



REPORT

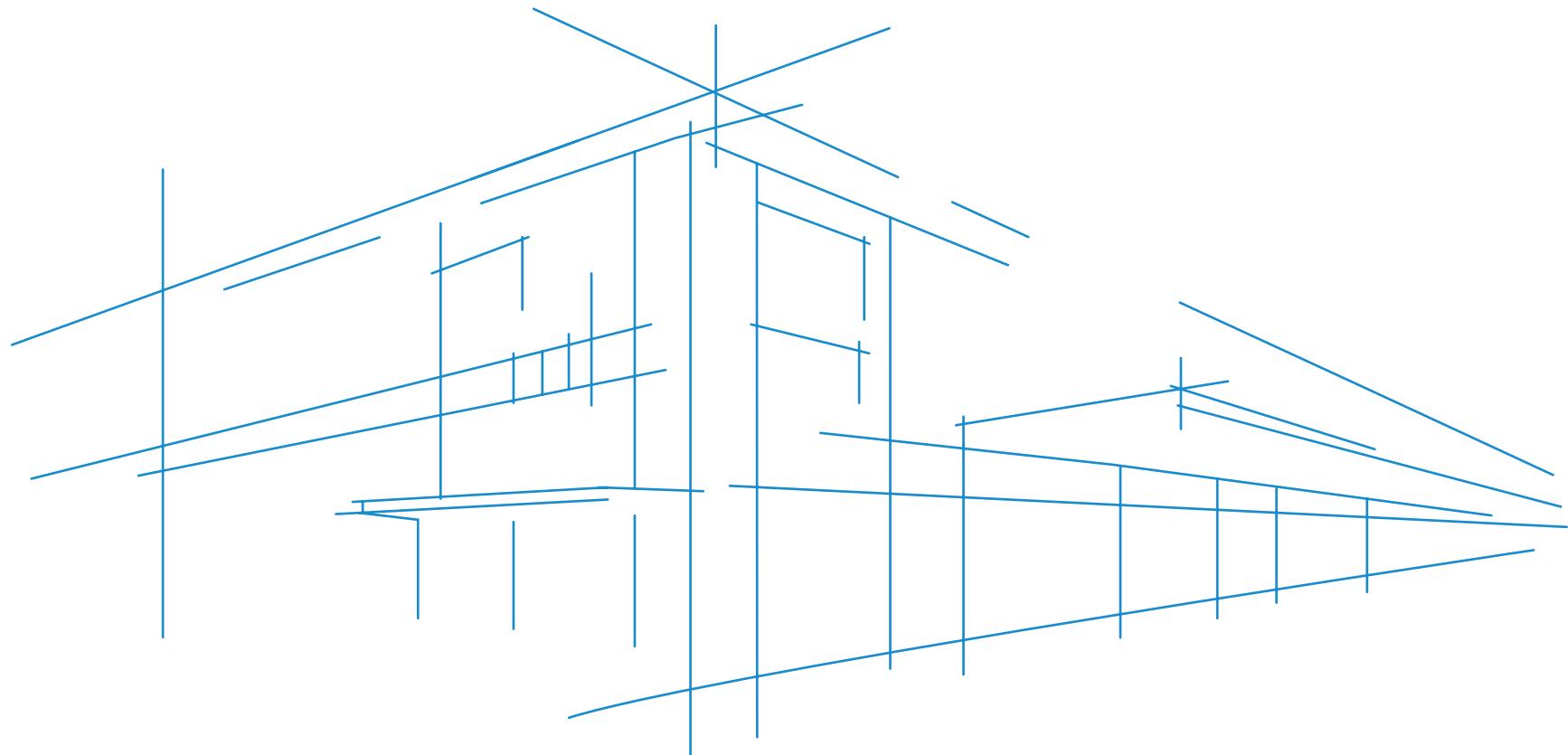
STATE OF THE MARKET REPORT - GLOBAL

SEPTEMBER 2022

RLB Rider Levett Bucknall

CONTENTS

Global Response Overview	1
Introduction	2
Effects of Current Geopolitical Crises	3
Severity of Supply Chain Disruption	4
Introduction / Re-introduction of Alternative Procurement Forms	6
Challenges and Solutions	7
Summary	8



MARKET VOLATILITY, CHALLENGES AND SOLUTIONS

GLOBAL RESPONSE OVERVIEW

RLB recently carried-out a global survey in which our Directors and Partners provided their views of the effects of the current geopolitical crises. Local and Regional analyses will be published at a local level, as will particular Regions' results, but this report looks at the overall global findings and responses.

The reader's attention is drawn to the fact that the global analysis can, and does in some places, produce conflicting results in the context of comparison with Regional views. This is inevitable, as the impacts experienced around the globe are variable depending on commercial and political relationships and geography.



INTRODUCTION

There can be no doubt that the construction industry has moved from trying to create certainty in the long term, to navigating uncertainty in the short term and within the larger economic climate. The global construction market is experiencing volatility of commodities and labour pricing caused by a combination of:

- Ukraine/Russia conflict
- Post-Covid recovery
- New Covid waves
- Rising cost of energy and fuel

We know there are project challenges around volatility of prices, lead in times of materials and shortages of labour - and at times project feasibility is being questioned. However, projects need to continue as the demand and need for buildings continues, be it affordable accommodation, a new school or new office space. At RLB, we listen to the wide range of voices in the supply chain, from suppliers, sub-contractors and contractors talking about price increases, profit margin squeezes and challenges within the labour market, as well as clients needing certainty in outcomes and reducing risk on projects.

To ensure we remain close to our supply chain and bring the best counsel to our clients, we recently launched a global survey to find out the exact impact of geo-political issues such as the war in Ukraine, the ensuing energy price volatility, and other global challenges.

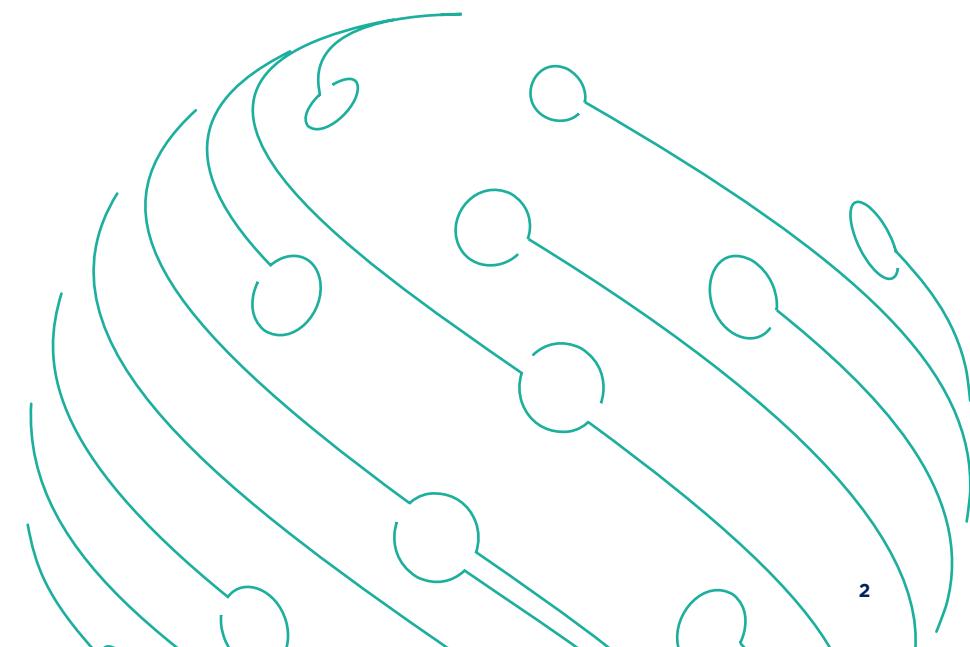
It is no surprise our first responses have come back with comments such as: "procurement strategies are being reviewed and project viabilities are possibly at risk", "we are now facing a new world order as a new normal" and "contractors are requesting contractual mechanisms to allow for price adjustment such is the price-volatility of materials." Key findings are summarised throughout this report.

MARKET SURVEY

The global survey sought RLB Partners' and Directors' views around the world on matters arising from and related to the economic shocks alluded-to previously. The intent was to compile respondents' views on a range of questions, using three "project phases" as focal points:

- Project inception/feasibility
- Project bid/tender stage
- Project on-site stage

By adopting these three anchor points, responses were funnelled into categories which were reasonably clearly defined, yet collectively captured opinions as to effects throughout the development process. The analysis below captures respondents' views globally on some of the key questions as applicable to particular phases of the development process.

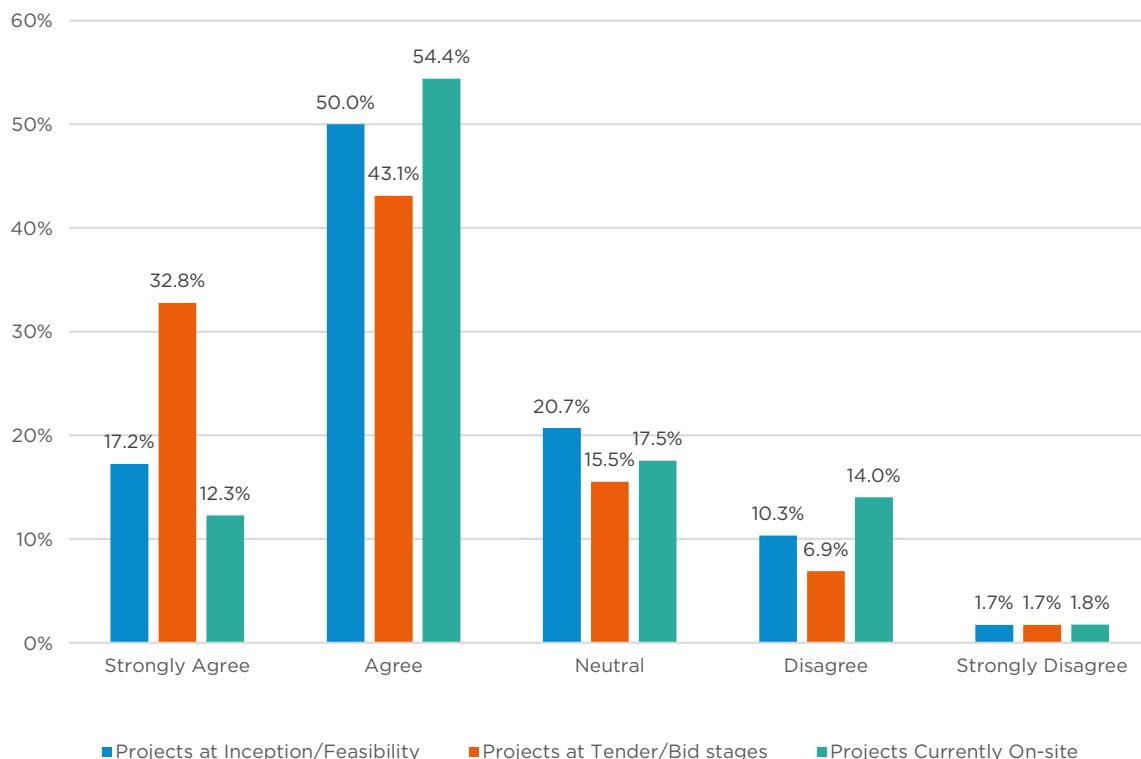


EFFECTS OF CURRENT GEOPOLITICAL CRISES

RLB Partners were asked whether current geopolitical difficulties are affecting projects and if so, to what extent. Responses strongly supported the view that projects are being adversely affected, but the weighting of the effect is variable as between projects at the identified three stages of the development process.

Overall, over 67% of respondents hold the view that projects at inception/feasibility stages are being directly affected by the current geopolitical crises.

That viewpoint is even more strongly felt in respect of tender/bid stage projects, with almost 76% either agreeing or strongly agreeing that it is the case.



Several respondents were of the opinion that the impacts resulting from the current geopolitical tensions exist in three dimensions. First of all, soaring energy prices will push up construction cost as the industry's activities are highly energy intensive. Second, it is another blow to the supply chain while the recovery from the pandemic is in sight, in turn raising the prices of commodities. Lastly, unfavourable investment sentiment due to market uncertainty could slow the economy. These three-dimension impacts may affect all sectors, and have been evidenced in the UK in some clients having decided to sell sites rather than develop out themselves, due to concerns as to market inflation and perceived increases in development risk.

At the sharp-end of advising clients, increased prices are generally impacting viability, with it becoming harder to make projects stack-up. Creative approaches to cost and value are required to tip formerly viable projects into the “currently viable” space.

Risk to tenderers due to rising prices is a key concern, and we are seeing tender lists decline due to withdrawal through increased perception of risk. Contractors are reluctant and even unwilling to increase order book values, due to labour shortages and potential cost increases affecting fixed price bids.

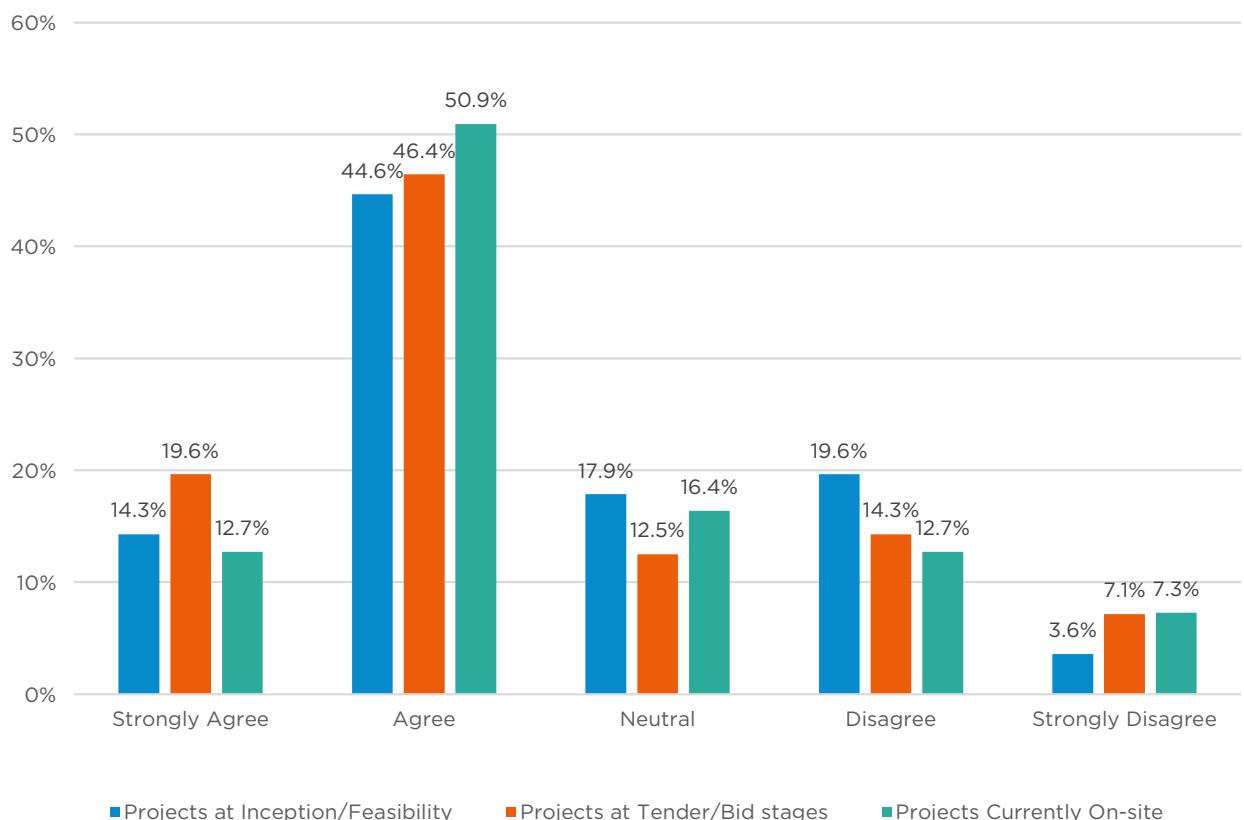
For projects on-site, overall opinion is again a high level of agreement, but with a slightly less strongly held view.

“We are now seeing a wide spread of tender ranges, limited validity i.e. 30 days versus 60 and contractors attempting to include rise and fall clauses and/or pre-payment clauses.”

Sydney, Australia

SEVERITY OF SUPPLY CHAIN DISRUPTION

Supply chain disruption is clearly evident throughout the development process. Although direct impacts would be expected to be felt mostly at the build-phase, around 60% of respondents' views were that such impacts were having an effect on early stages and at bid/tender stage, with procurement solutions being amended to suit. Whatever the stage, a majority of respondents agreed that supply chain disruption is real and is impacting upon all stages of the development process.



"Supply chain has been disrupted in recent months when there was a surge of Covid-19 cases in various parts of China, as materials are mostly imported from there. Although there has also been logistics issues for materials imported from Europe, the disruption has so far not been significantly worsened by the Ukraine situation."

Hong Kong, China

"With new lockdown measures introduced in China, Covid-19 is still having negative consequences on the supply chain."

New York, USA

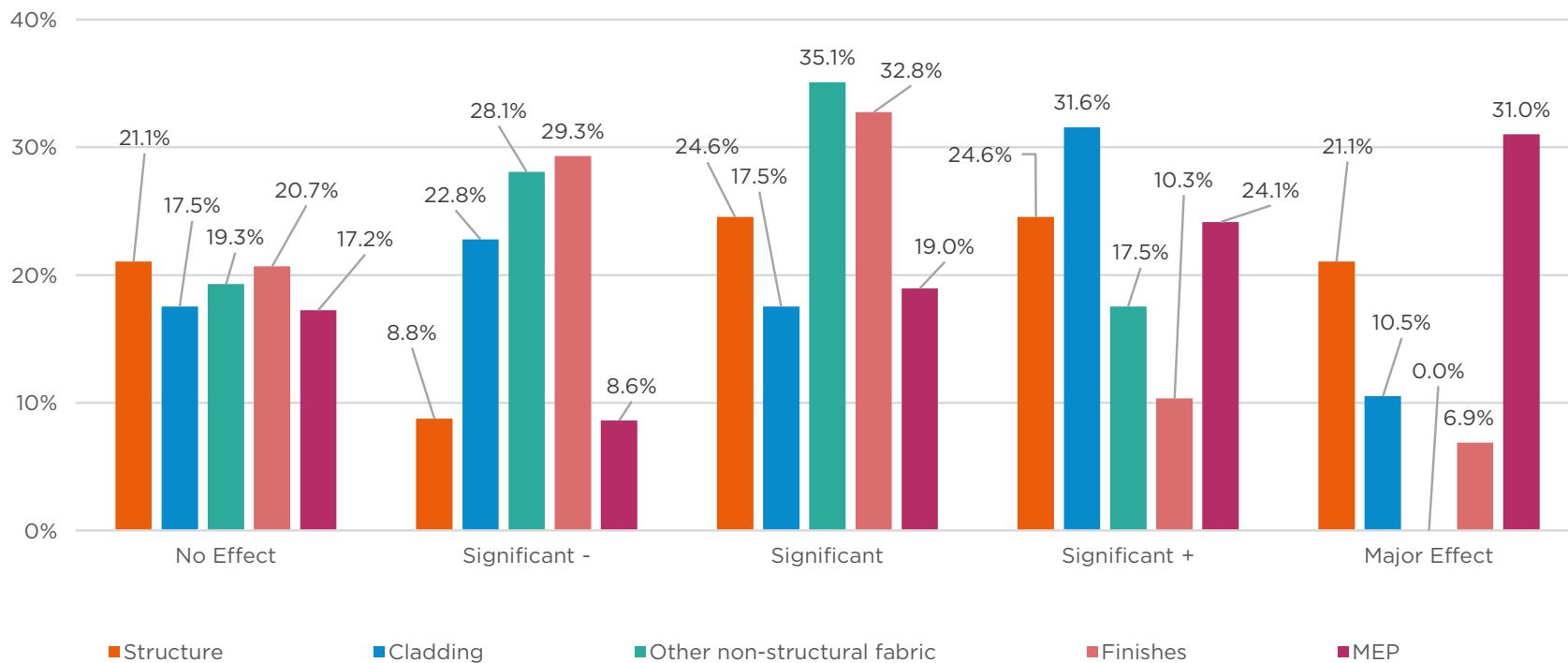
"Problems are arising due to shortages of materials and labour, together with prices having risen above levels anticipated at tender stage."

Warsaw, Poland

SEVERITY OF SUPPLY CHAIN DISRUPTION

Whilst much has been published about materials and commodity price movements over the last few months, and in fact these are subject to tracking by RLB R&D, what is more relevant to our advice to clients is the effect as seen on tenders for work packages. Seeking to capture this, the questionnaire asked about impacts on trades groups, to try to represent a wide range of coverage of building work in a simple and understandable format.

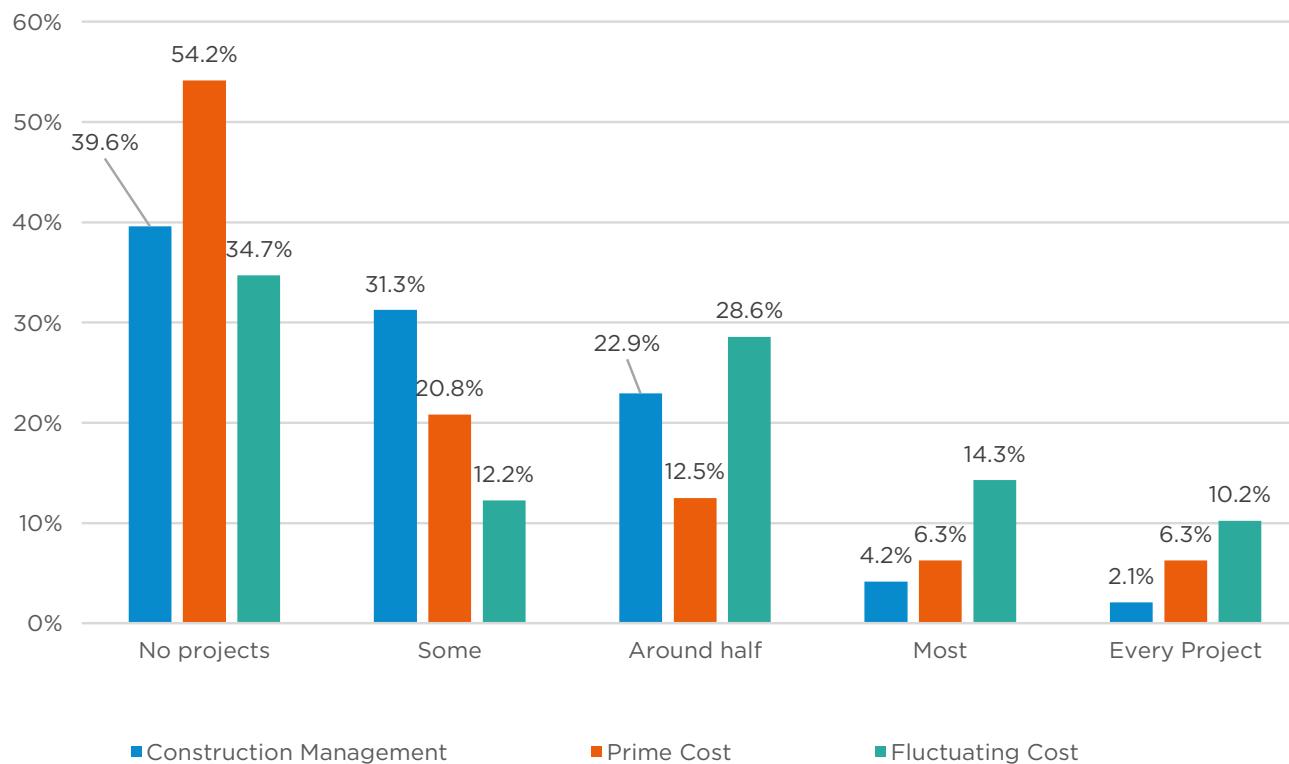
As represented in the chart below, grouping trades together permits us to examine in broad terms where the bottlenecks and price spikes are considered to most likely occur. In broad terms, around 80% of respondents took the view that there are disruptive supply chain effects, although the extent is locally felt and extremely variable around the world, with no clear and identifiable consistency. Although all five of the groupings selected in the chart below show effects, clearly structure, cladding and MEP are the most collectively adversely affected. The logic of this could be due to the proportion of imported materials in these groups of project work. Non-structural fabric and finishing trades appear to be considered to be less of a problem, although there remain some significant impacts which may be due to availability or lead-times for key labour and materials inputs.



INTRODUCTION/RE-INTRODUCTION OF ALTERNATIVE PROCUREMENT FORMS

A reasonable response to the foregoing could be the promotion of non-traditional alternative forms of procuring projects.

Respondents, in respect of a question asking about alternative approaches, identified some interest being shown in such approaches, but the key point here is the strength of view that no projects are so affected.



This suggests that despite markets' volatility, funders and clients' requirements for lump-sum fixed price agreements remain a strong feature of the overall market. However, there is clearly also significant interest in what would, in more stable times, be considered to be less attractive options providing less cost-certainty for clients and demanding significantly different risk-sharing optionality.

“Projects generally are still “fixed price” however a portion of tender prices, mostly in relation to material supply, will be tagged to cost fluctuation.”

Auckland, New Zealand

“Off site manufacture is being promoted, but for environmental and quality reasons rather than geopolitical or resources shortage reasons.”

Southern China

Readers should note that this chart displays the proportion of respondents whose view is that a particular procurement route has been considered, though not necessarily implemented.

While there may be some reluctance in some localities to stray from the fixed price model, a part of that reluctance may be due to differences in the granularity of cost data and price documentation available, which gives rise to differences in levels of transparency of control of costs.

MARKET VOLATILITY, CHALLENGES AND SOLUTIONS



CHALLENGES AND SOLUTIONS

Being open to different solutions to help us meet our design, procurement and build requirements will also be key during these uncertain times. The table below examines some of the challenges, solutions and outcomes that RLB can offer.

	CHALLENGES	SOLUTIONS	OUTCOMES
Inception	Stalled business cases	Project risk analysis, including effect of cost risk/inflation Defining project value beyond time, capital cost and quality	Value optimisation. Wider project risk analysis that impact business case including LCC, Environmental, Carbon and Social Value
	Programme delay	Pre-construction programme review	Re-planned project programme – shifting and actively managing critical path items
	Market volatility giving rise to unacceptable corporate risk exposure	Project assurance review	Demonstrable risk management and assured project processes Peer reviews of outcomes
Design	Designed solutions may no longer be market facing in terms of heated trades and market capacity/risk appetite	Outcome optimisation (design optimisation/value management)	More appealing risk/volatility profile when bought out in procurement. Peer reviews VM workshops
	Material and labour availability	DFMA & MMC strategy	De-risked construction widens market appeal
	Cost planning forecasts	Elemental forecasting with quantified risk analysis of possible outcomes (3-point estimating)	Project specific inflation forecast, not generic, all in Tender Price Forecasting
Procurement	Market appeal of procurement route	Market facing strategy (procurement trends report)	Wider market appeal
	Supply chain dichotomy and planning approval delays resulting in programme slippages/elongation	Provision of early tender specifications. Change in procurement strategy to two-stage tendering	Early tender specifications to ensure design and cost certainty, with a positive impact on project timescales
	Time taken to conclude fixed price negotiations	Early contractor and sub-contract engagement Collaborative approach Iterative client approvals Project specific procurement strategies Claim avoidance	Reducing time between pricing and contracting
	Contract conditions	Fluctuations Early ordering/materials off-site Bonding/warranties Risk sharing (time) Claims avoidance Project partnering Category management	Redistributed but acceptable risk profiles
	Increased insolvency risk	Project bank accounts Insolvency administration	Surety over payments Governance of insolvency process
Construction	Increased contractor claims due to project duress on input costs	Claims avoidance Claims assessment and quantification	Cost certainty tied to performance outcomes Claims settlement

SUMMARY

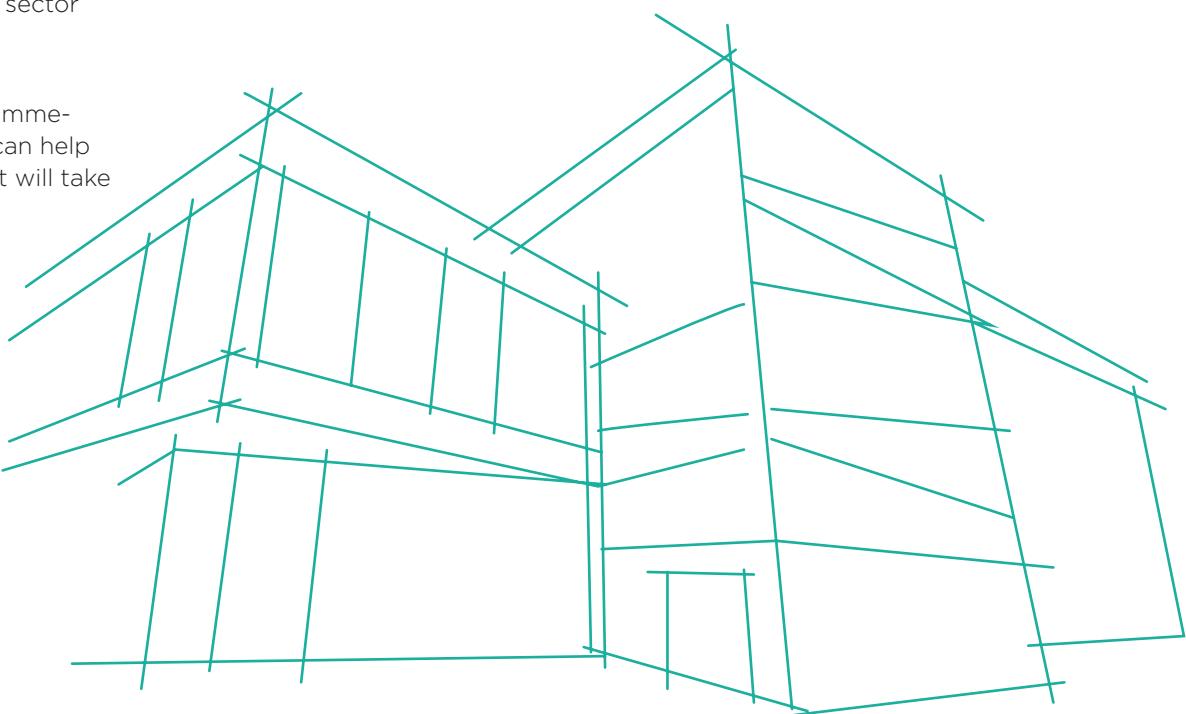
In summary, the current geo-political tensions are definitely seen as affecting decisions of client organisations. They are thinking long and hard about estate rationalisation policy and utilisation, before decisions are taken. This, however, sits in conjunction with Covid-19 and attendance and remote working impacts too, resulting in projects being delayed until some degree of confidence has returned to the market and analysis of covid impact is known.

Investment in infrastructure (Public and Private) by its nature is often mandated by regulators or is being used by central and local government as a stimulus for the economy and hence is not affected in the same way privately invested developments are by such events as those in Ukraine or even Brexit. Private sector projects that still "work" and are viable will continue to proceed. Public sector projects or programmes with fixed budgets may struggle.

Clients are aware that budgets may need to increase. Project or programme-specific risk analysis and procurement strategies as mentioned above can help mitigate increase costs from the market, but the question is how long it will take for appraisals and funding to adjust to the new reality.

"Generally there is an increasing risk of extension of time claims and material price fluctuation claims. Clients should be aware of the risk these place on Contractors pricing, cash flow and, in worst case, viability to continue projects."

Dubai, UAE



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