Southern Construction Framework

Market Intelligence

Q1 2024

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Introduction

As part of SCF's commitment to collaboration and transparency, every quarter, SCF main contractors gather market intelligence from the construction industry directly through their trade supply chains. Our intelligence analyses data across 11 key trade packages from across the south of the UK, identifying regional market trends and forecasts for the following year.

Professional consultants from the SCF Consult framework also share their valuable monitoring of the construction market and provide supporting commentary on the returned data.
Data for this report has been formed from over 150 subcontractors from across the south of the UK, providing a real-time indication of market trends from those directly involved with construction. We share this information with our clients to highlight key areas of risk that may impact on project delivery.

SCF Main Contractors, Consultants, 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.

Foreword

- **Tender Workload +3.2%**
- **Building Cost +2.3%**
- **Employment +0.4%**
- **Stable Material Availability**

Data from the ONS shows construction output to have decreased throughout Q1 for both New Work and Repair & Maintenance, however, our trade subcontractors reported an increase in tender workload this quarter, suggesting that the road to recovery is complex with many factors influencing the market.
Insolvencies within the industry still remain a real concern with a high number of firms going into administration. This may be reducing the pool of suppliers available to bid and resulting in the remaining subcontractors experiencing increased tender activity.

As a result, with mounting insolvencies our latest annual supply chain survey shows some subcontractors to have adopted a risk adverse approach with an increasingly selective view over the projects they choose to bid; with procurement factors such as main contractor solvency, high quality design information, and pipeline visibility heavily influencing bid decisions.

Past inflation is still causing affordability pressures on budgets and leading to elongated preconstruction programmes. Consequently, many projects are still subject to rounds of value engineering in order to achieve affordability, again contributing to high levels of tender workload amongst the supply chain but not necessarily increasing construction output within the industry.

The rest of the year will likely remain challenging, Mace Consult suggest that the recovery of the construction industry will not rebound until interest rates begin to fall, although interest rates have remained high in the year to date, there are expectations that these could be cut come June as services inflation and wage growth slows. However, Mace warn that a number of cuts will need to take place before developers' confidence resumes and construction spending improves.

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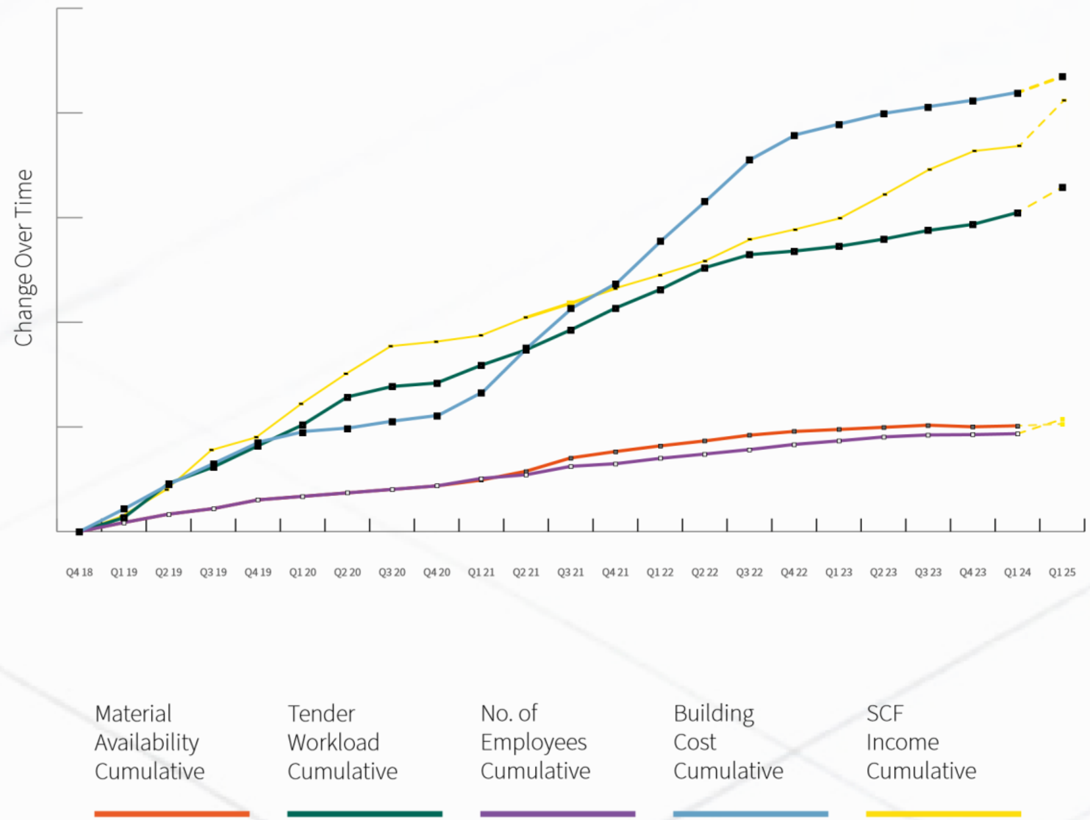
Tender Workload

Throughout Q1 tender workload increased by an average of 3.2% across all trades. The trades with the largest increase include:

- M&E 9.5%
- Dry Lining 6.7%
- Steelwork 5.4%
- Concrete Frame 4.9%

This suggests that for some trades, pipelines are still relatively strong. For example, a recent M&E survey by Gardiner & Theobald, identified order books to be healthy with 90% of M&E contractors forecasting an increase in turnover for 2024 with an average increase of 26% this past financial year. Firms reported workstreams such as decarbonisation to help contribute to this pipeline.

However, a rise in tendering activity may not solely reflect strong workload within the industry. Although our data shows building cost to be less volatile in 2023/24 when compared with 2021/22, affordability pressures on projects are still frequent with many schemes vulnerable to outdated budget setting and high interest rates. Cost challenges are often resulting in elongated preconstruction programmes with multiple iterations of value engineering taking place to reach viability. Thus, driving up tendering activity amongst the supply chain, but not necessarily leading to an increase in construction output. This is highly applicable for M&E services, our trade with the greatest increase (9.5%), where value engineering opportunities have the potential to lead to considerable cost savings.



Similarly, results from our annual supply chain survey show 5% of subcontractors view their biggest challenge over the next 12 months to be the certainty of projects progressing from preconstruction to onsite derived from ongoing programme delays and project cancellations. This is leading to concerns over securing sufficient workload and managing fluctuating programmes.

Analysis from the ONS supports this, with monthly construction output having decreased in volume by 1.9% in February 2024. Both new work and repair & maintenance decreased by 2.3% and 1.4% respectively showcasing a downturn in industry workload. The ONS suggests that heavy rainfall in February also contributed to this monthly reduction with planned starts being delayed.

When compared with the same time last year, our dataset shows tender workload was only 0.5% greater in Q1 24 – with 6 of 11 trades reporting an average downturn in tender activity.

- Windows -9.6%
- Tower Crane -5.6%
- Curtain Walling -3.9%
- Brickwork -2.8%
- Concrete Frame -2.2%
- M&E -1.1%

Similarly, data from the ONS, measured 8 out of the 9 analysed sectors experienced a downturn in construction output in February 24.

For some trades high levels of tender workload could reflect an increasingly competitive market and a resulting appetite to bid more to secure necessary turnover. Our survey shows subcontractors are still cautious over future pipelines, particularly with expected political changes and local elections due to take place. As a result, some businesses may look to chase turnover to try and mitigate against future volatility.

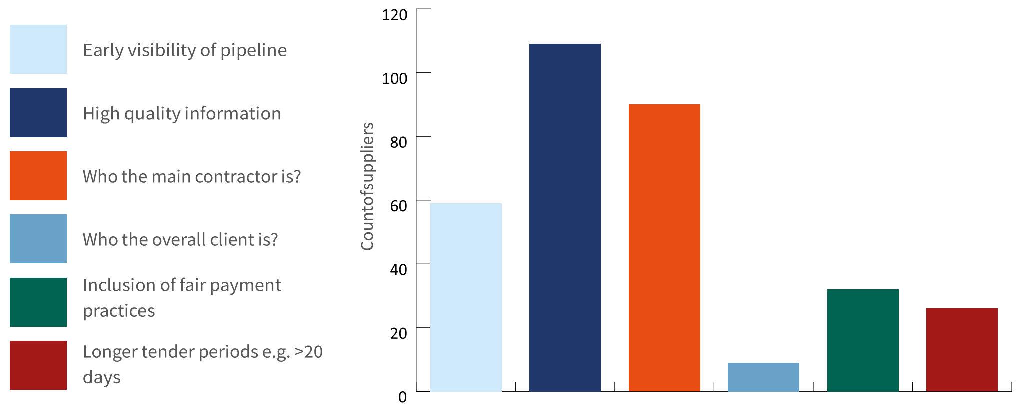
SCF Top Tip

Due to uncertainty in the market, SCF Main Contractors reported that some subcontractors are increasingly selective over the opportunities they choose to pursue to minimise risk to their business using factors such as the below to help dictate procurement choices:

- Main contractor solvency
- Fair payment practices
- High quality design information
- Pipeline visibility & programme certainty

From our survey, suppliers ranked a high quality of design information and identity of main contractor as the two most influential factors when deciding to bid projects. In many cases, trades are looking to secure schemes that utilise forward engagement. Where possible, clients should look to utilise early engagement with their Main Contractor, this way you can work together to ensure that design solutions incorporate current market pressures and supply chain input before detailed design. Our data shows a 49% increase in added value benefits can be achieved when engaging a main contractor at RIBA 1 compared with RIBA 4, our survey also shows 78% of subcontractors would provide impartial early advice to clients even if an opportunity to tender for works was not guaranteed.

Factors affecting bid submission:



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Employment

Employment was 2.4% greater in Q1 24 when compared with the same time last year. Trades with the largest increase in annual employee numbers include:

- Groundworks 8.2%
- M&E 6.6%
- Carpentry & Joinery 5.8%

Although construction output has decreased annually suggesting a reduced need for onsite staff, high tender workloads have likely led to the requirement for bigger preconstruction teams in order to respond to enquiries; helping to driving our employment data amongst some disciplines.

However, trades such as Brickwork and Tower Crane reported a decrease in the number of employees when compared with the same time last year at -4.81 % and -5.2% respectively. A decrease in employment for brickwork firms aligns with findings from Glenigans, where main contract award for housing projects was 29% less in March24 when compared with the previous year. A decrease in tower crane usage may reflect a rising demand for refurbishment projects over new build construction, particularly in urban areas like London.

SCF data shows a disparity between the rate of increase in tender workload and employee numbers over time; suggesting there is a shortfall in work force being able to respond to both delivery or tender demands. SCF's annual supply chain survey shows 15% of subcontractors viewed a lack of skilled workers to be the construction industry's greatest challenge over the next year.

SCF Top Tip

Through mandatory apprentices and compulsory Employment and Skills Plans on every project, SCF Main Contractors are doing their part to tackle the industry wide skills shortage. To support these efforts, clients should look to engage Main Contractors and the supply chain early. This will enable sufficient engagement with local people and ensure as many opportunities as possible are created for new entrants to the industry. In partnership with the Local Supply Chain portal, SCF has launched an apprenticeship database. This tool enables apprentices to register interest in large construction projects helping to connect them with main contractors and trade supply chains.

To help raise awareness of the construction industry, SCF Main Contractors are working to highlight the diversity of roles available through virtual learning modules. Content is currently targeted at primary school children to help generate interest in the industry at an early age.

Material Availability

On a positive note, at present SCF Main Contractors report material availability to be stable, with trades observing no change in average lead time for Q1. Brickwork and Roofing & Cladding firms confirmed improved availability for materials; likely driven by a downturn in the housing sector. M&E was the only trade with a 2 week increase in lead time during Q1, an M&E questionnaire by Gardiner & Theobald cites transformers, HV equipment, generators, switchgear, and air source heat pumps to be some of the products effecting lead times.

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Building Cost

Build cost continued to rise in Q1 with an average increase of 2.3%. Trades with the largest increase include:

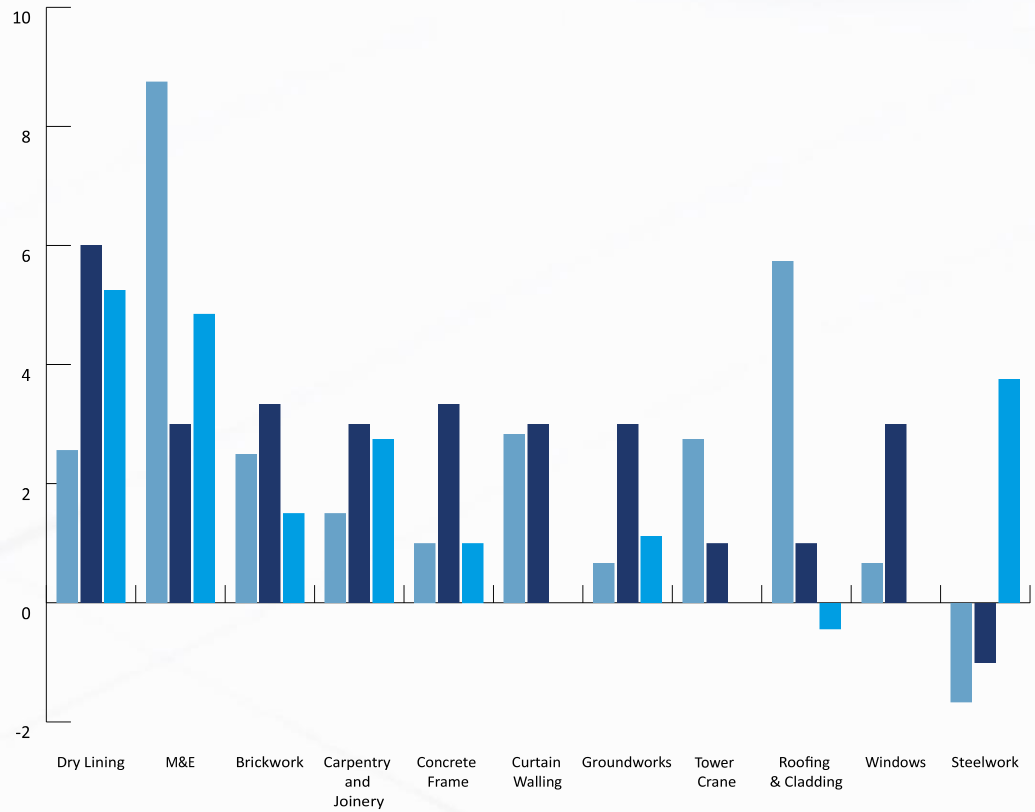
- Dry Lining 4.7%
- M&E 4.6%
- Brickwork 2.6%
- Carpentry & Joinery 2.4%

Although our data shows rate of increase in 23/24 slowed when compared with 21/22, suggesting that prices are stabilising to more typical levels of inflation, building cost was still 5% greater in Q1 when compared with the same time last year. The trades with the largest increase include the below.

- Drylining 10.2%
- Roofing & Cladding 8.9%
- M&E 7.4%
- Brickwork 5.8%

In March 24 the Consumer Price Index (CPIH) was at 3.8% when compared with the previous year, slightly lower than our average data, suggesting some trades are more heavily impacted by input costs such as material and labour than others.

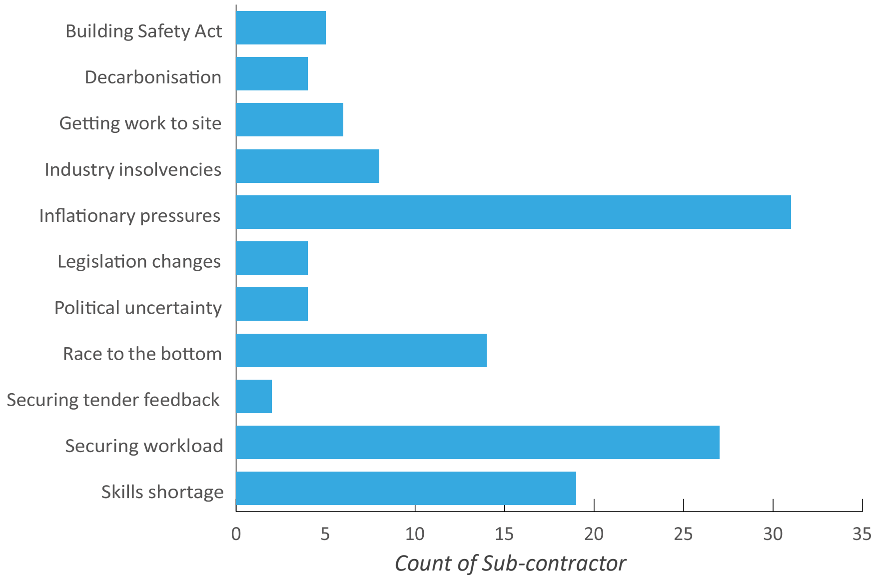
However, reports from the ONS and BCIS suggest that on the whole pricing in the industry is becoming more competitive amongst suppliers as overall output has downturned.



Reports from the Insolvency Service, showcase the construction industry to be responsible for 16.6% of all insolvencies in England and Wales in January 2024, with a total of 4,383 firms becoming insolvent over the 12 months prior. This trend is likely driven by a slowing of construction activity and past inflationary pressures.

Our supply chain survey shows 11% of subcontractors thought that their biggest challenge over the next 12 months was the impacts of "*race to the bottom*" procurement and insolvencies as firms may look to cut margins in attempt to secure turnover.

Biggest supply chain challenge



SCF Main Contractors warn that high profile insolvencies may leave gaps in the market where the number of capable firms being able to bid work will reduce, particularly amongst specialists. As recovery unfolds this could lead to a pool of less competing businesses and hinder competitive pricing going forwards. In some cases, main contractors may be pressured into approaching and contracting with tier 2 or 3 suppliers to demonstrate value but risk overloading their capacity.

SCF Top Tip

The SCF process places emphasis on a mutually agreed procurement strategy and threads this throughout its governance, project teams should look to understand and agree risks and opportunities surrounding package procurement. Utilise supply chain databases, such as the Local Supply Chain portal, these can be used to robustly test the local market ensuring your procurement strategy provides maximum value and factors in supply chain resilience.

Biodiversity Net Gain
In February 24, it became legislation developers to achieve a 10% biodiversity net gain on projects. It's estimated this could add anywhere between 0.1% and 5% of the build cost. Look at our BNG tool to view opportunities to support compliance at each RIBA stage. Biodiversity Net Gain Guidance

Building Safety Act
As changes from the Building for Safety Act come into effect, SCF Main Contractors will be tracking the cost and lead time of fire stopping products. With the act placing greater emphasis on design, compliance, and competency, contractors expect cost to increase due to greater management and documentation.

Looking Ahead

Tender Workload

By this time next year, tender workload is expected to increase by an average of 7.3% across all trades. The trades with the largest increase include:

- Concrete Frame 16.6%
- M&E 10.9%
- Steelwork 8.7%
- Groundworks 8.7%

Employment

Average employee numbers are expected to increase by 4.2% by Q1 25. The trades with the largest increase include:

- Brickwork 10.1%
- M&E 9.1%
- Drylining 6.0%
- Groundworks 5.3%

Building Cost

SCF Main Contractors and their trade supply chain forecast building cost to increase by 4.6% by Q1 25. The trades with the largest increase include:

- Drylining 6.6%
- M&E 6.1%
- Carpentry & Joinery 5.1%
- Brickwork 5.0%

Material Availability

Material lead times are expected to remain constant over the course of the year. However, contractors remain cautious that geopolitical political impacts, such as the ongoing volatility in the middle east, could cause disruptions to supply chains.

SCF Consult

Reconciling survey respondents reporting strong tender activity with falling construction output and weak new orders data published by the ONS, is not immediately straightforward. While new orders did rise in Q1 2024, this was from a very low base and the volume of new contracts is not only still slightly lower than it was a year ago, but also considerably down on where they were in 2022. Worryingly, insolvencies remain very high, however this in part could explain the strength of tendering activity. With fewer firms operating, it means clients and main contractors have a smaller pool of subcontractors who they can engage.

This mix of firms seeing more tendering opportunities despite the high levels of insolvencies could create a complex mix. Firms will continue to fail this year, and some of those near collapse may believe that going in with ultracompetitive bids will help stave off their troubles. Meanwhile, better placed firms are becoming increasingly risk averse. Aware of the challenges in the market, they are being selective with their bids, and this could leave those in difficulty as the ones most keen on winning the work. Therefore, clients need to be careful about who they select. In some cases, budgets will be very tight, making the lowest cost bidder attractive. However, simply selecting on price could be incredibly damaging for a project, if the chosen firm is unable to deliver on what they promise.

As we have previously discussed, before construction is likely to recover, interest rates need to start to fall. At the Monetary Policy Committee's meeting in May, they left interest rates on hold at 5.25%. Having jumped so much, in a relatively short space of time, this level is clearly acting as a deterrent to investment and hurting the industry. However, we should start to see rates cut very soon. Markets are currently giving about a 50% chance of a rate cut at the MPC's next meeting in June, and if not then, it is likely to happen in August.

Before they vote for a cut, services inflation needs to ease, and the Bank of England would also like to see more evidence of wage growth slowing. Both of these things appear on the right track, but upcoming data releases will determine when the first move happens. Nonetheless, one interest rate cut will not suddenly result in a huge uptick in construction spending. Instead, there will need to be a number of cuts before developers' confidence picks-up enough to truly return to the market. This therefore may take some time, and so challenges are likely to remain throughout the rest of 2024, with conditions only likely to really improve next year.