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Market Update

June

2020

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G&T's Market Update for June 2020 provides an overview of the London construction market. In light of the disruption caused by the coronavirus (COVID-19) pandemic and its impacts on the construction industry, 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 productivity survey data in order to gain an insight into current productivity levels on site, the factors impacting productivity the most, as well as expectations for future productivity
- Provide an overview of some of the key takeaways from Deloitte's Summer 2020 London Office Crane Survey

Please note – whilst our Market Update uses the most recently published data at the time of writing, release schedules between datasets differ. This will inevitably mean that whilst some datasets will show the impacts of Covid-19, other datasets will not.

UK economy
CONTRACTED BY
(Q1 2020)
2%

UK GDP FELL
by a record amount
(April 2020)
20.4%

Total imports
monthly rate
fell by
(April 2020)
26%

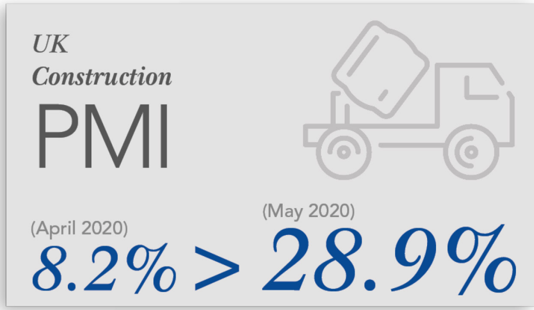
The UK economy contracted by ***2%*** in Q1 2020, following flat GDP growth in the fourth quarter of 2019.

Nearly all sub-sectors contributed to the overall fall in GDP in Q1. Construction was the hardest hit sector with output contracting by ***2.6%.*** Production fell by ***2.1%*** and services fell by ***1.9%***.

UK GDP fell by a record ***20.4%*** in April following a ***5.8%*** fall in March. The Government-imposed lockdown restrictions have paralysed the economy, setting the country on course for the worst recession in more than three centuries.

COVID-19 has caused a significant supply, demand and financial shock to the UK economy. Although the trough in activity is likely behind us, the recovery is expected to be far more drawn-out than the collapse. The fiscal cost of the collapse is only just starting to emerge but it's clear that the economy will take some time to recover and significant downside risks remain. As such, the Bank of England has increased its bond buying (quantitative easing) program by £100bn to £745bn, compared with £200bn in the 2009 financial crisis.

- In its interim (June 2020) forecast the EY Item Club cut its 2020 economic growth forecast from ***-6.8%*** to ***-8%*** but noted that the economy is expected to start to recover in Q3
- Substantial fiscal and monetary stimulus enacted by HM Treasury and the Bank of England should support activity but resulted in Public Sector Net Borrowing surging to a record £62.1bn in April
- Pent-up demand is expected to be released following a collapse in consumer spending in Q2, but consumer and business confidence will take time to fully recover
- Pandemic restrictions hit trade in April as total imports fell at an unprecedented monthly rate of ***26%*** and exports by a record ***19%***
- A trade deal between the UK and EU has yet to materialise which could mean an extended transition period or trade taking place between the UK and EU under World Trade Organisation (**WTO**) rules.



The UK Construction ***PMI rose to 28.9 in May 2020*** from an all-time low of ***8.2*** in the previous month. A reading below 50 indicates an overall deterioration in construction activity.

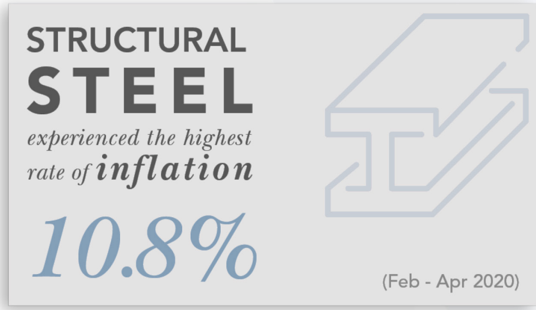
May's PMI reading pointed to the second-sharpest contraction in the sector since February 2009, but the improvement from April's reading reflected a gradual reopening of construction sites as lockdown measures were eased in England.

New orders and employment continued to fall at a sharp pace, while lead times for construction products and materials continued to lengthen at a rapid pace. Looking ahead, business sentiment held close to April's low amid recession worries and fears of postponements to new projects.

According to the latest ONS data:

- UK construction output (All Work) fell by **40.1%** in April – the sharpest monthly fall on record since the monthly records began in January 2010
- Month-on-month output growth fell across all sub-sectors but largest falls were in new housing. Infrastructure and public non-housing saw the lowest declines in output
- UK new orders rose **11.8%** in Q1 2020 compared to the previous quarter and were **4%** higher than the same period one year ago. **81%** of Q1 new orders were recorded in January and February following greater political certainty after the General Election
- In a sign of improving market confidence pre Covid-19, London residential and commercial new orders rose in Q1 by **84%** and **86%** respectively putting them well above their five-year quarterly average

SUMMARY OF KEY FINDINGS: MATERIAL PRICES AND TPI



Construction material prices began to reverse their 2019 deflationary trend in Q1 2020. The ONS' material price index for ***'All Work'*** rose by ***1%*** between January and April 2020 but prices softened in April as demand for materials dropped as work on site was suspended for many projects

- After dipping towards the end of 2019 structural steel experienced the highest rate of inflation (***10.8%***) in the three months to April 2020, but prices were still ***2.4%*** lower than they were one year ago
- Upward price pressure from reduced manufacturing capacity and supply disruptions of imported materials were overshadowed by a unprecedented drop in demand for construction materials as sites temporarily closed
- The pandemic has caused shortages and lags in supply for some materials (eg plaster, plasterboard, aggregates and bricks, insulation) due to reduced capacity of manufacturers and builders merchants
- Recovering demand and low supply inventories are expected to create above average cost inflation for material prices until supplier/distribution channels return to more typical output and operating levels
- Greater downward pressure on tender price inflation as the market tightens and firms bid on a reduced number of new projects to secure pipeline. Input costs are likely to follow a weaker market downwards
- Given the unprecedented levels of market uncertainty, our Q2 2020 TPI report adopted a scenario-based approach. Whilst we generally expect lower tender price inflation in the short to medium-term, precise movements will depend on the rapidly changing supply, demand and economic conditions

Europe

The Eurozone economy contracted by ***3.6%*** in Q1 2020 – a historic decline caused, by and large, by domestic lockdowns.

Household consumption and investment fell in the quarter as a result of the pandemic, which is expected to trigger a deep recession.

ECB expects GDP to shrink ***8.7%*** in 2020, marked by severe job and income losses, elevated uncertainty and falls in consumer spending and investment.

ECB extended and increased its quantitative easing bond-buying programme to €1.35tn to help support funding conditions and keep borrowing costs low.

The IMF cut its Eurozone growth projections for 2020 from ***1.3%*** to ***-7.5%.***

US

US GDP fell at an annual rate of ***5%*** in Q1 2020 as 'stay-at-home' orders in March dented demand.

National debt expected to surpass nominal GDP in 2020, as Government increases borrowing to avert the coronavirus crisis.

Mid-May jobless report revealed 21.05 million continuing jobless claims, pointing to an extended period of high unemployment and a slower recovery.

The FED projects the US economy will shrink ***6.5%*** in 2020 and suggested that interest rates will remain at near-zero until at least 2022.

The IMF expects the economy to contract by ***5.9%*** in 2020, but projects a return to growth in 2021.

China

China's economy shrank by ***6.8%*** in Q1 2020 from a year ago as Beijing implemented large-scale shutdowns and quarantines.

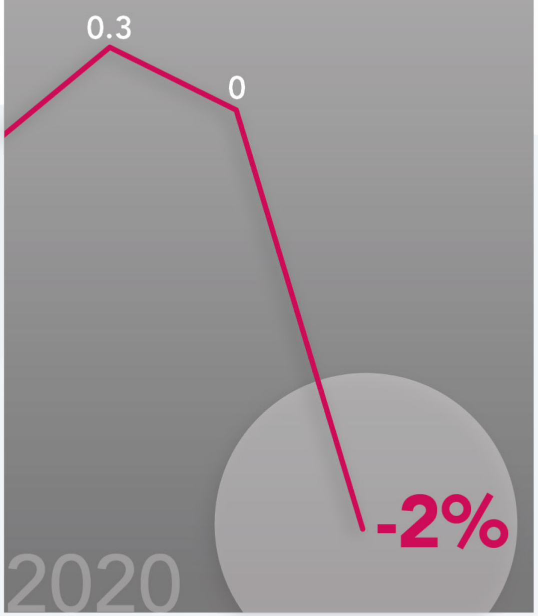
Industrial production dropped, as did retail sales and investment as a result of the outbreak.

Nearly all major industrial enterprises have now resumed work but business activity has not yet returned to normal due to a drop in lower global demand.

Plans to boost spending on infrastructures through an increase in local government borrowing.

The IMF projects that China's economy will grow ***1.2%*** in 2020, followed by ***9.2%*** in 2021.

UK GDP growth fell by **2%** Q1 2020, having been flat in the previous quarter. All three major drivers of growth – services, manufacturing and construction – went into reverse

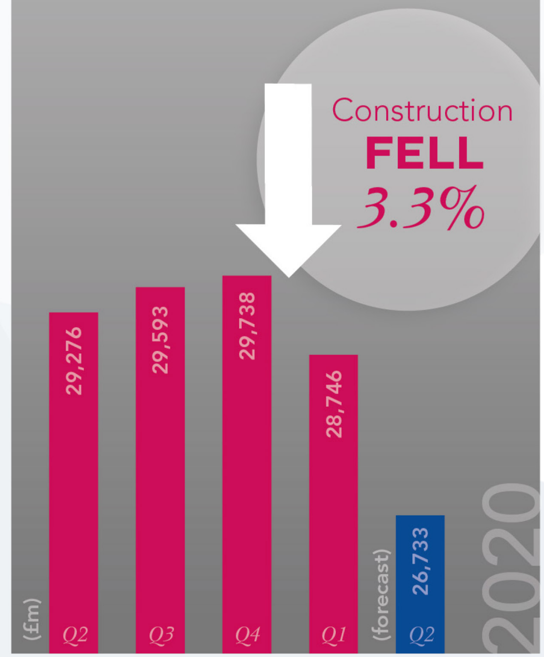


GDP: Quarter on Quarter Growth: Chained Volume Measure* Seasonally Adjusted

In Q4 2019 UK construction productivity fell by ***0.6%*** compared to the previous quarter

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

After hitting an all-time high in Q4 2019, UK GDP from Construction fell to ***£28,746m*** in Q1 2020 – a ***3.3%*** decline from the ***£29,738m*** in Q4 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 (ie monetary inflation or deflation) have been removed.* ***Source:*** *Trading Economics and ONS*

UK Economy

Overview	Latest	Forecast Q2/20	Q3/20	Q4/20	Q1/21	Q2/21	Units
GDP Growth Rate	-2.0	-26.0	10.5	4.8	1.0	0.7	%
Unemployment Rate	3.9	6.0	6.9	6.8	6.5	6.0	%
Inflation Rate (CPI)	0.8	0.4	0.8	1.2	1.9	2.0	%
Interest Rate	0.1	0.1	0.1	0.1	0.1	0.3	%
GDP from Construction	28,746	26,733	28,699	28,238	28,085	29,142	GBP Million
Government Debt to GDP (the ratio between a country's government debt (cumulative amount) and its GDP)	80.7	100	100	100	96	96	%

Source: *Trading Economics and ONS*

Services

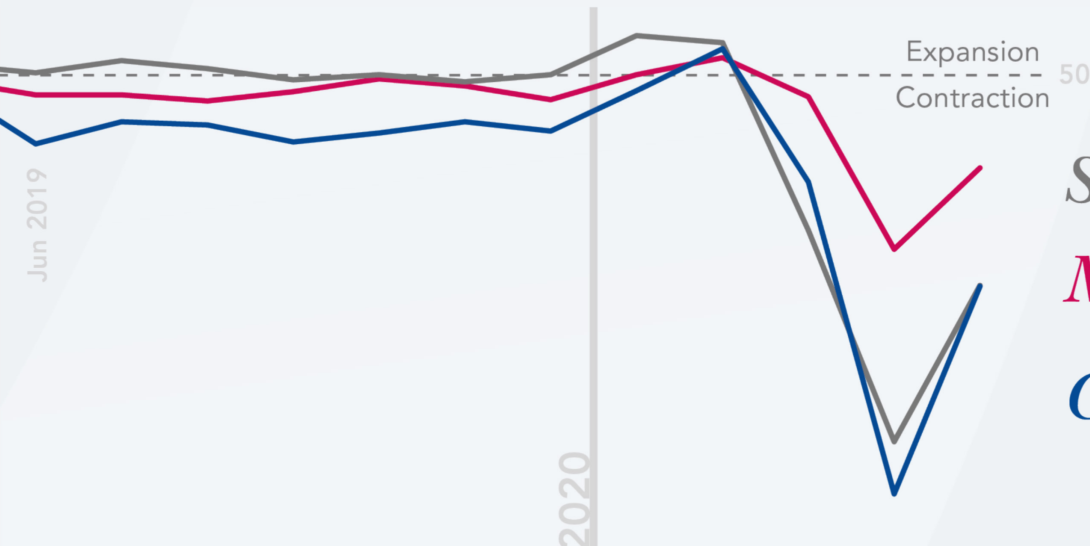
- UK Services PMI fell to ***29.0*** in May 2020 – a softer pace of decline in activity than April's record low of ***13.4***
- Survey respondents noted that deep cutbacks to spending, closures and constrained sales operations as a result of COVID-19 had resulted new business and new export work falling
- Subdued consumer demand with large areas of the service economy still in the planning stage of restarting operations

Manufacturing

- UK Manufacturing PMI stood at ***40.7*** in May as the pace of contraction slowed from April's low of ***32.6***
- Output, new orders and export sales fell at steep rates as restrictions to combat the spread of COVID-19 caused widespread disruptions to economic activity, demand and global supply chains
- However, inflows of new business showed signs of restarting

Construction

- UK Construction PMI increased from an all-time low of ***8.2*** in April to ***28.9*** in May
- Rapid drop in new orders almost exclusively attributed to coronavirus as projects were cancelled and spending scaled back
- Ongoing closures, reduced site activity and disruptions across the supply chain held back the extent of recovery
- Supply of building materials constrained but vendors are gradually reopening

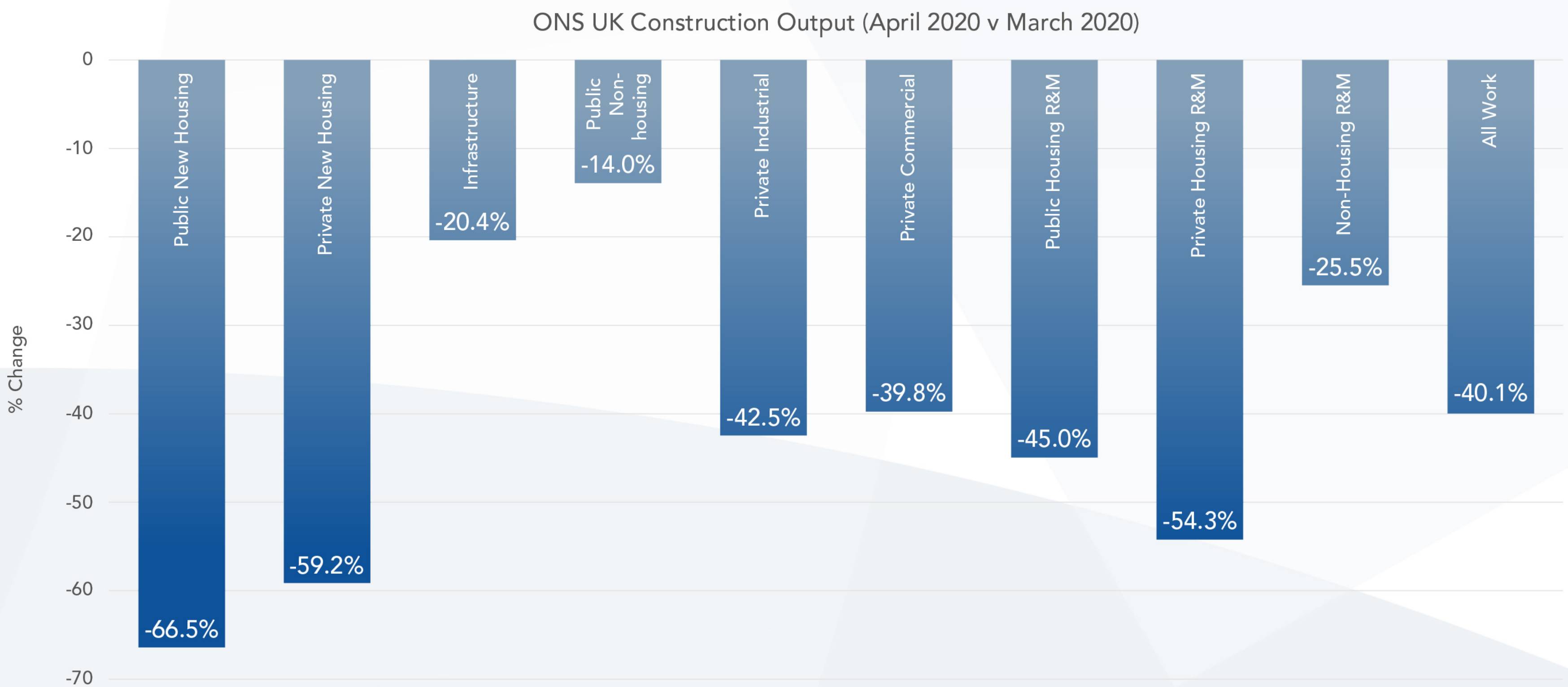


Services **29.0**

Manufacturing **40.7**

Construction **28.9**

Source: *IHS Markit/CIPS*

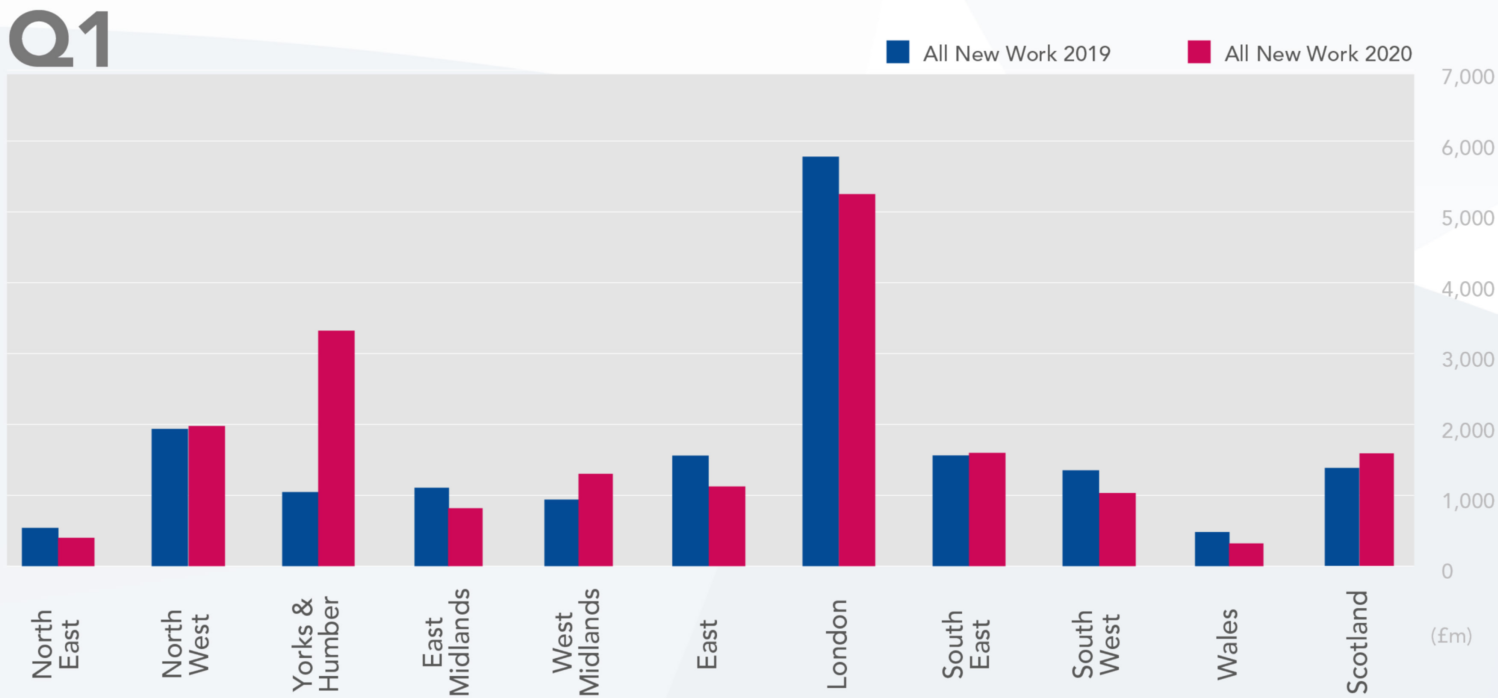


- The ONS has suspended the sub-national dataset for construction output. Please see our previous Market Update for Q4 2019 London and regional construction output.
- National output data shows a **40%** (or **£5.1bn**) drop in the value of 'All Work' output in April compared to March and was **44%** lower than one year ago.
- All sectors experienced a substantial drop on output between March and April 2020 but new housing was the worst affected, falling by more than **60%**.
- Lowest falls in output were in public non-housing (**-14%**) primarily due to work on hospitals and schools. Infrastructure (**-20%**) was also less affected as social distancing is easier to maintain on large sites.

Source: *ONS*

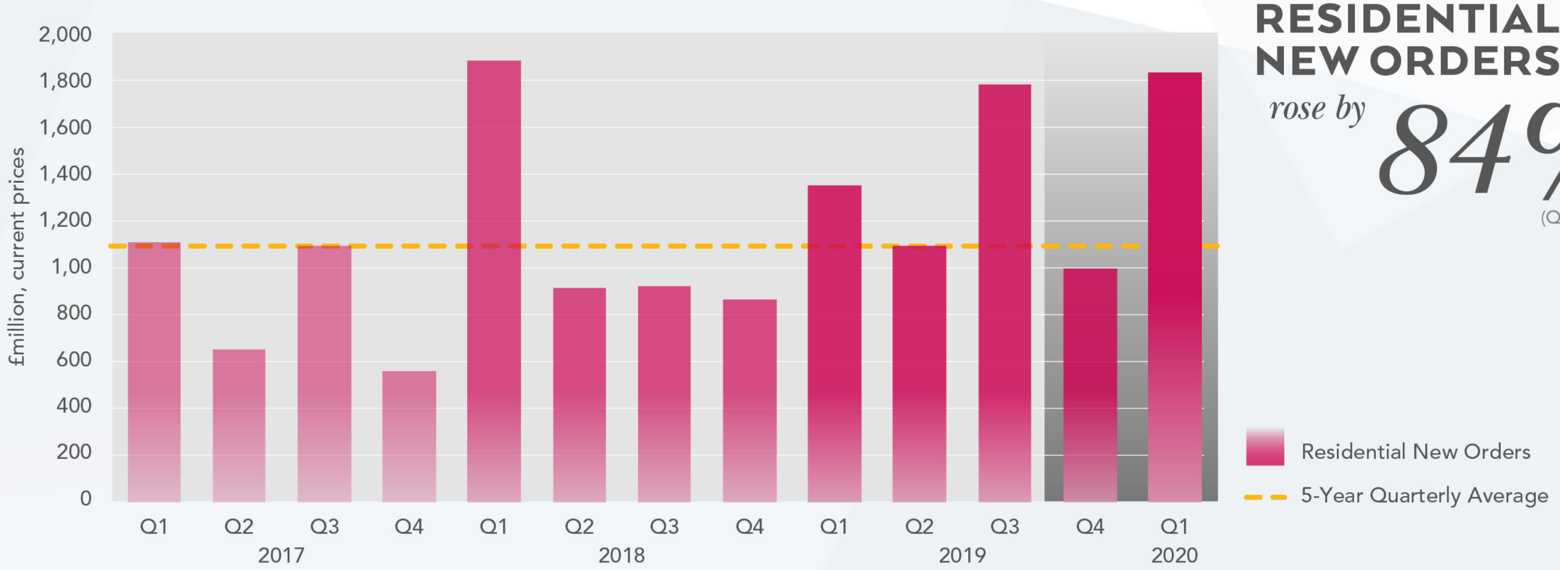
Note: In a letter from the UK Statistics Authority dated 7th March 2019, the ONS stated that these sub-national and sub-sectoral estimates of construction output no longer carry National Statistics status

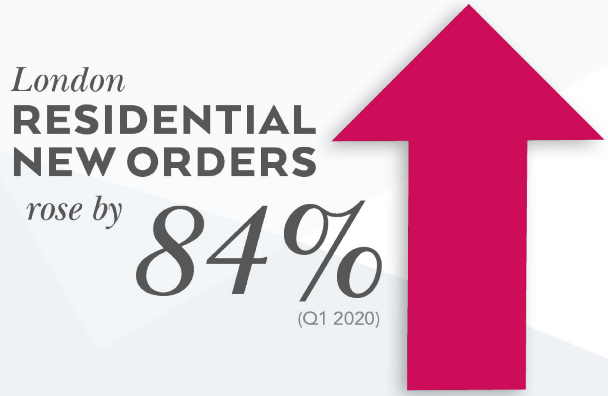
- In Q1 2020, six of the 11 regions experienced lower new order values than in the same period one year ago
- Yorkshire & Humber saw the largest year-on-year increase in new order values in Q1 2020, rising by ***221%***
- Several large industrial, warehousing and infrastructure projects meant that Yorkshire & Humber recorded its highest quarterly value for new orders on record, making it the second best performing region after London in Q1 2020
- May's PMI data pointed to a steep reduction in new orders which was almost exclusively attributed to the COVID-19 pandemic
- New order values are likely to fall significantly in Q2 2020 with firms anticipating a reduced pipeline of work in the short-term as developers/investors defer projects



Source: ONS

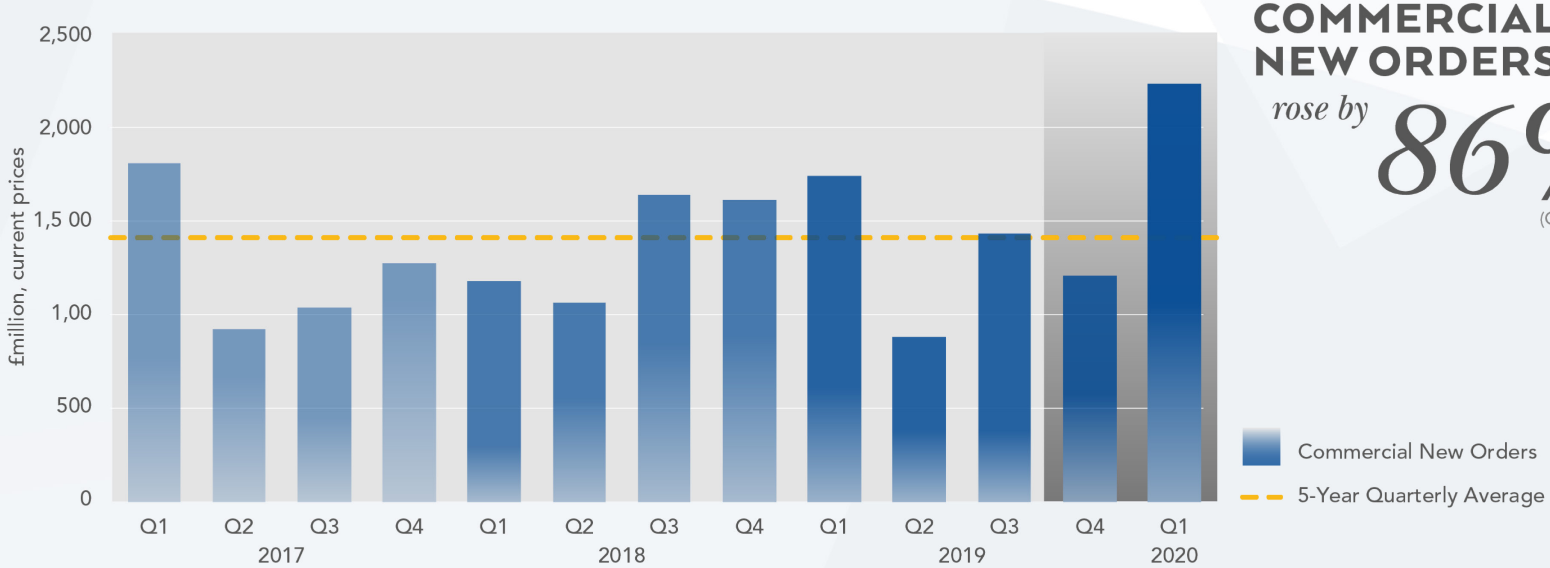
- London Residential New Orders rose by ***84%*** to ***£1.8bn*** in Q1 2020 compared to the previous quarter – well above the five-year quarterly average of ***£1.09bn.***
- **23,500** housing completions recorded in the year to Q1 2020 – well below the **66,00** homes per annum outlined in the draft London Plan.
- A pause in construction activity, as housebuilders down tools due to the COVID-19 restrictions, will undoubtedly lead to a drop in new home completions this year and probably next.
- Residential construction costs are expected to rise significantly, fueled by regulation changes, labour shortages and potential. supply disruption. According to the BCIS, build costs are forecast to rise by **23.6%** over the next five years.
- According to the BPF, build-to-rent home completions in London rose ***29%*** in Q1 2020 compared to the same quarter one year ago. However, the number of BTR homes in planning fell by ***10%*** over the same period. London's BTR pipeline is likely to weaken further in Q2 2020 as a result of coronavirus.

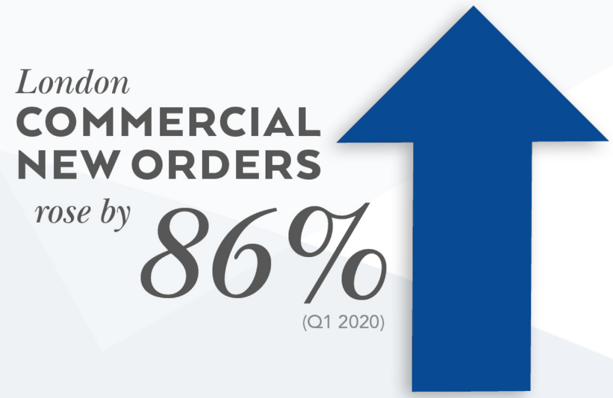




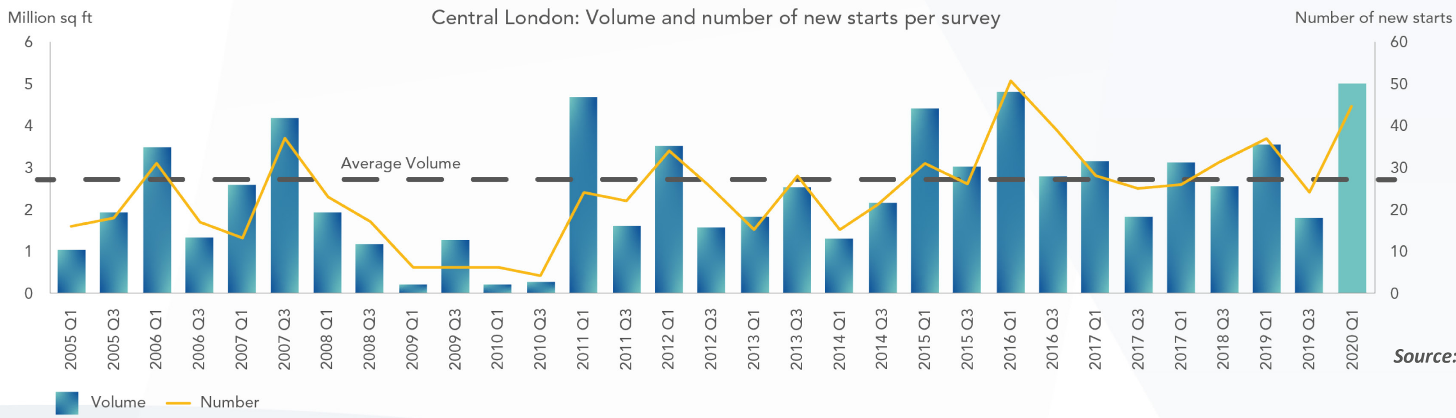
Source: *ONS, Knight Frank*

- London Commercial new orders in Q1 2020 rose by ***86%*** compared to the previous quarter from ***£1.2bn*** to ***£2.2bn*** – well above the five-year quarterly average of ***£1.4bn.***
- Strong central London office pipeline with the amount of new office space under construction hitting an all-time high (15.3m sq ft across 112 schemes in Q1 2020). This represents an ***29%*** uplift compared to the previous six months and is ***41%*** higher than the long-term average (Deloitte).
- Construction started on more than 5m sq ft of new office space in the six months to 21 March 2020 with 45 schemes breaking ground – almost double the long-term average.
- Q1 data reflected a surge in optimism on the back of much sought-after political uncertainty. However, sentiment has since shifted with COVID-19 decreasing construction activity and temporarily reducing demand for space.



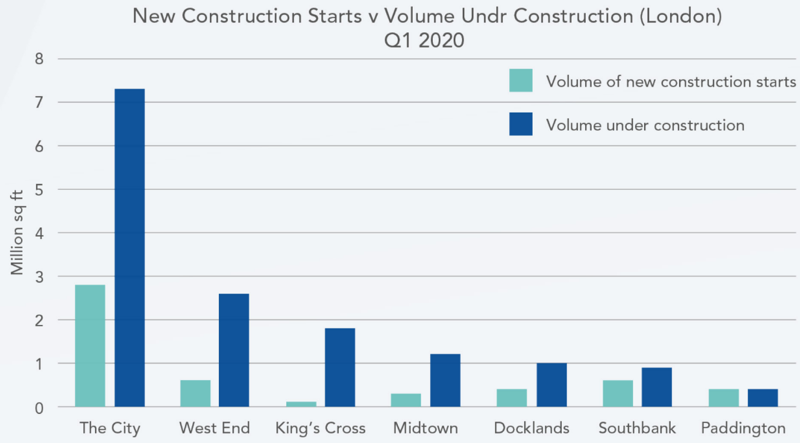


Source: *ONS*



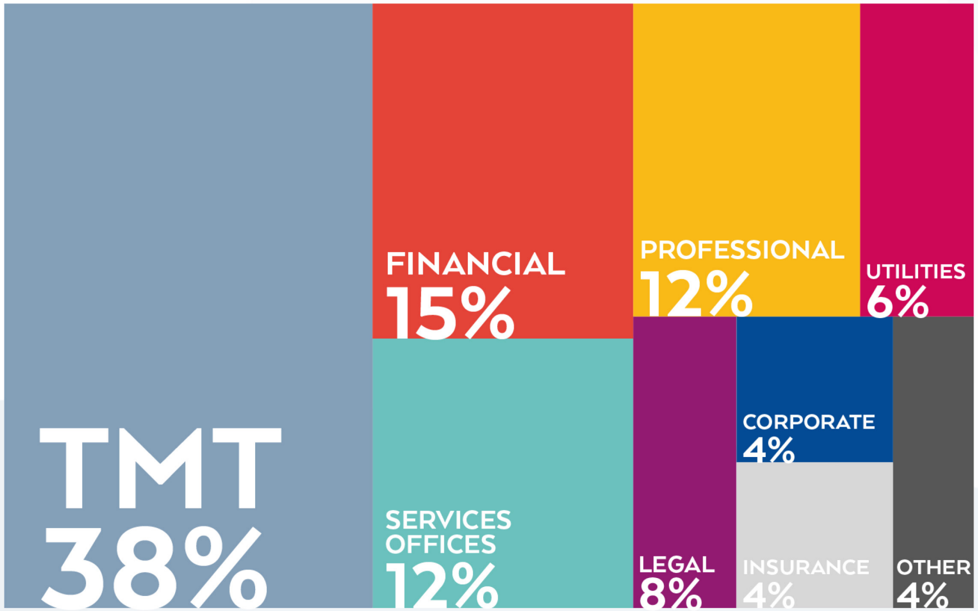
Source: *Deloitte Real Estate*

- 5m sq ft of new London office projects started in the six months to March 2020
- Highest volume of new starts on record
- 40 Leadenhall and 8 Bishopsgate broke ground in the period. Both developments account for ***33%*** of all new construction volume



- 15.3m sq ft currently under construction across 112 schemes
- Construction volumes in the City grew by ***38%*** to a total of 7.3m sq ft. The City also currently represents ***48%*** of all space under construction in Central London
- The West End experienced steady rise in construction activity. With 2.6m sq ft underway, the submarket accounts for nearly ***20%*** of all central London office space currently under construction

Percentage of pre-completion space let by sector



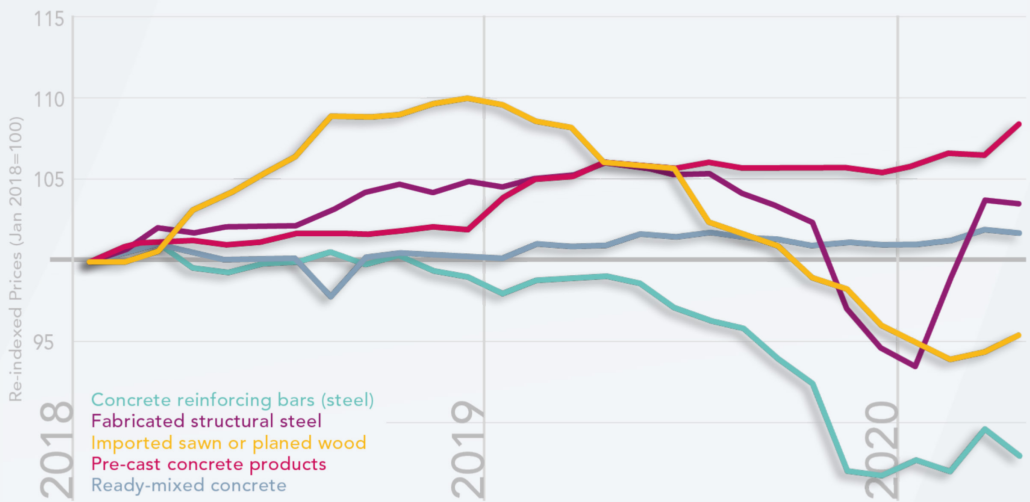
Source: *Deloitte, Summer 2020 London Office Crane Survey*

- ***44%*** of the 15.3m sq ft of space currently under construction is pre-let
- Strong pre-letting market driven by limited 'ready to occupy' Grade A space, especially for larger requirements
- TMT sector continues to drive office demand taking up ***38%*** of all pre-let space under construction
- Serviced office providers likely to reduce their office footprint in coming months in response to weaker tenant demand for short-term space
- Deloitte anticipates that given the disruption caused by the pandemic, businesses will take a three-six month break before committing to new office space

OUTLOOK

- Construction material price inflation rebounded in Q1 2020. Prices for all key materials in the graph below have risen in the three months to April 2020, but it was structural steel that experienced the highest rate of inflation (***10.8%***).
- In the year to April 2020 the material price index for 'All Work' fell by ***0.2%.*** Prices reversed their 2019 downward trend in Q1 2020 but dropped by 1% in April coinciding with the first fall month of lockdown.
- Upward price pressure from reduced manufacturing capacity and supply disruptions of imported materials were overshadowed by a unprecedented drop in demand for construction materials as sites temporarily closed.

Price Indices of Key Construction Materials, UK

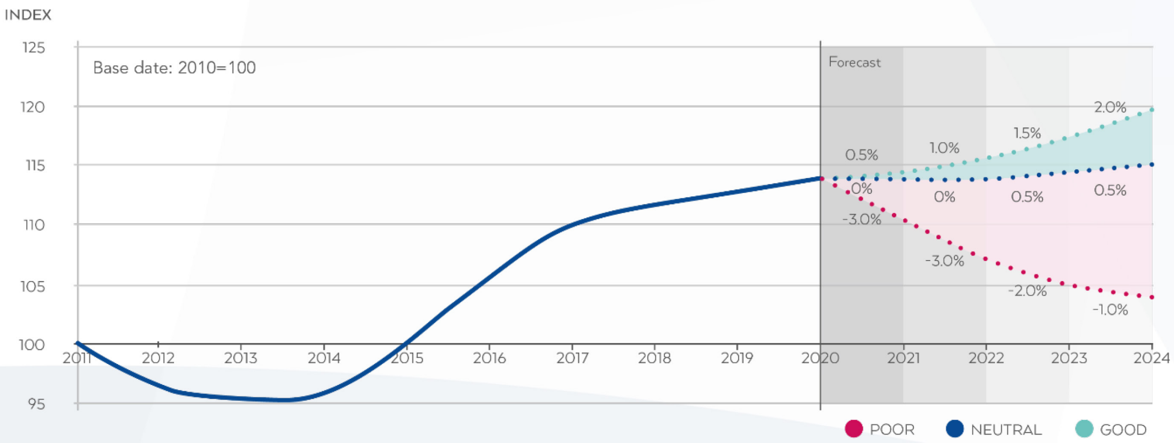


Source: *gov.uk*

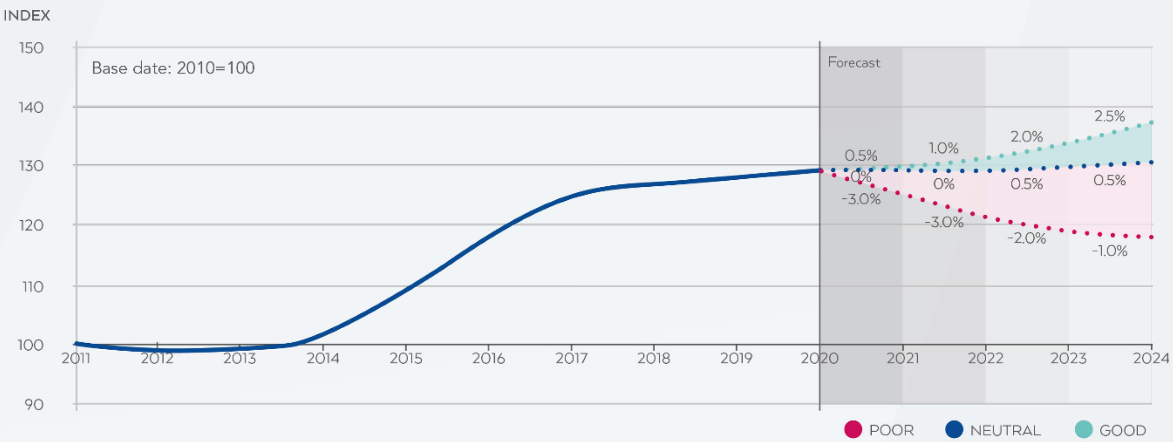
Construction Material Price Indices

	Month on Month May 20 - Jun 20	Year on Year Jun 19 - Jun 20
New Housing	-0.6%	0.2%
Other New Work	-1.0%	-0.1%
Repair & Maintenance	-2.2%	-0.2%
All Work	-1.0%	-0.2%

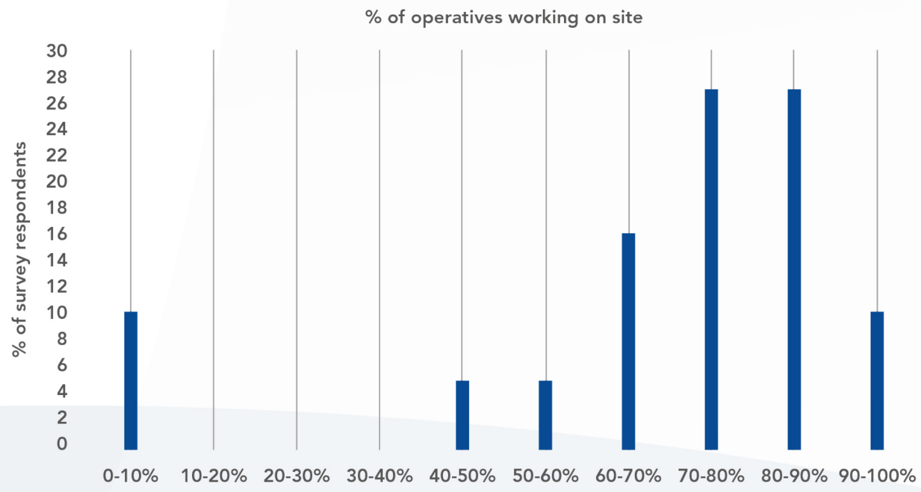
TENDER PRICE TREND **"UK AVERAGE FORECAST SCENARIO"** Q2 2020



TENDER PRICE TREND **"LONDON FORECAST SCENARIO"** Q2 2020

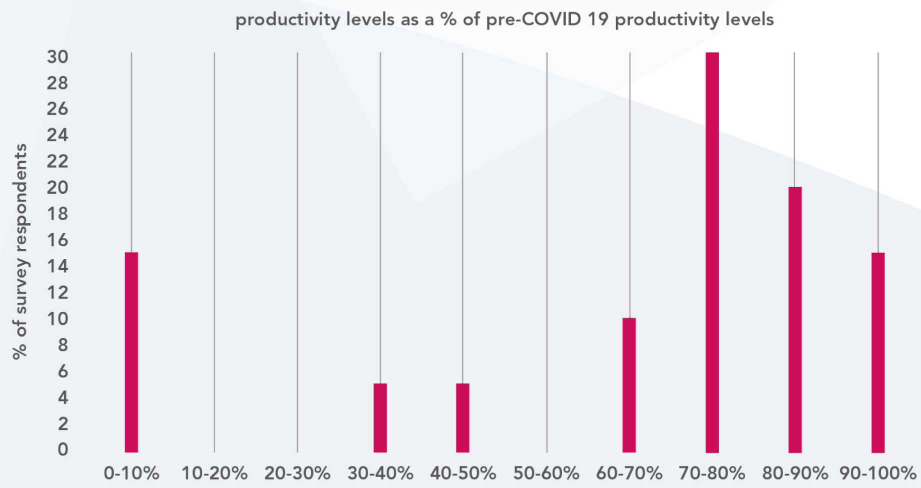


- Due to the uncertain economic outlook, our Q2 2020 TPI report outlined three potential inflationary scenarios: Good, Neutral and Poor
- Each scenario includes a number of events and conditions which, if they materialise, will have varying impacts on tendering conditions
- A number of inflationary and deflationary pressures are likely to impact input costs and tender pricing
- One of the most significant inflationary pressures is the reduced levels of productivity on site due to the current Site Operating Procedures (**SOP**) and social distancing guidelines
- Currently there are a number of deflationary pressures such as lower demand and fewer new tendering opportunities coming forward, resulting in a tighter and more competitive tendering environment
- Contractors pricing in greater risk and uncertainty into tenders as parties find it difficult to agree on risk profile of COVID-19 clauses



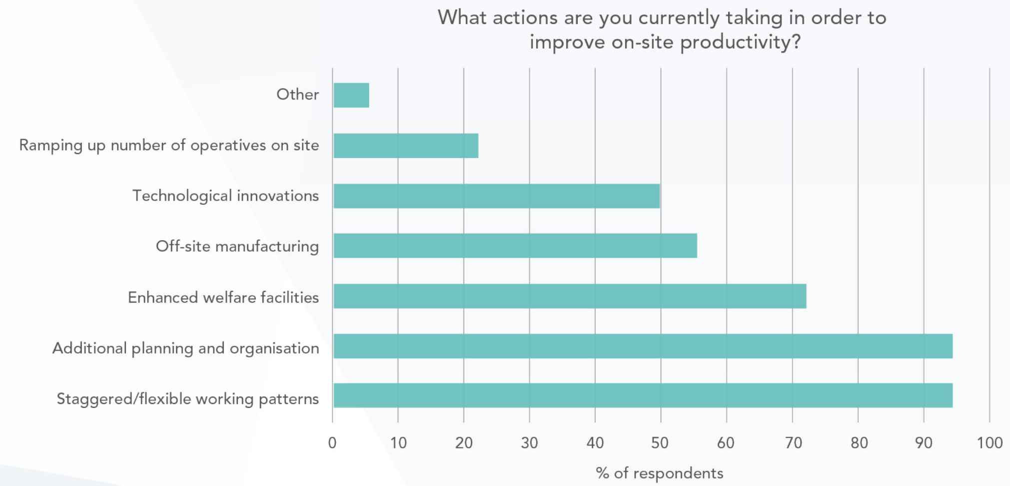
- Most survey respondents said that between ***70-100%*** of operatives were currently working on site compared to pre-COVID-19 levels
- Previously furloughed workers are returning to site, building up workforces to optimum capacity
- The percentage of UK construction workers on furlough decreased from 41% in March and April to ***29%*** in May (UHY Hacker Young)
- Scotland allowing workers to gradually return to sites with physical distancing and hand hygiene protocols in place

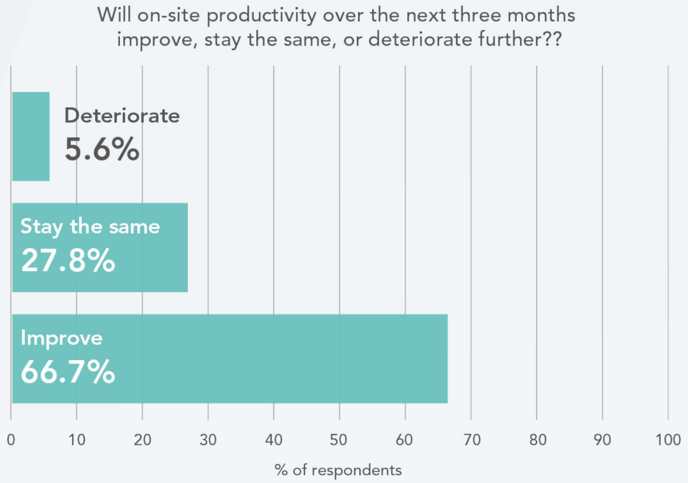
- Most survey respondents said that on-site productivity levels were 70-100% of pre-COVID-19 productivity levels
- Build UK: On-site productivity averaging at ***79%*** in England and Wales in early June
- Sites implementing new processes and ways of working to boost productivity
- CLC's 'Roadmap to Recovery' seeks to drive long-term productivity improvement by creating an innovation culture, delivering efficient products, processes and built assets by embedding digital and offsite manufacturing technologies



Top three factors currently impacting on-site productivity:

1. Increased idle time of workforce
2. Lack of workspace to social distance
3. Site Operating Procedures/ PHE guidance





- Cost and delivery times likely to increase as a result of lost productivity from implementing social distancing
- New approaches and innovations will be needed to compensate for loss of productivity due to restrictions
- Survey respondents anticipate that sites won't return to 100% productivity until the 2m social distancing rule is relaxed
- More firms expected to adopt digital technologies to improve efficiency, productivity and sustainability (eg BIM, wearable technologies, remote site visits using on-site cameras/VR headsets to monitor progress and compliance)

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