Inflation on Construction Materials

Market update

February 2024

CUMMING GROUP

BUILDING VALUE THROUGH EXPERTISE

Foreword

In the early months of 2024, the construction sector is seeing some green shoots in key markets such as concrete and steel reinforcement, where costs have softened from the highs of 2022. That said, regulatory changes are still being navigated and a further assessment is required to understand the true impact on construction costing – our current analysis is showing that inflation was the key driver of cost increases through 2023, accounting for 6-7% of overall cost increases, with 4% attributable to changes in legislation.

Generally, the key factors to consider for construction as we move through 2024 are how the Bank of England manages interest rates; with the market currently expecting a base rate cut as early as Q2 and potentially falling to 4.25% by the year-end and the impact on projects from Building Safety Act Gateways; in terms of both a deliverability and cost perspective.

Within the report, we highlight the Industrial and Logistics sector which experienced deflation of 2-3% in Q2 2023, before costs stabilised for the remainder of the year. Competitive tenders are returning to the market, which demonstrates the resilience of the sector, with contractors looking to secure workbooks aligning with cost reductions. Contractor insolvencies remain an unfortunate hot topic. We touch upon the ways in which we are adding value to our clients in navigating through turbulent markets, which we expect to continue through 2024.

2023 Pricing Trends

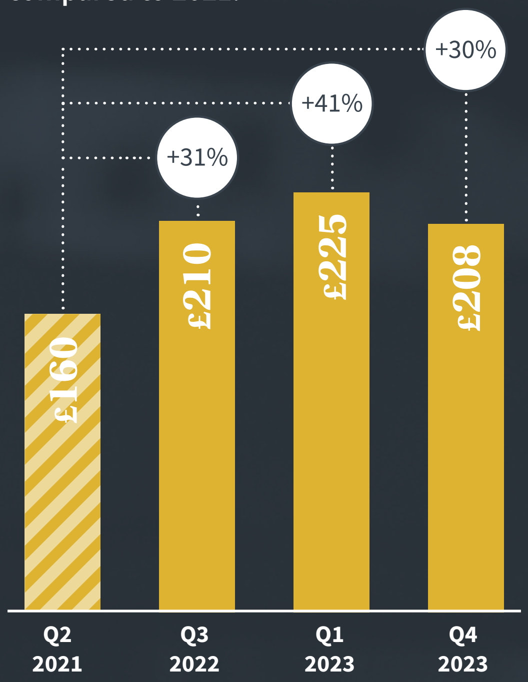
Looking back over the last 12 months, cost inflation across the key package contracts has softened, with price falls evident in some areas. With regulatory changes also impacting on site development costs throughout 2023, we have prepared some analysis below into when and where these two factors have impacted most.

Concrete

From Q2 2021 to Q1 2023, the price of concrete rose from £160 per m3 to £225 per m3, an increase of circa 40%.

However, from Q1 2023 to Q4 2023, prices have largely stabilised, with ranges of £194 to £221 per m3, dependant on specification and quantity. This equates to price reductions ranging from 2% to 16%.

Changes in concrete costs per m3 compared to 2021.



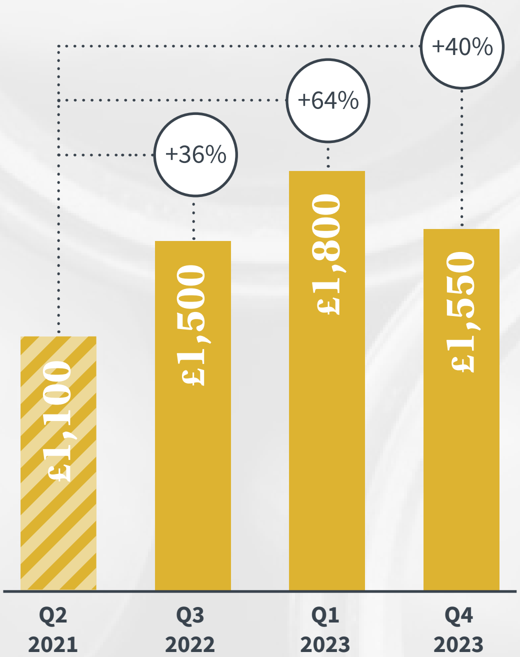
Source: Cumming Group

Steel

From Q2 2021 to Q1 2023, the price of steel rose from £1,100 per tonne to £1,800 per tonne, an increase of circa 64%.

From Q1 2023 to Q4 2023, there has been a significant decrease to £1,550 per tonne depending on quantity, a reduction of circa 16%.

Changes in Steel costs per tonne compared to 2021.



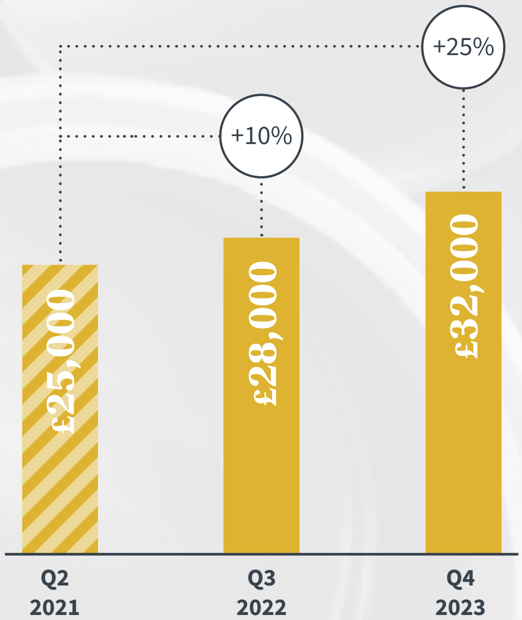
Source: Cumming Group

Mechanical, Electrical & Plumbing (MEP)

From Q2 2021 to Q1 2023, the cost of MEP on a typical Build-to-Rent (BtR) scheme rose by 14% from £25,500 to £32,000 per key.

Some of this can be attributed to changes in legislation such as building regulations, sprinkler regulations and the Building Safety Act.

Changes in MEP costs per key compared to 2021.

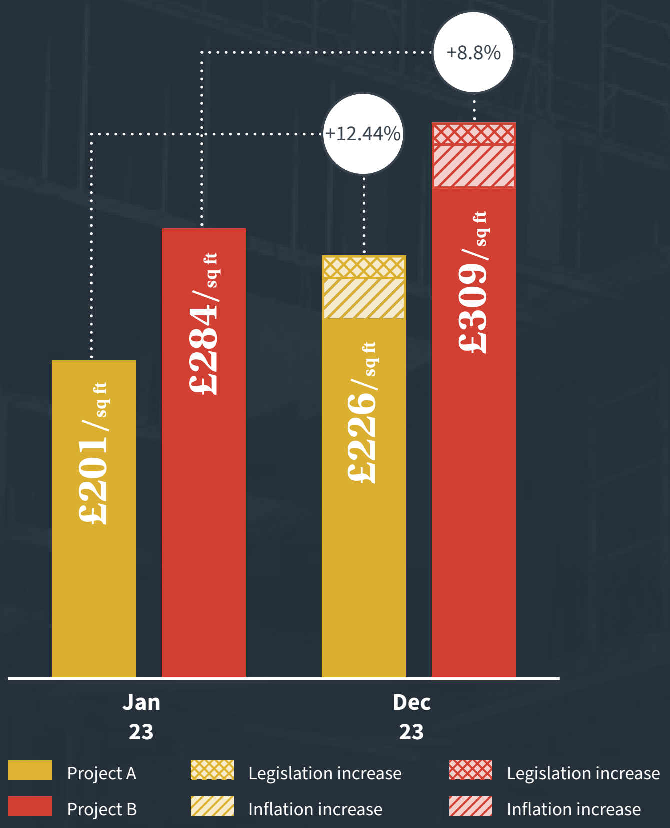


Source: Cumming Group

Regulatory Changes

Regulatory changes such as the updated Building Regulations and Building Safety Act have also impacted on costs, however, it can be difficult to fully understand the extent to which increases have been driven more by inflation or by legislation. Consequently, we have undertaken reviews of a number of projects to improve our knowledge in this area, with our summary findings below.

Overall, we are seeing that the impact has ranged from circa 8% to 12.5%. Our analysis suggests that around 6-7% of cost increases are due to inflation, with circa 4% resulting from legislation. It is, however, important to note that this does not take into account the impact of the building safety gateways and any impacts on preliminaries and other contractor costs.



Source: Cumming Group

Outlook for 2024

Inflation & Building Regulations

Average cost increases of around 3% are expected, with higher increases of 5% on concrete and 7% on partition and insulation products. Inflation on MEP elements should remain fairly stable, with any changes being driven by BRUKL/ Thermal and overheating modelling. This has presented challenges on some schemes, where additional mechanical ventilation and triple glazing has been required.

Building Safety Act

The first schemes to go through the Building Safety Act process will provide evidence of expected timelines, which have been assessed as circa twelve weeks for Gateway 2 and twelve weeks for Gateway 3. This may impact on schemes moving to site and handover and may also extend borrowing periods (which is good news for lenders).

Interest Rates

The direction of travel on interest rates will be closely monitored in the coming months. As at mid-December, market expectations suggest a potential reduction in the base rate in 2024, perhaps as early as the summer – although the Bank has persisted with its ‘higher for longer’ mantra and is downplaying expectations of a possible rate cut. Any reduction will, however, provide a degree of comfort across the funding market, which may allow some stalled schemes to re-start.

Sector Focus: Industrial & Logistics

2023 Market trends

As a precursor, 2022 saw unprecedented tender price increases in the Industrial & Logistics sector, with up to 35% increases on pre-covid levels. This peaked in Q1 2023, with prices falling by 2-3% into Q2 2023, before stabilising for the remainder of the year.

The Bank of England (BoE) rate increases commencing from the end of January 2023 triggered a pause in developer activity as margins tightened, and the cost of funding increased. This had a significant effect on the anticipated pipeline of logistics deliveries for Main Contractors operating in the sector.

Materials pricing

We have seen a circa 2-4% fall in materials prices generally in 2023. Whilst prices are still high compared with pre-covid levels, the recent stabilisation of prices for steel and concrete, as well as falling energy prices, have all added to the downward pressure on costs.

Tendering market

We have seen a return to competitive tenders, which is a contrast to the tendering market in the previous year, which was predominantly single source negotiation.

Contractors in the sector are keen to fill order books following a tentative outlook from developers in the wake of interest rate rises.

Occupier uptake

Potential occupiers were cautious in 2023, as firms adjusted to the higher interest rate environment and put growth plans on hold.

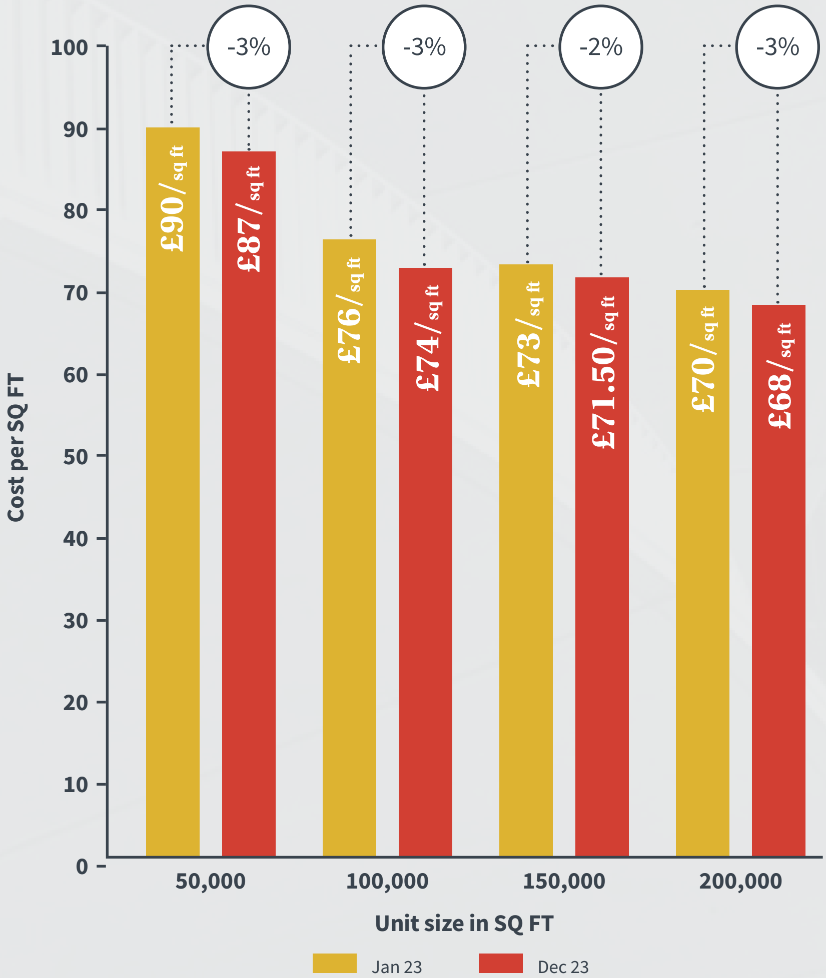
We are beginning to see occupier interest increasing which should gain momentum as we move into 2024, while developers are focused on letting existing stock to facilitate new speculative development.

Contractor Insolvency

A large warehouse slab sub-contractor (Malin Floors) entered administration in February 2023, followed by Main Contractor involved in the sector (Buckingham Group) in August and the unfortunate administration of £400m turnover logistics specialist Readie Construction in Q1 2024. These events are indicative of the pressures facing many construction firms, with the cascading impact of unfinished works, defect rectifications, residual debts to the wider supply chain, and a stricter bond market.

Clients will be understandably cautious regarding the financial standing of preferred main contractors and subcontractors, and we are working closely with our developer clients to advise on and mitigate these associated risks using our expertise to provide more pre-contract due diligence mechanisms and tighter post-contract monitoring of supply chain cash flow. Our robust commercial advice and management is demonstrating our value to clients in what will continue to be a turbulent market in 2024.

Indicative cost per square foot comparison by Unit Size



Outlook for 2024

Developer clients will remain understandably cautious the BoE consider rate cuts, but those quickest to react when others are hesitant will benefit. We are working closely with our developer clients to consider and mitigate these associated risks regarding the financial standing of preferred main contractors and sub-contractors.

There remains strong demand for high quality logistics buildings, and we are starting to see increased occupier enquiries as interest rates stabilise.

We continue to monitor the workload pressures of Main Contractors who have inherited projects from troubled competitors.

Carbon Reduction

Carbon reduction measures are becoming increasingly required by developer clients, with increased uptake of green concrete, lower carbon steel products, and the offsetting of project embodied carbon. These are likely to increase initial development costs by circa 10-15% but will attract more blue-chip occupiers.

Electric Arc Furnace steel is becoming an increasingly popular carbon reduction method for a sector with very few large elements to target, although there are a limited number of production facilities in Europe. Difficulties in obtaining supplies from those manufacturers is a potential risk in 2024 if the current level of demand continues, which could increase steel costs and lead-in times.

Export of Power

There has been a notable increase in the quantum of PV installations on logistics buildings in the past 12 months and as such we are witnessing increased cases of the grid network being unequipped to accept higher export demands.

We are seeing increasing cases of capital payments being required to export power to the grid or being faced with export limitations below the full capability of installed PV arrays, which should be considered by developers in the sector.

Building Regulations

Newly defined roles and responsibilities are the biggest change to the logistics sector rather than direct impacts on building design, given that most logistics buildings are not considered 'high risk'.

We expect to see some early reluctance from designers to be appointed as building regulations principal designer due to lack of familiarity with the named role and required changes to PII cover.

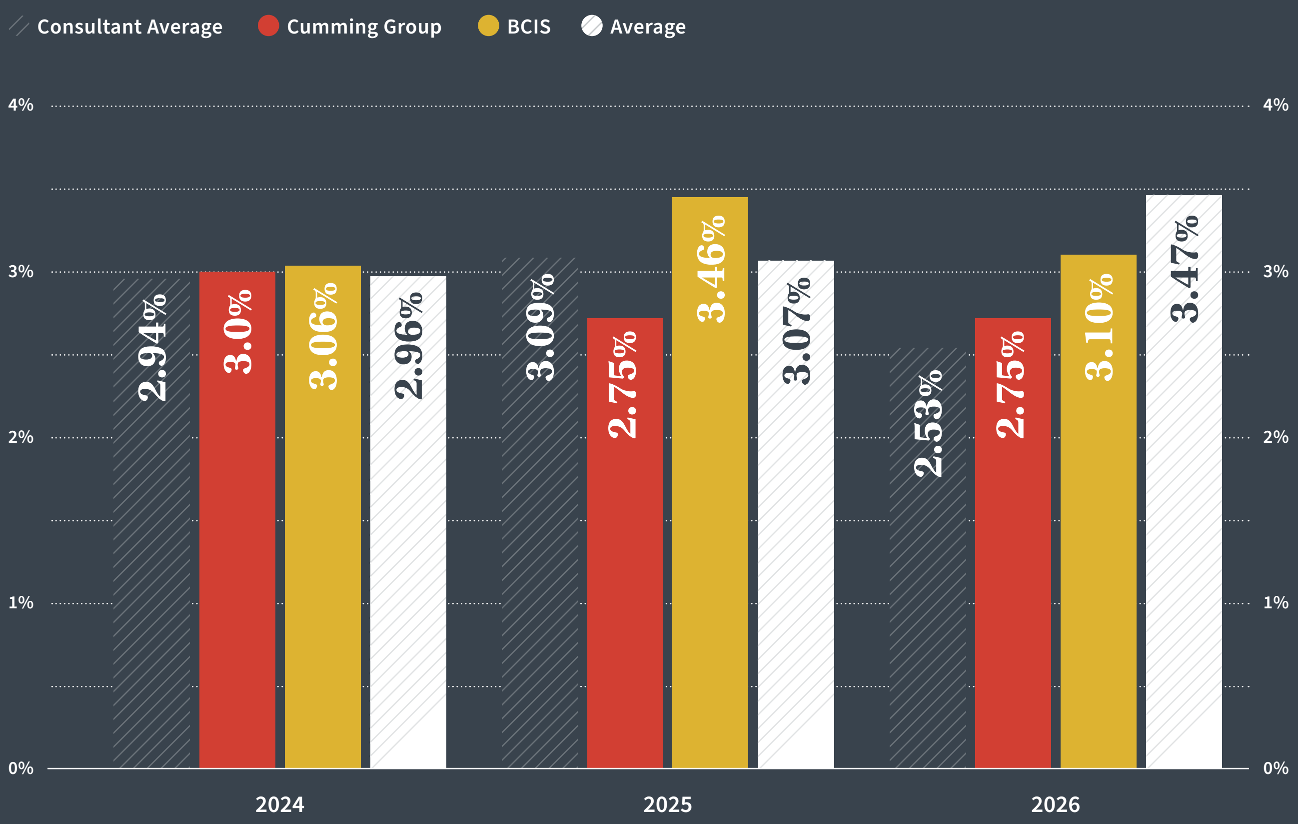
Inflation Summary

Once again, there has been little movement across the next three years of inflation from BCIS and the general market.

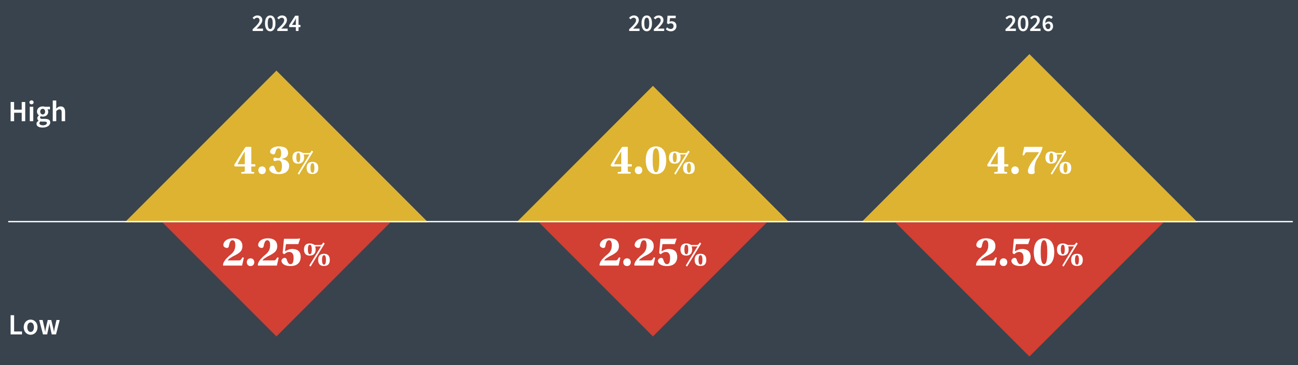
On average, across the three subsequent years, Consultant Average projects an inflation rate of 2.84%. Cumming Group's predictions average at 2.93%, and BCIS forecasts average 3.21%. The combined average across all three sources stands at 3.00%.

While there are variations in each year's predictions, this general overview suggests a moderate inflationary trend over the specified period. Decision-makers and stakeholders may find value in considering these diverse perspectives to inform strategic planning and risk management strategies for the broader economic landscape.

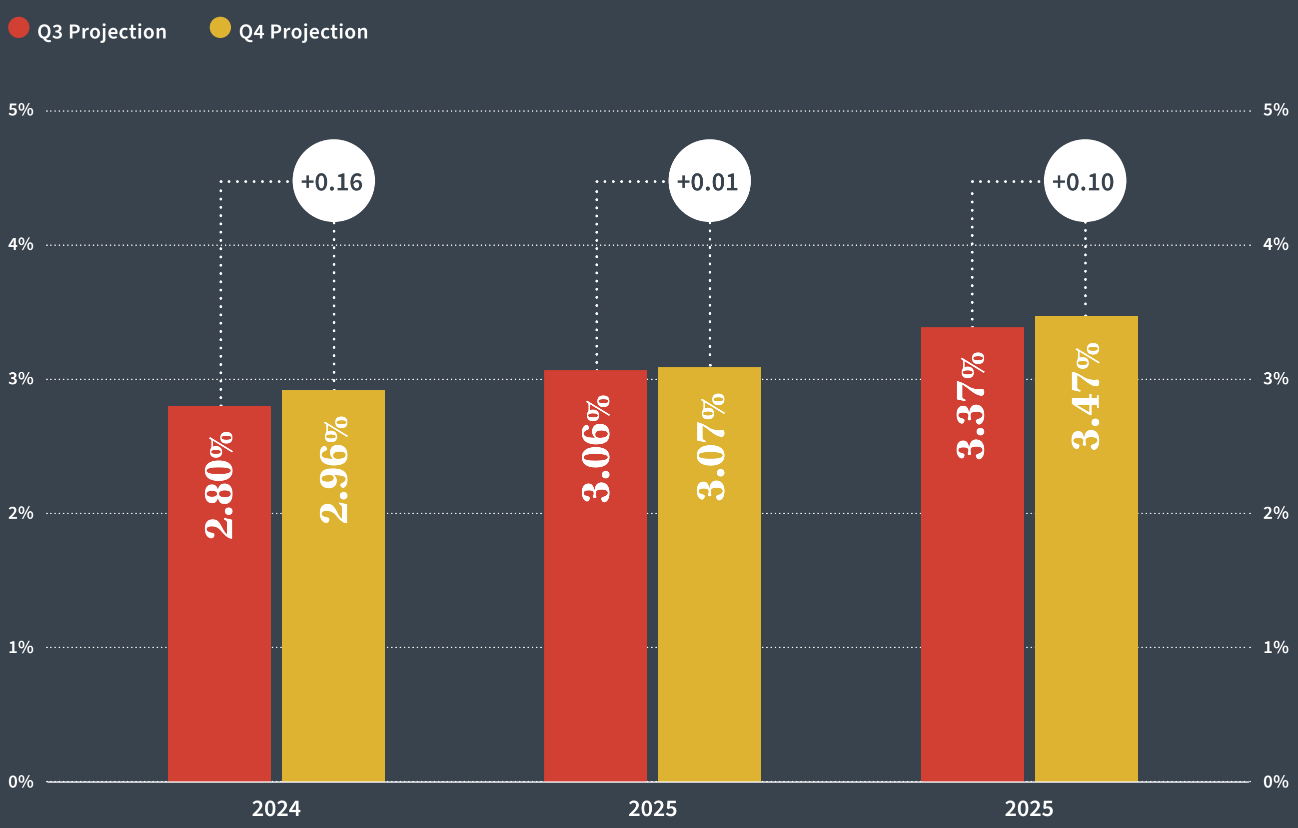
Year-On-Year



Highlights



Average



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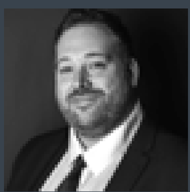

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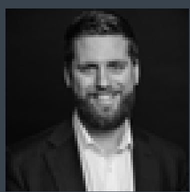

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