G&T Main Contractor Survey

June

2022

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G&T's Main Contractor Survey report for June 2022 summarises some of the key trends and themes generated from the responses to our most recent Main Contractor survey.

Please note: *For confidentiality reasons, the names of the individual contractors that responded to the survey have not been disclosed in this report. Survey respondents operate across all geographical regions of the UK, but the majority tend to operate in Greater London and the South East.*

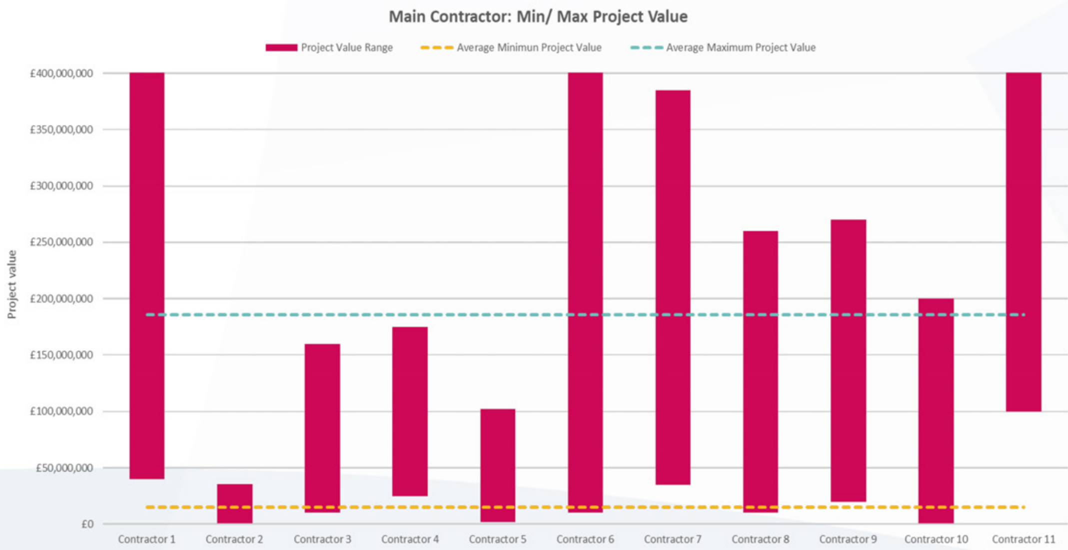
G&T's second Main Contractor survey revealed a host of insights on the current state of the UK construction market. All but one of the contractors that responded to our survey were Tier One contractors and are among the most time-served and financially secure construction companies trading.

Compared to our previous survey in Q4 2021, contractors have evidently built on their strong financial positions, capitalising on a release of pent-up demand for construction work. Forward pipelines have grown strongly, and, across the whole, contractors have secured most of their workloads for this year and above-average amount for 2023.

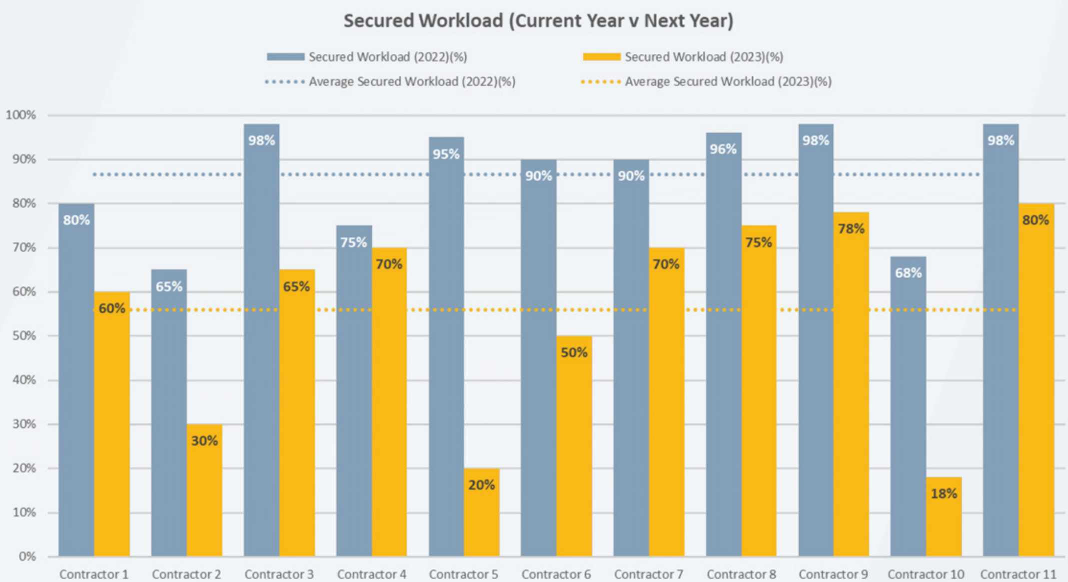
Workloads aren't expected to fall significantly in the short-term, but contractors are very much aware of mounting inflationary pressures and rising input costs, and the risk this poses to demand and scheme viability as some clients proceed with increased hesitancy on projects. Fortunately, there are early signs that some pressures have or at least will soon peak with certain materials coming off from their recent high points. However, material prices look set to remain elevated for the next 12 months while upward pressure on labour cost movements will continue to be supported by endemic skills shortages across the entire industry.

Some of the highlights from our latest report include:

- **Typical Overheads and Profit (OH&P) levels varied significantly** across project sizes between main contractors, but particularly for the highest value projects
- Despite record vacancies, staff and project labour resource was largely described as 'available', but there is **volatility around the movement of staff/resource** caused by high levels of activity and the competition that accompanies it
- Most of the expected inflation to materials over the next 12 months will be front-loaded according to contractors, with the rate of price rises moderating from early 2023
- **Lead times are expected to lengthen** over the next year due to a mixture of strong demand and the direct/indirect consequences of the conflict in Ukraine
- Tendered prices are being held from anything between 0-3 months and are being **split by package with fluctuation mechanisms proposed**
- A **hot tendering market** has prompted a **shift in procurement route** with all contractors preferring Two Stage or Negotiated tendering to help mitigate programme risk, lead time issues and provide greater cost certainty
- **Rising energy prices and material costs** are expected to be the two biggest issues for contractors over the next year, but other pressures will weigh heavily on business operations

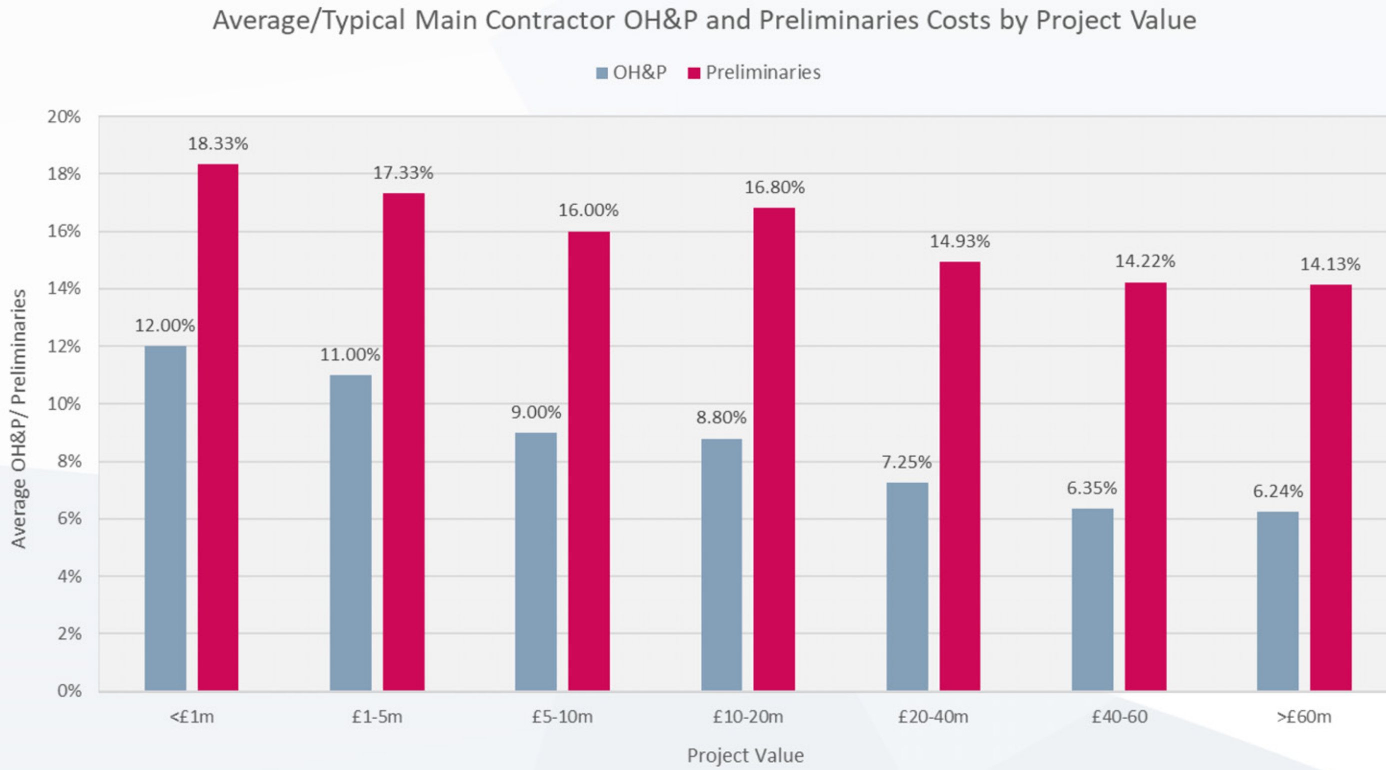


- The average minimum project value across all surveyed contractors was just under ***£23m***, but some respondents get involved in projects with values as low as ***£250k***
- However, the average minimum project value was distorted by one contractor whose stated minimum project value was £100m. Excluding this contractor brought the average minimum down to ***£15.3m***
- Three of the contractors (all Tier One) noted that providing they had capacity, there was no maximum/upper project value. However, the average maximum project value among those contractors that did specify an upper range was ***£185.6m***

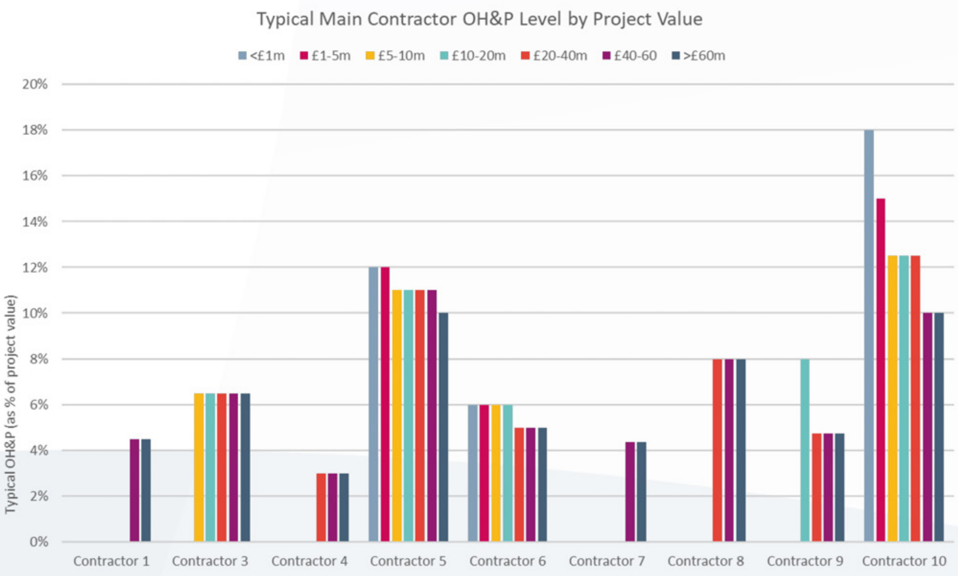


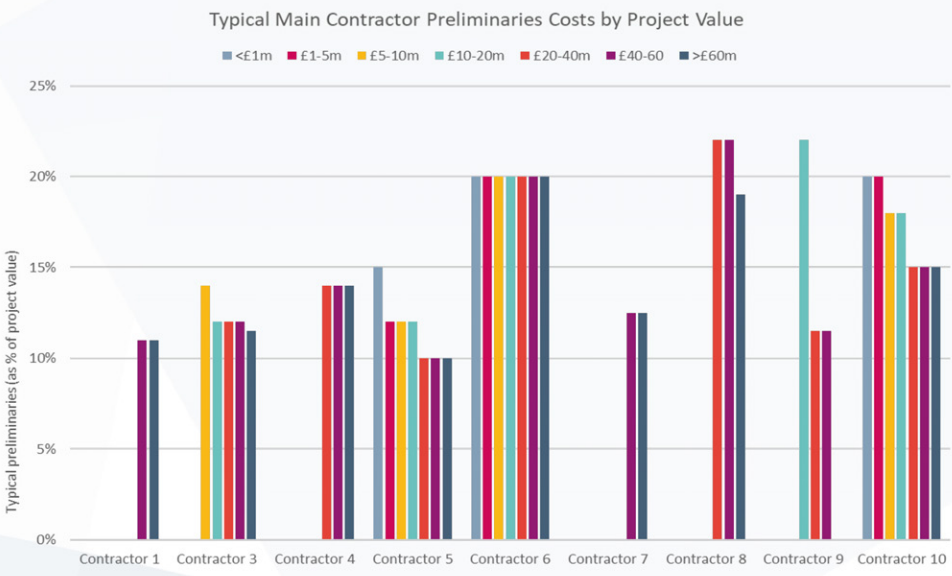
- On average, surveyed main contractors have secured ***87%*** of their workload capacity for 2022 but only ***56%*** for 2023
- The majority of contractors have secured in excess of ***90%*** of their workloads for this year with three reporting near full capacity at ***98%***
- 2023 has a wider spread of secured workloads with the some having secured ***c.20%*** while others in excess of ***70%***
- Strong new order growth in recent quarters has left many main contractors with limited capacity to take on new work for 2022
- At ***56%***, the secured workload average for 2023 is slightly ahead of the typical average for the time of year (***c.50%***), but signs of slowing new order growth and downward revisions to the projected forward construction pipeline in recent months could create more spare capacity in the market next year

Data from surveyed contractors shows average or typical overheads and profits (OH&P) and preliminaries costs decreasing as project values increase

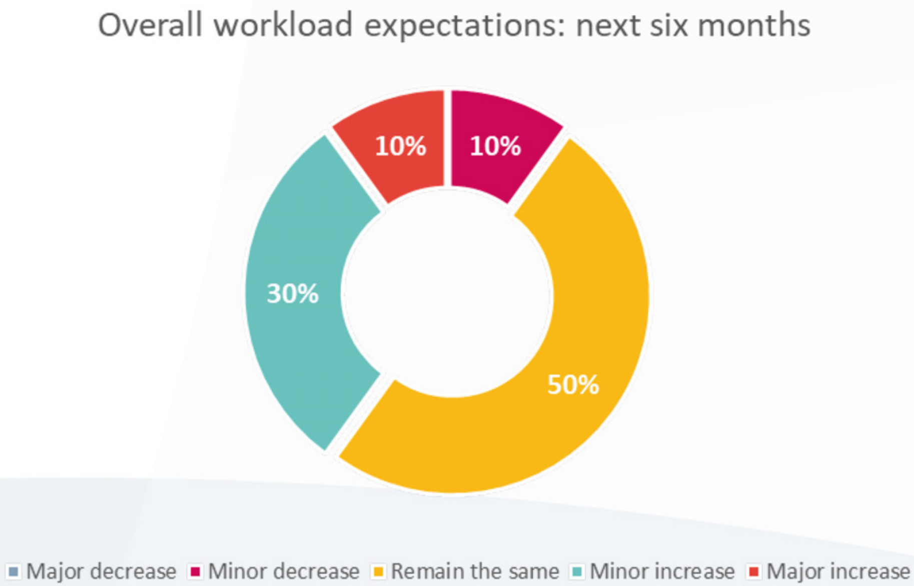


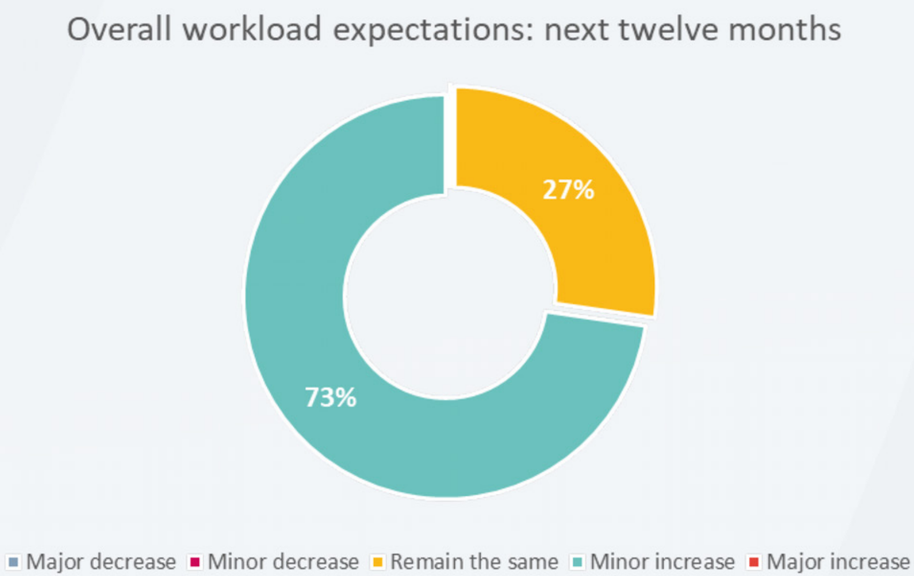
- For the lowest value projects (<£1m), OH&P and preliminaries costs averaged at ***12%*** and ***18.3%*** respectively but decreased to ***6.2%*** and ***14.1%*** for projects over £60m
- This is due to scalable cost saving benefits for higher value projects as well as OH&P/preliminaries costs invariably accounting for a smaller proportion of the total project cost as the overall project value increases
- The average OH&P figure for projects costing in excess of £60m (at ***6.2%***) was distorted by two particularly high submissions of ***10%***
- Removing these two outlier responses sees the average OH&P figure drop from ***6.2%*** to ***5.2%***





- For the largest value projects (ie those costing more than £60m), there was a wide range of typical OH&P/Preliminaries costs between different contractors
- One contractor said ***3%*** was a typical OH&P level for projects costing more than £60m, while at the other end of the scale two contractors said ***10%*** was typical
- Similarly, preliminaries costs for projects >£60m ranged from ***10%*** to ***20%*** between contractors, but this is likely due to contractors working across different sectors where set-up costs can vary significantly



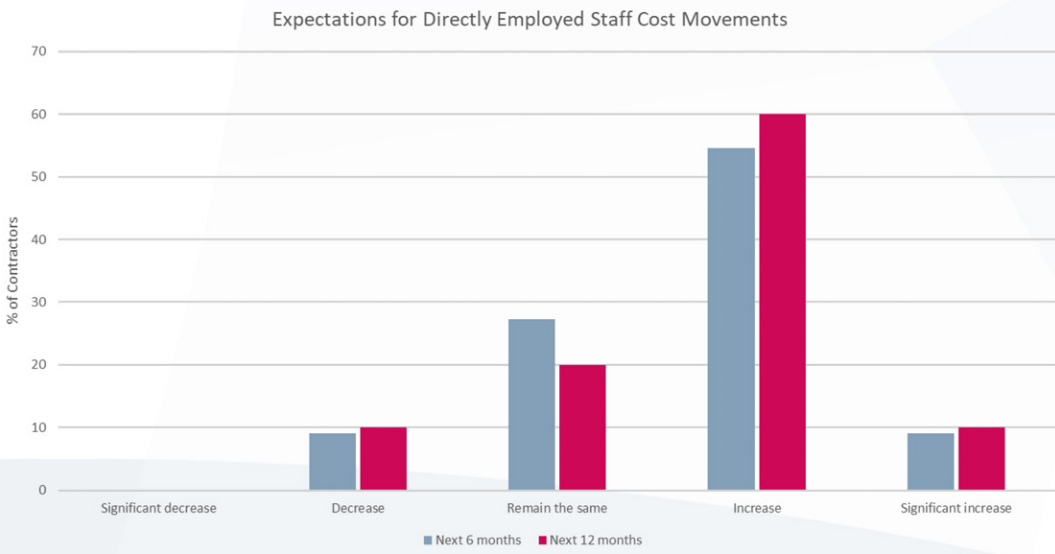


- Workload expectations for the next six months largely unchanged from our previous (Nov 2021) survey
- Despite the currency supply chain and economic uncertainties, half (***50%***) of respondents expect workloads to 'remain the same' while ***30%*** expect a 'minor increase'. ***10%*** of contractors were more bullish and expect a 'major increase' while an equal proportion anticipate workloads to see a 'minor decrease'
- Over the longer 12-month period, workload expectations become less polarised and more positive
- The vast majority (***73%***) expect a 'minor increase' in workloads over the next 12 months while the remainder (***27%)*** said that workloads will remain at the same level

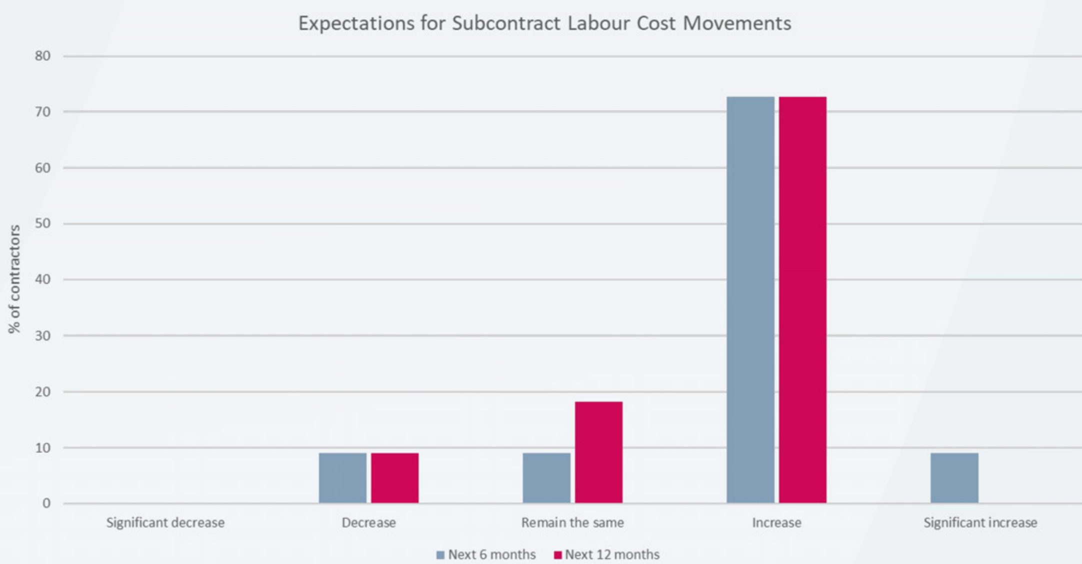
Recent geopolitical issues have done little to dampen workload growth expectations of main contractors. Pent-up demand during the pandemic spilled through into the market in early 2022, but beyond the next 12 months a worsening economic outlook and intense inflationary pressures may soften demand and increase client hesitancy to commit to projects. This would impact on workload growth in the medium to long-term.

- The majority of main contractors described both project labour and office staff resource as being ‘Available’
- Nearly ***73%*** of respondents said that office staff resource was available but fewer (c.***55%***) thought that project/site workers were available
- More than ***45%*** of contractors described project labour as having ‘low’ or ‘very low’ availability’ with one contractor noting that good engineering and operations support is very difficult to find
- Good quality pre-construction staff were also more difficult to employ, with staff (and indeed operatives) more focused on being localised rather than travelling greater distances
- One contactor said that London in particular is seeing volatility around the movement of staff/resource caused by high levels of activity and the competition that accompanies it. This is manifesting itself through increased labour retention costs

- Most contractors don't expect any changes to the availability of labour over the next six and 12 month periods
- Around ***27%*** of contractors expect a labour availability to deteriorate further over the next year as strong forward order books keep labour resource requirements high in the short-term
- These contractors also suggested that record high number of unfilled construction vacancies and a declining labour pool (from retiring site workers and a loss of migrant labour) point to a further tightening in the supply of skilled workers

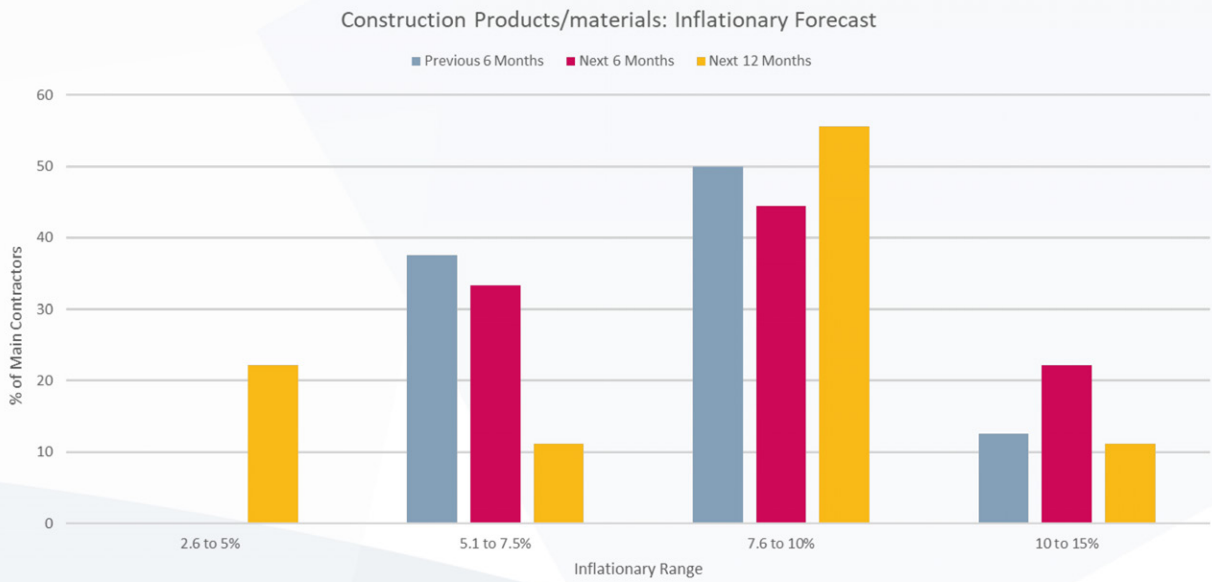


- The majority of contractors expect directly employed staff costs to increase (***60%***) or 'significantly increase' (***10%***) over the next year in light of the cost-of-living crisis and the current construction employment market dynamics
- Others contractors were less bullish on staff cost movements, with ***20%*** expecting no changes over the next 12 months and ***10%*** even anticipating a 'decrease' in costs

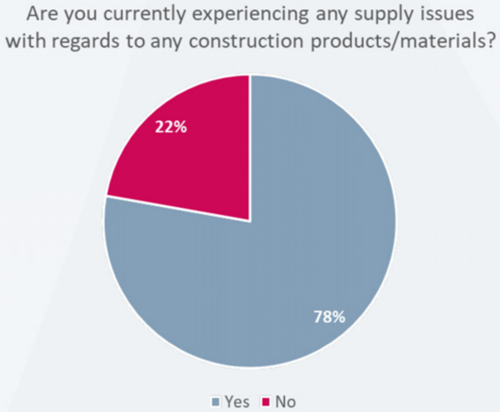


- Expectations for sub-contract labour cost movements follow a similar pattern to staff costs, but a greater proportion of contractors (***73%***) expect rates to rise
- Rates are being supported by strong levels of construction activity and a decline in the number of site workers/tradespeople in the UK
- This, according to respondents, has increased competition between contractors to secure labour, triggering wage spirals in certain growth sectors and trades such as brick/blockwork

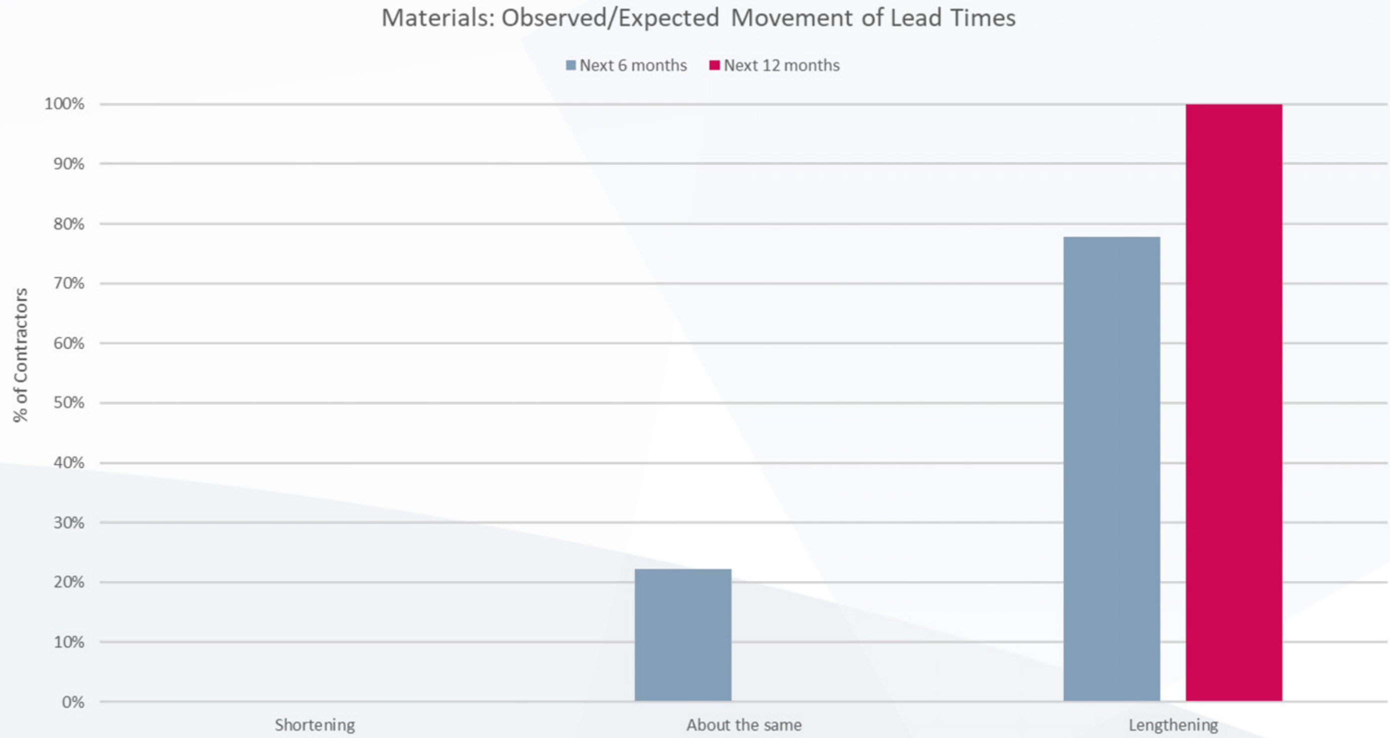
- Over the past six months, ***50%*** of contractors said that construction product/material prices has risen by '***7.6 to 10%***'. A smaller, but significant, portion (***38%***) however thought that materials inflation sat within a lower range of '***5.1 to 7.5%***'
- Over the next six months, ***44%*** of contractors expect to see similar levels of inflation (***7.6 to 10%***) to that which was seen in the past six months, but beyond this a cooling of prices is projected
- Most of the expected inflation over the next 12 months will be front-loaded, with the rate of price rises moderating from early 2023



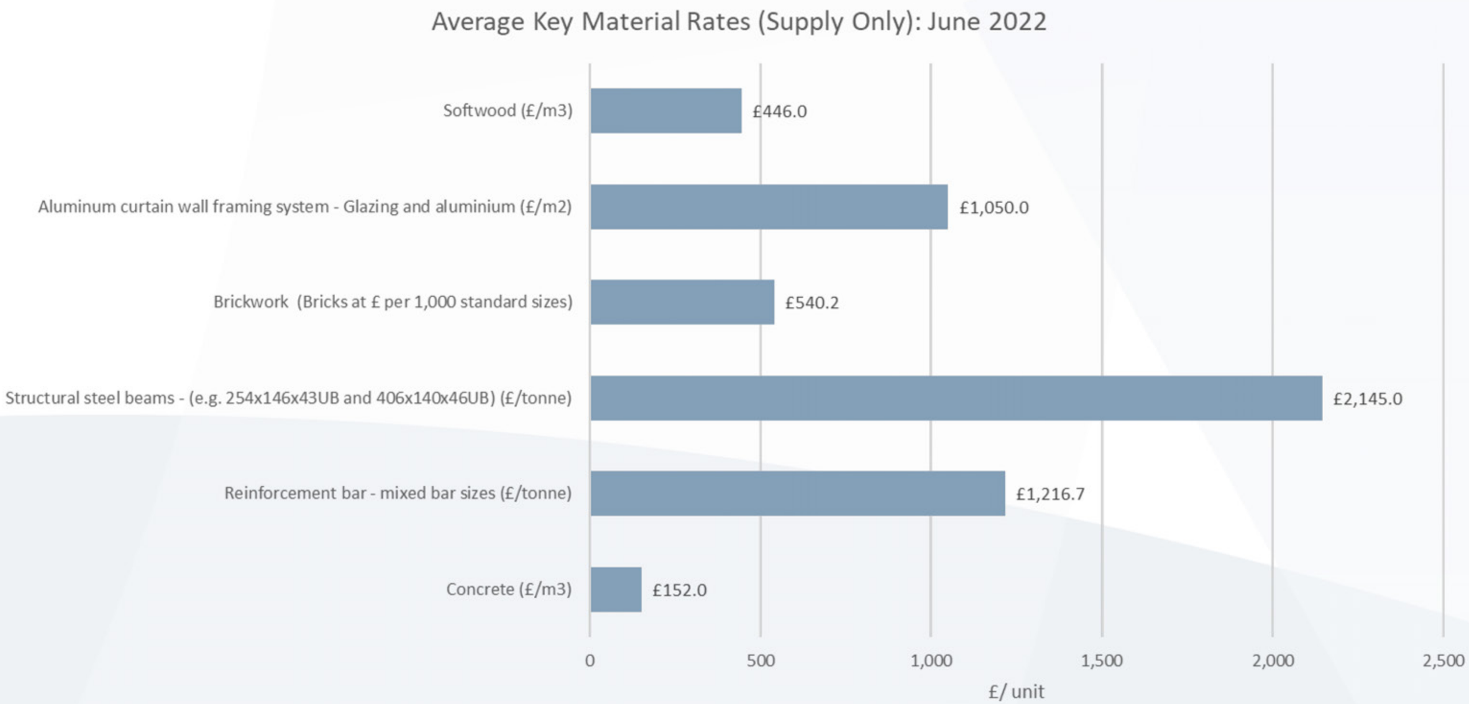
CONTRACTORS REPORTED SEEING MULTIPLE, UNSCHEDULED PRICE INCREASES FROM KEY MATERIAL SUPPLIERS BUT THAT MOST PRICE INCREASES STEMMING FROM THE GEOPOLITICAL SITUATION WILL BE FULLY PRICED IN WITHIN THE NEXT SIX MONTHS. AFTER THIS, MORE NORMAL (IE PRE-PANDEMIC) PRICE INFLATION SHOULD RESUME.



Most, but not all respondents confirmed they were currently experiencing supply issues with regards to construction products and materials

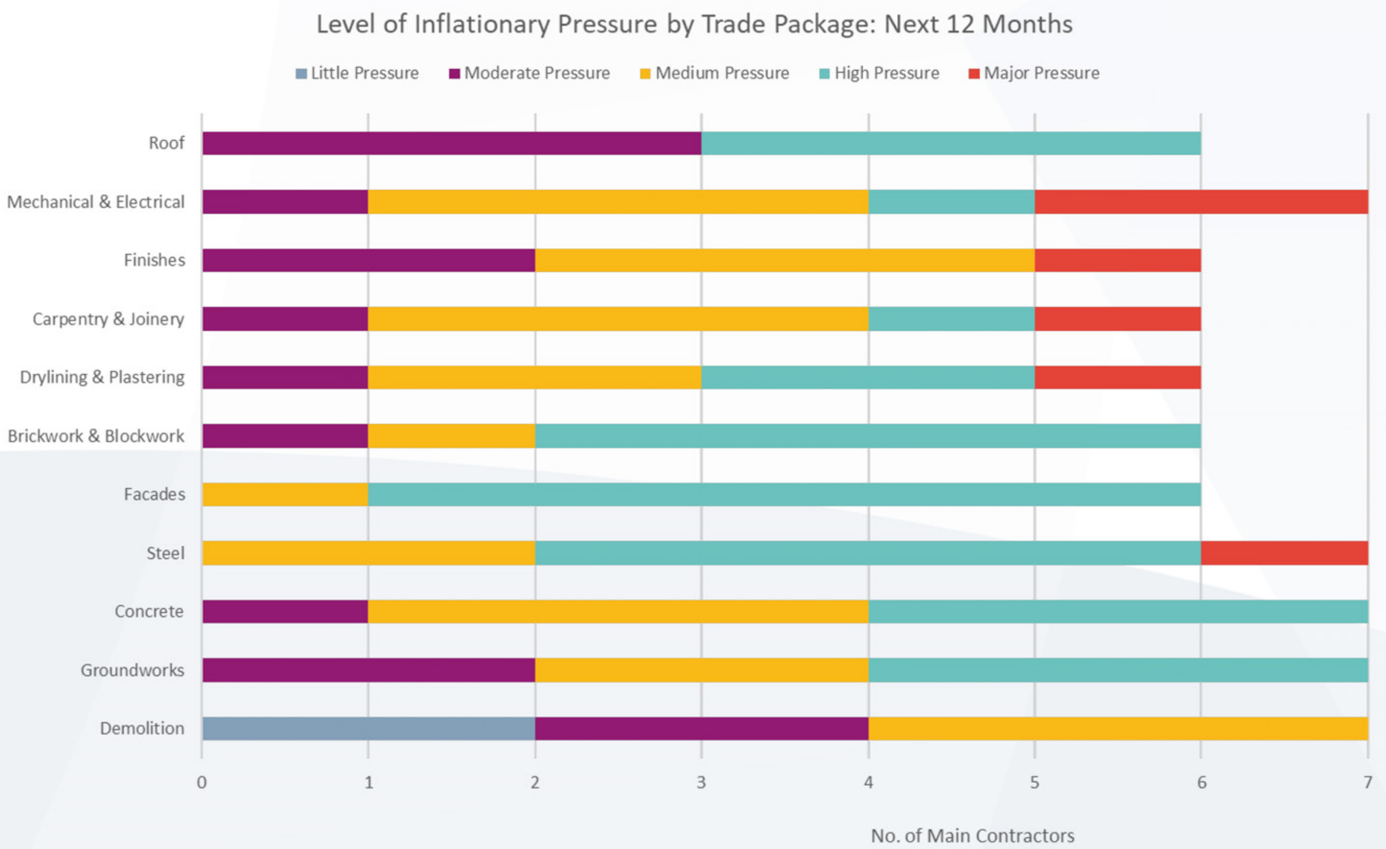


- Almost all main contractors expect a further lengthening in lead times over the next six and 12 month periods
- Supply and availability issues with steel, aluminium, bricks, plasterboard, roof tiles and certain M&E items (ie generators, products with microchips) are extending lead times due to a mixture of strong demand and the direct/indirect consequences of the conflict in Ukraine
- Lead in periods and delivery dates were said to be less reliable with multiple contractors reporting experiences with part order completion
- One contractor explained that it was procuring materials and fixing prices much earlier on in the project to try and mitigate against lengthening lead times and potential future inflationary increases



- Prices for almost all construction materials have risen since the start of 2022 due to higher input and manufacturing costs, with contractors noting that the affordability of schemes is being closely assessed
- Prices for steel products rose sharply in March according to BEIS data: Rebar (+***31.6%)*** and fabricated structural steel (+***19.2%***)
- BEIS data shows this was followed by smaller price rises in April of ***2.1%*** and ***1.4%*** respectively for rebar and structural steel
- However, since April steel prices have dropped. Inventory is piling up as demand for steel in China fell amid pandemic lockdowns, all while blast furnaces were operating at close to full capacity
- Iron ore prices have been on a downward trajectory, surrendering their 2022 gains as investors became fearful about waning Chinese demand and weak construction starts in the country
- While steel prices are still at historically high levels, oversupply and falling iron ore prices are helping to offset the impact of high energy costs in the steelmaking process. Some to suggest that rebar, for example, could come off by £200/tonne in the next 3-6 months from current prices

Source: *BEIS*



Contractors expect to see high-major inflationary pressures applied across several key trades, but particularly for ***steel, façades, Mechanical & Electrical*** *packages*

- All trade packages are being affected by input cost inflation but those with high exposure to energy-intensive commodities and materials are perhaps set to see the greatest amount of upward price pressure over the next year
- Shortages of aluminium cladding/roofing materials were flagged as a major concern, as were steep price rises for these materials
- Labour shortages in bricklaying, MEP, roofing/façades, drylining and finishing trades are putting pressure on these packages, but there is a general shortage of skills across all trades due to few new entrants/apprentices
- Labour inflation will become the bigger issue as material costs stabilise, but currently broad inflationary pressures are making it difficult to obtain fixed prices for most packages

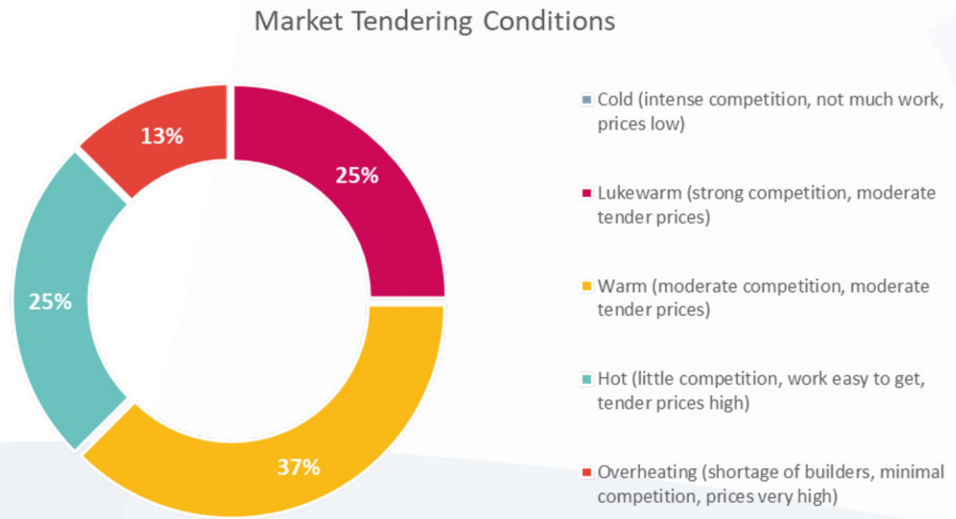
For more details about MEP inflationary pressures, see our latest MEP Contractor Survey report

HOW LONG ARE YOU HOLDING TENDERED PRICES FOR?

- Most contractors are holding tendered prices from anything between **0-3 months,** which is fairly typical, but a handful specified prices were being held for no more than **30 days**
- A number of contractors noted there was no simple answer for this question and length of price fixing varied according to intended programme and that if the programme was pushed back, prices were adjusted accordingly

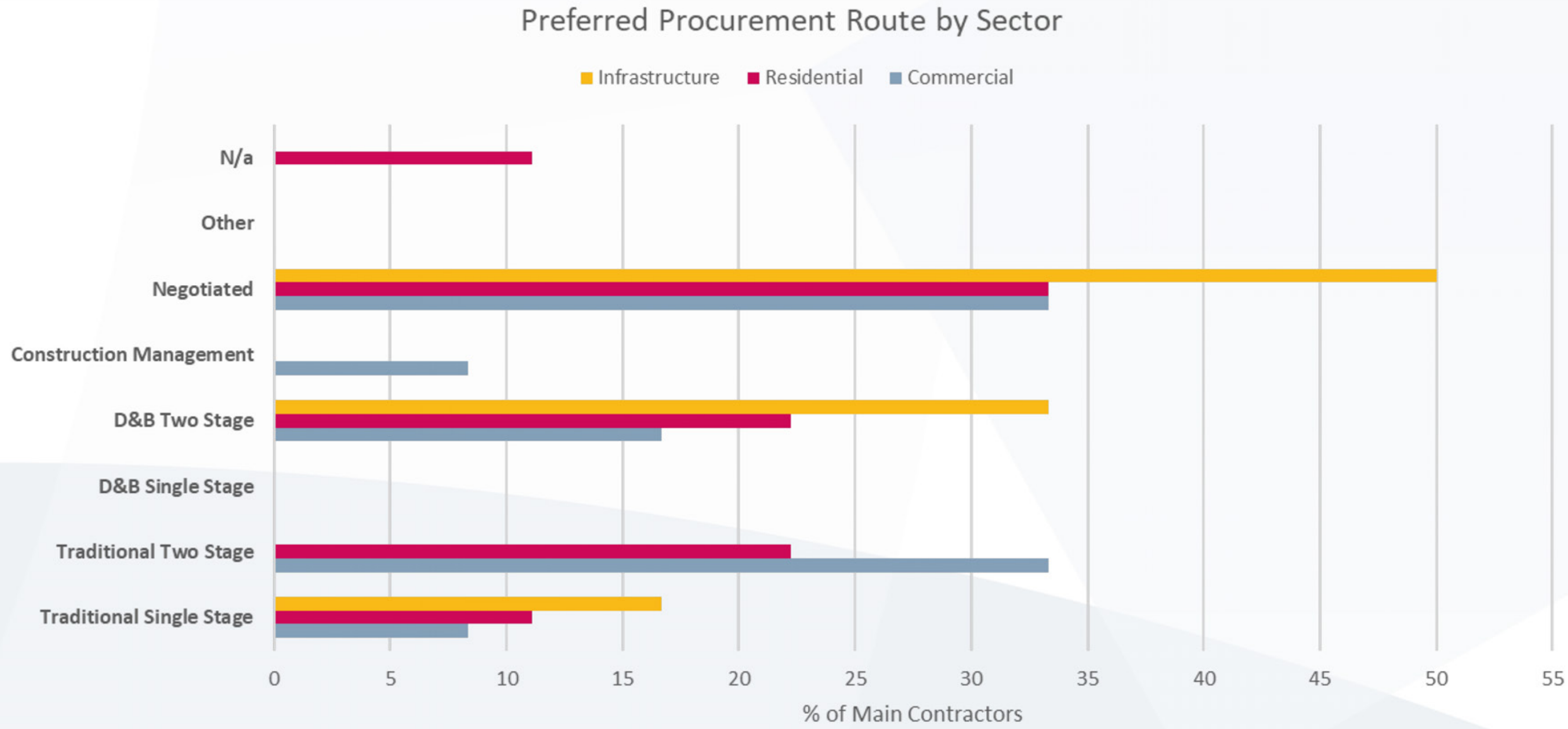
"Tendered prices are being held for very short periods and are being split by package with fluctuation mechanisms proposed"

- The ratio of successful tenders (or the 'Bid-Hit' ratio) averaged at ***36%*** but ranged between ***20%*** to ***60%***
- This is significantly higher than the 'Bid-Hit' ratio recorded in our Q4 2021 Main Contractor survey, which averaged at ***28%*** and ranged between ***20%*** to ***40%***
- The higher ratio average coincides with strong new order growth in recent quarters and a greater number of bidding opportunities coming through the pipeline

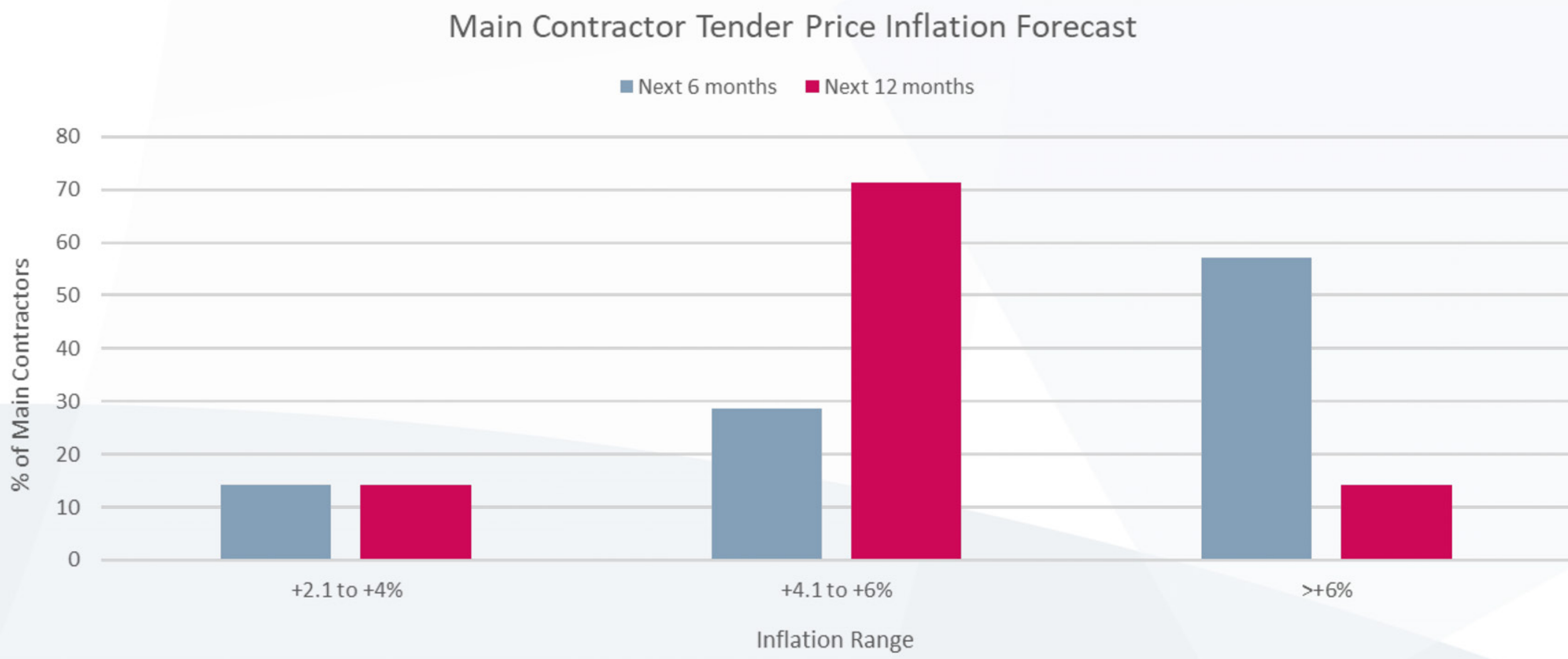


- Market tendering conditions were described as 'Warm' by 37% of the surveyed contractors (ie moderate competition producing moderate tendering prices)
- There has been a shift in tendering conditions with a greater proportion of contractors (***25%***) describing conditions as 'hot' – ie little competition, work easy to get and tender prices high – compared to ***10%*** in our last (Oct 2021) survey
- ***13%*** went even further, describing the market tendering conditions as 'overheating' given the general shortage of skilled labour, minimal competition to win work and high costs

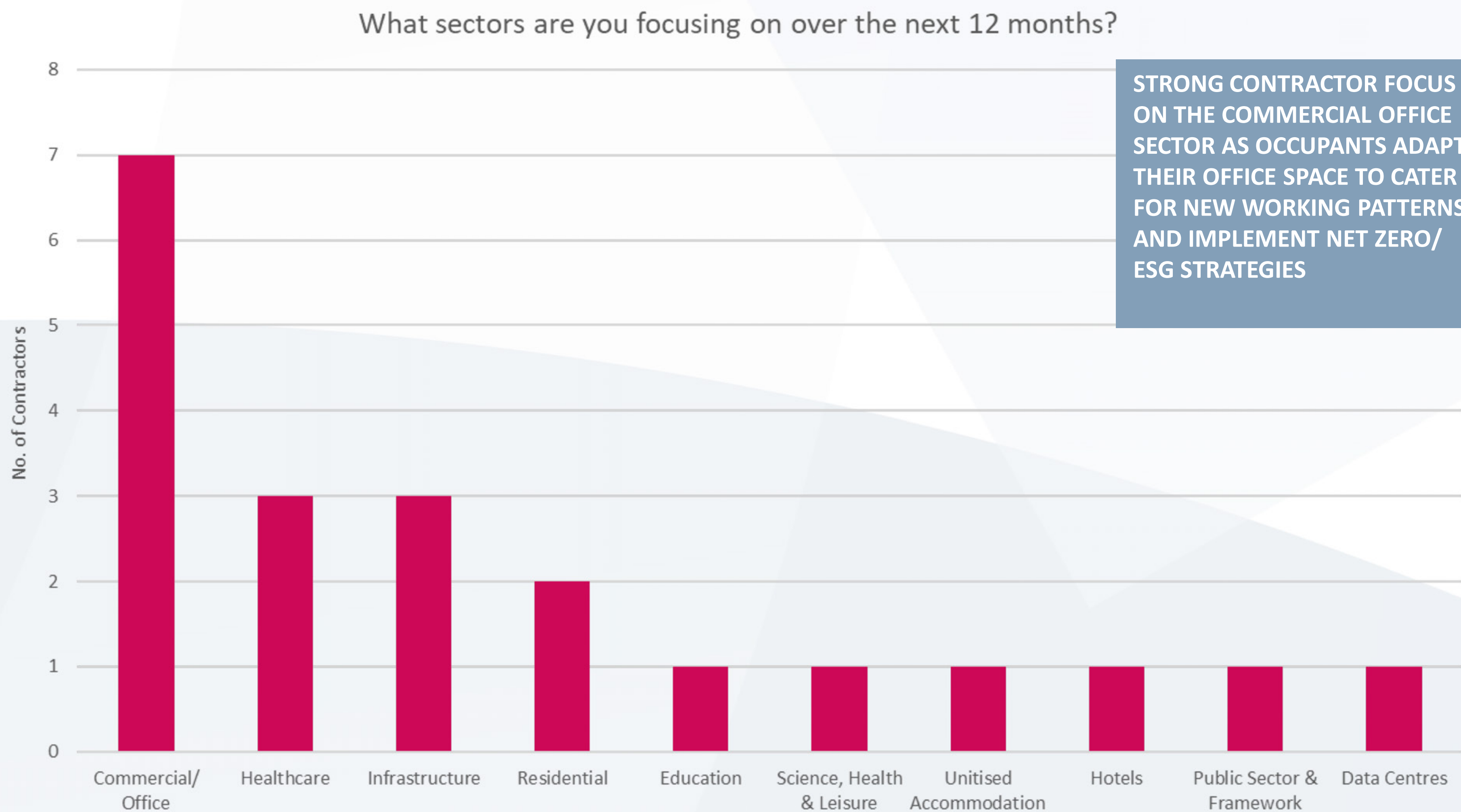
- Average project risk allowances at contract award have increased from ***2.2%*** in our previous survey to ***3.3%***, with allowances ranging from ***1%*** to ***7.5%***
- By removing the outlier response of ***7.5%***, average risk allowances drop to ***2.7%*** which is more in line with what G&T is seeing in tender returns
- Risk allowance is dependant on multiple factors, including design stage, project type and key risks exposure
- The supply chain remains nervous about volatile cost movements and is therefore adding significant premiums through higher risk allowances to fix prices for projects starting in 2022/23
- In the current market, with above-average new work volumes and uncertain material prices movements, risk allowances are expected to remain elevated



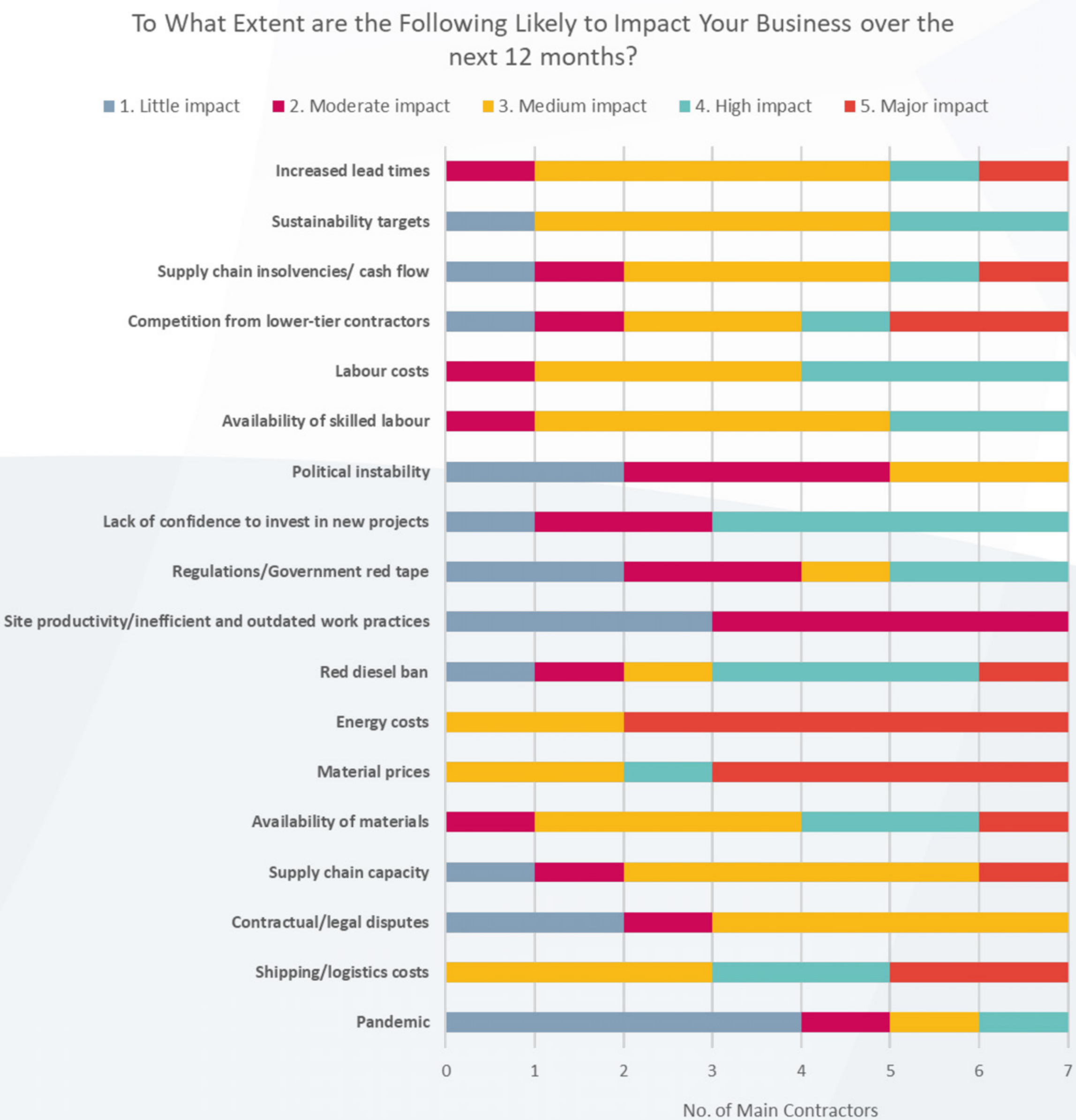
- When asked about preferred procurement routes for different project types/sectors, contractors indicated that **Negotiated** and **Two Stage** were most favoured
- As new order volumes recovered throughout 2021 and appetite for taking on inflationary risks/fixed prices fell, contractors became less willing to bid on **Single Stage** projects
- According to contractors, an advantage of **Two Stage/Negotiated** tendering is earlier engagement, helping to mitigate programme risk and lead time issues, as well as providing greater cost certainty as contractors can price with an informed understanding of the project
- However, both routes (**Two Stage/Negotiated**) have disadvantages for clients (eg the risk of higher price as works are not competitively tendered, or the risk the contractor withdraws before reaching an agreement, putting the client back to square one to tender the works again)
- While G&T is certainly still seeing **Single Stage** tendered projects, due to the current market conditions some clients are becoming more flexible regarding their procurement route preferences in order to minimise the number of declined bids from contractors



- More than ***70%*** of contractors expect tender price inflation to increase by ‘***+4.1 to +6%***’ over the next 12 months
- Again, contractors expect most tender inflation over the next 12 months to happen in the next six months, with ***57%*** of surveyed contractors indicating that tender price inflation is likely to exceed ***6%*** in the next six month period alone
- Inflation is being driven by rising materials prices, labour shortages and higher risk allowances in tenders but the current high levels of inflation are not expected to be sustained into next year



STRONG CONTRACTOR FOCUS ON THE COMMERCIAL OFFICE SECTOR AS OCCUPANTS ADAPT THEIR OFFICE SPACE TO CATER FOR NEW WORKING PATTERNS AND IMPLEMENT NET ZERO/ ESG STRATEGIES



In G&T's Q2 2022 Main Contractor Survey, surveyed Tier One main contractors said that:

'rising energy costs' and 'material prices'

were likely to be the two biggest issues over the next 12 months. This was followed by:

'competition from lower-tier contractors'

and concerns over

'shipping/logistics costs'.

What market pressures are currently driving construction prices?

- Concrete, steel and façade supplier pricing
- Energy and fuel prices being driven upwards from conflict in Ukraine
- Shipping and logistics costs
- Supply issues from post-Brexit/Pandemic and conflict in Ukraine continue to apply pressure
- Commodity price inflation and higher production costs
- Risk acceptance
- Unscheduled supplier increases
- Materials availability/longer lead times
- Lack of skilled labour and professional staff driving wages higher
- Overheating market
- Weakening pound/sterling

Are you currently seeing any interesting market trends or themes emerging?

- Life Sciences, Technology (Batteries, Chips) and film studios
- Net Zero Carbon projects and clients wanting to become more sustainable
- CLT frames/floors and off-site manufacturing for construction increasing
- More direct delivery opportunities from employers beyond demolition (eg piling, basement and frame)
- Plenty of investors/capital
- Significant increase in cost for basic brickwork construction as fire detailing and wall thicknesses increase
- Affordability of schemes is being assessed due to inflation hikes

"We are seeing an increase in construction techniques that are quicker (so as to mitigate inflationary costs) and that involve less steel and cement to reduce rates."

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