Equals

Tender Price Inflation Report (London)

3rd Quarter 2016

Headlines

— Equals predicts 2% TPI for both 2017 and 2018.
— Concerns regarding potential slowdown begin to materialise as demand drops off.
— Investment in commercial property sector declines.
— Tender price forecasts flatten but pockets of high demand and inflation persist.
— Medium and long term impacts of the UK's vote to leave the EU remain unclear.
— Exchange rate fluctuations increase import prices.

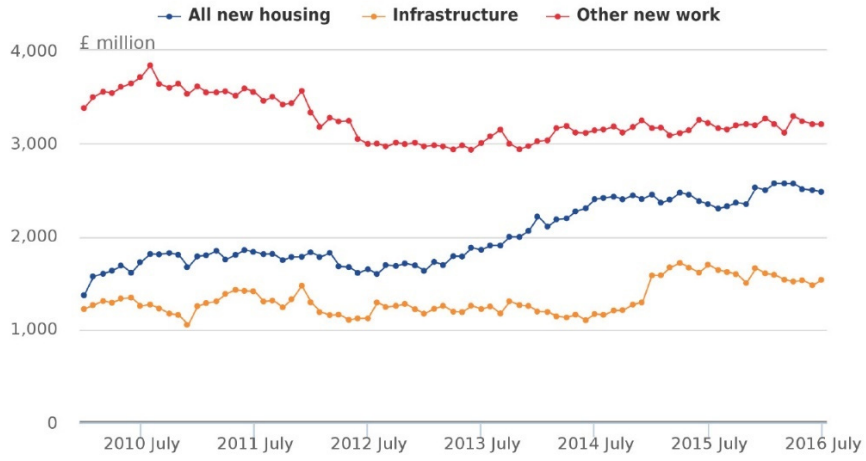
Introduction

In our last report we forecast that annual tender price increases would begin to slow with consequential impacts on procurement and tendering methods. We previously forecast inflation of 4.5% for 2016, dipping slightly by 4.25% - 4.0% into 2017 – 2018. In this report we maintain that tender prices will continue to rise but at a slower pace (see table). Across the market forecasters have dramatically revised their forecasts downwards for tender price inflation.

Industry Overview

Overall, in the past year (July 2015 to July 2016) output decreased by 1.5% indicating there is an ongoing contraction of the market. There are signs this contraction is accelerating as in the 3 months of May/June/July compared to the previous 3 months all output fell by 1.2%, however this is likely to be reflective of the Brexit vote and short term reaction. For new work only, housing has grown over the year by 5.6% showing continued strength, however for other new work excluding infrastructure and housing the picture was fairly flat in the year to date with a slight fall of 0.4%. This will encapsulate the widely reported decline in the commercial property market. Within the infrastructure market despite a general downward trend in output over the year to date there have been recent boosts resulting in growth during July 2016. These include a commitment by the Chancellor of the Exchequer to continue to support infrastructure spending with the recent approval of Hinckley Point C.

Components of all new work, July 2016
Chained volume measure, seasonally adjusted, Great Britain



Source: Construction: Output and Employment – Office for National Statistics[1]

Both the Bank of England and RICS UK Construction Market Survey have also reported slowdowns in the economy. The RICS highlights skills shortages, financial constraints, and planning and regulatory delay as key inhibitors of growth.

Whilst a downturn in the market was anticipated market sentiment does not generally foresee it to be as sharp a correction as during the previous recession of 2007 where there were underlying structural issues. The impact of the external shock to the industry of the UK voting to leave the EU will however have consequences on the construction market and may amplify the underlying downturn; the full extent of which are not yet known. In summary, industry output is slowing and construction is technically in a recession. However existing orders and a limited supply base keep the market busy particularly in certain trades and geographic areas such as London.

1. Office for National Statistics, Statistical Bulletin Construction Output in GB: July 2016, released 9 September 2016

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Tender Price Inflation

The following table shows the forecasts for tender price inflation from a number of different market commentators as well as the BCIS (Building Cost Information Service), the industry data collection service. Tender price inflation forecasts have been largely reduced across the board in the light of both the apparent down turn and the uncertainty following the UK's vote to leave the EU. Our forecast assumes the Brexit negotiations are not protracted and there is no significant market reaction either nationally or globally.

	Report Date	2016	2017	2018	2019
Post Brexit Forecasts					
BCIS (UK)	Q3 2016	0.4	-2.6	-1.5	2.7
Alinea (London)	Q3 2016	6.0	1.5	2.0	3.5
Arcadis (London)	Q3 2016	1.0	-2.5	-1.0	N/A
Equals (London)	Q3 2016	3.5	2.0	2.0	3.0
Mace (London)	Q3 2016	2.0	0.0	-1.0	N/A
Pre Brexit Forecasts					
AECOM (London)	Q1 2016	5.6	5.2	4.0	3.9
G&T (London)	Q2 2016	5.0	3.5	3.0	2.5
Gleeds (London)	Q4 2015	7.0	6.0	6.0	5.0
Faithful+Gould (UK)	Q4 2015	4.5	4.0	4.0	N/A

Impact of Brexit

Whilst many of the potential impacts of Britain's choice to leave the EU are still unknown there is undoubtedly increased uncertainty in the market particularly around the following key areas.

- The drop in the pound against the Euro and USD. The sterling to euro exchange rate dropped from €1.37 in January 2016 to an annual low of €1.15 in August this year (a drop of 16%)[2]. Whilst it appears to have largely stabilised at around this lower level this has increased the cost of imports from Europe.
- Uncertainty regarding the continuing supply of labour to trades from within the European Union could reduce supply and has the potential to result in an increase in the prices of labour intensive elements.
- On the 4th August the Bank of England reduced the base rate to 0.25% to encourage investment and growth.[3] Foreign interest in commercial property particularly has dropped following withdrawal of investment from property funds and it remains to be seen whether the base rate change is sufficient to precipitate a return to confidence.

Key Risks and Opportunities

- Client appraisals need to consider the increased level of risk surrounding purchasing and supply-side constraints.
- There is a potential increase in supply side costs triggered by statutory change such as the apprenticeship levy and shortage of labour.
- Existing tenders or prices with foreign exchange risk embedded may need to provision for exchange rate fluctuations.
- The speculative new build commercial property market is expected to remain subdued.
- A period of persistent residual inflation in the short term along with a falling market for sales could trigger a contraction of the market and increasing pressure on contractors as costs potentially escalate.

Equals is an independent consultancy formed by highly experienced industry professionals providing project management and cost management.

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2.Reuters data, accessed 23/09/2016
3.Bank of England website, accessed 23/09/2016