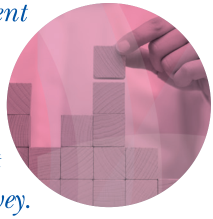
TENDER PRICE INDICATOR

UK prospects for construction growth remain subdued for 2018

1st Quarter 2018

Our Tender Price Inflation report looks at the movement of prices in tenders for building contracts in the UK. The report examines a number of contributing factors including GDP, sterling, price of oil, unemployment levels, input costs and construction output together with our market survey.



Prospects for growth remain limited with the post-Brexit horizon still developing, making medium and long-term forecasting more difficult to formulate.

Our forecast for UK average tender price inflation remains flat at an average 1% in 2018.

We have downgraded our 2018 forecasts for some UK regions, with the exception of Greater London and South East which have increased to 1% and 0.5% growth respectively to reflect the market demand we are seeing.

Growth continues into 2019 with London and South East up 0.5% and the rest of the UK broadly flat at 1%.

Despite upward pressure on input costs, our analysis of tenders and market survey is not indicating tender prices rising at the same rate. This may be reflective of contractors trying to build forward order books in 2018 and 2019.

In the longer term assuming a clear agreement with the EU on future trading and continued construction demand, we are currently forecasting a return to long term average inflation levels in 2022.

Our forecasts take account of all sectors and all projects as a statistical average indicating an overall trend in pricing. It should be remembered that individual projects may experience tender pricing above and below the average according to project specific components.

MACRO ECONOMICS

GDP OUTPUT

▲ *1.5%* ▲

CPI JANUARY 2018

◀ *3.0%* ▶

RPI JANUARY 2018

▼ *4.0%* ▼

INTEREST RATE

▲ *0.5%* ▲

UNEMPLOYMENT

▲ *4.4%* ▲

ECONOMY

▲ *Weekly earnings 2.2%* ▲

The influence of higher import costs due to the weaker pound is thought to have peaked, the recent rally in sterling is helping, albeit pressure is still being felt in rising oil prices.

Concerns remain on the level of UK productivity which lags behind G7 counterparts, with GDP at 1.5% annualised. There was good news for manufacturing in 2017, which saw growth outpacing the service sector for the first time in seven years.

CPI

The Consumer Price Index (CPI) measure of inflation remains static in January at 3.0% having dropped from 3.1% to 3.0% between November and December.

RPI

The Retail Price Index (RPI) measure fell to 4.0% from 4.1%. Pressure remains on the consumer with average earnings growing at only 2.2%.

INTEREST RATES

Interest rates were raised in November 2017 for the first time in a decade from 0.25% to 0.5%, with the market pricing further rises in 3Q 2018.

CONSTRUCTION OUTPUT

The Construction Products Association (CPA) remains cautious about growth in 2018, with infrastructure and private housing continuing to see increased output but the rest of the market less buoyant and at best flat.

The potential for import tariffs and tougher border controls could both impact the supply of materials in a post-Brexit market.

INFRASTRUCTURE

The volume of infrastructure work remains high with major projects moving forward. However, both TFL and Network Rail have cut investment programmes reflecting their constrained budgets.

INPUT COSTS - YEAR ON YEAR

M&E COMPONENTS

▲ *3.9%* ▲

STRUCTURAL STEEL

▼ *2.0%* ▼

REINFORCEMENT

▲ *5.5%* ▲

CONCRETE

▲ *1.0%* ▲

OIL PRICES

▲ *US$70 bbl* ▲

CONSTRUCTION INDUSTRY

▲ *Weekly earnings 3.2%* ▲

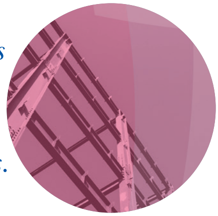
MARGINS

◀ *Flat* ▶

MANUFACTURING JANUARY 2018

▲ *3.5%* ▲

The majority of indicators for building costs continued to show increases over the 12 months to the end of 2017 with housing materials dominating demand and price rises.



MATERIALS

Mechanical and electrical components were ahead of general building costs at 3.9% and 0.7% respectively in the last quarter.

Structural steel was down 2% while reinforcement was up by 5.5% and concrete up 1% over the last quarter.

OIL

Fuel oil continued to rise in the quarter with US$70 bbl recorded in January 2018. Increases are being passed on to petrol pump prices, adversely impacting transportation and manufacturing costs for construction.

LABOUR RATES

Construction rates of pay continue to be ahead of average earnings rising 2% in the third quarter of 2017 giving an annualised increase of 3.2%.

UNEMPLOYMENT

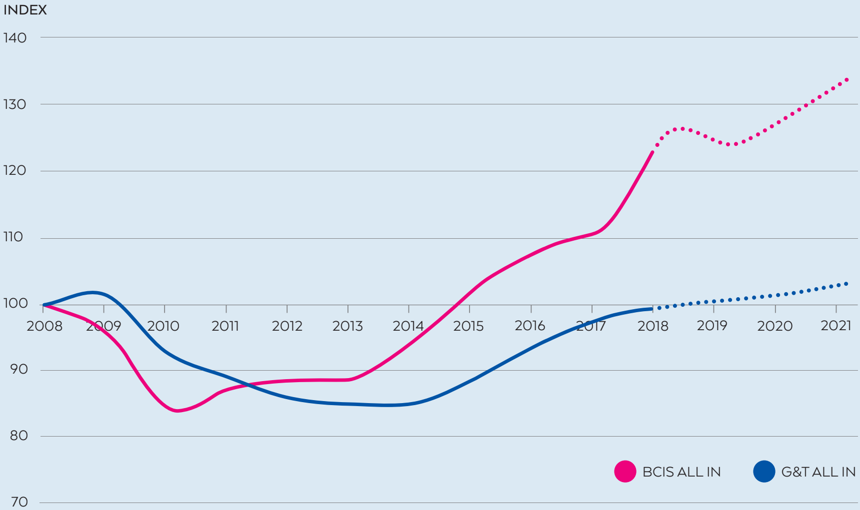
The UK unemployment rate rose marginally to 4.4% in the three months to December 2017, taking total employment to just below the record 32.2 million. Low unemployment reflects a continued demand for UK goods and services with a shift noted in full-time employees over self-employed.

There is significant disparity across the regions of the UK with the North East (5.4%) and West Midlands (5.6%) having the highest rates of unemployment, and the South East (3%) and South West (3.8%) the lowest.

MARGINS

Returned bids are evidencing stable margins with limited appetite to absorb increased input costs. A slowing demand could influence this but the impact of construction insolvency is likely to add more caution and risk aversion.

TENDER PRICE TREND "ALL UK TPI" 1Q 2018



TENDER PRICE TREND "LONDON TPI" 1Q 2018

Note: BCIS do not publish regional forecasts only records of prices received

TENDER PRICE ANNUAL PERCENTAGE CHANGE 1Q 2018

%	2018		2019		2020		2021		2022	
Regional forecasts	Now	Last	Now	Last	Now	Last	Now	Last	Now	Last
Greater London	1.00	0.00	0.50	0.00	1.50	1.50	2.00	2.50	2.50	2.50
South East	0.50	0.00	0.50	0.00	1.50	1.50	2.00	2.50	2.50	2.50
South West	0.50	1.00	0.50	1.25	1.25	1.25	2.00	2.50	2.50	2.50
East Anglia	1.00	1.00	1.00	1.50	1.50	1.50	2.50	2.50	2.50	2.50
Midlands	1.00	1.00	1.50	2.00	1.50	1.50	2.50	2.50	2.50	2.50
Wales	0.50	1.00	0.50	1.00	1.50	1.50	2.00	2.00	2.00	2.00
Yorks & Humber	1.00	1.25	1.25	1.25	1.50	1.25	1.50	2.50	2.50	2.50
North West	2.00	2.50	1.50	2.00	1.00	2.00	2.00	2.50	2.50	2.50
North	1.00	1.00	1.00	1.00	1.50	2.00	2.00	2.00	2.00	2.00
Scotland	1.00	1.50	1.50	2.00	1.50	2.50	2.00	3.00	2.50	2.50
Northern Ireland	1.00	2.00	1.00	2.50	2.00	2.00	2.00	2.00	2.00	2.00
UK Average	**1.00**	**1.00**	**1.00**	**1.00**	**1.50**	**1.50**	**2.00**	**2.50**	**2.50**	**2.50**

Note: 2022 is long term average market forecast

COMPARISON OF PUBLISHED FORECASTS FOR TENDER PRICE CHANGE

	G&T UK AVER.	BCIS UK AVER.	G&T LONDON	AECOM LONDON	ARCADIS LONDON
	1Q TO 1Q	JAN 18	1Q TO 1Q	4Q17	Mid range 4Q17
	% CHANGE				
2018	1.00	4.70	1.00	2.20	1.00
2019	1.00	0.60	0.50	1.90	3.00
2020	1.50	4.20	1.50	2.90	4.00
2021	2.00	4.30	2.00	N/A	4.00

Note: All figures relate to year on year quarterly changes

TENDER PRICE INDICATOR

The UK's second largest construction company, Carillion PLC, went into liquidation on 15th January 2018.

As well as threatening thousands of jobs it has the potential for significant impact on construction projects including Aberdeen Bypass, the Library of Birmingham and Tate Modern as well as many hospitals, prisons and schools.

The impact of Carillion's failure on the construction industry has not been fully realised. In the short-term, several projects remain at large and creditors unpaid, leading to potential financial difficulties for suppliers and sub-contractors.

The liquidation of Carillion may cause a ripple effect throughout the supply chain, and we may see smaller contractors, sub-contractors and suppliers who were working with Carillion experience cash flow difficulties which could translate into further insolvencies.

INSOLVENCY

In the aftermath of Carillion's demise we have seen a number of other contractors issue profit warnings.

Insolvency risk within the construction industry remains high. The overall number of UK company insolvencies increased by 4.2% in 2017 and individual voluntary arrangements were up 2%.

WARNING SIGNS

All clients should work with their advisors to ensure projects have financial checks and guarantees in place to highlight any warning signs, along with adopting fair payment terms for all parties to ensure commercial viability.

The warning signs of insolvency generally fall into two categories – "tangible" signs (those which can be seen) and "intangible" signs (those which are harder to pin down as they are generally subjective). One of these signs alone may not be sufficient to raise the alarm, but the more warning signs seen, the greater the risk. Insolvency can happen very quickly in the construction sector and it is important to be prepared.

For further advice please contact your G&T Partner
www.gardiner.com/people

Key Contacts

FOR FURTHER INFORMATION PLEASE SPEAK TO
YOUR GARDINER & THEOBALD EXPERT,
OR CONTACT:

Gavin Murgatroyd

PARTNER, LONDON

+44 (0)20 7209 3000

g.murgatroyd@gardiner.com

GARDINER & THEOBALD LLP
10 SOUTH CRESCENT
LONDON
WC1E 7BD

Our advice is to review each project on its own merits. This forecast publication must be treated as a guide only, being that it is based on averages of various types and sizes of projects across a region, ascertained through our latest market research. The quality, both of design and desired end product, procurement route (particularly ownership and transfer risk), delivery timescales, complexity of design and desire of contractors to tender should be carefully considered in project specific estimates and their outturn cost.

Suitable allowances should be made for project specific designs, site conditions and local market conditions, which should be reviewed regularly with your Gardiner & Theobald team to determine the appropriate base cost.