Shaping public construction

SCF Market Intelligence Q2 2022

Quarterly report based on data from our main contractors and their supply chain.

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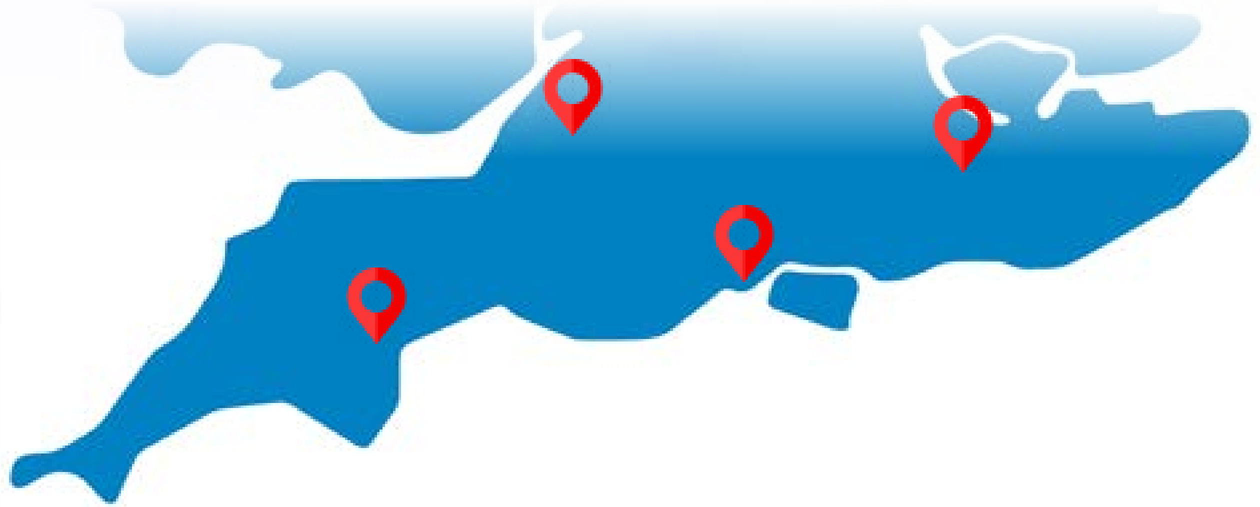
Q2 Market Intelligence Report



As part of SCF's commitment to collaboration and transparency, every quarter, SCF Main Contractors gather market intelligence from the construction industry through their trade supply chains.

With an expected recovery from the pandemic taking route towards the end of 2021, the industry and the UK economy expected the new year to be a welcomed step towards stabilisation. Nevertheless, throughout the first 6 months of 2022 a wave of unforeseen impacts derived from political volatility, unprecedented energy costs, and the rising cost of living has continued to challenge a return to stability.

As a result, alike the first quarter of 2022 it remains crucial for public sector clients to develop a deeper understanding of the current market conditions when procuring their projects.

This will ensure the best possible cost and time outcomes as budgets come under ever-increasing stress.

To this end, SCF market intelligence analyses data across 10 key trade packages. Data is collected across four cities within the south of the UK. The analysis identifies regional market trends and forecasts for the following year by commenting on changes in tender workload, number of employees, building costs and material & labour availability. When compared with other indices, this survey provides a unique outlook for clients by identifying the perspective of those trades directly involved with construction providing a real-time representation of market trends.

SCF shares this information with its clients to highlight key areas of risk that may impact on project delivery. SCF Main Contractors and Clients can use this information to predict pressures and opportunities in the market, to make decisions about material specification, construction methodology, off-site or automated construction techniques and project planning and programming, ensuring the best possible decision making to deliver maximum value.

This data, combined with SCF's integrated team approach, maximises the benefits of the two-stage open book process, ensuring predictable and high-quality outcomes for our clients and their communities.

Get in touch...

To discuss the SCF procurement process or a particular project you have in mind, please contact our Operations leads.

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Trades featured

- Carpentry & Joinery
- Brickwork
- Curtain Walling
- Dry Lining
- Groundworks
- Concrete Frames
- Mechanical & Electrical
- Steelwork
- Tower Cranes
- Windows

Tender Workload

To encourage post-pandemic recovery, an injection of capital investment has been made over the past 24 months by Central Government in support of the Build Back Better initiative. Example funding streams include Levelling Up, Building Safety, School Rebuilding Programme and Salix Decarbonisation.

As a result, tender workload over the past 12 months has been strong. In a reflection of capital spending, SCF Main Contractors and their trade supply chain have identified tender workload to increase by an average of 6% during Q2 alone, this is now 11% higher when compared to this same time last year.

SCF Main Contractors observed the greatest quarterly increase in tender workload for the following trades:

- Concrete Frame 17%
- Dry Lining 11%
- Brickwork 6%
- M&E 6%

However, in contrast to strong tender workload, a recent Glenigan & BCIS forecast has predicted an overall reduction of 2% in the value of project starts throughout 2022. With the industry experiencing continued inflationary pressures, the pace of projects progressing to site has slowed, demonstrating the extent of disruption to project development due to redesign and reappraisal of project costs.

For example, Glenigan has identified an average 23% increase in the time taken for projects to progress from detailed planning consent to start on site. To this end, SCF Main Contractors suggest that the supply chain will look to load their order books with a robust and diverse pipeline with the expectation that start on site dates may slip.

The overall value of project starts is not expected to recover until 2023 before stabilising in 2024, where an 8% and 2% growth is anticipated respectively. Heavily government funded sectors such as Education, Community & Amenity are expected to make a strong recovery this year with an increase in project start value of 7% and 24%, respectively. On the other hand, regardless of inflationary pressures Central Government have maintained funding in line with the October 2021 spending review and as a result the number of projects delivered within programmes will likely decrease to absorb increased building costs.

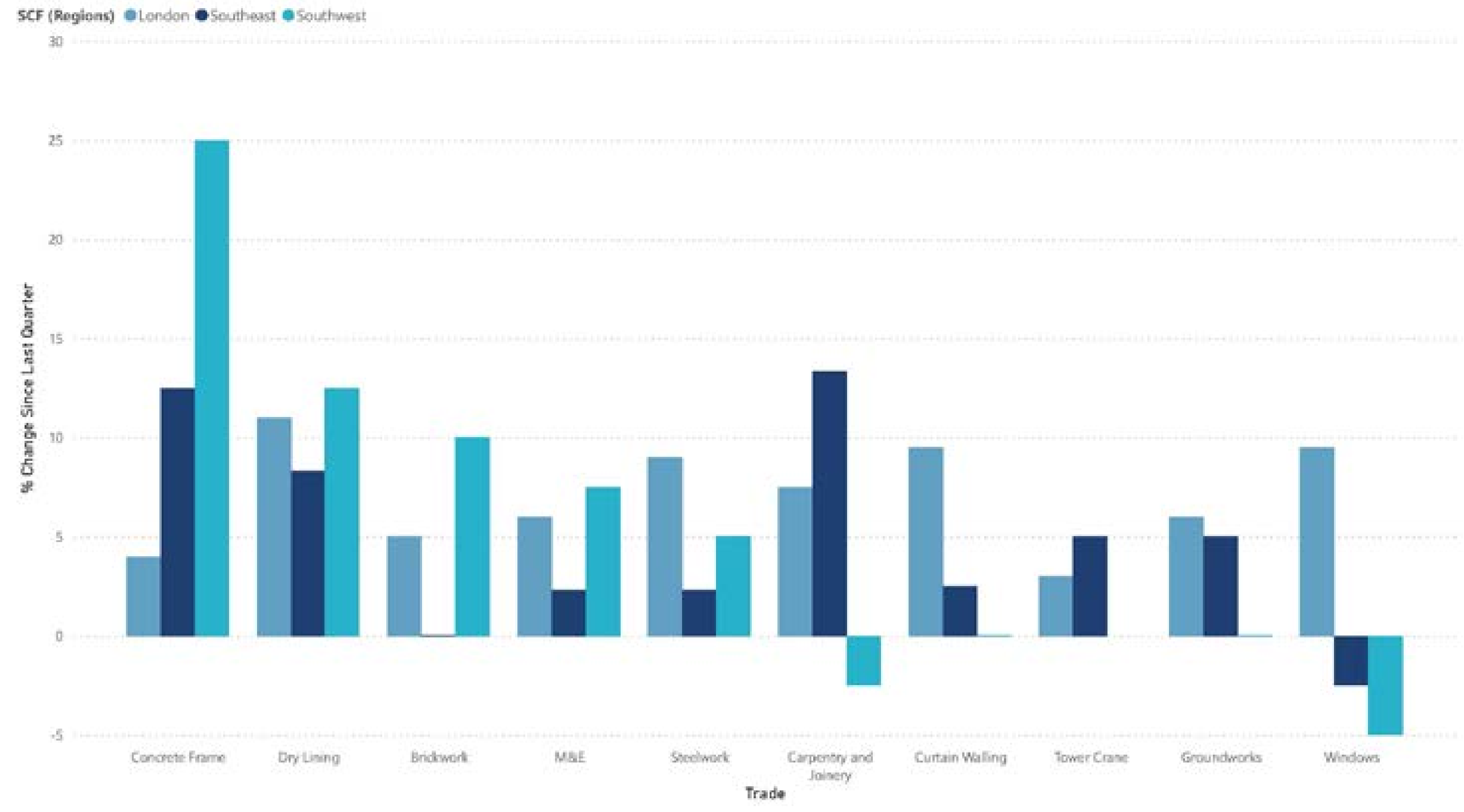
Similarly, in response to the pandemic, office refurbishments and industrial logistics centres are expected to recover during the year. However, pipeline heavily influenced by the rising cost of living, such as Private & Social Housing, Retail and Hotel & Leisure, is expected to fall.

SCF Top Tips

“ *With high tender workload and volatile building cost, it is becoming increasingly important for projects to appear attractive to the supply chain. As economic uncertainty continues, the supply chain will gravitate towards opportunities with a high certainty of programme and progression to site. Aim to share detailed designs to better eliminate procurement risk and de-risk procurement.* ”

“ *With a strong pipeline, the return period for pricing from the supply chain can be longer than expected and as result it is important to include sufficient time within procurement programmes. As recommended by the Construction Playbook, share your pipeline and upcoming projects with the market. Boost visibility and interest in your project, allow contractors and their supply chain to align their resources with your scheme to ensure the best levels of interest and competition.* ”

Quarterly Change in Tender Workload



Employment

SCF Main Contractors and their trade supply chains have identified a minimal increase in employment throughout Q2, with an average 1% increase in the number of employees across all trades.

SCF Main Contractors observed the greatest quarterly increase in the number of employees for the following trades:

- Dry Lining 3%
- Windows 2%
- M&E 2%

A skills shortage in the construction sector has been well documented for many years and has only been intensified by the pandemic and Brexit with record high vacancies. This shortage poses a risk to the timely delivery of ambitious capital programmes expected over the following years associated with new hospitals, schools, decarbonisation, and major infrastructure projects such as HS2. Following the pandemic, many workers have chosen early retirement. This has exaggerated the skills shortage; of which was already vulnerable to an ageing workforce. To this end, data from the CITB estimates that in order to deliver this pipeline in place for 2025, an additional 40,000 workers per year will need to be sourced into the construction sector.

However, over the course of the year, SCF Main Contractors have identified little change in employment, with an average 3% increase in the total number of employees across all trades when compared to Q2 of 2021. This is relatively conservative when compared with the observed increase in tender workload.

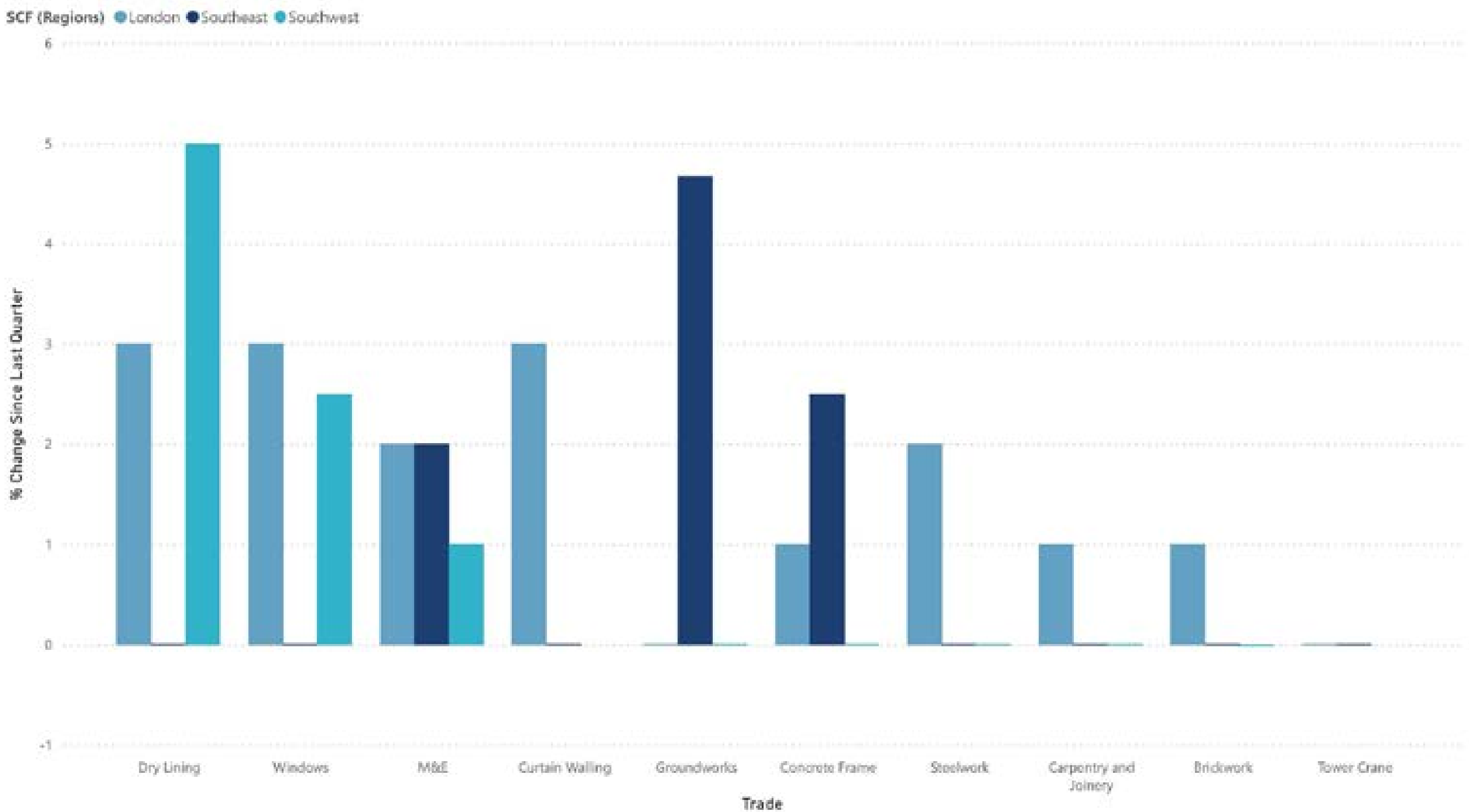
Nevertheless, it is important to note that the result from this survey depicts the total change in the number of employees amongst the supply chain each quarter, and as a result this will not necessarily capture the complex dynamic between recruitment and the loss of staff currently experienced in the industry. SCF Main Contractors warn that with an increase in the length of preconstruction programmes, many project teams will attempt to streamline construction through an increased workforce on site, however with the current labour shortage this will be challenging.

"In attempt to connect local labour and microbusinesses with large construction projects, SCF endorse the use of Work Radar. This database enables SME's, tradespersons, and Social Enterprises to express an interest in large construction pipeline. Contact information is then shared with SCF Main Contractors and their trade supply chain to encourage local labour.

A transition to net zero carbon delivery is under increasing threat due to a lack of sufficient skilled workers. Explore local schemes such as Skills for a Sustainable Skyline Taskforce, here you can share valuable workforce data for London projects to support the development of impactful solutions to the skills gaps." [Skills for a Sustainable Skyline - Share your views]

***Adam Sanford,** Operations Lead*

Quarterly Change in Number of Employees



Building Cost

Throughout Q1 the industry hoped for a smooth recovery in response to the easing restrictions from the pandemic. However, market conditions were incredibly volatile, and conflict in Ukraine helped to trigger an escalating energy cost to truly unprecedented levels. To this end, there was great uncertainty surrounding the short to medium-term impacts to both cost inflation and material availability.

Unfortunately, conflict in Ukraine has continued and energy prices have remained volatile throughout Q2 and as a result the price for energy intensive materials such as insulation, cement, concrete, and steel products have continued to increase. SCF Main Contractors caution that the commodity price of crude oil and natural gas is now 86.96% and 199.49% greater than this same time last year. To add to the already complex mix of volatile market impacts, China have adopted a Zero Covid Strategy, which has resulted in manufacturing and logistical lockdowns that has rippled across global supply chains. To this end, SCF Main Contractors and their trade supply chains have identified building cost to have increased by 11% over Q2 alone, this is now 22% higher than this same time last year.

These observations align well with the Construction Material Price index, where a 5% increase was observed in March alone and is now almost 25% higher than this same time last year.

SCF Main Contractors have identified the greatest quarterly increase in building cost for the following trades:

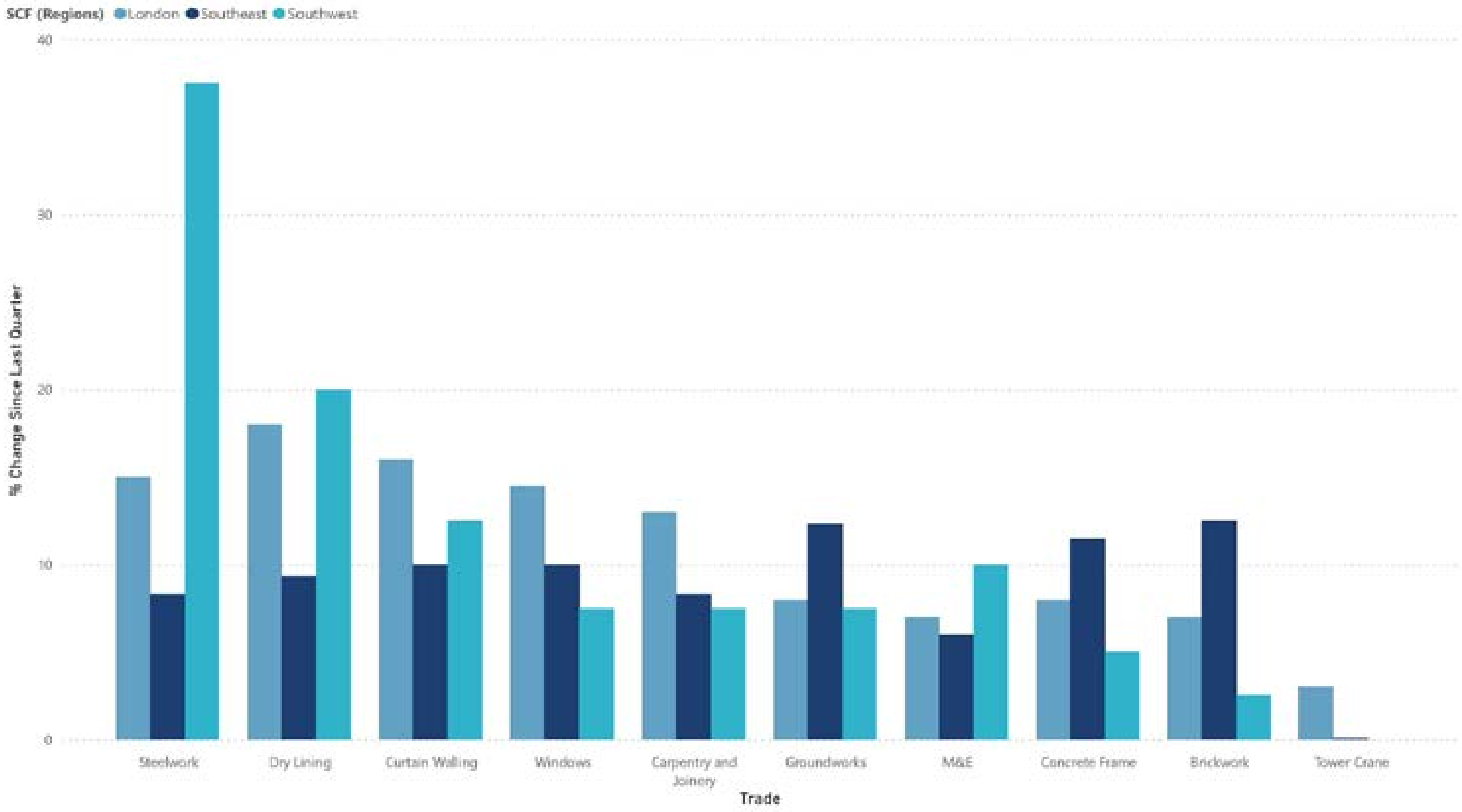
- Steelwork 25%
- Dry Lining 17%
- Curtain Walling 13%
- Windows 11%

SCF Main Contractors and their trade supply chain continue to experience difficulties in sourcing fixed prices from suppliers and to this end high risk pricing is frequent.

The continued stress of high inflation has the potential to apply pressure to profit margins amongst the supply chain, particularly that of SMEs and those with premature fixed prices. As a result, the supply chain may adopt a guarded approach to risk and will look to selectively target opportunities that they can comfortably deliver upon. To this end, it is becoming increasingly challenging for main contractors to readily obtain quotes from the market and SCF Main Contractors warn of longer return times.

With market conditions such as these, cash flow remains integral to the health of the supply chain. Build UK has transparently published the construction sector's payment performance over the last 6 months and has identified that half of main contractors pay supply chain in 30 days or less. Over the last 4 years of SCF, on average 80.8% and 98.8% of payments from client to main contractor and main contractor to supply chain have been made within 30 days respectively.

Quarterly Change in Building Cost



Steelwork

Steel prices have continued to be of concern throughout Q2. SCF Main Contractors have observed the building cost of Steelwork to now be an average 16% higher than this same time last year, with some Steel Framing System manufacturers reporting an uplift in cost of 20% during Q2 alone.

These uplifts have been heavily derived from the cost of energy manufacture and transportation and as result national suppliers such as British Steel have held their prices regardless of changes in demand.

Dry Lining

SCF Main Contractors have identified the average building cost of Dry Lining to be 27% greater than this same time last year. Suppliers of glass wool insulation products have raised prices up to 30% due to high energy costs.

Windows

The energy intensive nature of glass manufacture has resulted in SCF Main Contractors identifying a 31% and 23% increase in the building cost of Window and Curtain Walling when compared to this time last year.

M&E

A variety of electrical components such as a microchips, motors, and extract fans have been in short supply and as a result have been subject to recent price increases. To this end, SCF Main Contractors have identified the average building cost of M&E to be 16% higher than this same time last year.

However, in recent weeks the cost of aluminium, used in products such as grilles and diffusers, has stabilised. However, market volatility in China continues to destabilise metal prices.

Transport

With fuel prices remaining high the cost of transporting goods continues to impact upon building cost.

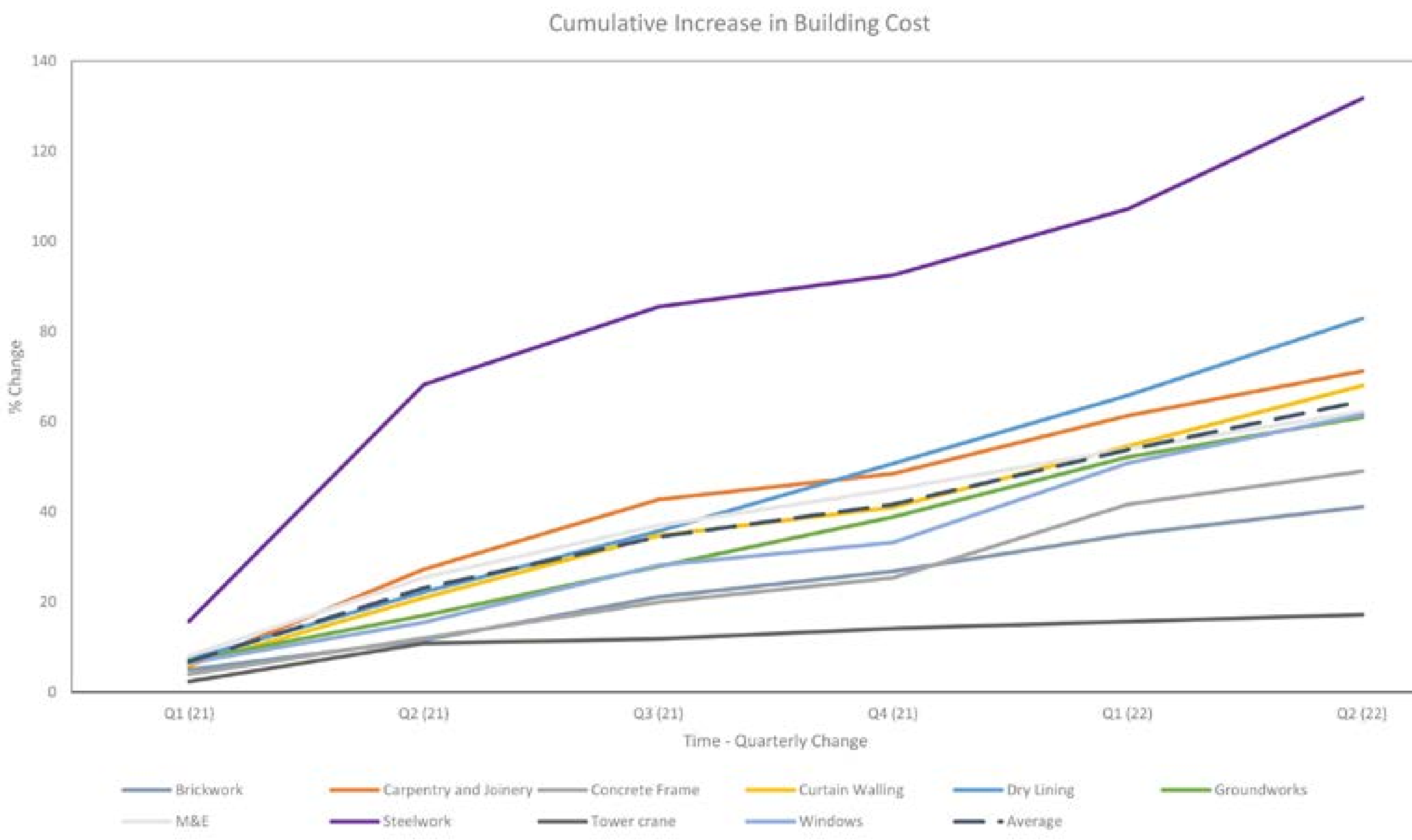
SCF Main Contractors warn of diesel costs and HVO now sitting 36.21% and 153.85% respectively higher than this same time last year.

However, the government decision to cut fuel duty by 5 pence per litre will result in an average saving of £2,356 per year, per 44-tonne truck.

"The need for prompt payment throughout the supply chain has never been so prevalent. With SME's being vulnerable to cashflow challenges, it is more important than ever for the appropriate allocation of risk.

With unprecedented market conditions, managing supply chains is increasingly complex. Utilise early contractor engagement and take an integrated team approach to discuss issues and best decide upon the optimum solution. A transparent approach to project budgets, risk allocation and pricing, will ensure an environment in which market risks can be effectively managed and mitigated, reducing uncertainty in procurement, and increasing certainty on costs.

Kingsley Clarke, Operations Lead



Material Availability

The zero Covid strategy employed in China has resulted in lengthy lockdowns in urban areas that have impacted heavily upon international shipping ports. As a result, material availability has been volatile as global shipping continues to settle.

In addition, SCF Main Contractors warn that as materials come under shortage a premium price is expected for those in urgent need of materials.

As a result, SCF Main Contractors and their trade supply chains have identified material lead time to have increased by 1.5 weeks during Q2 alone, this is now 2.5 weeks greater than this same time last year.

SCF Main Contractors have identified the greatest quarterly increase in material lead time for the following trades:

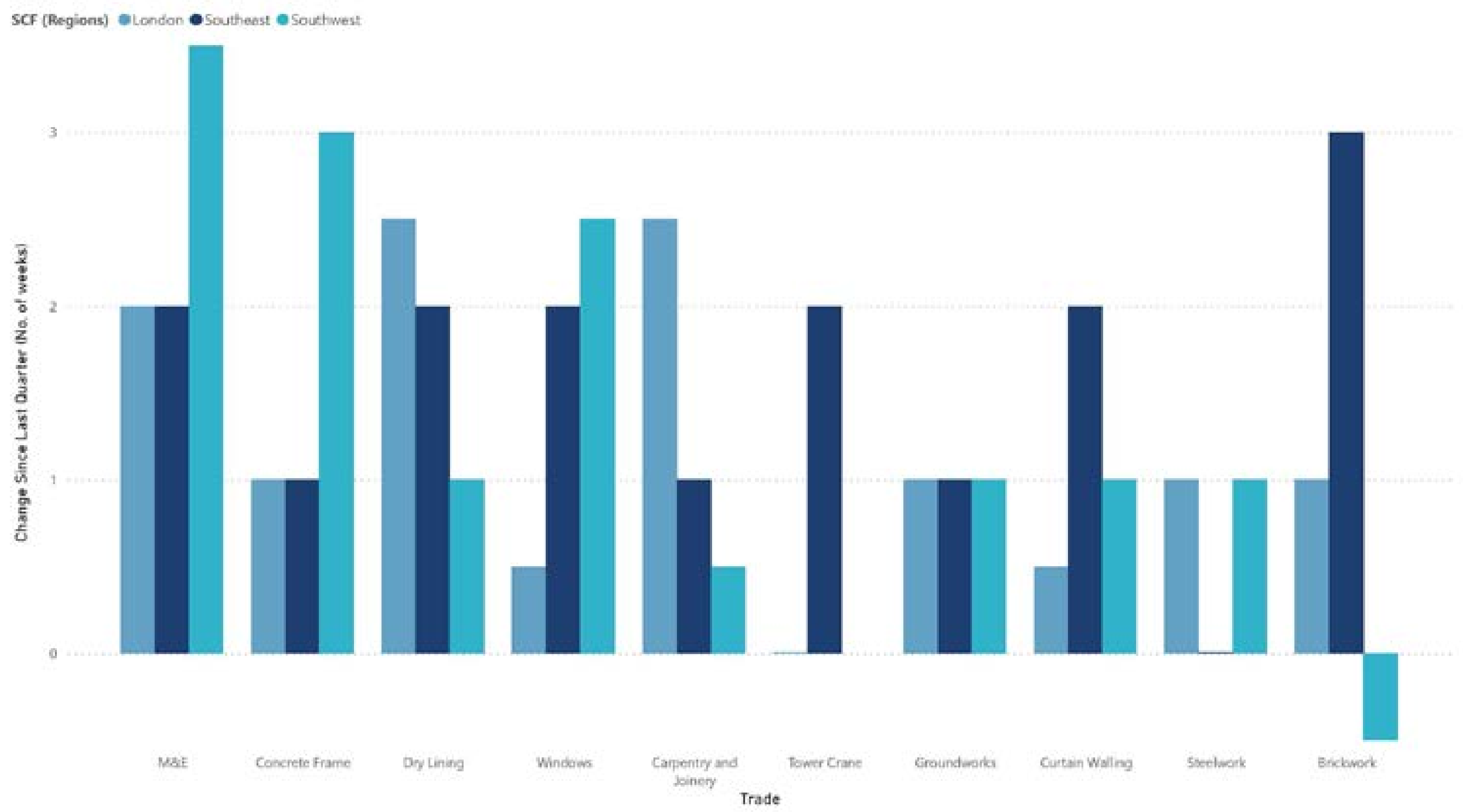
- M&E +3 weeks
- Concrete Frame +2 weeks
- Windows +2 weeks

Although lead time for materials has significantly increased over the last 12 months, SCF Main Contractors highlight that they are now better equipped to manage these risks through prompt planning and early engagement.

A wide range of electrical and engineering components have been particularly challenging to source throughout Q2.

Product	Usual Lead Time (Weeks)	Current Lead Time (Weeks)
Air Handling Units	8-10	12-16
Fan Coil Units	4-6	5-8
Roof Top Units	8-10	14-15
Commercial Boilers	8	12
Air Source Heat Pumps	3-4	4-6
Water Source Heat Pumps	6-8	11
Chillers	10-12	14-16
Copper Tube Fittings	1	3-4
Dry Coolers	8-10	20-22
Transformers	12	16
Generators	12	18-30
UPS System	4	14
Cables	2	2-12

Quarterly Change in Material & Labour Availability



Looking ahead: 2023 Forecast

The SCF survey depicts life from the view of the supply chain and captures how individual businesses are faring throughout these challenging times. With market conditions being so volatile and the cost of living expected to rise, the supply chain has found it particularly challenging to forecast what life will look, especially in regard to building cost at this same time next year.

Tender Workload

SCF Main Contractors and their trade supply chain forecast an average annual increase of 3% in tender workload.

The trades with the greatest forecasted increase include:

- Concrete Frame 6%
- Tower crane 6%
- Curtain Walling 5%

However, when compared to previous quarters, a forecasted 3% increase in tender workload is relatively modest, suggesting a slowing of pipeline as the potential for a recession emerges.

"SCF Main Contractors suggest that where possible avoid fixing specification at planning. This can limit your options in sourcing alternate materials with availability and cost benefits over the course of your project.

Consider early orders and pre-manufactured building elements of key materials on your critical path. This will support with timely delivery."

James Wright*, *Senior Framework Manager

Employment

In our Q1 report, SCF Main Contractors and their trade supply chains forecast an annual average increase of 3% in the number of employees across all trades in response to high tender workload.

In contrast, SCF Main Contractors and their trade supply chain have now forecast an annual 1.5% increase in the number of employees across all trades. With prolonged economic uncertainty the supply chain may lack confidence in their capacity to recruit.

For example, the number of Steelwork employees is anticipated to decrease by 1% over the next 12 months, with no change anticipated for Tower Crane, Carpentry & Joinery and Groundworks. However, if conflict in Ukraine was to cease in the near future, the need for construction in Ukraine may draw a decreasing European workforce away from the UK.

Building Cost

With energy prices due to be reviewed in October, products are vulnerable to continued price uplifts. To this end, SCF Main Contractors and their trades supply chain forecast an average increase in building cost of 10% across all trades over the next 12 months.

The trades with the greatest forecasted increase in building cost include:

- Dry Lining 16%
- Curtain Walling 12%
- Steelwork 12%
- Groundworks 11%

Material Availability

A statement from the Construction Leadership Council's Product Availability group has forecasted a stabilisation in material availability over the rest of the year as bottlenecks start to ease. If tender workload begins to stabilise in response to economic hardship, material availability may improve, and stockpiles continue to replenish.

However, SCF Main Contractors and their trade supply chain have warned that it will take time for supply chains to unblock and return to pre-pandemic conditions. To this end, SCF Main Contractors and their trades supply chain forecast an average increase in lead time of 1.5 weeks across all trades over the next 12 months.

The trades with the greatest annual forecast in increased lead time include:

- M&E +4 weeks
- Concrete Frame +3 weeks
- Curtain Walling + 2 weeks

SCF Consult - Reflective Note

A recent release from the Construction Leadership Council mentioned the risk that in 2023, wage inflation may become more of an issue. With hopes of material availability settling down, they suggested it could become the key risk for contractors next year.

Notably, construction, as with other sectors, have seen vacancies hit record highs over the past year. Highlighting just how many open roles there are, whereas in 2019, the average number of vacancies was 26,000, they have recently hit 48,000.

While they have fallen back slightly in the past couple of months, they are still significantly larger than their pre-pandemic levels. Having been at such elevated levels for so long, and with the overall construction industry having ambitious growth plans, it is clear why the CLC fears mounting difficulties in sourcing the necessary labour.

So far, the ONS data on employee earnings has shown only limited, albeit increasing, effects of the struggles some employers are having in finding staff. At the end of last year, regular pay growth stood at 2.1%, which has since risen to 5.2%. At this level, which in being similar to that seen at points in both 2018 and 2019, firms may feel able to manage the increases.

Similarly, as material price inflation is currently over 25%, increasing labour costs are not the main cause for concern. Yet, if they continue to pick-up, it is easy to see why the CLC believe 2023 may be a more challenging year.

Furthermore, while there is still a lid being kept on regular pay, bonuses and one-off payments have soared. As a result, total pay is now rising at over 8% a year, which is more problematic. Firms using bonuses as incentives is something that other surveys, including one produced by the Bank of England, have also remarked on. While avoiding increases to regular pay will help keep staff costs down if the economy weakens, if firms start to find such payments aren't enough to keep staff, they may have to raise regular pay further.

Managing Inflation Through Contracts

Inflationary pressures following Brexit, COVID-19 and the war in Ukraine are likely to be with the industry for a considerable time. This will increase tension between SCF clients' desire for price certainty and the supply chain's ability to deliver at fixed prices, and to a pre-determined programme, over the life of a contract. This tension will be exacerbated for projects with lengthy programmes and reliance on scarce materials. Consequently, the supply chain will seek ways to manage the risks of cost escalation, including re-allocating risk in construction contracts.

SCF clients are best advised to collaborate in finding solutions – committing time to planning ahead, thinking strategically about procurement and working together with the supply chain to actively address inflationary pressures. SCF's framework procurement model of two-stage with early contractor engagement provides the opportunity for early planning, design and sourcing which is increasingly important in inflationary times. In order to maximise this opportunity, ensuring prospective delivery partners at initial procurement (Stage 1) are engaged based upon a robust and appropriate suite of information is paramount. Moreover, SCF clients are advised in ensuring that they are proactive and focused around ensuring robust processes, governance and controls are in place to work collaboratively with their elected delivery partner to support and effect the attainment of best value from the supply chain at point of 2nd stage procurement. This is critical to avoid cost escalation over the pre-construction lifecycle.

In addition to collaborative engagement, clients should also explore and consider alternative designs, suppliers, materials or components that could be substituted and are less prone to the risk of delay and inflation. Consider material availability when seeking planning approvals, then review availability and delivery times of key components and materials and how these may be secured before ordering. Consider early ordering of and payment for material or key components to lock-in prices.

JCT and NEC contracts provide for advance payment and off-site material bonds to secure early orders and deliveries. Conduct regular financial checks on companies in your supply chain. Consider whether these suppliers are sufficiently resilient and have their own plans in place to deal with shortages and lead-times. As cash flow will be increasingly important to the supply chain, ensure that contractor's applications for payment are submitted in accordance with the contract's requirements, and are valued correctly.

In current conditions of price volatility, for projects with long programmes or materials subject to high price volatility where the supply chain is unwilling to tender on a fixed price basis or prices such risk at an unacceptably high premium, fluctuations clauses may provide an effective mechanism for managing price inflation through the contract and thus securing supply chain engagement. Fluctuations clauses allow the price of a construction contract to be adjusted to reflect changes in the cost of materials and/or labour during the contract period in accordance with objectively measured price rises. JCT 2016 contracts include three fluctuation options which cover statutory changes; labour and materials cost and tax fluctuations; and formula adjustment using cost indices produced by the RICS. NEC4 contracts include three groups of options in relation to price inflation: a lump sum for the works where the supplying party carries the cost risk including inflation, save for Compensation Events or specific risks allocated under the contract; a target price for the works and respective shares of savings or overrun known as pain/gain sharing; and "cost plus" options where the client carries the risk on costs including inflation.

As always, risks need to be appropriately identified and assessed with those best placed to manage them taking responsibility. This is in line with the Construction Playbook, which highlights the importance of good risk managment being key to delivering value for money and successful outcomes.