Tender Price Inflation Report (London)

4th Quarter 2021

Tender Price Inflation

It appears that, as of January 2022, the UK has gone back to something resembling 'normal' after the pandemic.

In this report we examine how COVID-19 and other market changes have affected the industry, and what key factors will influence future pricing levels.

As we break free from Covid-19, what factors will influence tender prices?

At the beginning of the pandemic, the construction industry was able to remain relatively buoyant and was considered a highlight of the economy over the pandemic period. However, Covid-19 started to show its teeth in mid-2021, as it has to almost every other industry, and the impacts appear to be severe. Over the last 6-12 months, the construction industry has started to feel the effects on both construction output and tender prices.

Rising material costs, labour shortages and diminishing consumer confidence have converged, leading to both an increase in construction costs and a decline in output.

Covid-19 is not the only factor that is affecting increasing construction costs. Rises to materials prices are also a result of increased energy prices. As manufacturing of materials is an energy-intensive process, increases to energy prices are having a direct and substantial effect on materials' prices. This looks set to continue in 2022.

British Steel, for example, has blamed soaring energy and transport costs for the latest price increase to structural steel in October 2021, citing wholesale electricity prices as being up 300% and natural gas prices almost 400% since the end of 2020 in October 2021, with cost increases set to continue.

These price increases have impacted several contractors who have undertaken fixed-price contracts prior to the pandemic effects, and some may now face challenges to successfully deliver existing projects.

Despite these challenges, sentiment remains positive in the industry which has been bolstered by the government's sizeable investments in infrastructure over the next 10 years. However, this may come at a price and with labour and materials shortages set to continue, construction costs are expected to rise in the short to medium term.

As a result of these factors, the Tender Price Index (TPI) is expected to continue to increase over the forecasting period, with energy price rises coming into effect in Q2 2022.

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Unsurprisingly, given the current climate, all sources have increased their TPI forecasts since their previous reports.

It is probable that these figures will increase further within any new Q4 2021 and Q1 2022 reports, as the market has seen further movement between mid-2021 and early-2022. Furthermore, demand is set to increase in the coming years due to several factors, including the lifting of Covid-19 restrictions, continued housing shortages throughout the UK and significant investment in infrastructure from the government over the next decade. As a result, demand-pull inflation is set to continue over the forecasting period.

With general inflation currently soaring, TPI is also expected to remain high due to the following reasons. Firstly, increasing construction demand together with paused projects over the lockdown period now resuming, has led to and will continue to create demand-pull inflation.

Secondly, rising energy prices, delays, and shortages caused by lack of HGV drivers and construction workers have combined to create significant cost-push inflation within the industry.

Looking longer term, BCIS have stated that materials supply difficulties are expected to stabilise by 3rd Quarter 2022, with materials' prices expected to rise by 15% between 3Q2021 and 3Q2026. This is after a rise of 16.9% between 3Q 2020 to 3Q 2021.

Tender price predictions (%)

Forecasts	Report date	2021	2022	2023	2024	2025
Equals (London)	**Q4 2021**	**4.0%**	**4.2%**	**3.8%**	**3.8%**	**4.0%**
BCIS (UK wide)	Q3 2021	6.5%	4.4%	4.8%	4.1%	4.4%
Arcadis (London)	Q4 2021	3.0%	3.0%	3.0%	5.0%	5.0%
G&T (London)	Q4 2021	2.5%	2.3%	2.0%	2.0%	-
F&G (London)	Q3 2021	3.0%	3.0%	3.5%	3.5%	-
RLB (London and SE)	Q4 2021	3.8%	3.3%	3.3%	3.0%	3.0%
T&T Infrastructure (UK)	Q3 2021	3.0%	3.5%	4.5%	5.0%	5.0%
T&T Real Estate (UK)	Q3 2021	5.5%	3.5%	4.0%	4.5%	4.5%
Mace (London)	Q3 2021	3.0%	3.5%	3.5%	2.5%	2.5%
Average		**3.8%**	**3.4%**	**3.6%**	**3.7%**	**4.1%**

Source: Construction Industry Reports

Construction output

— Construction output fell month-on-month in July 2021 by 1.6%. Output is now below its pre-Covid February 2020 level according to the ONS.
— Decreases in new work, as well as repair and maintenance, both contributed to the decline and anecdotal evidence suggests that these decreases have been due to significant price increases and materials shortages caused by supply chain issues.
— Infrastructure was the only new work sector where the level of output in July 2021 was above that of February 2020. This is due to the Government's continued spending on infrastructure throughout the pandemic.
— Construction output within infrastructure looks set to continue as the Government announced their latest National Infrastructure and Construction Pipeline, in which, a further £650bn of private and public investment is expected in infrastructure over the next decade.

Difference in Construction Output
February 2020 to July 2021

	%	£ millions
Total All Work	**-1.8**	**-287**
Total all New Work	-3.2	-285
Total repair and maintenance	0.6	27
New Housing		
Public	-11.2	-62
Private	-8.4	-249
Other New Work		
Infrastructure	35.7	649
Public	-11.9	-105
Private Industrial	-7.7	-36
Private Commercial	-20.3	-481
Repair and Maintenance		
Public Housing	-5.0	-34
Private Housing	-4.0	-70
Non-housing	5.4	131

Source: Office for National Statistics - Construction Output and Employment

Summary

Despite the construction industry staying relatively resilient to Covid-19 initially, it has since become apparent over the last year that the pandemic has clearly affected the industry with significant increases to costs. However, Covid-19 is not the only factor, with Brexit, energy prices and labour shortages also playing a part. It is possible that once the effects of Covid-19 have been absorbed, moving forward, Brexit and energy prices will be the determining factors in tender price inflation, together with general inflation within the UK.

There are two main factors that will affect tender price inflation over the coming years. Firstly, demand-pull inflation which was brought about by a bottle-necking of now resumed projects caused by the lockdown. Furthermore, demand-pull inflation is set to continue with construction demand expected to increase over the forecasting period.

The second factor is cost-push inflation. There is currently significant pressure on the supply chain mainly due to labour shortages, specifically HGV drivers, and considerable increases to energy prices. These factors lead to several issues, the most important being the increased cost of materials, and therefore construction.

Over the past year, we have seen that contractors have been taking the brunt of these increased costs by reducing their margins; however, this will not be sustainable in the long term.

The anticipated tender price increases in Q1 and Q2 2022 resulting from these factors can only be exacerbated by the developing crisis in Ukraine, paving the way for potential sharp TPI movement in the next period.

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

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