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TENDER PRICE **FORECAST**

for 2nd Quarter 2023 is...

2.75%

Annual UK Average

compared to 2.75% Annual UK Avg. in Q1 2023

Prospects for the UK economy have improved in recent months, albeit the possibility of a slowdown in 2023 still looms. Construction pipelines remain resilient, but the record-high levels of output and demand are unlikely to be sustained as we forecast weaker activity in 2024 with the industry moving from growth to stabilisation. More competitive tendering in the second half of 2023 and evidence of easing input cost inflation could lead to procurement opportunities.

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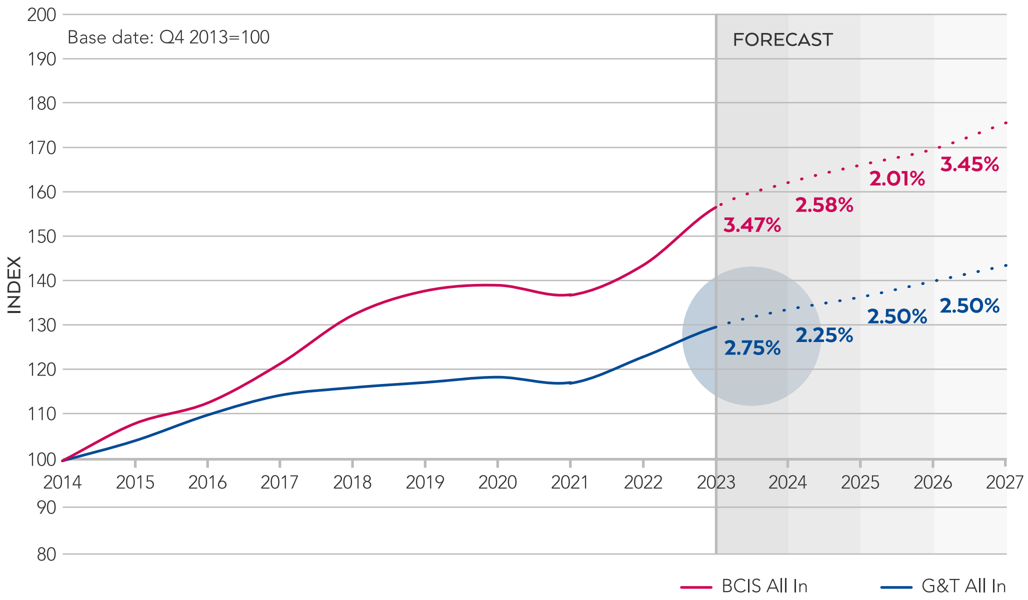
TENDER PRICE ANNUAL PERCENTAGE CHANGE Q2 2023

%	2023		2024		2025		2026	
Regional forecasts	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***
Greater London	2.75	2.75	2.00	2.25	2.50	2.50	2.50	2.50
South East	2.75	2.75	2.00	2.25	2.50	2.50	2.50	2.50
South West	3.25	3.75	3.25	3.50	3.00	3.00	2.50	2.50
East	2.75	2.75	2.50	2.50	2.50	2.50	2.50	2.50
Midlands	3.00	3.00	2.50	2.50	2.00	3.00	2.50	2.50
Wales	2.50	2.50	2.50	2.50	2.50	2.00	2.50	2.50
Yorks & Humber	2.50	3.00	2.50	2.50	2.50	2.50	2.50	2.50
North West	2.00	2.00	2.00	2.00	2.00	2.00	2.50	2.00
North East	2.50	2.50	2.00	2.00	2.50	2.50	2.00	2.00
Scotland	2.75	2.25	2.50	2.00	2.25	2.00	2.25	2.00
Northern Ireland	3.00	3.00	2.25	2.50	2.00	2.00	2.50	2.50
UK Average	**2.75**	**2.75**	**2.25**	**2.50**	**2.50**	**2.25**	**2.50**	**2.50**

Last* 1Q23

Our forward forecasts show annual tender price inflation (Jan-Dec)

TENDER PRICE TREND 'ALL UK TPI'



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.

HOW DO WE REACH OUR TENDER PRICE FORECAST?

We conduct a detailed industry survey and consider factors including...

INPUT COSTS

- ▲ 5.0% ● BCIS Labour Cost Index, Feb 2022 - Feb 2023
- ▲ 22.0% ● BCIS Plant Cost Index, Feb 2022 - Feb 2023
- ▲ 4.8% ● BCIS M&E Cost Index, Feb 2022 - Feb 2023
- ▼ -1.5% ● Fabricated Structural Steel, Jan 2022 - Jan 2023
- ▲ 9.8% ● Concrete Reinforcing Bars (Steel), Jan 2022 - Jan 2023
- ▼ -15.8% ● Imported Sawn or Planed Wood, Jan 2022 - Jan 2023
- ▲ 18.4% ● Ready Mixed Concrete, Jan 2022 - Jan 2023
- ▼ -27.0% ● Oil Prices Brent Crude, Mar 2022 - Mar 2023

KEY

Input to tender price movement of a typical project has a range of contributory impacts from:

● *High Cost Driver* ● *Medium Cost Driver* ● *Low Cost Driver*

MACRO ECONOMICS

Unless otherwise indicated, figures show percentage change over 12 months

- ▲ 0.4% UK GDP Annual Growth Rate, Q4 2021 – Q4 2022
- ▲ 10.4% CPI Feb 2023, 12-month rate
- ▲ 13.8% RPI Feb 2022, 12-month rate
- ▲ 4.25% UK Base Interest Rate, Mar 2023
- ▼ 3.7% UK Unemployment Rate, Nov 2022 - Jan 2023
- ▲ 5.7% UK Wage Growth, Average Weekly Earnings (Total Pay), Y-on-Y three-month average to Jan 2023

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Our Tender Price Inflation report looks at the movement of prices in tenders for construction contracts in the UK. The report examines a number of contributing factors and is further informed by our market survey responses and contractor consultations. This forward forecast illustrates our view of annual tender price inflation from January to December 2023 and beyond.

OUR FORECASTS

Prospects for the UK economy have improved in recent months, but the possibility of an economic slowdown in 2023 still looms. In construction, forward pipelines remain resilient, but the record-high levels of output and demand seen over the past two years are unlikely to be sustained with forecasters expecting weaker construction activity in 2023.

However, the construction market is still busy largely due to the spill over effects of a strong 2022, with some contractors continuing to struggle with tendering and capacity to bid on new orders. Sustained demand has also allowed contractors to continue to be selective but tendering conditions are showing some signs of moderating. High interest rates and elevated construction costs have curbed demand in recent months, prompting softer tendering competition in some instances.

Reflecting the general economic trend, the industry has moved from high growth to stabilisation. Project starts, contract awards and planning approvals have all largely been on a downward trend since Q3 2022. Contractors are currently being supported by a strong base level of tendering opportunities and a historic pipeline of committed work that will be built out over the next 6-12 months, but if activity continues to soften then contractors will have to consider their pricing strategies.

With the prospect of more competitive tendering in the second half of 2023 and evidence of easing input cost inflation, a buying window could be opening. Our 2023 UK average TPI forecast of **2.75%** remains unchanged from the previous quarter. However, high interest rates and borrowing costs will undoubtedly weigh on demand and new construction orders. As contractor pipeline's dry and the rate of input cost inflation continues to soften, we would expect tender pricing to ease further in H2 2023. The inflationary profile for 2023 will therefore be one of higher tender price inflation in the first half of the year and lower inflation in the second half. We expect lower levels of inflation will continue into 2024, as our UK TPI forecast drops to **2.25%** - below our long-term annual average.

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

The UK economy has fared better than many forecast but the outlook is still weak. Growth is expected to be flat in Q1 once figures are released narrowly avoiding technical recession in 2023, according to the Office of Budget Responsibility (**OBR**). However, a small contraction of **0.2%** for the year is expected.

The OBR is projecting that (**CPI**) inflation will fall to **2.9%** by the end of 2023 as the energy price spikes drop out of the annual comparison. However, this forecast relies on several assumptions and there are significant risks that inflation may not fall so quickly. UK wage growth is still historically strong which could mean higher service sector inflation and labour costs. From a global perspective, a further escalation in the war in Ukraine and manipulation by OPEC could also see energy prices jump again. The lifting of COVID restrictions in China could increase demand for gas and commodities, pushing prices up and slowing the pace at which inflation drops. These factors could result in potentially "stickier" headline inflation.

Conversely, a change in the weightings on the CPI index to include a greater proportion of gas and electricity (from **3.6%** to **4.8%**) is expected to accelerate the decline in inflation. Any falls in energy prices will have a strong drag effect on overall rates for the rest of the year.

The UK Central Bank's interest rate hiking cycle is likely to slow and come to an end. However, February's unexpected rise in CPI casts some doubt that the regulator's job is done. Further interest rate hikes may be needed to reduce inflationary pressures, with BoE governor indicating a willingness to do this – even amid the recent turmoil in the banking sector. Falling inflation isn't inevitable and higher borrowing costs will be with us for longer. This uncertainty will doubtless bring a degree of volatility in the markets until clearer and more consistent trends are seen.

Although the economy is sending some mixed signals, it has been surprising how strong to upside growth the UK has been. Strong balance sheets post the financial crisis have helped make businesses and consumers more resilient to interest rate hikes. A soft landing scenario in which borrowing and spending slow just enough to tame inflation without tipping the economy into a recession appears likely to most commentators. But the inflation battle is still far from being won with continued volatility leaving a question mark around the outlook for the UK growth.

CONSTRUCTION OUTPUT AND NEW ORDERS

While contracting **1.7%** in January – one of its worst months over the past two years – construction output remains **4.4%** above the five-year monthly average and **2%** higher than before the pandemic in February 2020.

January's drop was driven by economic uncertainty (which led to delays and cancellations of projects) as well as exceptionally bad weather. Output in all new work sectors contracted in January with the exception of the private industrial sector. Conversely, repair and maintenance work sectors all grew, partly offsetting the weaker performance of new work growth.

Uncertainty over future growth prospects and higher interest rates also had an impact on client demand, and consequently new work growth in the final quarter of 2022. New orders fell **4.3%** in Q4 but, like output, remained above the five-year quarterly average. However, the outlook has improved somewhat since.

The construction purchasing manager's index (**PMI**) returned to growth after two months of contracting construction activity. Activity beat expectations to register the highest growth rate in nine months, pushed higher by growing order books and a modest improvement in employment numbers. With the majority of businesses now reporting an expansion in activity, the index paints a brighter picture than it did just a few short months ago. 'Robust' continues to be the word attributed to the industry after successfully dealing with numerous headwinds over the past few years, but the industry is not immune to the effects of wider economic pressures. Construction output is forecast to slow this year (by as much as **4.7%** according to the CPA), but the extent of any slowdown will largely depend on client confidence in demand as well as input cost inflation.

G&T TPI SURVEY FEEDBACK

Workload

The market remains busy and buoyant, with opportunities in most sectors according to those surveyed in our latest TPI survey. Sentiment is largely positive in contrast to the gloomier outlook of past months, with new projects still landing and progressing through RIBA development phases.

Current commercial project commitments are stable with long-term programmes continuing into procurement over 2024 and 2025. RFPs for new projects that commence in the coming months continue to be received in addition to projects that fell into a holding pattern now being considered again.

Despite material and labour costs being at or near all-time highs, there is a continuing interest from clients on new projects to get into contract. At the same time, clients are acutely aware of the current market pressures and if prices continue to rise, appraisals may not be attractive to continue to procurement.

However, there were some more negative perceptions about future workload prospects among survey respondents. A cooling in new starts in residential and housing sector compared to recent years was expected, with large projects finishing new ones are not replacing them. Reasons quoted ranging from town planning delays and negative appraisals to difficulty obtaining funding. A proportion of speculative and live projects may still be cancelled, reducing the number of opportunities towards the end of 2023.

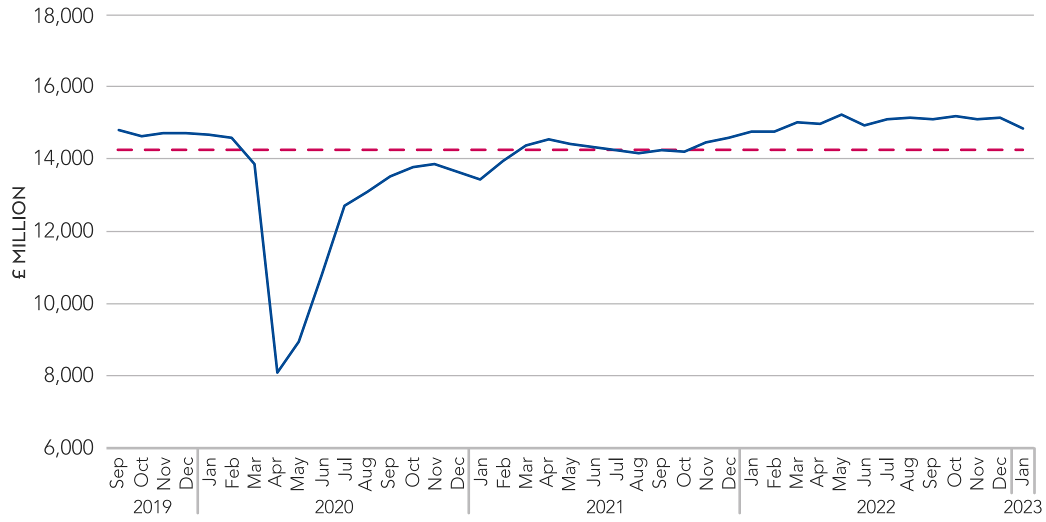
MARKET CONDITIONS

The perception of market conditions saw little movement in our latest survey. If anything, market activity has stepped up a gear, with a greater proportion noting higher activity and more passive tendering rather than falling activity and more competitive bidding.

The expected drop-off in market activity seems to be pushing out as enquiries and 2023 contractor pipelines look stable. Many are now more concerned about a downturn in 2024.

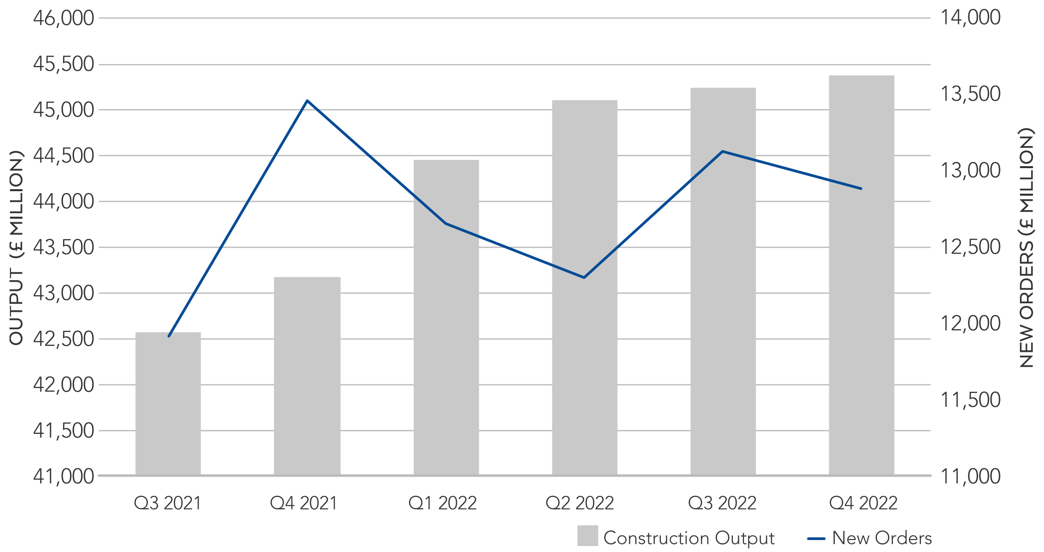
CONSTRUCTION OUTPUT: ALL WORK

Seasonally adjusted



Source: *ONS*

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



Source: *ONS*

With the risk that new project opportunities may start to slow towards the end of this year and into 2024, contractors appear keener to tender on more projects due to concerns over longer-term order books. Despite a more competitive attitude towards securing projects, contractors continue to be selective with what they are tendering at present given the strong levels of pre-contract activity in the market.

We anticipate seeing more competitive bidding in the not-too-distant future as new orders and project starts slow down. Early works trades (eg groundworks and demolition) are actively seeking opportunities to tender and have higher levels of available capacity. Later trades such as façades and drylining however, are still declining tenders due to a lack of supply availability and it is likely to take more time for inflationary pressures on these trades to ease.

The recent rise in industry insolvencies is likely to have a growing impact taking supply capacity out of the market. A growing number of contractors have been caught out by rising construction costs and inflexible contracts, especially where prices were fixed before 2022. Consequently, the supply chain is unwilling to accept the risk levels they many have done in the past.

The cost of borrowing and debt financed project funding has increased significantly with clients moving slower, holding back investment plans due to the uncertainty and pressures on appraisals. The supply chain continues to wrestle with variables causing price increases, but after a period of strong activity and excessive inflation, there are clear indications of cooling demand and softening input cost inflation.

INPUT COSTS

Key inflationary and deflationary pressures

Input cost inflation, which shot up coming out of COVID lockdowns fuelled by the war in Ukraine wreaking havoc on supply chains, is evidently slowing. However, navigating lingering inflation in a way that protects construction businesses and project viability remains a priority in 2023.

The latest BCIS input cost metrics show inputs of materials and plant were the biggest drivers of inflation in 2022, but sharply falling plant costs and a gradual easing in material prices in the latter half of the year alleviated construction cost pressure. Consequently, in H2 2022, the BCIS General Building Cost Index contracted by **2.3%** in Q3 and was almost flat in Q4, suggesting the period of high inflation has passed into a more standard or longer-term average rate.

Although labour was the least inflated input cost variable in 2022 (at **4.8%**), the BCIS and our forecasts expect labour will be the main cost driver in 2023, with earnings expected to grow by more than **6.5%** due to ongoing pressures.

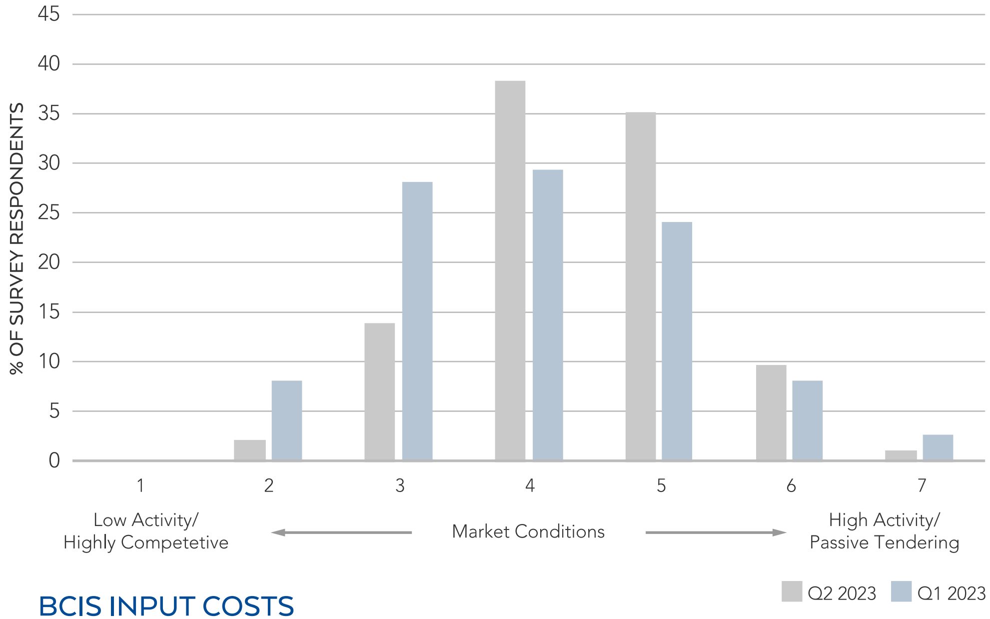
As deflationary pressures mount, a lower rate of inflation is expected in 2023. Improvements in the availability of materials and the balance between supply and demand has helped calm price volatility for construction products, but price hikes later in the year remain an upside risk to inflation.

Material Costs

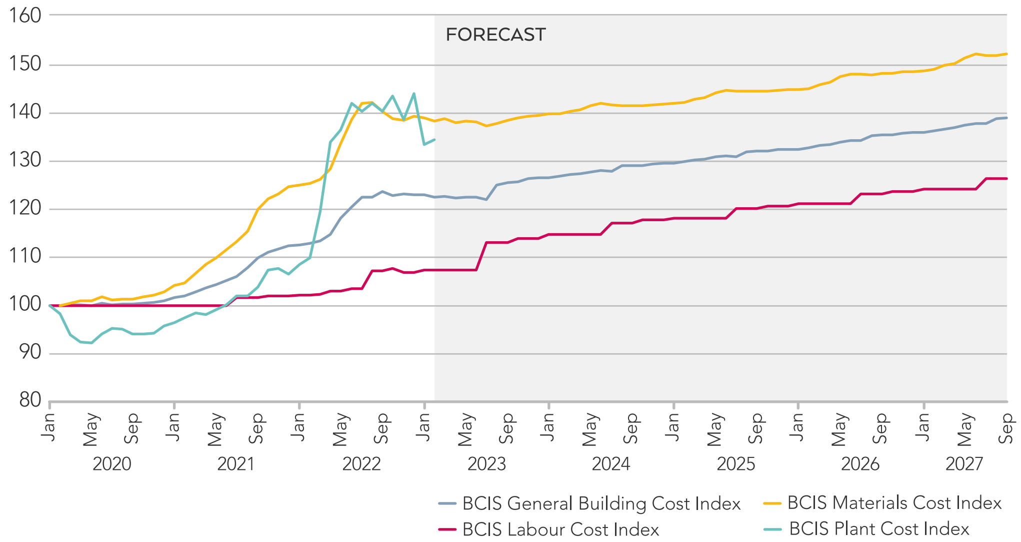
Drops in wholesale energy and commodity prices are expected to feed into lower material prices in 2023. Concerns remain for certain materials, concrete in particular (with energy costs and demand for low carbon varieties), drylining and imported MEP fitting seeing pressure on prices.

PERCEPTION OF MARKET CONDITIONS OVER THE NEXT SIX MONTHS

London



BCIS INPUT COSTS



Source: BCIS

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Softer construction activity and a more subdued economic growth outlook has allowed material supply to catch up with demand. Manufacturers have taken advantage of this slowdown to rebuild stock inventory, but shortages continue to pose an operational challenge for wholesalers of certain MEP products such as solar panels, heat pumps and transformers. Cladding, concrete, plasterboard and insulation materials are also experiencing some supply issues but lead times have improved significantly for most products.

The BEIS All-Work Index indicates that normalising supply and demand are alleviating cost pressures. The index is down **4.1%** from its peak in July 2022 and, other than an uptick in October, has been on a downward trend.

Even though certain product categories continue to see prices rise, the index has been driven lower overall by a handful of key materials such as imported timber, structural steel, and rebar – some of the most heavily inflated materials over the past 18-24 months.

On the demand-side, economic uncertainty and rising borrowing costs coincided with a slowdown in the new-build sector (in contrast to the buoyancy of refurbishment and energy-efficiency retrofit work). This saw demand for heavy materials such as steel, bricks and timber fall – easing prevailing supply-demand imbalances and price pressure.

Outlook for commodities in 2023 is one of opposing forces: supporting higher prices is Russian supply curtailment, the reopening of China and a prolonged period of underinvestment in production capacity. However, supporting lower prices is the global economic slowdown and the impact of higher borrowing costs weighing on business/consumer sentiment and demand.

For now, at least, an improved supply-demand balance has helped material price inflation to soften, but further price hikes are possible. According to the CLC, some suppliers have simply deferred price increases as demand has slowed, while manufacturers of energy-intensive projects may still need to pass on higher costs having hedged their requirements in 2022 (when wholesale prices were higher). Energy bought at higher rates can often take months to feed through to product prices.

Labour

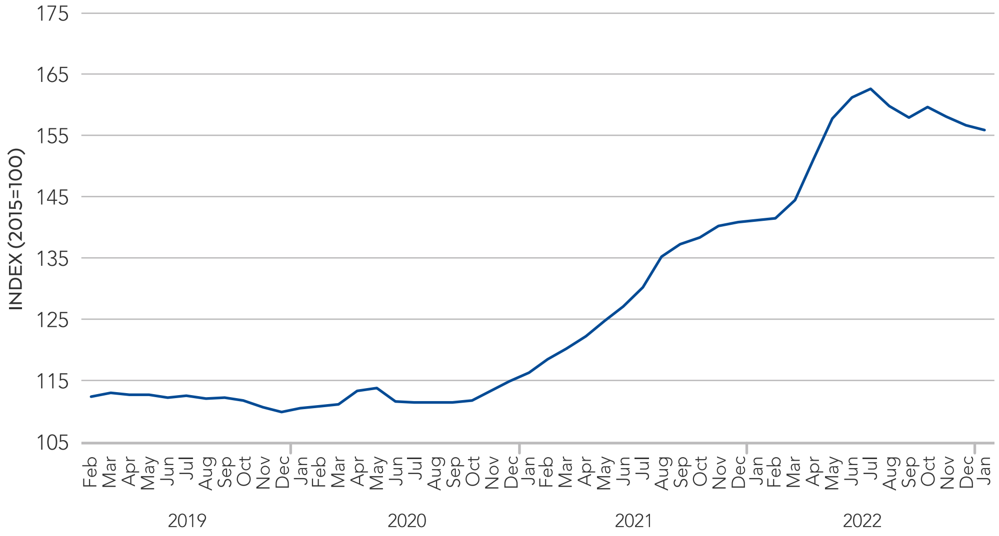
Availability of both supervisory and project labour resource continues to be an issue pushing rates and salary expectations higher, but also affecting outputs as the quality of resource available may not be achieving expected productivity levels.

Construction average weekly earnings saw a minor fall in January 2023 compared to the previous month, but monthly changes can be volatile. The better series to consider is the year-on-year, three-month average change, and in January this was **4.6%** – well above the long-term average annual change of **3%**.

Many of the structural issues supporting higher labour rates (ie skills shortages) are not expected to change anytime soon, but Government plans to add certain construction workers (such as bricklayers, plasterers, roofers) to a "shortage occupation list" to tackle chronic post-Brexit labour shortages may alleviate some pressure. Labour availability may also improve if workload demand falls, easing competition to secure resource and potentially reducing upward pressure on labour rates.

The rate of job creation is much weaker than seen on average last year, reflecting a dip in new orders and expectations of a slowdown in activity. This is reflected in the declining

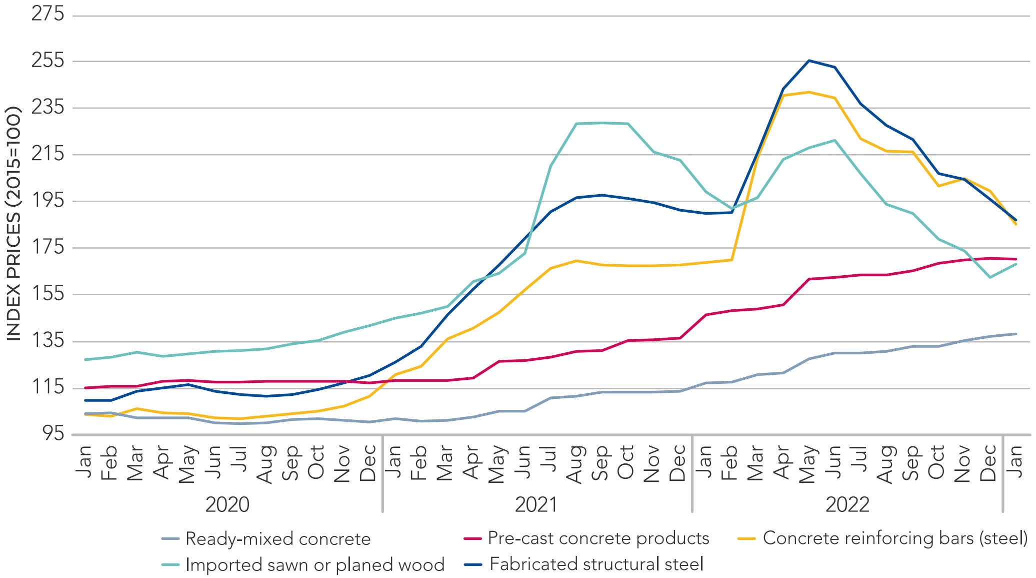
BEIS: 'ALL WORK' CONSTRUCTION MATERIAL PRICES INDEX, UK



Source: BEIS

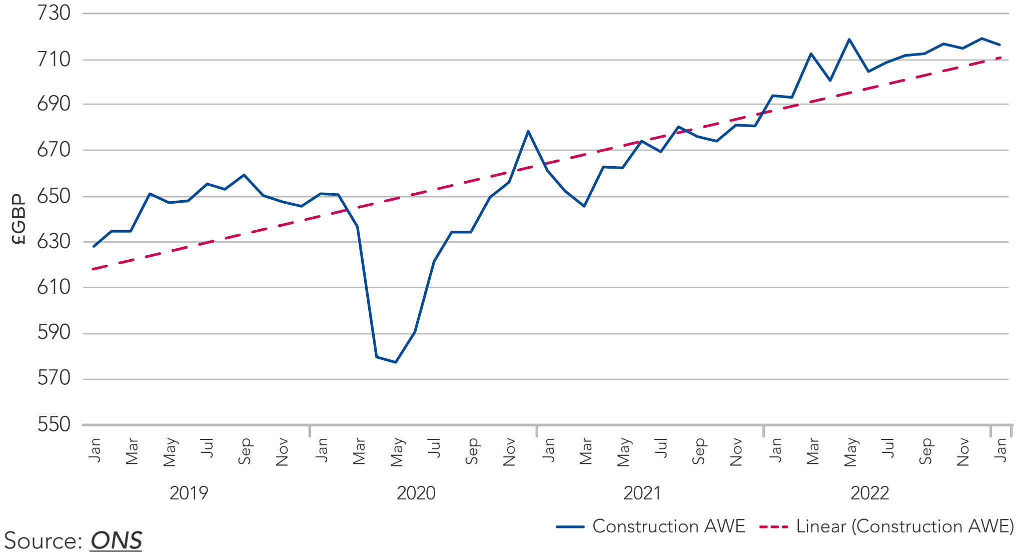
BEIS: PRICE INDICES OF CONSTRUCTION MATERIALS (UK)

Index 2015 = 100



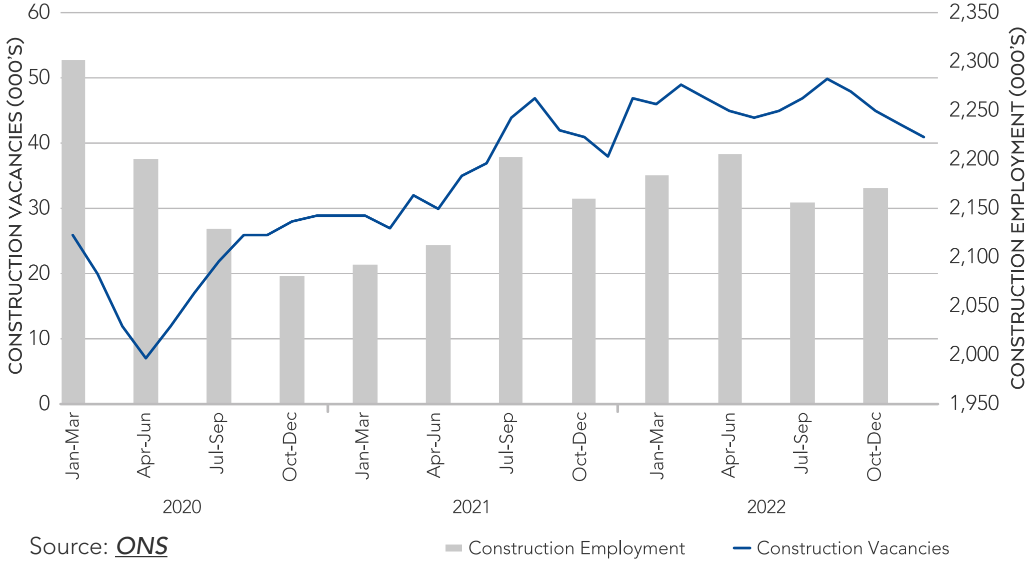
Source: BEIS

AVERAGE WEEKLY EARNINGS: UK CONSTRUCTION V WHOLE ECONOMY *Seasonally adjusted*



Source: *ONS*

VACANCIES IN UK CONSTRUCTIONS (SA) V CONSTRUCTION EMPLOYMENT (NON SA)



Source: *ONS*

construction vacancy rate produced by the ONS following a downward trend since the Aug-Oct 2022 period.

Despite falling vacancies and a weaker rate of job creation, labour shortages are prevalent with the market is best described as 'tight'. Labour costs in trades where there is a lack of capacity due to full short-term order books are also problematic with finishing trades in particular (eg glazing, drylining, joinery, MEP) are experiencing challenges given strong workloads and an undersupply of labour.

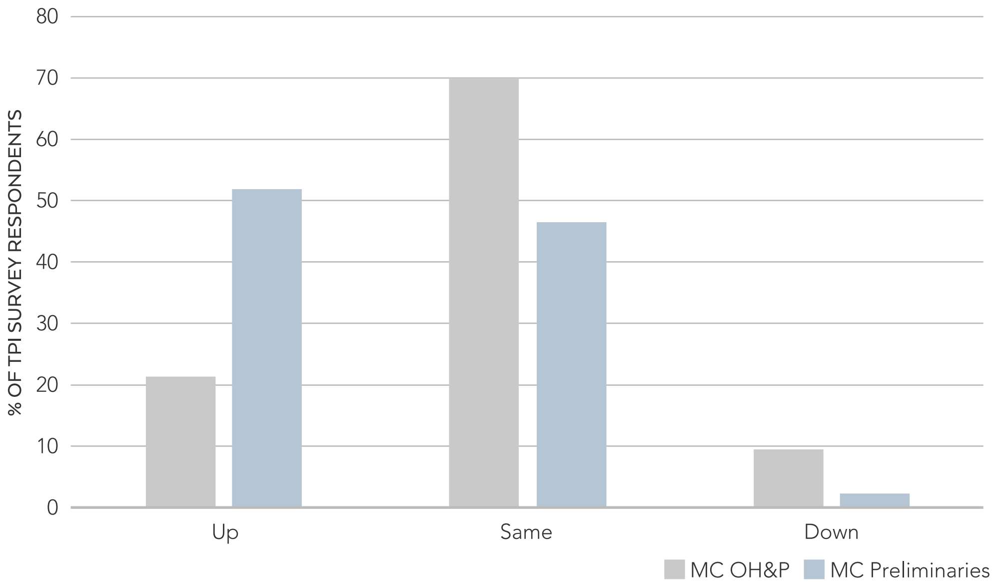
Forecasters such as the OBR are expecting overall unemployment to rise moderately from current levels (**3.7%** to a peak of **4.4%** in 2024) as output growth/GDP slows, but this is unlikely to improve construction's labour shortage issues. Wages are unlikely to be deflationary given pressures on cost of living and will to be the key inflationary cost driver in 2023.

On-costs:

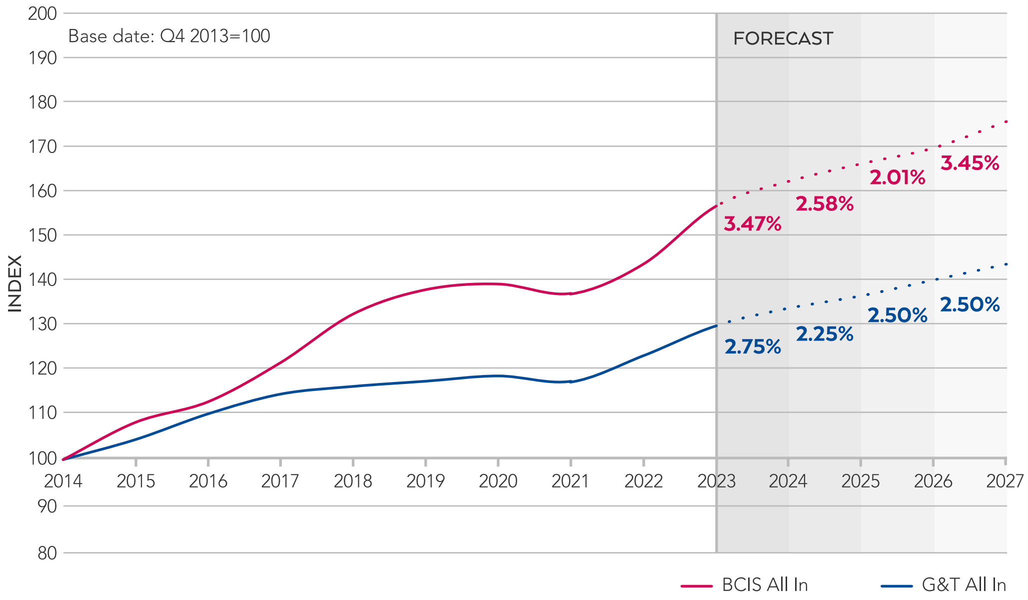
Main Contractor Preliminaries continue to increase in line with labour/wage price increases. High energy and utilities together with insurance premium costs have also put upward pressure on preliminaries over the past one to two years.

Following our TPI survey we anticipate Main Contractor Overhead and Profit (**OH&P**) levels will remain the same over the course of the year, with downward pressure on margins if there is a significant drop-off in demand and workloads. If market activity does cool significantly in the coming months, contractors may reduce their controllable costs to win work and secure longer-term pipeline. Margins are dependent on the procurement route and project type (including its size and complexity) and client however, strong workloads continue to support OH&P at current levels.

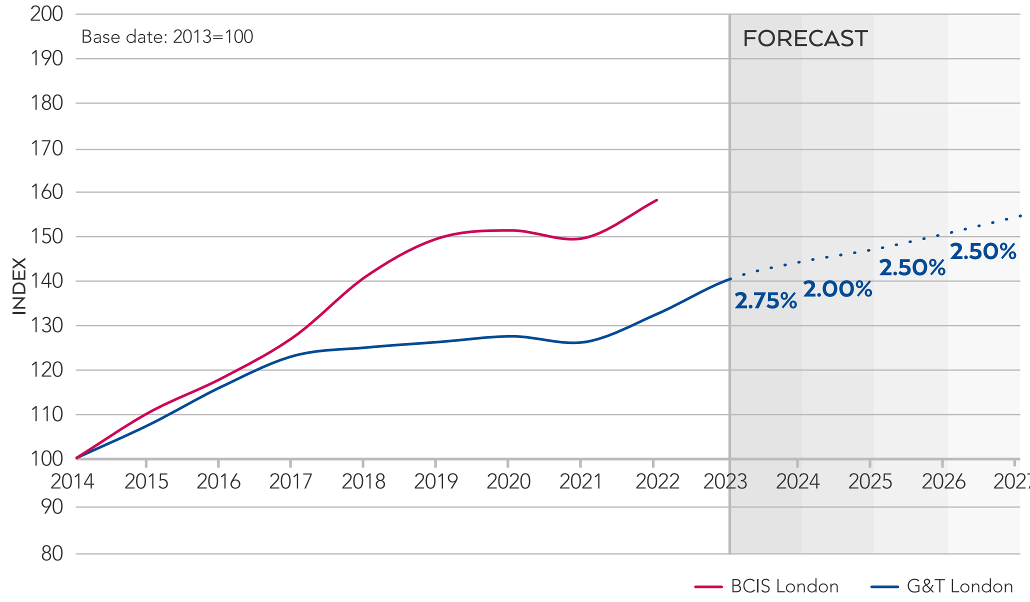
INFLATIONARY PREDICTION FOR MAIN CONTRACTOR OH&P AND PRELIMINARIES OVER THE NEXT 12 MONTHS



TENDER PRICE TREND 'ALL UK TPI'



TENDER PRICE TREND 'LONDON TPI'



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Yorks & Humber	2.50	3.00	2.50	2.50	2.50	2.50	2.50	2.50
North West	2.00	2.00	2.00	2.00	2.00	2.00	2.50	2.00
North East	2.50	2.50	2.00	2.00	2.50	2.50	2.00	2.00
Scotland	2.75	2.25	2.50	2.00	2.25	2.00	2.25	2.00
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UK Average (weighted)	**2.75**	**2.75**	**2.25**	**2.50**	**2.50**	**2.25**	**2.50**	**2.50**

Last*	1Q23

COMPARISON OF PUBLISHED FORECASTS FOR TENDER PRICE CHANGE

G&T UK AVER.	**BCIS** UK AVER.	**G&T** LONDON	**AECOM** UK	**ARCADIS** LONDON	
Q2 2023	Mar 2023	Q2 2023	Q1 2023	Spring 2022	
		% CHANGE			
2.75	3.47	2.75	5.00	3.00	**2023**
2.25	2.58	2.25	3.50	3.00	**2024**
2.50	2.01	2.50	N/A	3.00	**2025**
2.50	3.45	2.50	N/A	5.00	**2026**
N/A	N/A	N/A	N/A	5.00	**2027**

Note: Arcadis' TPI figures are for its 'London Building Construction TPI' series

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.