TPF

RIDER LEVETT BUCKNALL TENDER PRICE FORECAST UK

Q2 2020 COVID-19 EDITION

Q2

Rider Levett Bucknall

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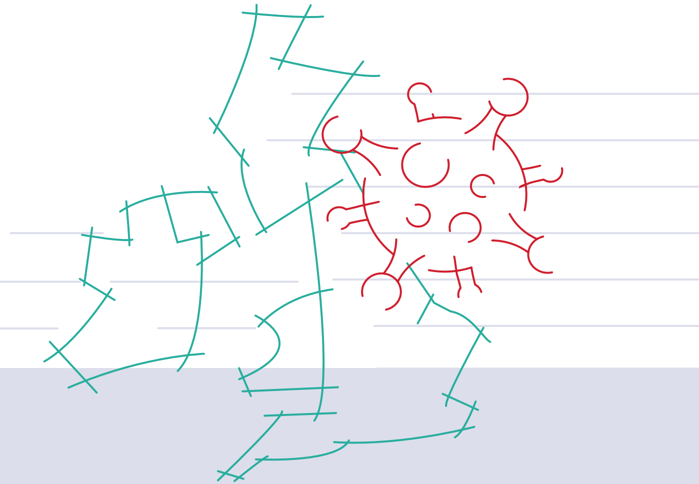

RLB UK's quarterly Tender Price Forecast (TPF) provides regional tender price breakdowns and commentary from our cost management experts.

INTRODUCTION

As the UK moves towards a phased relaxation of the original economic, social and business oriented lockdown constraints imposed by governments to deal with COVID-19, the looming issues moving into view are that of recovery and reinstatement.

The full extent of effects of the lockdown may only become fully known upon the withdrawal of government support to businesses across the UK. The Job Retention Scheme (JRS) has undoubtedly protected many jobs, but the real challenge may be its winding-back, in a business environment purposely temporarily flattened to depress the outbreak.

Much has been made of the question of whether we can expect a U, or a V, a bathtub shaped or even a 'hockey stick' shaped recovery, but these simple images belie the complexity, locally, regionally and globally, of the task ahead.

The ideal is a V-shaped recovery, a speedy bounce-back to previous consumption and output. Whether this is possible depends on the tens of millions of us who have been cloistered these past months, returning to circulation. That is not necessarily a given, as parents' reluctance to send their children back to school has demonstrated. But without that re-invigoration of the economy, a V-shaped recovery is not possible. Moreover, it is dependent on the recovery of people's disposable income, along with the desire to spend.

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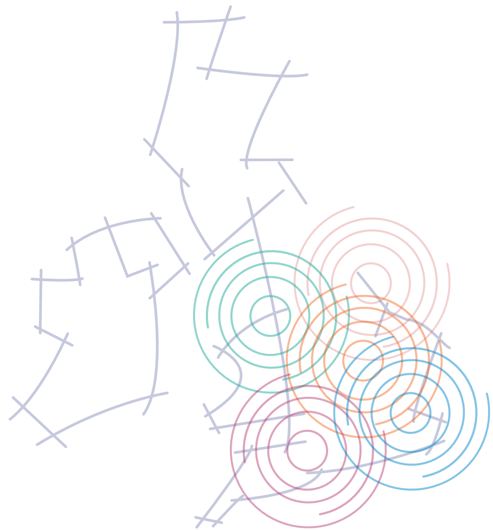
INTRODUCTION

Another possibility is the U-shaped recovery, which foresees a period of 'bottoming' before a rapid recovery phase taking us back to the prior situation. Again though, recovery needs to be stimulated, both by the public's demand and by governments' policy support. Clearly, people suffering from 'cabin fever' wish to be released to live and work as before, but whether they will then choose to do so, when the opportunity exists, remains an open question. The world that existed was replaced by one drained of active retail, travel by land, sea and air is minimal and major businesses' city offices lie empty.

The bathtub shaped trajectory, with the recovery long and progress slow, has much in common with the 'hockey-stick' shape. This depicts recovery over a long period of time, during which, businesses would have to find ways to re-establish turnover against a very much changed backdrop of trading circumstances.

However, the wider question is whether we recover to the original status quo at all or whether, on a positive note, this crisis has brought forward, by 10 years, the changes that we had envisaged creeping into workplaces and lifestyles.

Around all of this, ongoing questions regarding availability of non-UK national labour after year-end, the existence or otherwise of a UK/EU trade deal and the consequences of trading globally on The Word Trade Organization (WTO) terms, conflate together to produce a complex mix of uncertainty that only the fullness of time will clear.



GENERAL MARKET OVERVIEW

Compliance with social distancing obligations and Site Operating Procedures (SOP) are having a significant influence on productivity in some sectors. In most cases, this will play through to increased labour cost per unit of output, but with significant variance by trade and construction typology. Some migrant workers returned home during the COVID-19 crisis and may be inclined to stay as Brexit looms; the result could be an upward pressure on costs.

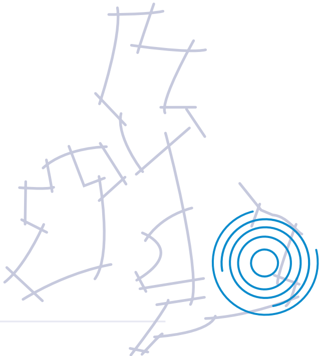
Materials prices in the short term have been affected by supply chain disruption. In the longer term, materials pricing is likely to be impacted by removal of capacity from the UK market, Brexit trade talk resolution (or resulting tariffs), as well as demand-side pricing responses. Preliminary costs are impacted by both productivity and SOP related prolongation, as well as thickening to achieve SOP compliance. The complexity of competing inflationary and deflationary input costs is likely to result in increased volatility and an increased spread in tender returns.

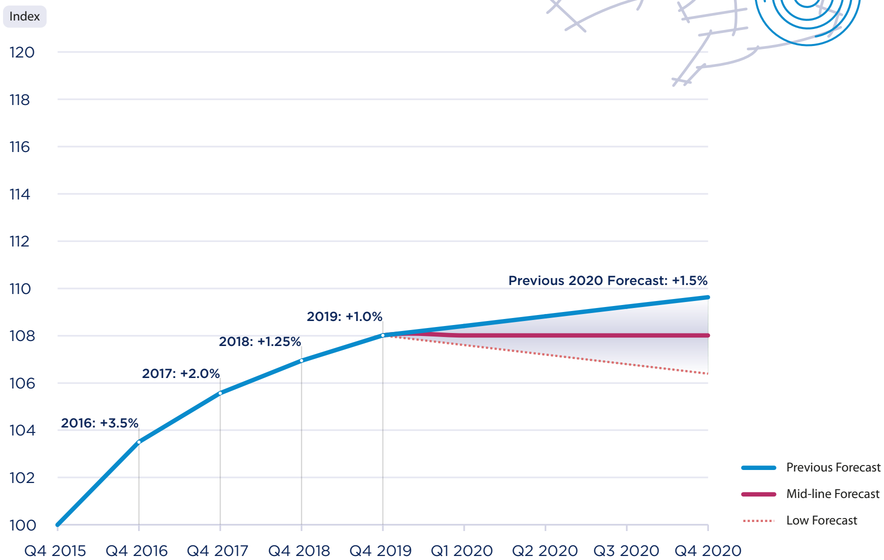
Generally, overhead and profit levels are tightening, and demand is likely to put them under increased pressure. There is evidence of contractors increasing competition amongst their supply chain (wider tender engagement) which may result in pushing pressure through the supply chain. After the immediate response of pausing, restarting and SOP compliance, the industry's overwhelming concern has been for pipeline status. Through the crisis a number of high-profile consents have worked their way into and through the planning system, but fragility in underlying confidence (and the all-important funding) is giving concern as to how many will translate to project starts.

Allocation and management of COVID-19 related risks are likely to be a significant factor in tender pricing. Those clients willing to take or share some of the risks are likely to see more competitive views on expected margins. Falling margins as a result of demand-side competition and an increased uncertainty of input costs is likely to see a riskier trading environment for contractors and increased insolvencies as a result.

Contracted prices (or even outturn costs) will be more telling of market sentiment than tender prices, with an increased use of contractor-qualifications, provisional sums and time-spend negotiating mutually acceptable terms.

LONDON & SOUTH EAST





The TPF for London & South East shows a spread of 3% below the previous uplift forecast in the Q1 2020 TPF. This is split to show a mid-range figure that would be no tender price growth for the year, and a low that would be a fall of 1.5%.

Given all of the current factors and uncertainties that can affect the planning, funding and delivery of construction projects, we believe that over the next six-eight months the overall market will remain fairly robust with no significant shortfall of projects proceeding through preconstruction and planning stages. However, the real litmus test for the private sector will come towards the latter part of the year when the requirement to press the green button on construction may cause investors, developers and funds to take pause and fully consider the risks associated with their full commitment. It will be interesting to see whether the market feels strong enough to take these projects forward or whether we see a lag and if so, for how long.

What is clear though, more than ever, is that whilst we all need to be proactive in the management and procurement of the entry price, we should all be very conscious of a motivation within the supply chain to inflate the exit price to recover potential losses as the result of any currently aggressive pricing levels taken now to secure future workload.

SECTORS

The immediate reaction by the construction industry to protect its workforce and adhere to the new emergency working methodologies has reduced productivity on sites. This in turn has meant that performance in the majority of sectors has declined in Q2 2020. The reason is that we are suggesting a process of decline, not just a single step change. There are, exceptions to this, with repurposing works and essential maintenance in healthcare estates ongoing. The rise in online retail has driven a surge in the requirement for the **industrial & logistics** sector, which is likely to continue into Q3.

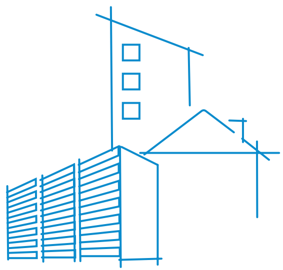
The increased usage of data, on a professional level as people operate from home offices, and also on a personal level, has led to at least a short-term increase in **data centre** demand. Potentially the use of remote working platforms may increase indefinitely in response to familiarisation with and acceptance of new ways of working (for example remote factory acceptance testing and switching to on-line in lieu of face-to-face meetings). Developers have endeavoured to maintain site activity as best as possible although productivity has inevitably declined, and pre-planning of some projects may be accelerated to meet anticipated demand and to be 'ahead of the game' when things return to normal.

After almost no **housing** transaction activity in London during lockdown, we are now seeing very early 'green shoots' signs of recovery after the government has recently allowed transactions to resume under social distancing rules. House-builder sales teams and estate agents have now returned to business. Meanwhile, the future of occupancy and the potential for a change in demand leading to uncertainty about value is, in our opinion, the most predominant issue facing the **commercial** office sector.

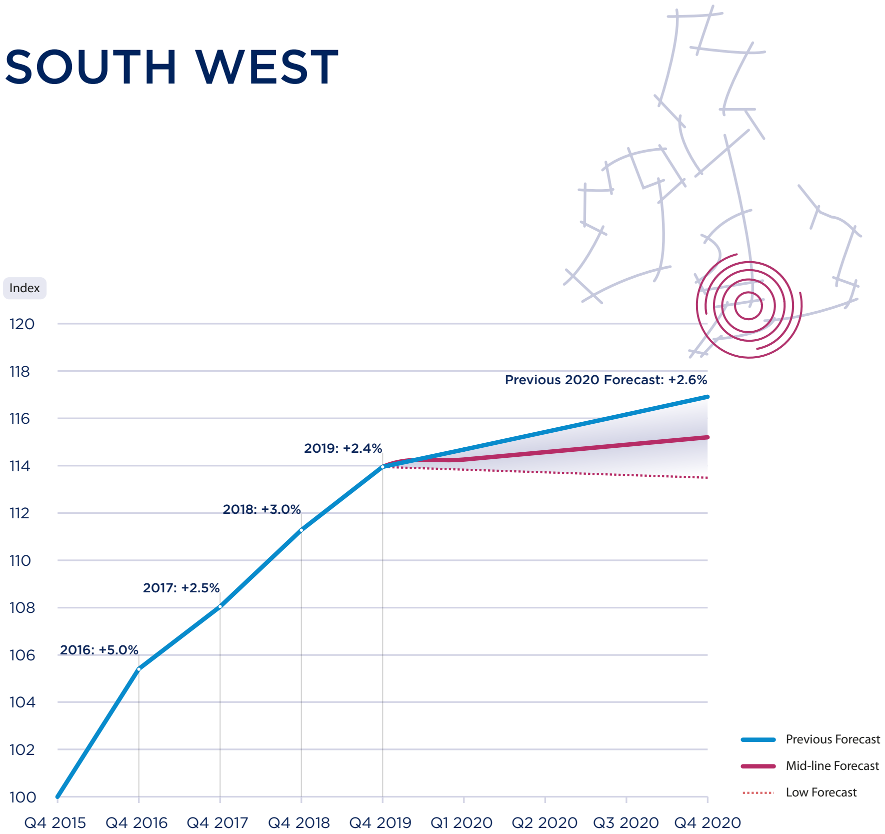
Further, the carrying through of the Westminster government's intention to continue with its major infrastructure, health and education initiatives will provide a boost to the general economy through the construction industry.

Aviation will be severely impacted for the next three years, as we embrace virtual communication more than ever before. With government borrowing having ballooned to provide furlough support, the existing long-term investment plans in rail, road and high-speed rail will have to be re-evaluated beyond the next three financial years and extending some investment plans over longer durations seems inevitable if efficiency cannot be driven to new levels across the industry.

Leisure and hospitality, including **sports**, will be the last to return to pre-pandemic levels of activity, with potential for existing spaces to be adapted or modified to increase resilience.



SOUTH WEST



The TPF for the South West shows a spread of 3% below the 2.6% previous uplift forecast in the Q1 2020 TPF. This is again split to show a mid-range figure that would be 1.1% tender price growth for the year, and a low that would be a marginal fail.

At Q1 2020, we reported a forecast tender price uplift of +2.6% for the year, but that has now been overtaken by the events surrounding COVID-19, particularly the social lockdown. The result is that, although we continue to see construction work progressing, we see a tightening of the tendering market, as contractors and sub-contractors look to secure a pipeline of work, against the background of complex operating and competitive conditions.

Our view of the immediate outlook for tendering for Bristol and the South West has fallen back from the 2.6% of earlier in the year, effectively now depicting a range of possible outcomes of between 0% and +3%.

We are seeing tenders priced earlier in the year being honoured by contractors.

However, initial feedback from sub-contractors is that they are struggling to obtain materials' prices from suppliers, causing extensions to tender deadlines. Also lead times quoted by timber frame manufacturers have increased.

Perhaps consequently, we are seeing longer tender periods and a few contractors decline tenders, due to resourcing issues within their own businesses as a consequence of the furloughing of staff.

Scarcity/long delivery timescales are also having an impact on materials availability, especially in the case of European-sourced materials such as lifts, plasterboard and plaster. In many cases, sites are having to produce alternative handover provisions for building control.

To overcome these problems, some contractors have been purchasing materials in bulk up-front, to ward against delay. This leads to additional storage costs/preliminaries and potential issues around waste and cashflow.

Although we would expect downward pressure on tender prices in the short to medium term, for a period of months, flowing from the downturn and increased competition among contractors and sub-contractors, to some extent this may be offset by increased levels of insolvency and restricted supply chains.

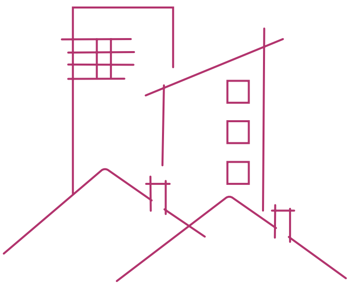
This is the underlying premise behind the re-setting of our forecast for 2020 tender price movement. Whilst we are forecasting a minimal increase in tender prices for the year, it is conceivable that at least in the short-term, prices may fall somewhat, as contractors deal with the recovery from the enforced lockdown and shutdowns.

SECTORS

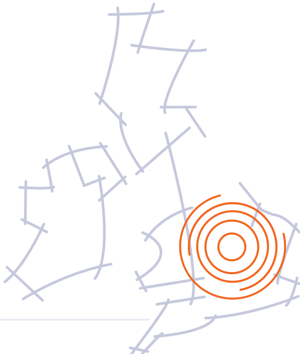
In the social **housing** sector buoyancy remains, with many sites in Bristol back working. This is influenced by the incumbent Mayor remaining in place for a further year, and his holding housing provision as a key deliverable.

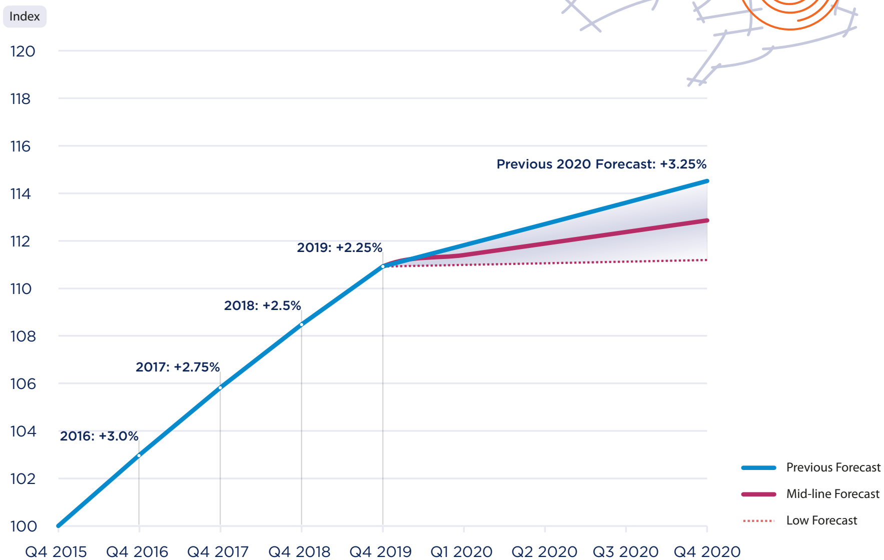
Student accommodation was a buoyant sector in Bristol prior to COVID-19, but the current unknowns on student intakes are likely to have a negative effect in terms of new schemes coming forward. Overall however, this remains a desirable market that will be assured competitive bidding. Likewise, **private residential** is expected to remain competitive and, as before, a large market within Bristol.

Public sector work, such as defence and infrastructure, is being identified by many in contracting as areas via which to hedge against a downturn, and it is envisaged these works will also be competitively priced.



WEST MIDLANDS





For the West Midlands, the TPF shows a spread of 3% below the 3.25% previous uplift forecast in the Q1 2020 TPF. This is again split to show a mid-range figure of +1.75% for the year, and a low that would be only +0.25%.

From the West Midlands perspective, the range of tender price inflation is driven by the unique set of circumstances currently seen by the region and industry.

A combination of concurrent inflationary and deflationary pressures currently exists, and the outcomes of the events that may unfold could swing the resulting pressures. It is assumed that social distancing and some form of SOP will exist for the duration of the forecast window.

Productivity improvements and a decrease in residential output could negatively affect regional tender price forecasts.

SECTORS

Commercial projects, especially end user fit-out, are not currently showing immediate demand impacts. Any 'return to work' and office alteration projects are expected to be relatively small. The market had been pivoting towards refurbishment of existing stock, which is a trend that is likely to last, but overall demand on the landlord and developer side is expected to show a slow return.

Residential projects with relatively long build-periods are expected to continue in the immediate term, with no evidence of demand slowing. Social distancing measures and SOP are likely to have a medium-term impact on build costs, with some upward pressures, which may, in turn, impact viability if not offset by margin adjustment. **Affordable housing** is likely to benefit from government recovery policies.

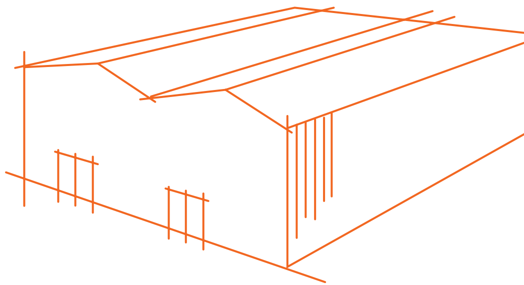
Interest in **industrial & logistics** has been driven by an upsurge in logistics facilities, with a focus on UK-based supply chain and less reliance placed on "just in time".

With a number of less urgent projects placed on hold, the **healthcare** sector has focused on preserving bed capacity and a number of more urgent projects accelerated. Less pressure on the NHS is likely to result in a rush to finish projects deferred, with a likely medium-term spreading out of workload to assist in preserving peak capacity for any second surge in infection rates.

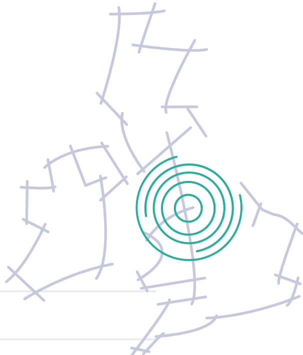
Infrastructure is considered likely to benefit in the short and medium-term as a result of government policy to assist in economic recovery. A number of proceed notices have recently been issued on HS2 contracts.

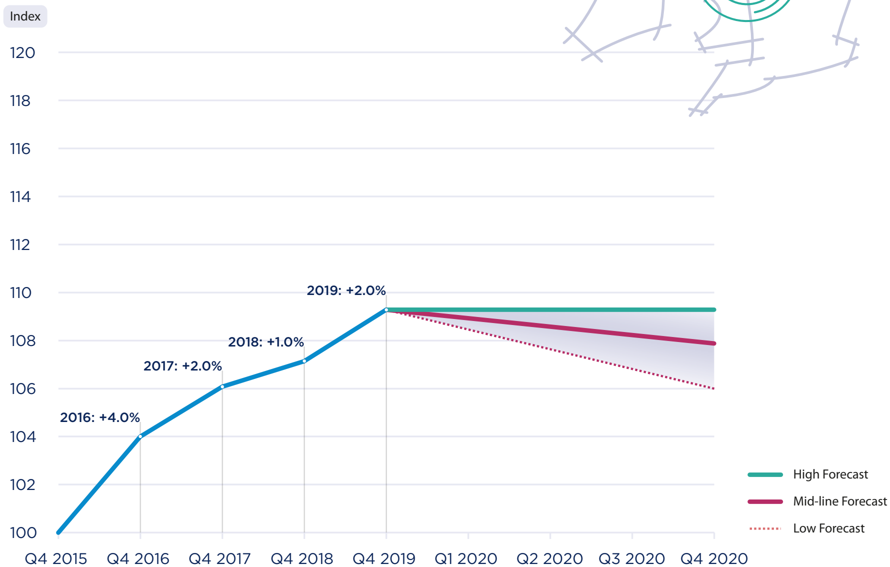
Leisure and **non-food retail** were the first projects to be put on hold going into the crisis, and are likely to see the deepest impact and slowest recovery.

Education projects have suffered as universities see their funding models disrupted and the number of overseas students likely to decrease as a result of the pandemic. Larger projects have been delayed as universities pause capital plans. As a result, tender pricing for projects is likely to be keen.



NORTH WEST





In the North West, tender price movement is forecast as flat, at best, over whole year 2020, with a mid-line possible outcome of -1.5% and a low-point outcome of -3%. This range reflects the uncertainty attached to tender price forecasting at present, and will be resolved later in the year.

Although the pandemic has caused considerable damage and loss almost everywhere, most sites in the North West remained open, despite an initial period of uncertainty. Initially there was a pause in activity, but once contractors had reorganised to suit the requirements of social distancing, things picked up again.

Very few sites, if any, are currently fully closed, although some are running less efficiently than usual, but good progress is still being made.

From the active sites we are working on, contractors are advising, particularly in respect of M&E and finishing trades, that they are indeed forecasting a 20% drop in output. Whilst contractors are confident in their ability to work through the restrictions, they are generally nervous about the ability of the supply chain to deliver.

SECTORS

Rider Levett Bucknall

We gauge the impact across most sectors to have been significant but manageable, although a full return to normality may take up to a year, as the effects work their way through projects' on-site programmes. Where output has been affected, our estimate is that productivity is about 20% down on output prior to the lockdown, but this is a very coarse measure, as site conditions and constraints are so very variable.

Likewise, where there have been projects put on hold prior to the tendering phase, we are seeing a pause rather than cancellation, as clients and client bodies re-group and re-assess.

In the **residential** sector, we expect social housing, low rise housing and the Private Rented Sector (PRS) to continue in the region as demand remains strong albeit on stretch programmes due to the implementation of Health & Safety measures on construction sites.

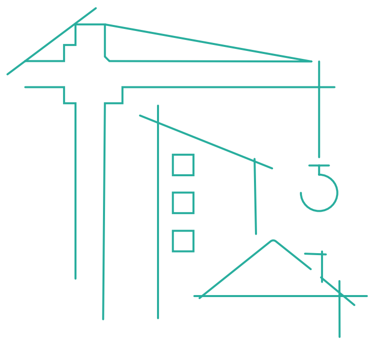
Developments in the **industrial & logistics** sector remain high as the sites are less impacted by COVID-19's Health & Safety measures as well as lockdown constraints on construction sites.

We expect a short to medium-term drop in **education** programmes due re-direction of budgets to other prioritised sectors. Issues with access from overseas students will impact on university spending plans.

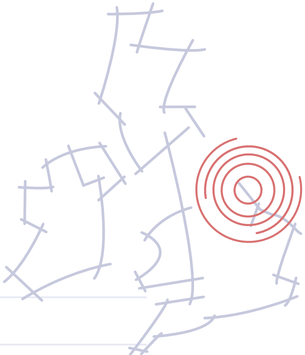
Healthcare remains buoyant and a growth sector in the region with significant funding from central government. We are heavily involved in NHSI HIP programme and are working with several of the larger NH trusts in the region.

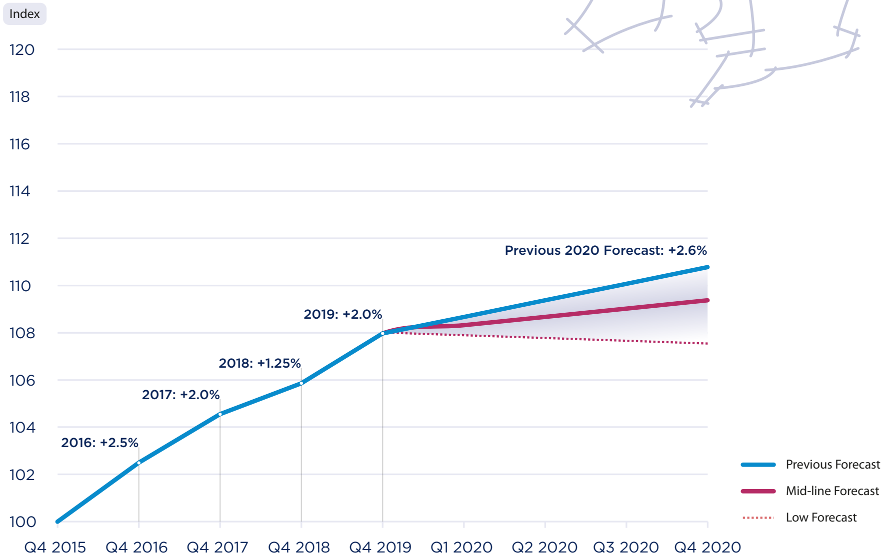
Government initiatives surrounding the outbreak have seemed to have limited impact on North West construction, with the exception of social distancing imperatives, which are largely responsible for the productivity downturns. We expect an upturn in funding going forward in government departments such as DWP, Border Force/Controls and Blue Light departments and therefore anticipate a growth in the public sector.

Given the impacts on construction noted above, some planning constraints may need to be reviewed, to stimulate more of the deferred project pipeline back into the marketplace sooner rather than later, and lenders will also have a part to play in this.



YORKSHIRE & HUMBER





The TPF for Yorkshire and Humber includes the markets of both Leeds and Sheffield, showing a spread of 3% below the 2.6% previous uplift forecast in the Q1 2020 TPF. This is split to show a mid-range figure that would be uplift of 1.1% and a low that would be a slight fall.

In Yorkshire & Humber tender price uplift has been pulled-back from the 2.5%-2.8% range published in Q1 2020 TPF, to an expectation of less than 0.5% uplift for the whole of 2020. This reflects a general expectation across the construction sector that, despite the developing loosening of social and business constraints, there will continue to be downstream effects of the lockdown that will persist, depending on the advent or otherwise of any second wave of COVID-19 cases. The uncertainty of the medical outcomes gives rise to inevitable issues for businesses' and sites' activities.

While it is accepted that work on building sites can carry on, the maintenance of social distancing constraints poses significant challenges to work methods and output levels. Programmes are obviously being affected, and contractual issues arise due to the effects of involvement of government in relationships between workers on-site.

SECTORS

In the **industrial & logistics** sector, online retail demand has increased, which bodes well for the future, and current projects are continuing. Generally, social distancing measures can be readily accommodated, due to the large scale of sites, although there are some preliminaries effects and programme considerations.

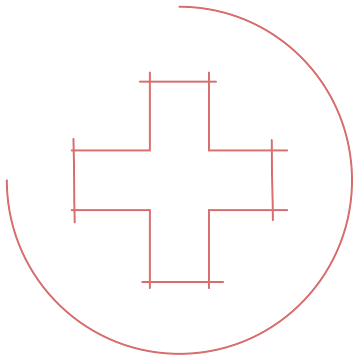
The **assisted living** sector continues, although some end users' funding has dried up, so postponing starts. Some sites closed and other continued but at reduced productivity rates. Where sites closed, they are re-opening with additional Health & Safety measures. However, suspension, re-programming and subsequent re-opening of works has brought considerable cost burdens and cash flow concerns.

In **housing**, sites have re-opened, with social distancing constraints on site and similar in marketing premises.

Healthcare continues to be one of the strongest sectors for the region. As well as work on the Development Control Plan for University Hospitals of Leicester, our teams are also delivering a number of health projects in the region. These projects were designated essential, so works were not halted by COVID-19.

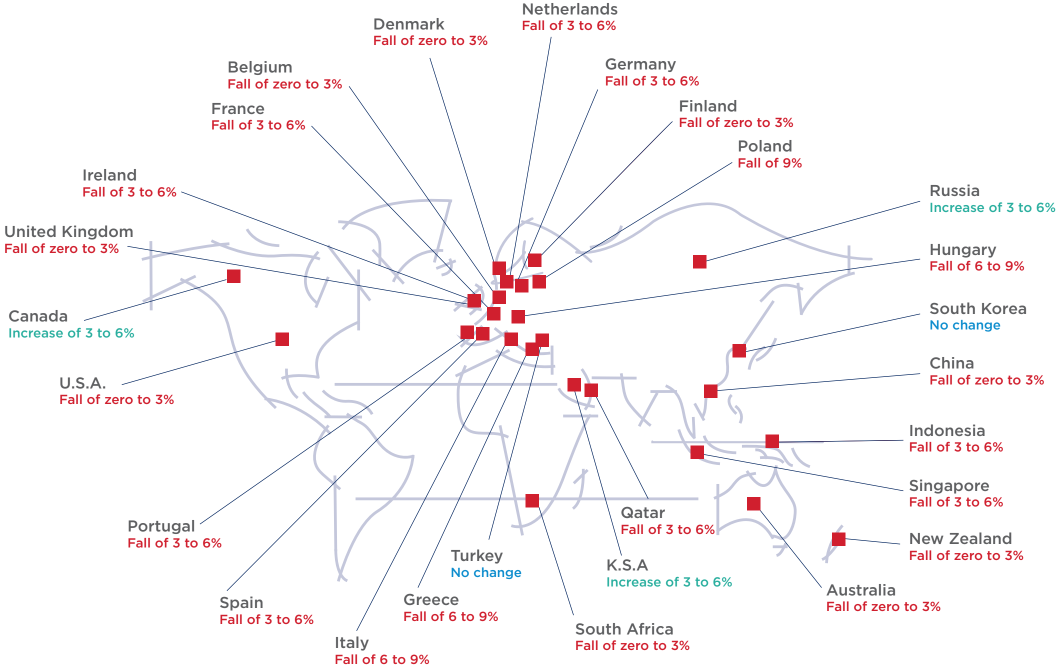
A key issue in the healthcare sector is the limited availability and experience of contractors for projects between the values or £3million - £10million. These project parameters do not seem to engage the interest of the larger contractors, but are too large for the regular smaller organisations which are often utilised.

As always there is an eye on pipeline work, and there may be a forthcoming review of public sector spending. However, as a result of COVID-19, working practices of hospitals and their estates are under review. NHS governors are reviewing existing estates and may issue guidance which suggests more isolation space. This could actually yield further works to be undertaken.



GLOBAL PERSPECTIVE

The map below represents the views of our colleagues across the world on tender price forecasts as a consequence of the COVID-19 crisis.



GLOBAL PERSPECTIVE

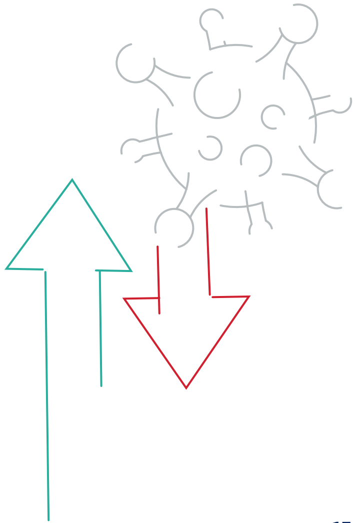
In the recent global survey carried out by RLB into the effects of the COVID-19 breakout on tender prices, 33 countries submitted figures. We asked our colleagues across the world to identify the impact of the outbreak on tender price forecasts made by them at the turn of the year. Two thirds of them responded with forecast falls of up to 6% for 2020, as compared to their earlier view.

Setting the UK in the context of the rest of the world, tender price forecasts are broadly in line with wider, global experiences. Of the 17 European respondents excluding the UK, 14 showed a fall in tender prices of up to 9%, with 6 of these showing between -3% and -6%. This grouping of 6 comprised The Netherlands, Germany, Ireland, Portugal, Spain and France.

In Asia, Vietnam and South Korea forecast no change overall, whereas the response of the other five Asian locations, Hong Kong, China, Macau, Indonesia and Singapore all showed up to -6%, which is illuminating, as they could all be said to be farther down the road to the full re-opening of their respective economies.

Respondents from Australia, New Zealand and South Africa showed forecasts centred around 0–3% fall, while in the USA, the view from offices across the country was also generally 0-3% fall.

However, a note of caution needs to be associated with this analysis, as some respondents, such as in Canada, the USA, Africa and the Middle East, consider there to be a real possibility of tender price increases, as demand is reinstated against a backdrop of possible skills losses and/or insolvencies.



CONCLUSION

As we finish quarter two of 2020 the construction industry needs to review and re-assess many of the norms and assumptions that have driven guidance and decision making in the past. The pandemic has had such impact that previous models may no longer apply, or certainly don't apply in the current situation. Consequently, we are showing a range of possible tender price movement outcomes, recognising that there are wide ranging and as yet some unquantifiable effects acting on contractors' pricing of tender documents.

We consider that the choice of procurement at this current time may have a greater effect on the cost than the supply chain attributes of a project, and recommend to our clients that investment in the review and selection of a preferred route tailored to the project specifics would be a wise and valuable one.

Across most construction related sectors, a 'hockey stick' shaped recovery is expected, with a slow, gradual recovery of new pipeline projects. Exceptions to this are those that are affected by government policy; infrastructure may in some cases be expected to recover with more of a V shape and likewise affordable housing, whereas hospitality and leisure are more likely to recover with a U or bathtub shape due to prolonged return to revenue generation.

OUR EXPERTS

Please contact our experts across our UK offices to discuss how the tender prices may affect your project or programme.

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