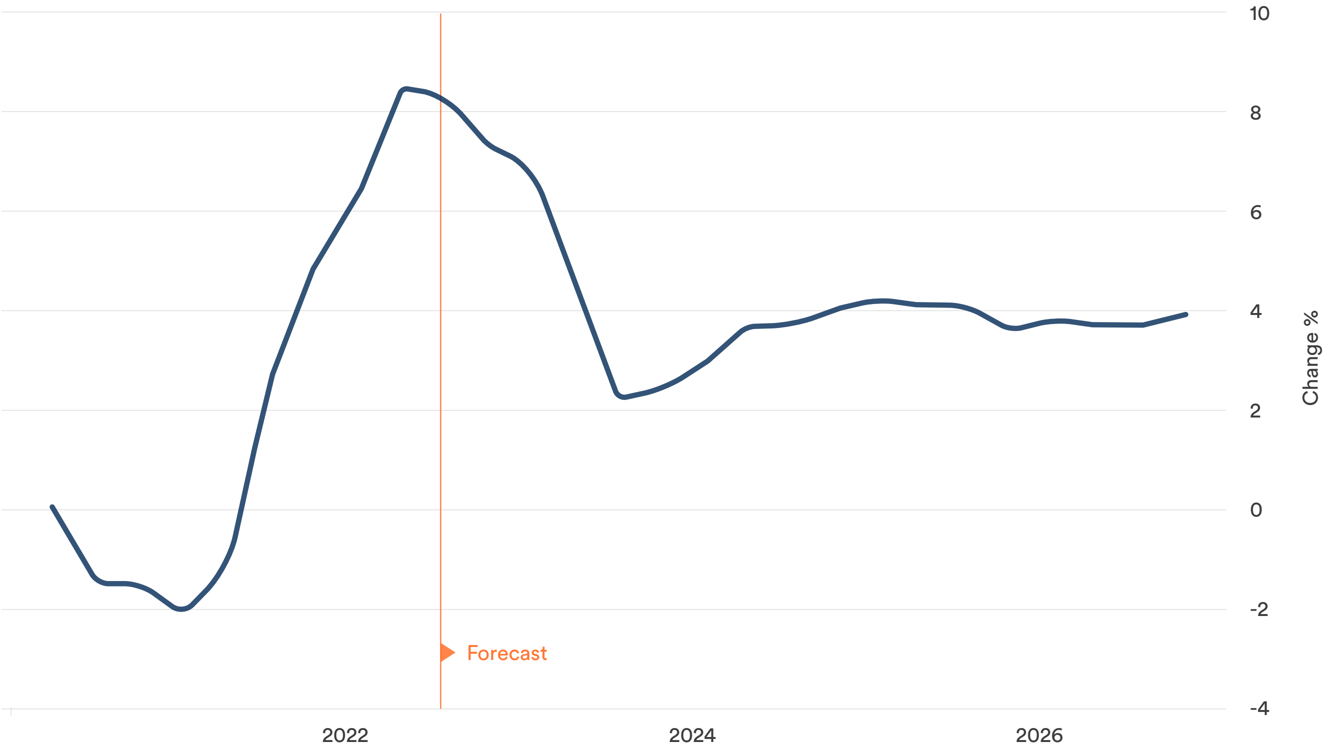
Figures published by the Building Cost Information Service (BCIS) indicates a 8.8% increase in tender prices to Q3 2022 compared to the same period the previous year. Inflationary pressures will endure through 2022, as supply constraints, ongoing operational challenges and price volatility continue.

The table on the right presents the forecast inflation from 2022 to 2025 from key consultants within the construction industry and the BCIS TPI indices. This highlights that the industry is expecting tender prices to increase over the next three to four years.

Forecast Inflation

	3Q 2022	3Q 2022	Summer	2Q 2022	3Q 2022		07/22
Year Ending	**G&T**	**Aecom**	**Arcadis**	**Mace**	**Fulkers**	**Average**	**BCIS**
2022	5.0%	8.4%	9.0%	8%	8.5%	7.8%	8.8%
2023	3.0%	6.2%	2.5%	4.5%	5.0%	4.2%	2.2%
2024	2.5%	4.2%	4.0%	2.0%	4.5%	3.4%	3.7%
2025	2.25%		5.0%	2.0%	3.0%	3.0%	4.1%

BCIS: All in TPI Indices



Data Source: BCIS

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The Construction Market.

3 The Construction Market.

3.1 Works on Site

The latest data from the Office of National Statistics shows that the monthly construction output decreased by 0.4% in volume terms in April 2022; this is the first monthly decline seen since October 2021.

The decrease in monthly construction output came from a fall in repair and maintenance (2.4%), which was offset slightly by a rise in new work (0.9%); the fall follows a growth of 3% in March 2022.

At the sector level, the main contributors to the decline in April 2022 were private housing repair and maintenance, and private commercial new work, which decreased by 6.5% and 3.8%, respectively.

Despite the monthly fall, the level of construction output in April 2022 was 3.3% (£481 million) above the February 2020 pre-coronavirus (COVID-19) level; new work was 0.7% (£68 million) below, while repair and maintenance work was 11.0% (£549 million) above.

The recovery to date, since the falls at the start of the coronavirus pandemic, is mixed at a sector level, with infrastructure 35.6% (£669 million) above and private commercial 27.2% (£676 million) below their respective February 2020 levels in April 2022.

Despite the monthly decrease, construction output increased 2.9% in the three months to April 2022. This is the sixth consecutive growth in the three-month on three-month series, with increases seen in both new work and repair and maintenance (2.2% and 4.0%, respectively).

3.2 Lead in Times and Material Availability

As we move through Q3 2022, we are still experiencing long lead times for certain key materials and associated cost premiums. This can be attributed to the effects of the war in Ukraine, backlog within the supply chain and rising energy prices. This is particularly the case with energy intensive materials, such as bricks, steel and cement and is likely to adversely impact costs as the suppliers will look to pass on these increased costs through the supply chain.

The Construction Leadership Council (CLC) warned earlier this year that high energy prices would impact on the year ahead.

Price inflation could potentially increase from 7-10+%, with multiple increases expected for some products.

Although the shortage of materials has eased up over the past few months, this increase in supply has not had an effect on the price of materials. Contractors are now facing delays of weeks for products that had previously been available either immediately or within a couple of days. These increased lead in times are creating programme issues for projects that are both on site or about to start. Contractors are reporting that lead in times are moving on a daily basis.

Work Package	Product	Current Lead Time
Site Accommodation	Modular Cabins	10-12 weeks
	AV linked	6-8 weeks
Biometric Turnstiles	Turnstiles	4-6 weeks
Piling	Piling Rig	6 weeks
Groundworks	Ready Mixed Concrete	2 weeks (large pours)
	Clay Drainage	2 weeks
	Plastic Drainage	4-6 weeks
	Concrete Drainage	1-2 weeks
	Linear Drainage	2-4 weeks
	PCC kerbs / edgings	2-4 weeks
	Cement bags	3-4 weeks
	Aggregates (bags)	2-3 days
	Aggregates (bulk, 3+ loads)	1-2 weeks
	Rebar	2-3 weeks
	Geotextile	6-8 weeks
	Attenuation Tank	3-4 weeks
Brickwork	Facing Bricks	4-20 weeks
	Engineering Bricks	10-12 weeks
	Concrete Blocks	10-20 weeks
	Ready Spread Mortar	4-5 weeks
	Brickwork Supports (Ancon)	3-4 weeks
	Insulation	6-8 weeks
	Lintels / Accessories	3-5 weeks
Structural Steelwork	Steelwork	12-14 weeks
SFS	SFS	8-24 weeks
Insitu Concrete Frame	Ready Mixed Concrete	1-2 weeks (large pours)
	Rebar	2-3 weeks

PCC Floors / Precast Stairs	Precast Stairs	10-12 weeks
	PCC Lift Shafts / Retaining Walls	8-10 weeks
Hard Landscaping	Granite Paving	China: 12 weeks, Portugal: 6-8 weeks
	Paving / Kerbs	3-4 weeks
	Street Furniture	6-8 weeks
Roofing	Single Ply	8-10 weeks
	Hotmelt	8-10 weeks
	Standing Seam	On allocation
Cladding	Rainscreen Cladding	On allocation
	Brick Slip	On allocation
Curtain Walling	Aluminium Windows	8-10 weeks
	External Doors	8-10 weeks
MEP	Sockets & switches etc.	2-3 Days
	Fire alarm sounder / panel	1-2 Weeks
	BMS	6-8 Weeks
	2nd fix data	1-2 Weeks
	Consumer units	3-4 Weeks
	Air Sourced Heat Pump	14-18 Weeks
	Buffer Vessels	14-18 Weeks
	Chillers	18-22 Weeks
	Air Conditioning	6 -8 Weeks
	Fan Coils	8-16 Weeks
	CRAC Units	8-10 Weeks
	Lighting	6 -8 Weeks
	Fire Sprinkler	6 - 8 Weeks
	Ventilation ducts & fittings	6-8 Weeks
	Audio Visual	12-28 Weeks
Metal Decking	Metal Deck	10 weeks
Bathroom Pods	Modular Bathrooms	18-20 weeks
Dry llning & Partitions	Metalwork	On allocation
	Plasterboard	2-3 weeks
	Plaster	6-8 weeks
Timber Doorsets & Ironmongery	Timber Doorsets	10-12 weeks
	Ironmongery	4 weeks
	Timber Screens	6 weeks
Timber & Plywood	Sheet Materials	2-3 weeks
	Trusses	8-10 weeks
Suspended Ceilings	Metal	6-8 weeks
	Standard, Acoustic	6-8 weeks
Soft Flooring	Soft flooring	4 weeks
Industrial Doors / Roller Shutters	Industrial Doors / Roller Shutters	8-10 weeks
Toilet Cubicles / IPS	Toilet Cubicles / IPS	6-8 weeks
Passenger Lifts	Lifts	24-32 weeks
Laboratory Furniture	Laboratory Furniture	16-20 weeks
FF&E	Fitted furniture	10-12 weeks
	White goods	4-6 weeks
Ceramic Tiling	Ceramic tiles	4-6 weeks
Decorating	Paint	2-4 weeks

3.3 Price of Materials

Across all industries, input costs have increased on average by nearly 30% which has resulted in increased material prices. The table to the right shows a selection of price increases in Q3 2022.

The CLC warned to expect further inflation for energy intensive products such as insulation, cement, concrete and steel and the statement raised concern that price volatility had led to the failure of relevant indices to reflect market reality.

Steelwork is still increasing in the market. This increase is the result of a combination of factors; the slow restart of the steel manufacturing capacity coincided with lower output of iron ore in Brazil and, larger than usual demand both from China and Europe.

The broader impact of the war in Ukraine can be felt through high energy costs. Europe has few short-term options to increase the supply of gas and petroleum products from sources other than Russia. This means that construction material prices are likely to remain at or near record levels for some time to come.

Until the capacity of supply chains is restored and energy prices stabilise, material prices are likely to increase in the short term.

3.4 Plant

Construction machinery prices continue to increase, as demand for good machinery remains high. In some cases, second-hand machinery is being sold at almost the same prices as the purchase price due to high demand.

Category	Manufacturer	Products Affected	Price Increase	Effective From
Insulation	Kingspan	Therma PIR & Optim+R	Up to 10%	19 September 2022
	Ecotherm	EcoTherm PIR Range & Optim-R	10%	5 September 2022
		GreenGuard	20%	
	YBS	All Products	TBC	1 September 2022
	Kingspan	Therma PIR - TP10 & TR26	15%	1 September 2022
Drylining and Plasters	Celotex	All Products	10%	1 September 2022
	Fermacell	Fibre Gypsum Wall Boards, Fibre	5%	1 September 2022
		Gypsum Flooring, Powerpanel	5%	
		H20 & All	5%	
		Accessories	5%	
Ceilings	Sektor	All Tiles	8.75%	22 August 2022
	Ecophon	All ceiling tiles and wall panels	6%	1 August 2022
Building Materials	Sika	Sikafloor ArmorTop natur.grey UK Bg 25KG	4%	1 August 2022
		All PUs (Excluding Sikaflex EBT+)	5%	
		Combiflex, Sikadur-52 Injection, SikaFuko VT1 & VT2	5%	
		SikaBond Rapid DPM, SikaSwell, SikaProof	10%	
		Sika Injection 307	12%	
		Sikaflex 113 RapidCure	15%	
		Sikafloor-1 MetalTop Colour 1500KG	16%	
		Sikafloor-1 MetalTop Colour 25KG	20%	
		SikaBond-5500S, SikaScreed Mortar	20%	
		Sikafloor-1 MetalTop natural Bg 25KG	22.50%	
		Sikafloor-1 MetalTop natural BB 1500KG	25%	
		Anchorfix Range	30%	
		Sikadur-33	70%	
	Visqueen	All Products	5%	1 August 2022
Roofing	VELUX	Blinds	5%	1 July 2022
		All Products Expect Blinds	9%	1 July 2022

An Insight into the Energy Market.

4

4 An Insight into the Energy Market.

High energy costs disproportionately affect the construction materials supply chain, so prices are expected to remain high until the UK and European energy markets are less dependent on Russian gas and oil.

Volatile energy and raw material markets, compounded by the Ukraine crisis, continue to add to levels of risk to construction contracts.

High prices and difficulties in reaching terms that are acceptable to clients, contractors and funders are delaying projects.

Although we have seen the price per barrel of Brent crude oil fall from a high of $122 in June 2022 to $95 in August 2022, this is still higher than the average price for 2021 which was $70. This higher price is continuing to influence the material production market.

Stagflation.

5

5 Stagflation.

What is Stagflation? In simplistic terms, it is a period of both negative growth of Gross Domestic Product (GDP) and higher than desired inflation. The term was coined in the House of Commons, by Iain McLeod speaking on economic issues.

There is a risk that we may be entering a period of stagflation where the economic growth slows (as predicted by the Bank of England) and, at the same time, prices are rising due to inflation. This was first recognised in the 1970's, stemming from the oil crisis. Economic policies, monetary factors and oil prices all have the effect of dramatically increasing the cost of goods and services, whilst at the same time the GDP and productive capacity is declining.

It generally occurs when the money supply is expanding (by printing of currency) as we experienced during the COVID-19 pandemic through quantitative easing, whilst supply is being constrained. This was last seen in the 1970's.

An article in Bloomberg notes:

"In a world reeling from soaring inflation and weak growth, the UK holds a special place. It's on track to be the advanced nations' stagflation capital. Prices are expected to rise 13% over this year and next, the most in the Group of Seven (sic G7), and the UK will drop to the bottom of the pack for growth in 2023, according to the International Monetary Fund. The National Institute of Economic & Social Research reckons the country will be in recession before next year."

In this environment of tightening credit conditions, the construction sector appears to be one of the most vulnerable. Rising borrowing costs (through increased interest rates) are expected to affect the housing market and, ultimately, construction activity. This is has started in the US where housing sales are declining rapidly.

It is highly possible that the UK will follow down this path, as was the case in the 2008 down turn. This will have the possible impact of shrinking order books as projects are delayed or cancelled, with the subsequent impacts that this will have on the sector as a whole, still recovering from labour and material shortages, stemming from Covid and Brexit.

It is also key to note that in these conditions it is recommended to ensure regular credit checks are undertaken on contractors and their supply chains and that valuations are undertaken with the risk of contractor insolvency in mind. Payment for materials off site and advance payment should also be undertaken with caution.

Advice & Recommendations.

6

The main issue affecting the construction industry is the spiralling inflation and looming recession. This has come quickly on the back of the impacts of COVID-19, the current war in Ukraine and the UK leaving the European Union. It has been quite the perfect storm for the construction industry.

Whilst there are currently inflationary issues within the construction industry leading to higher costs and programme issues, there are mitigation measures that can be applied in order to minimise the effect to projects.

- Clients should consider expedited design programmes in order to get to site more promptly.
- Clients should consider early order of building materials with particularly long lead in times and those which have a great price sensitivity, providing all necessary vesting is in place.
- Greater collaboration with contractors in order to manage risk and ensure sufficient financial allowances and lead in times are accounted for.
- Allowing for early order of materials in construction contracts to minimise the risk of sudden increase in prices and make sure that contract conditions include are sufficient to allow purchase of materials off site.

It is also worth considering fluctuation provisions such as BCIS PAFI (price adjustment formulae indices). This is a method of calculating the increase or decrease in contractors costs over any period. These may not be appropriate for all projects and the risk mechanism must be measured considerately.

Delays in the supply of materials and labour, together with fluctuating costs, are risks generally borne by the contractor. Fluctuations will always be present, but current events have the potential to create unpredictable variations in material prices and labour costs.

The present challenge is that these are not manageable, leading to the contractor either pricing significant risk premiums within a fixed price contract sum to carry these risks or being unwilling to take on these risks completely through the tendering process. This can lead to inflated tender prices or can create post contract issues where the premium is still inadequate.

Building contracts include fluctuation provisions to account for such risks between the client and contractor. The choice of fluctuation provisions should be determined by the application of a risk assessment in order that the risk sits with the party best placed to quantify, manage and bear such risks with provisions included that are fair and reasonable to both client and contractor. Further information can be sought from the RICS guidance note on fluctuations, available on their website.

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