GARDINER &THEOBALD

G&T M&E Contractor Survey

June *2024*

G&T's M&E Contractor Survey summary for June 2024 analyses some of the key trends and themes generated from the responses of our most recent M&E contractor survey.

Please note: *Although survey respondents operate across all geographical regions of the UK, the majority tend to operate in Greater London and the South East.*

G&T's latest survey of M&E contractors has provided valuable insights into the current state of the UK MEP market. Although construction input cost inflation has returned to more normal levels, surveyed contractors remain concerned about labour cost pressures, supply chain insolvencies and the recent spike in copper prices. The M&E supply chain is also contending with capacity issues and strong industry demand from certain buoyant sectors. These factors are impacting MEP package prices, squeezing certain sub-trades and putting further risk on the supply chain.

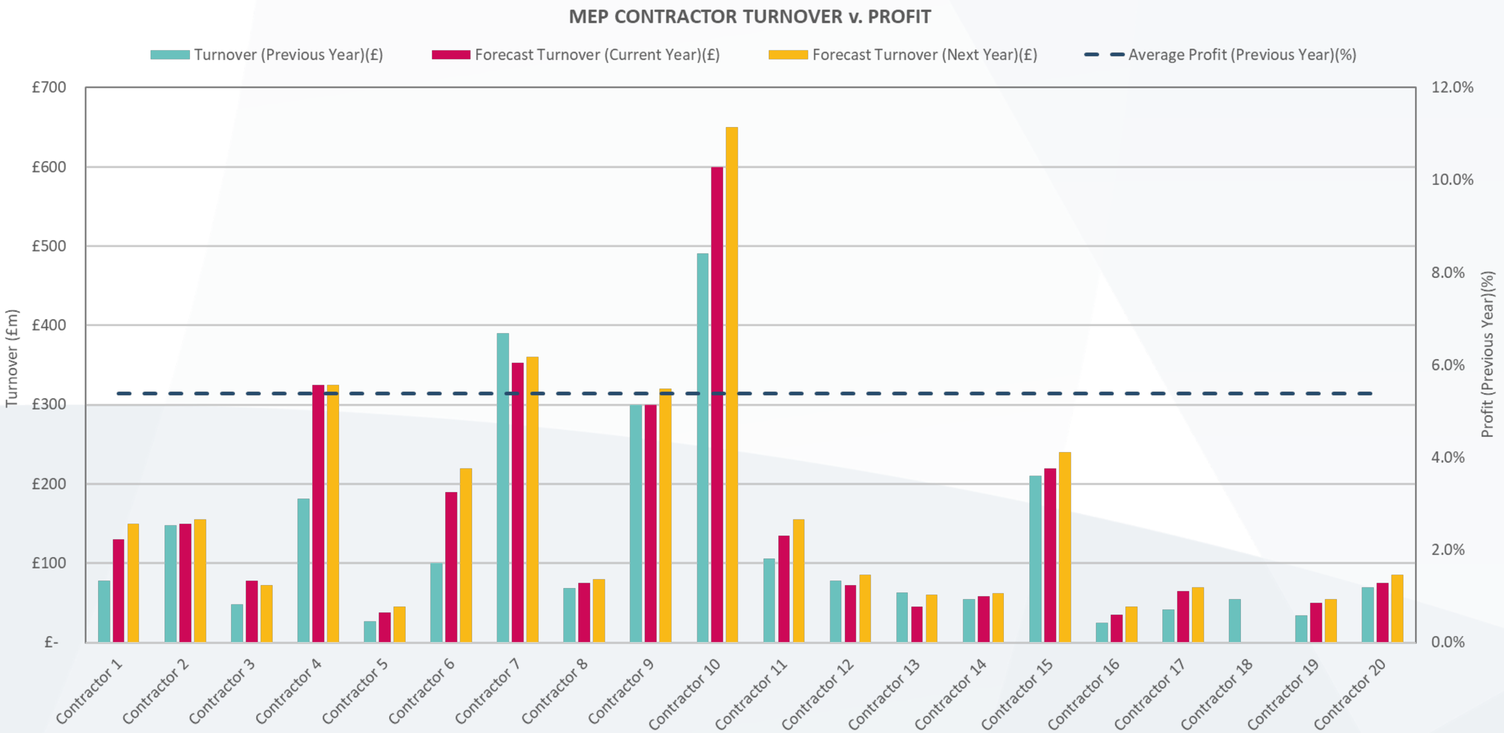
MEP intensive projects such as data centres, life sciences and plant replacement are all absorbing contractor capacity in the market, resulting in smaller tender lists and limiting bidding competition. These projects are also absorbing key plant factory capacity and driving higher pricing for items like switchgear, generators and heat pumps. Geopolitical pressures, trade embargoes and supply disruption in the Red Sea are also putting pressure on some imported MEP items.

Faced with the prospect of further cost volatility, contractors in the UK MEP market remain risk-averse. There are significant concerns about offering fixed prices on projects with long lead-in periods. Many noted they are being more selective with their tendering, looking closely at the Main Contractor lists before committing to tender and choosing to walk away rather than being pressured into taking work at too low margins.

Key Takeaways from the Report

- *Although buoyant sectors have placed significant demand on the MEP supply chain, most contractors still have some capacity to take on additional workload.*
- *Activity is being bolstered by the decarbonisation agenda, which includes plant replacement, renewables and advancements in building technology.*
- *MEP tender price inflation is projected to remain at 4% or higher for the next three years. However, a slowdown in live projects might drive the need to secure new projects and encourage more competitive pricing with the right tender list.*
- *Contractors expressed a preference for schemes where they can engage early and have a design at a stage that allows for early procurement rather than inheriting a poor design and having to go back to first principles.*
- *An attractive tender with good design and balanced risk profile is essential to secure a competitive tender in the current market.*

**Note*: The views and forecasts expressed in this report are solely those of the survey respondents and do not necessarily reflect the views or opinions of Gardiner & Theobald.*



90%

of contractors expect **turnover to increase** in their next financial year

by an average of…

+8%

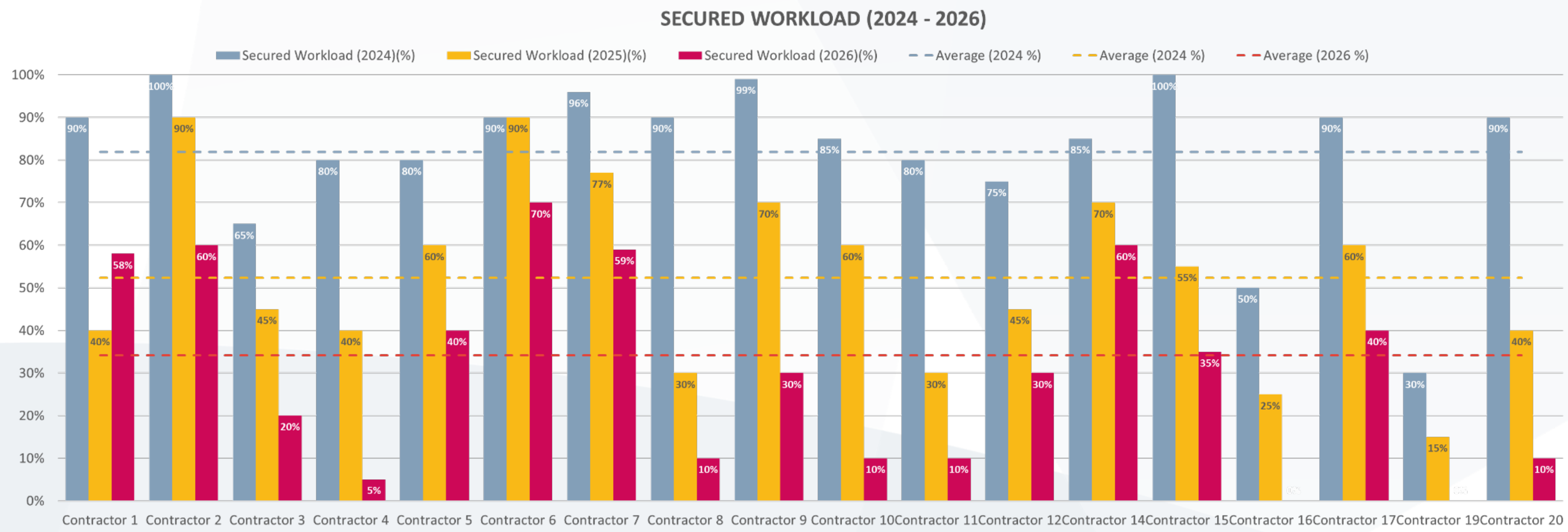
(compared to forecast turnover for current year)

Average Profit previous financial year…

5.4%

*(compared to **5.7%** in 2022-23)*

- According to surveyed MEP contractors, turnover for the current financial year is projected to be, on average, **16.5%** higher than that of the previous year
- Contractors also expect turnover to rise again in their next financial year, with an average **increase of 8%** compared to the current financial year
- In line with previous surveys, most contractors (**90%**) anticipate that turnover in their next financial year will surpass the current year
- The average profit in the previous financial year (2023-24) was **5.4%** – down from **5.7%** in the 2022-23 financial year



On average, contractors have secured 82% of 2024 workloads, 52% of 2025 workloads and 34% of 2026 workloads

- The workload secured for the year ahead is slightly lower than in June 2023 (**52%** in this survey vs. **58%** in June 2023)
- Despite high demand placed on the MEP supply chain by buoyant sectors, most contractors still have some capacity to take on additional workload. Specifically, **75%** of contractors have at least **10%** slack available for 2024

- While the MEP market currently boasts a healthy volume of work and a robust pipeline, contractors remain eager to secure future projects. They are actively seeking opportunities to fill any gaps in their order books resulting from stalled or cancelled projects

“Uncertainty in the market for projects moving into construction is the key concern, with private sector clients not pushing forward [with] projects due to budget constraints and a slow down in public sector spend due to [the] election…”

TYPICAL PROJECT OH&P, PRELIMINARIES AND RISK ALLOWANCE

TYPICAL OH&P

11.2%

(Range: **5-15%**)

TYPICAL PROJECT PRELIMINARIES

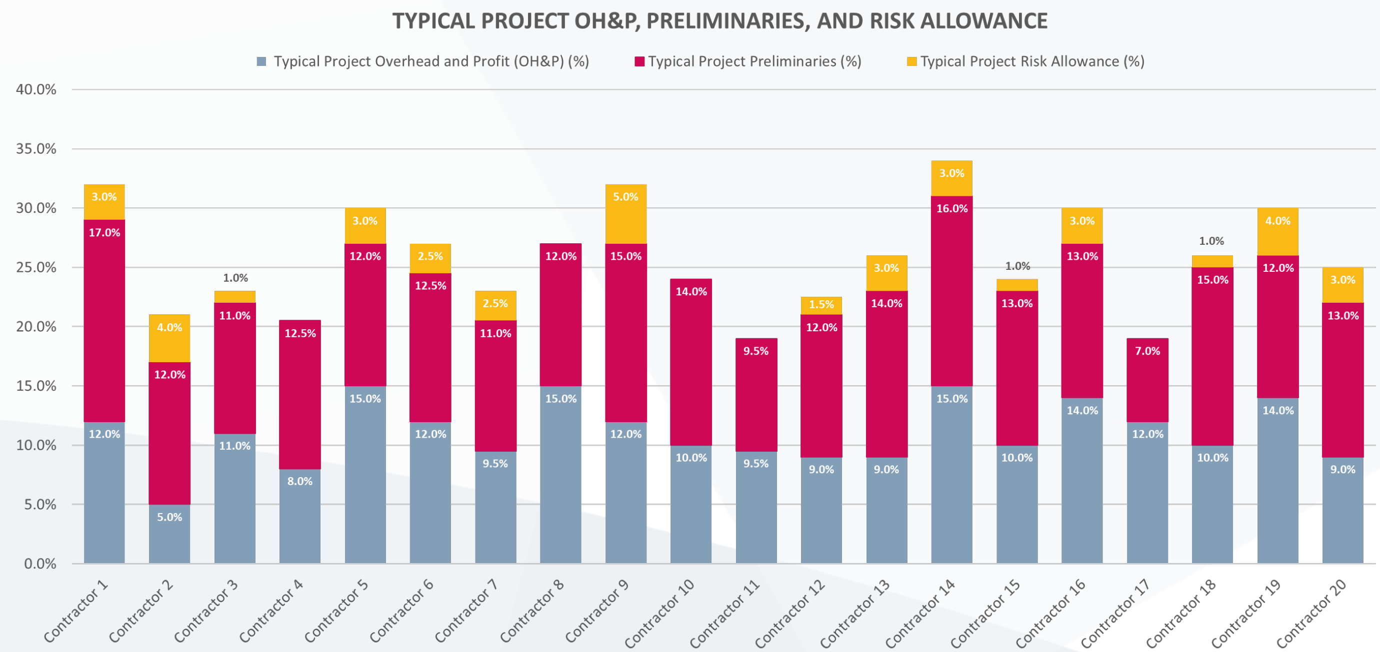
12.7%

(Range: **7-17%**)

TYPICAL RISK ALLOWANCE

2.7%

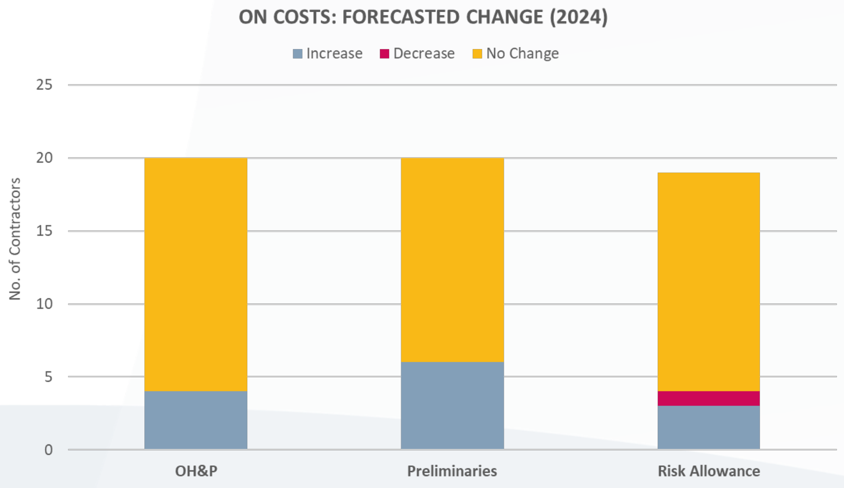
(Range: **0-5%**)

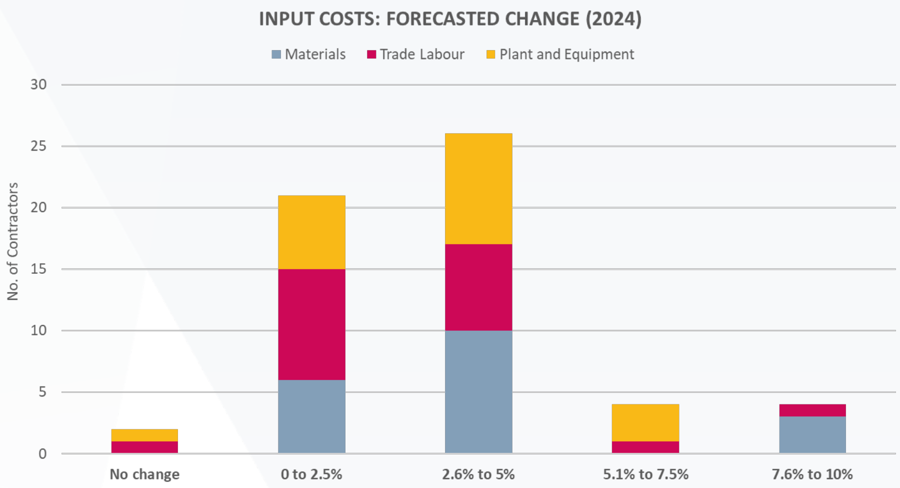


"...we see a lot of 'hungry' contractors and competitors with jobs being actively sought after due to a slow down in private and public spend [caused by] economic factors..."

- Average Overheads and Profit (**OH&P**) fell from **11.3%** to **11.2%** since our **January 2024 M&E report**. However, typical preliminaries costs rose from **12.4%** to **12.7%**
- Skilled labour resource continues to tighten, putting pressure on staff wages and preliminaries costs
- Buoyed by strong workloads, most MEP contractors face minimal pressure to reduce OH&P margins. However, extended project lead times have led to increased competition in tendering, prompting more competitive pricing
- Risk allowances rose from **2.5%** to **2.7%** due to concerns about sub-contractor financial stability, additional regulatory and compliance demands and the risk of global supply chain disruption

***Note**: Differences between typical OH&P and Preliminaries costs between contractors could be due to the sectors in which they primarily work, as well as the way they structure their pricing. For example, the **7%** preliminaries figure provided by one contractor may be due to passing most of the works onto sub-contractors and just performing a very high-level management role. Higher OH&P levels may be due to how individual companies cost their overheads. Some may include more scope than others within their overheads, such as director costs.





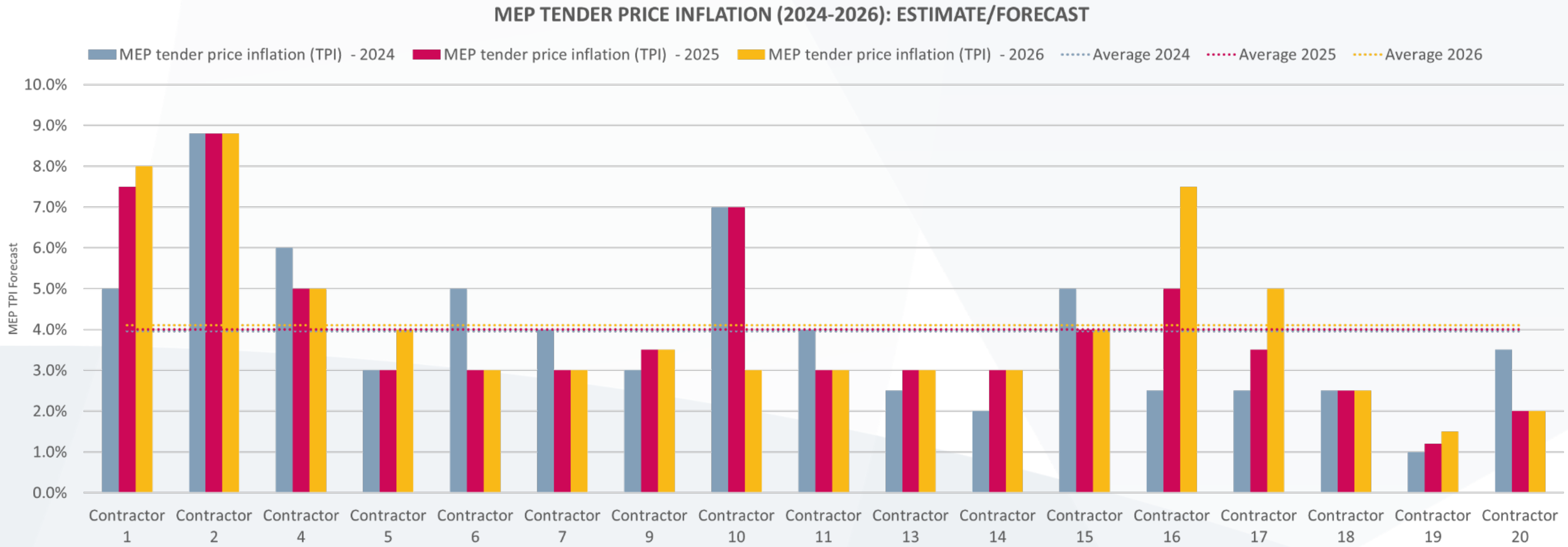
On Costs:

- Most surveyed MEP contractors expect no further change to on costs in 2024
- Although no contractors predict a decrease in OH&P and preliminaries this year, fewer contractors anticipate an 'increase' compared to our previous (Jan 2024) survey
- Average risk allowances may have risen over the past six months, but few contractors expect further increases

Input Costs:

- Input cost forecasts for 2024 clumped around two ranges: **'0% to 2.5%'** and **'2.6% to 5%'**
- Contractor feedback suggests an anticipated normalisation in construction input cost inflation this year
- Concern among a minority that spiking copper prices (for cable and busbar) is usually followed by higher prices for main plant items and other MEP materials

**Note: on-costs refer to additional expenses beyond the direct construction works*



Average MEP Contractor Forecast (2024)

4.0%

Average MEP Contractor Forecast (2025)

4.0%

Average MEP Contractor Forecast (2026)

4.1%

"Whilst inflation has been a constant issue over the past 2-3 years following COVID impacts, the market has steadied over the past 6-12 months. However, inflation is still positive. We envisage prices to still increase bi-annually as minimum."

*This compares to a **G&T MEP** inflationary forecast range of **3-5%** over the next 12 months.

**Note*: M&E tender price inflation forecasts/estimates can be influenced by a variety of factors, such as size of the contractor, its purchasing power and the type/size/value of projects the firm typically works on. The forecasts provided are solely those of the survey respondents and do not necessarily reflect the views or opinions of Gardiner & Theobald.*

Market pressures currently driving M&E prices...

Supply chain and contractor availability

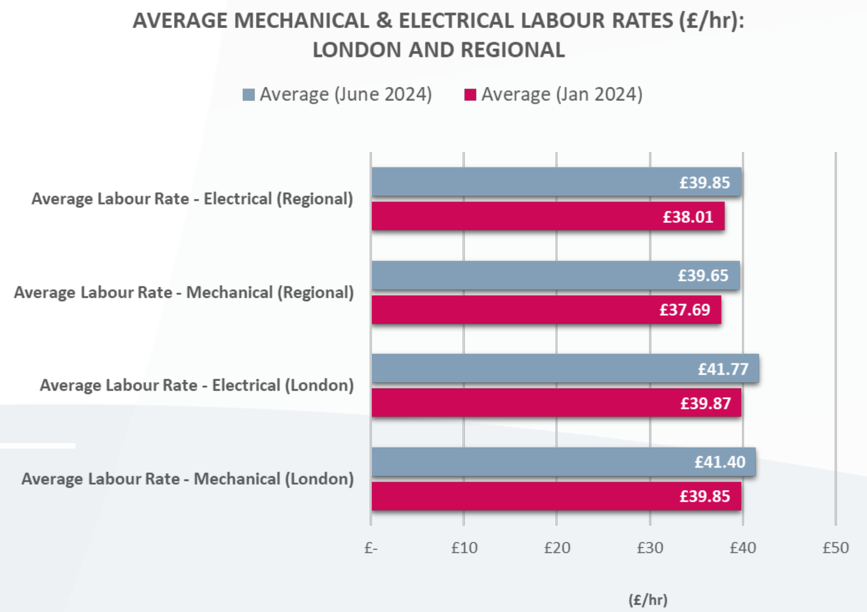
Sustained pressure on materials and labour

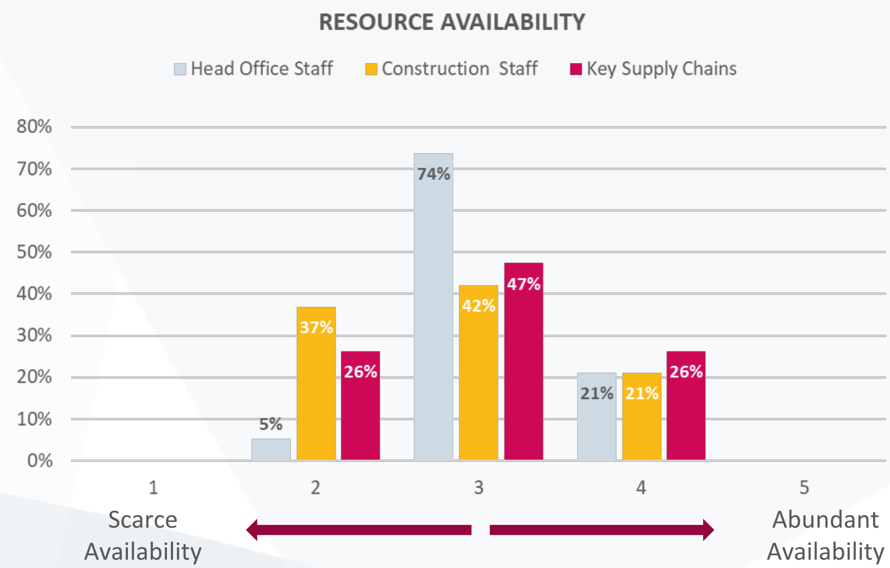
Intensifying competition to secure projects

Economic factors and financial constraints

Market risks for 2024...

- Materials and labour inflation
- Economic and political instability
- Supply chain challenges
- Market competition and pricing volatility
- Election and policy uncertainty



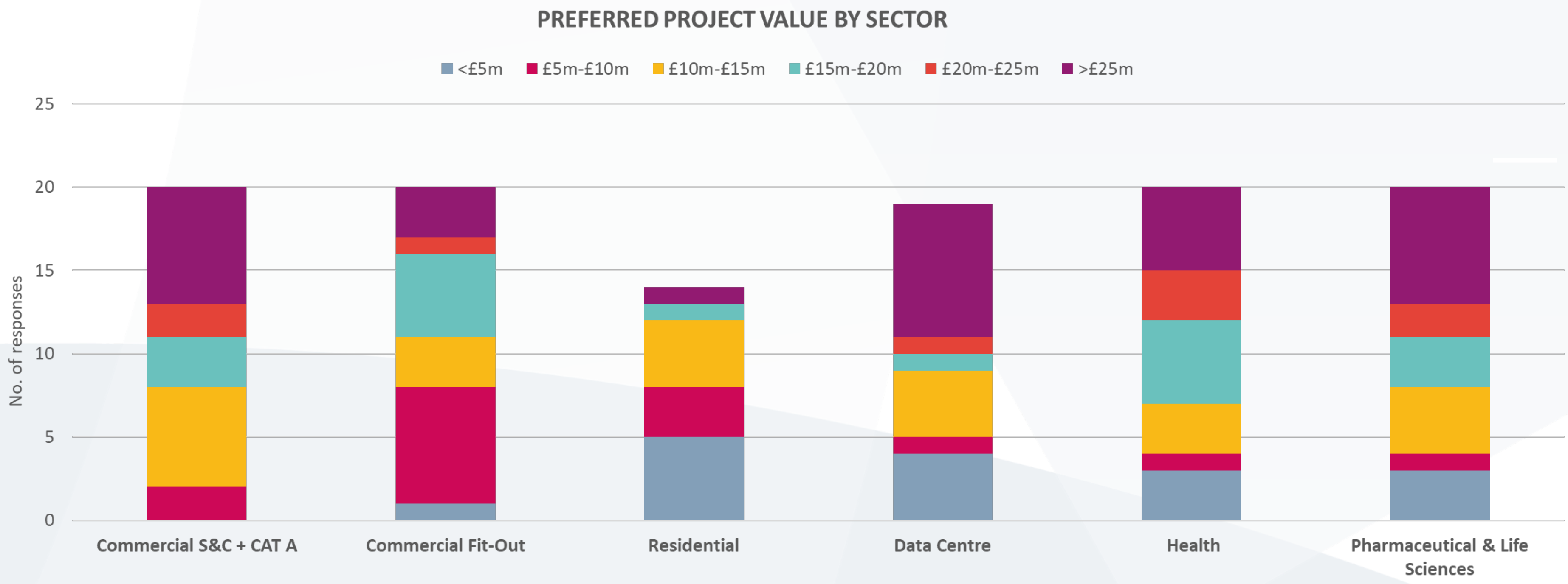


Average mechanical and electrical rates (London) increase by 3.9% and 4.8% since Jan 2024 survey

- Labour, from an availability and skills perspective, remains a key issue. Buoyant market activity is driving demand for labour, while a reduction in sub-contractor numbers has concentrated market power, giving remaining contractors greater leverage to increase prices, driving up labour costs
- MEP contractors reported a notable lack of quality labour in the market, driving up costs. High competition for skilled roles means businesses must offer higher salaries to attract and retain talent

Resource availability worsens across all categories, particularly for construction staff

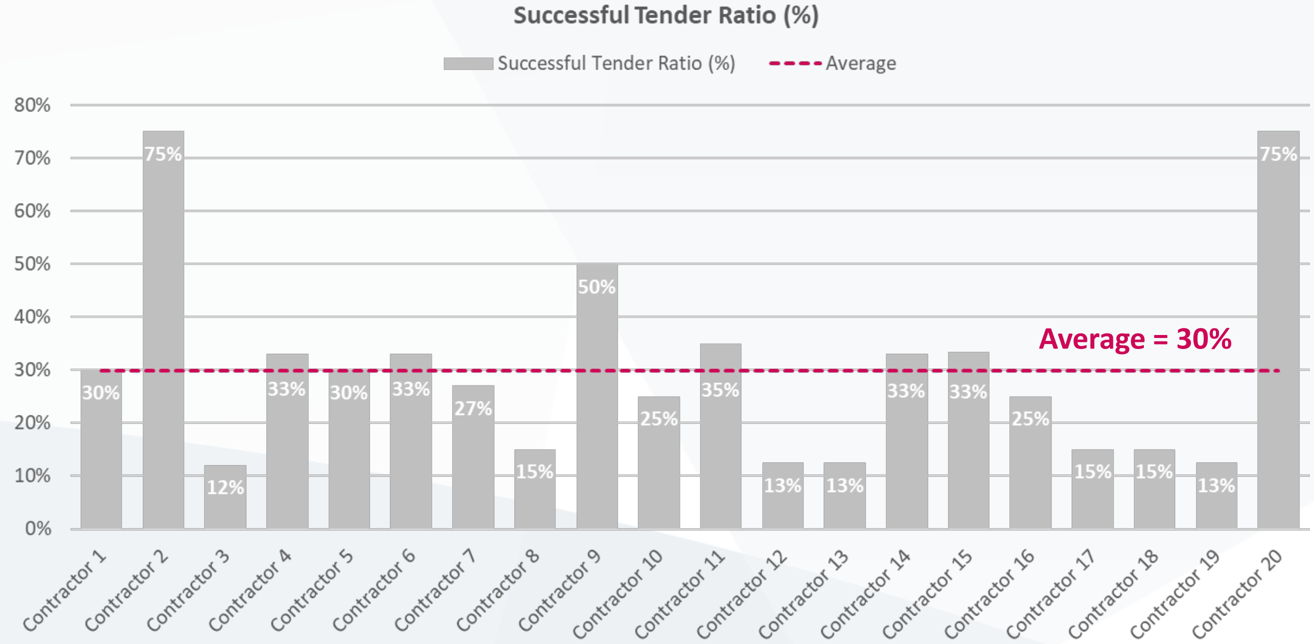
- Demand for highly skilled roles, especially in specialist areas like sprinklers and electrical work, is increasing. This heightened demand against a backdrop of limited supply chain capacity, especially in specific trades, is pushing labour costs upward
- From a supply chain perspective, there is capacity in the market to take on additional workload. Contractors have observed heightened demand on bids from peers, suggesting the market is keen for future work



Contractors continue to prioritise high-growth sectors, such as Data Centres and Pharmaceutical & Life Sciences, while interest in high-value Residential projects remains muted due to weaker demand

- Ongoing trend of MEP contractors preferring higher-value (**>£25m**) projects, especially in sectors like data centres, pharmaceutical and life sciences. This trend is partly driven by their complex and intensive MEP requirements
- The preferred project value for residential projects is lower than other sectors. This is due to these projects having less complex MEP requirements. Profit margins can also be smaller given the price sensitive and competitive nature of the sector

"…we need to be a little more selective in tendering, looking at who the Main Contractors lists are before committing to tender and, on occasion, choosing to walk away rather than being pressured into low margins."



Average Successful Tender Ratio

30%

With ratios ranging between 12-75%

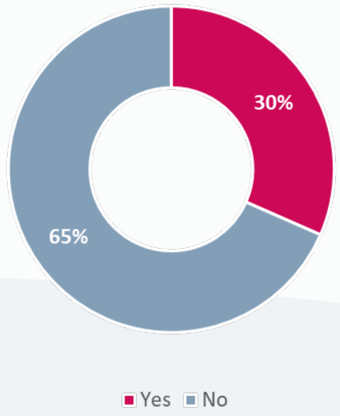
Successful tender ratio has risen since our January 2024 survey, where the average was **29%**

- Although the average successful tender ratio rose from **29%** to **30%**, some contractors reported lower ratios due to projects changing direction or being halted, reflecting the uncertainties and dynamic nature of the current market
- One contractor noted it had bid on too many projects due to ambitious growth plans and efforts to engage new partners, indicating a need for more focused bidding strategies

The wide range in successful tender ratios, from **12%** to **75%**, could be attributed to:

- **Experience and specialisation** (ie higher success rates due to reputation and expertise)
- **Market focus** (ie some contractors may focus on less competitive niches or regions, improving their chances of winning bids)
- **Bid quality and strategy** (ie contractors with well-developed bidding strategies and higher-quality proposals are more likely to succeed)

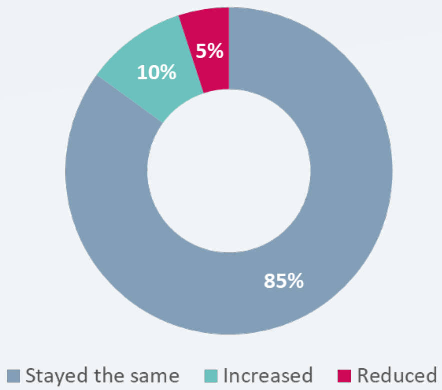
ARE YOU CURRENTLY EXPERIENCING ANY SUPPLY ISSUES WITH REGARDS TO MEP PRODUCTS/MATERIALS?



"Despite strong market demand maintaining elevated lead times for ASHPs, generators and switchgear, our supply chain has stabilised. We are now consistently delivering materials to sites within reasonable timeframes, integrating these demands into our pre-construction and construction programmes effectively."

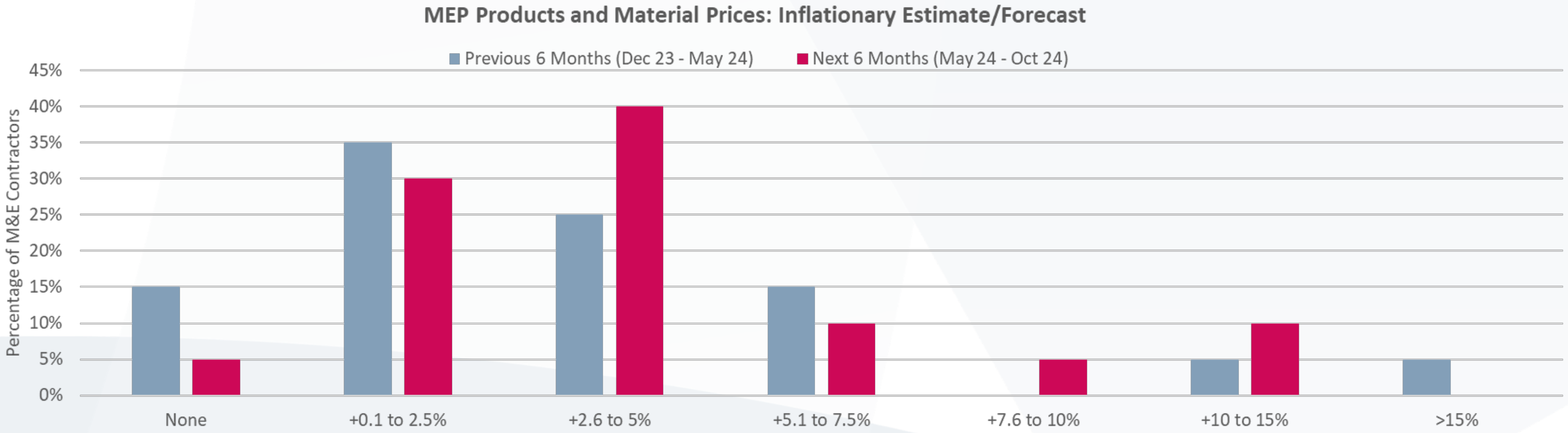
- Only **30%** of contractors are currently experiencing supply issues with certain MEP products/materials, compared to **56%** in the Jan 2024 report and **73%** in the July 2023 report
- Copper supply issues (due to mine closures and production disruption) have impacted procurement of cables and busbars
- Additionally, long lead times persist for critical MEP items such as generators and switchgear, exacerbated by high demand, particularly in sectors like data centres, and logistical challenges due to geopolitical tensions affecting shipping times from the Far East

MEP PRODUCTS/MATERIALS LEAD TIMES: PAST SIX MONTHS



MEP Products/Materials Affected by Long/Extending Lead Times:

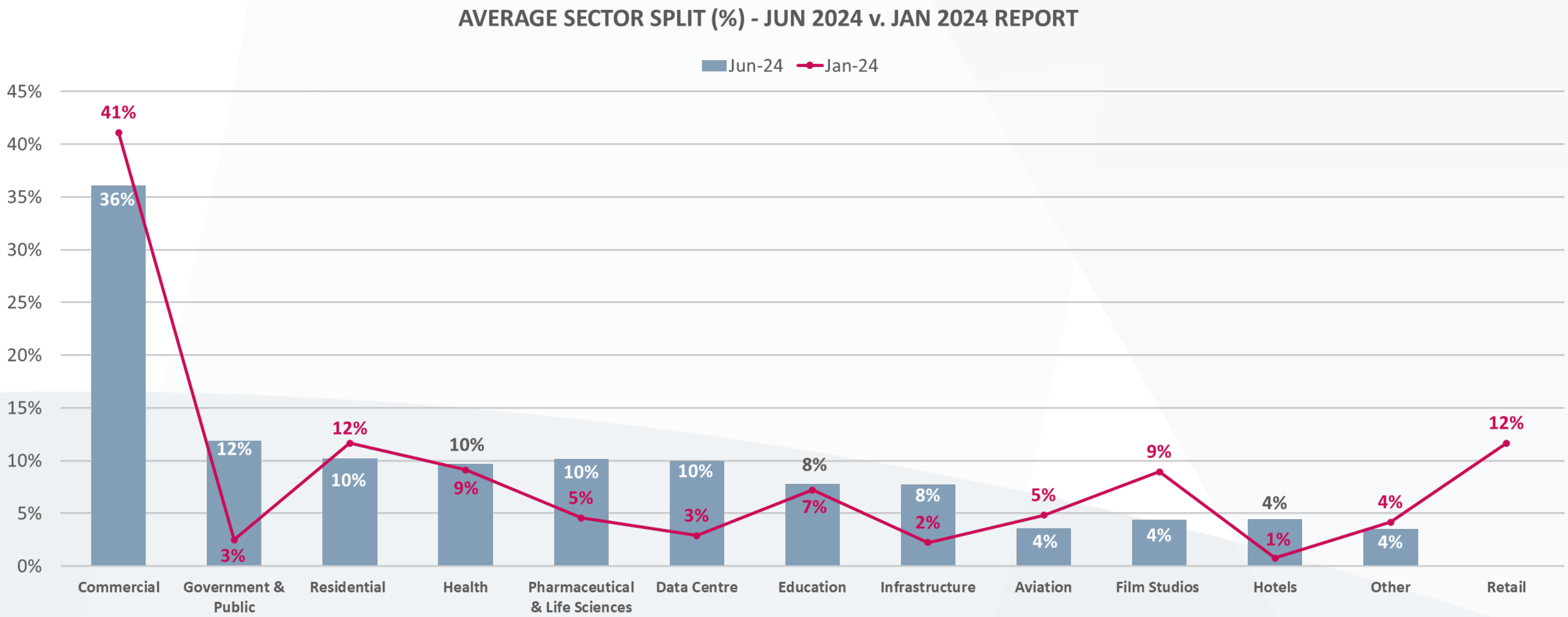
- Copper (for cable and busbar)
- ASHPs
- Generators
- Switchgear
- Transformers



Though MEP material price inflation has softened, becoming less volatile, some key materials continue to see significant price pressure…

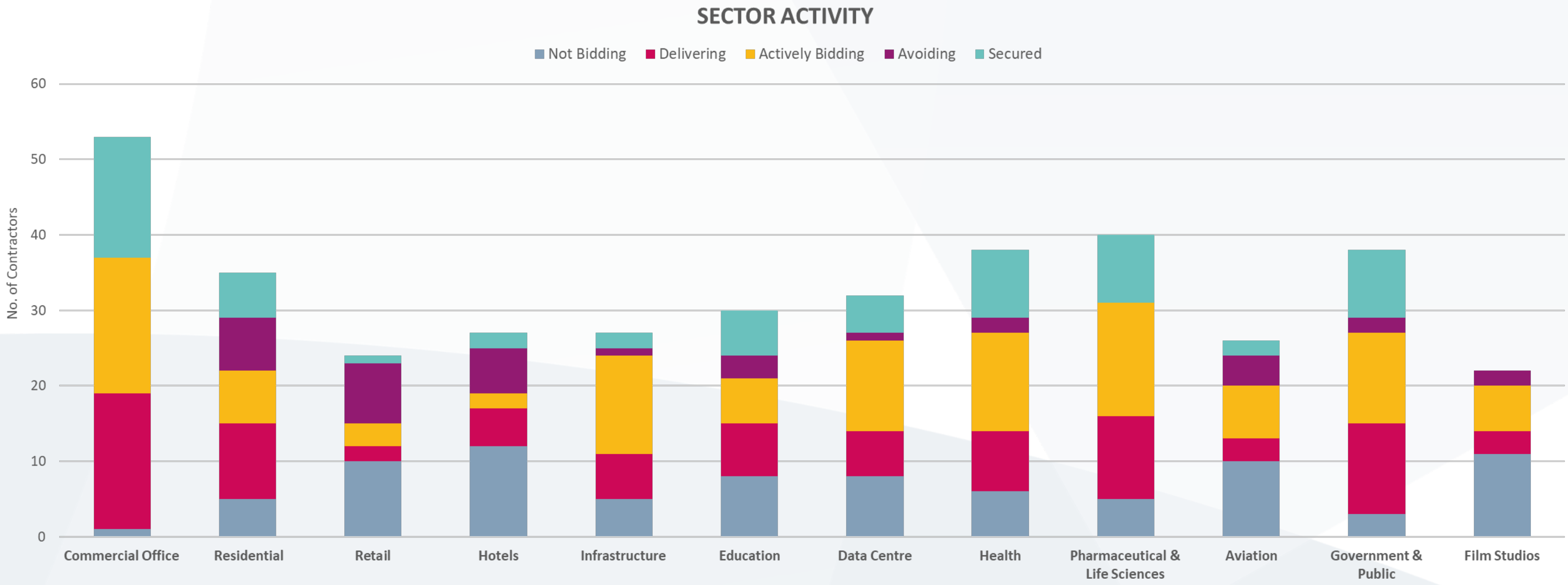
"Inflation has settled, but there are still increases and spikes. Amidst the backdrop of geopolitical tensions, political instability and burgeoning demand, the trajectory suggests a persistent strain on prices for the foreseeable future."

- Price pressures eased over the past six months, but most expect inflation for MEP materials to rise by **'+2.6 to 5%'** over the next six months
- Higher forecasts are partly based on current raw material cost increases, particularly copper, which is a major concern
- Others anticipate a more modest increase (**+0.1 to 2.5%**), attributing this to reduced market opportunities and the need for suppliers to maintain factory output. Consequently, negotiations on procurement are anticipated to mitigate expected price hikes in September or October 2024



"Our strategy is to become more aligned as a group and focus more on Data Centre, Industrial and Life Science sectors."

- Fewer opportunities in the commercial and residential sectors have redirected focus to more active sectors. Contractors are now concentrating on government and public projects, infrastructure, data centres and pharmaceutical schemes to make up for the shortfall
- Several respondents have adapted their business models to meet the surge in demand from these sectors. Most aim to expand their presence in the data center market, focusing on new developments and refurbishing existing facilities to cater to the growing need for high-powered computing and to boost revenue
- The sectors that experienced the sharpest drops compared to our last report were retail (**12%** to **0%**), film studios (**9%** to **4%**) and commercial (**41%** to **36%**). Development feasibility issues persist for many projects in these sectors
- The growing focus on non-traditional sectors (ie data centres) may provide an opportunity for smaller, new entrants. However, this shift could create capacity issues in long-established markets (ie residential), potentially hindering their recovery



Significant portion of contractors are either avoiding or not bidding on **Residential**, **Retail** and **Hotels**

Almost all contractors are actively bidding on and delivering **Commercial Office** schemes

Pharmaceutical & Life Sciences has become the second most 'active' sector

Main Risks Facing UK Market:

- Rising material prices, driven by global economic and political instability
- Continued issues with skilled labour availability due to retirements and insufficient new entrants into the industry
- Increased risk of insolvencies within the supply chain and among main contractors, affecting project continuity and financial stability
- Election-related uncertainty may lead to project delays or cancellations, impacting both private and public sector investments
- Ongoing pressure on the supply chain with potential defaults and delays, requiring proactive engagement to mitigate impacts on projects
- Tight margins, demand for upfront payments and challenging bond requirements pose financial risks, particularly concerning project viability and contractor selection
- Continuous drive towards Net Carbon Zero making jobs unaffordable

"We believe there is continued pressure on the supply chain and more insolvencies to come. We're concerned about the impact of this on our projects and are actively engaging with [our suppliers] to understand their financial position but also [their] current performance."

Factors Currently Influencing Successful Project Procurement

- Ensuring full compliance and buying the project right first time
- Pressure from insufficiently developed designs at Stage 3 (leading to premature fixed-price commitments and risk debates)
- Early collaboration/contractor engagement and setting realistic budgets are crucial for efficient procurement
- Package procurement and managing multiple projects across the UK
- Quality of staff, lead times, and the necessity for upfront payments
- Vesting of major plant items to ensure delivery slots and mitigate risks

What Market Pressures Are Driving Pricing?

- Competition to secure projects based on cost plans rather than detailed estimates
- Rising labour costs and shortages of skilled workers
- Availability issues with quality contractors, especially for specialised services like sprinklers
- Increasing material costs, particularly copper, impacting budgets
- Economic and political uncertainties, including high interest rates and lack of funding
- Heightened risk of sub-contractor/supplier insolvencies
- Accelerated and potentially unrealistic project timelines

Interesting MEP Market Trends

- Carbon reduction and sustainability cost pressures
- Shift in project types (from shell and core to cut-and-carve and fit-out)
- Digital and smart technology adoption
- Delayed project starts due to economic and planning issues

Strategic/business model changes planned...

- Shift in project focus and expansion into new sectors
- Selective tendering, opting out of low-margin projects
- Sustainable growth strategy, targeting low-risk projects
- Internal delivery on large, complex projects to minimise risk
- Ensuring the right people are in place to manage constant evolution

Following the administration challenges in the MEP market, we are seeing different approaches to procurement including splitting the packages. What is your preferred package split?

"Our business would always prefer combined MEP packages as we have equal resource both Mechanically and Electrically."

"Splitting packages isn't ideal for us as the main contractors tend to go out to Tier 3 contractors, some of whom are part of our supply chain. We cannot compete against Tier 3 contractors."

"We prefer to keep mechanical and electrical installation as separate packages, while we purchase and provide all the major plant and key materials such as DBs, Pumps etc."

"We are open to conversations on any split if the package is big enough to warrant it. The obvious splits are area by area, shell & core or fit-out, or by discipline."

"We would take an electrical or mechanical single package as long as it was at the right value."

For further information, please contact:

Jonathan Wilson ***(Partner)***: j.wilson@gardiner.com
Lee Moore ***(Partner)***: l.moore@gardiner.com
Rob Butler ***(Partner):*** r.butler@gardiner.com
Michael Urie ***(Senior Market Analyst)***: m.urie@gardiner.com