



Insight

Spring 2015

making the difference

UK market intelligence Rising to the challenge

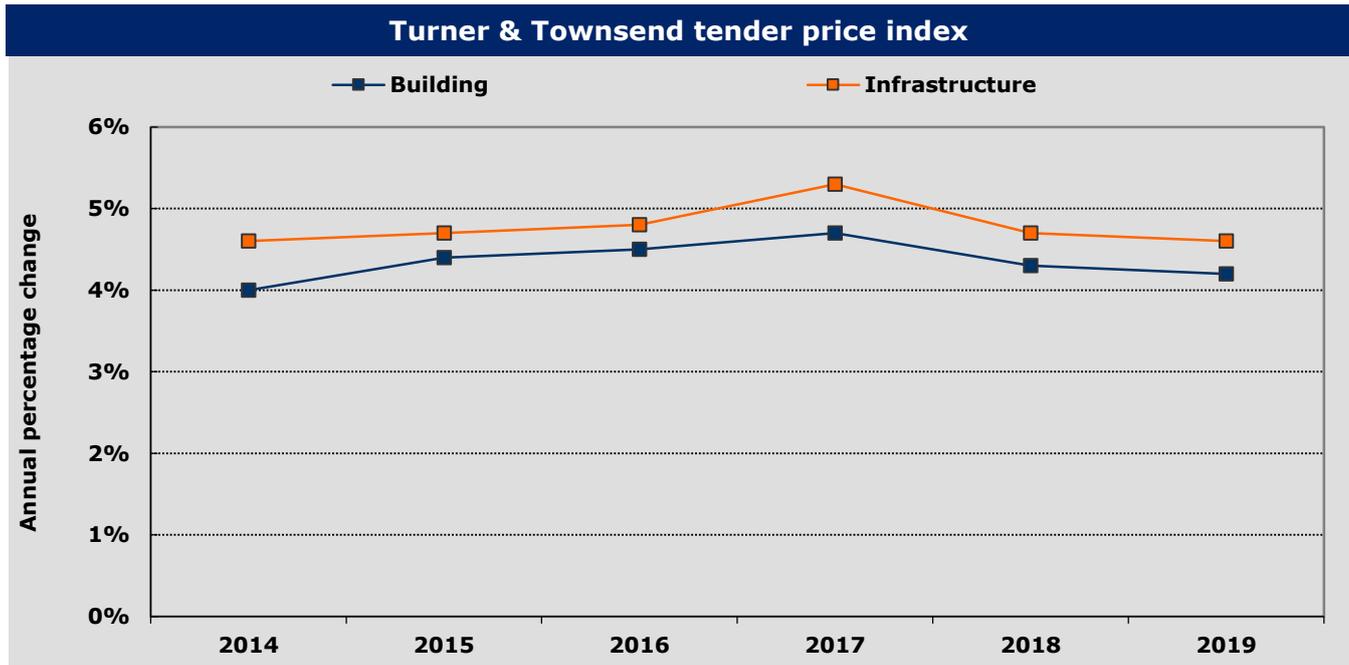
The first quarter of 2015 came to a close with the UK's economic recovery remaining on track as provisional GDP data increased by 2.4 percent when compared to its respective quarter in 2014. That being said, the main risk to the sustained development of the UK economy is a considerable one - the stability of the European Union and Greece's tenuous bailout. Closer to home, the General Election has created doubt, delaying businesses investment until further clarity on policies and government arise.

Following on from the Autumn statements refresh on infrastructure spending, the 2015 Budget produced little to boost construction. During this period, construction output decreased by 1.6 percent on the quarter as of the first quarter of 2015, falling in-line with a sharp decline of private sector investment in the industry over the fourth quarter of 2014 – by 20.5 percent. Despite this, business confidence within construction, reported by Markit, is at its highest level since 2006. Uncertainty of the general election is bound to affect investment, but positivity remains within the industry as activity continues to grow.

It is this increased activity that has been causing tender prices to rise within the industry. Capacity constraints, both in skilled labour and professional staff, are becoming more widespread across the UK. Attitudes to risk, especially in complex schemes is falling. This selective tendering approach is driving inflation increases.

Turner & Townsend tender price index annual percentage change		
	Building	Infrastructure
2014	4.0%	4.6%
2015	4.4%	4.7%
2016	4.5%	4.8%
2017	4.7%	5.3%
2018	4.3%	4.7%
2019	4.2%	4.6%

The data shown above is representative for the UK as a whole and costs may vary substantially between regions. For further assistance on cost assurance and inflation analysis in your area, please contact Turner & Townsend.



Key indicators



Materials: Increased lead in times of materials are generating rises in prices. Demand is exceeding supply as a result of more opportunities within the market.



Preliminaries: Predominantly increases seen from main contractors but progressively seen further down the supply chain.



Overheads and profits: Growing contractor order books has led to tendering at levels with greater profit margins.



Labour: Traditional trades are continuing to command a higher wage within the housing sector and general construction companies are having to reciprocate to attract skilled labour to site.

Construction by numbers

- Construction employment grew by 1.1 percent on the quarter, and increased by 2.9 percent on the year in Q4 2014. This now leaves construction employment at 2,265,633.
- Vacancy statistics gained in the fourth quarter of 2014, increasing by 4.5 percent when compared to the previous quarter and 38.9 percent compared to the previous year.
- Total construction new orders decreased by 2.9 and 2.3 percent on the quarter and year respectively as of the fourth quarter of 2014. Declines were led by a reduction in the new housing and commercial sectors – falling by 6.4 and 8.6 percent on the quarter.
- Construction insolvencies fell by 4.2 and 8 percent on the quarter and year respectively as of the third quarter of 2014.

UK economic data



GDP (at market prices) index
Q1 2015: 106.6
Q4 2014: 106.2
Increase: +0.6%



Bank of England base rate
April 15: 0.5%
January 15: 0.5%
No change



Consumer price inflation
February 15: 0.0%
November 14: 1.0%
Decrease: -1.0pp



Unemployment level (thousand)
Q4 2014: 1,862
Q3 2014: 1,959
Decrease: -5.0%



Construction output index
Q1 2015: 100.3
Q4 2014: 100.3
Decrease: -1.6%

Hot rates



Brick price index
Q4 2014: 118.6
Q3 2014: 116.3
Increase: +1.9%



Fuel (Diesel) price index
Q1 2015: 116.2
Q4 2014: 126.9
Decrease: -8.4%



Sawn wood price index
Q4 2014: 117.1
Q3 2014: 117.3
Decrease: -0.1%



Structural steel price index
Q4 2014: 98.0
Q3 2014: 100.8
Decrease: -2.8%



Copper price index
Q4 2014: 102.7
Q3 2014: 100.8
Increase: 1.9%



Hot Topic

Rising to the challenge – managing commercial interest in an overheating market

The UK contractor market continues to show evidence of overheating and contractors and specialist sub-contractors are now in the enviable position of being able to be selective and risk averse about which projects they bid for and ultimately take on. Order books remain healthy and tender prices continue to rise as capacity constraints persist and the industry skills shortages fail to be addressed, leading to post recessionary resourcing problems for all.

Contractors' tender prices are not rising as fast as tender prices for specialist sub-contractors and hence contractor margins are becoming squeezed. This change in the market has created tensions in the supply chain and we are seeing a trend for parties to consider disputes as a means of recovering risk.

We have set out 5 focus areas below to help manage risk in the current market. Many of these are basic good practice but should provide a timely reminder of the significance and importance in reducing the tensions referred to above.

1. Secure the right capability

Many of the issues we are currently seeing in the market are resource driven. It is therefore important to be objective and realistic about current project delivery resource capability. Three areas to consider:

- Identify skills gaps as early as possible and invest in recruitment and learning and development to bolster existing technical and commercial capability.
- Build a properly defined and structured project delivery team with an authority approval process to ensure that there are no delays in business critical project decision making.
- Deploy an effective document management system complete with the resources to manage it. Remember the old adage of records, records, records.

2. Be realistic about risk transfer

During the period of low growth in the construction industry, single stage tendering has been prevalent with project risk compressed into the supply chain. In the current market, where two stage is more widespread, contractors are being increasingly selective about the terms and engagement they expect from their chosen procurement route. The current market, however, does not favour single stage tendering and contractors may refuse to participate in bidding activity unless a two stage procurement approach is adopted. This can impact on the number of competitive bids received.

Contractors and specialist sub-contractors are also now less likely to agree to fixed price lump sum contracts, favouring – more commonly – re measurement/cost reimbursable or target cost contracts.

Given the current market conditions therefore, we have set out below 3 areas to bear in mind;

- Consider a two stage procurement approach which will generate greater interest from a wider contracting community than single stage in some markets;
- Use a standard form of contract which will be more acceptable to interested parties, and assume a flexible and conservative position in negotiating specific terms. It may be that you will have to give a little to get a little.
- Avoid adversarial contract terms and bargaining styles and incorporate terms and conditions which obligate the parties to provide early warning, collaborative and proactive (rather than reactive) behaviour and – where possible - incentivisation to perform.

3. Comply with the requirements of the contract

This may seem an obvious point, however, teams can come under pressure when resources are stretched Claims are much harder to make or defend against where the contract has not been complied with – you can leave yourself exposed to unmeritorious claims.



We are seeing a trend in the number of issues resulting from a failure to properly manage the contractual payment process.

Equally, compliance with the contractual timescales for issuing payment notices and payless notices is very important. Remember here that a failure to issue a payment notice and a payless notice in the prescribed time limits means that the payment applied for must then be paid, often following expensive and time consuming adjudication.

4. Avoid change where possible

Changes to the design or design development and design creep give rise to more claims and issues than any other aspect of the construction process. Sub-contractors, especially specialist ones, are in high demand and contractors may struggle to demand competitive prices in delayed and changing projects.

Be wary of design and build contract terms which purport to allow additional payment for significant changes to the design and others which are not clearly drafted and create ambiguity and uncertainty when dealing with changes.

The timeliness of M&E design release and design accountability is always a challenge. Much of the construction issue M&E design tends to be specialist supplier design & build and requires incorporation into the client team's base design. This often causes overlap problems – only discovered when the construction phase is well underway. This creates risk and often gives rise to variation requests.

It is absolutely imperative that the client design is fixed as far as reasonably practicable ahead of both tender and construction phase. The client team should consider early contractor/sub-contractor involvement (ECI) in the process to ensure that the design follows right first time principles.

ECI is a very effective method of developing the design during the design stages. It helps to drive value for money, completeness and robustness of design and risk identification.

5. Address issues quickly

It is vitally important that contract issues which arise are dealt with quickly and effectively and not allowed to develop traction. This requires a strong commercial mind-set, effective decision making processes and the right resources. Do not let issues fester.

Summary

The market has changed and the need to keep abreast of strategies and approaches to address this remains ever present. In this environment teams need to be well resourced, maintain good records and administer contracts appropriately to manage down risk.

Turner & Townsend can assist in helping to avoid or address claims and disputes

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