

TENDER PRICE INDICATOR

1st Quarter 2022

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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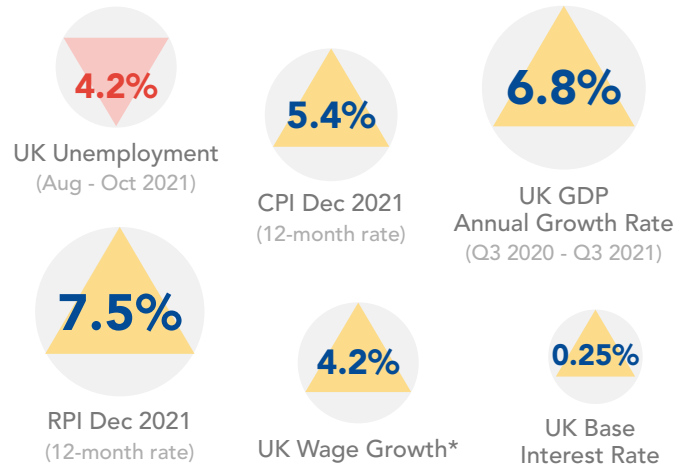
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MACRO ECONOMIC HEADLINES

January 2022

Unless otherwise indicated, figures show percentage change over 12 months

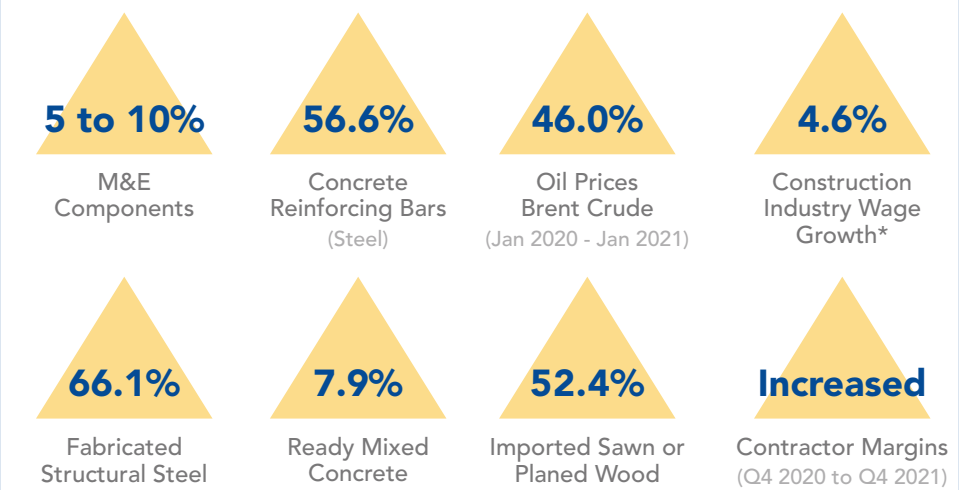


Arrows indicate direction of movement over a one-year period.
*Average Weekly Earnings (Total Pay), Y-on-Y three-month average to Nov 2021.

INPUT COSTS

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

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



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

TENDER PRICE CHANGE

Tender price annual percentage change Q1 2022

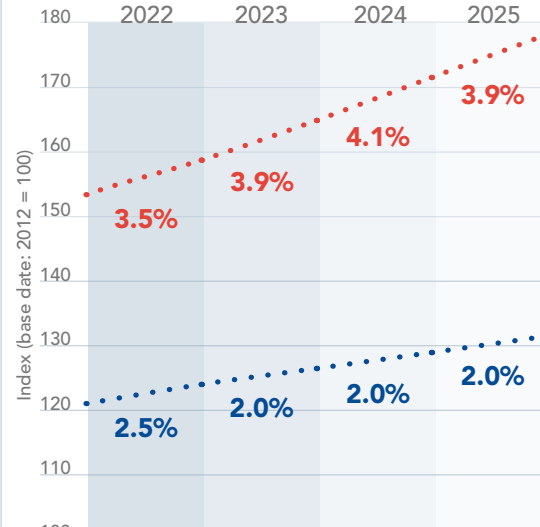
% Regional forecasts	2022		2023		2024		2025	
	Now	Last*	Now	Last*	Now	Last*	Now	Last*
Greater London	2.50	2.25	2.00	2.00	2.00	2.00	2.00	N/A
South East	2.50	2.00	2.00	1.75	2.00	2.00	2.00	N/A
South West	2.50	2.00	2.00	1.75	2.00	2.00	2.00	N/A
East	2.50	2.00	2.00	1.75	2.00	1.75	2.00	N/A
Midlands	2.50	1.75	2.00	1.50	2.00	1.50	2.00	N/A
Wales	2.00	1.75	1.75	1.50	1.75	1.50	1.75	N/A
Yorks & Humber	2.00	1.75	2.00	1.50	1.50	1.25	1.50	N/A
North West	2.50	1.75	2.50	1.50	2.00	1.50	2.00	N/A
North East	2.00	1.50	1.75	1.50	2.00	1.50	2.00	N/A
Scotland	2.25	1.75	2.00	1.50	2.00	1.50	2.00	N/A
Northern Ireland	4.00	4.00	2.00	2.00	2.00	2.00	2.00	N/A
UK Average (weighted)	2.50	2.00	2.00	1.75	2.00	2.00	2.00	N/A

Last* 4Q 2021

Figures are cumulative annual

FORECASTS

Tender Price Trend, All UK TPI Q1 2022



BCIS All In
G&T UK Average

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

Ever since inflation reared its ugly head, much has been written about the transitory or structural inflationary view in an attempt to predict price movement. Some have likened inflation to toothpaste inasmuch that once it's out, it's hard to get back in the tube. A number of economists are now leaning towards the view that we've entered a more structural inflationary period and that inflation is here to stay for the short to medium term. However, simple maths tells us that from the spring, some price rises will drop out of the annual headline inflation data. This will leave us with higher price levels, but a much lower inflation rate.

Seldom does inflation get as much attention as it has done over the past year or so. The news cycle continues to be awash with supply chain problems driving inflationary pressures and the impact it is having on a global scale. The UK construction has seen its fair share of inflationary rises in 2021 with material prices rising at record rates and wages showing potential signs of following suit. Higher logistics, shipping, fuel and energy costs have added to the growing wall of input cost pressures, but we suspect some of these will ease throughout 2022.

Inflation is a key measure of how the economy is doing. For the first time in a decade, headline inflation has exceeded 5%, prompting the first interest rate rise in three years. With inflation so high (and expected to peak higher in the spring

due to rising energy prices), the importance of productivity and efficiency becomes elevated as businesses carefully consider their cost base. The Bank of England's main concern is not so much what inflation does in the coming months, but whether it triggers longer-term inflationary pressures, namely wages in a tightening labour market.

The current material price inflation issues are far easier to address than the labour-driven inflationary issues. We anticipate material price inflation normalising in the short to medium term as supply and demand meet and production output returns to capacity, but the key drivers of labour cost inflation will not be as easily resolved. The ongoing skills shortage is led by demographics and societal perceptions which are far more difficult to change. Adopting new technologies and practices may help address our labour shortfalls, but these innovations will likely lag the squeeze on labour resource which is an immediate and mounting pressure.

Against this backdrop, we expect that the UK construction sector will remain in a continued inflationary environment all the way to 2025 as various input cost rises weigh in on tender pricing and construction costs. We anticipate that the greatest inflationary rises over this period will likely be experienced this year.

Our latest set of forecasts sees our previous estimates for tender price inflation rise across nearly all regions, with only Northern Ireland remaining unchanged at 4% annual inflation. This has pushed up our UK weighted average inflationary forecast to 2.5% this year (previously 2%). Much of the inflation being forecast for 2022 is likely to be seen in the first half of the year (ie a front-loading of inflation) due to the confluence of numerous input cost pressures. Thereafter, we anticipate that demand side factors contributing to higher material price inflation will fade and supply side inflation factors will begin to normalise, putting less upward pressure on material prices. Supply chain pressures are showing signs of improvement and, pending no further supply chain shocks, this is expected to

continue. The anticipation of UK plc returning to normal working patterns and dealing with COVID without significant disruption have helped this forecast. Last year's surge in energy prices is also widely expected to unwind as the year progresses but will likely remain above historic levels.

The above will take some of the heat out of headline inflation but as we explore in this report, inflationary labour pressures will come to the fore and help keep annual tender price inflation at an average rate of 2% between 2023 to 2025.

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

Although the impact of the Omicron wave of COVID-19 infections is expected to be modest, when official GDP figures are published for December and January, they will likely show a contracting level of economic output.

The short dip creates a weak starting point for expansion in 2022 and so economists expect to see a rebound in GDP growth thereafter and a surpassing of pre-pandemic GDP levels in the first half of the year. The bigger impediment to growth in 2022 is likely to be the rising cost of living, spurred by rampant inflation. Real incomes will also be affected by April's National Insurance tax rise which will play a part in capping consumer spending growth in 2022.

Recent surveys by Deloitte indicate that British corporate leaders, while concerned about labour shortages, are optimistic about the outlook for 2022. UK companies are looking past Omicron and plan to expand operations and increase investment this year with the expectation of strong UK and global demand for goods and services. Supply chain disruption and inflationary pressures are key areas of concern, but labour shortages

were seen as the greatest risk to businesses and therefore economic growth. Grappling with issues in recruiting and retaining staff, businesses have said they will have to diversify their hiring streams in the face of ongoing skill shortages.

In the fourth quarter of 2021, spiralling inflation prompted a rise in interest rates by the Bank of England. The UK consumer price index jumped to 5.4% in December largely due to persistent increases in energy prices and is still expected to peak higher this year. In this environment of elevated consumer price inflation, further interest rate rises are being priced in the market this year in an attempt to bring inflation back to the 2% target over the medium term. However, the BoE's monetary policy committee has a difficult path to tread as it trades off higher inflation with potential slower growth headwinds from the resumption of global lockdown restrictions. New Brexit import controls coming into effect at the start of 2022 will further contribute to lasting price pressures, which risk feeding into longer term inflation expectations.

The BoE is acutely aware that setting interest rates with the sole aim of controlling inflation runs the risk of undermining economic growth. This is, in part, why the BoE has until recently been less willing to act on inflation, as a series of interest rate hikes could derail the economic recovery. The hiking cycle has kicked off, but it remains to be seen how far rate rises will go to bring inflation back down to target in the medium term.

No one has a crystal ball to predict what is in store for the economy but there are some key themes we expect to carry over from the end of 2021 into this year. On top of rising interest rates and high inflation (that will hopefully stabilise), a tight labour market and squeezed incomes impacting spending and consumption will play a key role in how 2022 unwinds. Economists also predict continued issues with supply chains. Despite these pressures, forecasters such as the OECD expect UK economic growth will be 4.6% in 2022, noting that previous waves of the pandemic have shown a successively smaller hit to GDP compared with the first phase of the emergency, when the

economy collapsed by a fifth in a single quarter in spring 2020.

Growth estimates vary wildly but almost all agree that the UK is losing momentum. The boost from reopenings has faded, labour shortages and supply bottlenecks are biting and demand shows signs of moderating.

CONSTRUCTION OUTPUT AND NEW ORDERS

After several weak months, new data from the ONS shows construction output recovering. Following a fall of 1.7% in October 2021, output rebounded by 3.5% in November – the fastest monthly rise since March 2021. The increase in monthly output was driven solely by a 5.7% increase in new work, while repair and maintenance saw a slight decline (-0.2%). Output growth was supported by strong new private housing activity (+5.5%), but it was the infrastructure sector that experienced the largest monthly rise at 11.4%.

Easing supply chain bottlenecks, fewer issues in sourcing products together with mild and dry weather helped builders to press on with new work and ramp up production in November. The latest figures mean that construction output is now 1.3% above its pre-coronavirus level. Also helping to weather this year's turbulence has been the Government's five-year spending plans for rail, water, roads and energy projects. As a result, infrastructure has seen staggering growth with output in the sector some 39% higher in Q3 2021 than it was in the same quarter one year earlier – eclipsing growth in all other sectors.

In Q3 2021, the quarterly 'All Work' construction output series fell for the first time since Q2 2020 but recovering from the pandemic was never going to be plain sailing. Despite the 1% drop in output in Q3, there has been significantly less volatility in 2021 compared to the previous year and data from October and November indicates that Q4 2021 will see another quarter of stable construction output.

However, looking beyond 2021, the CPA's autumn forecast downgraded output growth for 2022, blaming ongoing supply issues and rising energy prices. The revised forecast for output growth in 2022 is down from 6.3% to 4.8% as skills and material shortages, cost inflation, rising energy prices and a shortage of HGV drivers are all expected to put "unprecedented" constraints on growth over the next 12 months.

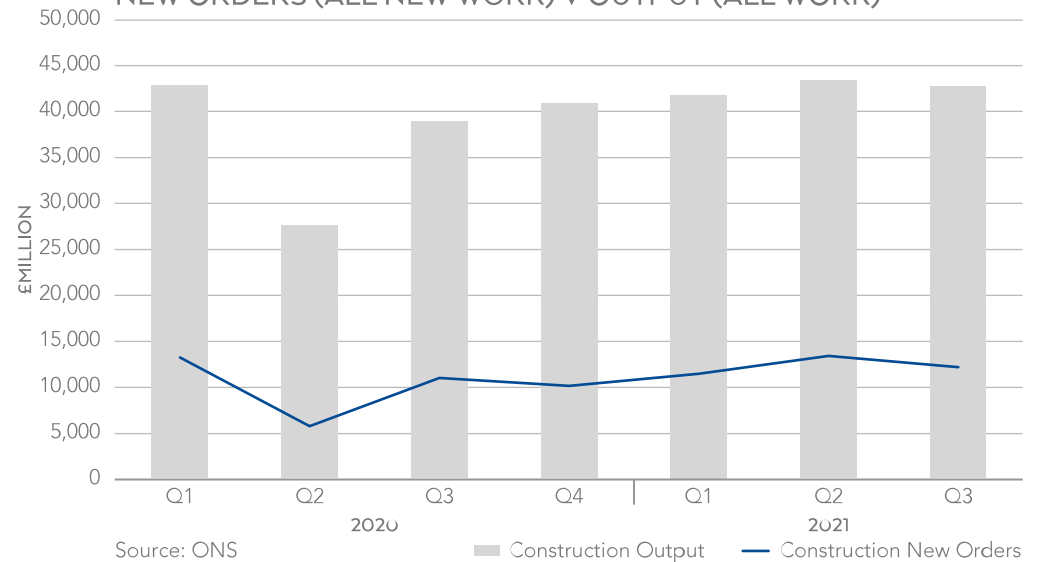
Turning to new work, ONS new order values in Q3 2021 remained above the five-year quarterly average of £11.9bn, but only just. After peaking in Q2 new orders dropped by more than 9% in Q3 (to £12.1bn) as shortages and supply chain issues took a toll on confidence. However, more recent data from construction purchasing managers indicates that after a significant dip in Q3, new orders have been slowly recovering. In tandem with reduced supply chain pressures, the IHS Markit New Orders Index has begun to edge higher in recent months. The index registered 54.8 in December, up from 54.4 in the previous month and the highest reading since August. Although client demand improved towards the end of 2021, the speed of expansion remains much weaker than the peak seen in May 2021 and there are concerns that the lack of new work will not be able to sustain the rapid growth rates seen earlier in 2021.

G&T TPI SURVEY FEEDBACK

Workload

In G&T's TPI survey, the consensus was that workflows are steady and that tendering opportunities (of varying values) are being released regularly. There is a general feeling of positivity in the market and the pipeline of potential projects appears to be strong. Also noted was an increase in enquiries and feasibility studies being undertaken which will hopefully materialise now that COVID hesitancy has subsided. Projects appear to be moving through feasibility to planning or procurement which is creating more market opportunities. There are also reports of a greater range of opportunities spanning across a wider range of sectors – not just the London office sector.

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



NEW ORDERS INDEX

sa, >50 = growth since previous month

54.8

Dec '21



Source: IHS Markit

While some noted that it is harder to get funding in light of risks from material price increases and that some projects are taking longer to get into contract, many clients have capital ready to invest and are committed to bringing new schemes forward. Indeed, foreign investment in UK property assets and their construction has continued at a strong pace. The constraints placed on capital expenditure by clients in certain sectors (eg Higher Education) appear to be lifting and longer-term strategies are being developed by a number of clients. Meanwhile, healthcare spending commitments by the Government are expected to bring new opportunities, as is strong demand in the residential, PRS and senior living sectors.

A steady stream of work is being provided by multiple, large-scale masterplan/regeneration schemes after having stalled since the pandemic struck. Demand for industrial warehousing and logistics facilities, which has shown unprecedented levels of growth over the last two years, is expected to remain strong. Glenigan reports that planning approvals and contract awards for industrial projects will continue to increase in 2022 and big civil engineering projects on the horizon will present a halo of investment opportunities in 2022 and 2023.

There is evidently a sector-dependant, two-speed pattern emerging in terms of construction activity and growth. Clients in certain, demand-hit sectors are less able to pass on increasing construction costs. One sector that is being particularly affected by pandemic-related uncertainty is leisure and hospitality, with respondents noting that new opportunities in this sector have slowed significantly. A collapse in overseas visitors as well as COVID-related regulatory restrictions in operations have damaged business viability for asset owners, delaying the recovery in new starts in this sector. Some clients operating in the wider commercial sector are also reporting that rents in off prime locations are not keeping up with the pace of inflation and that this is starting to hurt appraisals from both a finance and construction cost perspective. Consequently, investors are likely to exercise caution for a number of years, but the pipeline is expected to slowly strengthen.

Market Conditions

2021 was a year of rapid input cost inflation. Heightened uncertainty in the market, particularly in the early part of the year, was accompanied by record rises in material prices. These rises did not initially pass through to tender prices and were to varying degrees absorbed by contractors looking to secure pipeline and turnover. Tender price inflation lagged input cost rises but as the year progressed and order books filled, these higher input prices were increasingly passed along the supply chain and on to clients.

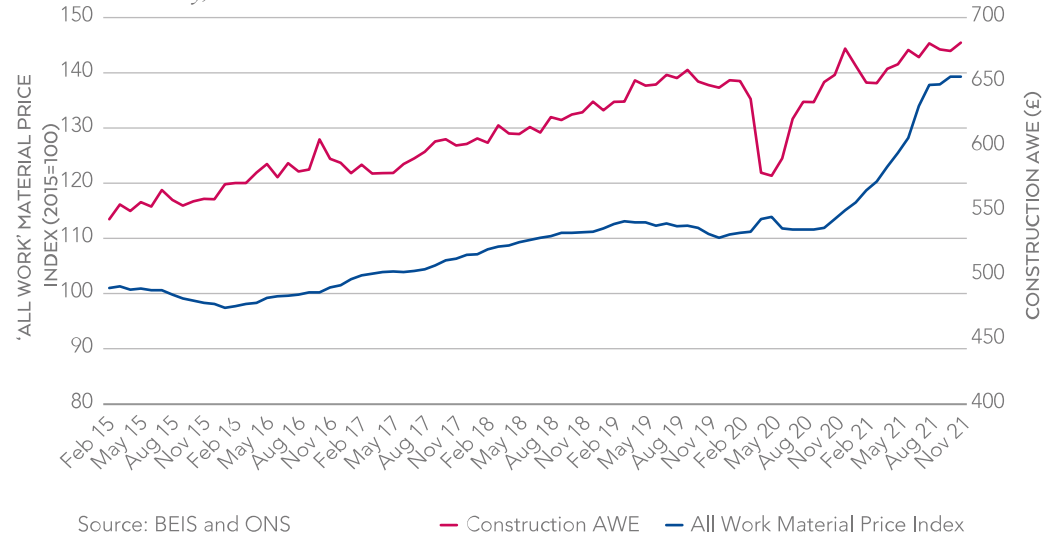
The graph below shows a sharp (11.3%) drop in construction average weekly earnings (AWE) between February and May 2020 but with a nearly equally sharp recovery in the following months. Shortly after AWE began to recover and return to their pre-pandemic levels, the BEIS material price index began to rise rapidly. In the year to November 2021, material prices rose by 22.7% and have evidently been the main driver of construction cost inflation in 2021, but we expect this to change in 2022, with labour costs outpacing material price growth.

Looking ahead, interest rate rises coupled with high material prices and labour shortages will make some developments less attractive or even unviable. Accordingly, some are suggesting a cooling/ levelling off in market activity will unfold as higher prices choke off demand. Others believe that we'll see a return to equilibrium and that tender prices will begin to stabilise as certain inflationary pressures (namely commodity and material prices) subside. A calmer market would certainly alleviate uncertainty and instil a greater confidence in clients to press ahead with planned projects.

While the spike in material prices may flatten towards the middle of 2022 and help inflated prices for certain trade packages fall back towards previous levels, the pressure to reach net zero carbon targets will impact construction material costs on some projects, as will higher energy costs in the short-term. The risk of labour cost inflation will also play an increasingly prominent role this year and is expected to be the next key

BEIS 'ALL WORK' MATERIAL PRICE INDEX V ONS CONSTRUCTION AVERAGE WEEKLY EARNINGS

Total Pay, SA



cost driver for tenders. Ongoing procurement of trade packages has seen upward labour cost movements on a quarterly basis and the supply chain is predicting further increases throughout 2022 in order to attract labourers and skilled workers to site.

Due to the recent volatility in pricing, all contractors and subcontractors are very resistant to hold prices firm for any more than ten weeks. With the market still very buoyant and order books relatively strong, contractors are generally unwilling to fix key packages without including significant premiums. Both the current market and economic conditions will continue to drive cost increases throughout 2022. To what extent clients start to scale back their development ambitions and investment plans in response to inflated pricing remains to be seen, but if as expected material supply issues settle down in the next six months, many clients will see this as an opportunity to push ahead despite other prevailing inflationary headwinds coming to the fore.

Strong activity growth has led to overheating in several sub-sectors. Fuller order books and an abundance of opportunities has made it difficult to elicit tender returns from both main and sub-contractors and in some cases, specialist trades are only getting a single return. This is a clear sign that contractors are not chasing work as hard as they were. Contractors' response time has also worsened but this could be due to delays with getting responses to queries from contractors. Nonetheless, contractors operating in these more active sectors are experiencing less pressure to absorb cost increases which is resulting in less predictable tender returns on some projects.

Supply chain disruption and delays will spill over into 2022, but as major global economies begin to transition from a more restrictive, lockdown-based approach to one of "learning to live" with COVID, supply disruption should become less common and acute. Just as supply chain disruptions began to fade in the latter part of 2021, the impact of Omicron offset some of the related gains for building firms. Rising infections

and fresh restrictions caused project delays and dented client demand. In fact, according to IHS Markit's Construction PMI survey for December 2021, construction firms reported delays to client decision making, contributing to the weakest pace of growth in the sector for three months.

Despite this, Tim Moore, a director at IHS Markit suggested that the worst phase of supplier delivery delays that have plagued the sector in the past year "seems to have passed", with December's survey noting significant improvements in the availability of construction products and materials. The number of construction firms reporting supplier delays dropped from 47% in November to 34% in December. Fewer shortages of essential raw materials and improved delivery times contributed to the slowest rate of inflation for building supplies for nine months. The respite in construction activity also allowed suppliers to the construction sector to catch up on backlogged work and boost their capacity.

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. While many of the pressures from our previous TPI report continue to impact tender pricing, a few new ones have become more prominent in recent months. However, the inflationary pressures continue to outweigh deflationary pressures.

MATERIAL COSTS

Material prices rose throughout much of 2021 but tapered off slightly from August as some of the supply chain issues began to ease as production caught up with strong demand. Despite the general easing of material price inflation between August and October 2021 and indications from December's construction PMI survey that availability of materials is improving, some pressures remain. Higher fuel and energy

costs have pushed up the prices for some raw materials. Materials requiring energy intensive manufacturing processes such as steel and cement are the most exposed to energy cost rises. Higher energy prices are also flowing through to plant and transportation costs, pushing up overall construction costs.

The latest Construction Product Availability Statement from the Construction Leadership Council (CLC) affirms the recent purchasing managers sentiments. The CLC indicates that the seasonal decline in activity has largely been responsible for taking some of the pressure of price rises but that challenges still remain in relation to UK production capacity, logistics and shipping. With construction activity expected to remain strong this year, supply chain pressures are likely to be with us for much of 2022, bringing with them further price rises and longer lead times.

The CLC has flagged up various issues with the following construction materials and products:

- **Bricks and blocks:** long-term supply issues ongoing and imported products are being relied on to meet shortfalls in UK capacity until new lines come on stream in 2023/24. With strong demand lead times will be an issue in 2022 and builders will need to work closely with manufacturers to ensure availability and to mitigate delays in delivery
- **Cement:** few issues with stocks currently but merchants are being advised not to deplete stocks in preparation of annual winter maintenance shutdowns. Manufacturers have raised concerns of rising energy costs leading to cement price inflation but have committed to produce as much supply as they physically can
- **Roof tiles:** demand remains high and average lead times are 24 weeks. However, timber battens have overtaken concrete roof tiles as the most difficult to obtain
- **Timber:** supply on many products (eg structural timber) has returned to normal levels and prices have come down from their recent highs but some products (eg tongue & groove) remain in short supply

INFLATIONARY PRESSURES	DEFLATIONARY PRESSURES
Competition for labour/skills shortages increasing rates	Although easing, ongoing supply chain issues are impacting client confidence and output growth
Strong demand and ongoing supply issues increasing construction materials costs across a wider range of products	Muted activity in some sectors (eg retail and hospitality) increasing competition to win work
Increased public sector spending/investment by Government leading to increased construction activity and competition for resources	Some clients withholding investment in certain sectors and scaling back their development ambitions in response to inflated pricing
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
High logistics/transport costs (rising container shipping and road distribution prices)	Some key commodity prices are beginning to normalise
Rising fuel prices increasing site and plant/machinery costs (eg related to the red diesel rebate)	Omicron restrictions dented confidence and limited activity, but most firms are looking past this
Strong workloads and rising new order levels stretching supply chain capacity and easing pressure to win new work	Improving productivity through adoption of digital practices and new/more productive ways of working
Volatility increasing project risk premiums	Some cost absorption by contractors looking to secure workload for 2023 and beyond
Insolvencies reducing supply chain capacity and tendering competition	
Contractors targeting higher margins	
Widespread awareness of global inflationary pressures generally	

- **MEP products:** certain electro-technical products (ie those with electronic components and those made from steel) such as cable trays and twin and earth cable remain in short supply. Product pricing has become a particular challenge for small-medium contractors working on tight, fixed price contracts

While supply pressures will continue to act on material prices for the short-term and push up average cost burdens, December's PMI survey showed the overall rate of inflation eased for a fourth month running. In fact, according to IHS Markit's 'Input Prices Index' the rate of input cost inflation was the lowest since March 2021. Furthermore, availability and delivery times for essential products and materials also improved.

Despite the softening rate of material price inflation, there's no getting away from the fact that many key construction materials have increased significantly in price over the course of 2021. Steel and timber, which have risen by around 70% in the year to October 2021, were key drivers of material

price inflation but recent higher energy prices will affect a broader range of construction materials. We've seen cement (which requires a high energy intensity of 150-175 kWh/tonne to produce) begin to increase in price since September, prompting producers to announce £15/ tonne (or 16%) price hikes which came into force at the end of 2021. The industry-wide hike means cement will break through £100/ tonne, hitting major projects and Government projects particularly hard.

In November, construction material price growth was flat for the first time since September 2020. The BEIS 'All Work' material price index showed no month-on-month rise in prices. Prices for several key materials levelled off or even fell in November compared to the previous month, with imported timber seeing the largest monthly decline (-7.6%). However, this levelling off may be short-lived with rising energy costs likely to produce a second (albeit less pronounced) wave of material price inflation in early 2022.

Steel, which fell marginally in price in November according to BEIS data, is being affected by soaring wholesale energy prices. Unable to absorb these, British Steel recently announced a second energy-related price increase of £30/tonne – a temporary surcharge of which £25/tonne is down to energy inflation and £5/tonne to HGV salary inflation and haulier prices. Acting against the impact of rising energy prices on steel production, prices for the steelmaking ingredient iron ore fell by more than 50% between July and mid-November, helping to keep steel prices relatively stable in the Autumn period. However, offsetting these lower iron ore prices has been high coking coal costs, which have now risen to an all-time high. With iron ore prices ticking up once again and sustained high energy prices, we're likely to see steel prices drift even higher.

Material price inflation is unlikely to subside significantly as new pressures come to the fore. Although widely welcome, the worldwide shift to low-carbon energy production will take many years. In this transitional period, many countries will make efforts to restrict the amount of pollutive materials they produce. For example, China has now begun to curb energy-intensive steel production as part of its overarching goal to cut carbon emissions as a country. Consequently, China's crude steel production fell sharply in November 2021 and was down by 22% (to 69.3 million tonnes) compared to the same month one year earlier. This follows a 15% decrease in its steel output in 2020 compared to what was produced in 2019. Such measures will likely result in shortfalls in global supply at a time when demand for raw materials is sky high.

The worst of the supply chain issues may have peaked but high material prices and shortages will still put pressure on costs in 2022.

Labour

Labour pressures continue to mount as skills shortages and a high number of construction vacancies push wages higher. On a seasonally adjusted basis, average weekly earnings in construction rose by 4.6% in the three-months to

November 2021 compared to the same period one year earlier. With the low base effect (ie the artificially low earnings data during peak furlough in 2020) now dropping out of the data, a clearer picture of real earnings growth in the sector is emerging.

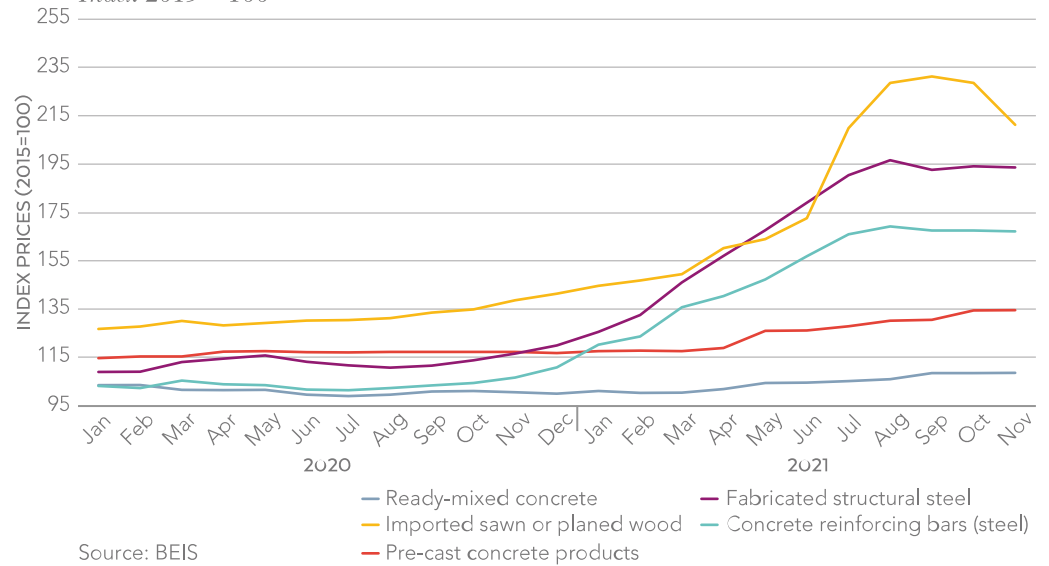
Over the past year, construction wage inflation has exceeded the broader rate of wage inflation across the 'whole economy', which was 4.2%. At 4.6%, the annual (three-month average) construction wage growth in the year to November 2021 was also significantly higher than the sector's long-term annual wage growth rate of 2.9%. Given the current dynamics in the UK construction labour market, we expect that wages will continue to outpace the long-term average rate of annual earnings growth in 2022 and beyond.

While rising construction labour costs have not been the key inflationary factor across the whole industry, rates in certain trades such as brick and blockwork increased massively in 2021. With Brexit having stemmed the flow of migrant labour supply, the current skills shortage will only intensify in the coming years, resulting in above-trend levels of labour cost inflation. However, labour shortages are not just being driven by a shortage of EU labour in the wake of Brexit. In fact, a recent study by the Construction Industry Training Board (CITB) using ONS 2020 labour force survey data found that British nationals are leaving the industry at just the same rate as foreign-born workers. The number of non-UK born workers in the UK construction industry fell from 305,000 in 2019 to 280,000 in 2020, broadly in line with employment trends throughout the industry over the same period.

Amid widespread reports of recruitment difficulties, the CITB noted construction employers are not training enough homegrown talent, nor are they coping with the new points-based immigration system. This is putting pressure on wages and is likely to lead to wage inflation spiralling even further. Recent commitments in the Autumn Budget to improve skills and recruit talent will all take time to come to fruition, but the

KEY MATERIAL PRICES

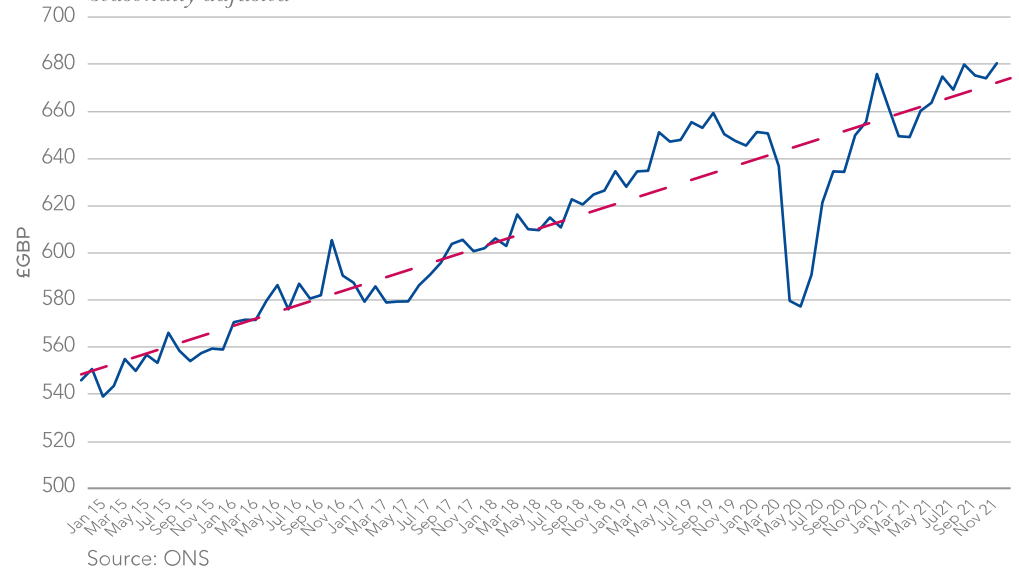
Index 2015 = 100



Source: BEIS

AVERAGE WEEKLY EARNINGS (UK CONSTRUCTION)

Seasonally adjusted



Source: ONS

demand to build is high now. The current market dynamic could result in increased competition between regions for labour, with London and the South East (which generally offer higher salaries) potentially pulling resource away from the rest of the country at a time when the Government has pledged to address regional inequality and level up the country.

Construction staffing numbers continue to rise according to the UK construction PMI Employment Index, but the rate of job creation is easing and in December the rate was the least marked for nine months. This is also reflected in the ONS data which shows that the total number of people in construction employment has increased for each successive three-month period since September 2020. However, we've seen the first significant dip in UK construction vacancies since they started to recover in Spring 2020. In the September-November period in 2021, the number of construction vacancies fell by 5% (to 43,000). While too early to tell if construction vacancies have peaked, improving client demand and positive new order growth (as outlined in December's PMI survey report) suggests that labour resource requirements will remain strong.

With a limited pool of skilled labour to draw from, the stage is set for a new labour-driven price cycle. There are concerns that the squeeze on labour will increase rates and dampen appetite for new investment or that workload will shrink to fit the reduced labour market. Neither outcomes are ideal. So far, the Government has resisted the pressure to provide more short-term visas to Europeans to ease the labour shortage, but there are doubts that such workers could even be enticed back even if such visas were available. While emergency visas may be a useful 'shot-in-the-arm', the longer-term solution will have to focus on investment in the UK domestic workforce, with the aim of drawing more young people into the industry and improving existing training and education.

A growing concern that was flagged in G&T's last Main Contractor Survey is high staff mobility, with workers moving around looking for the best pay

packages. This has caused significant disruption to projects in recent months with some smaller contractors having to turn down projects because of the current lack of available workers. Larger firms have been able to navigate the disruption caused by shortages (due to their scale and greater bargaining power), but smaller specialist sub-contractors are evidently struggling. An average of 266 construction business per month collapsed in the three months to October 2021 according to the latest [Insolvency Service](#) data – the largest number since before the pandemic.

With the anticipated steadying of material price inflation as certain inflationary drivers fall away, labour is set to take over and put significant upward pressure on input cost inflation.

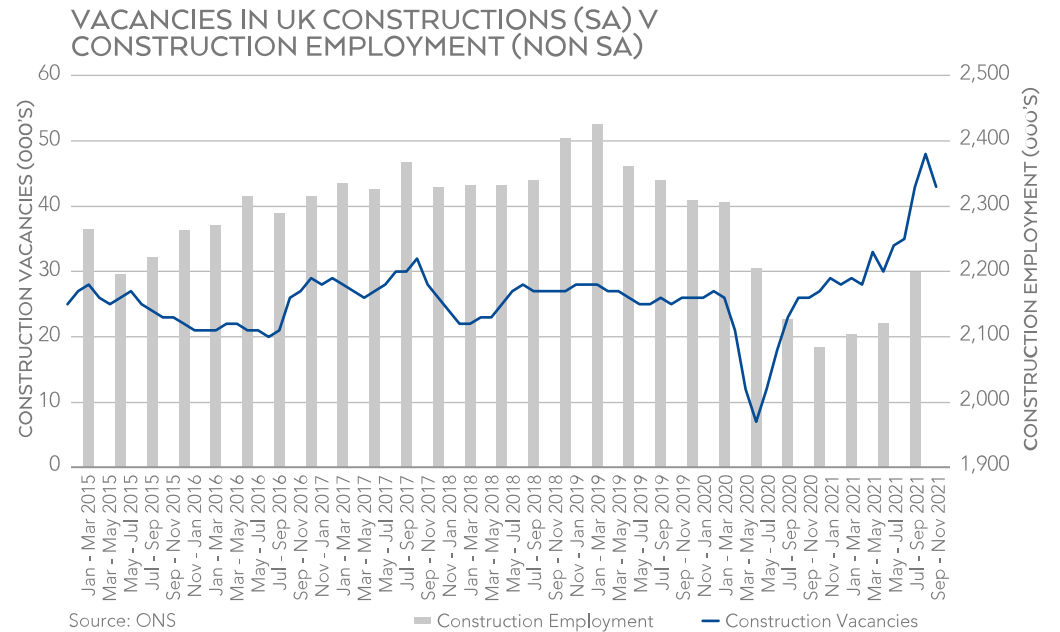
PROFITABILITY AND PROCUREMENT

OH&P and Preliminaries

Although showing an upward trend over the past year, there have been no significant swings in on-costs over the last three months. Most of our TPI survey respondents reported that both main contractor overheads and profit (OH&P) and preliminaries costs were unchanged from the previous quarter. However, slightly higher proportions of respondents thought that both OH&P and preliminaries had increased in Q4 (18% and 32% respectively compared to 14% and 27% in the previous quarter).

Rising labour rates and fuel prices, along with reduced availability of plant, are set to keep upward pressure on preliminaries costs in 2022. Rising costs for skilled management will also factor in as firms vie to retain good staff. Materials and labour shortages could constrain construction activity and productivity on site. If programmes become extended as a result, this will translate into higher preliminaries costs. Equally, any return of pandemic-related restrictions could potentially impact on project delivery and site productivity, weighing in preliminaries costs.

In terms of OH&P, with improving market conditions and demand for work getting stronger



in many sectors, contractors will be looking to bolster their margins after a turbulent couple of years. On the whole, contractor pipelines are fairly secure for 2022 and into 2023 which will help push up OH&P levels as contractors pick and choose the projects they wish to bid for. This will not be a broad-brush trend though. Certain sectors are suffering from reduced or lagging demand and will push some contractors to absorb rising input costs through lower margins. Fewer tendering opportunities will invariably lead to further pressure to win work by reducing margins.

Procurement Route

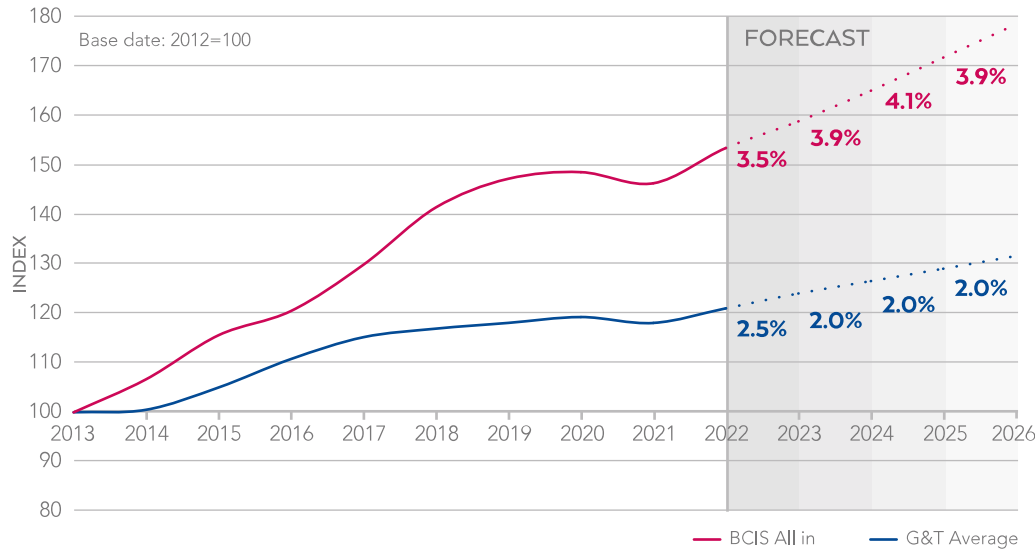
Although we continue to see all forms of procurement, two-stage tendering remains the preferred route according to nearly 50% of our survey respondents.

With so much volatility in the supply chain, it is understandable why many contractors are reluctant to tender on a single stage basis, but choice of procurement is driven by a variety of

factors including sector, project size, length of programme and design liability. Having said this, survey respondents have generally experienced good levels of contractor engagement on major projects in two-stage tendering opportunities, given the level of prevailing inflationary pressures and ongoing concerns over price fixity. A handful of respondents even noted that changing the original procurement route to two-stage achieved better engagement levels from the market.

In sectors where workloads are lower and activity is subdued, total risk transfer via single-stage tendering appears to be more prevalent and acceptable to contractors. Similarly, lower value projects are more likely to be procured on a single stage basis. Regardless of the procurement route chosen, it was emphasised that early engagement with the supply chain was proving to be hugely beneficial in helping to mitigate risks and in 2022 we expect this to be more vital than ever.

TENDER PRICE TREND 'ALL UK TPI'



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	2.25	2.00	2.00	2.00	2.00	2.00	N/A
South East	2.50	2.00	2.00	1.75	2.00	2.00	2.00	N/A
South West	2.50	2.00	2.00	1.75	2.00	2.00	2.00	N/A
East	2.50	2.00	2.00	1.75	2.00	1.75	2.00	N/A
Midlands	2.50	1.75	2.00	1.50	2.00	1.50	2.00	N/A
Wales	2.00	1.75	1.75	1.50	1.75	1.50	1.75	N/A
Yorks & Humber	2.00	1.75	2.00	1.50	1.50	1.25	1.50	N/A
North West	2.50	1.75	2.50	1.50	2.00	1.50	2.00	N/A
North East	2.00	1.50	1.75	1.50	2.00	1.50	2.00	N/A
Scotland	2.25	1.75	2.00	1.50	2.00	1.50	2.00	N/A
Northern Ireland	4.00	4.00	2.00	2.00	2.00	2.00	2.00	N/A
UK Average (weighted)	2.50	2.00	2.00	1.75	2.00	2.00	2.00	N/A

Last* 4Q21

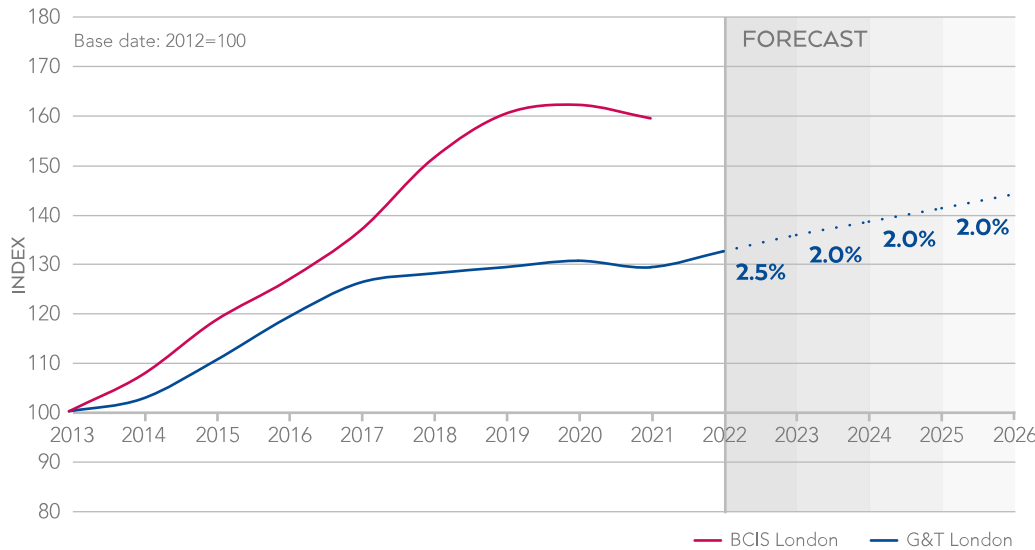
COMPARISON OF PUBLISHED FORECASTS FOR TENDER PRICE CHANGE

	G&T UK AVER.	BCIS UK AVER.	G&T LONDON	AECOM UK	ARCADIS LONDON
	Q1 2022	January 2022	Q1 2022	Q4 21	Winter 21
% CHANGE					
2022	2.50	3.49	2.50	4.40	2.00
2023	2.00	3.93	2.00	4.20	4.00
2024	2.00	4.05	2.00	N/A	5.00
2025	2.00	3.90	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.

TENDER PRICE TREND 'LONDON TPI'



Note: BCIS does not publish regional forecasts.