Market Intelligence Report
3Q 2024

PICK EVERARD | LICHFIELDS

Deliver better together.

In this issue of the report we team up with Lichfields to forecast what comes next for the construction and development industry. As part of the report we've surveyed over 120 construction professionals to get the most up to date view of the market from our peer group and supply chain.

Gavin Mason,
Operations Director,
Pick Everard

This report highlights some of the trends that we think will shape the near to medium term future for the construction and property sector, using information from our business, key industry operators and other sources.

In this issue we focus on the potential impacts of a new government. It should be noted that by the end of 2024 the UK, USA and France will all have new political landscapes for 4 to 5 years with Canada and Germany having new governments by the end of 2025. This should offer a platform for some level of decision-making stability across the western world.

The Labour Party, widely predicted to form the next government, have stated that they intend to grow the economy to fund their spending plans, so we take a look at what we can expect from their manifesto, and have surveyed contractors, developers, consultants and others within the market to find out what they want the new government to do in order to stimulate construction sector growth.

This is all against a backdrop of falling construction output which has dropped 5% in the last 9 months. We'll take a look at the cost of construction pre and post covid, and see what key factors might help us to understand the future direction of the market in the short to medium term.

However, we'll start by looking at the overall context of the economy, particularly focussed on inflation, which has recently reached the Bank of England (BoE) target of 2%. We review why there has been such a lag between reductions in inflation and reductions in the rate of interest, and what that will mean for the future.

General Economic Backdrop

Inflation and Interest Rates

Back in 1998, as some of our more experienced readers will remember, the Blair Government turned the Bank of England (BoE) into an independent organisation under the supervision of the Treasury Solicitor – tasking the BoE with maintaining price stability.

Up to this point of course Governments in the run up to a General Election would tell the BoE to reduce interest rates for a year, to make everyone feel 'happier', and hope that this was rewarded at the ballot box. To our less experienced readers this would seem to be economic insanity and, well, it was. It took decades of debate until the political class were prepared to surrender this hugely influential political tool.

So should Sir Keir Starmer's Labour Party win the upcoming election he'll partly have Blair's reform partly to thank, as the rate of inflation has been tumbling through 2023 and 2024.

By June 2024 the Consumer Price Index (CPI) was at the Government's target of 2% - job done! Interest rates have not been reduced. Certainly, Rishi Sunak and Jeremy Hunt would have had enough economic and political cover to cut rates for 6 months now at least, had the decision been in their hands, so will be campaigning with gritted teeth at the lost opportunity.

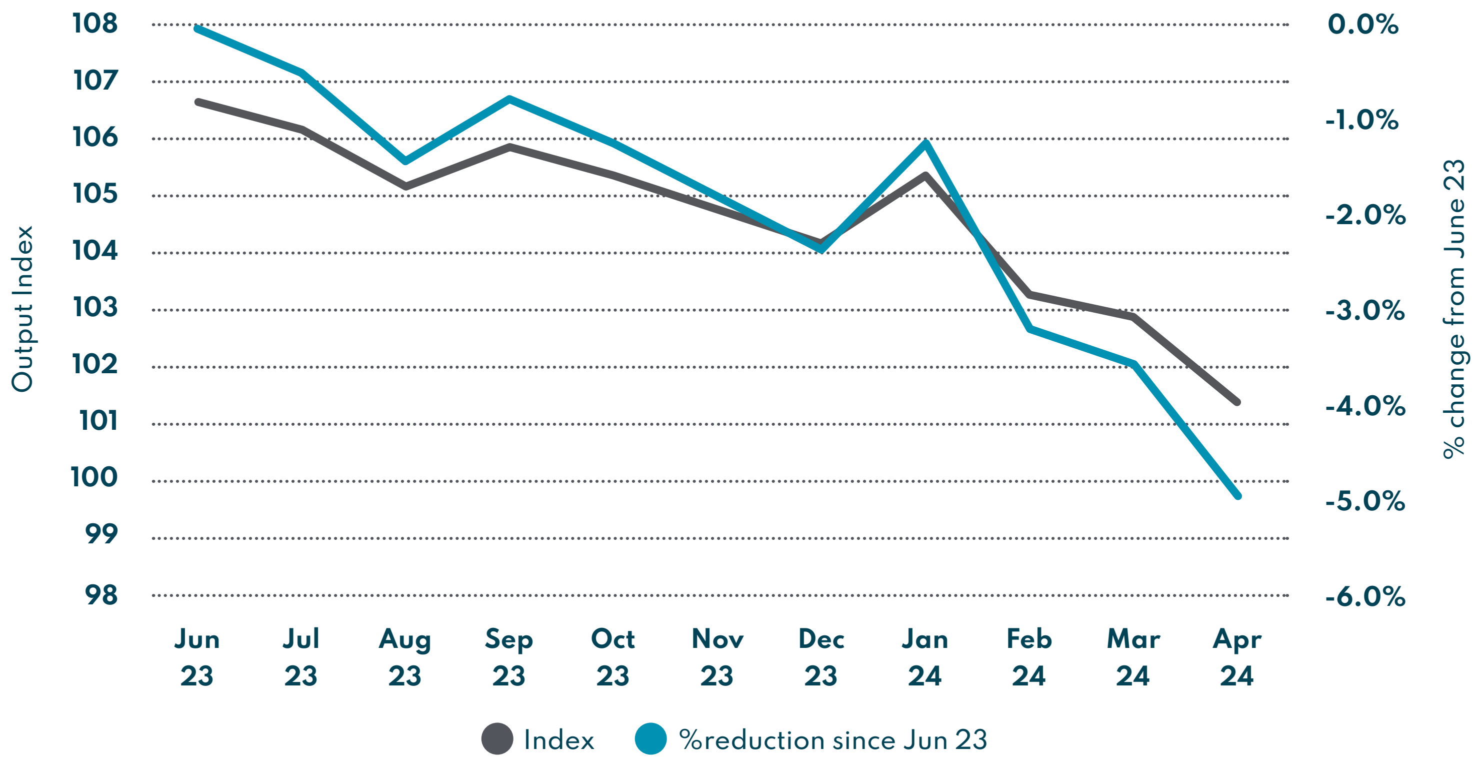
In reality, we are all waiting for interest rates to go down: reduce our mortgages, upgrade the kitchen, and allow us to start more exciting construction projects.

Figure 1 (overleaf) shows how construction output in the UK has fallen over the last 8 months 5% less than it was. So why haven't interest rates been cut?

Outwardly the BoE's monetary policy committee (MPC) has suggested it was high core inflation in the services sector weighing on their decision, but it is noticeable that this became a stated factor once it was being signalled by the US Federal Reserve that they would not be reducing rates.

Figure 1: Reduction in construction output Peak output Jun 23 to most recent data April 24

Source: ONS



The rate of interest paid on pound sterling remains one of the biggest factors in the demand for our currency. So, one of the thought processes will be that by reducing interest rates, whilst dollar and euro interest rates remain static, the value of our currency would drop, meaning we'd be importing inflation as our imports would increase in cost. Overall, there is a feeling that the MPC won't want to be too out-of-kilter with the global economy.

Figure 2 shows what is happening in terms of inflation in the UK, Eurozone and USA. The rate of inflation is showing a lot more resistance to interest rates in the USA in the last 6 months than in the UK. In fact, inflation has even risen across the US economy since June 23, which is a concern as it brings into question whether UK rates are able to be cut significantly.

Whilst the world has been distracted by the strength and potential of the Chinese economy, it is currently evident that the US economy is perhaps stronger than ever. Technologically from weapons to websites, and software to medicine, the country is taking more and more control over global business and profit. NVIDIA now has a higher market capitalisation than all listed stocks in the UK, France and Germany put together.

Whilst there appear to be good reasons to start reducing interest rates, this may not happen until the federal reserve commits to a rate reduction.

Figure 2: Consumer Inflation Rates in US, Eurozone and UK 2022-2024

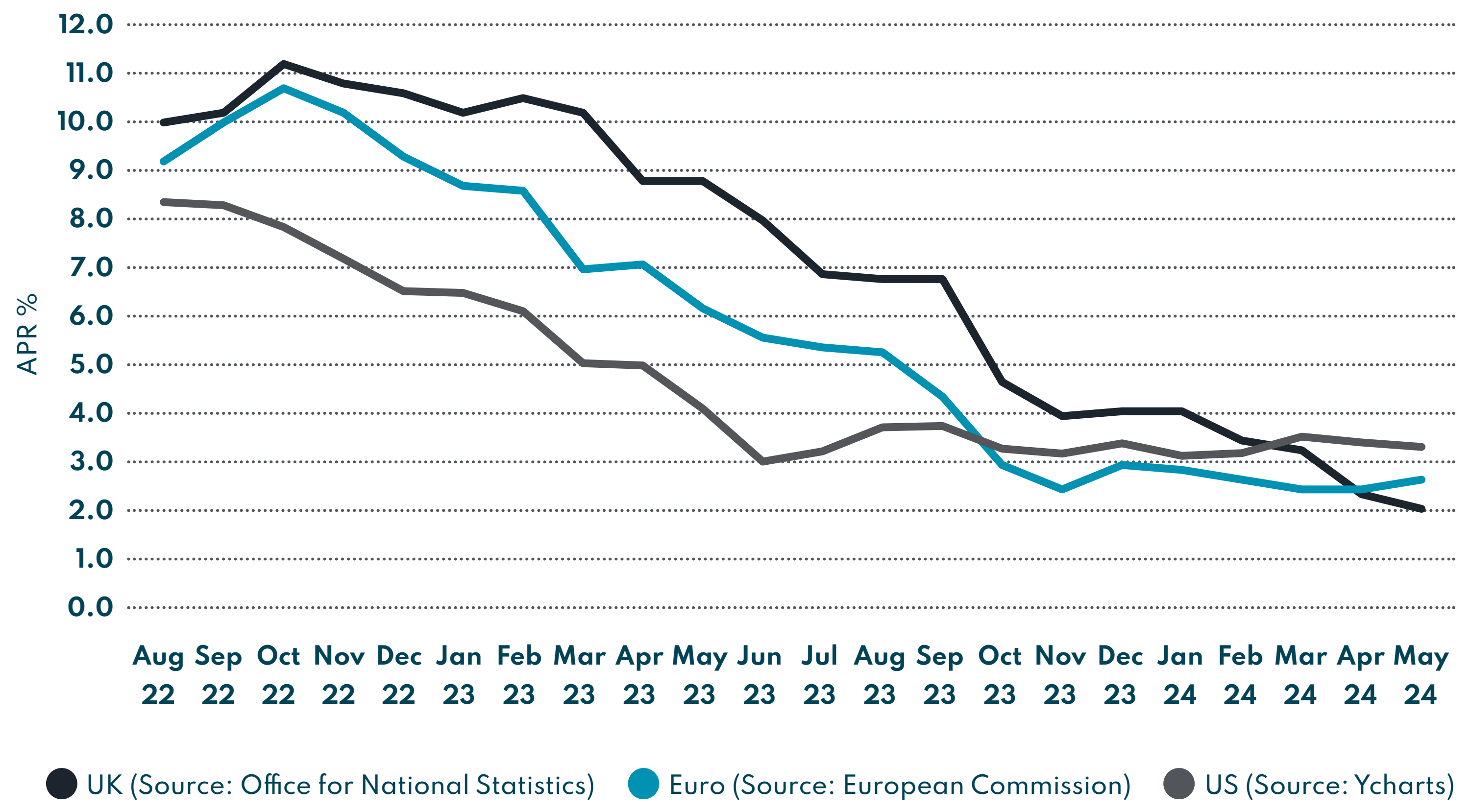


Figure 3: Policy Change Timeline

– growth of legislation affecting the sector

2022

Public Sector Decarbonisation Scheme

Grants for public sector bodies to fund heat decarbonisation and energy efficiency measures were set out in the Net Zero and Heat and Buildings strategies

Building and Safety Bill

Gains Royal Assent

Part L&F Building Regulations Update

Strengthening thermal performance and increasing ventilation requirements

Part B Approved Document Update

Fire Safety Improvements

2023

Second Staircase

Second staircases would be mandatory in buildings over 18m

Procurement Act 2023

Granted Royal Assent

2024

Biodiversity Net Gain

Mandatory requirement for all Town and Country Planning Act development

Building Safety Act – Building Control

Requirements for all building control inspectors to register with BSR

2025+

Carbon Emissions Buildings Bill

Requires whole-life carbon emissions to be reported and to limit embodied carbon emissions in the construction of building

Future Buildings Standard

Grants for public sector bodies to fund heat decarbonisation and energy efficiency measures were set out in the Net Zero and Heat and Buildings strategies

Carbon Import Levy

In 2027 the government plans to introduce levy on imports of steel, aluminium, ceramics and cement to ensure carbon price is comparable to UK produced product

Focus on Cost

Construction cost pre-post covid period

We all know there has been a significant shift in prices since January 2020 and the start of the pandemic. The headline CPI when compounded from 1Q20 to 2Q24 has risen 23.5% which appears to be a modest increase when compared to prices we have seen in the construction sector.

We have reviewed similar Pick Everard projects pre and post covid and normalised the scope of the scheme. The work has focussed on leisure centres and schools but has demonstrated a similar scheme post covid can be between 40% – 75% more expensive.

We are not alone in experiencing much higher tender return costs with Exigere recently reporting seeing a 30-35% increase in costs post covid in the commercial office sector.

This new normal can be difficult adjusting to and the question is will this new cost level persist or will there be a decline in pricing?

Cost Drivers **Market capacity & demand**

Despite falling construction output, capacity appears more restricted than pre covid, and the market is becoming highly selective about returning tenders.

At Pick Everard we have noticed that despite intensive market warming exercises, open market and framework routes to markets, we'll see 40-60% of contractors disengage prior to submitting a return.

A Gleeds survey recently reported 90% of contractors stated that they or their supply-chain had declined to price tenders. Clearly, competition is fundamentally a key factor in setting prices and with reduced levels of competition, contractors will be less likely to reduce the risk pricing within their bids.

Insolvencies

The construction sector currently has the highest level of bankruptcy and high-profile names such as Buckingham Group, Geoffrey Osborne and MJL. In the top tier, Lendlease are withdrawing from the UK market. At a certain project size there will be real limitations in terms of the supply chain available to carry out the work, and the risks that they are prepared to absorb.

Rather counter intuitively buoyant inflating markets are often the most dangerous period for contracting organisations. Fixed price contracts entered into 6 months earlier can look a lot less healthy when the downstream order comes to be placed.

Legislative changes **(See Figure 3 - Timeline)**

The buildings that are designed and built today are different in many ways to buildings which were built in the past, and the costs of the projects can encompass many additional hidden costs including:

- Lower Net to Gross areas ratios for the same functionality to accommodate fire regulations.
- Gateway 2 requirements to fully design elements of 18 storey plus buildings prior to construction.
- Part L energy efficiency models and low carbon energy systems meaning whole building designed to reduce energy and carbon model of the building.
- Biodiversity improvements to all developments.
- Pre-commencement conditions slowing programmes.
- Conflicts between local, national and regional policy delaying the design and delivery process.

Materials' prices

The Construction Products Association has reported that material costs are still 39% above their pre covid levels, although material prices are actually deflating, currently led by strong declines in key construction materials such as steel and timber. Overall, they are of the view that across a suite of products material costs are 3%+ year to date.

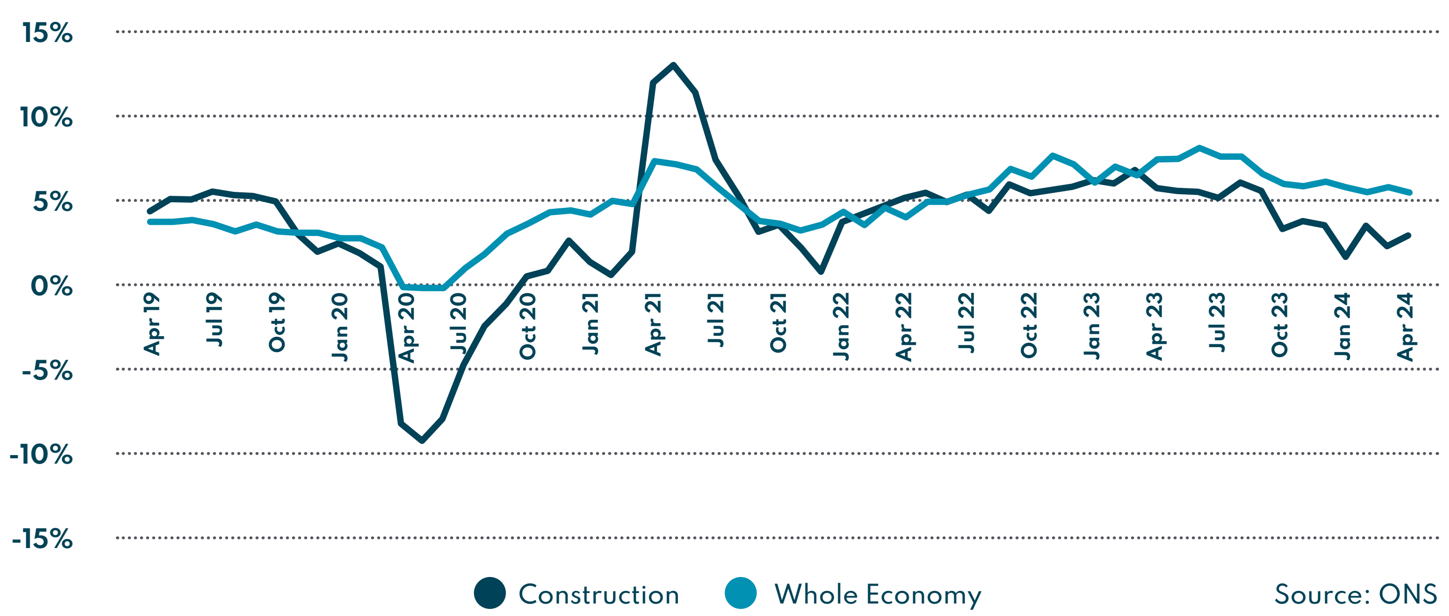
Arguably oil, as an input cost to construction materials, may start to decrease as more environmentally friendly sources of electricity are brought on stream but for the medium term it will be a significant cost factor. The International Energy Agency is forecasting that there will be a 25% increase in surplus capacity in the industry by 2030. These 8 million barrels will represent 8% of current daily oil consumption. Citibank analysts are forecasting oil could be trading at c. $60 per barrel as early as 2025 from the current $85 range.

Expectations

While inflation expectations do play a part in what happens next, and the forecast for inflation to be in excess of 3% formed 33% of our survey group, with contractors being 10% more likely to respond that inflation would be higher than 3%.

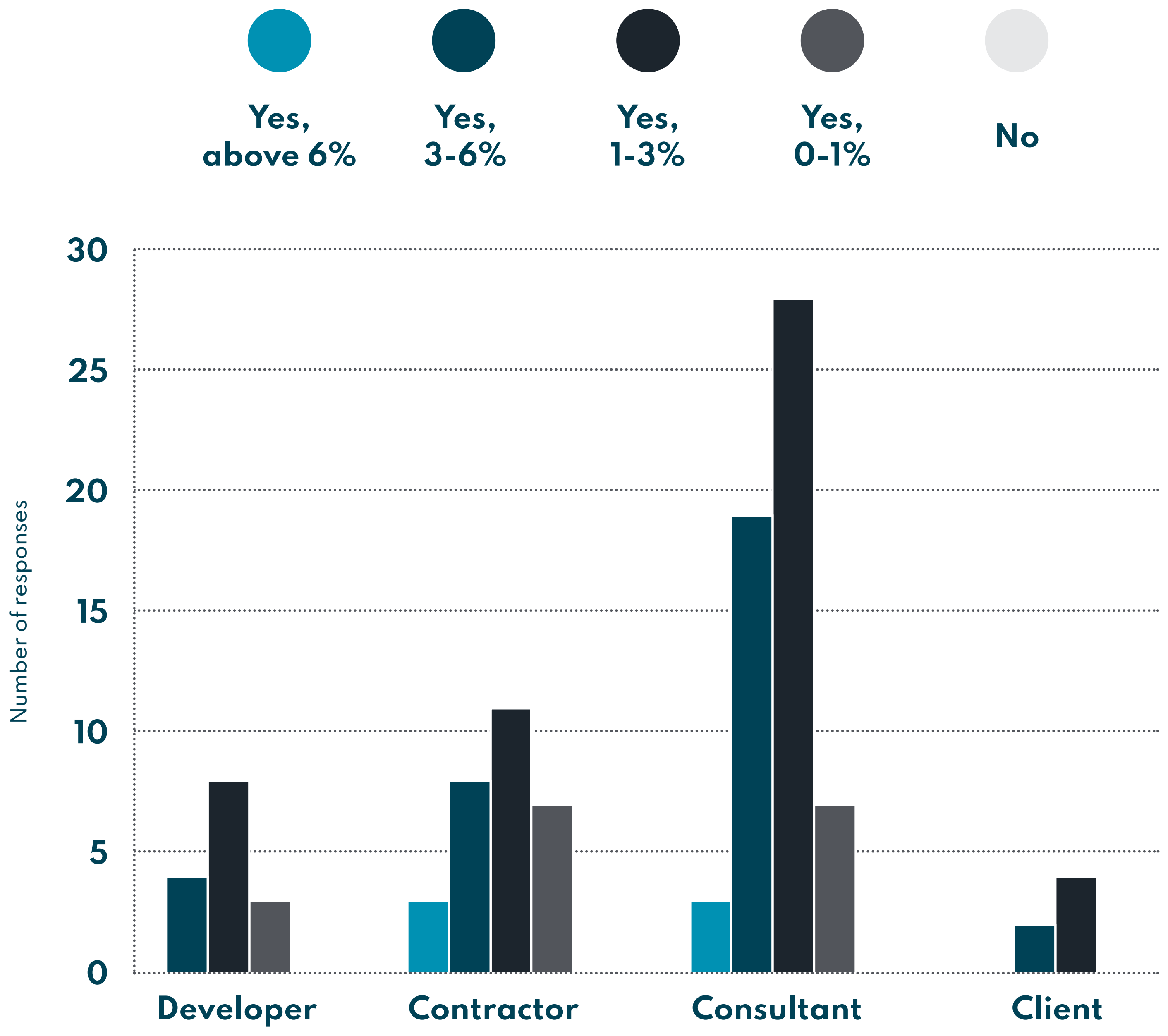
The graph below shows earnings growth in the construction sector. Interestingly it lags behind the graph for the overall economy meaning that expectations of future wage and material growth may be misplaced.

Figure 4: Weekly Earnings construction and whole economy percentage change on year



Source: ONS

Figure 5: Do you think tender prices will continue to rise over the next 12 months, and if so at what pace?



What needs to be done to inflation?

In our survey several consultant and contractor respondents stated that the industry was operating at a more realistic and sustainable level than previously. Other comments were that prices didn't need to come down as the buildings being produced were the buildings society needed. All good points.

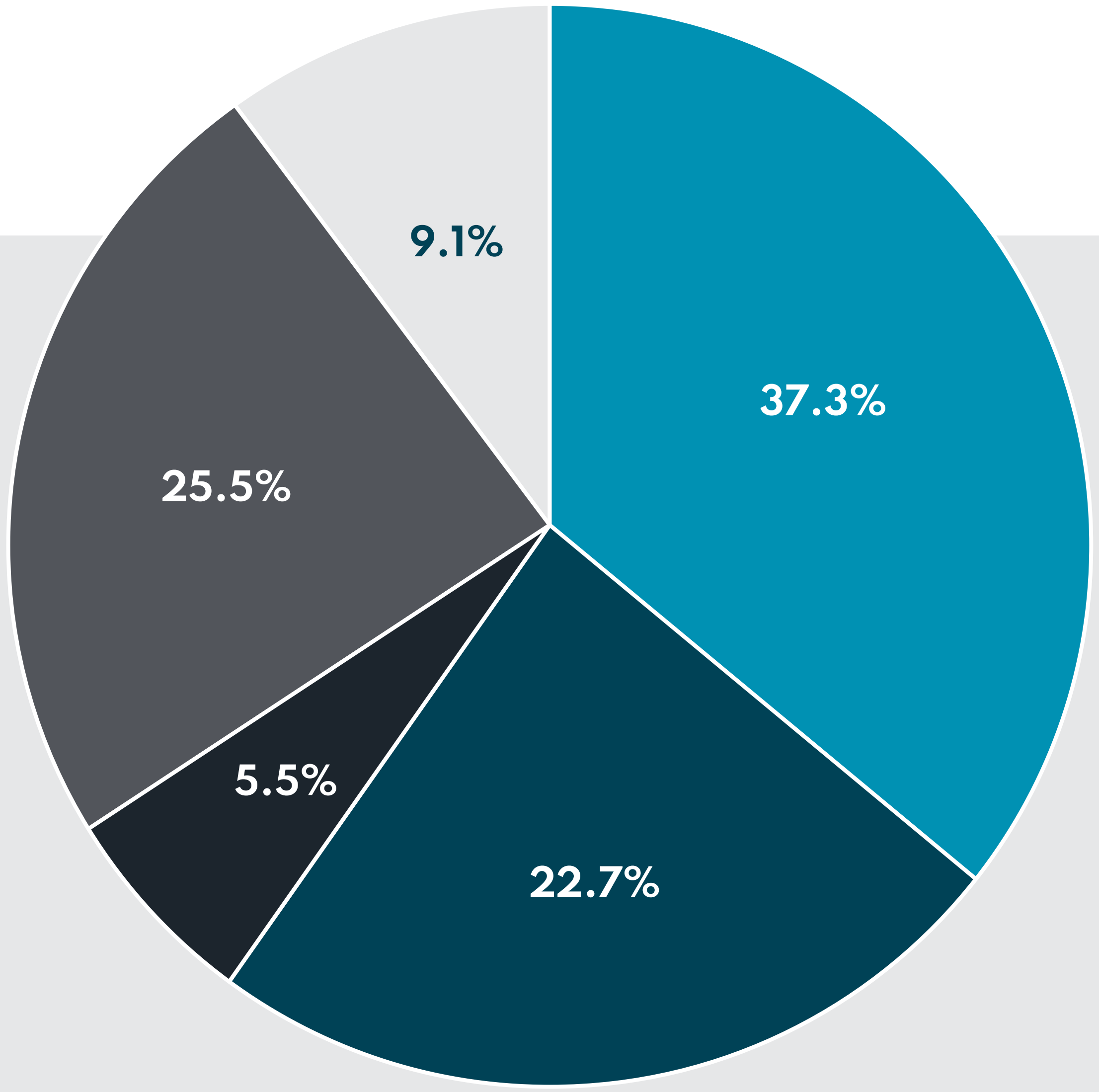
Clearly there is a level of cost that makes a development financially viable, and our survey identified key issues that the government should tackle.

A key measure the industry wants the government to tackle is the training and support of new skills to fill the skills gap. Since 2019 the number of workers employed in the construction sector has dropped by 12%.

Issues such as demographic changes, working pattern changes, tax changes and IR35 has seen the workforce reduce to 2.1m people. This is going to have an inevitable cost impact but prevents us from building the environment the country needs.

A similar number of respondents identified government interventions as being a key issue to address. The graphic here shows the legislative issues which the industry should look to adopt.

Figure 6: What measure would you like to see taken by the post-July 4th government to help reduce the cost of construction in the UK?



- Work with BoE to reduce interest rates and cost of borrowing
- Increase training grants and other incentives to improve skills in industry
- Reduce government expenditure on national infrastructure schemes and therefore improve supply of resources.
- Review and revise elements of current legislation affecting areas such as Biodiversity net gain, Gateway 2 of the Building Safety Act, Part L of the building regulations to reduce cost
- Other

What measures would you like to see taken by the post-July 4th government to help reduce the cost of construction in the UK?

A more stable project pipeline and an overhaul of the planning regime (consent delays are the biggest driver of project costs)

Better signalling to the market about the demand for low carbon goods

Invest in and drive the public sector to return to full capacity and provide the service that is required to enable industry to thrive and drive efficiency and growth

Plus reduce interest rates and cost of borrowing

Reduce government expenditure on national infrastructure schemes and therefore improve supply of resources.

Review and revise elements of current legislation affecting areas such as Biodiversity net gain, Gateway 2 of the Building Safety Act, Part L of the building regulations to reduce cost

I do not believe the cost of construction needs to be reduced. I would much rather see an increase in cost resulting in higher quality outcomes

Increase training grants and other incentives to improve skills in industry

Reduce inflationary pressures and lower borrowing rates.

Fix the broken planning system

Increase the sustainability and biodiversity requirements

No appetite for costs to reduce. The market is currently realistic for the first time in a long time. Market conditions have stopped people low bidding and those that do are struggling to sustain low bidding

None of the above. Construction prices should grow higher in order to ensure higher quality and economy of use to generate higher quality longer lasting buildings

Work with BofE to reduce interest rates and cost of borrowing

Election Forward Look

Based on the expectations from the latest opinion polls, it would be quite a surprise to see Rishi Sunak being invited to the Palace on 5th July. So, let's take a look at what the Labour Party is proposing for the industry.

Overall, the party is suggesting that they will look to spend through growth, and the key aspects of their proposals that will affect the construction industry:

- Invest through national wealth fund (£7.3m).
- Create a strategic planning system to co-ordinate development across different regions.
- Identify 'grey belt land' in the Green Belt and release for development.
- Bring forward new towns and large-scale urban development.
- Changes to simplify and reform the planning process and increase consultation and transparency.
- Fund additional planning officers by increasing stamp duty payments for non-UK residents.
- "Encourage" the construction of more genuinely affordable housing.

There isn't much detail as to how this is going to be achieved and some of the key issues that need to be addressed are:

- Taking local party politics out of the planning approval process.
- A consistent and co-ordinated planning system where Council, Regional, Mayoral and National policies are co-ordinated and not contradictory, thus holding up planning applications.
- Increasing public consultation comes at a risk of slowing down planning permissions.
- How will stricter application of environmental and sustainable objectives be achieved without adding additional cost and planning burden?
- Additional pressure on scheme viability in terms of affordable housing.

National Wealth Fund

The National Wealth Fund aims to boost investment in the UK's infrastructure and key sectors to drive economic growth and innovation. This initiative focuses on fostering long-term prosperity by strategically allocating resources to areas with the potential for high returns and substantial public benefit.

The fund will channel investments into renewable energy projects, including wind, solar, and hydrogen power. It will support the development of modern, efficient public transport systems, including high-speed rail networks and electric vehicle infrastructure. It will also increase digital infrastructure, particularly in expanding high-speed internet access nationwide. This will support remote work, education, and innovation in various industries, driving economic resilience and growth in the digital age.

National Wealth Fund Source: Labour Party Manifesto 2024	
Activity	**£bn**
Upgrade ports and build supply chains across the UK	1.8
New gigafactories so our automotive industry leads the world	1.5
Rebuild our steel industry	2.5
Accelerate the deployment of carbon capture	1.0
Support the manufacturing of green hydrogen	0.5
Total	**7.3**

Planning system reform

One of the suggested reforms is the introduction of a "fast-track" system for certain types of developments, particularly those that align with national priorities such as affordable housing and green infrastructure. This fast-track system is designed to cut through red tape and reduce the time it takes for essential projects to receive approval, thereby accelerating the delivery of much-needed housing and infrastructure.

Labour also proposes to enhance community involvement in the planning process. This includes greater transparency and opportunities for local residents to have a say in developments that affect their areas. They are planning to introduce stricter environmental standards for new developments, ensuring they contribute to the UK's net-zero carbon targets. This includes promoting the use of green building materials, energy-efficient designs, and renewable energy sources in new construction projects.

Labour also aims to address the imbalance in housing supply by encouraging the development of affordable housing.

This includes measures to ensure that a higher proportion of new homes built are genuinely affordable for local people. The party plans to leverage public land and work with local authorities to deliver these homes, ensuring that development benefits those most in need.

Development certainty and pro-growth policies top sector's demands to government, Pick Everard and Lichfields survey finds.

Ciaran Gunne-Jones, Lichfields

Survey Insights

The imminent general election takes place amidst warnings of challenges on multiple fronts from all the major political parties, and as such the next government will be taking office amid significant uncertainty. The latest Pick Everard survey, designed with Lichfields, asks 120 construction and property professionals what they are looking for and what they are expecting from the next government. It finds that the construction industry is ready to help put the economy on a growth footing if there can be greater policy certainty on a number of fronts.

The ability and capacity of the new government to generate new revenues or make large spending commitments without achieving economic growth is severely limited, placing an even greater emphasis on the need to generate economic growth. However, productivity and economic growth has remained stubbornly low since the pandemic, with mortgage and interest rate rises compounding the effects on the cost of living. Ring fenced spending pots on health and education, alongside defence and net zero commitments, will continue to limit the capacity of the next government to make a fundamental shift in departmental spending decisions. Finally, the tax-to-GDP ratio is now (according to the Resolution Foundation) at its highest level since 1949.

Unsurprisingly all the major party manifestos are looking to the development industry to 'kickstart economic growth', 'secure a stronger economy' or 'build a stronger economy' - without requiring significant public investment. Construction and development, and by association planning policy, have therefore become key political, economic and social policy battlegrounds.

Results from the latest Pick Everard survey, of 120 industry stakeholders, point to concerns about uncertainty as a significant issue in the industry. Some 40% regard policy uncertainty as one of the most significant barriers to increasing investment, second to the 55% of those who point to the wider

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economic uncertainty. This caution extends to respondents' views on the industry itself, with most respondents expecting tender prices to rise over the next year. Some 76% of respondents are expecting an increase of between 1-6%. While the reasons for this included higher material costs (21%), a lack of capacity in the construction industry (20%) and geo-political volatility (19%), the primary driver identified most often was the impact of government legislation (26%). These included the requirements for Biodiversity net gain, Gateway 2 of the Building Safety Act, and Building Regulations Part L.

Sector-specific challenges are also mounting, while public-led investment has decreased over the last fifteen years, and there are few plans for big infrastructure investments being talked about compared to some previous elections. Residential planning permissions are down to the lowest level for a decade, while brick shortages and construction worker shortages have challenged the industry over the last five years on top of specific shocks in the sector such as RAAC concrete.

Notwithstanding this backdrop, our survey indicates that the industry is looking to the new government to create a much more supportive policy platform to bring forward. Housing policy has been relatively clear from both the major parties since conference season, with Labour pledging to put housing at the centre of their growth plans, through a blitz of planning reform. The Conservatives want to prioritise home ownership paths by reviving 'help to buy' and continuing the affordable homes programme. Both have called for densifying urban areas, and Labour also plan to realise the potential of development on 'grey belt' land (i.e. Green Belt land which is of lower quality) in order to release more land for housing. Our survey found broad support for this, with 38% of respondents choosing 'increasing investments for affordable housing' as one of the most important investment decisions from the next government that might increase their activity as well as support for more robust housing targets (28%).

83%

of respondents identified policy or economic uncertainty as major investment stumbling blocks.

55%

of respondents stated the need for achieving comprehensive local plan coverage as a priority

> **Recent Lichfields research suggests that by end of 2025, just 22% of local plans will be up to date and less than five years old.**

However, beyond housing, future policy proposals have been less clearly set out, and so the development industry is now rightly asking what this might mean for them. Across a range of stakeholders – from architecture firms, developers, construction firms and consultants – over half highlighted achieving better local plan coverage across the country as being a priority for the next government. Recent Lichfields research suggests that by end of 2025, just 22% of local plans will be up to date and less than five years old.

Working with the independent Bank of England to reduce interest rates was also seen as important by over a third of respondents (36%), followed by increased investment in training grants and other incentives to improve skills in the industry (24%), and reviewing specific elements of current legislation affecting areas such as Biodiversity net gain, Gateway 2 of the Building Safety Act, and Building Regulations Part L to reduce costs (24%).

Some 40% called on the next government to bring forward a long-term industrial strategy to set out a blueprint for investment, something that has been absent in recent years. Regarding investment priorities, 39% of respondents highlighted clean energy investments, and 38% highlighted improvements to national grid capacity.

The construction and development industry has suffered over the past few years from the same structural challenges as the rest of the economy, but this has also been compounded by policy and legislation uncertainty. An ongoing cycle of planning reforms has also not helped. The results of this survey suggests a real appetite in the sector to get growth moving again, in anticipation that a new government will bring greater certainty and be able to set a clearer agenda, whichever party wins.

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