Construction Market Report

December 2023 Q4

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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 our assessment of inflation is based on historic data and forecasts, which have been used for guidance only.

Overall, construction output in the UK is estimated to have increased by 0.9% in 2023. This growth was driven by strong performances in the infrastructure and industrial sectors, which grew by 4.7% and 3.8% respectively. However, the private housing sector declined by 1.2% and the repair and maintenance sector grew by just 0.6%

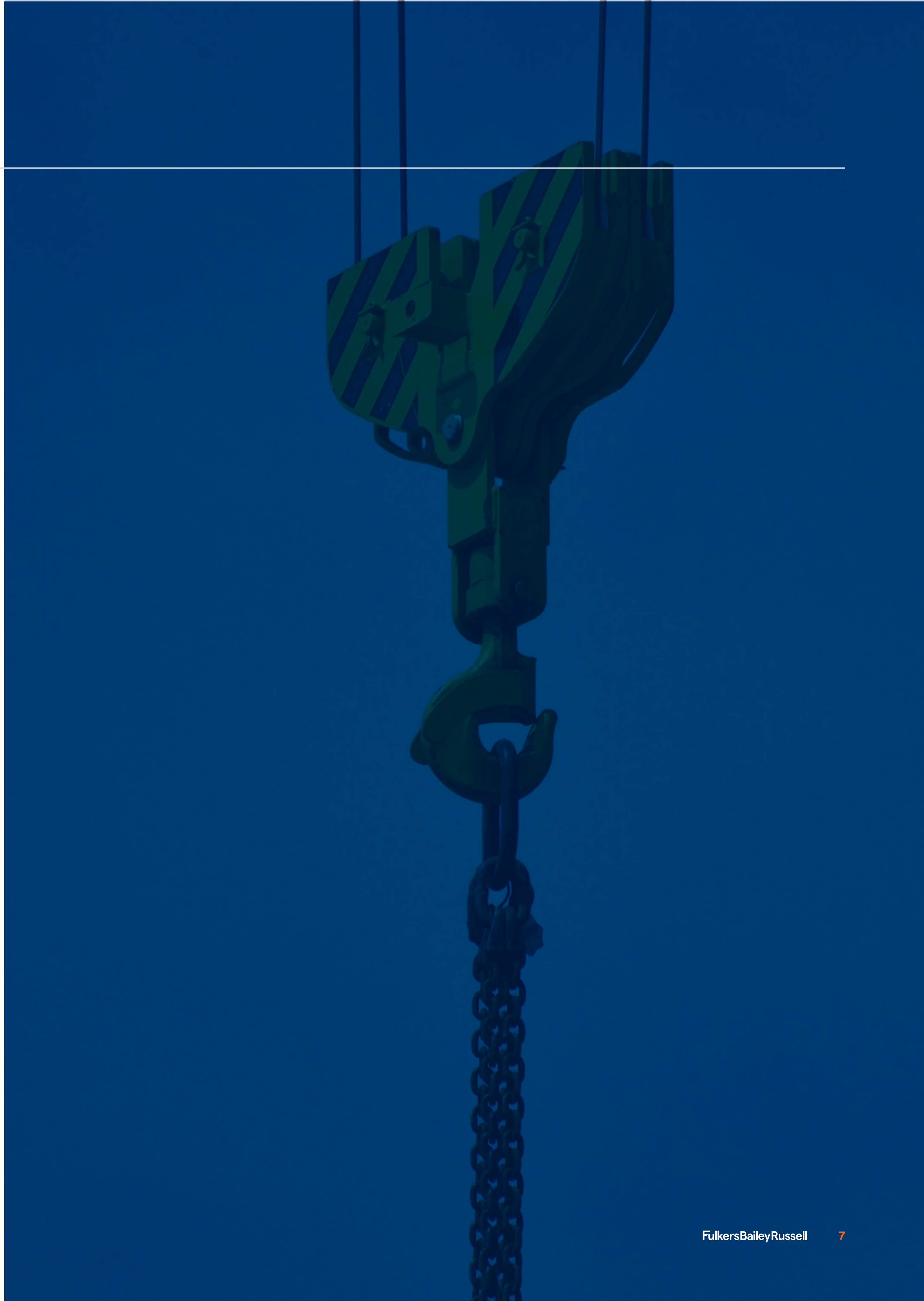
The UK construction market is expected to continue to grow in 2024, with an estimated growth rate of 2.2%. This growth will be driven by continued investment in infrastructure and industrial projects, as well as an increase in demand for repair and maintenance work. However, the private housing sector is expected to remain subdued due to the ongoing challenges of rising costs and the availability of mortgage finance.

In 2023 the UK construction industry output is estimated to be £159.4 billion, employing circa 2.4m people. This accounts for around 6% of the UK economy. In the last year we have had 7 Ministers of State for Housing – Rachel MacLean was the last to be removed from this position. We hope that following his appointment on the 13th November (in the latest cabinet reshuffle) Lee Rowley is given the time and dedication that this role deserves.

The current Bank of England base rate is **5.25%.** This has remained static since our last report.

The inflation rate unexpectedly fell by more than anticipated over the last two months. The current inflation rate is **4.6%**, with the target being **2%.** Inflation is expected to average 5.5% in 2024, and 3.25% in 2025.

Sustainability is becoming increasingly important to both consumers and businesses. Recently Fulkers Bailey Russell announced that we are now a B Corp company. Becoming part of B Corp UK is a huge achievement for our company. It is a validation of our long-standing commitment to sustainability and social responsibility. To recognised this, we have a feature in this quarters report on a decarbonisation project that we have recently been involved in with Royal United Hospital in Bath.



Inflation Review.

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Inflation Review.

1.1 Tender Price Index

In the UK, the Tender Price Index increased by 0.5% between Q3 and Q4 2023. This means that the average price of tenders submitted for construction projects increased by 0.5% during this period.

A recent BCIS article issued during November 2023 discusses the impact of the recent Autumn Statement on the construction industry, including the potential for a slowdown in construction activity and a decline in profit margins for contractors. The BCIS article applauded the UK government's £650 billion infrastructure investment pledge over the next five years, anticipating a resurgence in construction activity and project opportunities. They also welcomed the government's efforts to mitigate rising energy costs through measures like the Energy Price Cap, whilst stressing the need for long-term energy security strategies.

BCIS projected a moderating effect on tender price inflation due to the Autumn Statement, but cautioned about persistent inflationary pressures, supply chain disruptions, and labour shortages that could still drive-up prices. Overall, BCIS viewed the Autumn Statement as a positive step, emphasizing the need for continued focus on skills development, energy security, and addressing regional disparities for long-term growth.

1.2 Building Cost Index

According to the latest BCIS data, the building cost index (BCI) increased by 0.4% between Q3 and Q4 2023 in the UK. The building cost index comprises input costs that directly relate to development, including materials, salaries and plant. BCIS projects that the BCI will continue to increase in the next few quarters, with an expected increase of 1.2% in Q1 2024, 0.8% in Q2 2024, and 0.6% in Q3 2024. This means that the overall cost of constructing a building is expected to increase by 2.6% in the first three quarters of 2024.

1.3 Consumer Price Index

The UK's Consumer Price Index (CPI) has been on a steady upward trend over the past 12 months, reaching a peak of 11.1% in October 2022 before gradually declining to 4.6% in October 2023. This trend is primarily driven by rising energy costs, particularly natural gas and electricity, which have been exacerbated by the ongoing war in Ukraine and the commencement of the war in Gaza. Additionally, supply chain disruptions and labour shortages have contributed to increased costs for goods and services across various sectors

In the most recent Q4 2023 figures, the CPI increased by 0.1% compared to the previous month. This relatively small increase indicates that inflation pressures are gradually easing. However, the overall CPI still remains above the Bank of England's target of 2%, reflecting the lingering effects of previous price surges.

Despite the recent fall in inflation, the Bank of England expects CPI to remain above its target for most of 2024. The bank projects CPI to average around 4% in 2024, reflecting the persistence of underlying inflationary pressures.

2.4 Tender Price Forecast

The UK construction industry is poised for a stabilising in tender price inflation, albeit with a continued upward trend throughout 2024. Whilst energy prices and government interventions are easing inflationary pressures, underlying factors like labour shortages and supply chain disruptions are keeping prices elevated. Infrastructure projects are facing the brunt of price increases, projected at 3.01% in 2026, whilst private residential construction is expected to see more moderate inflation, with a forecast of 2.51% in 2026. Despite the slowdown, the industry will need to adapt to these challenges to ensure sustainable growth.

Forecast Inflation

	Q3 202	Q3 2023	Q4 2023	Q3 2023	Q3 2023	Q4 2023	
Year Ending	G&T	Arcadis	FBR	T+T	Mace	BCIS	Average
2024	2.25%	1.50%	3.00%	2.7%	2.50%	2.10%	2.34%
2025	2.25%	3.50%	3.00%	3.00%	3.00%	3.55%	3.05%
2026	2.50%	4.00%	2.50%	3.5%	3.00%	3.67%	3.20%
2027		4.00%	2.50%	3.50%	3.00%	3.67%	3.33%

The average inflation rate by quarter:

- Q1 2023: 6.7%
- Q2 2023: 7.9%
- Q3 2023: 6.7%
- Q4 2023: 4.6%

As you can see, inflation was highest in the first half of the year and then gradually declined in the second half. An average inflation rate of 5.5% is significantly higher than the forecasts projected by G&T, Arcadis, FBR, Mace and BCIS. With that being said, FBR and BCIS' projections have been the closest to the actual inflation figures. It will be interesting to see whose projections will be the most accurate during 2024.

Market Confidence/ Conditions.

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2 Market Confidence / Conditions.

The latest UK Construction Purchasing and Supply Purchasing Managers Index (PMI), which measures the performance of the construction industry, has dropped to 45 which is a sharp decrease from 50.8 in the previous month. It is also well below the forecast of 49.9. For reference, a reading below 50 indicates that most businesses have reported that activity has contracted. This is the third time in the past four months that new business has decreased and is currently the steepest decline seen since May 2020. Within the survey, construction companies typically cited cutbacks to new residential development projects in the wake of sluggish demand conditions and rising borrowing costs.

The cutback of residential development projects is evidenced by a separate index for residential work, which fell to 38.1. This was by far the worst-performing area of construction output and the steepest downturn since April 2009 (apart from the downturn due to Covid). Commercial and civil engineering activity also contracted, which reversed the growth seen throughout the earlier months of the year. Builders noted that worries about the economic outlook had damped client demand. This data comes shortly after the government announced axing the HS2 rail project. Kelly Boorman, partner and national head of construction at RSM UK, said: “The scrapping of HS2 will undoubtedly derail the pipeline of future activity for many contractors and their supply chain. Coupled with the delay in mobilising new infrastructure projects not even announced by the government, this will put some businesses at risk and create further industry uncertainty,” she added.

The data from the survey provided additional evidence that higher interest rates are weighing on demand in the UK economy as intended by the Bank of England in its fight against high inflation. The BoE left its interest rate unchanged at 5.25 per cent in December.

Whilst the data has cast a negative image of the existing market conditions, Samuel Tombs, the chief UK economist at Pantheon Macroeconomics, said that whilst the industry is going through a bad patch, other indicators have shown it is likely to recover. He stated that “The modest decline in the future activity index to 61.9 in September, from 62.6 in August, suggests that most businesses do not expect demand to fall further over the next 12 months,”. The jobs index also remained above the 50 mark, at 52, “which also indicates that builders expect the recent drop in activity to be just a blip”.

Labour Costs / Prices.

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4 Labour Costs / Prices.

The unemployment rate was unchanged at 4.2 per cent. This is the lowest unemployment rate since 1974.

In the three months to the end of October, the estimated number of vacancies in the UK fell by 58,000 to 957,000.

Unemployment remains below the 4.5 per cent level that the Bank of England judges to put downward pressure on inflation. Nonetheless, vacancies continued the recent downtrend, underscoring the impact of slowing economic activity feeding through to the labour market.

The unemployment rate is expected to remain low in to 2024. The Bank of England expects the unemployment rate to average 4.3% in 2023, 4.2% in 2024, and 4.0% in 2025.

The low unemployment rate is good news for the UK economy. It means that more people are able to find work and contribute to the economy. This is expected to lead to higher consumer spending and economic growth.

However, there are still some challenges in the labour market. There is a shortage of skilled workers in some sectors, and some people are still struggling to find work after losing their jobs during the COVID-19 pandemic. A low unemployment rate can make it difficult for construction companies to find qualified workers, especially in skilled trades such as bricklaying, plumbing, and carpentry.

Material Price Inceases.

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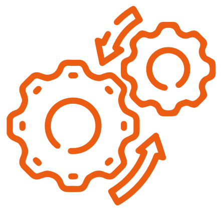
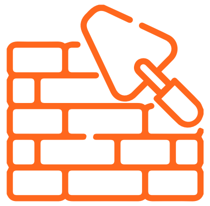
5 Material Price Increases.

The MPI increased by 0.43% between Q3 and Q4 2023. This increase is a continuation of a trend of rising material prices that has been ongoing for several quarters. There are several factors that have contributed to this trend, including:

A rise in the cost of materials, such as steel and timber: The cost of materials has been increasing due to a number of factors, including supply chain disruptions, the war in Ukraine, and increased demand from the construction industry.

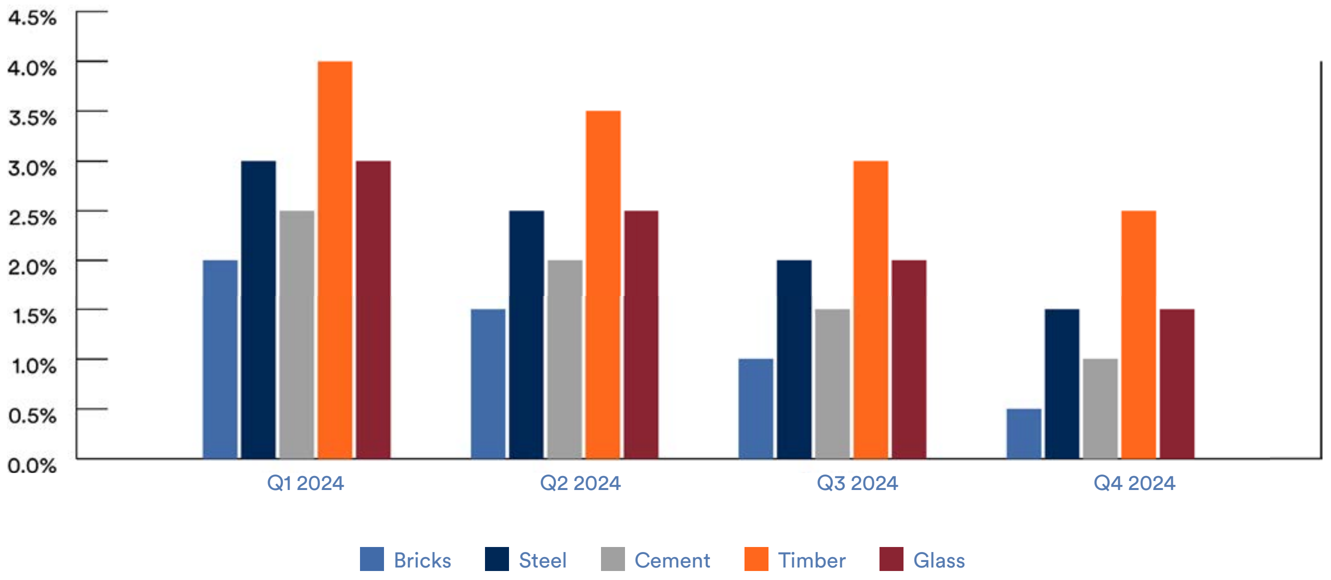


An increase in the cost of labour: The cost of labour has been increasing due to a shortage of skilled labour in the construction industry. This shortage is putting upward pressure on wages.



Last month, construction buyers reported the largest drop in purchasing costs in 14 years, as the ongoing housing slump impacted material demand. A combination of increased price competition among suppliers and falling raw material costs contributed to another drop in construction input prices.

Material Price Index (MPI) Percentage Forecasts 2024.



A shortage of skilled labour: The shortage of skilled labour is also contributing to the increase in the MPI. This is because skilled labour is in high demand, but there is a limited supply of workers available.

The graph represents the following projections to material prices over the next 12 months:

Bricks:

- Supply chain disruptions: The ongoing war in Ukraine and other geopolitical events could continue to disrupt supply chains for bricks, leading to higher prices.
- Last year the UK brick industry couldn't keep up with demand, however, brickyards are now struggling to store the increased stock of bricks which they are holding.
- Labor shortages: There is a shortage of bricklayers in the UK, which could put upward pressure on wages and prices.

Steel:

- Global supply and demand factors: The global supply and demand for steel will continue to be a major factor in determining prices in 2024.
- Energy costs: Energy costs are a major input to steel production, and rising energy prices could lead to higher steel prices.

Cement:

- Supply chain disruptions: Supply chain disruptions could make it more difficult and expensive to transport cement, leading to higher prices.
- Increased demand: Demand for cement is expected to increase in 2024 as construction activity picks up.

Timber:

- Global supply and demand factors: The global supply and demand for timber will continue to be a major factor in determining prices in 2024.
- Labor shortages: There is a shortage of loggers and sawmill workers in the UK, which could put upward pressure on wages and prices.

Glass:

- Supply chain disruptions: Supply chain disruptions could make it more difficult and expensive to transport glass, leading to higher prices.
- Increased demand: Demand for glass is expected to increase in 2024 as construction activity picks up.

This increase is likely to have a significant impact on the construction industry, leading to higher project costs, slower activity, and reduced profit margins for contractors. To mitigate these challenges, construction companies should consider negotiating better prices with suppliers, investing in labour-saving technologies, and enhancing project planning and management practices.

Decarbonisation of the Built Environment.

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6 Decarbonisation of the Built Environment.

In the drive to achieve net zero by the government's stated date of 2050, the construction industry and estate owners must work together to accelerate the decarbonisation of the existing built environment and all new build projects. Progress is slowly increasing in this area, but there is a huge amount still to be done. The balance of achieving net zero and with sound investment is a continuous process. The scale of this challenge is huge

According to a 2019 RICS report, existing building stock accounts for approximately 23% of UK carbon emissions. In the housing sector alone, the UK Green Building Council estimates that the UK's 29 million homes must be retrofitted at a rate of 1.8 every minute to achieve net zero by 2050. This equates to the second largest source of climate emissions after surface transport.

Decarbonising of buildings is often seen as a cost, which indeed it is, but it must also be looked at in terms of life cycle savings. A fabric first approach is vital. In terms of new build this can be achieved through improved design, material and plant specifications, with life cycle and embodied carbon cost plans being implemented in the feasibility stages of the design so these can be tracked throughout the project.

In terms of existing buildings, the below items should be considered:

- Improvement of the thermal insulation of buildings, via improved insulation, cladding changes, improvement of windows, upgrading roof insulation etc. However, a consideration of the embodied carbon in these materials should also be considered as part of the overall review of the project.

- Improve the air tightness of the structure.

- Improved Building Management Systems, to help regulate heating and cooling more efficiently.

- Replacement of inefficient boilers with air source heat pumps.

- Use of renewables across an estate, and potentially the use of on-site power generation, or use of a district network system.

- Use of hydrogen in heating buildings. This has been identified by the government as an area of huge potential and are estimating that by 2035 roughly 13 million homes will have low carbon heating, comprising around 7 million with heat pumps, 4 million using hydrogen, and around 2 million homes using heat networks.

When considering the above, it must also be noted that they should be designed in conjunction with a carbon lifecycle costing tool, to ensure that replacing and renewing the building does not incur more carbon emissions and embodied carbon than would be the case if items of the building were left in situ.

Developing greener buildings could deliver..

Support for around	Around	Savings of
50,000 jobs in 2030	**£11bn** of private investment in the 2020s	**71MtCO$_2$e** between 2023 and 2032 or **16%** of 2018 UK emissions

Fulkers are working with several clients on decarbonisation projects and strategies and are seeing this becoming increasing important for clients as they review their estates and built assets. It will become increasingly important as planning and building regulations become ever tighter on ensuring decarbonisation occurs in line with government targets.

One example of this was the production of a Stage 3 Cost Plan for Decarbonisation Works at Royal United Hospital, Bath. The decarbonisation covered almost the entire estate, with over 30 buildings of varying sizes and included a new build energy centre.

We initially costed several design options, firstly considering connecting into a district heat network or utilising ASHP or GSHPs to serve independent buildings. The district heat network, being the cheaper option, was further developed by the design team, with additional optioneering exercises carried out by FBR to determine best locations for the new energy centre and associated plant. One of the main considerations was the location of the dry air coolers, which were to be located on a grated platform at roof level. In addition, there were a number of challenges to consider, namely removal of existing oil tanks, allowing an uninterrupted power supply to the hospital, trenching below roads, phasing and the general logistical issues associated with works to a busy hospital operating 24/7.

A further cost exercise was carried out to review façade upgrade options, ranging from overcladding existing buildings with rainscreen cladding, to using cavity blown insulation to upgrade U-values of the existing external walls on site. This exercise was carried out to assess whether the cost investment required to improve the building fabric would meet the £350/tCO2e lifetime savings requirement.

The works were costed on a block-by-block basis, due to different blocks having different funding streams, with infrastructure, electrical upgrade and energy centre building works identified separately.

The below drawing shows the number of blocks in scope and the scale of the site.

This project would be a logistical challenge for the hospital, with works programmed to extend to 2027 and beyond.

Advice and Recommendations.

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8 Advice and Recommendations.

Focus on sustainability: Sustainability is becoming increasingly important to both consumers and businesses. Construction companies that can demonstrate their commitment to sustainability will be well-positioned for success. This includes using sustainable building materials, reducing waste, and improving energy efficiency.

Develop strong relationships with supply chain partners: The construction industry is heavily reliant on its supply chain partners. Construction companies that can develop strong relationships with their suppliers will be able to secure the materials they need at competitive prices.

Embrace technology and innovation: The construction industry is rapidly evolving, and those companies that are at the forefront of technological innovation will be the most successful. This includes adopting technologies such as Building Information Modelling (BIM), robotics, and artificial intelligence (AI).

Invest in your workforce: The construction industry is facing a skills shortage. Construction companies that invest in training and apprenticeships will be able to attract and retain the best talent.

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