TPF

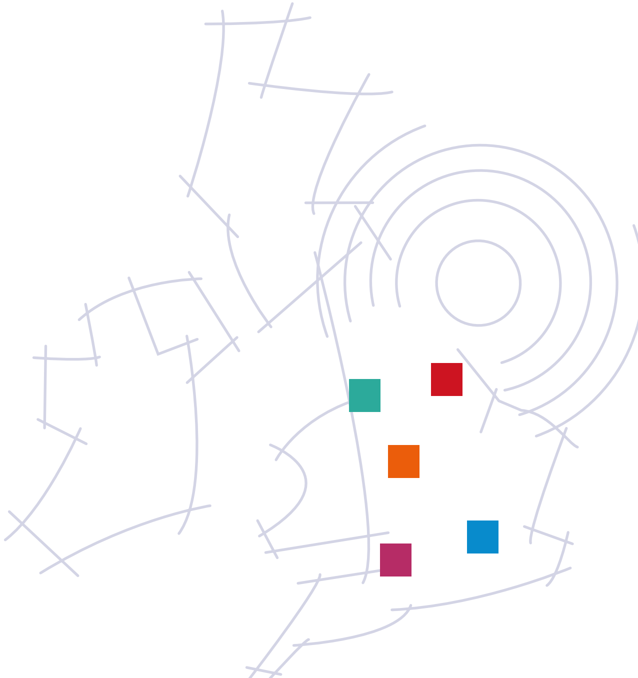
RIDER LEVETT BUCKNALL TENDER PRICE FORECAST UK

Q3 2021

2021 Q3

RLB Rider Levett Bucknall

CONTENTS



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INTRODUCTION

Publication of the Q3 2021 TPF arrives at the conjunction of easing of Covid restrictions in the UK, growing awareness of the follow-on impacts of lockdowns, production drop-offs and labour-related effects of Brexit, and ongoing concerns regarding upcoming end of furlough, materials costs and material and labour availability issues.

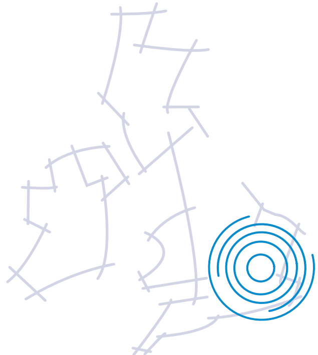
This complex mix of often competing effects is played-out in different ways in the various locations featured in the report, but the common feature is that all are present in all locations across the UK at this time.

After five years of maelstrom over the final outcome of Brexit negotiations, we are now in the second half of the year after having left the EU, yet "pre-leave" effects still rumble on and there are more labour and materials shortages now, combined with uncertainty as to the end of "grace periods" and required new EU and UK certification standards-setting requirements.

Looking back, Covid undoubtedly struck hard on materials production, as factories, plants and quarries were closed and/or cut back production levels. Consequently, stock levels fell, and have not yet recovered. This was not a purely UK problem, and it occurred throughout Europe. However, the effects have been magnified in the UK by the return of large numbers of skilled workers employed in construction and in manufacturing, to their European countries of origin following formal Brexit.

Looking forward, materials availability and distribution capability will be addressed over time, but contractors and subcontractors alike are faced with the necessity of buying future workload now in uncertain and volatile circumstances that are unique to the construction industry. Knowing this to be the case, we have included a section after the regional analyses in this quarter's TPF, dedicated to the general impact of volatility in materials and labour availability.

LONDON & SOUTH EAST



The capital's activity levels are slowly increasing, with the construction environment starting to become more lively.

Companies are returning to their offices, with the result that businesses are assessing their working patterns and re-considering the functioning of the office against the background of continuing need for separation-space. Likewise, people are coming together again for social activities and events, and the hospitality sector is welcoming people back with open arms.

Source	% Uplift reported	2020	2021	2022	2023	2024	2025
London & South East	**Q3 2021**	**0.00**	**3.75**	**3.25**	**3.25**	**3.00**	**3.00**
Others - Upper Range (London)	Q3 2021	2.40	4.50	3.60	4.10	5.00	5.00
Others - Lower Range (London)	Q3 2021	-4.00	0.00	1.50	1.50	1.75	2.00
BCIS (National)	Q3 2021	-1.50	3.70	2.60	4.00	3.90	4.00

OVERVIEW

Looking closely at the construction sector, the industry has seen a steep increase in many materials costs, due to supply issues.

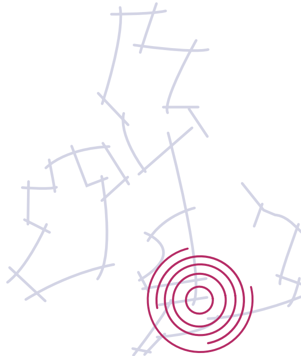
Coupled with a shortage of labour, both in-production and on-site, these additional costs have to be accommodated within the overall supply and demand picture. The other constraining factor is the difficulties and shortages in relation to imported goods and materials, which have been similarly affected in-production and as regards distribution from, in particular, European sources.

London has been particularly affected by skilled labour shortages, as there had hitherto been high dependence in London upon tradespeople from mainland Europe and Ireland. Given the effects of Brexit, Covid and the new UK immigration and work permit systems, the supply tap of that source of labour has been tightened to the point at which London's labour market is now having to draw from elsewhere in the UK, which merely passes on the pain, given the chronic under supply of new blood to the trades and an ageing trades workforce.

Taken together, the combined difficulties convert to higher tender prices as tenderers are required to include cost escalation within fixed price contracts, although we are seeing varying levels of correlation, depending on the material and the various works-packages. For example, copper, steel and aluminium prices have differing levels of effect on mechanical, electrical, structural steelwork and cladding packages. Also, the level of pass-through of these input cost imposts varies in relation to contractors' and subcontractors' appetite for replacement workload. Where tenderers' workload pipelines are secure, there is naturally less incentive to absorb cost increases without passing them on in-full via tendered figures.

On the other hand, where the necessity for replacement workload is urgent, there may be an element of acceptance of more margin compression in order to win work. While that may seem to be a good result for clients, there is an underlying risk, because supply chains in construction are very much interlaced, and problems with a single link in the chain could produce downstream effects costing time and money to resolve.

SOUTH WEST



The South West remains buoyant, with clients continuing in earnest with interest in site development.

This demand for site work, along with the tension between site-worker availability and white-collar worker shortages, is having an impact on tender returns, with higher numbers of contractor withdrawals being experienced.

Source	% Uplift reported	2020	2021	2022	2023	2024	2025
Bristol	**Q3 2021**	**0.50**	**3.50**	**4.00**	**4.00**	**3.50**	**3.50**
Others - Upper Range (Bristol)	Q3 2021	2.60	2.90	3.25	3.90	4.10	4.20
Others - Lower Range (Bristol)	Q3 2021	-2.00	1.00	1.50	1.75	2.00	4.20
BCIS (National)	Q3 2021	-1.50	3.70	2.60	4.00	3.90	4.00

OVERVIEW

In relation to contractors' input costs, materials price increases are certainly having an effect on tender prices.

Bidders are seeking to limit the fixing of prices to a much shorter period of time than has been usual in the past. We believe this volatility may stabilise, but overall prices will remain inflated due to increased importation costs, continued Covid closures and lingering shortages through the remainder of 2021 and into the new year.

Looking to market sectors, the residential sector social housing pipeline and on-site workload remain buoyant, with local authorities still looking to push through schemes on both small and large-scale sites. The end of the stamp duty holiday does not initially appear to have impacted residential sales significantly in Bristol or the South West, leaving demand still outstripping supply, and people still looking for significant changes to their living and working from home environment post Covid lockdowns.

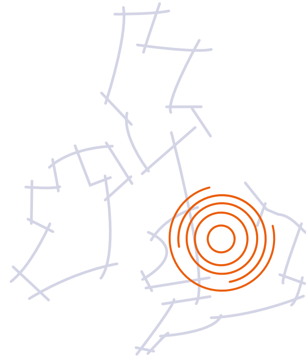
The commercial office market sector has some significant-sized projects on site. These are attracting significant tenant interest due to their cutting-edge technology and commitment to leading sustainability and wellbeing assessments. This is drawing in large blue-chip companies looking for differentiators to offer their workforce to encourage a return to offices. We are also seeing continued repurposing of existing space into smaller, boutique offices with breakout space, to meet the demand for smaller footprints and the continued flexible work patterns of a large section of the population.

Data Centre and industrial developments continue to flourish, with key demand in areas along the M4 motorway. Higher Education entities have been encouraged by the easing of lockdowns and vaccination roll out. This has driven student returns for the start of new term, with the knock-on effect of new capital works projects starting to come on-line again. For projects such as healthcare, education and infrastructure, central Government investment in public sector works via fiscal support measures and the "levelling up strategies" will need to be continued.

For retail, hospitality and hotels sectors, the unknown effect of the ending of the furlough scheme may yet have an impact on already elevated levels of pressure. Many slated plots are being developed through other streams such as supermarkets or fast food.

Given the above, and especially the volatile materials impacts currently being experienced, we have raised significantly the 2021 forecast, while slightly moderating succeeding years' figures for now.

MIDLANDS



In the Midlands region, the most buoyant sectors remain infrastructure and industrial.

However, while pipeline workload availability and opportunity are beginning to outstrip capacity levels, actual output at site level is being damped by viability being stretched and programme-busting lead-ins. One key facet of this is that the impact of HS2 is still being felt and is impacting upon civil engineering trades.

Source	% Uplift reported	2020	2021	2022	2023	2024	2025
Birmingham	**Q3 2021**	**0.00**	**3.50**	**3.50**	**4.00**	**3.50**	**3.50**
Others - Upper Range (Birmingham)	Q3 2021	2.00	3.00	3.25	3.70	4.10	4.50
Others - Lower Range (Birmingham)	Q3 2021	-2.50	1.00	1.75	1.50	1.75	4.50
BCIS (National)	Q3 2021	-1.50	3.70	2.60	4.00	3.90	4.00

OVERVIEW

Across the local market, commercial projects are a bit more subdued, with investor confidence not yet fully returned, much like the occupancy levels of many city office buildings, although underlying metrics suggest the sector will pick up.

New planning consents for city centre build to rent apartments continue, with increased regional interest beyond the second city.

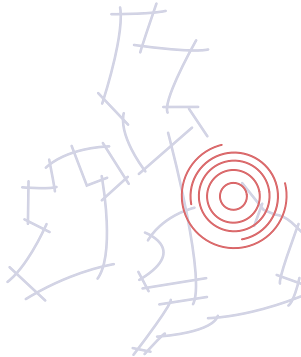
Looking to market structures in more detail, materials availability and pricing volatility are now feeding through to tender prices. Tender pricing throughout the supply chain is generally passing-through input cost movement, but against a backcloth of availability concerns and programme risk also now affecting risk allocation and pricing. Tier one contractors are de-risking by lining up all primary trades on a back to back basis, resulting in delicate and time consuming final contract negotiations. Structural and reinforcement steel trades were early indicators of significant tender price movement, with cladding materials now also a key concern, and mechanical electrical and plumbing trades also expected to see increased volatility.

Lead-in periods are pushing out, particularly in sectors with relatively short on-site programmes, compounded by the programme challenges of actually getting projects into contract. Over the course of a tender engagement process, movement in materials pricing and availability can be problematic for both contractors and clients.

Vertical integration of supply chains, either client-led or contractors' initiative, is increasingly seen as a hedging strategy, but with the primary focus being on continuity of supply rather than on cost. Improved workload pipeline strength is resulting in contractors being more selective in choosing bid opportunities, with a corresponding uptick in alternative procurement routes. Contractors are showing a clear preference for immediacy of contract award to mitigate cost inflationary pressures, with negotiation therefore favoured, rather than a protracted two-stage process.

Labour availability issues are less widely reported in the Midlands, as the region is historically less dependent on EU workers than is the capital. Even so, inflationary pressures are still expected, as skilled labour is geographically mobile, even within the UK. There has been some evidence of the "pingdemic" affecting contractor output through the last quarter, but this has proved more of an on-site delivery challenge rather than an effect having real inflationary impact.

YORKSHIRE & HUMBER



There has been a warming of opportunities in recent months, which suggests that demand isn't slowing and will continue to impact on construction tender prices.

Whilst external forecasts lean towards a slowing in new orders over the next few years, the key challenges around labour shortages and materials price inflation linked to both cost and demand will continue in the short to medium term.

Source	% Uplift reported	2020	2021	2022	2023	2024	2025
Sheffield	**Q3 2021**	**0.00**	**3.20**	**3.60**	**3.60**	**3.80**	**4.00**
Leeds	**Q3 2021**	**0.00**	**3.00**	**3.80**	**3.80**	**4.00**	**4.20**
Others - Upper Range (Yorkshire & Humber)	Q3 2021	1.75	3.00	3.00	3.70	4.00	4.70
Others - Lower Range (Yorkshire & Humber)	Q3 2021	-2.30	1.00	1.25	1.25	1.50	4.70
BCIS (National)	Q3 2021	-1.50	3.70	2.60	4.00	3.90	4.00

OVERVIEW

With much investment in infrastructure and currently all sectors, except Retail, being buoyant in Yorkshire, we expect the tender price inflation to remain at circa 3 – 4% year-on-year growth.

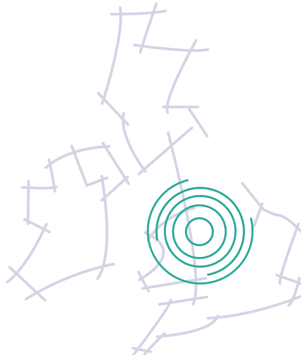
In the short term, there is pressure on construction prices due to labour shortages, leading to wage inflation, and materials price inflation due to supply chain challenges and increased demand. New orders are forecast to slow from the 9% increase of 2021, to 4% by 2024. That will increase competition, however, not significantly enough to offset materials and labour input price increases. Expressing the above in the marketplace, current demand for construction services is leading the larger contractors to be more selective in their pricing of projects, which is easing competition somewhat.

In the medium term, our forecast is 3 - 4% increase in tender prices per annum through to 2025. Following a settling in materials price inflation, longer-term Leeds contractor demand is forecast to increase when large government-backed schemes come on-line, such as LTH, the £600m HIP scheme, DfT new headquarters, new Infrastructure bank and the WYCA backlog of infrastructure projects filter through.

Therefore, on balance whilst material supply chain issues will level out, demand-led inflation will still continue to impact on tender prices, underpinning our tender price inflation forecast through to 2025.

For Sheffield, the short-term sees the area enjoying a similarly buoyant construction market. We expect this will impact on competition and prices, which may result in the tender price movement in 2021 being slightly greater for Sheffield than for Leeds. We anticipate residential, infrastructure, industrial and government investment in Sheffield remaining strong, which should provide a steady pipeline of construction new orders over the coming few years. However, the challenge around contractor demand, labour shortages and materials cost inflation will continue to apply pressure to tender prices.

NORTH WEST



Construction in the North West remains extremely active, although there are ongoing concerns regarding both materials and labour.

For materials, the combined effects of Covid and Brexit have resulted in already long lead-ins extending further, particularly in the case of materials sourced from mainland Europe.

Source	% Uplift reported	2020	2021	2022	2023	2024	2025
Manchester	**Q3 2021**	**2.50**	**4.00**	**3.50**	**3.50**	**3.50**	**3.50**
Liverpool	**Q3 2021**	**2.00**	**4.00**	**3.50**	**3.50**	**3.50**	**3.50**
Others - Upper Range (North West)	Q3 2021	1.75	3.00	3.25	3.70	4.00	4.60
Others - Lower Range (North West)	Q3 2021	-2.70	1.00	1.50	1.75	1.50	4.60
BCIS (National)	Q3 2021	-1.50	3.70	2.60	4.00	3.90	4.00

OVERVIEW

The HGV driver shortage evident in other sectors of the economy is no less clear in construction, and again the impact is most notable for products arriving from outside of the UK.

For UK-sourced materials there are also aspects of the driver shortage that impact upon deliveries, but a more pressing issue is the marked reduction of stocks and the whole question of availability of particular products or substitutes.

The North West is clearly not alone in suffering from these problems, which are in part labour-access problems, and in part distribution network and supply chain issues. Whether in the UK or in Europe, the underlying feature is that of dramatically lowered production levels last year, resulting in depletion of stockholdings even despite site closures and lockdowns, and consequent catch-up of productive capacity. All of this is set against a backdrop of burgeoning workload availability and high levels of aggregate construction demand which we note is the case right across Europe, so the North West is no doubt suffering from lesser proximity to ports having materials coming into the UK from Europe.

From the standpoint of labour, Manchester, Liverpool and the North West generally have not shared the dependence of the London and South East market on European tradespeople, but there remain acute shortages in multiple trades, due partly because of the overall gaps in labour availability, and also to the draw of higher wage levels in London, as the capital pulls labour desperately needed there.

The combination of geography and the coming-together of these critical considerations, plus the need for governments to force the policy imperatives of "building back better" and levelling-up, now must reflect the danger of rapid tender price inflation. Flooding an already stressed market with new and urgent workload despite the likely inability to deliver on time and to a pre-agreed cost, risks disputes and contractual concerns.

Lead-in times continue to extend, but contractors and sub-contractors are every day less inclined to provide fixed price bids, giving rise to an increase in two stage tendering, which will itself reduce competitiveness in the market.

Taken together, all of the foregoing considerations present in a market that remains highly volatile. While it is true that contractors need and want workload, yet they must guard against having purchased that workload at a price and on a timeframe within which they cannot deliver. Consequently, time as well as cost are now aspects for second stage negotiation, as the risk of absent delivery can become a major barrier to fixed pricing.

OVERVIEW: INPUT COST VOLATILITY – SOLUTIONS FOR PROJECT TEAMS

A common feature of the regional reports above is the current existence of input cost volatility – uncertainty and risk being created by problems in foreseeing input cost changes' nature and extent, as well as their impacts on tendering processes. By way of informing and clarifying on this topic, RLB has produced the following matrix of issues and possible solutions:

	PROCUREMENT	SUPPLY CHAIN INTEGRATION
Market Conditions	Reduction of two stage procurement: contractors reluctant to tie-up pre-construction teams, and extended engagements may exacerbate cost pressures. Contractors are backing-off risk down the supply chain. Taking Longer to get into contract.	Surety of supply is becoming key to projects proceeding. Extended lead times may also threaten viability.
Project Team Response	Negotiated routes may provide overall quicker procurement solutions. Enabling works contracts or separation of fit-out in order to reduce overall on-site durations.	Pre-procurement of key sub-contract packages in advance of main contractor. Client sources supply deals for key products. Interrogation of contractor's vertical integration (e.g. key trades providers as sister companies; materials supply / fabrication in-house). Assessment of Contractor's supply chain capacity.
Considerations from the Construction Playbook	Consider pipelines and longer-term contracts. Sustainable relationships.	Collaborative working and "one team" ethos Early supply chain involvement Broad engagement including SMEs

While the matrix suggests responses to the various facets of the issues, the generality of these responses has to be applied to the circumstances of a project, so there may be a wide range of possible outcomes, depending on the particulars of that project.

	DESIGN FLEXIBILITY	RISK ASSURANCE AND RISK REBALANCE
Market Conditions	Longer lead times are dictating: ▪ earlier client decisions ▪ earlier contractor procurement ▪ earlier design completion	Increased risk of contractor failures Decreasing contractor risk-tolerance in contractual terms Increasing requests and need for off-site payments and advance payments. Decrease in fixed price durations being offered. Requests for “unavailability” clauses in contracts
Project Team Response	Design out most heated trades in favour of alternatives. Performance/outcome specifications Designing-in flexibility to permit alternatives at the point in the programme when buying choices are made. Monitoring and reviewing alternatives to ensure true equivalence. Consideration of MMC options.	Consider bonds, performance guarantee and other security provisions. Fluctuation provisions in longer-term contracts. Advance payment bonds
Considerations from the Construction Playbook	Aggregating demand across portfolios Adoption of MMC	Fair and balanced contracts Standard clauses Financial monitoring and contingency planning

SUMMARY

As noted in the Introduction and throughout this edition of the TPF, a key feature of the current and upcoming situation of the UK's construction industry is the aspect of labour-pool limitations and growing shortages of available skilled personnel.

That has impacts not only upon local construction environments, but right across the board, because labour can be reasonably mobile on the small island that is Great Britain.

The result is that locations where better wage levels can be found will attract workers, at the expense of other regions' labour pools, potentially undermining any notion of "levelling-up". Obviously, this affects only the edges of labour pools, because not everyone is able to relocate, but its mere existence as a possibility puts wage pressure on all locations as a means of alleviating leaching of workers away to the major cities, particularly London.

Setting this mobility and wage-growth aspect alongside an ageing workforce and also materials concerns, produces multiple competing problems at tender stage. Both contractors and subcontractors need follow-on work as projects run to completion.

Tendering and bidding takes place against a backdrop of uncertainty as to materials prices, bidding for projects in volatile conditions, winning work at acceptable margins and then producing output within accepted contract sums.

Although materials cost prices displayed conspicuous volatility in the first half of the year, the expectation of forecasters in that field is that they will level-out in the remainder of the year, providing bidders with a slightly more level playing field. However, there will still be significant raw materials cost fluctuations and changing differentials over time, which will continue to show in risk and contingency figures, as well as in negotiated fixed-price timelines. For manufactured materials, stockpiles will recover over the next year, all things being equal and no more Covid-related-shutdowns permitting, but in the meantime, the industry will see "selling prices", tender prices, continue to rise to accommodate the added input costs. Whether that will lead to any windfall profits for contractors and subcontractors if cost prices stabilise and/or fall remains to be seen.

In the meantime, all RLB offices report higher levels of tender pricing than had previously been forecast, uplifts which are projected out into the next couple of years and which will certainly need the experience of the short to medium term phase to fully digest.

ABOUT RIDER LEVETT BUCKNALL

RLB Rider Levett Bucknall

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