EarlKendrick
Project & Building Consultancy

Earl Kendrick Construction Inflation Bulletin

November 2022

2022 has been a torrid year for inflation across the board, with the triple-whammy effect of Brexit aftershocks, coming out of Covid and the Ukraine War disrupting global supply chains. Many commentators are saying we're back in the 1970s! Construction inflation has been no different.

This is our five minute read on Construction Inflation, penned by the heads of Earl Kendrick's Reinstatement Cost Assessment, Cost Management and Building Surveying teams to discuss what has been going on over the past few months.

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Regulated by RICS

EK Reinstatement Cost Assessments

James Paul MRICS
EK Reinstatement Cost Assessments

EK RCAs' focus is primarily on full insurance rebuild costs. We value everything from the tallest £300m+ towers in London to six-figure valuations of rural country cottages.

What we're seeing at the moment is rampant inflation with regional variations across the country and rebuild figures are currently around 9–13% higher than they were this time last year. If you look back to 2019 prices as is frequently the case for us in the three-yearly cycle of RCA updates, the increase is over 15% and touching 20% in some regions. Couple that with a typical under-insurance scenario and a residential client not including VAT on works previously, and the increase can easily be over 50% — a shock to anyone, especially those paying the insurance premiums.

We are seeing interim updates from the BCIS mid-quarter with the tender price index now changing seven or eight times a year as opposed to the usual quarterly updates, and insurance underwriters such as AXA and Aviva are recommending index linking of declared values of between 10% and 16%, according to insurance brokers we consulted.

Other factors which are influencing insurance costs are rebuild time-frames. The shortage in the supply of construction materials, and full order books on the part of contractors and sub-contractors can prolongate a standard rebuild timeframe by the order of 40%. So a 21-month rebuild programme could become 30 months. It's even worse on partial rebuild scenarios. In the listed building sector where specialist trade skills are required, the prolongation can be dramatic. We recently issued an RCA on a Grade I listed building with an eight-year rebuild period; that would have been five years or less not so long ago.

This prolongation in typical rebuild times is working its way into RCA in reports, and in turn will affect applied inflation provisions. The 2020s does not now look like a decade where annual inflation will be following a linear trajectory of 2% like we have become used to.

▲9–13%

Higher rebuild figures than this time last year

▲40%

Increase in rebuild timeframes due to material & contractor shortages

Philip Thomas MRICS
EK Cost Management

During the past couple of years, we have seen an extraordinary mix of events that have contributed to sustained volatility in the construction industry and in turn sustained uncertainty for those undertaking development and construction work.

Post-Brexit uncertainty contributed to higher costs and uncertainty around importing materials, exacerbated by the haulage driver shortage, foreign worker exodus and shipping crisis. Record oil prices contributed to higher costs to operate plant and machinery, and to manufacture and ship goods. DIY projects which gained in popularity during the coronavirus lockdowns, contributed to higher material costs and general material shortages, and continually increasing inflation contributed to an increased labour cost. There remains a gap between wage growth and inflation, and the potential risk of disruptive industrial action persists.

The coronavirus pandemic saw productivity levels plummet, with many workers furloughed or made redundant and as we see demand picking up again, there remains an underlying, prolonged general shortage of skilled labour.

All of these factors have combined to create something of a ‘perfect storm’ resulting in sustained inflationary pressure on tender returns as contractors attempt to pass on the various uncertainties and cost risks to clients.

In our tender returns, we are seeing an unwillingness to fix prices for longer than a few weeks. We are also seeing an increased demand for advance payments in order to secure prices from suppliers which continue to be volatile in many trades, and a clear preference for the ‘design and build’ procurement route has emerged which is no surprise as it gives contractors greater control over their supply chains.

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Cost Management

The last year or so since Covid has recorded strong resilient construction output with demand remaining consistently high, albeit with indications of a reduction commencing. Materials' prices have stabilised somewhat since the lockdown periods which give greater cost certainty when cost estimating, but remain volatile in some areas, especially when influenced by external factors.

We work both client side and contractor side. Pricing tenders when working with contractors gives us an ability that many PQS firms will not have — the ability to collect, collate and use raw first-hand data in the moment. Our access to contractor supply chains allows us to keep a 'finger on the pulse' of the market and understand the mood and key underlying issues.

With interest rates now set to rise to as much as 6%, there will be real pressure on the ability of homeowners through to institutional developers/funders to start or fund (viable) projects as they focus instead on simply paying their mortgages and the affordability of debt.

Combined with the aforementioned issues, a growing energy crisis, anticipated labour disputes and the Ukraine crisis, we foresee a difficult year ahead for the industry with continuing price increases, increasing uncertainty, and delays to or cancellation of new projects. Indeed, published ONS data reports a reduction in new project starts in Q2 of 10% vs Q1 perhaps providing early indicators of the beginning of a slowdown.

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Chris Stansell MRICS
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In the London projects team, we're at the coal face of it all, analysing tenders on a daily basis. We tender everything from five-figure minor repair projects to major phased refurbishments of London's prime and super prime developments in the millions.

We have seen contractors becoming increasing selective as to the projects they are willing to tender for; even long-standing, reliable main contractors are declining opportunities to quote for profitable work. Even if the funds are in place to embark on a given project, tender deadlines are routinely extended as contractors are struggling to return priced specifications.

A recent request from a contractor to delay an external refurbishment project just one week before commencement on site, annoyed the client and their tenants. The contractor's reasons: general unavailability of labour and supply of materials.

Certain manufacturers of materials have been forced to increase the price of their most commonly used products such as paint, panelling and mineral wool by 7–12%. When the price of bigger ticket items (such as window units and doors) increases by these percentages, funding becomes an issue, particularly when service charge payers are funding the works and spending is subject to strict consultation requirements.

Labour wise, main contractors are complaining of a skilled worker shortage, increasing wages and encouraging the use of subcontractors instead of employees. Those contractors aiming to maintain the highest standards refrain from using subcontractors as much as possible but that means paying over the recommended CIJC (The Construction Industry Joint Council) pay increase level in order to maintain their directly employed labour force or risk losing them to competitors. This increased cost is accounted for within their tender submissions.

One concerning knock-on effect is clients instructing – somewhat reluctantly – jobbing building firms and even glorified handymen on six-figure refurbishment contracts, which is a risky business for all stakeholders.

▲7–12%

Increase in the price of commonly used products such as paint, panelling and mineral wool

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There are ways to mitigate project works inflation, although they carry risk. For instance, paying upfront for materials months ahead of a start date means a large initial outlay but ought to lessen the financial burden on clients and their leaseholders or tenants. Naturally, the site needs to have good security and sufficient space to store these materials.

Professional Expertise

Availability of contractors and materials is prolonging rebuild periods, driving up inflation provisions and sums insured. The insurance market is jittery with underwriters pulling out of providing cover for certain perils (flood, fire/combustible cladding), and the government is encouraging insurers to come together to create 'pool' solutions to keep higher buildings insured. Underwriters still providing cover to higher risk buildings are putting up premiums by eye-watering amounts.

Should you ever have the misfortune to succumb to a disastrous event, you will find the availability of contractors is scarce, waits for work to commence can be longer than anticipated, and some surprisingly small and inexperienced maintenance companies are being trusted to manage the refurbishments and rebuilds of some surprisingly complex projects, all at inflated rates.

The good news is, we can help, and never has it been more important to have a trusty professional services provider up your sleeve to navigate the tricky world of insurance and major works projects. If you need cost advice, or a second opinion to verify whether something is fair value for money in the current market, EK Cost Management is here to help.

If you're set to embark on a major works project, whether that is a cyclical programme of redecorations and repairs under 'section 20' notices, or an extension, refurbishment or repurposing, Earl Kendrick can assist nationwide through our network of regional offices.

And whatever you own or manage, before you do anything at all, you need to make sure you are insuring it for an adequate amount, and there is no better way of avoiding wasteful over-insurance than by ordering a lean but accurate RCA from EK Reinstatement Cost Assessments.

The Earl Kendrick group also project manages insurance claim reinstatements, so if you are an insurer or in the situation where you require professional support with a reinstatement scenario, we can help with that as well, and have additional expertise in drone surveying, party wall matters, green retrofit, rope access and many other specialities.

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