FRANKHAM MARKET UPDATE

Autumn 2023 | 17 November

FRANKHAM MARKET UPDATE

Autumn 2023
17 November

With inflation finally falling to its lowest level since November 2021 and interest rates remaining stable since July, the economy proves to be more resilient than some anticipated. Coupled with real-time wage growth, the outlook is brighter for the general consumer.

A more substantial fall in the rate of inflation for the third quarter of 2023 has now been published, with the rate of inflation decreasing to 4.7% which may well assist to maintain the base rate and pave the way for eventually triggering a reduction.

“The driver maintaining positive growth in terms of output and offsetting the falls in the housing sector is new infrastructure work, which grew by 0.8%, and repair and maintenance work, combined for housing and non-housing which grew by 0.7%. This indicates that although there remains uncertainty, opportunities remain throughout the industry despite the challenging economic outlook.

However, our industry remains plagued by gloomy news with all too regular reports of contractor insolvency, continued falls in sector-specific construction output and redundancies in the housing sector. The scrapping of the Northern leg of HS2 has proven to be one of the more controversial topics of the last three months.

Whilst there are clearly pressures on public finances at the moment, and many could build a successful case for the scrapping of the Northern leg of HS2 in the short term, the fire-sale of the acquired land remains questionable. This not only casts further doubts on the UK's ability to deliver successful, on time and to budget high-profile infrastructure projects, but indicates a continued failure to address the north-south divide. That's before mentioning the reported cost to the taxpayer of selling the land below market value.

UK construction output, overall, did actually grow in the third quarter of 2023, albeit at a negligible 0.1%. The increase in total output was in spite of the continued falls in new build housing output, which has now fallen to its lowest quarterly level since the third quarter of 2021. The fall in output remains on a downwards trajectory and positive news on the inflation front may provide lenders with certainty to reduce longer term mortgage rates. However, this alone is unlikely to be enough to kick-start the housing market in the short-term.

Although there remains a clear fall in demand in the housing market, house price data remains varied and contradictory. The UK House Price Index, prepared by HM Land Registry, in its latest figures (to August) reported a 0.1% fall in year-on-year house price.

This is in contrast to the Nationwide's index which has reported a more significant 3.3% fall and Halifax's index which reported a 3.2% fall (both to October).

The driver maintaining positive growth in terms of output and offsetting the falls in the housing sector is new infrastructure work, which grew by 0.8%, and repair and maintenance work, combined for housing and non-housing which grew by 0.7%. This indicates that although there remains uncertainty, opportunities remain throughout the industry despite the challenging economic outlook.

These challenging economics have been consequential to a number of recent, high profile insolvencies. Whilst the actual number of construction related insolvencies actually fell in July, the number of insolvencies in the year to August 2023 is 8.3% up on the same period in 2022 and 114% up on that period in 2021.

The insolvencies seen over the last quarter have been big names; Buckingham Group Contracting, with a £665m turnover, and Michael J Lonsdale, an M&E specialist with a £250m have proven that no matter the size of contractor, there is no immunity from the effects of inflations.

Continued tougher borrowing conditions with reduced access to credit, coupled with inevitable projects delays and reductions in project scopes to meet budgetary constraints will no doubt prove a further challenge in the coming months.

It is in this climate where our clients, no matter the sector they operate or size of their projects must ensure they are taking a proactive approach to limiting their levels of risk by:

- Undertaking credit checks; prior to tender and regularly throughout the course of their project.
- Ensuring valuations are robust and accurate and minimising the risk of overpayments.
- Limiting upfront payments and where made, ensuring adequate surety bonds are in place.
- Maintaining the holding of appropriate retentions.
- Protecting their project by ensuring contractors procure performance bonds at the outset of a contract.

At Frankham Group, our professional teams not only assist with the implementation of these measures, but if insolvency does strike, we're accustomed to acting quickly. We execute the necessary contractual procedures and provisions to limit any losses and getting the project moving forward as soon as possible.

In terms of tender prices, the BCIS all-in tender price index is finally indicating signs of stability, with the three most recent publications all showing broadly similarly levels of projections, with the recent volatility now appearing firmly in the past. The Building Materials and Components statistics continue to indicate that the substantial material price rises from last year are in reverse. However, for a handful of small anomalies, wages continue to grow and now exceed the rate of inflation providing real-time wage rise for workers.

Although there are clearly signs of stability with an element of predictability, we're unlikely to realise a substantial move to a return to acceptance in single stage tendering from contractors. Fixed priced-lump sum contracts, without additional provisions, have been continuously cited by administrators as the cause of failures. Smart contractors should have learnt from recent lessons and we should be embracing a collaborative, but competitive two-stage approaches to the procurement of projects.

Moving into 2024, the outlook is clearly mixed. The scaling back of high-profile infrastructure projects will hit confidence levels, and the housing market will likely remain flatlined. However, increased stability will hopefully be a driver behind confidence in the industry. Even with the Government's recent watering down of net zero targets, we're seeing a clear and continued growth in repairs and maintenance. There is an emphasis on maximising the value of current assets and a pushing ahead with decarbonisation works to reach net zero, providing solid workstreams for consultants and contractors alike.

Market Update overleaf >

For any enquiries, please contact:

Robert Ray
Associate Quantity Surveyor
07595 069 806
robert.ray@frankham.com

Market Update

Autumn 2023 | 17/11/23

Contact Robert Ray for any enquiries:
robert.ray@frankham.com

FRANKHAM GROUP

Economic Overview

0.1% Gross Domestic Product

GDP remained unchanged in 3rd Quarter 2023, with a 0.1% increase in the construction sector. This is following an identical 0.2% increase in 2nd Quarter 2023. However, month-on-month, GDP rose 0.2% in September 2023 following consecutive falls in July and August. GDP is estimated to have increased by 0.6% in in 3rd Quarter 2023, compared with the same quarter a year ago.

4.7% Consumer Price Index

Year-on year, CPI reduced to 4.7% in October 2023, remaining steady in July and August, down from 7.3% in June and falling from 9.2% in February 2023.This remains above the 2% Bank of England target but continues to fall steadily.

5.25% Interest Rates

2023 has seen multiple further rises in the Bank of England interest rate which remain at a 15 year high. This is an increase from 3.5% in December 2022 and 4.5% in May 2023 in the BoE's attempt curb inflation.

4.3% UK Unemployment Rate

UK Unemployment continues to steadily increase and is now at 4.3%, increasing from 3.8% at the turn of the year.

-0.1% UK House Prices

The average UK house price, according to the UK House Price Index, was £291,000 in September 2023, 0.1% down from 12 months ago, but £9,000 above the recent low in March 2023. The Royal Institution of Chartered Surveyors' (RICS') August 2023 UK Residential Market Survey reported a sharp downturn in buyer demand. In contrast, Nationwide's house price index reported a more significant 3.3% year-on-year fall to October.

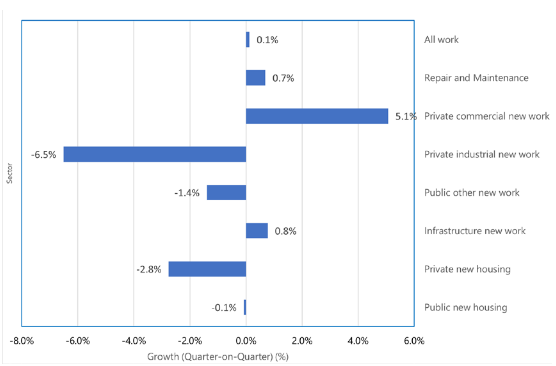
7.9% UK Wage Growth

Year-on year wage growth increased to 7.9% in September 2023 and now above the rate of inflation, with real-time wage growth not being seen.

Sources: ONS, HM land Registry, Bank of England. All data is the latest available

Construction Output

Quarter-on-Quarter Construction Output Growth **0.1%** *average increase*



Quarterly construction output increased 0.1% in 3rd Quarter 2023 compared with the 2nd quarter. This was driven solely by growth in September 2023 after two months of falls; the quarterly increase was because of repair and maintenance (0.7%), while new work saw a decrease of 0.3%.

Although increasing quarter-on-quarter, the infrastructure sector is on a downward trend with output now falling for a third consecutive month.

Year on year, excluding housing, new work is 5.0% up and repair and maintenance is up 10.2%. All work is up 2.8% year-on year.

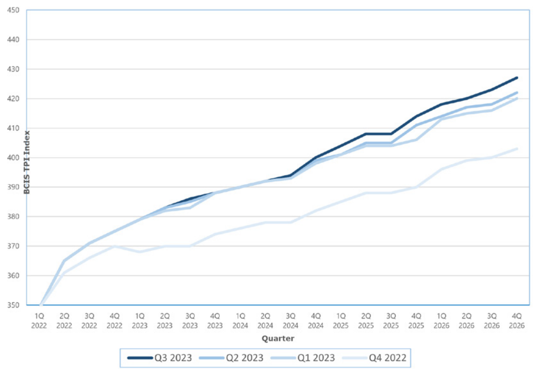
Private new build housing output continues to fall with a 2.8% drop quarter-on-quarter and 13.2% fall year on year. Total housing output is now at it's lowest monthly level since November 2021.

Overall, total construction output does continue to slow rise, with rises in the infrastructure and R&M sectors offsetting the sustainable housing falls.

Source: ONS. All data is the latest available

Inflation Forecasts

BCIS All-in Tender Prices Index **3.5%** *YoY increase to 4Q2023*



The latest BCIS All-in Tender Price Index is now indicating a 3.5% year-on-year increase in tender price, unchanged from the previous forecast.

The latest indices available in 4Q2023 indicate forecasts have stabilised, with year-on-year increases previously forecasted at identical level. The 3Q2024 forecast has however increased from 385 to 386, and increase of 0.1%.

Although forecasts increased in 3Q2023 from that predicated in 2Q2023, the three latest datasheets are now generally aligned, indicating and sign of stability and predictability.

Year-on-year inflation is also down from 9.0% peak at the same time last year and the peak of 10.3% seen in the second quarter of 2022; normal levels of inflation are returning.

The BCIS TPI now tender prices to remains steady and below a 4% annual rise for the foreseeable future, but for a spike in 2Q 2025

Although remaining steady at mainly less than 4%, latest indices generally show a higher index moving forward, from that projected previously.

Source: BCIS. All data is the latest available

Market Trends: Materials

Material prices continue to remain volatile in the 3rd Quarter of 2023 with both increases, as well as decreases being realised. Items such as **steel** and imported **timber**, which saw unprecedented rises in 2022 have continue to fall from their highs. **Imported timber** is now 19.2% down from a peak in August 2022, **imported plywood** down 13.9% from the August 2022 peak and **structural steel** 29.3% down from August 2022.

Supply and demand economics has contributed to these falls with reduced demand, decreases in manufacturing prices from lower fuel costs and the reopening of China being likely contributing factors.

In contrast to steel and timber, **cement** and **doors & windows** are seeing significant year-on-year increase at c.20% from last year.

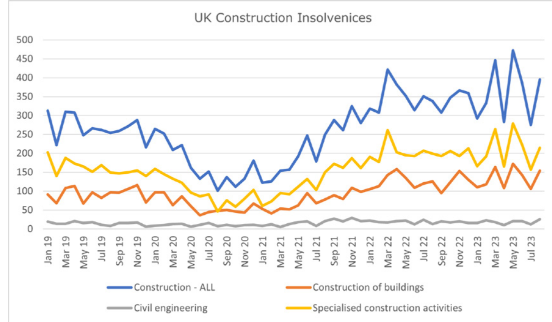
Prolonged levels high interest rates and elevated inflation may continue to provide pressures on material prices.

YoY change to August 2023

-29.3%	Structural Steel
-28.0%	Steel Reinforcing Bars
-19.2%	Imported Timber
-13.9%	Imported Plywood
25.3%	Screws
20.4%	Metal Doors and Windows
20.1%	Ready Mix Concrete
14.1%	Kitchen Furniture
12.6%	Insulating materials *(Thermal or Acoustic)*
6.6%	Plastic Doors and Windows
6.6%	Cement

Source: BEIS Material Price Index. All data is the latest available

Insolvency



The construction industry continues to have the highest quarterly number of insolvencies of any industry grouping and the number of insolvencies remain on an upward trajectory.

Insolvency levels remains above pre-pandemic levels with inflationary pressures continuing to prove difficult for contractors to navigate and overcome.

Buckingham Group, with a £665m turnover, entered administration in August owing than £108m, according to its administrators. They cited "significant and increasing losses incurred on key sports and leisure contracts due to inflation pressures", likely driven by earlier increases in steel and concrete.

Michael J Lonsdale, one of the UK's largest M&E contractors, appointed administrator in October. In a letter from the owners, they said "the ongoing conflict in Ukraine has added further strain, with surging inflation, workforce shortages, project delays, and supply chain disruptions, ultimately culminating in financial difficulties for the business".

A £57m turnover contract, **HB Projects**, who specialists in retail works appointed administrators in early November. They cited it was "due to a number of cancelled and/or deferred projects which has meant that we are unable to maintain a positive cash flow throughout the forthcoming months".

Source: The Insolvency Service; Construction News