GT GARDINER &THEOBALD

TPI.

4TH QUARTER 2021

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.

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GT MARKET INTELLIGENCE

MACRO ECONOMIC HEADLINES

October 2021

Unless otherwise indicated, figures show percentage change over 12 months

- **4.6%** UK Unemployment (May - Jul 2021)
- **3.2%** CPI Aug 2021 (12-month rate)
- **23.6%** UK GDP Annual Growth Rate (Q2 2020 - Q2 2021)
- **4.8%** RPI Aug 2021 (12-month rate)
- **8.3%** UK Wage Growth*
- **0.1%** UK Base Interest Rate

Arrows indicate direction of movement over a one-year period.
**Average Weekly Earnings (Total Pay), Y-on-Y three-month average to Jul 2021.*

INPUT COSTS

Year-on-Year (August 2020 – August 2021)

ONS building materials tables. Figures are cumulative annual ▽△ denotes movement trend

- **5 to 10%** M&E Components
- **67.8%** Concrete Reinforcing Bars (Steel)
- **$82.6** Oil Prices Brent Crude (Barrel) (As of 6th October 2021)
- **11.8%** Construction Industry Wage Growth*
- **74.8%** Fabricated Structural Steel
- **3.9%** Ready Mixed Concrete
- **74.0%** Imported Sawn or Planed Wood
- **Same** Contractor Margins (Q3 2020 to Q3 2021)

**Average Weekly Earnings (Total Pay), Y-on-Y three-month average to Apr 2021.*

TENDER PRICE CHANGE

Tender price annual percentage change Q4 2021

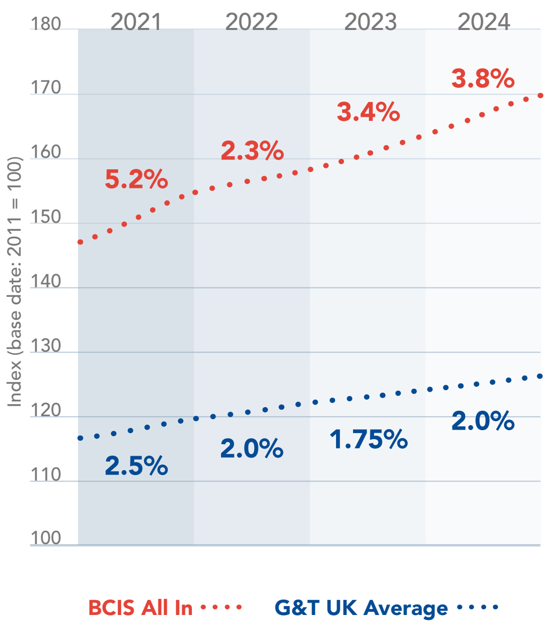
%	2021		2022		2023		2024	
Regional forecasts	Now	Last*	Now	Last*	Now	Last*	Now	Last*
Greater London	2.50	2.00	2.25	1.50	2.00	1.75	2.00	2.00
South East	2.50	2.00	2.00	1.50	1.75	1.75	2.00	2.00
South West	2.50	1.75	2.00	1.50	1.75	1.75	2.00	2.00
East	2.50	2.00	2.00	2.00	1.75	1.75	1.75	1.75
Midlands	2.25	2.00	1.75	1.75	1.50	1.50	1.50	1.75
Wales	1.50	1.25	1.75	1.50	1.50	1.50	1.50	1.50
Yorks & Humber	2.00	1.50	1.75	1.25	1.50	1.25	1.25	1.50
North West	2.50	1.75	1.75	1.50	1.50	1.75	1.50	1.75
North East	1.75	1.75	1.50	1.50	1.50	1.5	1.50	1.50
Scotland	3.00	3.00	1.75	1.50	1.50	1.75	1.50	2.00
Northern Ireland	6.00	3.00	4.00	2.00	2.00	2.00	2.00	2.00
UK Average(weighted)	**2.50**	**2.00**	**2.00**	**1.50**	**1.75**	**1.75**	**2.00**	**2.00**

Last* 3Q 2021

Figures are cumulative annual

FORECASTS

Tender Price Trend, All UK TPI Q4 2021



Surge pricing spikes are currently affecting materials and trade costs, 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.

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OUR FORECASTS

From toilet rolls to timber, supply chain issues have evolved and expanded over the last year-and-a-half.

Rapid demand shifts left manufacturers of construction products and materials struggling to keep up, unable to ramp up production capacity quickly enough to meet the soaring new demand. Perceiving the current supply issues to be short-term, manufacturers saw little point in investing capex into expanding capacity. Instead, they have been happy to accept the higher prices and enjoy increased margins.

There are early signs that record-high material prices across the construction industry have started to soften demand and create some hesitancy regarding new contract awards. Despite this, prices are set to remain 'sticky' for a period, resistant to change quickly despite shifts in the market suggesting that a different price is optimal. Falling raw material costs take time to filter through the supply chain and become reflected in prices. Suppliers will also need to sell their existing inventory bought at higher prices and increase their inventory at these lower prices. Retailers will naturally try to hold on to higher prices for as long as they can, particularly when there is still demand.

How long will these supply chain pressures last, exactly? The short answer is, no one knows. The longevity of these issues depends, in part, on whether another round of the pandemic shuts down more countries and what fiscal policy decisions those countries make in the short to medium term. These things are inherently unknowable. Although most see these supply issues as a flash in the pan which will work themselves out as time marches on, it's important to separate the longer-term structural supply issues from the near-term issues.

There are two inflationary camps: one suggesting that the 'one-off' inflationary drivers are transitory, linked to the re-opening of the economy, and that the base effects will disappear or even reverse next year. The other camp suggests there is a broad risk of inflation accelerating and re-basing itself at higher levels. What is clear is that supply and demand imbalances, heightened by disruption to transport and logistics, look set to continue into 2022. Material price input cost inflation can therefore no longer be considered a short-term issue or 'blip'.

The recent imbalances between supply and demand have reminded us that the global economy is fragile and finely balanced. If key ports are shut down there are very few workarounds, similarly if there are rapid changes in consumer preferences and industries take prolonged periods to adjust to this, it can create significant bottlenecks. It is these real world constraints (particularly when combined with a rapid increase in fiscal stimulus and money supply to keep demand elevated) that create inflation.

Against this backdrop, our inflationary forecasts have been upwardly revised across most regions in 2021. Our resultant weighted UK average indicates that tender price inflation will rise by an average of 2.5% this year – higher than our previous forecast of 2% in Q3 2021. The high levels of competition in the earlier part of 2021 meant that the rapidly rising input cost inflation wasn't fully feeding through into tender prices. As workloads began to pick up and construction activity indicators went from strength to strength, bidding competition slackened and tender price inflation accelerated.

G&T expects many of the current issues and underlying causes of inflation to spill over into next year but anticipate that the rate of tender price inflation will begin to ease off as supply and demand begins to rebalance. Our 2022 UK average TPI forecast therefore drops by half a percentage point to 2% as the ongoing supply chain issues threaten to dent new work growth in the early part of the year. While falling key commodity prices are a good lead indicator of material price inflationary pressures easing in the medium-term, other pressures look set to take centre stage. An increasingly tight labour market and fierce competition to attract workers is likely to result in mounting wage pressures and translate into "stickier" inflation. Labour constraints are therefore likely to be the primary driver of inflation throughout 2022 and beyond.

All forecasts in this report 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.

THE ECONOMY

While the revised UK gross domestic product figures pointed to a stronger growth than previously reported, it was not enough to claw its way back to its pre-pandemic size. GDP rose 5.5% in the second quarter (higher than the 4.8% previously estimated) but the economy was still around 3.3% smaller than it was in the quarter before the pandemic struck.

The fact that the economy had grown more quickly in the second quarter meant it had less spare capacity and was more prone to inflationary pressure. Faced with the twin headwinds of accelerating inflation and supply chain problems, lost output is unlikely to be recovered this year. With the Bank of England cutting their Q3 growth expectations to 2.1%, the recovery is far from secured. In fact, estimates are that the economy won't reach its pre-pandemic size until mid-2022 while Bank of England governor Andrew Bailey has warned the recovery is facing "hard yards" ahead.

The Bank of England's view is that price pressures will be transient. While acknowledging the current pressures being experienced, Andrew Bailey said, "demand will shift back from goods to services, global supply chains are likely to repair themselves, and many commodity prices have demonstrated mean reverting tendencies over time." More pass-through to retail prices is expected and manufacturers' output prices are still rising rapidly. A lot rests on how quickly and effectively supply capacity is rebuilt.

Consumer price inflation made its biggest jump on record in August to 3.2% on an annual basis. The jump was caused by a slump in prices last year and while inflation is expected to climb higher (potentially above 4%) in the coming months, the ONS urged caution from reading too much into the price increase. Some of this is genuine (eg rising shipping and transport costs) but much of it is due to extensive discounting in 2020. Regardless, higher inflation will raise questions about tightening monetary policy and interest rate hikes to contain inflationary risks down the line.

Added to this is a sense of nervousness among policymakers about winding down state intervention and how ending the furlough scheme will impact on hiring and wages. Even if furloughed workers are re-absorbed into their old jobs, reducing unemployment and inactivity in the economy, we are still left with the issue of excess job vacancies. This will continue to push up wages in certain sectors where vacancies are already high. Average weekly earnings (AWE) across the whole economy rose by 8.3% in the latest three-month period to July compared to one year ago. While this number is somewhat distorted by a few temporary effects, including the use of the furlough scheme, labour shortages are contributing to faster underlying pay growth. However, these same shortages are impeding further output growth and, if they persist, will cause inflation to stay high.

An average of all new forecasts for the UK economy points to a GDP growth rate of 6.1% in 2021, followed by 5.5% in 2022. Most of this year's growth will be front-loaded, coming from a strong expansion in activity in the first half of the year. Growth slowed to a crawl in July as the Delta variant and so-called 'pingdemic' impacted consumer spending. Since then, constraints on activity have grown. Shortages of labour and materials and supply chain disruptions intensified, acting as a drag on growth. Despite these growth headwinds, forecasters argue that the economic recovery remains on track.

CONSTRUCTION OUTPUT AND NEW ORDERS

Data from the ONS showed construction output fell for a fourth consecutive month in July and was down by 5.1% compared to the same month in 2019, prior to the pandemic. The ONS suggested that the main reasons for the monthly decline were price increases and product shortages caused by supply chain problems.

Both new work and repair & maintenance output fell in July 2021, the former being 6.9% below what it was the same month in 2019, while the latter was down 1.6%. The monthly contraction was attributed to shortages of key materials such as timber and roof tiles. Consequently, output growth cooled in sectors requiring a lot of these materials, such as the residential sector.

On a quarterly basis output figures appear a little more positive. Q2 2021 construction output was marginally lower (-2.1%) than the same quarter in 2019 but since the peak of the pandemic in Q2 2020, output has grown quarter-on-quarter. Q3 output figures are set to put a stop to this growth trend as supply chain issues and price rises continue to worsen and increase.

Growing confidence had been feeding in to new order figures which grew by 17.6% in Q2 2021 compared to the previous quarter. In fact Q2 new order values were the highest they have been since Q3 2017 and were some 11.6% above the quarterly average over the last five years.

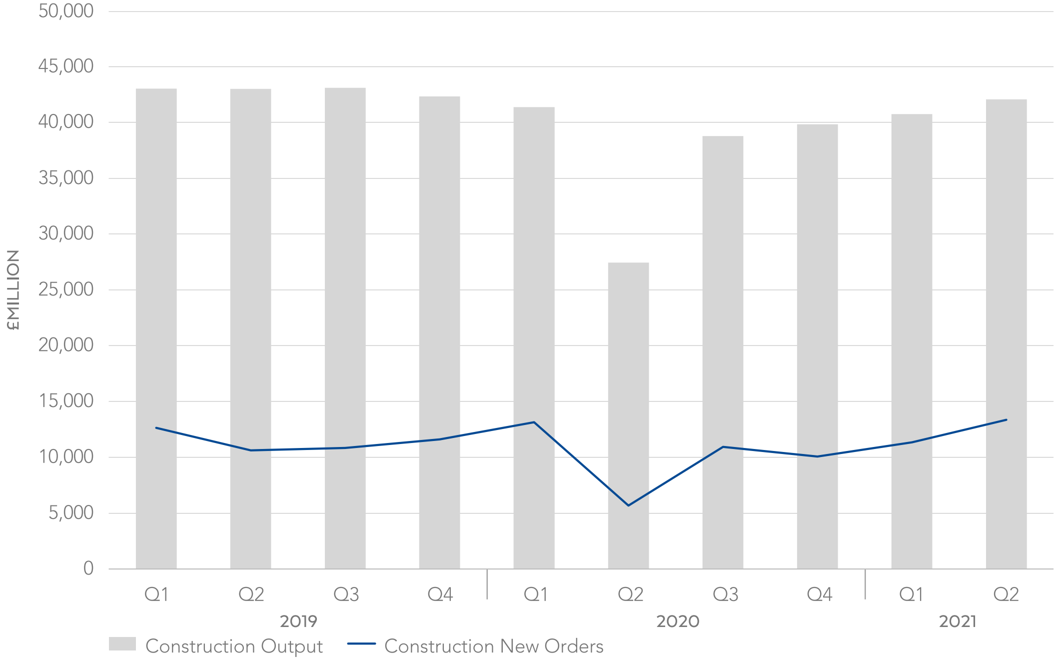
New work in all apart from two sectors (public new housing and private industrial) expanded in Q2 suggesting the recovery to date is now fairly broad. New private industrial work may have dipped in Q2 but its growth over the last year has been staggering, outperforming all other sectors and growing by nearly 300% between Q2 2020 and Q2 2021.

Inflation and supply chain issues may dent both output and new order growth in the final half of the year. Our latest Main Contractor survey suggests that over the next 12 months the availability of materials and rising material prices are expected to have the biggest impacts on their businesses. However, this hasn't dented their workload expectations for the same period with the majority expecting their workloads to see a 'minor increase'.

A look at recent IHS Markit's Construction PMI surveys shows that, although still expanding and remaining well above the long-run series average, total new work growth is tapering off and in August, growth eased to a five-month low. Despite this, the survey noted that greater confidence levels among clients and the resumption of projects following the lifting of COVID-19 restrictions were a key reason for rising new business intakes.

While the pipeline of work looks healthy and businesses are optimistic of the year-ahead outlook, if the ongoing supply chain disruption persists it will restrain purchasing activity and become increasingly difficult to complete some of the pipeline of work. The pace of output growth is already showing signs of easing because of these issues and if not resolved soon, new orders could suffer if clients decide to delay their projects and wait for input cost inflation to stabilise.

UK CONSTRUCTION:
NEW ORDERS (ALL NEW WORK) V OUTPUT (ALL WORK)



Source: ONS

G&T TPI SURVEY FEEDBACK

Workload

In G&T's TPI survey, numerous respondents suggested they had seen a market resurgence in the last quarter and pointed to the fact that a number of key projects are lined up to be on site in the next quarter or two. Also observed was a rise in speculative bid opportunities, an increase in the number of requests for proposals (RfPs) and comments indicating that discussions are picking up with clients to restart projects that were mothballed due to the pandemic.

No projects are reported to have been cancelled in the period but some schemes are taking longer to start and may not progress as fast as originally expected until input prices are more certain/fixed. Despite some concerns that overheating in the industry could make some projects unviable, based on the number of enquiries and commissions G&T is receiving, it is evident that workloads are set to continue to increase. There is a sense that momentum is building and pipeline opportunities are beginning to firm up and commit, but in some sectors (eg commercial office) there is still an element of 'wait and see' in terms of what occupiers/tenants want from their space moving forward.

Projects that have been through planning are starting to get funding and moving to the next phase of design and procurement. Funders are particularly keen to finance developments with good levels of sustainability and carbon friendly credentials as Net Zero targets are being embraced across the industry.

Respondents added that a number of large masterplanning/regeneration schemes that stalled over the last year are now showing signs of coming back to life, but in contrast work in other sectors, such as hospitality, remains slow due to changed behaviours and preferences. An increasing number of opportunities were reported in both the healthcare and education sectors. Growth in these areas are in response to the UK's new hospital building programme and the consolidation of existing higher education estates due to changes in working patterns. Workloads in the commercial office sector are also high with significant volumes of tenant-controlled space either being refurbished or repurposed to accommodate hybrid working. There is also strong desire to bring existing building specifications up to standard and in line with tighter energy requirements. However, some suggested that workloads in the commercial office sector may settle down or level off given the fine line between development and tenant demand.

Market Conditions

While the market is busy, it is still reasonably competitive. Market tendering conditions are predominantly being described by contractors as 'warm' with moderate competition and tender pricing. However, some sectors such as office fit out are experiencing higher levels of competition which is helping to keep tender prices in check.

With strong pipelines secured and greater certainty of work, Tier one contractors are generally feeling more comfortable and see less of a need to work to tight margins. However, a growing number of challenges and pressures are driving the market - namely labour availability, plant prices, global supply shortages and material price inflation. These ongoing issues generally stem from the following:

- **Demand:** A simultaneous global increase in international demand for construction materials and products driven by housebuilding booms, Government infrastructure-based stimulus packages and delayed project starts.
- **Supply disruption:** Disrupted raw material supply lines, particularly for imported products. Manufacturers are struggling to ramp up production capacity in response to the rising market and quickly shifting appetites after having scaled down supply during the pandemic.
- **Bottlenecks:** Shipping container logistics issues causing supply chain bottlenecks (ie difficulties moving containers that are stuck in the wrong places quickly enough) and haulage issues stemming from a lack of HGV drivers.
- **Raw materials:** Most inflation has so far been driven by rising raw material prices. However, with demand so high, some of the recent falls in commodity prices (eg copper, iron ore, timber) have not been passed down the supply chain. Retailers are also still selling inventory bought at higher prices.

Furthermore, accidents (eg the Suez Canal blockage) and weather events (winter storms in Texas disrupting plastic polymer production) have also had a part to play at various points during the year. More recently, rising energy costs have added to the inflationary pressures.

Competition for nearly all resources is fierce. However, if we keep surge pricing to one side, good growth is underpinning reduced tendering competition and higher prices. While it's possible that this short-to-medium term blip will subside as the supply chain adjusts and constrained supply lines ease, there is a growing concern that this 'transitory inflation' will not fall away for all elements and a new base level could be set. The supply chain could take advantage of the current demand-supply imbalance by seeking to retain higher prices rather than returning to previous pricing levels.

Some of the resultant uplift in tender pricing is down to price volatility that is making it difficult to fix trade package prices. The supply chain is understandably nervous about cost movements and is therefore adding significant premiums through higher risk allowances to fix prices for projects starting in 2022 and beyond. Although main contractors suggest that typical risk allowances are in the 2-3% region, allowances of 5% or more in the past few months haven't been uncommon. Furthermore, the length of time contractors are willing to hold tendered prices on packages has also fallen. In some cases prices are only being held for 24-48 hours, driven by supplier pricing. Difficulties in getting the supply chain to fix prices isn't something that is expected to go away anytime soon.

Compounding the issues stemming from resource shortages are increased levels of contractor stockpiling, rising workloads and the Government's commitment to deliver a number of large infrastructure projects. Commitments to deliver some of these major schemes by a certain date will mean that a number of them could come to the market at a similar time, putting additional pressure on already strained resources. Concerns over sub-contractor capacity are also emerging. A surge in activity has created short-term capacity constraints and contractors are feeling increasingly stretched. Indeed, on average, main contractors have secured 94% of their workloads this year but capacity issues look likely to ease in 2022 as just 64% of their workload has been secured.

It remains to be seen how the winding down of Government-backed debt funding and the end of the furlough scheme will impact companies. While construction has the greatest share of insolvencies of any UK sector, the number of annual insolvencies appears to have fallen during the pandemic. Arguably, sector insolvencies have been kept artificially low by Government intervention and support measures but taking these away may result in a spike. Unwinding these support measures could put pressure on finances and cashflow, particularly in an environment of soaring input costs. Zombie companies kept alive by the Government's support schemes may have been inclined to take on work at wafer-thin margins and could potentially struggle to survive without support measures, particularly if contractual disputes ensue.

Increasing workloads and constrained supply, coupled with labour cost and material price inflation, means that for the time being at least, there is only one direction for tender price inflation.

GT

INPUT COSTS

Key inflationary and deflationary pressures

Based on our observations of the market, survey feedback and our extensive discussions with the supply chain, we have established that a number of inflationary and deflationary pressures are likely to impact tender pricing. The rapid recovery has brought with it significant inflationary side effects. Meanwhile, the number and severity of deflationary pressures continues to fall and lessen.

MATERIAL COSTS

Soaring prices, patchy availability and lengthy delays are preventing contractors from taking on new work or completing some of the pipeline of work.

The effect of the supply chain crisis has been to curtail expansion of the UK construction sector. Restricted supply of materials has weighed on output growth and construction activity, and comes at a time when the economy has just started to bounce back. Furthermore, the crisis has dented confidence and increased cost burdens which have started to spill over into increasing tender prices.

Disruption to global supply chains has arguably been caused by the pandemic but exacerbated by Brexit migration rules and border controls. A handful of secondary, but directly related, factors have also acted to create a scarcity of construction products and materials, triggering steep inflationary rises. According to BEIS data, in the five years leading up to the pandemic (2015-2019) the annual average rate of material price inflation was 1.75%. Now, as we emerge from the pandemic, the 'All Work' material price index has risen by more than 23.5% in the year to August 2021, catching many contractors and clients off guard. Assuming that the materials element accounts for around 30% of the total cost of a construction project, the overall inflationary impact of the recent material price rises on the cost of a project would be around 6%.

Of course tender prices, on average at least, haven't risen by this much over the last year. Other factors such as the sector and the specific choice of materials have a bearing. Due to the staggered and somewhat uneven recovery in the economy, tendering in certain sectors has been more competitive than others. Accordingly, a portion of the material price inflation element on certain projects may have been absorbed in order to secure work and guarantee turnover for contractors in these less active sectors.

Due to the volatility in prices, materials pricing has been difficult to fix in tenders. Contractors are often requiring payments in advance in order to purchase the materials early, otherwise they are unwilling to commit to fixed prices. We are also seeing requests from the supply chain to make amendments to payment terms in order to improve their cashflow.

Another inflationary trigger set to continue to impact on the pace of recovery is logistical challenges. A lack of shipping containers and HGV drivers is causing delays and increasing transport costs. The Road Haulage Association estimates that there is a shortage of more than 100,000 qualified HGV drivers in the UK alone, so this is clearly a pressure that is set to be with us for the longer-term.

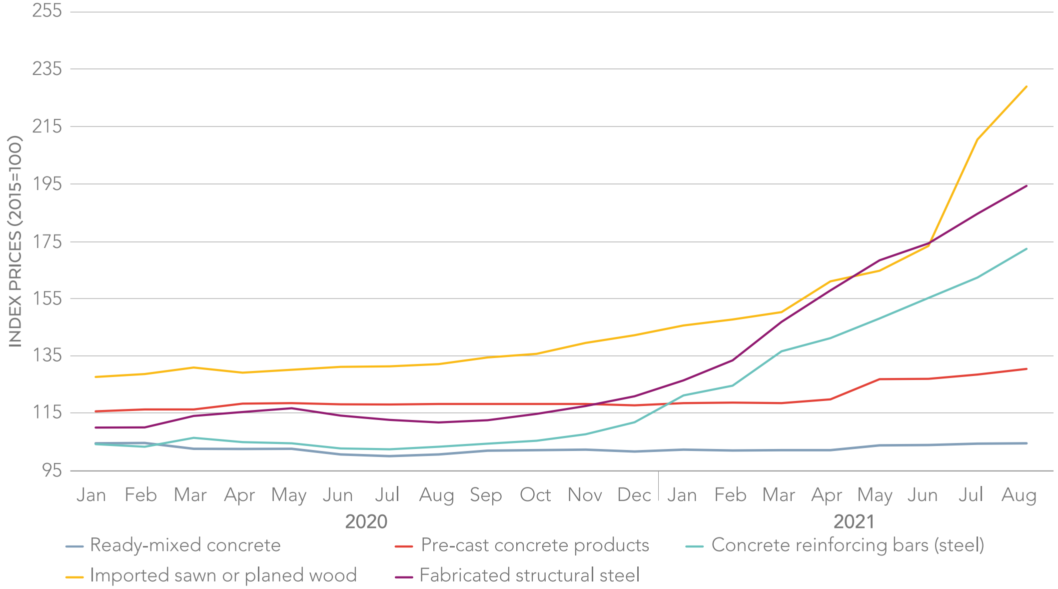
What was originally an issue primarily affecting steel and timber, inflation has spread to other materials and product categories. Although fabricated structural steel inflation (up 74.8% in the year to August 2021) and imported wood (up 74% to 78.4%) still lead the charge, according to the BEIS almost all other materials have experienced above-average levels of inflation over the past 12 months.

Paint prices are up nearly 10%, pre-cast concrete products are up 10.5% and sanitaryware is up by more than 11% - all well above the 1.75% annual average rate of material price inflation between 2015 and 2019. Our survey revealed pressures on the following:

INFLATIONARY PRESSURES	**DEFLATIONARY** PRESSURES
Competition for labour/skills shortages increasing rates	Supply chain issues starting to impact client confidence and output growth
Strong demand and ongoing supply issues increasing construction materials costs	Muted activity in some sectors (eg retail and hospitality sectors) increasing competition to win work
Increased public sector spending/investment by Government leading to increased construction activity and competition for resources	Clients withholding investment in some sectors until new working patterns established
Global manufacturing capacity/factory output unable to keep up with demand	Lower-tier contractors actively competing with tier one contractors in new sectors/contract size bands to secure pipeline, squeezing margins
Escalating logistics/ transport costs (rising container shipping and road distribution prices)	Key commodity prices beginning to normalise
Rising fuel prices increasing site and plant/machinery costs	Potential return of pandemic-related restrictions denting confidence and limiting activity
Strong workloads and rising new order levels stretching supply chain capacity	Improving productivity through adoption of digital practices and new/more productive ways of working
Volatility increasing project risk premiums	
Insolvencies reducing supply chain capacity and tendering competition	

KEY MATERIAL PRICES

Index 2015 = 100



Source: BEIS

- Cost of some M&E items (eg sprinkler pipework, cables) has increased by 10% or more due to shortages
- Lead times on semiconductors are now six months
- Cost of steel is fluctuating dramatically and can cost anything from £2,500/tonne to £3,500/tonne and lead times are long
- Significant shortages in drylining and MDF are affecting fit-out projects, especially due to the strong demand for remedial works
- Brick shortages (despite brickmakers getting back to full production capacity)
- 2030 sustainability targets, limited supply and a heavy reliance on the EU is pushing up prices of facades and making some models financially unviable
- Fierce competition for concrete deliveries and further issues are envisioned as demand for low-carbon concrete grows
- Most materials are on long lead times and clients are often having to procure directly and novate orders to maintain the programme

The IHS Markit/CIPS UK Construction PMI in September didn't reveal any signs of material price inflation abating just yet as shortages of building materials led to another rapid increase in purchase prices during the month. Over 60% of supply chain managers said their deliveries were taking longer and 78% said they were paying more for their goods as inflation remained stubbornly high. However, a positive lead indicator for material price inflation is falling commodity prices. Iron ore, copper and timber prices have all fallen from their recent peaks in late spring/ early summer. While these price corrections haven't filtered down the supply chain yet, falling commodity prices bodes well for construction material prices in the medium-term.

In the meantime, we can expect project delays on-site and lengthened lead times. This unpredictable pricing environment has slowed clients' decision-making on new orders and led to delays with contract awards. The volatility has hindered new business intakes and some contractors, unable to hold prices, will have renegotiate, re-bid or revise their cost projections in the coming months.

Labour

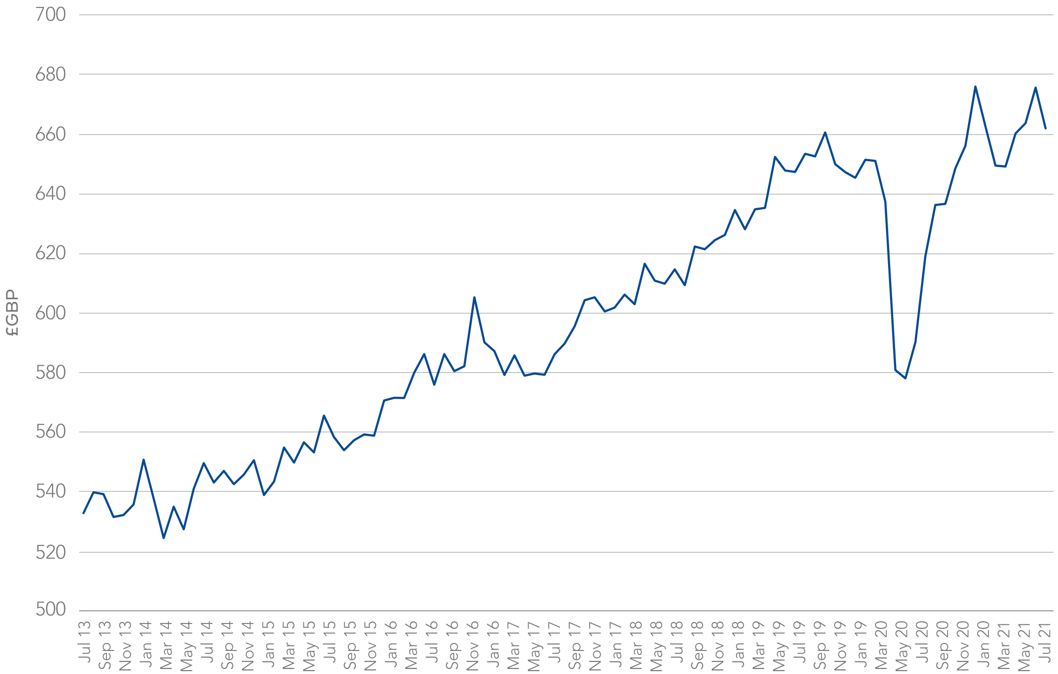
Labour pressures are mounting as skills shortages and a high number of construction vacancies push wages higher. On a seasonally adjusted basis, average weekly earnings in construction rose 11.8% in the three-months to July 2021 compared to the same period one year earlier. However, the low base effect (which is of a statistical nature) has made this rise seem more pronounced. While the month-on-month series for average weekly earnings shows a dip in July to £662 per week – down from their peak of £676 in June – this is unlikely to mark the start of a persistent downward trend in labour costs.

According to G&T's Main Contractor survey, the current availability of project labour resource is low with some commenting that the rates currently being demanded are unrealistic and unsustainable. The availability of staff has, according to some, been impacted by demands from big projects like HS2 and Hinkley Point but also by Brexit, and is quickly becoming a major business and industry issue. Expectations for labour availability over the next six months are split between remaining the same and decreasing but fortunately there is slightly more optimism that this will improve over the next year. Despite this, over the next year nearly all main contractors surveyed said they expected both staff and sub-contract labour costs to increase and most said that this would have a medium to major impact on their businesses.

Labour capacity constraints are currently plaguing certain specialist trades such as groundworks, bricklayers and dryliners. Cladding and MEP sub-contractors also have resource capacity

AVERAGE WEEKLY EARNINGS (UK CONSTRUCTION)

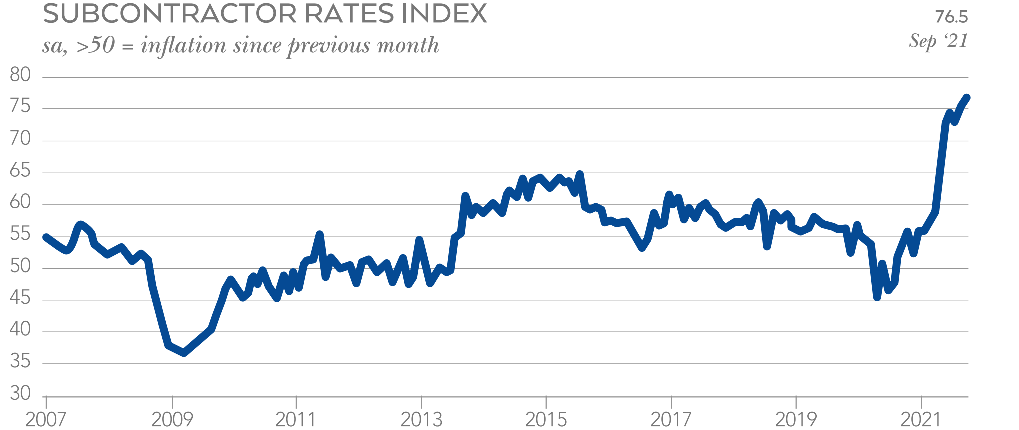
Seasonally adjusted



Source: ONS

SUBCONTRACTOR RATES INDEX

sa, >50 = inflation since previous month



Source: IHS Markit CIPS

constraints ranging from pre-construction, design and installation. The sub-contractor squeeze has featured prominently in the most recent PMI surveys, with September's survey noting that shortages have led to additional cost pressures in terms of rates charged for sub-contracted work. Because sub-contractors are struggling to fill the widening gap of need, prices charged accelerated to survey-record levels according to the IHS Markit CIPS subcontractor rates index.

Until headcount improves, sub-contractors will continue to enjoy strong pricing power and capacity will remain stagnant. Unfortunately, there appears to be no quick fix to improve labour availability but encouragingly the latest ONS statistics suggest the employment levels of EU nationals are beginning to recover after having dropped by more than 13% between Jan-Mar 2020 and Jul-Sep 2020. With London and the UK regions heavily reliant on this source of labour for construction work this is a positive recovery trend but nearly 80,000 more are needed to fulfil the Government's building ambitions. For this, a demand-led system of long-term visas may be required to plug gaps in labour supply while the UK works to attract and train a domestic workforce.

PROFITABILITY AND PROCUREMENT

OH&P and Preliminaries

There have been no seismic shifts in on-costs or preliminaries over the last three months. Most TPI survey respondents reported that both main contractor overheads and profit (OH&P) and preliminaries costs were unchanged. However, over the next 12 months a growing majority believe both will increase.

Some contractors appear to be de-risking themselves by increasing overheads on new work. Meanwhile BIM and additional health and safety measures are expected to drive overheads higher and as more work comes forward and contractors are able to be more selective on which projects they tender. There was some reticence among survey respondents who suggested that if new work begins to drop, contractors would aim to keep their on-costs at the same level in order to remain competitive and counter expected rises in labour and material costs. Some also noted that they expected headline OH&P to remain static over the next year but that contractors would aim to increase margins through package procurement.

Another recent phenomenon is larger contractors adapting their business model and entering into new sectors (eg repurposing commercial into residential) and persuing projects in different contract size bands to help meet their overheads. In some cases this has pushed smaller contractors out of the market or caused some to reduce their margins to remain competitive.

Preliminaries costs are being pushed higher by rising fuel prices and reduced plant availability. Increased management staff wages is also applying upward pressure to preliminaries costs. Until recently the market has been competitive and so ramping up preliminaries costs would have been a bold choice. However, now that tendering competition has eased and general inflation has been seen in the wider economy, contractors are likely to exercise a little less restraint and look to recover losses incurred during the pandemic.

Procurement Route

While contractors still appear to be keen to get on tender lists, they are certainly being more selective on the projects they bid for.

The main reason for turning down requests to tender stems from an unwillingness to accept projects with higher risk profiles due to the current supply chain issues. The supply chain is generally unwilling to fix prices and take the risk of inflation on packages in two-three years' time. Against this backdrop, contractors are seeking to de-risk work and limit their exposure by using two-stage tendering or negotiated contract tenders.

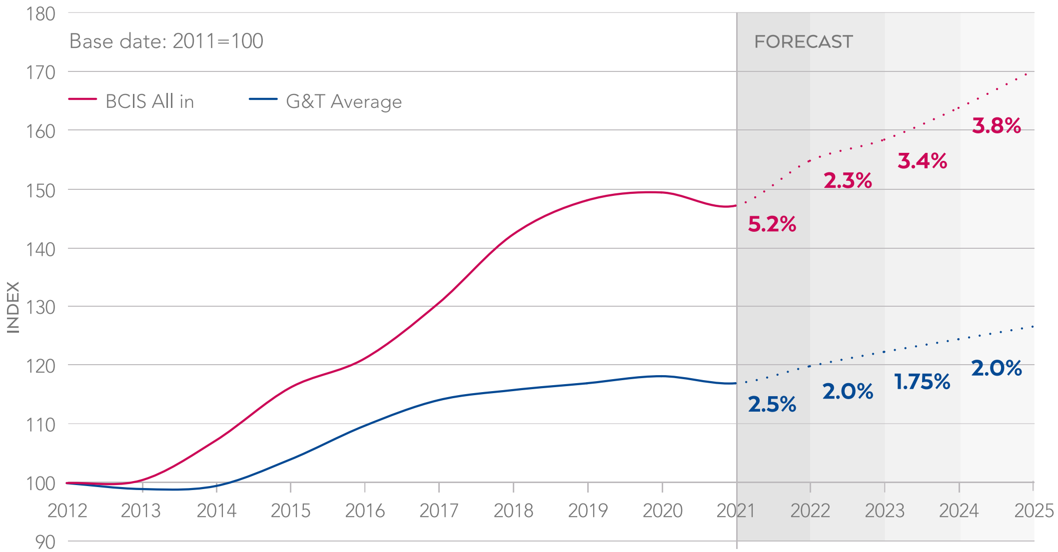
Furthermore, it was noted that design and build (D&B) contracts are currently preferred due to the current issue of materials shortages. These shortages are forcing design changes that can be better managed by the contractor in order to maintain the programme.

Clients inevitably favour the single-stage procurement route to get the most competitive price but this requires a good team and a quality set of employer's requirements setting out a detailed specification, scope of service and risk allocation in order to be successful.

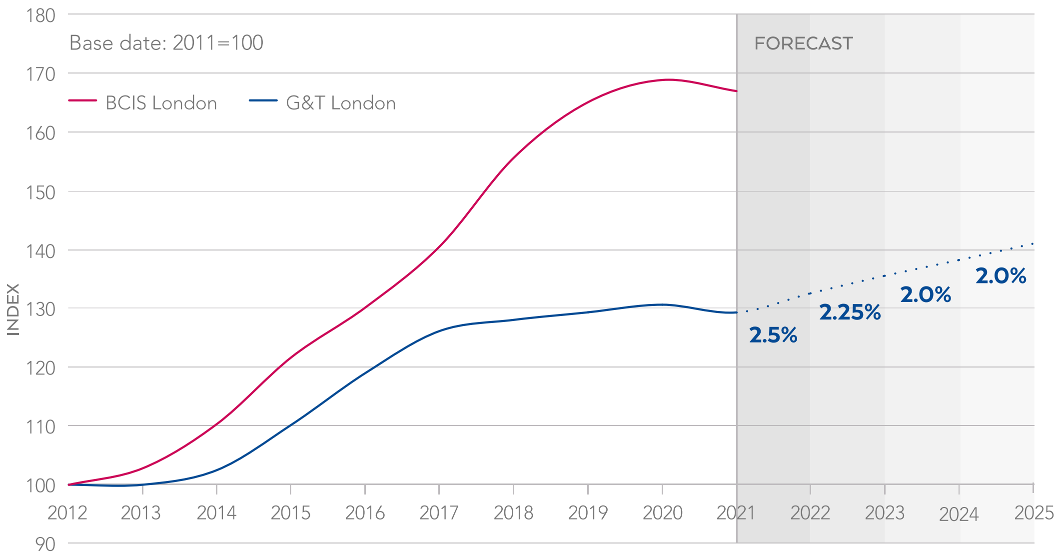
In our last Q3 TPI report, a little over 44% said that D&B two-stage tendering was the most favoured procurement route in the preceding three months. In our Q4 TPI survey this dropped slightly to just over 36%. The reverse was true for D&B single-stage, which saw the proportion of respondents indicating this was the most favoured route jumping from 27% to 37%. Although choice of procurement route is driven by sector, size and project strategy rather than the market, this Q-on-Q shift is perhaps telling - an indication of the increasingly risk-averse nature of contractors in a market where workloads are rising and space capacity is low.

GT

TENDER PRICE TREND ‘ALL UK TPI’



TENDER PRICE TREND ‘LONDON TPI’



Note: BCIS does not publish regional forecasts.

TENDER PRICE CHANGE

TENDER PRICE ANNUAL PERCENTAGE CHANGE Q4 2021

%	2021		2022		2023		2024	
Regional forecasts	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***
Greater London	2.50	2.00	2.25	1.50	2.00	1.75	2.00	2.00
South East	2.50	2.00	2.00	1.50	1.75	1.75	2.00	2.00
South West	2.50	1.75	2.00	1.50	1.75	1.75	2.00	2.00
East	2.50	2.00	2.00	2.00	1.75	1.75	1.75	1.75
Midlands	2.25	2.00	1.75	1.75	1.50	1.50	1.50	1.75
Wales	1.50	1.25	1.75	1.50	1.50	1.50	1.50	1.50
Yorks & Humber	2.00	1.50	1.75	1.25	1.50	1.25	1.25	1.50
North West	2.50	1.75	1.75	1.50	1.50	1.75	1.50	1.75
North East	1.75	1.75	1.50	1.50	1.50	1.50	1.50	1.50
Scotland	3.00	3.00	1.75	1.50	1.50	1.75	1.50	2.00
Northern Ireland	6.00	3.00	4.00	2.00	2.00	2.00	2.00	2.00
UK Average (weighted)	**2.50**	**2.00**	**2.00**	**1.50**	**1.75**	**1.75**	**2.00**	**2.00**

Last*	3Q21

COMPARISON OF PUBLISHED FORECASTS FOR TENDER PRICE CHANGE

	G&T UK AVER.	BCIS UK AVER.	G&T LONDON	AECOM UK	ARCADIS LONDON
	Q4 2021	October 2021	Q4 2021	Q3 2021	summer 2021
	% CHANGE				
2021	2.50	5.18	2.50	4.00	3.00
2022	2.00	2.32	2.25	4.00	3.50
2023	1.75	3.40	2.00	N/A	3.00
2024	1.75	3.84	2.00	N/A	5.00

Note: All figures relate to year on year quarterly changes

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.