The New Normal:

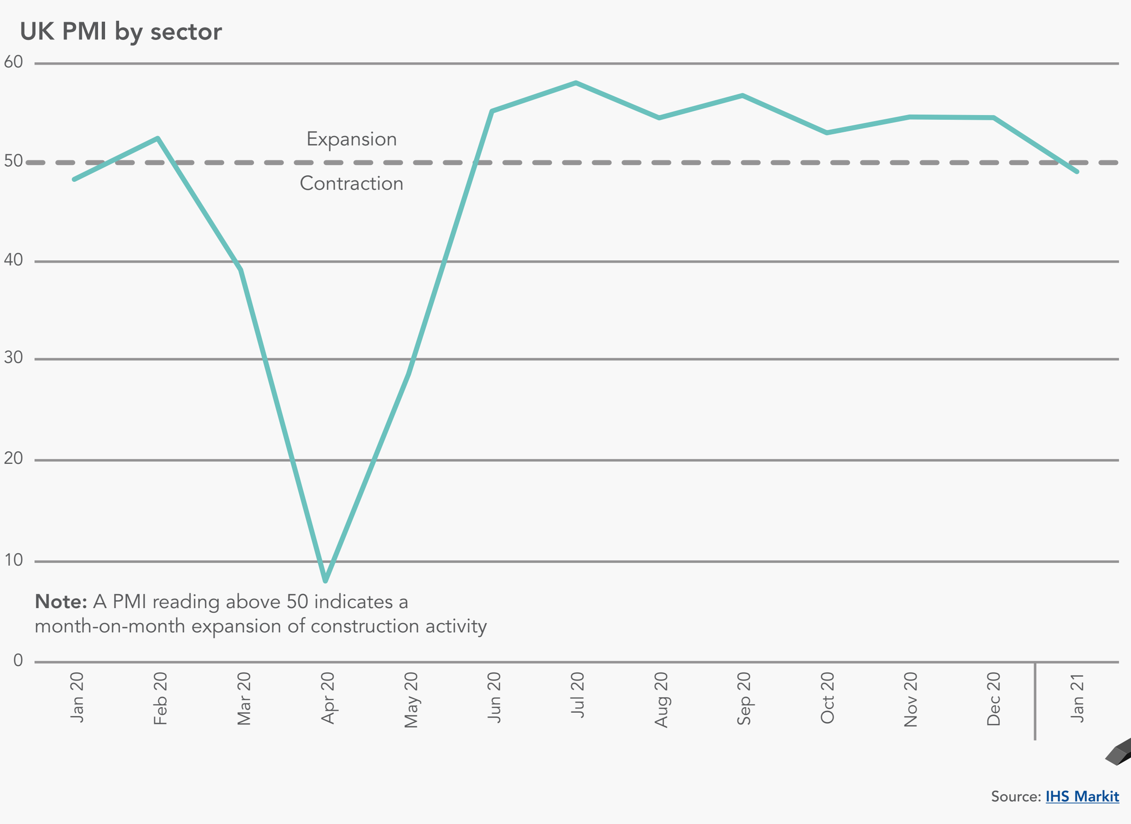
CONSTRUCTION UPDATE

9th February 2021

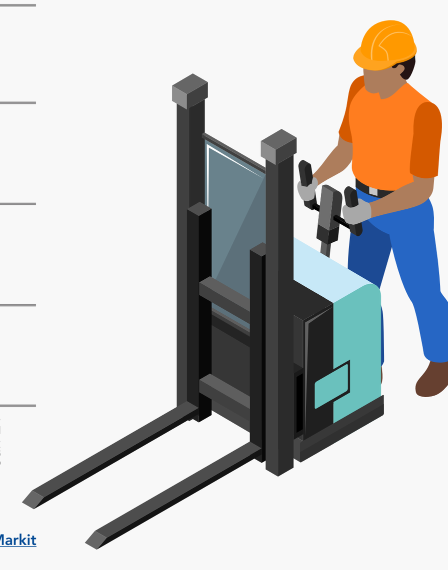
Construction

1. Data from the ONS' 'business insights and impact on the UK economy' series indicates that in the two weeks between 28th December 2020 and 10th January 2021, nearly 93% of surveyed construction firms reported that they did not experience any challenges with importing products or materials. However, a small proportion of firms (circa 3%) did report changes in transportation costs, a lack of hauliers to transport goods and disruption at UK borders. Just 2% reported that 'suppliers were not customs ready'. However, this is in stark contrast with the UK manufacturing sector where only 54% of respondents said that they did not experience any challenges with importing and nearly 35% reported disruption at the border.

2. According to January's IHS Markit/CIPS UK construction PMI, construction activity contracted for the first time in seven months – the first reduction in activity seen in seven months.



Source: IHS Markit



According to the PMI survey:

- Overall output fell for the first time since May 2020
- A renewed fall in commercial activity and another drop in work on civil engineering projects offset strong growth in the residential subsector
- New orders rose the least in seven months with the third national lockdown and concerns about the near-term economic outlook causing client hesitancy
- Employment levels declined due to the non-replacement of leavers following project completions
- Input cost inflation accelerated to its highest for just over two-and-a-half years, driven by higher plaster, steel and timber prices

3. In its latest forecast, the CPA expects that construction output will rise by 14% in 2021 and 4.9% in 2022. A sustained recovery is expected from Q2 2021 as vaccines are rolled out and the services-based economy reopens. The forecasted rises will follow an estimated contraction of 14.3% in 2020 but the CPA warned that output was only expected to return to pre-COVID levels in 2022. The CPA noted that while some sectors of construction are dependent on consumer and business confidence returning, construction activity has largely been able to bounce back quicker than the overall economy.

4. Mayor Sadiq Khan has formally adopted a much-altered London Plan, more than four years after starting work on the document. The plan implements many of the manifesto commitments made by Khan when he was elected mayor in 2016, including improving the capital's air quality, making London a zero-carbon city by 2030, a long-term target for 50% affordable homes in new developments and protecting the green belt. The plan also includes updated space and quality standards for new build homes. However, housing number targets in the adopted plan have been reduced as they were considered 'undeliverable'.

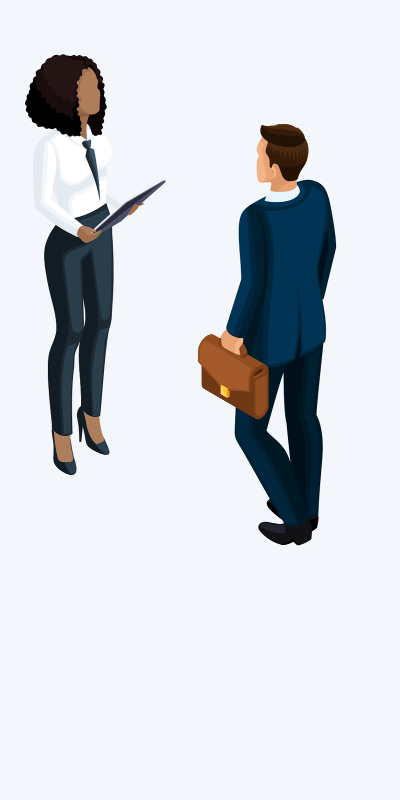
5. A report by the Public Accounts Committee (**PAC**) has highlighted the risk that tax payers will not get value for money from the planned £600bn infrastructure pipeline. The report also called in to question the private sector's ability to deliver the project pipeline, raising concerns about speed of delivery, transparency and overspend. The PAC report also said that calibre and number of people in leadership positions in major projects was still not strong enough. It suggested that senior project delivery workers should be required to attend the Infrastructure and Projects Authority's major projects leadership academy.

6. The latest HMRC statistics show the number of construction employees on furlough rose from 130,700 at 31st October 2021 to 169,700 at 30th November - a 29% month-on-month increase. Of the construction positions furloughed in November, 120,000 were fully furloughed while 49,400 were partially furloughed. Provisional estimates at the end of December 2020 suggest this figure rose again (to 193,400), representing 15% of the sector's workforce. However, the trend was reflected in the wider figures across other UK sectors.

Contractor news

1. Main contractor payment times have improved in the last six months dispelling fears the industry would be hit by COVID-related payment delays. On average, the 32 leading contractors paid subcontractors within 35 days - 10 days quicker than when the trade body Build UK first started collating payment data in July 2018. Vinci, Morgan Sindall, Sir Robert McAlpine and Sisk now rank as the promptest payers managing to pay faster than the Government target of 30 days. Willmott Dixon, Kier, Mace and Interserve also managed to hit 30-day terms.

2. **BAM** has signed a £192m deal to build a TV and film studio for Sky in Elstree, Hertfordshire. The 32 acre complex is being developed in partnership with sister firm NBCUniversal and will include 14 sound stages, production offices, a set construction workshop, a screening cinema and state-of-the-art post-production and digital facilities. The studios will not use gas or fossil fuels to power day-to-day running of the site – instead it will source renewable energy with the capability to generate up to 20% of energy on-site through solar energy. Rainwater will also be harvested for use around the site and no single-use plastics will be used during construction.



3. The order book of M&E contractor **T Clarke** hit a record high of £465m according to its recent trading update, indicating healthy future workloads. However, the firm indicated that underlying profit would be down as a result of the pandemic. Margins recovered to 3% in the second half of 2020 after the impact of COVID-19 sent it to a pre-tax loss of £1.5m in the first half of the year (from a £4.5m pre-tax profit last time). The firm noted that trading had improved considerably from Q2 2020, adding it was expecting revenue for the year to be around £232m with underlying profit of approximately £6m – although this is considerably down on the £335m turnover it posted in 2019 when underlying profit stood at £9.2m.

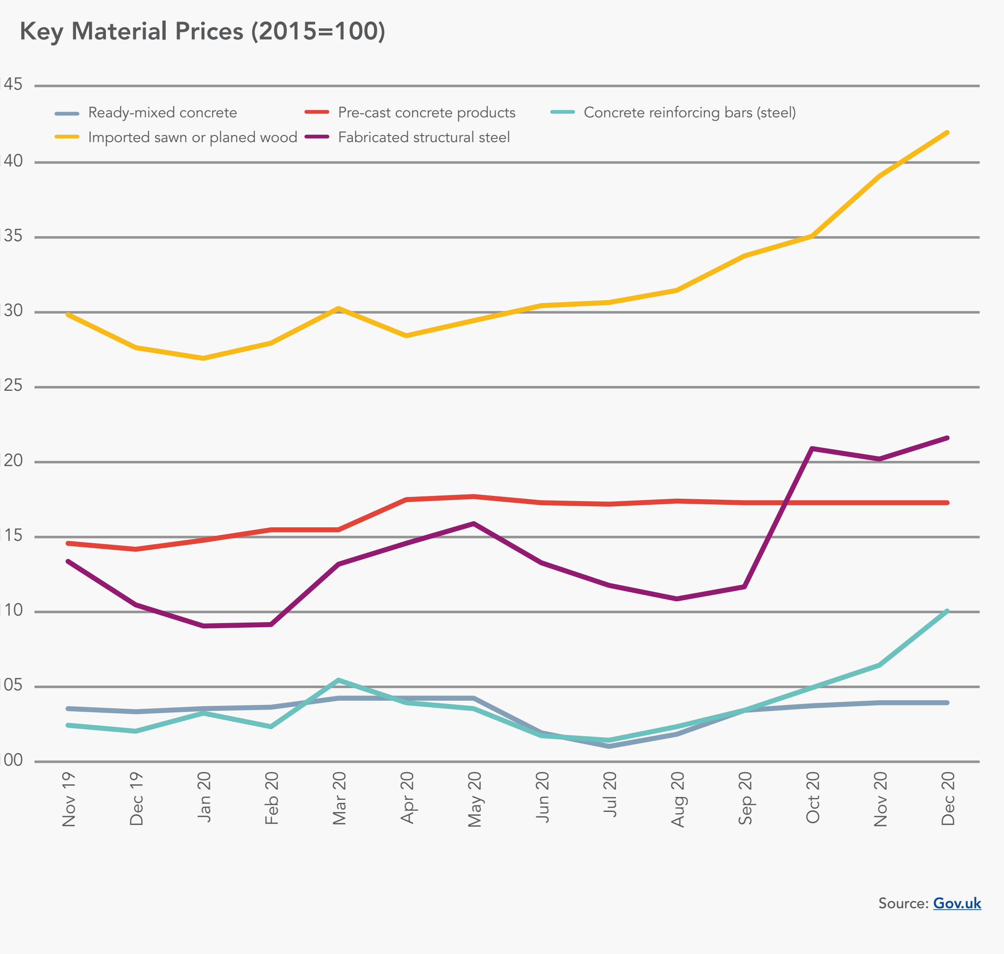
4. **Kier** has been appointed on an £87m job to replace England's oldest operating theatre at Musgrove Park Hospital in Somerset. The new surgical centre will replace the 1940s-built Taunton hospital's critical care unit and will include eight operating theatres, six endoscopy rooms, a patient recovery and clinical support area together with a 22-bed critical care unit specifically catering for level 2 and 3 critical care patients. Enabling works are currently being carried out on site but main construction works aren't expected to start until 2022 with completion scheduled in 2024.

5. **ISG** has won a contract to fit out the new UK headquarters of US tech giant Facebook in King's Cross. The job is due to start in the coming weeks after BAM, who has been working on the scheme since late 2018, wraps up works on the buildings' shell and core. The job, involves fitting out the two Facebook buildings (currently known as T2 and T3) which feature between 10 and 12 storeys of office space, providing a total of 415,000 sq ft. *G&T is providing Project Management services on the fit-out stage of the scheme. G&T has also been providing Project Management, Quantity Surveying and Employer's Agent services on the base build.*

6. Fletcher Priest's plans for a 32-storey tower in the Square Mile have been approved by City of London planners. The scheme at 55 Gracechurch Street at the southern end of Bishopsgate is being developed by Hong Kong firm Tenacity and will sit in the shadow of the Walkie Talkie building. The building will feature 25 floors of office space on top of a six-storey podium with a public garden at the base. The scheme is aimed at start-ups and traditional City occupiers and will provide "hybrid, new generation, resilient" workspace. Both Mace and Sir Robert McAlpine are expected to run the rule over the work but others (including Lendlease, Skanska and Laing O'Rourke) are also thought to be interested.

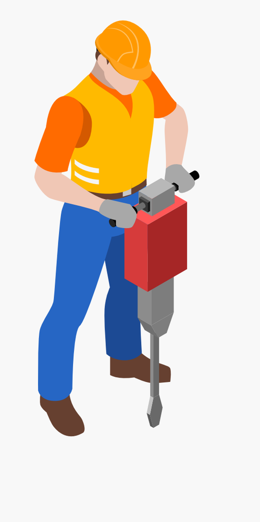
Commodities & Materials

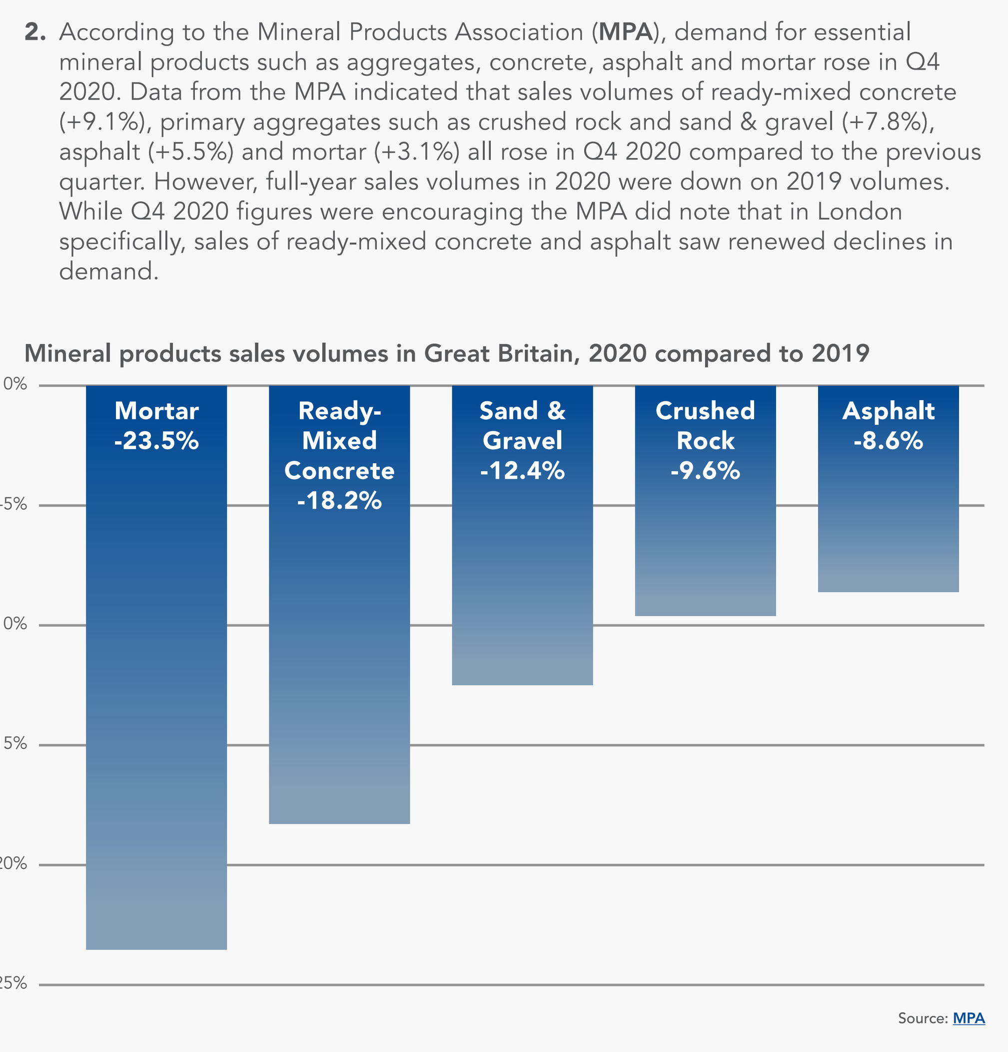
1. Construction material prices continued to rise in December 2020 as the ONS' 'All Work' material price index grew by 0.9% month-on-month. Material prices in December 2020 were, on average, 4.6% higher than they were one year ago. Price rises have been driven by a few key materials. Fabricated structural steel prices have increased by 10% over the last 12 months due to rising raw material costs and a supply/demand imbalance. Timber (+11.2%) and rebar (+7.8%) prices have also risen dramatically over the last 12 months as manufacturing capacity struggled to keep up with demand.



Source: Gov.uk

2. According to the Mineral Products Association (**MPA**), demand for essential mineral products such as aggregates, concrete, asphalt and mortar rose in Q4 2020. Data from the MPA indicated that sales volumes of ready-mixed concrete (+9.1%), primary aggregates such as crushed rock and sand & gravel (+7.8%), asphalt (+5.5%) and mortar (+3.1%) all rose in Q4 2020 compared to the previous quarter. However, full-year sales volumes in 2020 were down on 2019 volumes. While Q4 2020 figures were encouraging the MPA did note that in London specifically, sales of ready-mixed concrete and asphalt saw renewed declines in demand.

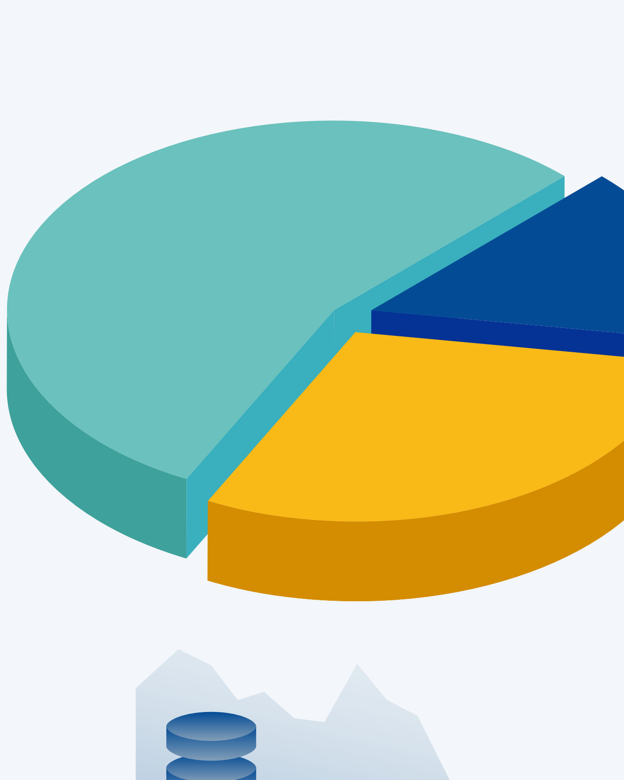




Source: MPA

3. UK factories are struggling to keep up with the high levels of demand of certain key materials. The Builders Merchants Federation (**BMF**) said that delivery dates for roofing material (ie pitched roof ties) have been extended from three months to six or more months as a result of coronavirus-related challenges. Although this isn't having a major impact on contractors and housebuilders yet, it could do in the next few months. The FMB also said shipping costs for imported materials from China (eg plumbing products and bathroom suites) hit record highs due to capacity issues at major container ports. Producers have been unable to absorb the huge price increases for container loads.

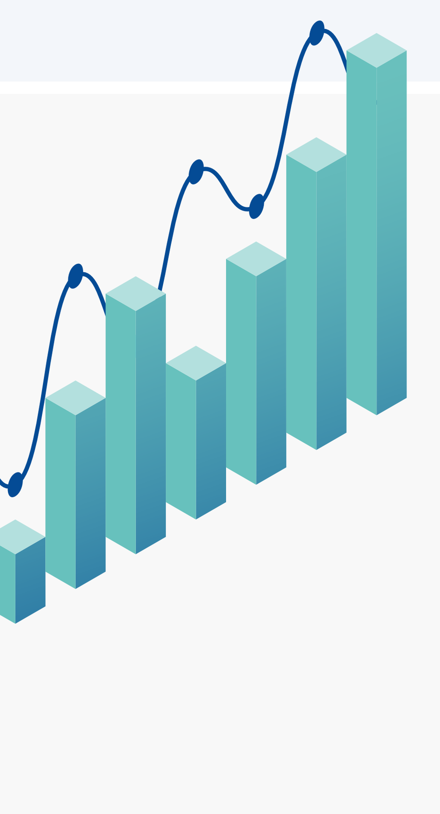
UK Economy



1. The Bank of England expects the UK economy to shrink by 4.2% in Q1 2021, but policymakers expect economic growth to "recover rapidly" in the spring as consumer confidence and household spending improves. Although the expected contraction in GDP in Q1 will drag on growth for 2021 as a whole, the BoE forecasts that the UK economy will still grow by 5% (compared to a previously predicted 7.25%). The bank said that forecasted growth will be supported by a successful vaccination programme which, in turn, will lead to an easing of COVID-related restrictions.

2. Although the Monetary Policy Committee (**MPC**) does not think such a move will be necessary, the BoE announced that it will start to prepare so that negative interest rates could be set within six months to help stimulate spending if the recovery is weaker than expected. In its quarterly report, the MPC noted that the economic outlook had brightened for the second half of 2021, but said that it still needed to complete the planned £150bn of additional quantitative easing to help keep inflation close to its 2% target.

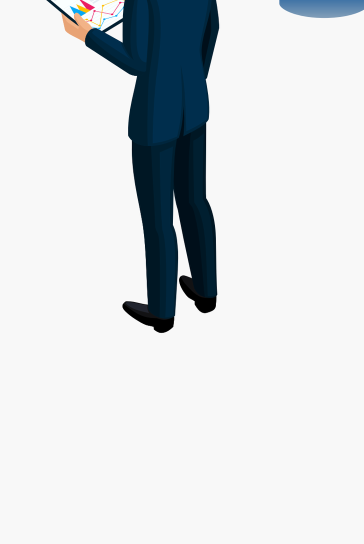
3. Supplier delivery times for UK manufacturers in January were among the longest in three decades according to the latest IHS Markit/CIPS manufacturing PMI. Factory production was constrained as EU-based clients brought forward purchasing to avoid expected disruption. Input shortages also acted to constrain supply in some sectors resulting in price increases and overall manufacturing cost inflation rising to a four-year high.



Global Economy

1. Eurozone inflation shot up to its highest level since the pandemic hit in early 2020, ending a five-month spell of falling prices. Headline CPI hit an 11-month high of 0.9% in January (0.3% in December 2020) according to Eurostat – the fastest jump in more than a decade. However, the jump was thought to have been driven by one-off factors (eg a reversal in a temporary reduction in German VAT, higher energy costs and supply chain disruption raising manufacturing/retail prices) rather than a revival in underlying demand. Given the extensive slack in the labour market, the rise is not expected to be sustained according to Capital Economics economist Andrew Kenningham:

"We expect inflation to drop back again as we think the impact of the pandemic recession will ultimately prove to be disinflationary."



2. The IMF expects that the US and China will recover most strongly from the economic hit caused by the global pandemic. In their updated forecasts, the fund predicts that by 2022 the recovery in both countries will leave their economies no more than 1.5% smaller than projected before the pandemic. Effective containment measures in China and fiscal stimulus/looser lockdowns in the US are the key reasons behind their expected success. Other advanced economies are expected to be 2.5% short of their pre-pandemic path.