



REPORT

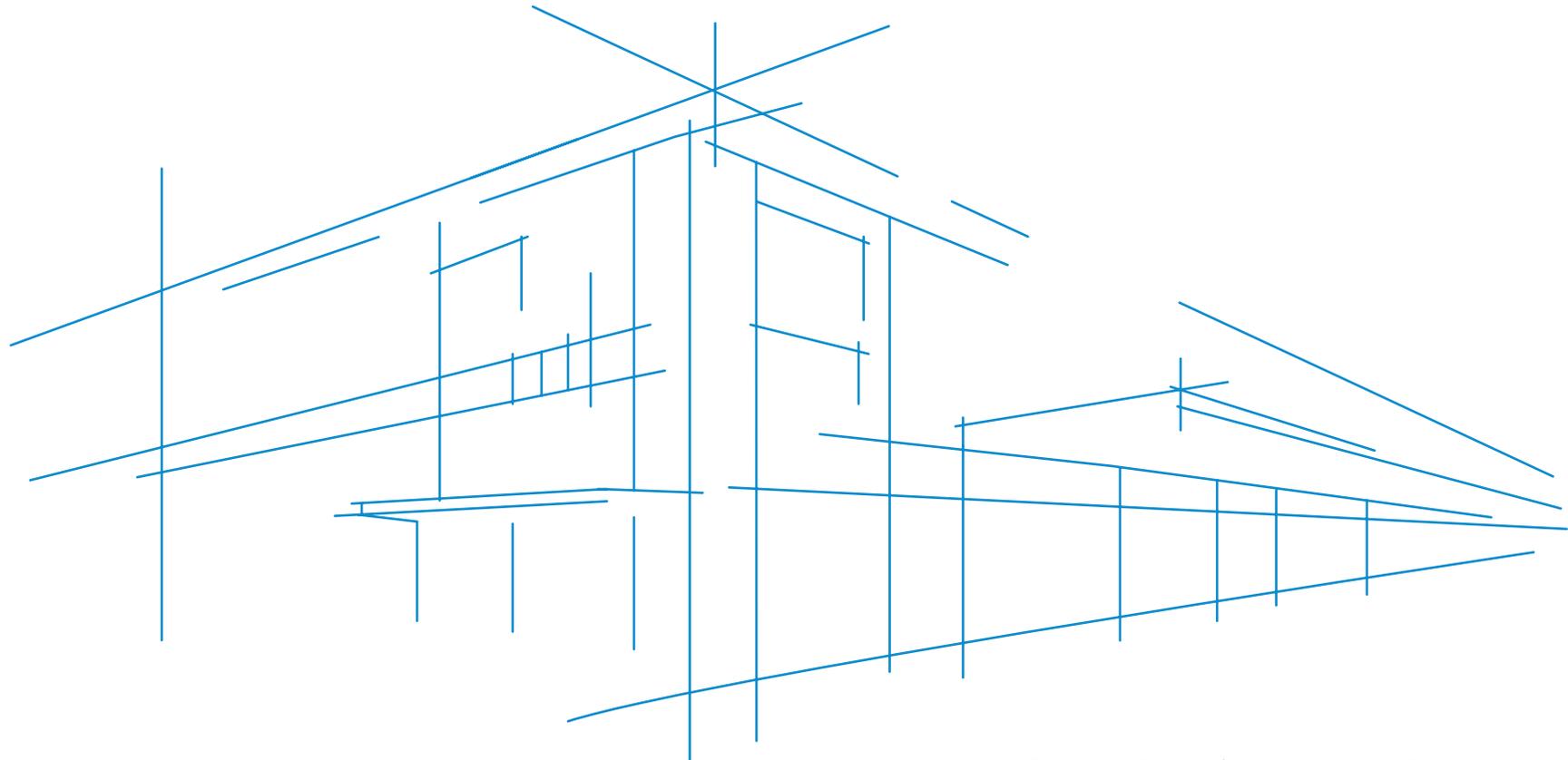
STATE OF THE MARKET REPORT

AUGUST 2022

RLB Rider
Levett
Bucknall

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UK RESPONSE OVERVIEW

RLB recently carried-out a global survey, where our Directors and Partners provided their views of the effects of the current geopolitical crises. The global analysis will be published as a separate document, as will particular regions' results, but this report looks at the UK findings and responses.



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
- Post-Brexit impact
- 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 geopolitical issues such as the war in Ukraine, the ensuing energy price volatility, the impact of Brexit and other global, European, and domestic 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 for the UK 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:

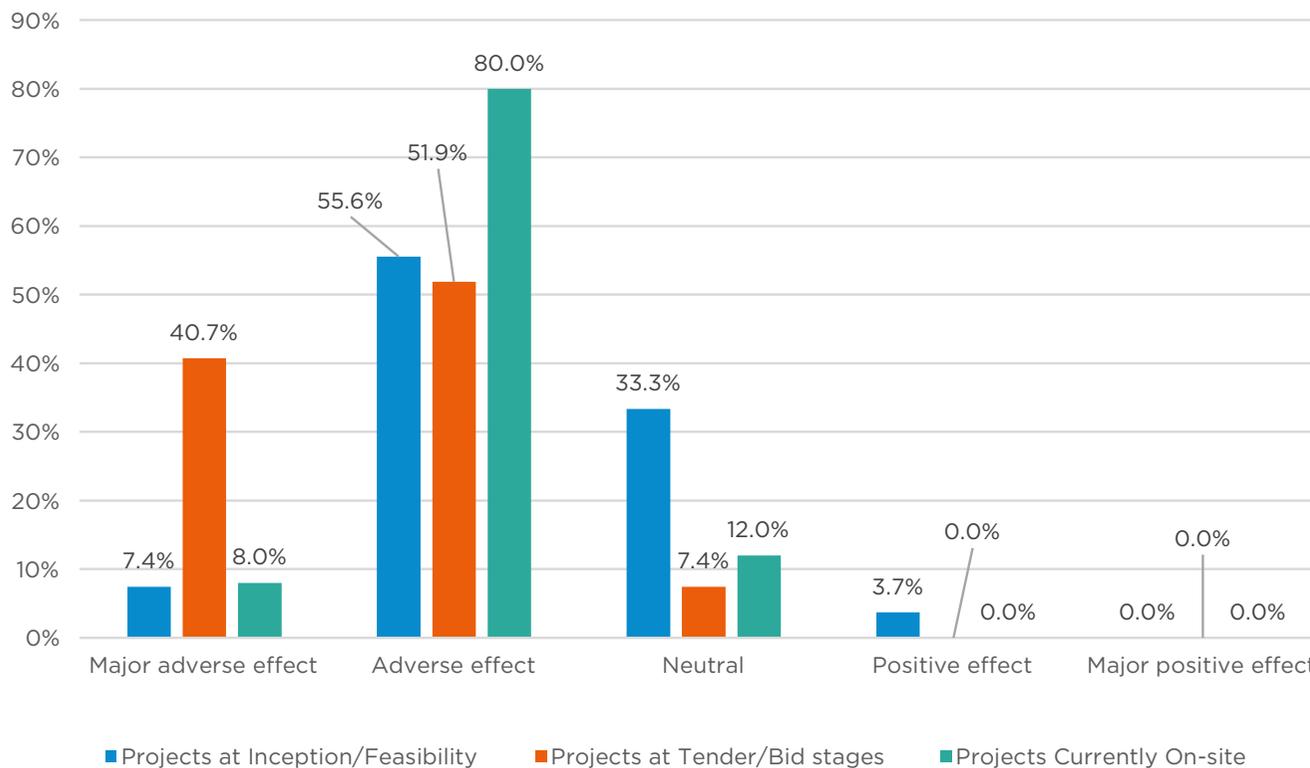
- Project inception/feasibility
- Project bid/tender stage
- Project on-site stage

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 UK respondents' views on some of the key questions as applicable to particular phases of the development process.

MARKET VOLATILITY, CHALLENGES AND SOLUTIONS

UK EFFECTS OF CURRENT GEOPOLITICAL CRISES

RLB Partners were asked whether current geopolitical difficulties are affecting UK 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.



“Ukraine is only exacerbating the current effects on prices and materials caused by Brexit and the Covid pandemic.”

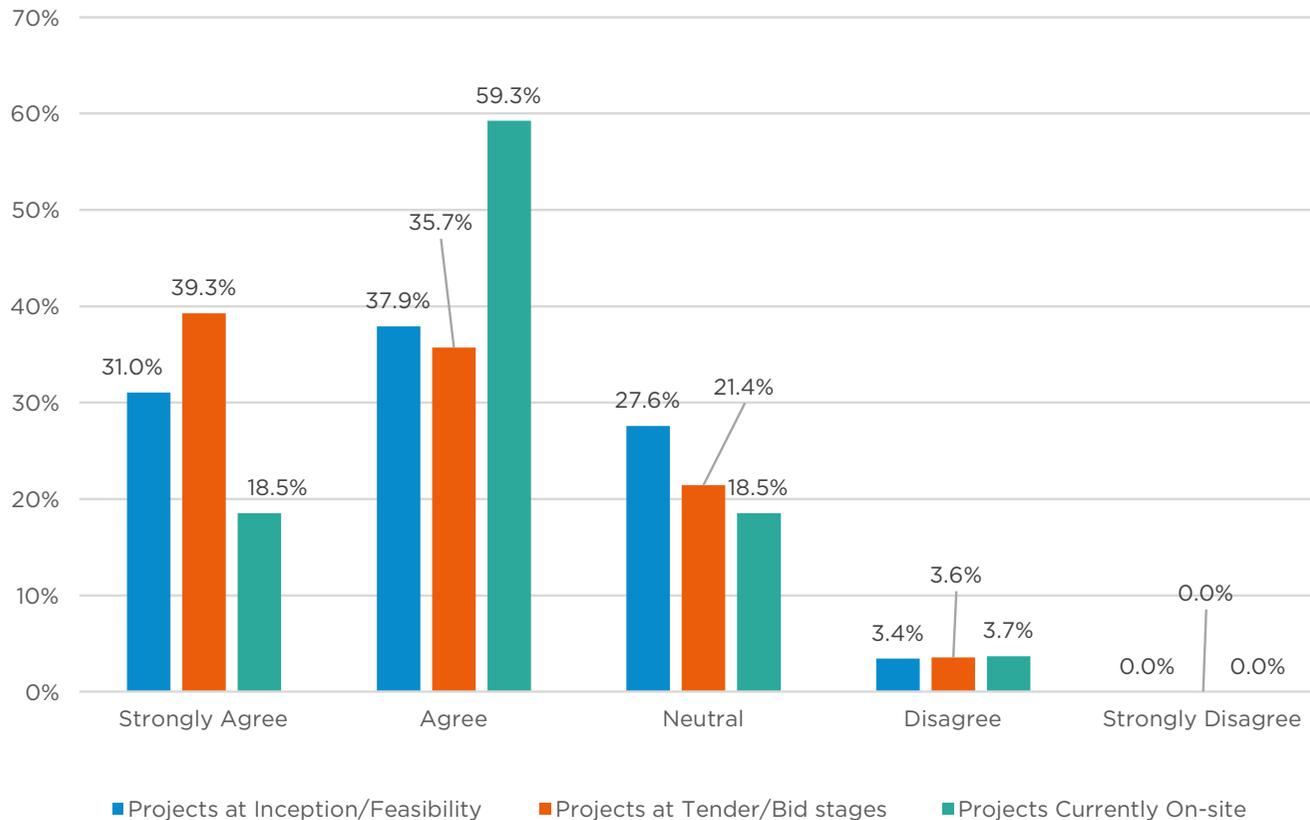
Jim Sudlow, **National Programmes Partner**

“Difficult to isolate effects of individual events; Brexit, then Covid, then Ukraine have all amalgamated to create current situation. Ukraine is most commonly being cited as the current driver but not sure the extent to which this is exacerbating the issues created by Brexit / Covid.”

Stephen Scott, **UK Education Lead**

SEVERITY OF SUPPLY CHAIN DISRUPTION

Supply chain disruption is clearly evident throughout the development process, with emphasis on the difficulties arising closer to and within the build-phase. However, notwithstanding that fact, almost 69% of respondents commented that at inception and feasibility stage, disruptions exist, and are as a consequence having to be built into procurement solutions.



“Programmes are being impacted by last minute delay, non-deliveries, and shortage of labour. Actual cost format contracts are having to meet “here & now” prices that are continually increasing.”

Chris Balshaw, **Partner**

“Some off-site manufactured items seem to be particularly adversely affected by material / labour supply problems / manufacturing capacity leading to unpredictable timescales and costs. Traditional construction techniques, whilst still suffering from same issues, seem to be more predictable.”

Stephen Scott, **UK Education Lead**

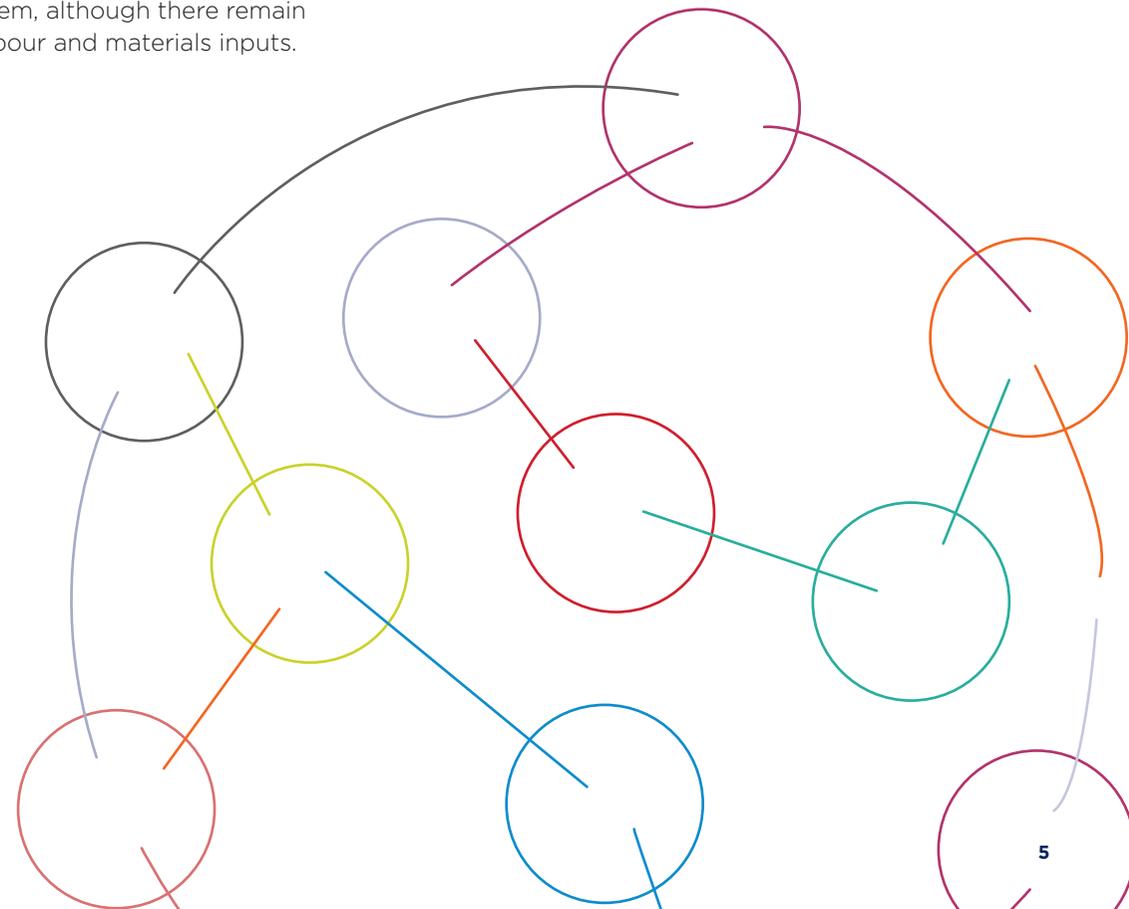
SEVERITY OF SUPPLY CHAIN DISRUPTION

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.

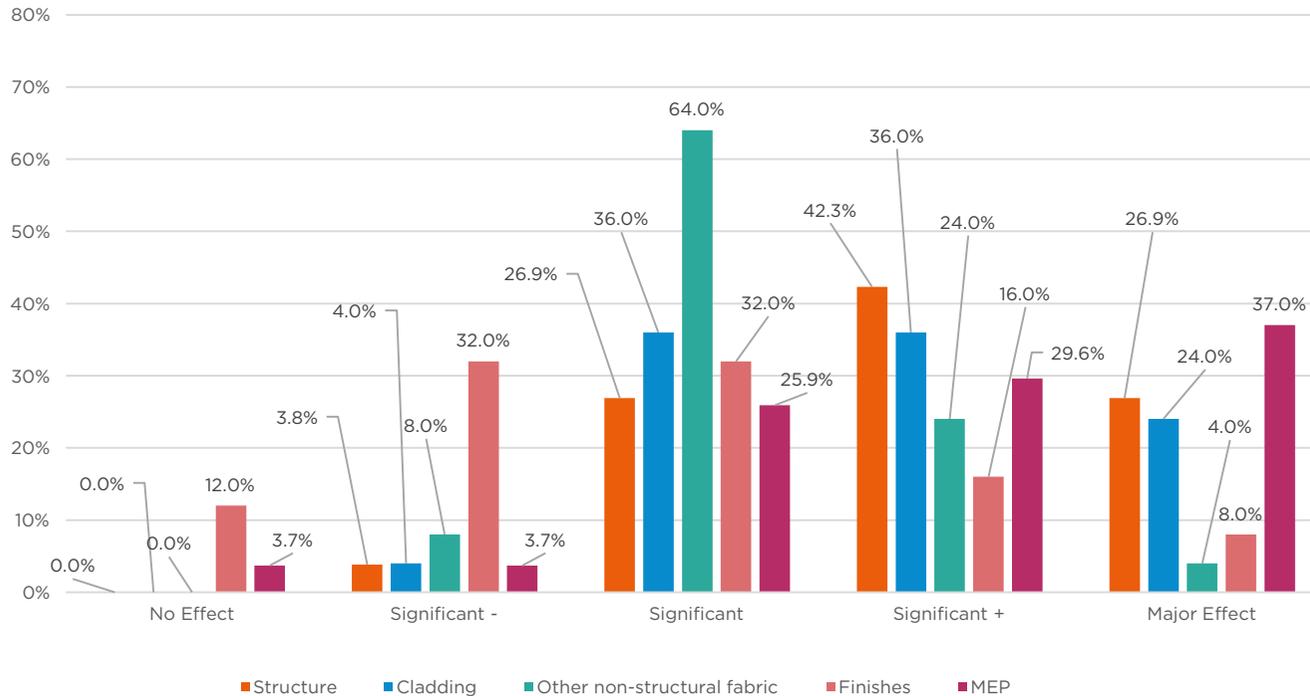
As represented in the chart overleaf, grouping trades together permits us to examine in broad terms where the bottlenecks and price spikes are considered to most likely occur. Although all five of the groupings selected in the chart show effects, clearly structure, cladding and MEP are the most collectively 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.

“Increased prices are generally impacting viability with it becoming harder to get projects to stack up. Creative approaches to cost and value are required to tip projects into being viable.”

Paul Beeston, **Partner**



EFFECTS ON GROUPED TRADES AT TENDER



“Projects at tender now have limited time for the returning prices to adjust and reconcile against initial budgeting. Huge fluctuations in pricing still needs to be validated to ensure VFM if the clients are to proceed. Greater time and pressure is on the clients team.”

Stuart Wands, **Partner**

“Risk to tenderers of rising prices is key concern as we are seeing tender lists decline due to withdrawal through increased perception of risk.”

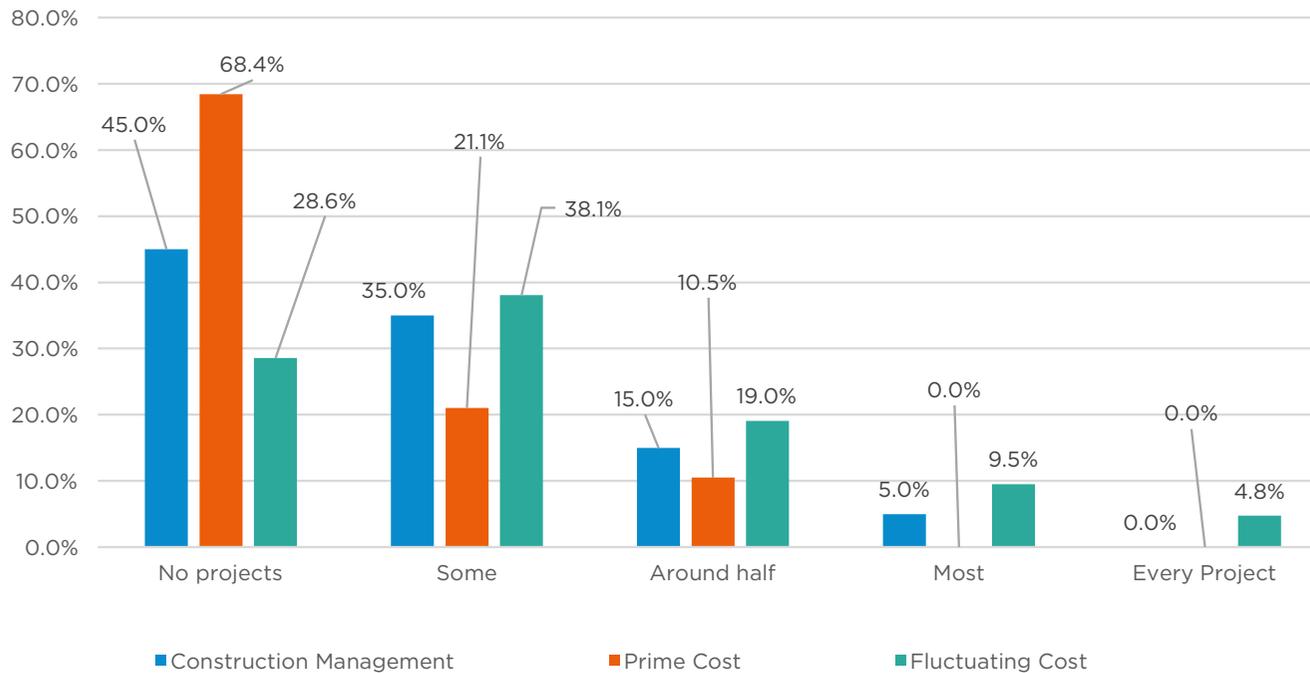
Julian King, **National Head of Retail**

“Volatility is causing difficult forecasting and also risk additions by contractors. The time taken to convert a project from tender to contract has also increased, with sub-contractors only offering very short tender validity. Main contactors are looking to back risk away by selecting sub-contractors at contract award.”

Paul Beeston, **Partner**

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.



Readers should note that this chart displays only the proportion of respondents whose views are that a particular effect is present, NOT the proportion of projects affected.

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 | Value Toolkit to offset cost risk / inflation Project risk analysis 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 |
| Construction | Increased insolvency risk | Project bank accounts Insolvency administration | Surety over payments Governance of insolvency process |
| | Increased contractor claims due to project duress on input costs | Claims avoidance Claims assessment and quantification | Cost certainty tied to performance outcomes Claims settlement |

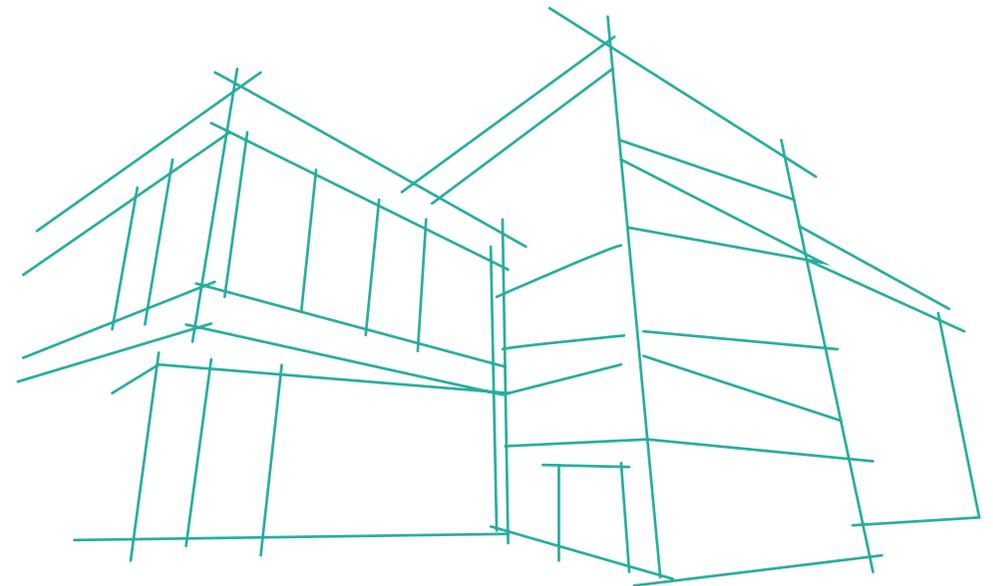
SUMMARY

Scenario planning is now needed to help navigate the uncertainty we find ourselves confronted with today and that we expect will continue for the next three to five years ahead. Looking at the best, mid and worst-case scenario will give us the ability to test those scenarios and undertake mitigation planning.

However, for the long-term benefit of the built environment we need to think of some of the longer-term elements we are facing as an industry, as well as some of the short-term challenges. For example, both the recently launched Value Toolkit and the Construction Playbook advocate value-based decision making. Using these tools to offset cost risk/inflation and project risk analysis can optimise value in the long term and help analyse wider project risk that can impact business case.

Although historically the private sector has been more agile to respond and therefore often quicker to adapt to changing environments, there are perhaps lessons the private sector can learn from the public sector when it comes to looking at collaborative procurement and contracting strategies. Fixed price contracts are not a prerequisite and there is a high level of use of the collaborative NEC form of contract where it is accepted that the contractor is entitled to defined cost, plus fee, and there are secondary option clauses to tailor the contract to project drivers and risks, such as price adjustment for inflation. This obviously differs in the private sector where often investors are driven by certainty of cost and income and profit.

We understand and appreciate the difficulty that our clients have in balancing some of these elements in today's climate and we know also, from feedback from our supply chain, the impact geo-political events are having on their day-to-day business activities. At this stage, certainty as to answers is limited. What we do need to have is conversations, collaboration, and to move toward the industry working together to navigate the uncertainty in the short term to ensure greater certainty for the long-term.



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