gleeds

Q3 2017

Economic and Regional Inflation Report

Economic

- CPI remains above 2% target
- Construction output falls by 1.3%
- GDP growth up 0.3% as forecast

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Aftermath of the General Election

The Prime Minister called a General Election in June, believing it would create unity in Westminster and that a new mandate would strengthen her hand in Brexit negotiations. Instead, the outcome of the election has resulted in a hung parliament with no overall majority. The result has raised questions over the direction in which the UK is now headed, particularly with regards to Brexit negotiations. The CBI and the Institute of Directors have both urged the Government to make issues such as infrastructure and the economy a priority, but clear direction is still awaited. This is further impacting economic growth, the value of sterling, and a lack of confidence amongst investors.

Following the result, Carolyn Fairbairn, Director General of the CBI commented: "For the next Government, the need and opportunity to deliver an open, competitive and fair post-Brexit economy has never been more important."

Stephen Martin, Director General of the Institute of Directors wrote in the IoD press release: "The issues of access to EU markets and the need for skilled workers are still paramount."

Public Sector Borrowing

The independent Office for Budget Responsibility (OBR) has forecast that public sector net borrowing will be £58.3bn during the financial year ending March 2018.

The ONS data showed that total Government debt, excluding public sector banks, stood at £1.758t at the end of July, which is equivalent to 87.5% of Gross Domestic Product (GDP).

Brexit negotiations

Following the triggering of Article 50 at the end of March 2017, uncertainty over Brexit is having a clear impact on the economy. Amidst signs that the economy is slowing, the UK will seek a transition deal of around three years, to enable businesses to adapt to life outside of the EU. It is thought that a transitional deal would temporarily bridge the gap between the UK's actual exit from the EU, and the arrival of a new and permanent UK-EU trade deal.

While economic growth initially held up better than expected, it has slowed this year and the pound's depreciation has driven up consumer prices. Consequently, the Bank of England (BoE) has cut this year's growth forecast to 1.7%, down from the previous forecast of 1.9% made in May, with Mark Carney, Governor of the BoE, explaining that business investment is now slower than previously expected due to Brexit and that this is likely to impact on wage growth.

"It's evident in our discussions across the country with businesses that uncertainties about the eventual relationship are weighing on the decisions of some businesses."
Mark Carney, Governor of the Bank of England

Calls for cladding overhaul following Grenfell Tower disaster

Following the fatal fire at Grenfell Tower, fears have been raised that the same flammable cladding could be attached to UK hospitals, schools and hotels. This has resulted in wide-scale testing and the removal of ACM panels and polyethylene filler and foam insulation from tower blocks.

New advice issued by the Department for Communities and Local Government (DCLG) states that this type of cladding represents a significant fire hazard for buildings over 18m tall.

The Government has subsequently announced an independent review, the terms of reference for which were published on 15th August. Under the Chairmanship of Sir Martin Moore-Bick, the Grenfell Inquiry will address crucial issues, such as the cause of the fire and the adequacy of building and fire regulations. The results of the inquiry will have far reaching implications for the design, construction and maintenance of high rise buildings.

It will not address any criminal activity which is under review by The Metropolitan Police, who have already stated that corporate manslaughter charges may result from their investigations.

PMI indicates construction slowdown

Construction activity slowed to an 11 month low in July 2017 with the Purchasing Managers' Index (PMI) coming in at 51.9, down from 54.8 in June. However, the index remains above 50, which signals a rise rather than a fall in output.

According to Tim Moore of IHS Markit, which compiles the PMI survey: "Worries about the economic outlook and heightened political uncertainty were key factors contributing to subdued demand. Construction firms reported that clients were more reluctant to spend and had opted to take longer in committing to new projects."

Source: IHS Markit, July 2017

Exchange rates

Sterling remains around 15-20% below its November 2015 peak against both the euro and the US dollar. In the run-up to the BoE's August Inflation report, sterling was estimated at 18% below its peak. Much of this is ascribed to changes in investors' perceptions of the UK's outlook for growth and risks emanating from the UK's imminent departure from the EU.

Source: Bank of England, Quarterly Inflation Report, August 2017

Sterling exchange rates continue to fall as uncertainty over the UK's post Brexit trade with the EU weighs on market sentiment despite more upbeat economic data. Further falls against major currencies are expected with HSBC Holdings and Morgan Stanley predicting parity with the euro by late 2017/ early 2018. This reflects a strengthening of the euro as much as further weakening of sterling.

Investment

After deteriorating sharply post-Referendum, the CBI business surveys show some improvement in investment plans. Anecdotal evidence suggests that minor projects and investments already in the pipeline are proceeding. However, uncertainty surrounds bigger spending projects and the longer term. According to a recent CBI survey of both members and non-members, over 40% of businesses say that Brexit has affected their investment decisions. Of those, 98% say that the impact has been negative. Nevertheless, the CBI still expects growth of 0.6% in business investment over 2017 and have upgraded their business investment forecast for 2018 to 1.5%.

New Projects in the Pipeline

Despite subdued growth during Q2 2017, several new projects have been announced this quarter:

Gatwick Airport has announced £1.2bn of investment over the next five years.

A £200m mixed-use development for **King's College London**, designed by Hopkins Architects, has been given planning approval.

Proposals to build a 67-storey 237m high skyscraper as part of the **Trinity Islands** development in Manchester has been given planning permission.

Balfour Beatty has won the contract to complete the electrification of the **Great Western Main** Line from Bristol to Cardiff.

The Department of Transport is to spend £16m on five new train stations, set to be completed by March 2020. The stations will be located at Horden Peterlee in County Durham, Warrington West, Reading Green Park, Bow Street in Ceredigion, and Portway Parkway in Bristol. A further £37m will be required to complete the projects.

The University of Oxford is committed to spending £100m per year for the next five years, with approximately half of the Oxford Colleges having significant spending programmes of between £10m-£50m in the coming two to three years.

Regeneration specialist developer U+I has won planning permission for a £130m mixed-use scheme on **Blackhorse Road** in Walthamstow, north-east London. This will provide 337 new homes and 18,830ft^2 of commercial space.

A £65m office building at Newcastle's £350m regeneration scheme **Science Central**, west of the city centre, has been given the go ahead by planners.

Economic Overview

Gleeds' Economic Report reviews various fiscal factors which affect UK construction, taking into account inflation, construction output and orders and employment. It also assesses other relevant matters, such as the implications of Brexit and the General Election, which impact on the economic environment and general confidence in the market.

LOOKING BACK TO Q1 2017	Q2 2017 - THE LATEST FIGURES
Construction output	
According to the Office of National Statistics (ONS), construction output increased by 0.2% in Q1 2017 compared to Q2 2017	Construction output decreased by 1.3% in Q2 2017 when compared to the previous quarter (Q1 2017)
Over the previous 12 month period construction period output had increased by 2.4%	Over the previous 12 month period, construction output increased by 0.9%
Pay and employment	
In Q1 2017, the unemployment rate fell to 4.6%	Unemployment fell to 4.4% in Q2 2017
ONS predicted that average weekly earnings (total pay) in the construction industry rose by 0.6% between March 2016 and March 2017	Average weekly earnings for construction workers rose by 2.1% in the year to June 2017

"The degree of uncertainty surrounding economic forecasts is virtually without precedent, and medium-term prospects will persist until we get greater clarity around the shape of the UK's post-Brexit relationship with the EU.

ROSS SAVAGE, DIRECTOR, GLEEDS

Gleeds' regional inflation forecast

ANNUAL % CHANGE	Q3 17 to Q3 18	Q3 18 to Q3 19	Q3 19 to Q3 20	Q3 20 to Q3 21
EASTERN	2.00	2.50	3.00	3.00
GREATER LONDON	2.00	2.00	4.00	5.00
NORTH EAST, YORKSHIRE & HUMBERSIDE	2.00	4.00	4.00	4.00
NORTHERN IRELAND	0.50	3.50	6.00	6.00
MIDLANDS	3.50	3.50	4.50	5.00
NORTH WEST	2.25	3.75	5.25	4.75
SCOTLAND	2.00	2.25	2.80	3.00
SOUTH EAST	2.00	2.00	4.00	4.00
SOUTH WEST	2.00	2.50	3.50	4.50
WALES	2.50	3.00	4.00	4.25
UK AVERAGE	2.08	2.90	4.11	4.35

Note: these are average regional forecasts based on activity and market awareness within each of our regional offices. Actual inflation will be determined by a combination of macroeconomics and micro project situations. Consequently, forecast inflation at a project level needs to be carefully considered based on the project's characteristics and prevailing local conditions. Published statistics can be misleading and subject to later revision and should be used with caution.

Furthermore, considering the uncertainty surrounding Brexit negotiations and the current political instability, extra caution is advised at this time.

Background to Economic Outlook

UK Economics

In their August Inflation Report, the BoE Monetary Policy Committee (MPC) voted by a majority of 6-2 to maintain the Bank Rate at 0.25%. The MPC also voted unanimously to continue with the programme of non-financial investment-grade corporate bond purchases at £435bn and UK Government bond purchases of £10bn financed by the issuance of central bank reserves (first announced 12 months prior in the August 2016 report). The committee voted unanimously to close the drawdown period for the Term Funding Scheme at the end of February 2018 in line with original plans.

The BoE assesses that the outlook for the economy in terms of inflation and activity remains broadly similar to the situation in May (the previous BoE Inflation Report release). GDP growth declined in Q1 2017 to 0.2% and has remained tempered at 0.3% in Q2. The depreciation in sterling is raising import prices and impacting on household real income growth. The pace at which households moderate their spending will be a key determinant of the outlook for overall GDP growth. Central forecasts of GDP growth remain sluggish in the short term at around 1.75% per annum. The squeeze on real household incomes continues to stunt consumption, but both GDP and consumption are expected to recover over the forecast period.

Net trade is anticipated to be positively influenced by strong global growth. The effect of the fall in value of sterling will support investment by UK firms, and offset some of the uncertainty surrounding Brexit negotiations. Investment is weaker than normally expected for a growing economy; the BoE concedes that the appetite to invest is less aggressive than it has been, but that the increased competitiveness of more affordable British exports is a welcome boost to manufacturing productivity.

The MPC expects inflation to rise over the coming months, peaking at around 3% in October 2017, as the effect of the weaker pound feeds through into consumer prices. Inflation is expected to remain above the 2% target throughout the forecast period, squeezing disposable incomes until wage growth begins to pick up. Wage growth is anticipated to be static at around 2% despite low unemployment and continued concerns around staff availability.

If the economy follows a path broadly consistent with the central projection outlined in the BoE's August 2017 Inflation Report, the Committee forsees that tightening of monetary policy would be required to achieve a sustainable return of inflation to the target of 2%. But there is some reluctance within the MPC to increase Bank Rates in case this dissuades consumer spending.

Global Economics

The outlook for the global economy has improved in recent quarters as growth has picked up. More recently, the BoE estimates global GDP to have risen further in Q2 2017, from 0.6% in Q1 2017 to 0.7% in Q2 2017, and growth is predicted to remain stable in coming quarters. This improving picture can be in part attributed to a recovery in investment growth, which should support the longer-term outlook. The IMF's global economic growth forecasts of 3.5% for 2017 and 3.6% for 2018 is unchanged on expectations that, despite cutting the economic growth outlook for the U.S. and U.K, the euro zone and Japanese growth will accelerate.

Economic growth in the emerging market economies is expected to have been stable over the first half of the year following a slowdown in recent years.

Source: Bank of England, Quarterly Inflation Report, August 2017

Summary

- The Bank Rate is maintained at 0.25%
- The tightening of real household incomes continues to impact consumer spending
- Inflation remains significantly above the 2% target where it is expected to remain for the remainder of 2017

> **One of the main factors that we believe has supported a revival of domestic confidence in the Euro area has been the removal of some of those political risks that six or nine months ago, we thought were weighing on confidence**
>
> HUW PILL, CHIEF EUROPEAN ECONOMIST, GOLDMAN SACHS

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Outlook for GDP & inflation

Sources: Office for National Statistics, Preliminary estimate of GDP: Apr to Jun 2017, Office for National Statistics, UK consumer price inflation: July 2017, CBI Economic forecast

As noted, GDP growth increased by 0.3% in Q2 2017, up slightly from 0.2% in Q1 2017. This growth has been driven mainly by the services sector, which grew by 0.5% in Q2, up from 0.1% in Q1. The largest contributor to services growth was the distribution, hotels and restaurants sector, which increased by 1.1%. Film production and distribution also contributed to services growth, increasing by 8.2% in Q2 2017.

The construction and production sectors were the main downward pulls on GDP growth this quarter, falling by 0.9% and 0.4% respectively. Manufacturing (a component of production) fell by 0.5%, while agriculture increased by 0.6% in Q2. Declines in the manufacture of motor vehicles were the main factor in falling production activity.

In the year to July 2017 Consumer Prices Inflation (CPI) stood at 2.6%, unchanged from June 2017 (CPI had fallen slightly from the five year high of 2.9% seen in May 2017). The falling price of motor fuels was offset by smaller upward contributions from a range of goods and services such as clothing, household goods, gas and electricity, and food and non-alcoholic beverages.

Inflation continues to exceed the BoE's Monetary Policy Committee's (MPC) target of 2% per annum and can be attributed to a combination of the effects of higher consumer prices, modest wage growth, and subdued household spending balanced out by other components of demand.

The BoE expects inflation to peak at 3% in approximately October. Their best guess is that inflation will not spiral but that it will be slow in falling back to 2%, remaining above the BoE target of 2% for the remainder of the forecast period (2017-2020).

The CBI expect net trade to support GDP throughout this year and 2018, as the lower exchange rate and improving global growth continue to underpin exports further ahead.

Summary

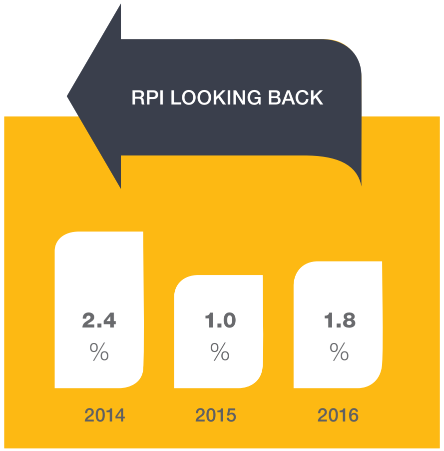
- GDP growth rose marginally to 0.3% in Q2 2017
- CPI remained unchanged at 2.6% in the year to July 2017, but has fallen from the five year high of 2.9% in May
- Inflation continues to exceed BoE targets The 2% inflation target has now been surpassed and is expected to remain above target for the remainder of 2017

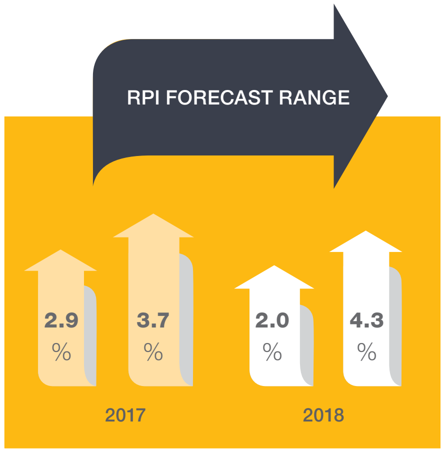
GDP, CPI & RPI Movement Predictions

	2017	MOVEMENT	2018	MOVEMENT	2019	MOVEMENT	2020	MOVEMENT	2021
GDP growth (%)	1.6	↓	1.5	↑	1.6	↑	1.8	↑	1.9
CPI (%)	2.7	↓	2.6	↓	2.2	↓	1.9	↔	1.9
RPI (%)	3.5	↔	3.5	↓	3.0	↔	3.0	↔	3.0

Source: HM Treasury Forecasts for the UK Economy, August 2017

"The risks around any forecasts are considerable"





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Infrastructure investment is a key driver of construction growth going forward. However, the election outcome and the UK's imminent departure from the EU, has created a high degree of uncertainty around the extent of infrastructure growth over the next few years.

SARAH DAVIDSON
DIRECTOR OF RESEARCH & DEVELOPMENT, GLEEDS

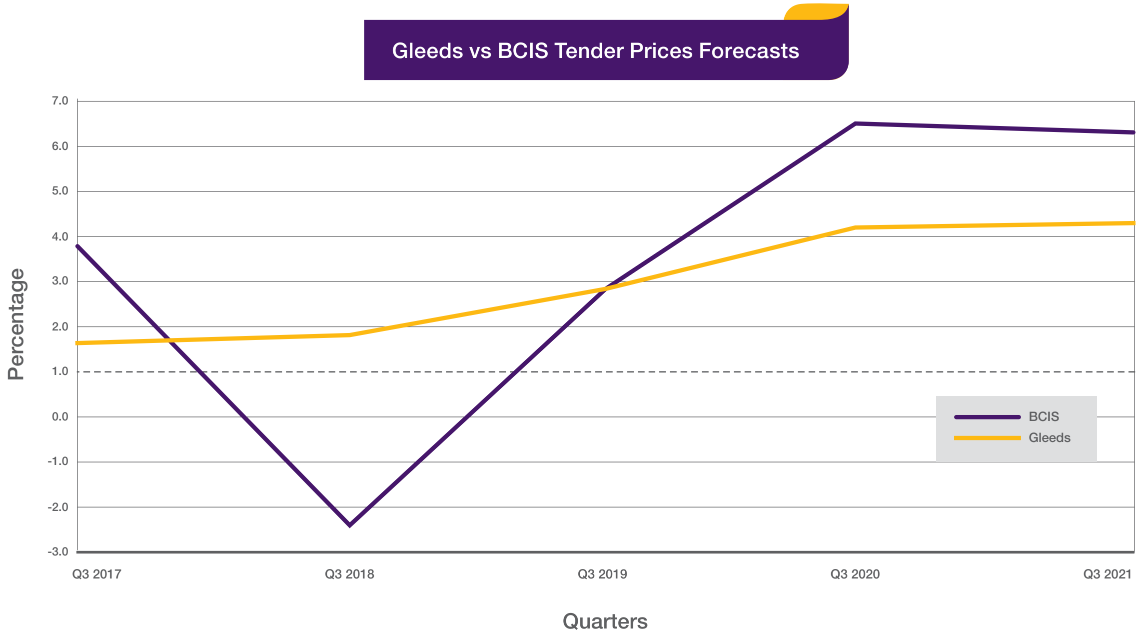
Tender Price Forecasts

Shortly after the EU Referendum, the Building Cost Information Service (BCIS) revised its tender price forecasts to present a picture of reducing prices in the construction industry. These forecasts have since altered, but continue to indicate some fluctuation between negative and positive growth throughout 2017 and 2018.

Year on Year	Current Forecast (04/08/2017)
Q3 2017 to Q3 2018	-2.4%
Q3 2018 to Q3 2019	+2.8%
Q3 2019 to Q3 2020	+6.5%
Q3 2020 to Q3 2021	+6.4%

Gleeds anticipates that tender prices will rise over the next four years (Q3-Q3) at a UK average rate of:

+ 1.8% between 2017-18
+ 2.9% between 2018-19
+ 4.2% between 2019-20
+ 4.3% between 2020-21



Note: the declines seen in the recent BCIS All-in-TPI forecasts are not reflected in Gleeds' forecasts. Whilst BCIS is of the opinion that tender prices first fell back in Q4 2016, the industry does not generally appear to be in consensus. Furthermore, whilst BCIS predicts a sharp rise from 2019 onwards, Gleeds' estimates are slightly more modest.

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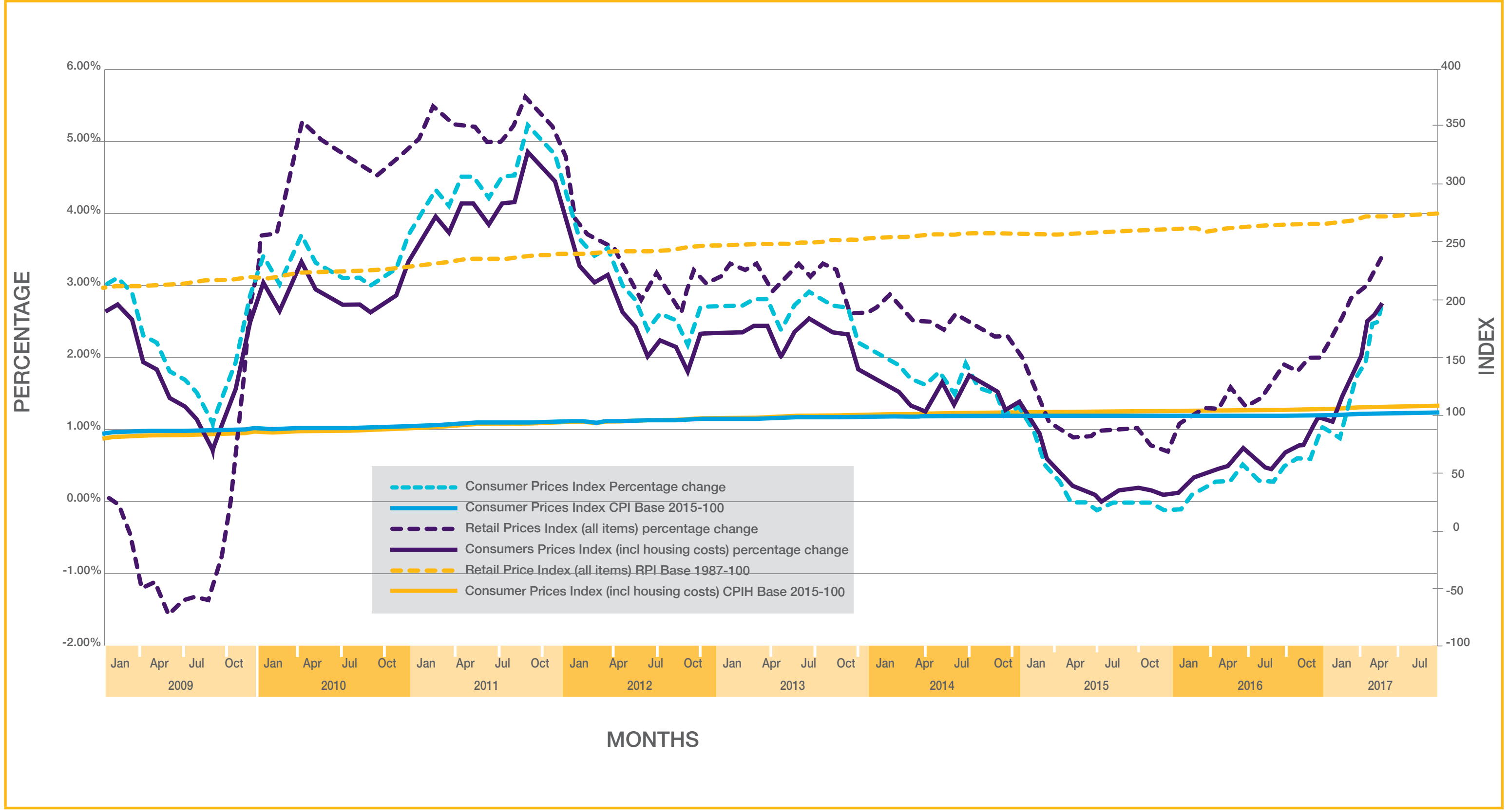
Annual Inflation Rates

ANNUAL INFLATION RATES OFFICE OF NATIONAL STATISTICS Q3 2017



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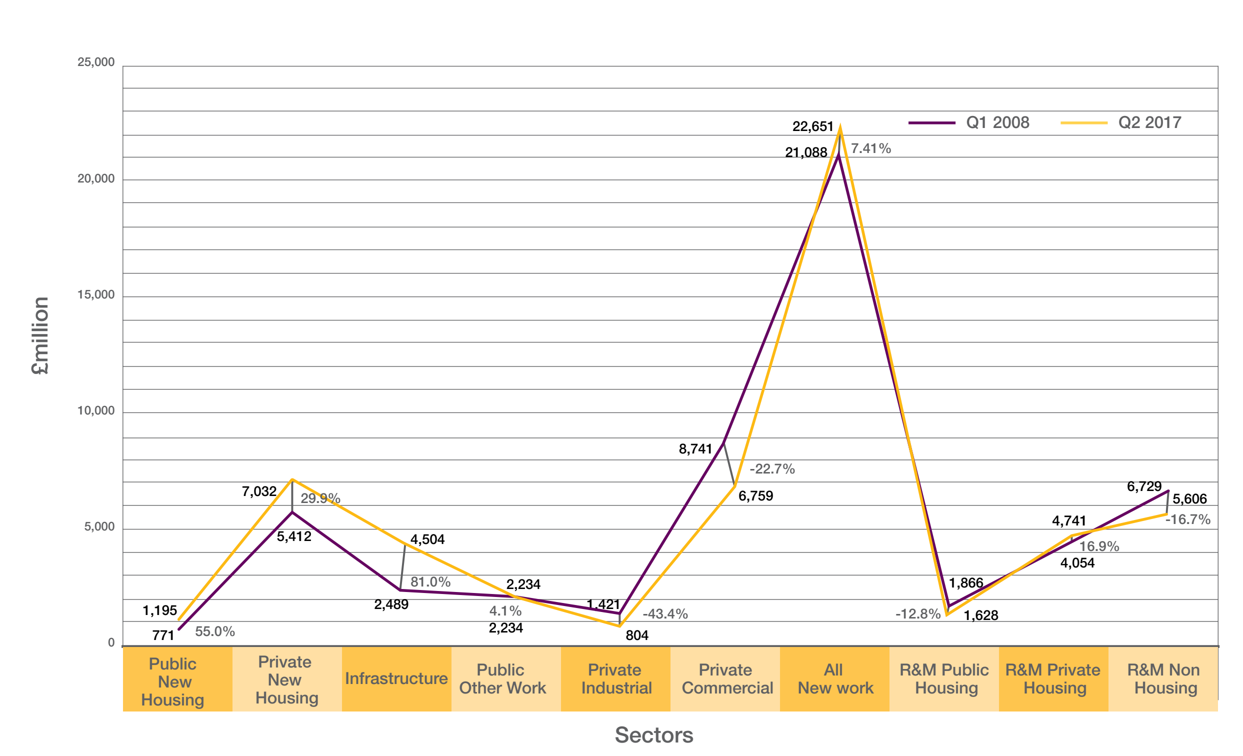
Volume of Construction Output

Looking at the volume of construction output, the ONS reports that:

- In Q2 2017, all **construction output fell** by 1.3% from Q1 2017, reversing the recovery seen in the first three months of the year. Comparing June 2017 to the previous month shows a smaller decline of 0.1% however, this is still up 0.9% on June 2016.
- **All new work** in Q2 2017 fell by 1.3%, with public non-housing the biggest contributor to this decline, down by 6.6% over the quarter. Private commercial output, which represents a much larger proportion of the value of construction output, fell by 2.0%. The public housing sectors helped to moderate the decline in new work, rising by 3.0% in Q2 2017.
- In Q2 2017 **all repair and maintenance works (R&M)** output declined by 1.4% compared to the previous quarter (Q1 2017). Non-housing R&M was the main contributor to this decline, falling by 2.4% over the quarter.

CONSTRUCTION OUTPUT - DIFFERENCE BETWEEN Q1 2008 (PEAK) AND Q2 2017



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Value of Construction Output

New work	Q1 2017 - Q2 2017	
Sector	Output	Movement
All work	↑	3.4%
All new work	↓	-0.3%
New public housing	↑	3.9%
New private housing	↑	2.0%
New private commercial	↓	-1.4%
New private industrial	↑	0.6%
New public non-housing	↑	1.3%
New infrastructure	↔	0.0%

R&M	Q1 2017 - Q2 2017	
Sector	Output	Movement
All R&M	↓	-1.2%
Public housing R&M	↑	1.3%
Private housing R&M	↑	0.1%
Non-housing R&M	↓	-0.6%

A comparison of output activity between Q1 2008 and Q1 2017 reveals that:

New private commercial is down by 11.4%
New private industrial is down by 47.6%
New public non-housing is down by 9.4%
Public housing R&M is down by 9.4%
Non-housing R&M is down by 95.9%

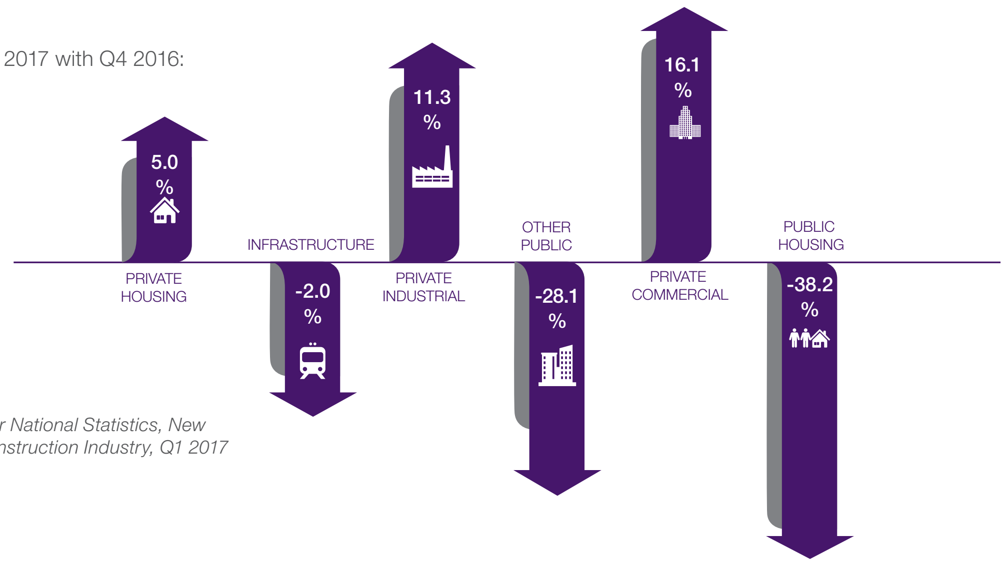
New public housing is up by 34.4%
New private housing is up 40%
New Infrastructure is up 50.0%
Private housing R&M is up by 29.8%
All work is up 15.7%
All New work is up 19.9%
All R&M is up 7.5%

Source: Office for National Statistics, Construction output in Great Britain: June 2017

Value of Construction Output

According to the ONS, the total volume of new orders for the construction industry increased by 0.7% in Q1 2017 compared with Q4 2016 and by 3.7% on Q1 2016.

Comparing Q1 2017 with Q4 2016:



Source: Office for National Statistics, New Orders in the Construction Industry, Q1 2017

Employment

During Q2 2017, UK wide unemployment fell to 4.4% from 4.6% in Q1 2017. This is the lowest unemployment rate seen since 1975. Over the same timeframe, the number of people in employment increased by 125,000 to 75.1%, the highest number since comparable records began in 1971. This is in part due to the introduction of a later state pension age for women.

Average weekly earnings (total pay) in the construction industry rose by 2.1% on the year to June 2017, while regular pay (excluding bonuses) rose by 2.4% over the same timeframe. With inflation at 2.6%, real earnings fell by 0.5%, as demonstrated by the ONS figures.

Some construction consultants and trades are attracting higher than average salary increases, which reflects the skill shortages in certain trades and in some geographical areas. In the longer term, this will create rising pressure on costs.

Source: Office for National Statistics, UK labour market: August 2017, Hayes salary and recruiting trends 2017

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Market Reports

The results of the Q2 2017 RICS Construction & Infrastructure Market Survey indicates a slowing in the pace of output growth. A net balance of 21% of respondents reported an increase in workload, down from 27% in the previous quarter.

According to survey responses, construction output growth moderated in all sectors over Q2 2017 with the private commercial and industrial sectors seeing the sharpest slowdown. The private housing sector remains relatively buoyant, with 29% of respondents reporting an increase in output. Anecdotal evidence from respondents suggests that uncertainty surrounding Brexit and political turmoil following June's General Election are impacting on investment decisions. The net balance on infrastructure workload remained broadly unchanged with growth anticipated in the rail, road and energy sub sectors over the next 12 months.

In the building sector, 69% of respondents expect tender prices to increase over the next 12 months, unchanged from Q1 2017.

Despite the slowdown in growth, the skills shortage remains as pronounced as in the previous quarter, with 55% of respondents believing this to be an impediment to growth (up from 53% in Q1 2017).

RICS

Construction Market Survey

29% REPORTING A RISE IN WORK

Q2 2017

RISE IN OUTPUT

Shortages of quantity surveyors, bricklayers, plumbers and electricians are particularly acute.

Respondents were also keen to point out that the quality of workers is just as important as the numbers.

Financial constraints are again reported to be the most significant obstacle to growth; the primary cause being cited as Brexit and the General Election result.

All regions of the UK (except the Midlands and East Anglia, which have benefitted from a surge in infrastructure works) have observed a fall in workloads. Growth was particularly subdued in Scotland and dropped into negative territory in Northern Ireland for the first time in four years.

69% EXPECT TENDER PRICES TO INCREASE

LABOUR SHORTAGE

BRICKLAYERS 54%

QUANTITY SURVEYORS 65%

> **"The Q2 2017 RICS UK Commercial Property Market Survey results show sentiment turning slightly more cautious compared with previously. A flatter picture for demand appears to be weighing on the near-term outlook for rental growth in the office and retail sectors, although expectations remain firm for industrial space. Political uncertainty is cited as a key factor weighing on occupier and investor decisions, with hesitancy now extending to some areas beyond London.**
>
> RICS, UK Commercial Property Market Survey, Q2 2017

Construction Output Summary of Forecasts

SECTOR	YEAR	EXPERIAN	CONSTRUCTION PRODUCTS ASSOCIATION
CONSTRUCTION OUTPUT	2017	1.3	1.3
	2018	0.9	1.2
	2019	1.8	2.3
TOTAL NEW WORK	2017	2.3	1.7
	2018	1.4	2.0
	2019	2.2	4.0
PUBLIC HOUSING	2017	-3.0	-2.0
	2018	2.0	4.0
	2019	3.0	5.0
PRIVATE HOUSING	2017	6.0	2.0
	2018	4.0	2.0
	2019	3.0	2.0
INFRASTRUCTURE	2017	0.0	7.3
	2018	2.0	11.1
	2019	10.0	12.8
PUBLIC NON-HOUSING	2017	0.0	-0.2
	2018	-1.0	-0.4
	2019	0.0	2.3
PRIVATE INDUSTRIAL	2017	-5.0	-5.4
	2018	1.0	-3.1
	2019	1.0	-1.1
PRIVATE COMMERCIAL	2017	3.0	-0.1
	2018	-1.0	-3.3
	2019	-3.0	0.0

Source: BCIS Summary of Output Forecasts, July 2017

The Glenigan Index

Glenigan's monthly Index provides data on the value of construction projects that have started on site during the previous three months, and the influences that will drive future industry workload over the coming two years.

The July 2017 index advises that, following on from June's General Election, there have been increased delays in public sector projects going to site. The total number of starts were down by 10% in Q2 2017 compared to the same quarter in 2016. Civil engineering starts were 23% lower than a year ago, following a drop in infrastructure developments, while health sector starts were down 59%.

However, there were sharp regional variations, with the number of project starts in the East, North East, North West, and Yorkshire and the Humber all increasing by 60%, 10%, 19% and 8% respectively over the past 12 months.

Source: The Glenigan Index, July 2017

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Construction Output Summary of Forecasts

On the assumption that the UK will withdraw from the single market and customs union, the BCIS expects that Brexit will result in restrictions on the movement of labour. They propose three possible political outcomes from the exit negotiations, each of which BCIS deem to be equally likely:

- **Upside scenario - the UK will remain in the EU free trade area but with restrictions on the movement of labour**
- **Downside scenario - the UK will not retain access to the EU market and that there will be restrictions on the movement of labour**
- **Central scenario - there will be some restrictions to trade and access to labour**

Based on these three scenarios, the BCIS has prepared three different construction output forecasts.

		Upside Scenario	Central Scenario	Downside Scenario
Sector	Year	Q1 2017	Q1 2017	Q1 2017
New Work Output	2017	1.4	0.0	-9.2
	2018	5.3	-1.3	-8.8
	2019	6.1	2.3	4.4
	2020	6.3	4.7	5.6
	2021	5.5	5.7	8.2

Source: BCIS Summary of Output Forecasts, July 2017

Regional Reports

Gleeds continues to monitor macroeconomic activity in each region of the UK, with the aim of anticipating the economic effects stressors, such as Brexit, may have on construction demand.

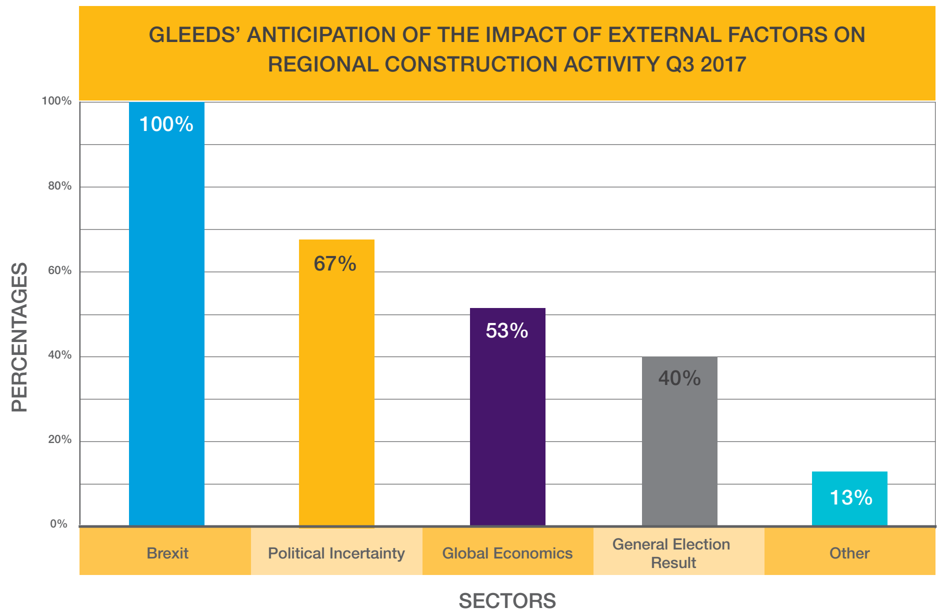
This quarter, we have also looked at other external factors impacting on the local regions such as the effect of global economic policy and political uncertainty following on from the General Election.

Each of our regional offices has been asked to advise which external factors are most affecting their local industry. The results are shown in the table below. Overwhelmingly, Brexit was viewed as the biggest stressor with all offices reporting as such.

Political uncertainty and global economics were also seen as having an impact. Other factors identified include the knock-on effect from US interest rates and the progression of HS2 implementation.

Our regional commentaries provide a mixed picture of construction activity across the UK. Although the incidence of projects being placed on hold or cancelled in the wake of Brexit is diminishing, many regions are seeing tender volumes fall as fewer opportunities arise in the first place. A potential effect of exchange rates on construction costs is anticipated by some regions, while others are also concerned about the shortage of skilled labour.

Gleeds' regional offices report as follows.



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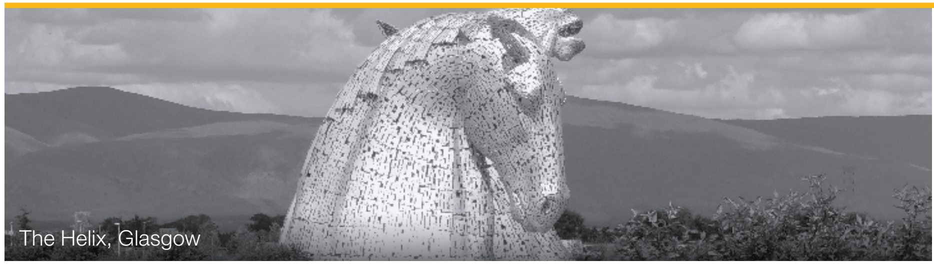

The Helix, Glasgow

Brian Stevenson

Reporting on the Scotland Region

The market in Scotland has gone through a prolonged period of uncertainty due to the Independence Referendum, and then the European Referendum, and will continue to do so until there is a better understanding of what Brexit will actually mean for the Scottish economy. Following June's General Election, the SNP has taken a step back from pushing for another Scottish Referendum. However, it is still likely that this will be on their manifesto for the next Scottish Election, and as such will continue to cause uncertainty for the time being.

The recent Fraser of Allander Economic Commentary noted that: "with the effects of any Brexit headwinds and rising inflation likely to become more significant in coming months, the resilience of the Scottish economy is likely to be severely tested". The Scottish Economy would undoubtedly benefit from the introduction of clear policies and concrete action to stimulate the economy, particularly in the construction sector.

Although initial contractor enquires on projects are often high contractors are becoming more selective in the projects they actually submit tenders for. However, tender prices received over the last quarter indicate that the market is still competitive.

With the Queensferry crossing and M8/M74 projects drawing to a close, and the Aberdeen Western Peripheral Route well under way, there is likely to be a significant downturn in infrastructure projects across Scotland whilst the 'empty building' rates continue to discourage speculative office and industrial/distribution developments.

There is still a significant level of uncertainty and a lack of confidence in the construction sector following Brexit. The weak pound has created concern regarding material prices and what effect this will have on tender prices, while bricks remain in short supply.

As has been the case for the last four quarters, Scotland is reporting heightened levels of uncertainty and weakened confidence across the construction sector. Rising material prices and the shortage of bricks are feeding in to tender price inflation.

Nigel Watkins

Reporting on the Wales Region

The Welsh market harbours a wealth of activity at present and tendering remains competitive, whether via single stage, two stage or framework tenders. Student accommodation and commercial office space are key drivers of growth across the country. Given the level of activity in the region, recruitment of skilled labour can be challenging.

The small number of projects which were placed on hold following Brexit are now progressing. Concerns now exist around the future demand for student accommodation should Brexit have an impact on the number of European students coming to study in the UK, given that this is a key sector in the region. Lack of clarity over the Brexit plan and programme is leading to increased uncertainty in the market but overall the outlook remains positive.

The local supply chain suggests no shortages at present (although this could change at any time). Public realm materials, granite/natural stone paving, large curtain walling systems, specialist internal and external finishes, specialist MEP plant, and reconstituted stone products are typically imported and the weaker pound is pushing the prices of the commodities up.

Construction output will likely increase over the next two to three years. Specifically, areas such as Cardiff and Swansea have potential for large numbers of schemes to commence across the commercial, educational, health and infrastructure sectors. Current interest in renewable energy schemes such as the Swansea Bay Tidal Lagoon (though slow to get moving), could kick-start a rollout programme of similar developments across Wales; with Cardiff, Newport and Colwyn Bay the most likely candidates.

Hinkley Point has now been given the go-ahead. Projects of this nature draw large labour forces, putting pressure on local projects and affecting tender prices as companies look to secure labour from further afield.

In our previous quarterly report, the construction market in Wales was seen as busy and there were a number of large scale projects underway and in the pipeline. Concerns over the impact of the weakened pound on tender prices were creeping in.

Regional Reports


Childrens Hospital for Wales, Cardiff

Galvin Tarling

Reporting on the Eastern Region

The Cambridge commercial, science, technology and pharmaceutical markets remain buoyant, although there are a number of significant developments drawing to a close, which will fuel contractor demand for 2018/2019.

This will serve to reduce the rate of inflationary increase. Both the residential and higher education sectors continue to remain strong.

The Eastern region is displaying renewed confidence, with high levels of assumed workload security and the anticipation of stable workloads going forward.

Tender pricing is still competitive although it is likely that the volume of tenders will decrease in the short term. This slowdown in activity may bring with it a general increase in construction costs.

The region is benefitting from good availability of labour and materials and it is possible that should a surplus arise, some of this could be soaked up by demand from London.

In our previous report, the Eastern region was beginning to show some momentum with projects which had previously stalled following Brexit. However, this was being tempered by a cautious investment and funding market.

Geoff Warke

Reporting on the Northern Ireland Region

The situation in the Northern Ireland region regarding Brexit is one of general uncertainty, especially as this region has the only international border within the UK. This has resulted in a positive expectation of a sympathetic solution to border controls.

Following the post-election deal between Northern Ireland's Democratic Unionist Party (DUP) and the Conservatives, the region looks set for heightened activity in the coming years. Of the £1bn of extra spending secured as part of the Government's 'confidence and supply' deal, £400m has been earmarked for infrastructure projects over the next two years. This will provide a welcome boost to the local construction industry.

The main project set to benefit from this cash injection is the planned York Street interchange in Belfast, one of seven flagship infrastructure projects identified as a priority. It was originally anticipated that the project would be funded by the EU but this possibility has diminished following the Referendum.

Other flagship projects include upgrades to the A5 and A6, the Belfast Rapid Transit bus system, and a new transport hub at Belfast's Queens Street rail station.

The first quarter of 2017 was the second best quarter for construction work in the last five years. Construction output was up 7.1% compared with the same period in 2016, and this excludes work carried out outside of Northern Ireland by large local contractors who do most their work elsewhere in the UK. The total volume of construction output for first quarter 2017 decreased by 1.7% compared with fourth quarter 2016, however the overall trend since 2014 has been upward.

The Northern Ireland economy is expected to grow by 1% in 2017 and 2018, even with the uncertainty over Brexit, and the additional capital spending will provide a boost to the local market.

gleeds

Regional Reports

St Pancras Renaissance, London

Paul Sweeney

Reporting on the Greater London Region

New major commercial projects in central London are generally stalling and at best, are typically proceeding through to planning. Smaller schemes, refurbishments and the fit-out market remain buoyant.

The high-end residential sector continues to be slow, although a buzz of activity remains in the mid-priced market. There is the sense that the market might be waiting to see if there is any reaction following the election of the new Mayor given his targets for more affordable homes.

First tier main contractors are becoming increasingly selective upon the type and risk profile of projects they wish to tender. Second and third tier contractors still appear to have an appetite for all projects.

Mirroring last quarter's sentiment, London's construction workloads are predicted to remain stable, although there may be a drop in the volume of tenders hitting the market. However, there is also the expectation that construction costs will start to rise as higher import costs become a factor. The majority of materials are currently being imported, compounding the effect of the pound's recent depreciation. The availability and quality of labour remains adequate at present.

In our previous quarterly report, some projects in London were still on hold following the Referendum result and longer term workload security was troubling many contractors. It was anticipated that the volume of tenders would continue to slow going forward.

Phil Wright

Reporting on the Midlands Region

There is a steady stream of work from a wide range of clients in the East Midlands, particularly within the education sector, which is helping to maintain regional contractor workloads. This is being driven by rising pupil numbers in both primary and secondary education and the opening up of student places in the higher education sector.

Some selective tendering decisions by contractors over the last 12 months indicate a definite preference for two-stage negotiated tenders over single-stage bids on projects above £15m.

There has been a noticeable impact post Brexit of contractors pursuing the right scheme to establish a turnover for the next 12-24 months. This has led to one or two projects being priced below anticipated market conditions as part of a noticeable strategy by regional contractors.

Public sector clients in the region are unsure of what, if any, alternatives will be in place to replace grants such as the European Regional Development Fund following Brexit. If this is not addressed shortly the Government will unintentionally cause a pause in the development cycle.

The local industry in and around Birmingham and the West Midlands remains largely positive with several key schemes either in construction or being brought to the market; the tower crane count on the city skyline has increased dramatically in recent times.

Multi-room residential schemes, including PRS projects are still increasing in order to fulfil the demand that is being driven by the commencement of HS2 and the increasing number of commercial office developments that are all interlinked.

Industrial and warehousing projects, both for end users and speculative developments, are also hitting the market in the wider region.

Major main contractors are reflecting on healthy order books and remain selective with the schemes they choose to tender.

Increased energy prices and the consequences of the exchange rate, particularly where materials and services are to be procured from the Euro zone, (which will include facade, steelwork, and mechanical and electrical plant) need to be considered and are adding to the current levels of pricing uncertainty. Across the region, we are continuing to see material price rises with some contractors reporting almost daily variations.

In our previous quarterly report, the Midlands region was continuing to adopt a wait-and-see approach. The volume of construction activity as well as construction costs were being impacted by inflation, rising import costs and fluctuating exchange rates.

Regional Reports

Liverpool School of Tropical Medicine

Alex Halliday

Reporting on the North West Region

Construction in the North West remains resilient with numerous tendering opportunities within several sectors - but in particular within the residential and education. The residential sector is buoyant in both the PRS and ‘for sale’ markets, supported with Gleeds’ latest commission for 550 units on the old Boddingtons site, in addition to large commissions in Castlefield and Salford Quays.

Construction activity in Manchester remains positive with further large scale developments at St Johns, Middlewood Locks and Spinningfields.

Construction activity in Liverpool continues to increase, with a large number of projects starting on site and old sites being developed out in recent months.

There is still a strong emphasis on student accommodation and PRS schemes, with the major £100m+ redevelopment at Otterspool (Festival Gardens) currently being discussed as a potential Scape opportunity. Other projects of note are three potential towers on Pall Mall and the new Everton Stadium.

The fire at Grenfell has made several employers question the cladding type and fire precaution measures on their projects. Although cost is typically their primary driver, a number of employers are considering more costly solutions, with a view to reducing risk and addressing end user fears.

In our previous quarterly report, concerns over the long-term stability and capacity of the industry in the North West were increasing due to a number of bankruptcies in the region. The slowdown in the availability of public funding was impacting on project viability and construction activity.

Steve Green

Reporting on the North East, Yorkshire & Humberside Region

Construction activity in West Yorkshire is buoyant and steady. In particular, the education sector is healthy with a steady flow of projects and enquiries. Similarly, enquiries are being received from the healthcare sector, which suggests that this is beginning to gather momentum despite a slow start to the year. Speculative work has remained at similar levels, however conversion of enquiries has been slow due to the sensitivity of the market place.

Decisions on investment are very market sensitive and funding on multimillion pound projects tends to be through joint ventures in order to spread the risk. European investment in the UK continues despite the start of Brexit negotiations although the long-term viability of this is in doubt. Brexit and the recent General Election result do not appear to have significantly affected any current or proposed local projects in the short-term but there is an expectation that they may do so in the medium-term.

Across the North East there has been a greater diversity of construction projects over the past couple of years, with an increased volume of new bespoke commercial office projects, light industrial units and inner city retail and residential redevelopment schemes. Alongside this, there is still an increasing demand for new build city centre student accommodation and an increasing (but relatively low) level of investment in local road and rail infrastructure projects.

Whilst there has been enough interest from local contractors when competitively tendering for medium and small value projects, most major contractors remain selective when being approached to tender for larger value projects. In the case of larger projects, contractors are still in favour of a negotiated procurement route, but are willing to provide competitive tenders where the project tender information is significantly advanced, and the number of tenderers is limited.

In the previous quarter, the market in the North East was reported as being busy with an increasing level of enquiries for new schemes at the beginning of the year. Demand was particularly high for bespoke commercial office projects, retail unit redevelopments and new city centre student accommodation.

Regional Reports

Bristol Civil Justice Centre, Bristol

Richard Hine

Reporting on the South East Region

Construction activity in the South East appears to be resilient heading into Q3 2017, having sustained solid growth in Q2 2017. The region continues to receive the knock-on effects of the strength of the London market, which saw the majority of contracts awarded in the last quarter (followed by the South East).

High levels of activity remain in the residential sector with some of these comprising mixed developments of mainly residential space, with some commercial and retail uses. Activity in private commercial and infrastructure projects has exhibited a modest pace of growth having eased slightly since the beginning of the year.

New care home developments also seem to be advancing throughout the region, unabated by market fluctuations in the short term. Contractors remain bullish about tender prices, with order books for the remainder of the year being 75-90% secured.

However, there are increasing levels of uncertainty and concern for future workloads, with smaller projects proceeding but larger projects being put on hold.

Contractors are pricing competitively but with limits on how long firm prices will be held, specifically regarding steel and M&E works. In general, contractors anticipate an escalation in prices on imported materials due to the weakened pound.

In our previous quarterly report, the South East continued to exhibit resilience as had been the case for the previous two quarters. However, shortages of labour and materials were becoming a concern and were feeding into heightened costs.

Matthew Quirk

Reporting on the South West Region

Construction activity within the South West appears resilient heading into Q3 2017, driven largely by the house-building and residential schemes (both large and small) that are evident throughout the region's cities. In line with continued market sector demand, there are also a number of student accommodation schemes under development, both new build projects and the conversion of existing buildings.

One possible threat to the residential market in Bristol and South Gloucestershire comes from South Wales, where estate agents have confirmed that the majority of recent house buyers are coming from the greater Bristol area, motivated in part by the prospect of lower commuting charges thanks to the shelving of the Severn Bridge tolls in 2018. In anticipation of this growing demand, there are already new housing developments underway in these areas.

Both the construction of the Metrobus in Bristol and the electrification of Paddington main line continues apace, with disruption being felt across the whole Bristol transport network. That said, the opening of the three-mile long Bristol South Ring Road earlier this year has significantly improved traffic flows in this area of the city, and aided in shortening travel times to Bristol International airport.

The South West is already seeing a substantial increase in the numbers of EU nationals leaving the UK, which is affecting the local labour market with further pressure coming from arguably the UK's largest construction project, the new nuclear power station at Hinkley Point. There are currently 1,600 people on site, and this is due to rise to 6,500 at peak construction. Whilst the project undoubtedly attempts to utilise as much local labour as possible, the sheer size and complexity of the project inevitably necessitates the need to mobilise expertise from around the country and beyond.

In our previous quarterly report, the South West construction market was competitive but beginning to suffer from significant skills shortages due to the sheer volume of activity in the region.

Overview
Statistics
market
regions

Acknowledgements

Thank you to the following:

(All data current as at 23 August 2017)

BCIS Summary of Output Forecasts

BCIS Update on Quarterly Briefing

Consumer Price Indices, Office of National Statistics

Forecasts for the UK Economy, HM Treasury

Gross Domestic Product, Office of National Statistics

Inflation Report, Bank of England

Labour Market Statistics, Office of National Statistics

Output in the Construction Industry, Office of National Statistics

RICS UK Commercial Market Survey

RICS UK Construction & Infrastructure Market Survey

The Glenigan Index

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Key

ONS: Office for National Statistics

HM Treasury: Her Majesty's Treasury

BCIS: Building Cost Information Service

RICS: Royal Institution of Chartered Surveyors

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