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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 and is further informed by our market survey responses and contractor consultations.

TPI

TENDER PRICE INDICATOR

In this issue

FUTURE HEALTH OF BUILDINGS

INTRODUCTION

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 and is further informed by our market survey responses and contractor consultations.

Given the uncertainty at the time, our previous TPI forecast used a scenario-based approach, outlining how different market conditions might weigh in on tendering conditions. Whilst there are still many unknowns with regards to the type of recovery that will materialise, it has become clear that substantial deflationary pressures will affect input costs and tender pricing into 2021.

Our weighted UK average TPI forecast shows a 1% fall in 2020, declining by a further 50 basis points to -1.5% in 2021. Although economic activity is expected to begin to recover in Q3 2020 as some pent-up demand is released, this could be tempered by lower business and consumer confidence, rising unemployment and slower investment. Added to this is the uncertainty over Brexit and what the UK's trading relationship with the EU will look like after the transition period ends on 31st December 2020. With an extension ruled out and little time for a deal to be struck, uncertain trading conditions may hamper economic activity and investment. At this point a tick-shaped recession and recovery period looks most likely, in line with an average GDP growth forecast of -9.2% for 2020 and 6.5% in 2021[1], taking time to recover to the previous path.

The focus for contractors over the next 18 months is likely to be on winning work and maintaining pipeline. Although cost pressures from rising preliminaries and programme delays will be significant, with a lack of new opportunities coming forward we anticipate seeing price discounting to win work.

Thereafter, we expect a slow but sustained recovery in tender price inflation, rising to a mid point in our range of 0.5% in 2022 and then 1% in 2023 as demand returns, new orders rise and output normalises.

All forecasts take account of all sectors and project sizes as a statistical average, indicating an overall trend in pricing levels. It should be remembered that individual projects may experience tender pricing above or below the published average rate, reflecting the project specific components and conditions.

MACRO ECONOMICS

Contracting by 2.2% in Q1 2020 – the joint largest fall since 1979 – the UK economy took a severe hit to output in a period that contained just nine lockdown days. The data, however, was just a prelude with worse to come as economists are braced for a dire set of second quarter figures.

Following a further 6.9% fall in March, GDP fell by 20.4% in April. The monthly contraction in April was the largest drop in a single month since records began – three times greater than the decline seen during the whole of the 2008/2009 economic downturn. Even with growth of 1.8% in May the economy is now 24.5% smaller than in February. The impacts of coronavirus (COVID-19) were seen right across the economy but it was construction that saw the largest fall with output contracting by 18.2% in the period.

After falling to an all-time low of 8.2 in April, the pace of contraction of the UK construction PMI softened in May as business activity picked up and construction sites re-opened. With site activity pausing, reduced client spending and furloughed staff across the supply chain, companies saw their capacity leak away and the construction sector facing a challenging environment. Whilst June's construction PMI figure of 55.3 indicated a return to growth, the increase in activity comes from a low level in the preceding month and does not indicate a recovery to normal levels of construction output. Although respondents were cautiously optimistic about their near-term prospects, construction firms continued to face challenges in securing new work against an unfavourable economic backdrop and a lost period for tender opportunities.

Consumer price inflation (**CPI**) dropped to a near four-year low of 0.5% in May as inflationary pressures continued to abate during the lockdown. Weak domestic price pressures as a result of the restrictions placed on the economy since the end of March have impacted inflation, prompting Samuel Tombs, the chief UK economist at consultancy Pantheon Economics, to say that headline inflation would fall even closer to zero in the coming months.

The Bank of England (**BoE**) has responded to the weakness of price pressure by increasing its bond-buying quantitative easing scheme. A £100bn of additional QE has been added to a total of £745bn as the bank seeks to underpin the nascent recovery. However, any speculation that the BoE was close to announcing negative interest rates was quashed by its monetary policy committee in June as interest rates were kept at 0.1%. Andy Haldane, the BoE's chief economist, has since said that the UK economy is recovering faster from the lockdown than the central bank had expected, casting doubt on the need for further stimulus. He said although an unemployment spiral remains a threat the recovery is "so far, so V [shaped]", noting that real-time data suggests the cumulative loss of annual GDP as a result of the pandemic will be 8%, rather than the 17% in the scenario modelled by the bank in May.

UK average weekly earnings declined at an annual pace of 1% in April 2020, but this paled in significance when compared to the 11% decline in average weekly earnings in the construction sector over the same period. ONS data shows that construction weekly earnings in April was £577 compared to £648 for the same month in 2019 - the biggest annual fall seen by any sector in Britain. April's data captures the first full month when businesses placed workers on furlough under the coronavirus jobs retention scheme. Sectors where furloughing was more widely used inevitably saw larger falls in earnings, the construction industry has been the second largest user of the scheme.

Although the UK unemployment rate (3.9%) was better than expected in the three months to April, economists fear bigger rises are on their way as the Government winds down its job retention scheme and other poor labour market indicators feed through to the actual unemployment figures.

The summer statement announced several new measures to save jobs, with a job retention bonus and temporary cuts in VAT for the hospitality sector. Construction is likely to benefit from the Talent Retention Scheme to help redeploy displaced workers and also a £3bn boost to 'green construction jobs' (£2bn in grants for homeowners carrying out energy-efficient refits, £1bn to decarbonise public buildings such as schools and hospitals). A temporary rise to the Stamp Duty threshold has been implemented immediately which will help kick-start the housing market.

CONSTRUCTION OUTPUT

The most recent UK construction output data published by the ONS revealed a 40% (£5.1bn) drop in the value of 'All Work' output in April compared to the previous month. April's output value was also 44% lower than the same month in 2019.

M&E COMPONENTS	FABRICATED STRUCTURAL STEEL	CONCRETE REINFORCING BARS (STEEL)	READY MIXED CONCRETE	OIL PRICES (BRENT CRUDE) *(As of 3rd July 2020)*	CONSTRUCTION INDUSTRY *Average Weekly Earnings (Annual Growth to Apr 2020)*	MARGINS	UK MANUFACTURING OUTPUT *(Apr 19 – Apr 20)*
◀ 0 - 2.5% ▶	▼ -1.4% ▼	▼ -11% ▼	▲ 0.2% ▲	▲ US$42.58/barrel ▲	▼ -11% ▼	▼ Reduced ▼	▼ -28.6% ▼

INPUT COSTS YEAR ON YEAR (MAY 19 – MAY 20)

ONS building materials tables

Figures are cumulative annual. ▼△ denotes movement trend.

All sectors experienced a substantial month-on-month drop in output but new housing appeared to be the worst affected, falling by more than 60%. The least affected sector was 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.

Whilst April's poor output figures point to a potentially tough recovery period for the sector, they may also represent the nadir given that they cover a full month of lockdown. According to Build UK, by mid-May 86% of infrastructure and construction sites in England and Wales had re-opened and output on site had risen to 75% of pre-Covid levels. Despite the fact that the vast majority of construction firms have now resumed work, many will experience reduced order pipelines over the next few months. With reduced workloads firms are more likely to experience lower revenue and greater cashflow pressures, creating market conditions for competitive bidding.

Currently, with a reduced number of workers on-site, productivity levels are averaging around 80% of pre-COVID levels. Recent changes in regulations that have allowed for extended site opening hours and staggered working patterns have certainly helped to improve productivity levels, but site output will continue to remain subdued for so long as there are fewer people on site, social distancing requirements remain, and supply chain disruption persists.

The Construction Products Association (**CPA**) forecasts that UK construction output will fall by 25% during 2020. The 25% decline is the CPA's most optimistic of three scenarios modelled and is based on a 'V-shaped' or 'tick-shaped' recession with a slow economic recovery from June. The CPA said that although the worst effects on activity were in late March, April and May, activity in each month in the second half of 2020 is likely to be lower than in the same month one year ago. It's anticipated that the least affected sectors will be non-housing R&M (-4.7%), public non-housing (-6%) and infrastructure (-9%). Construction output is then anticipated to rise later in 2021 under its main scenario.

NEW ORDERS

Construction new order data in Q1 was largely positive, with the 'All New Work' value increasing by 11.8% compared to the previous quarter. The infrastructure sector performed particularly well, growing by nearly 78% in the quarter. At the other end of the spectrum private industrial new orders fell by over 40% quarter-on-quarter.

Strong new order growth came off the back of greater political certainty provided by the decisive UK general election result in December 2019, and provides a silver lining to the slew of more recent negative COVID-19 related data. Stronger new orders in Q1 will have helped strengthen contractor's pipeline, acting as a buffer for cancelled projects as a result of the pandemic. However, new order values are likely to fall significantly in Q2 and Q3 2020 with firms anticipating a reduced pipeline of work in the short-term as developers/investors defer projects.

IHS Markit/CIPS construction PMI readings in March, April and May pointed to a rapid drop in new orders received by UK construction companies as a result of the pandemic. Survey respondents commented on a sharp decline in demand for new construction projects, with the pace of decline exceeding the equivalent measures seen in the manufacturing and service sectors. However, June's construction PMI report recorded a return to growth, with the reopening of sites helping to alleviate the scale of the downturn in order books. New orders showed signs of stabilising in June with new work from infrastructure projects acting as a key source of growth. Flat new order levels reflect ongoing hesitancy among clients and also longer lead-times to secure new contracts.

Fewer new orders will be a key driver of tender prices the coming months. Competition for new opportunities is likely to increase as the primary focus for contractors will be to win work in order to maintain pipeline.

MARKET CONDITIONS

An atypical downturn cannot be expected to follow a typical recovery. There is a broad range of upside and downside risks and it is far from clear how prevalent these risks will be and how significantly they will affect pricing. Regardless, the pandemic is likely to create a new dynamic with firms bidding for a fewer number of projects in a more competitive market.

Initially, the focus will be on getting sites fully functional, ramping up productivity and ensuring that pipeline projects can maintain cashflow. As firms move out of 'survival mode' the focus will shift to winning work and increasing market share in a tighter tendering environment. With fewer new projects coming forwards contractors may be forced to start discounting in order to secure future pipeline work.

G&T's experience has been that although enquiry levels have been better than initially expected, a number of projects have paused, holding back investment whilst undertaking diligence of viability in light of a changing market demand. Clients whose current assets aren't currently performing as they'd like are experiencing liquidity issues and will inevitably be more focused on shoring up their balance sheets rather than commissioning new capital projects. Equally, new projects may struggle to get commissioned if clients feel that social distancing will increase project delivery times and costs. The Government will play a crucial role in supporting the recovery and stimulating growth. So far, the Government has brought forward £5bn of planned spending to accelerate key projects in the UK's long-term infrastructure pipeline under Boris Johnson's 'new deal'.

Some opportunistic clients will use the pandemic to drive costs down or perhaps bring projects forward in anticipation of tendering becoming more competitive. Whilst lower productivity levels and additional preliminary items will apply upwards pressure on tender pricing, contractors' concerns about securing turnover may more than balance out these additional costs, resulting in a net reduction in tender prices.

To manage the effects of the lockdown, main contractors have had to conduct consolidation exercises. The supply chain is currently having to resize to cater for anticipated lower levels of demand for projects and schemes. Builders' merchants and suppliers have been operating at reduced capacities since March in attempt to match demand for materials. Whilst there has been a significant recovery in trading volumes in recent weeks, it is evident that the UK is facing an economic recession and this will have a corresponding impact on demand for materials in 2020 and 2021. This has prompted action from the likes of Travis Perkins to close 165 of its stores with its chief executive Nick Roberts stating, "While we have experienced improving trends more recently, we do not expect a return to pre-COVID trading conditions for some time."

INPUT COSTS

MATERIAL COSTS

Measures taken in response to the pandemic have resulted in shortages, price spikes and longer lead times for some materials. A huge drop in global demand led to substantial price reductions for

UK GDP ANNUAL GROWTH RATE
(Q1 2019 – Q1 2020)
▼ *-1.7%* ▼

CPI MAY 2020
(12-month rate)
▼ *0.5%* ▼

RPI MAY 2020
(12-month rate)
▼ *1%* ▼

UK BASE INTEREST RATE
▼ *0.1%* ▼

UK UNEMPLOYMENT RATE
Feb – Apr 2020
▲ *3.9%* ▲

UK WAGE GROWTH
(Year-on-Year three month average to Apr 2020)
▼ *1%* ▼

raw materials but whether these reductions pass through the supply chain will, in part, depend on the speed of recovery. Resilient demand will support higher material prices whilst subdued demand will likely mean that lower raw material prices will feed through the supply chain to clients.

According to the ONS, material price movements are currently volatile. In Q1 2020 construction material prices began to reverse their slow downward trend seen in 2019. However, April showed a 1% month-on-month decline in material price inflation for the 'All Work' construction material price index. The pandemic has caused both supply and demand side shocks. Disruption to the extraction, processing and distribution of materials has resulted in heavy cuts to supply, but this coincided with lower demand which has acted as a counterbalance to price increases.

The recovery in demand has, to an extent, outpaced supply. A backlog of orders accumulated during the lockdown period due to reduced manufacturing/production capacity has resulted in supply shortages for materials such as plasterboard, aggregates and bricks and insulation. However, the increased lead times for these materials are likely to be short-lived as factories and merchants ramp up capacity.

After hitting a near three-year low in February 2020, fabricated structural steel prices increased by 11% in March as a result of supply disruptions and steel mill closures in Europe. Steelmakers have since restarted production but output has been cut significantly in response to a 50% fall in demand since the start of the pandemic in March. However, there is still excess global supply as Chinese mills produced steel at a faster rate through the COVID-19 crisis. IHS Markit now projects that demand weakness and excess capacity will lead to a 4.2% fall in structural steel prices in 2020, followed by an additional 4% drop in 2021 before prices rally by 2.5% in 2022.

Generally, material prices are expected to strengthen in 2021. Halted manufacturing capacity has come back online and commodity prices have rallied since hitting a low in April, but many anticipate that a rebound in prices will be prolonged. IHS Markit, for example, expects that material prices will still be around 10% lower at the end of 2022 than they were in the middle of 2019. However, downside risks remain and material price inflation will be directly impacted by the economic recovery profile and subsequent outbreaks of COVID-19.

With so much uncertainty and volatility in the short-medium term, some clients and contractors will favour localised production (or 'nearshoring)', specifying the use of UK-manufactured materials to reduce the risk of supply chain disruption. A free trade agreement (**FTA**) with the EU has yet to be finalised and many will want to avoid the potential risk of higher import costs and tariffs if the transition period ends without an FTA in place. However, safeguarding their supply chain in this way may still result in higher material costs due to the limited production capacity in the UK for some construction products and materials such as steel and electrical goods and components.

LABOUR

Average weekly earnings (**AWE**) in the construction industry fell by 11% in the year to April 2020. In April alone, construction AWE dropped by 12.9% on a month-on-month basis, making it the largest monthly fall on record (since January 2000). The drop is unsurprising given that the construction sector has been the second largest user of the Government's job retention scheme.

According to the ONS, between 18th-31st May 2020 UK construction firms reported that 34.5% of their workforce had been furloughed. However, this figure appears to be improving as activity on site picks up. The latest figures show that between 1st-14th June construction firms reported that 26.2% of their workforce was furloughed.

Alongside the widespread furloughing, the number of vacancies in the industry has more than halved. In the three months to the end of May 2020, the ONS recorded 13,000 job vacancies in the industry compared to 27,000 for the same period last year. Against this backdrop labour costs are likely to remain suppressed for the remainder of the year. With a large pool of unused labour anxious about their future employment prospects, there will be far less upward cost pressure in the short term, which will help keep tender prices in check.

Some upward cost pressure may come from extended site working hours and staggered shift patterns. There could also be an impact on labour costs if those European construction workers that returned home before or during the lockdown are unable or less incentivised to return to the UK under the Government's 14-day quarantine period. Some of these workers may decide to stay put given this requirement, reducing the pool of skilled construction labour. This could hit London particularly hard as the capital has a large proportion of integral non-UK employees. The UK's new immigration rules (due to come into effect in 2021) could also impact the pool of construction labour as many won't be able to meet the entry criteria under the points-based system.

Notwithstanding this, with more than a quarter of the UK construction workforce furloughed, there is a large pool of idle labour to fall back on. Furloughed employees will only be brought back if activity and demand conditions improve. If demand returns to pre-COVID levels the supply of labour could become more of an issue and this will put upward pressure on labour costs. If demand doesn't improve before the Government's furlough scheme ends in October and fewer new projects come forward, we could see redundancies on a large scale which will have a dampening effect on tender price changes.

PROFITABILITY AND PROCUREMENT

Tender returns have shown a mixture of pricing levels for OH&P and Preliminaries over the last three months, with our survey showing rates largely unchanged, but some localised reductions in competitive markets for office fit-out and new build commercial.

So far, it seems that preliminaries rises have been kept to a minimum due to market pressure to win work. Over the next 12 months many anticipate preliminaries costs will rise as a result of costs for adapting welfare facilities, satisfying health and safety requirements and elongated programmes from reduced productivity. However, respondents noted this will be balanced against contractors running leaner teams to operate more efficiently and the willingness of pricing to win new work.

68% of respondents indicated that contractors will reduce their OH&P further in order to win work and secure turnover. Keener rates in a more competitive environment are expected in Q3 and Q4 2020 but a few respondents believe that whilst OH&P may reduce as a headline, contractors will still be required to recover similar levels of overhead from lower turnover. To what extent contractors will be forced to start discounting to win projects and secure turnover remains to be seen.

Procurement route will also play a part in creating a more competitive tendering environment. Parties are currently finding it difficult to agree on risk profile and how it should be shared and managed, but contractor's desire to win work may encourage them to take on unfavourable procurement routes in certain sectors. Whilst design and build two-stage has been the most favoured procurement route in the past three months, in a more competitive tendering environment, contractors may have to become more comfortable tendering on a single stage basis and taking on more of the risk.

REGIONAL BREAKDOWN OF CONSTRUCTION OUTPUT
(Annual Growth Q4 2018 – Q4 2019)

Region	Construction Output Growth % (Q4 2018 - Q4 2019) All Work
Greater London	5.16
South East	0.55
South West	6.44
East	7.57
East and West Midlands (Average)	4.30
Wales	0.19
Yorks & Humber	▼ -2.48 ▼
North West	0.04
North East	24.16
Scotland	12.06
Northern Ireland	1.03

Note: The ONS has temporarily suspended its 'Output in the construction industry: sub-national and sub-sector dataset'. Q4 2019 is the last quarter for which data has been published.

FUTURE HEALTH OF BUILDINGS

COVID-19 has created two new requirements for buildings: 1. owners and occupiers need to provide an objectively safe indoor environment and 2. they must communicate trust and a sense of welcome to those coming through the doors. While both are critical, they do not necessarily align. Consider the harsh cleaning chemicals and taped-off areas that are now part of the "new normal." These measures might be necessary, but they are hardly comforting. To be truly successful going forward, offices (like retail before them) must provide a better experience than staying at home.

Luckily, there is an alternative. Smart companies are beginning to align healthy building solutions with sustainability goals and mainstream consumer preferences. Think of it for a moment - green and healthy products are outperforming conventional products in many other aspects of our lives. So why not buildings? In fact, two top factors that reduce pathogens indoors – sunlight and natural ventilation - are also key to net zero carbon and at the top of employee wish-lists. We know from our work that what people want from buildings is remarkably basic. Or - to use a more powerful term these days - essential.

COVID-19 IS A HEALTHY BUILDING GAMECHANGER

COVID-19 has focused attention squarely on how indoor environments contribute to personal health. Indoor environmental quality, particularly in the form of clean air, is now one of the most important factors involved in opening, and staying open.

The demand for healthy buildings is not the only thing that will change - so too will the focus. The UK is a sophisticated market, having the most projects in the world registered for WELL certification and the third most registered for its nearest competitor, Fitwel. But despite these impressive results, the universe of projects is still small, uniform, complex and expensive. Almost all work on wellbeing in buildings has focused on new, city-centre developments. The simple truth is that the most numerous and ambitious buildings in this space are yet to be built. Until a few months ago, most existing buildings had been untouched by the healthy building agenda.

The lesson of COVID-19 is this: it is now necessary to assure a healthy environment across a much wider universe of buildings. A range of bespoke solutions will be required, along with creative, quick thinking that can meet objectives where time and money – always a concern – loom larger.

MAINSTREAMING HEALTHY BUILDINGS: THE WORLD GREEN BUILDING COUNCIL APPROACH

One resource we can recommend is the Better Places for People project by the World Green Building Council (WorldGBC). Its express purpose is to find the synergies between green and healthy buildings and do it in a way that is practical and economical.

This is an extract from a longer article.
Visit: **marketintel.gardiner.com** to read in full.

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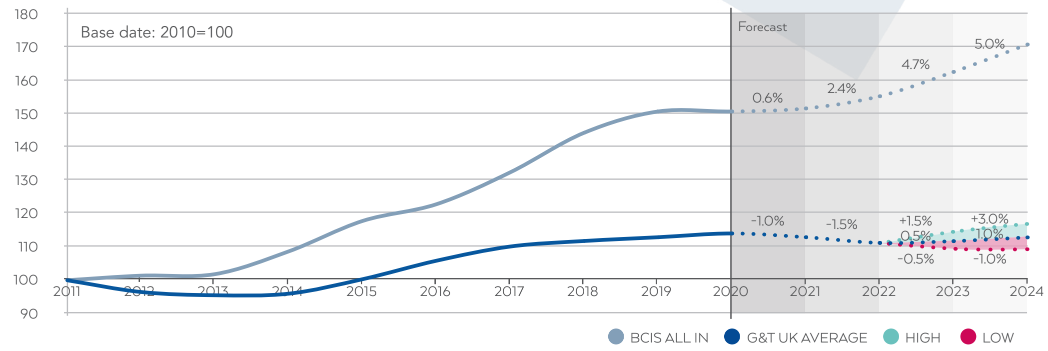
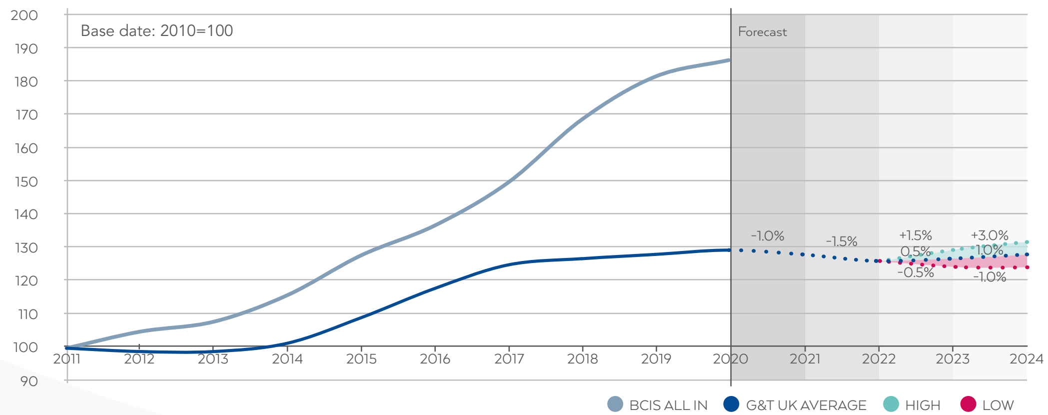
TENDER PRICE INDICATOR TRENDS & FORECASTS

TENDER PRICE TREND **"ALL UK TPI"** Q3 2020



TENDER PRICE TREND **"LONDON TPI"** Q3 2020



Note: BCIS does not publish regional forecasts.

Note: The Range of forecasts from 2022 to 2023 depend upon the speed of economic recovery

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TENDER PRICE CHANGE

TENDER PRICE ANNUAL PERCENTAGE CHANGE Q3 2020

%	2020		2021		2022		2023	
Regional forecasts	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***
Greater London	-1.00	1.00	-1.50	1.50	0.50	2.00	1.00	2.00
South East	-1.50	1.00	-1.50	1.50	0.50	2.00	0.50	2.00
South West	-1.00	1.50	-0.50	1.50	0.50	1.50	1.25	1.50
East	-0.50	2.00	-1.00	2.00	1.50	2.00	1.50	2.00
Midlands	-1.00	2.00	-0.50	1.50	1.00	1.50	2.00	1.50
Wales	-3.00	1.00	-3.00	0.50	1.00	0.50	1.50	0.50
Yorks & Humber	-1.00	1.00	-3.00	1.50	0.50	1.50	1.00	1.50
North West	-2.50	1.00	-3.00	1.50	0.00	1.00	1.00	1.00
North East	-3.00	1.00	-3.00	1.50	1.00	1.50	1.00	1.50
Scotland	-1.00	2.00	-1.50	2.50	0.00	2.00	1.00	2.00
Northern Ireland	-2.00	1.50	-3.00	1.50	0.00	1.50	1.00	1.50
UK Average (weighted)	**-1.00**	**1.00**	**-1.50**	**1.50**	**0.50**	**1.50**	**1.00**	**1.50**

Last* 4Q19

Now = Midpoint

COMPARISON OF PUBLISHED FORECASTS FOR TENDER PRICE CHANGE

	G&T UK AVER. Q3 2020	BCIS UK AVER. JUNE 2020	G&T LONDON Q3 2020	AECOM UK Q2 2020	ARCADIS LONDON SPRING 2020
	% CHANGE				
2020	-1.00	0.60	-1.00	-1.00 to 1.00	0.00
2021	-1.50	2.40	-1.50	1.00 to 2.00	0.00
2022	-0.50 to +1.50	4.69	-0.50 to +1.50	2.00 to 3.00	2.00
2023	-1.00 to +3.00	5.04	-1.00 to +3.00	N/A	5.00

Note: All figures relate to year on year quarterly changes

Note: Aecom's forecasts are taken from their 'Scenario 2: slower rebound' scenario

[1]*https://www.gov.uk/government/statistics/forecasts-for-the-uk-economy-june-2020*

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.