GARDINER &THEOBALD

Market Update
February
2020

@gt_llp
gardiner.com
marketintel.gardiner.com

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G&T's Market Update for February 2020 provides an overview of the London construction market. Although the full economic implications of the coronavirus (COVID-19) pandemic and its impacts on the construction industry are largely unknown, the report highlights changes to key macro-economic indicators over the reporting period, as well as significant construction-specific metrics such as the UK Purchasing Managers' Index, construction output, London commercial and residential new orders, key material costs, trade package inflation and tender price trends and forecasts.

In this update we:

- Analyse G&T's latest TPI survey data in order to gain an insight into market and supply chain conditions over the next six months in London
- Include an M&E dashboard summarising some of the market feedback received in G&T's latest M&E contractor survey

Click HERE to view TPI online

SUMMARY OF KEY FINDINGS: THE ECONOMY

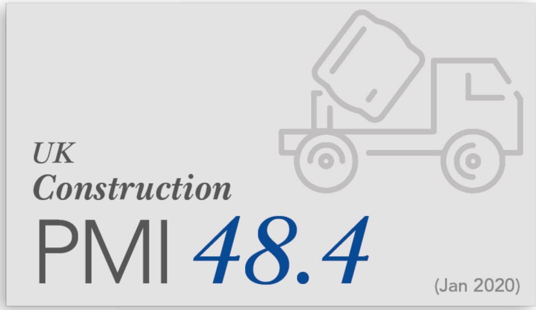
The UK economy flat-lined in Q4 2019, recording **no growth in output** compared to the previous three-month period.

Services and construction contributed positively to growth in the output approach to GDP in Q4 2019, ***growing 0.1% and 0.5% respectively***. Meanwhile production output contributed negatively to growth, ***falling 0.8%.***

As expected, political uncertainty caused the economy to stall in the final quarter of 2019, but there were early signs of a tentative post-election bounce as Boris Johnson seeks to 'level up' the economy. More positive PMI data from January pointed to a recovery in business confidence, and this was supported with improvements in consumer spending, employment rate and real wage growth.

Coronavirus (COVID-19) will undoubtedly have a negative impact on UK supply chains, productivity and economic growth in 2020. The end of the 11-year bull run in the US and dramatic falls in worldwide markets could result in delayed investments. Trade is also likely to be impacted as the Government steps up its response to the pandemic.

- The extent of economic damage resulting from COVID-19 remains unclear, but the Bank of England's emergency rate cut from 0.75% to 0.25% to mitigate the economic impact of COVID-19 is an indication of the potential severity it could have on the UK economy and construction sector
- Fiscal policy may be more expansionary than expected in 2020/21 as the Conservatives look to boost investment in UK infrastructure.
- Uncertainty over the future trading relationship with EU and other major trading partners remains.
- Government currently consulting on UK's new Global Tariff regime which will come into effect on 1st January 2021 for imports from any country that the UK does not have a free trade agreement with.
- Supply chain disruption for imported materials and products coming from China and other COVID-19 affected regions



The UK Construction ***PMI rose from 44.4 to 48.4*** in January 2020. Although still contracting, January's reading signalled the slowest pace of contraction since May 2019.

Softer declines in new business and improved business optimism were the stand-out positives from the survey. Although all areas of construction experienced declines in activity due to lack of opportunities to replace completed contracts, respondents commented on signs of a turnaround in demand conditions.

In London, ONS data revealed the following:

- ***London construction output (All Work) fell by -1.1%*** in Q4 2019 to ***£9.1bn***. Output growth for most sectors was either flat or negative but New Public Housing and Infrastructure Repair and Maintenance experienced positive quarter-on-quarter growth.

- New order growth was impacted by pre-election uncertainty. ***Total New Orders*** in London ***fell 26%*** in the final quarter of the year, but on an annual basis 2019 new orders were significantly higher (31%) than last year.

- London ***Residential New Orders fell by 44%*** to ***£993m*** in Q4 2019 compared to the previous quarter - below the five-year quarterly average of ***£1.05bn***.

- London ***Commercial New Orders*** in Q4 2019 ***fell 16%*** compared to the previous quarter from ***£1.43bn*** to ***£1.2bn***, dipping below the quarterly five-year historical average of ***£1.4bn***. But despite this the value of office project starts were up ***47%*** in Q4 2019 compared to the same period a year ago.

Construction material price inflation continues to soften. In the year to December 2019 the material price index for ***'All Work' fell by 1.1%*** as Sterling strengthened against the Euro, easing import cost pressure.

- All ***key materials*** shown in our graph on page 15 ***fell in Q4*** 2019, but it was ***rebar*** that experienced the biggest drop, ***falling by 7.5%*** in the three-month period
- Falling commodity prices, lower energy costs and suppressed demand have inhibited material price growth. Despite initial signs of a 'Boris bounce', COVID-19 is expected to dent demand and put downward pressure on commodity and material price inflation
- IHS Markit forecasts that ***steel rebar*** and ***structural steel*** prices have further to ***fall*** in 2020 (***8.5%*** and ***6%*** respectively) but ***lumber*** prices will see a ***4.6% rebound*** due to shortages and supply delays

- In terms of trade packages, we anticipate that M&E, Façades and Brick and Blockwork will experience the greatest package inflation rates over the next 12 months, largely as a result higher skilled labour costs (M&E), increased workloads creating supply pressure (Façades) and buoyant demand for bricks from the new build housing sector (Brick and Blockwork)
- G&T continues to forecast 2020 ***tender price inflation*** for **London at 1%, rising to 1.5%** in 2021 and ***2%*** in both 2022 and 2023 as rates trend closer to the long-term average.

Please see our Q4 2019 TPI report for further details.

Europe

The Eurozone economy grew by ***0.1%*** in Q4 2019, with France and Italy recording contractions.

Battered by global trade tensions year-on-year manufacturing output in the Eurozone fell ***4.1%*** in December 2019.

ECB is preparing to announce a monetary policy stimulus package to reduce the economic impact of COVID-19 as European countries unveil their own rescue packages.

The IMF cut its Eurozone growth projections for 2020 from ***1.4%*** to ***1.3%.***

US

US' annual GDP growth was ***2.3%*** in 2019 – the weakest growth rate in three years.

Moderate economic growth expected to continue into 2020 but US presidential elections, ongoing trade tensions with China and COVID-19 outbreak could dent growth.

The IMF expects the economy to grow ***2.1%*** in 2020 – a ***0.2%*** improvement from its previous forecast.

US signed phase 1 trade deal with China in 2019 but this is unlikely to boost the economy as US tariffs remain in effect on ***$360bn*** of Chinese imports.

China

Annual GDP growth was ***6.1%*** in 2019 – the slowest pace of growth in 29 years.

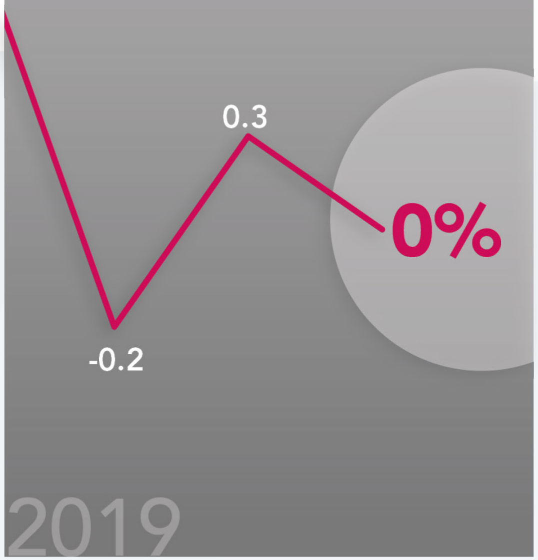
Existing trade tariffs remain in place under phase 1 trade deal with the US but tensions have eased and business optimism increased.

Further monetary easing needed to boost domestic demand.

COVID-19 lowers Chinese factory output and impacts global supply chains.

The IMF raised its 2020 growth forecast from ***5.8%*** to ***6%*** partly because of the phase 1 trade deal.

UK GDP growth was flat in Q4 2019, having risen by ***0.3%*** in the previous quarter. Growth in both services and construction was offset by a fall in production.



GDP: Quarter on Quarter Growth: Chained Volume Measure* Seasonally Adjusted

In Q3 2019 UK construction productivity rose by ***2.2%*** compared to the previous quarter

Construction Productivity Index: Output per job (Q1 1990=100), SA, UK

UK GDP from Construction rose to an all-time high of ***£29,738m*** in Q4 2019 – up ***0.5%*** from ***£29,593m*** in Q3 2019

UK GDP From Construction

*** Please note** – Chained Volume Measure (CVM) means that data from successive years have been put in real (inflation-adjusted) terms by computing the production volume for each year in the prices of the preceding year, and then 'chain linking' the data together to obtain a time-series of production figures from which the effects of price changes (i.e. monetary inflation or deflation) have been removed. **Source:** Trading Economics and ONS*

UK Economy

Overview	Latest	Forecast Q1/20	Q2/20	Q3/20	Q4/20	Q1/21	Units
GDP Growth Rate	0.0	0.2	0.5	0.4	0.5	0.4	%
Unemployment Rate	3.8	3.8	3.9	3.9	3.8	4.0	%
Inflation Rate (CPIH)	1.8	1.4	1.8	2.0	1.9	2.5	%
Interest Rate	0.25	0.25	0.25	0.25	0.25	0.5	%
GDP from Construction	29,738	29,636	29,344	29,711	30,035	30,456	GBP Million
Government Debt to GDP (the ratio between a country's government debt (cumulative amount) and its GDP**)**	80.8	81.3	81.3	81.3	81.3	78.2	%

Source: *Trading Economics and ONS*

Services

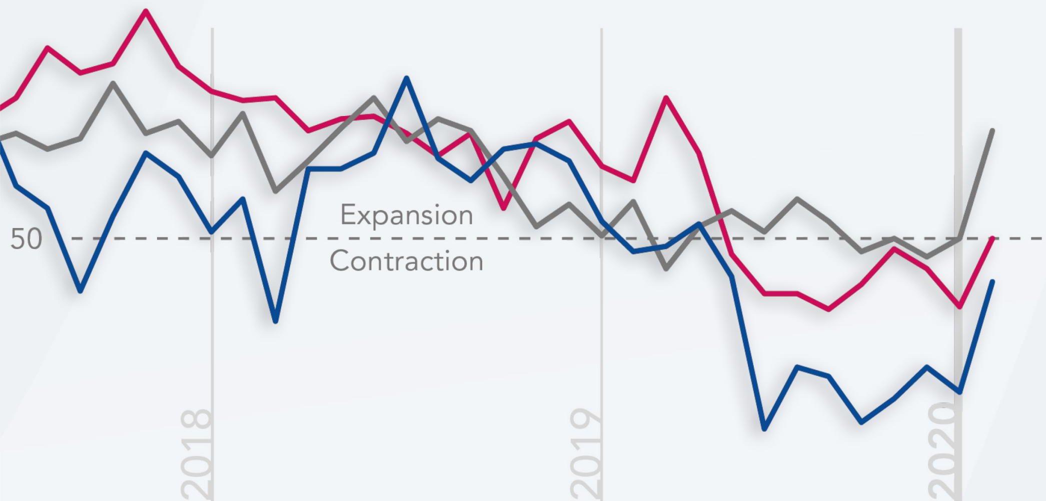
- UK Services PMI rose to ***53.9*** in January 2020 – its strongest pace of expansion since September 2018.
- New business growth accelerated and workloads rose as there was an upturn in clients willingness to spend.
- Headwinds from delayed decision making have been lifted since the general election, translating into rising business and consumer spending.

Manufacturing

- UK Manufacturing PMI rose to a nine-month high of ***50*** in January 2020.
- Business conditions stabilised and political uncertainty eased, strengthening the domestic market.
- Recovery in new order intakes, employment and business confidence but reduced export orders.

Construction

- UK Construction PMI rose to ***48.4*** in January 2020 – the slowest pace of contraction since May 2019.
- New work fell the least for 10 months and a modest degree of pressure on supply chain capacity was recorded, with lead-times from vendors lengthening slightly despite a drop in purchasing volumes.
- Business optimism bounced back as did clients' willingness to spend.

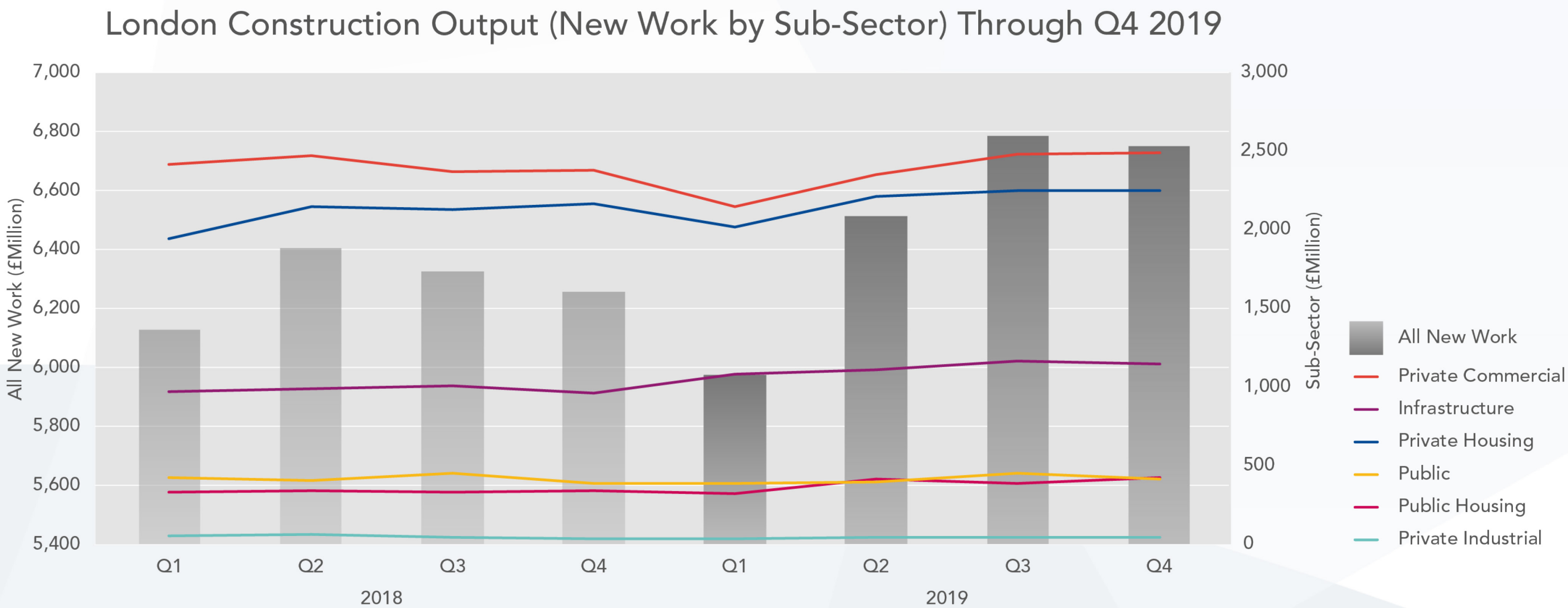


Services **53.9**

Manufacturing **50.0**

Construction **48.4**

Source: IHS Markit/CIPS



- Construction output was slightly weaker in Q4 2019, falling by ***1.1%*** compared to the previous quarter on a non-seasonally adjusted basis

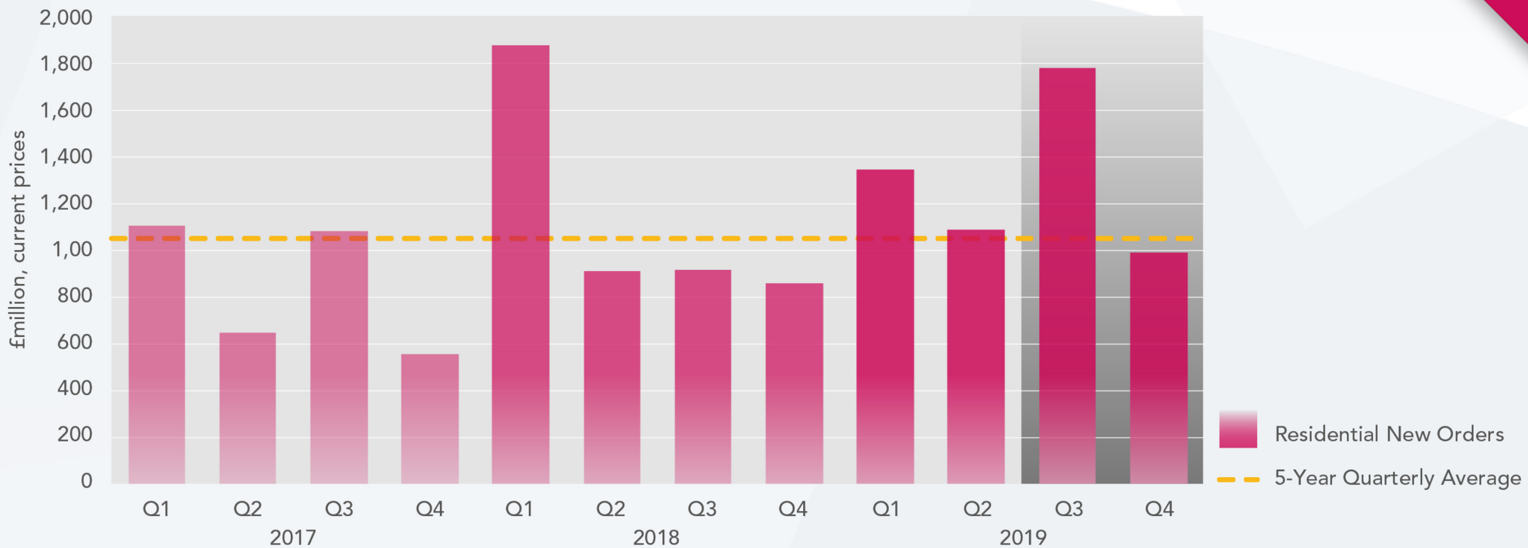
- Both New and Repair & Maintenance work fell in the final quarter of 2019 (by ***0.5%*** and ***2.9%*** respectively), but the All Work value for 2019 as a whole was still ***2.9%*** higher than in the previous year (2018)

- In Q4 2019 all 'New Work' sectors in London experienced a fall in output values other than Public Housing and Private Commercial, which grew ***9%*** and ***0.2%*** respectively compared to the previous quarter

Source: *ONS*

Note: In a letter from the UK Statistics Authority dated 7th March 2019, the ONS stated that these sub-national and sub-sectoral estimates of construction output no longer carry National Statistics status

- London Residential New Orders fell by ***44%*** to ***£993m*** in Q4 2019 compared to the previous quarter - below the five-year quarterly average of ***£1.05bn***.
- Purpose-built rental blocks of more than ***100*** private units accounted for ***28%*** of private construction starts as at the end of Q2 2019. Some ***8,816*** units were approved in the fist six months of 2019 – a ***20%*** year-on-year increase.
- The number of residential units that received planning rose to almost ***42,000*** during the 12 months to Q2 2019, however just over ***9,000*** units were started during the first half of 2019. The construction pipeline suggests completions will remain suppressed and fall below the Mayor's target of ***66,000*** homes a year.

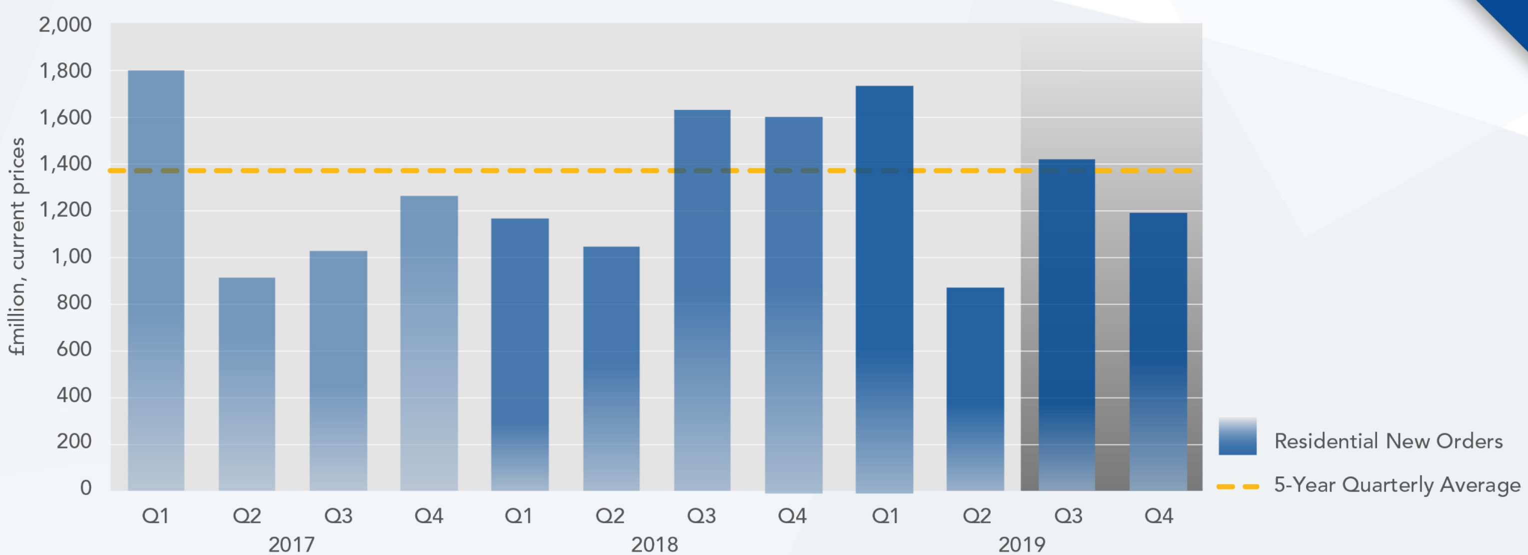


Source: *ONS, Knight Frank*

- London Commercial new orders in Q4 2019 fell ***16%*** compared to the previous quarter from ***£1.43bn*** to ***£1.2bn***.

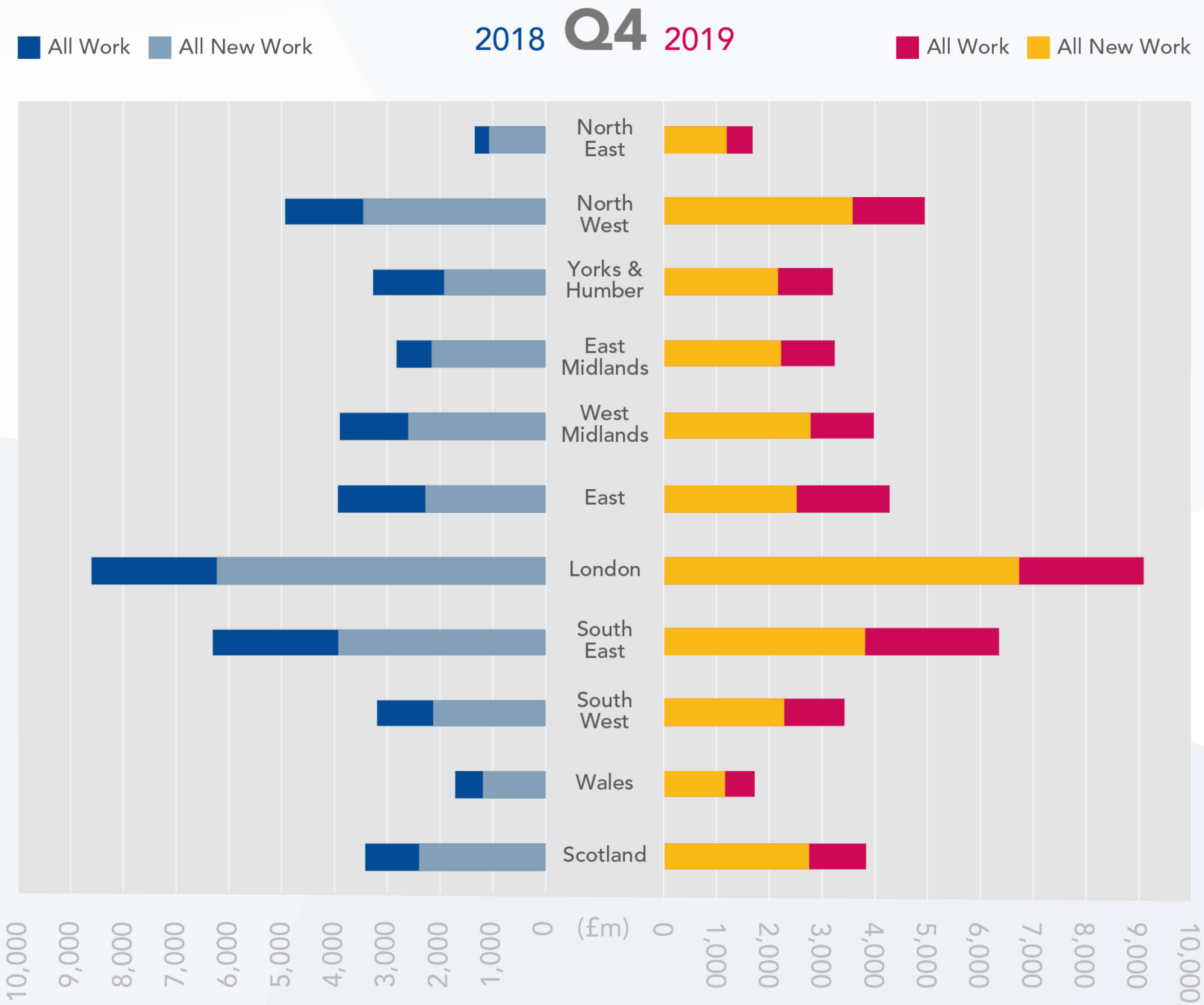
- Q4 2019 Commercial new orders dipped below the five-year quarterly average of ***£1.4bn***, but the value of office project starts were up ***47%*** in Q4 2019 compared to the same period a year ago.

- Availability of office space in the capital stands at ***13m sq ft***, a vacancy rate of just ***4.8%*** and some ***6%*** below the ten-year average. Low supply, strengthening demand and greater economic/political certainty may help to boost the 2020 commercial pipeline.



Source: ONS

- In Q4 2019, all regions other than the Yorkshire & Humber saw an increase in construction output (all work) compared to Q4 2018.
- Highest output growth seen in North East, East Midlands and Scotland, which grew ***24%, 15%*** and ***12%*** respectively.
- New work output in the South East and Wales dropped in Q4 2019 compared to Q4 2018. All other regions experienced output growth.
- Output growth was highest in Scotland and the North East over the period, growing by ***14%*** and ***13%*** respectively.



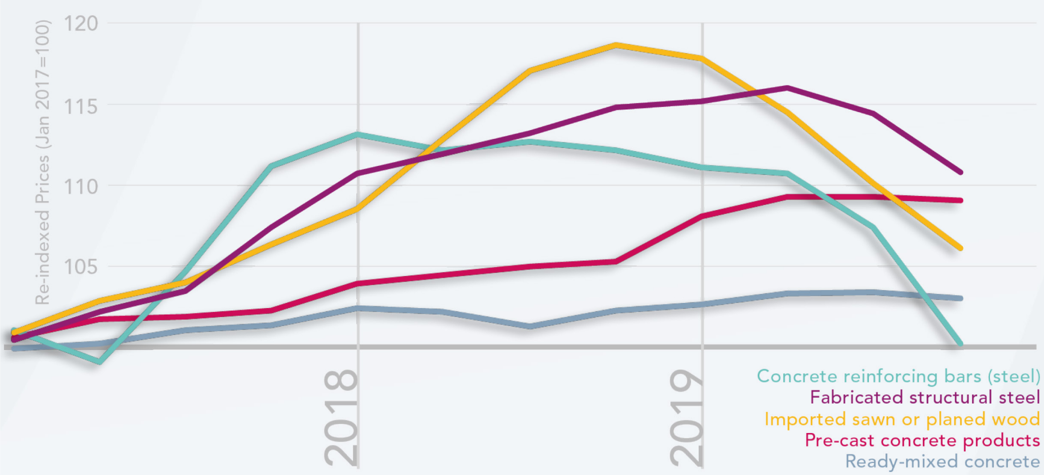
Source: *ONS*

Construction material price inflation continues to soften. All key materials shown in the graph below fell in Q4 2019, but it was rebar that experienced the biggest drop, falling by ***7.5%*** in the three-month period

In the year to December 2019 the material price index for 'All Work' fell by ***1.1%*** as Sterling strengthened against the Euro, easing input cost pressure

Falling commodity prices, lower energy costs and suppressed demand have inhibited material price growth. Higher anticipated demand in 2020 may help to stem falling prices but many (including IHS Markit) are forecasting that prices for materials such as rebar and steel will fall further in 2020

Price Indices of Key Construction Materials (Quarterly Average Growth)



Source: *gov.uk*

Construction Material Price Indices

	Month on Month Nov 19 - Dec 19	Year on Year Dec 18 - Dec 19
New Housing	-0.2%	-0.4%
Other New Work	-0.5%	-1.3%
Repair & Maintenance	-0.2%	-1.5%
All Work	-0.4%	-1.1%

Key Trade Analysis

Likely 12-month inflationary range for key trade packages based on our Q4 2019 TPI Survey results

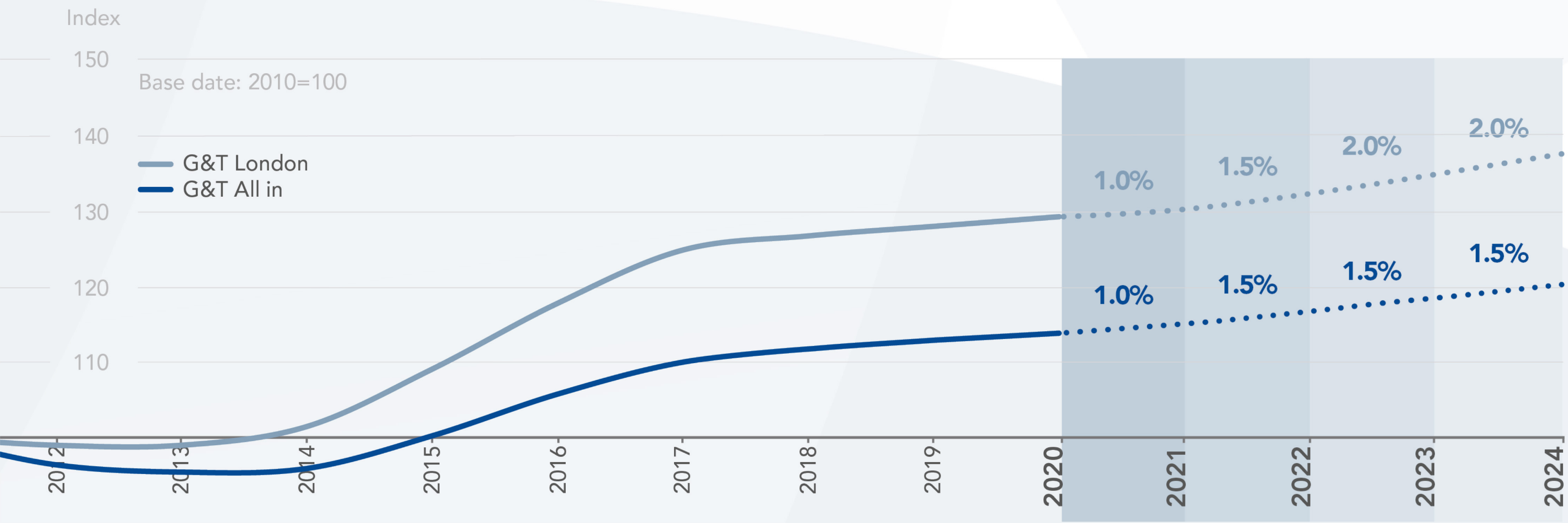
Key Trade Packages	Summary	Likely Inflation Range (Next 12 months)
Demolition	Competitive pricing for projects with an immediate start date as contractors remain keen to secure work Particularly evident among tier 2 & 3 contractors and those not linked to London's major regeneration schemes	**-2% - 0.5%**
Groundworks	Contractors noticing a drop-off in new work and greater competition to win work	**-1% - 1%**
Concrete	Suppliers keener for good quality workload – better pricing than past two years due to falling investment in commercial buildings and slowing housebuilding activity in the capital Lead times and enquiry levels remain static but there is a possibility of a post-election spike Ready-mixed concrete deliveries were up 4.3% in Q3 2019 compared to the previous quarter	**0.5% - 1.5%**
Steel	Fabricated structural steel prices fell by 4.1% in the three months to December 2019 Slowing global demand, at the same time as an increase in supply, has created a glut of steel on the international market, putting downward pressure on iron ore prices and ultimately steel ArcelorMittal (the world's biggest steel producer) expects European steel consumption to grow by 1-2% in 2020 (compared with 1.1% in 2019) Although the Steel Pipeline shows that the Government plans to use over 3m tonnes of steel (worth around £0.5 billion) over the next decade on infrastructure projects, supressed steel demand is expected in 2020	**0.5% - 1.5%**
Facades	Supply pressure and increased cost of design, installation and materials resulting from Hackitt report Cladding firms reporting increased workloads and enquiries compared to six months ago Limited contractor capacity on tier 1 level projects	**1% - 2%**
Brick	Demand for bricks remains buoyant, particularly from the new build housing sector ONS data indicates that brick production in the year to November 2019 is 3% higher than it was in the previous year. Domestic production is expected to increase as factories increase plant capacity Lead times are not expected to rise as workload and enquiries remain at a consistent level, despite reports of a shortage of bricklayers	**1% - 2%**

Key Trade Packages	Summary	Likely Inflation Range (Next 12 months)
Dry lining	Shortages of skilled labour are supporting prices, particularly in residential Workload remains higher, but enquiries have levelled off Costs are being pushed up by supplier stock shortages of plasterboard and insulation materials	**0.5% - 1.5%**
Carpentry	Demand for carpentry from the residential sector continues to stretch capacity Imported sawn or planed wood prices fell by 12% in 2019 but are expected to rise in 2020 due to tighter supply Demand for stockpiled timber pushed up prices prior to the original March Brexit deadline. Surplus stock is moving through the system leading to a softening of prices	**0.5% - 1.5%**
Joinery	Strong demand continues with no evidence of weakening in pricing Labour shortages, increased workload and enquiry levels have pushed lead times up to 18 weeks	**1% - 2%**
Finishes	Enquiries and workload remain stable Rates are high due to demand working through rather than any shortage of skilled labour	**0.5% - 1.5%**
M&E	Enquiries expected to pick up post-general election result Some contractors were tendering at or below cost on some projects in Q4 2019 to maintain turnover A skills gap in the sector is causing resourcing issues and pushing labour costs higher Contractors are focusing on alternative sources of materials outside of Europe, helping to ease price pressure Copper and aluminium prices rose steadily in Q4 2019 but dropped in January 2020 as a result of uncertain global demand	**1.5% - 2.5%**
Roof	Costs remain high due to the high-risk nature of the trade. Costs also being pushed up by a shortage of contractors and labour, as well as a volatile insulation market Oil prices rose steadily in Q4 2019 but have since fallen back to January 2019 levels, lowering the price of asphalt shingles and reducing overhead cost pressure on roofing contractors	**1% - 2%**
Fittings	Rates are being driven by higher demand and a shortage of labour	**0.5% - 1.5%**
Preliminaries	Main contractor preliminaries experiencing upward pressure from rising labour costs but some of this is likely to be absorbed by contractors wishing to secure immediate turnover in a tighter market. We anticipate that preliminaries will remain largely unchanged in 2020 - averaging around 15% - but could increase marginally	**0 - 1%**
OH&P	Main contractor OH&P levels expected to remain steady. Competition for work is likely to increase in the short term but margins are already squeezed. Contractors in some sectors may be forced to reduce OH&P in order to maintain turnover but overall we expect OH&P to remain at an average of 5-6% over the next 12 months	**0%**

Note: Inflationary ranges were produced prior to the COVID-19 outbreak. The pandemic is likely to impact trade package inflation in the short-medium term.

- Our London TPI forecast for 2020 remains unchanged at ***1%***, rising to ***1.5%*** in 2021 and ***2%*** in 2022 and 2023
- Business confidence and demand was expected to grow in 2020, but the COVID-19 pandemic may make any post-general election uplift short-lived. Confirmation in the 2020 Budget that over £600bn will be spent on UK infrastructure over the next five years positive, but greater clarity is needed regarding the type of trade deal that can be struck with the EU in order to bolster longer-term confidence to invest and move projects forwards
- Tendering on small and medium-sized projects in particular are experiencing high levels of competition with larger contractors now stepping down to compete for such projects to fill order books and secure their pipeline towards the end of 2020

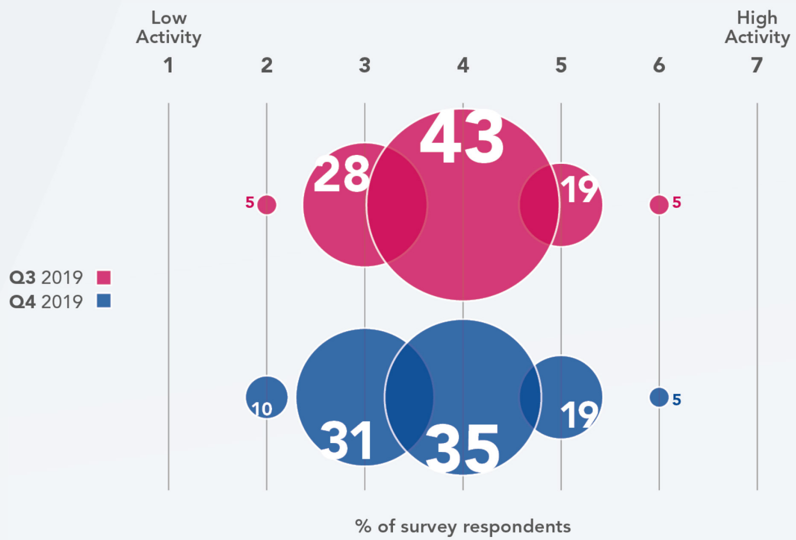
TPI
forecast for 2020
UNCHANGED



Market Conditions…

Perception over the next six months (London)

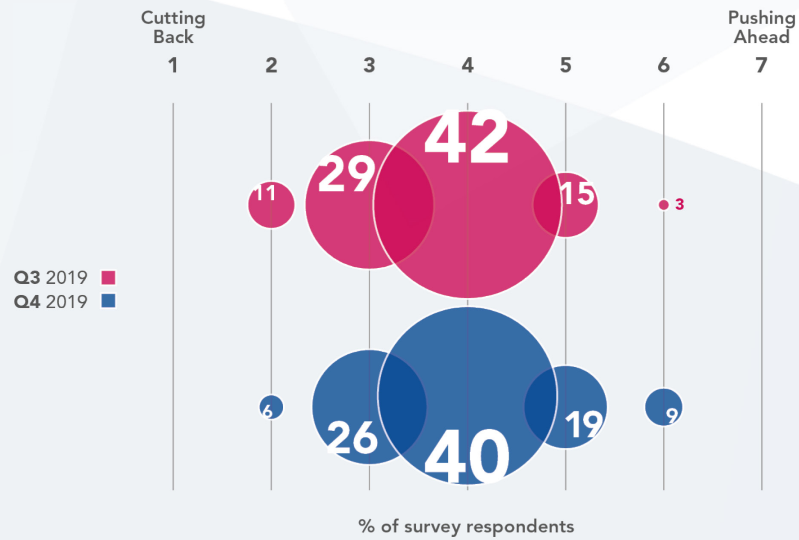
- Respondents anticipated slightly lower levels of activity and a more competitive market in H1 2020.
- Main contractors looked for more work in Q4 as investors became more risk averse and project conversion rate slowed.
- Respondents noted that political uncertainty had impacted market activity but that the decisive general election result could boost client confidence.



Client Investment…

Perception over the next six months (London)

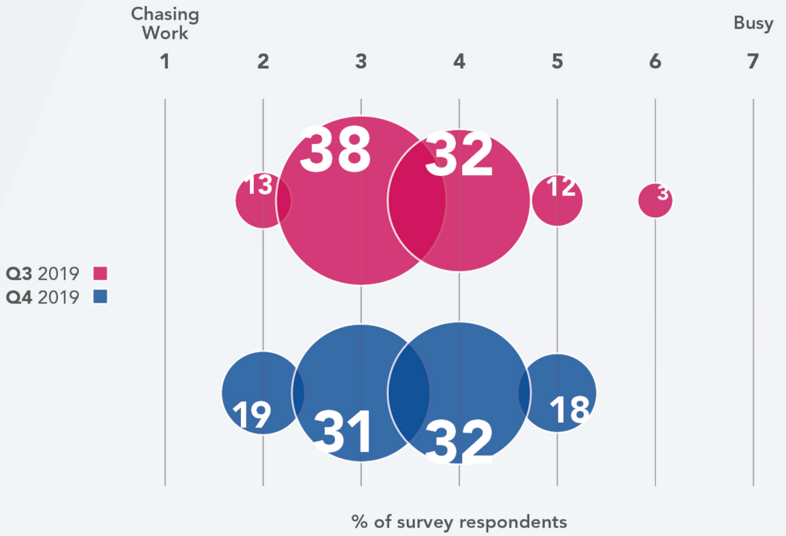
- Perception that clients will be increasingly inclined to push ahead with investment plans over the next six months.
- Clients to reactivate investment plans and move forward with stalled or slow-moving projects.
- Greater capital investment in public infrastructure projects expected. Sectors which rely on immediate capital growth for return on investment, such as retail and commercial, are likely to see more cut backs.



Contractors' Workload…

Perception over the next six months (London)

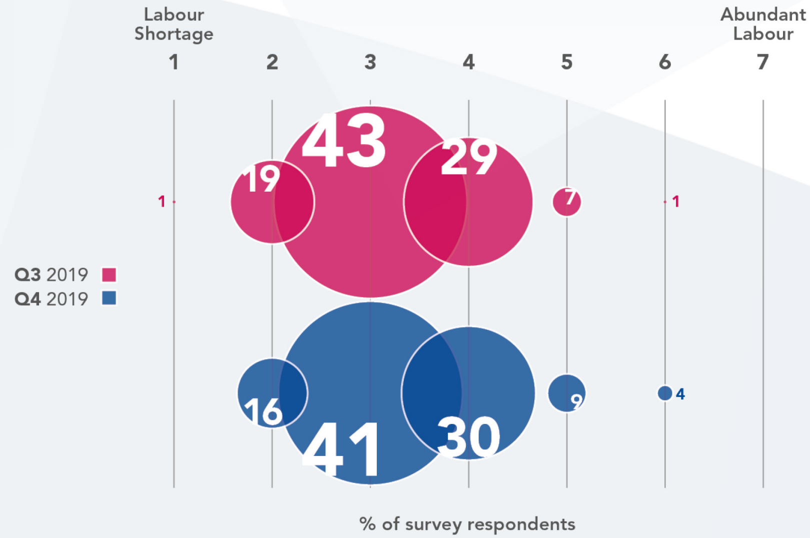
- Notable increase in the proportion of respondents who perceive that contractors will be chasing work over the next six months.
- Contractor insolvencies means there are fewer firms able to carry out work. This has helped contractors to keep their workloads relatively high (and space capacity low) despite lower demand in an uncertain market.
- Poor new order data from Q4 2019 will likely create a gap in the construction pipeline.



Skilled Labour…

Perception over the next six months (London)

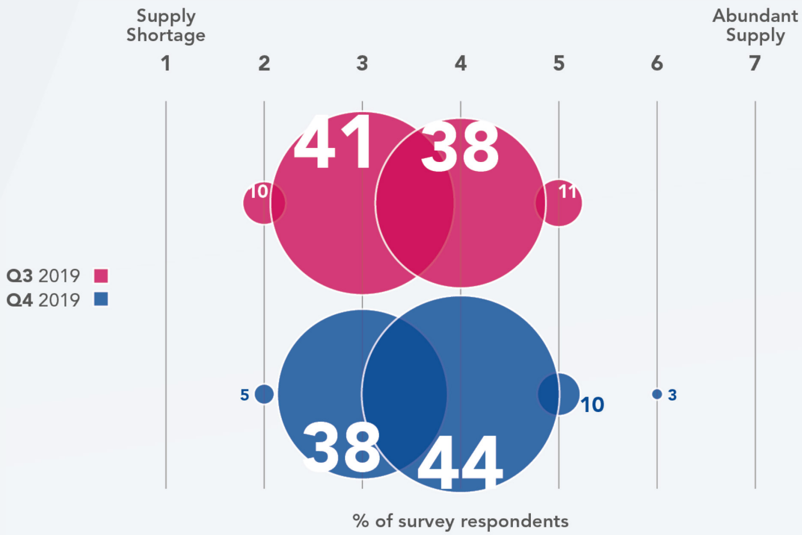
- Labour supply largely unchanged from last TPI survey. Supply remains stretched and shortages are being reported across some projects.
- Trade packages such as masonry/ brickwork have been particularly affected by tight labour supply, increasing project preliminaries.
- Reports of direct employment decreasing and construction companies becoming increasingly reliant on sub-contractors.
- A sustained decline in skilled labour supply is anticipated, creating an industry skills gap.



Materials Supply…

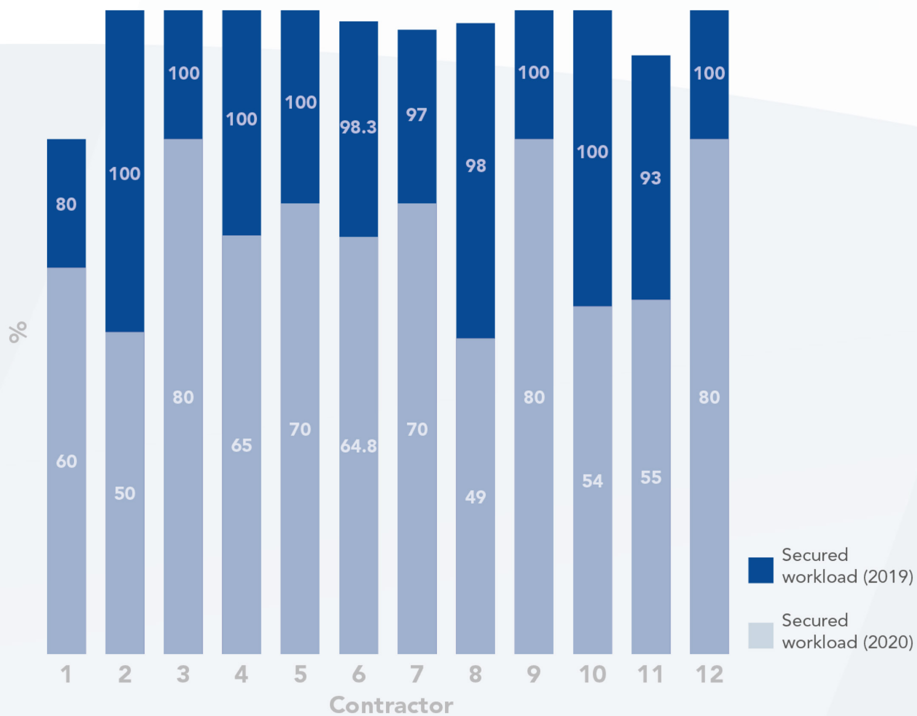
Perception over the next six months (London)

- Vast majority have a neutral perception regarding the supply of materials.
- China accounted for 17% of all UK construction imports in 2019. COVID-19 related supply chain disruption could impact heavily imported construction products from China such as electrical wires and air conditioning equipment.
- With Italy in quarantine until April there are fears that products such as cladding, along with other key Italian materials including stone, will be stuck in the country for weeks.
- Government currently consulting on UK's new Global Tariff regime which will come into effect on 1st January 2021 for imports from any country that the UK does not have a free trade agreement with.
- 'Inevitable' new border controls and regulatory checks at UK ports likely to cause disruption to logistics and the just-in-time delivery model.

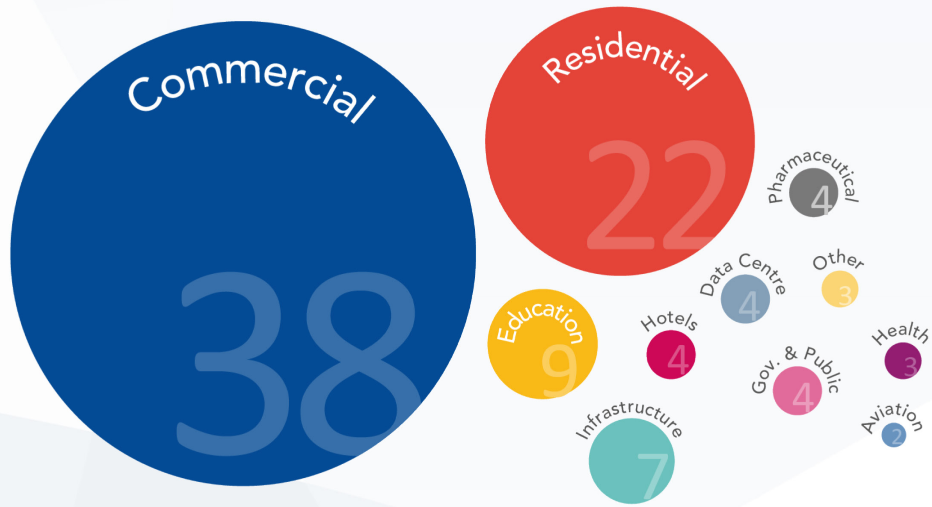


G&T surveyed 12 M&E contractors in Q3 2019. The dashboard below highlights some of the key findings...

Average secured
WORKLOAD
for 2020
65%



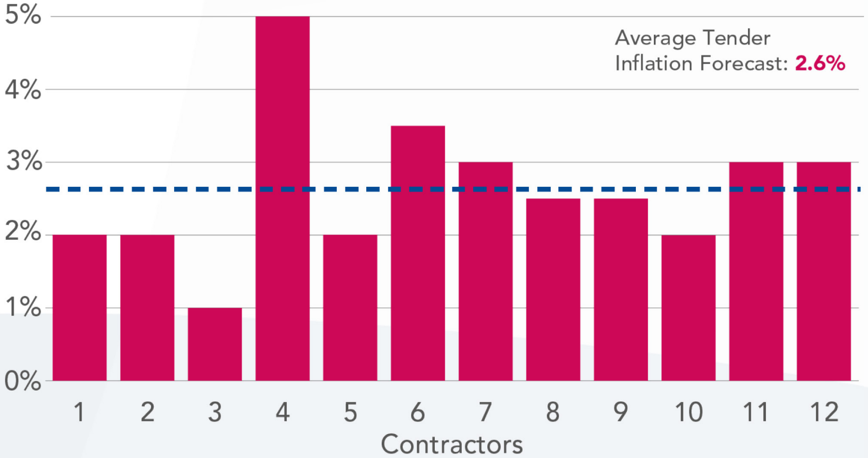
Average Sector Split (%) - Q3 2019



Seven out of 12 contractors said the
majority of work
was in the...
COMMERCIAL SECTOR

In Q3 2019, contractors said that on average ***38%*** of their work was in the commercial sector, followed by residential ***(22%).***

12 Month MEP Tender Inflation Forecast
(Q3 2019 - Q3 2020)

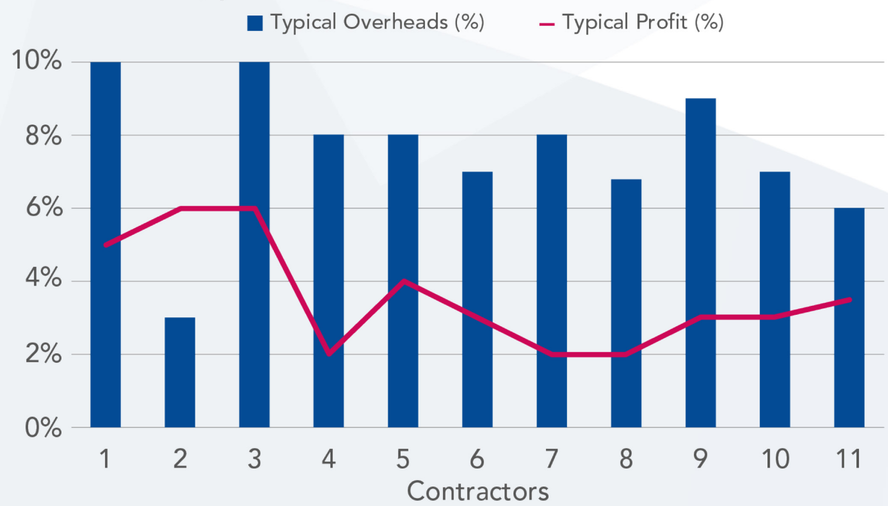


Average 12 month
MEP TENDER
inflation forecast
2.6%

TYPICAL
Overhead
7.5%

TYPICAL
PROFIT
3.6%

Typical Project Overheads & Profits



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