GT GARDINER &THEOBALD

TPI.

1ST QUARTER 2021

Our Tender Price Inflation report looks at the movement of prices in tenders for building contracts in the UK. The report examines a number of contributing factors and is further informed by our market survey responses and contractor consultations.

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Macro Economic Headlines January 2021

Unless otherwise indicated, figures show percentage change over 12 months

0.6%
CPI Dec 2020
12 month rate

0.9%
RPI Nov 2020
12 month rate

5.0%
UK Unemployment
Sep - Nov 2020

-8.6%
UK GDP
Annual Growth Rate
Q3 2019 - Q3 2020

0.1%
UK Base Interest Rate

3.6%
UK Wage Growth*

*Year-on-Year three month average to Nov 2020. Figures are cumulative annual

Input Costs

Year On Year, November 2019 – November 2020

ONS building materials tables. Figures are cumulative annual — denotes movement trend

-1.5 to 1.5%
M&E Components

3.9%
Concrete Reinforcing Bars (Steel)

$56
Oil Prices Brent Crude (Barrel)
As of 15th Jan 2021

-1.1%
Construction Industry
Year-on-year three month average growth to Nov 2020

6.0%
Fabricated Structural Steel

0.2%
Ready Mixed Concrete

Reduced
Contractor Margins

-3.8%
UK Manufacturing Output
Nov 2019 - Nov 2020

Tender Price Change

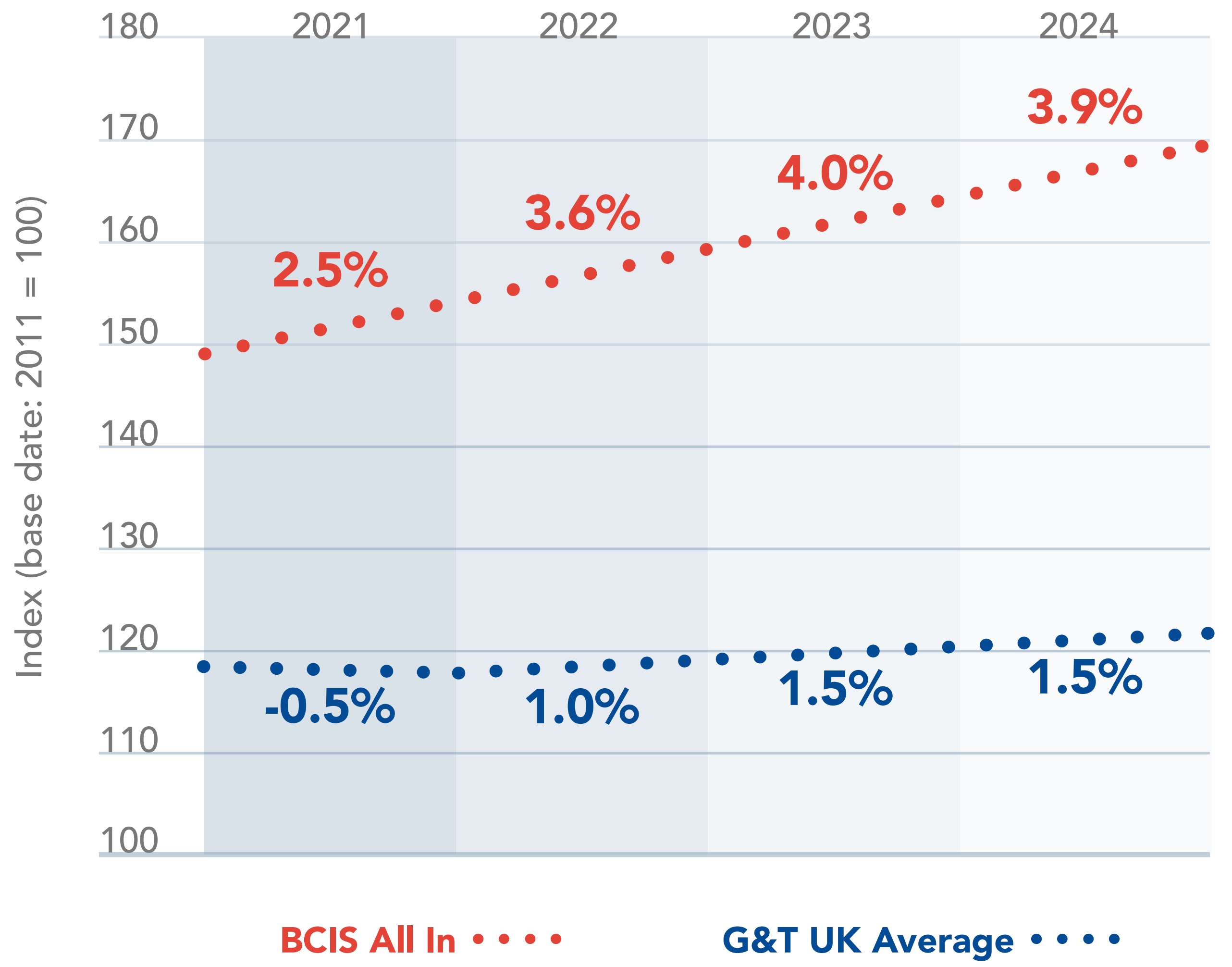
Tender price annual percentage change Q1 2021

%	2021		2022		2023		2024	
Regional forecasts	Now	Last*	Now	Last*	Now	Last*	Now	Last*
Greater London	-1.00	-1.50	1.00	1.00	1.50	1.50	1.50	N/A
South East	-1.00	-1.50	1.00	1.00	1.50	1.50	1.50	N/A
South West	-1.00	-1.00	0.50	0.00	1.00	1.00	1.50	N/A
East	0.00	-1.00	1.00	1.00	1.50	1.00	1.50	N/A
Midlands	-0.50	-0.50	1.00	2.00	1.50	2.00	1.50	N/A
Wales	-1.50	-1.50	1.00	1.00	1.50	1.50	1.50	N/A
Yorks & Humber	-0.50	0.50	0.50	1.00	1.00	1.50	1.25	N/A
North West	0.00	0.50	1.00	1.00	1.50	1.50	1.50	N/A
North East	-1.50	-3.00	0.00	-1.00	1.00	0.50	1.50	N/A
Scotland	0.00	-1.00	0.50	0.00	1.00	1.00	1.50	N/A
Northern Ireland	-2.00	-2.00	0.00	0.00	1.00	1.00	1.50	N/A
UK Average (weighted)	-0.50	-1.00	1.00	1.00	1.50	1.50	1.50	N/A

Last* 4Q 2020

Forecasts

Tender Price Trend, All UK TPI Q1 2021



Our advice is to review each project on its own merits. This forecast publication must be treated as a guide only, being that it is based on averages of various types and sizes of projects across a region, ascertained through our latest market research. The quality, both of design and desired end product, procurement route (particularly ownership and transfer risk), delivery timescales, complexity of design and desire of contractors to tender should be carefully considered in project specific estimates and their outturn cost. Suitable allowances should be made for project specific designs, site conditions and local market conditions, which should be reviewed regularly with your Gardiner & Theobald team to determine the appropriate base cost.

INTRODUCTION

As we approached the end of a tumultuous and unprecedented year, it was looking increasingly likely that the construction industry would have to contend with not only an ongoing global pandemic in 2021, but also the shockwaves associated with a no-deal Brexit. Fortunately, much to the relief of the industry, a historic bilateral trade deal with the EU was signed on 30th December 2020, ending a four-year process that was riddled with uncertainty.

The signing of the Trade and Cooperation Agreement with the EU ensures tariff-free trade between the UK and the European trading block but construction will have to come to terms with a host of new rules and regulations that will impact the procurement and delivery of projects.

Just days after the trade agreement was signed, the UK was dragged into a third national lockdown - dubbed 'lockdown 3.0'. Fortunately, under England's new national lockdown, construction (and its supply chain) was once again given a free pass by the Government to continue, with new business secretary Kwasi Kwarteng saying that the industry is making a major contribution to the economic recovery following COVID-19. In response, the seventh version of the Construction Leadership Council's Site Operating Procedures was published but with only minimal changes. Whilst construction sites have demonstrated that they can operate safely over the past nine months, contractors are acutely aware that if sites are hit with outbreaks, construction could be accused of not managing sites correctly. Consequently, contractors are being extra vigilant in sticking to the current guidelines and creating COVID-secure working environments.

OUR **FORCAST**

With greater certainty over Brexit, our 2021 UK average TPI forecast has been revised upwards to -0.5% (previously -1%) as overall demand holds up. We expect to see a bumpy start to the year as businesses adjust to the new trading relationship and supply chains remain strained due to a slowdown in production from some factories in the EU. We anticipate that the early part of 2021 will be the bottom of the market. However, tender pricing is expected to remain keen in the short-term as the economy recovers and normal levels of demand return.

All regions are expected to see gradual inflationary rises towards long-term average levels of tender price inflation over the next two to three years. However, the market is likely to remain cautious for some time and clients may hold back projects until there is greater confidence in the economic recovery and we see a return to pre-COVID behaviours.

Although trading conditions are, on the whole, expected to be tough in 2021 as contractors wait for the market to stabilise, they will vary by sector. In the healthcare, infrastructure and logistics sectors for example, we're likely to see above-trend tender price inflation as capacity is limited. In other sectors, such as commercial and retail, contractors will be very keen to win work and market discounts will be prevalent.

While the current competitive market conditions could present clients with a good buying opportunity in the first half of 2021, some clients will expect more of a reduction in prices than contractors are willing to give. Faced with rising materials costs (particularly steel) and lower productivity, contractors are evidently pushing back and in some cases are even trying to raise prices.

All forecasts in this report take account of all sectors and project sizes as a statistical average, indicating an overall trend in pricing levels. It should be remembered that individual projects may experience tender pricing above or below the published average rate, reflecting the project specific components and conditions.

MACRO **ECONOMICS**

Two consecutive quarters of decline in 2020 were followed by a 16% quarter-on-quarter rise in GDP in Q3. However, in light of the Government lockdown restrictions in Q4 2020, it's highly probable that the UK will experience a double-dip recession in 2021.

On an annual basis, 2020 will record the biggest drop in national output since 1709. The bounce in Q3 2020 prompted some to hope that the UK would recover much of the lost ground by the year's end. However, this proved to be a false dawn. GDP growth in the third quarter of 2020 proved to be fleeting and the UK economy now looks set to end 2020 more than 10% smaller than it was in the final few months of 2019.

Other macro indicators, namely the CPI and the RPI, indicate that the UK is in a sustained low-inflation environment. Consumer prices rose at an annual rate of 0.6% in December 2020 – well below the Bank of England's 2% target – whilst retail prices over the last 12 months rose by 1.2%. UK inflation has been falling gradually for the past two years but it has dropped more sharply during the pandemic. Although price conscious consumers, excess capacity, limited earnings and curtailed economic activity are likely to limit inflation in the near term, the expectation is that this trend will reverse in the coming months and inflation will gradually edge back up. A comparison of independent forecasts for the UK economy published by HM Treasury in December 2020 showed that UK CPI (on average) is expected to grow by 1.9% whilst the RPI is forecast to grow 2.6% in 2021. However, these figures are likely to be moderated in light of the latest lockdown restrictions.

The central bank has so far resisted further cuts to the base interest rate which remains at a record low of 0.1%. The Bank of England (BoE) has prepared the groundwork for negative interest rates and BoE policymakers suggest that cutting interest rates below zero could be good for growth and would help boost inflation back towards target levels. However, no decision will be made until the Monetary Policy Committee meet in February after it has had a chance to look at the technical feasibility of negative rates.

UK unemployment rose steadily in the second half of 2020. In the three-month period between September and November, the rate reached 5%. The extension of the Job Retention Scheme will provide a lifeline for many jobs over the winter period, but it remains to be seen what happens after it ends at the end of April. Some economists expect a steady trickle, rather than a tsunami, of job losses over the next few months but the OBR estimated, before the tougher restrictions were introduced in January, that the jobless rate would hit 7.5% by mid-2021 (up from 4% before the pandemic struck). Regardless, while the UK unemployment figures could be much worse, the labour market remains fragile and uncertain.

CONSTRUCTION **OUTPUT**

UK construction output ('All Work') has staged a remarkably strong recovery since the peak of the first wave of the virus in April 2020. Output has now grown for seven consecutive months and in November 2020, construction output was just 1.4% lower than it was in the same month in 2019. In fact, output levels in November 2020 were actually 0.6% higher than they were in February 2020 – just before the introduction of the first national lockdown.

With sites being told they can stay open, contractors and developers appear to be managing the risks fairly well at the present time but with the more infectious COVID-19 variant spreading across the UK, site productivity levels may take a hit if work has to be suspended. Also impacting site productivity and project delivery is the fact that, despite calls from industry bodies such as RIBA, most construction workers do not have 'key worker' status. Consequently, a significant proportion of workers will struggle to attend site and manage their homeschooling and childcare commitments, and this could have an impact on output in Q1 2021.

Despite the impressive V-shaped recovery in Q3 2020, we estimate that construction output for the year as a whole will be around 15% lower than it was in the previous year (2019). Looking further ahead, the Construction Products Association's (CPA) winter scenarios forecast indicates that output will grow by 14% in 2021 and a further 4.9% in 2022. However, the CPA, which predicts an overall 'W' shaped economic recession and recovery, warns that output could slump later on in 2021 if there is a sharp rise in unemployment once the furlough and self-employment support schemes end in April. It also notes that the delivery of major infrastructure projects will be crucial to output growth in 2021.

NEW **ORDERS**

New orders experienced a spectacular recovery in Q3 2020 (the latest period for which data is available).

New orders (All New Work) rose by 89% in Q3 compared to the previous quarter. In fact, new order values in Q3 were marginally higher than they were in the same quarter in 2019 – 0.6% or £70m higher.

MARKET **CONDITIONS**

A number of projects that were previously on hold came back to life in Q4, moving to the early stages of design and planning. TPI survey respondents expressed cautious optimism, noting that enquiry levels and new commissions had been positive and that there was an increase in the number of feasibility studies undertaken in Q4 which could potentially materialise into new projects. However, this was caveated, with some suggesting that whether clients commit beyond planning stage will be tenant-led and funding-related.

Currently, there appears to be a two-tier tendering market with lower tier contractors more actively chasing a smaller pool of work and offering increased market discounts. Tier one contractors, however, whilst having to be a little more competitive with their tender price bidding, have largely secured their pipelines for 2021 with some projects spilling into 2022. Accordingly, tier one contractors have been better equipped to bid selectively and avoid low or even 'suicide bidding' to secure turnover. Many of these larger contractors have declined to bid in anticipation of more opportunities and increasing levels of tender activity as we progress through 2021.

Recent Government advice may give the impression that lockdown 3.0 is just 'business as usual' for the construction sector. However, the latest version of the CLC's Site Operating Procedures requires contractors to take action if five or more cases of COVID-19 are identified on site within 14 days. Despite having good protocols in place which are being followed vigilantly, some contractors are concerned that with COVID-19 cases rising in the UK, there is a greater risk of sites having to temporarily shut. This is compounded in metropolitan areas by the lack of capacity on public transport leading to heavily congested travel with no social distancing. If site closures happened at scale, it would damage client confidence and result in delays and postponements of projects.

INPUT **COSTS**

KEY INFLATIONARY AND DEFLATIONARY PRESSURES

Based on our observations of the market, survey feedback and our extensive discussions with the supply chain, we have established that a number of inflationary and deflationary pressures are likely to impact tender pricing.

LABOUR

Construction labour rates have recovered strongly since hitting their low-point in May 2020. According to the ONS, average weekly earnings (total pay) rose for six consecutive months between May and November 2020, nearly returning to pre-pandemic levels. In November 2020, the three-month weekly earnings average was just 1.1% lower than it was one year ago.

Weekly earnings recovered relatively quickly once work on construction sites resumed and employees were unfurloughed. Whilst initially utilising the Government's Job Retention Scheme heavily, BCIS data (covering 30th November to 13th December 2020) shows that the construction sector had just 2.8% of its workforce on partial or furlough leave, making it the third best performing sector in this respect. However, without the Government's support to keep sites open, the labour market could have been starkly different.

DEFLATIONARY PRESSURES

- If recovery in new orders isn't sustained and workloads fall, competition for new work will increase
- Muted activity in commercial, retail and hospitality sectors expected in 2021
- New/more productive ways of working introduced on site
- Clients withholding investment and delaying projects until vaccine rollout has made further progress and restrictions are relaxed
- Contractor focus on preserving cashflow and securing pipeline, squeezing margins

INFLATIONARY PRESSURES

- Constrained labour supply if EU workers don't return to site
- Site Operating Procedures adding cost and reducing potential productivity levels on site by around 20%
- Delays at ports as new customs systems bed in, increasing transport costs
- Full safety and security declarations on construction products at the border from July, increasing the risk of supply chain disruption
- Increased public sector spending/investment by central Government leading to increased construction activity
- Reduced manufacturing/factory output resulting in materials shortages
- Demand outpacing supply for key materials (eg steel)
- Surging commodity prices after declining in early 2020
- Risk of extended programmes if sites are hit by COVID-19 and work is suspended

MATERIAL COSTS

According to the ONS, the 'All Work' material price index rose by 3.1% in the year to November 2020. After briefly falling in the summer months, the index rose sharply in the autumn

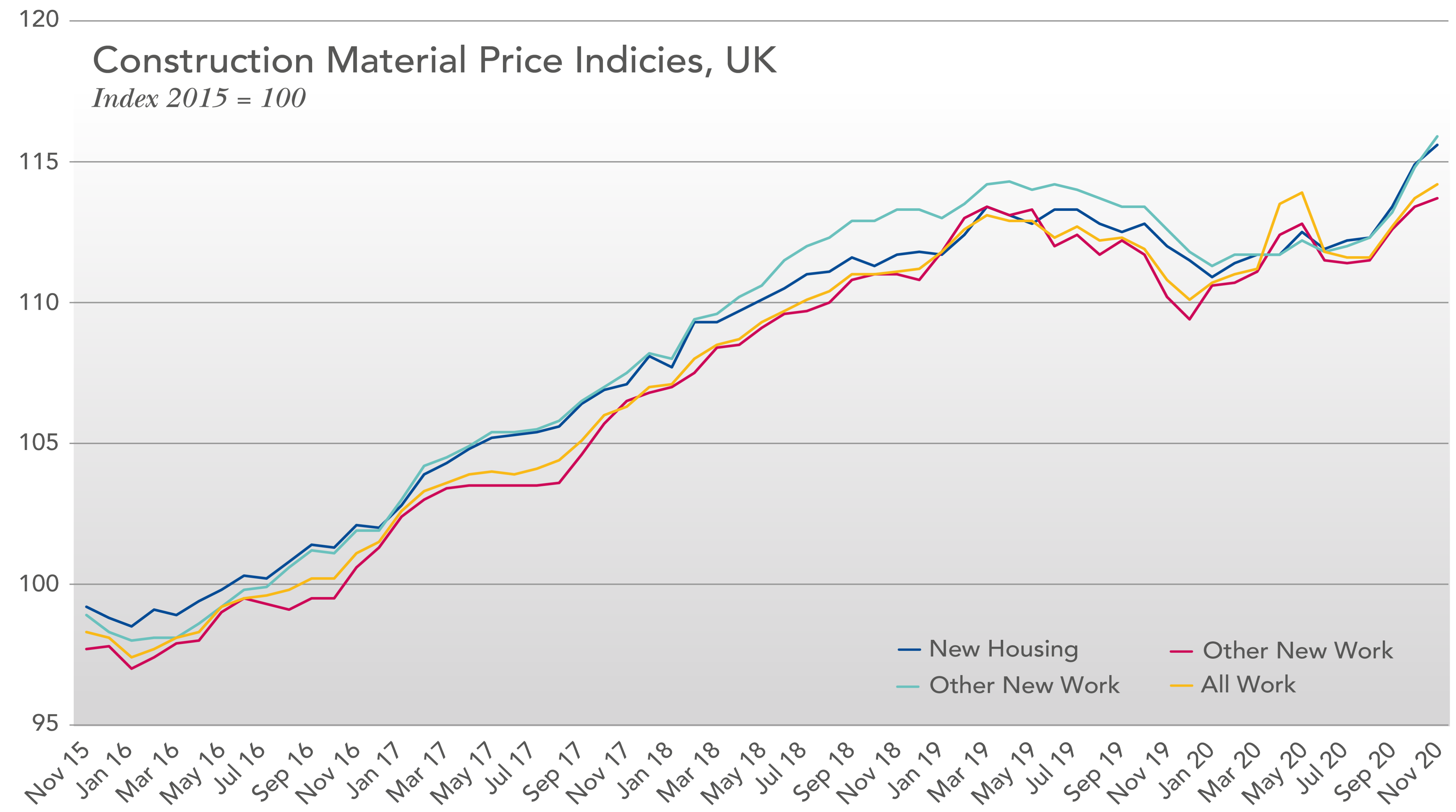
Shortages and supply issues helped push up prices as a whole in 2020. As site activity picked up in the second half of 2020 and demand outpaced supply, several key materials such as fabricated structural steel and imported timber experienced above-average cost inflation of 8.4% and 5.8% respectively in the three months to November 2020.

PROFITABILITY AND **PROCUREMENT**

Our latest TPI survey found that a slight majority of respondents (51.4%) believed that overhead and profit (OH&P) remained largely unchanged in the three months to December 2020 compared to the previous three-month period. However, over 45% of respondents said that they had seen an overall downward movement in OH&P in Q4 2020. These respondents noted that a lack of new work in certain sectors (eg commercial office fit-out) was putting downward pressure on OH&P, particularly on lower value projects receiving bids from smaller contractors.

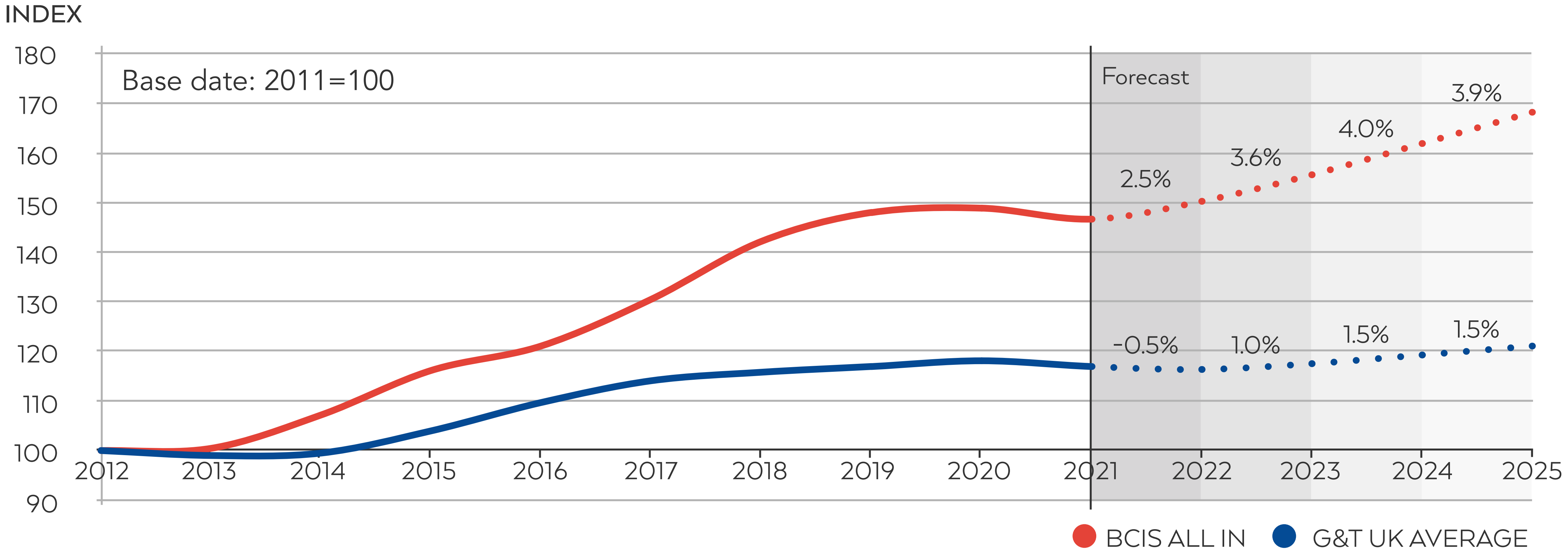
This trend isn't expected to change significantly over the next 12 months according to survey respondents.

Most respondents (63%) reported that there were no changes to preliminaries costs in Q4 compared to the previous quarter. As with OH&P, smaller contractors appear to be more readily willing to reduce preliminaries despite the additional costs resulting from compliance with SOPs and enhanced welfare provision. It's envisioned that stringent SOPs will remain in place for the foreseeable future and so most survey respondents (55%) believe preliminary costs will not change from current levels. However, a significant proportion (31%) believe that preliminary costs will fall in 2021 as firms feel sustained pressure to price keenly and offer discounts in order to win work.

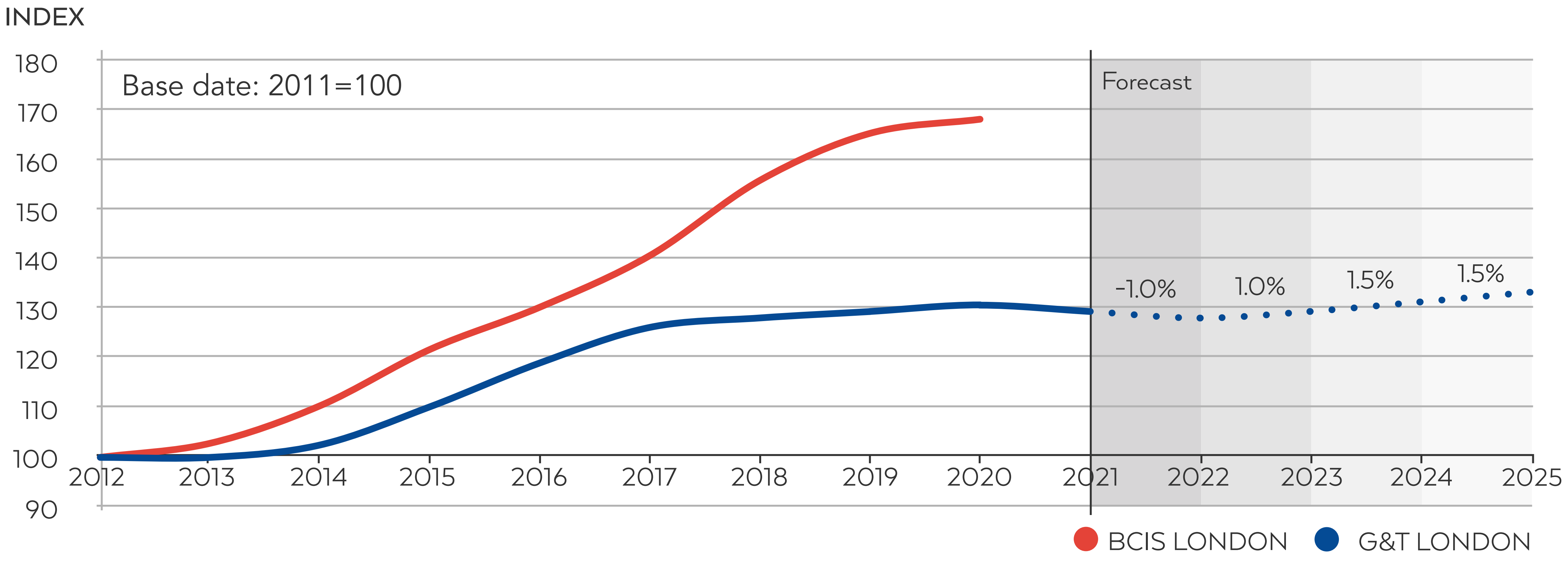


Tender Price Indicator Trends & Forecasts

*Tender Price Trend **"UK Average"** Q1 2021*



*Tender Price Trend **"London"** Q1 2021*



Note: BCIS does not publish regional TPI forecasts.

Tender Price Change

Tender price annual percentage change Q1 2021

%	2021		2022		2023		2024	
Regional forecasts	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***
Greater London	-1.00	-1.50	1.00	1.00	1.50	1.50	1.50	N/A
South East	-1.00	-1.50	1.00	1.00	1.50	1.50	1.50	N/A
South West	-1.00	-1.00	0.50	0.00	1.00	1.00	1.50	N/A
East	0.00	-1.00	1.00	1.00	1.50	1.00	1.50	N/A
Midlands	-0.50	-0.50	1.00	2.00	1.50	2.00	1.50	N/A
Wales	-1.50	-1.50	1.00	1.00	1.50	1.50	1.50	N/A
Yorks & Humber	-0.50	0.50	0.50	1.00	1.00	1.50	1.25	N/A
North West	0.00	0.50	1.00	1.00	1.50	1.50	1.50	N/A
North East	-1.50	-3.00	0.00	-1.00	1.00	0.50	1.50	N/A
Scotland	0.00	-1.00	0.50	0.00	1.50	1.00	1.50	N/A
Northern Ireland	-2.00	-2.00	0.00	0.00	1.00	1.00	1.50	N/A
UK Average (weighted)	**-0.50**	**-1.00**	**1.00**	**1.00**	**1.50**	**1.50**	**1.50**	**N/A**

Last* 4Q 2020

COMPARISON OF PUBLISHED FORECASTS FOR TENDER PRICE CHANGE

Note: All figures relate to year-on-year quarterly changes
Note: These are Aecom's baseline TPI forecasts

	G&T UK AVER. Q1 2021	**BCIS** UK AVER. JANUARY 2021	**G&T** LONDON Q1 2021	**AECOM** UK Q1 2021	**ARCADIS** LONDON WINTER 2021
	% CHANGE				
2021	-0.50	2.54	-1.00	0.80	0.00
2022	1.00	3.58	1.00	2.40	2.00
2023	1.50	4.03	1.50	N/A	4.00
2024	1.50	3.88	1.50	N/A	5.00

BREXIT:
CHANGES FOR UK CONSTRUCTION

To the relief of many working in the UK construction sector, the UK signed an historic Trade and Cooperation Agreement (TCA) with the EU on 30th December 2020. The TCA ensures tariff-free trade between the UK and European trading block, but construction will have to come to terms with a host of new rules and regulations that will impact the procurement and delivery of projects.

Despite being described as a 'thin' deal by some, the broadly welcomed agreement reached with the EU will enable construction companies to continue to forecast the cost and availability of products and materials imported from the EU (or comprising components made in the EU). The inflationary shocks that would have ensued from tariff and quota introductions, as well as the expected currency depreciation associated with a no-deal, have been averted. The TCA delivers a certain degree of continuity that will help maintain the current cost levels of importing construction products and materials to the UK.

In addition, the mutual commitment by the UK and the EU to minimise technical trade barriers and an agreement on regulatory co-operation at the border will help to avoid some of the risks of delay and disruption. However, some administrative burdens will be unavoidable. These, along with additional checks at the border, are likely to increase the cost of moving construction products and materials across the border. Fortunately, the TCA includes various grace periods that will offer temporary relief as the new arrangements bed in. There is a 12-month grace period on some elements of 'rules of origin' declarations and full safety and security declarations on construction products crossing the border will only have to be made from July 2021 onwards. However, once these end, the volume of paperwork required will increase and the risk of supply chain disruption will rise.

The deal, while delivering certainty around the future relationship between the UK and the EU, only contains vague commitments around trade in services. The lack of details around providing consultancy services, for example, remains a serious concern for construction and the exclusion of financial services from the agreement is major risk to the health of the UK economy as a whole. With limited provisions on trade in services included in the TCA, we're likely to see more segmentation and complexity which may ultimately result in restrictions and reduced market access.

There are also concerns around capacity problems at UK container ports. Although the recent capacity issues are thought to be largely COVID-related, stemming from disrupted container movement at ports since September and resulting in logistical logjams, it demonstrated just how quickly supply issues can cause delays, shortages and consequential price increases.

The most drastic disruption of a no-deal outcome has been avoided but in the coming weeks and months the complexities of the EU-UK trade agreement, and the impact it will have on the construction supply chain, will become clearer.

This is an extract from a longer article.
Visit: marketintel.gardiner.com to read in full.

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