THE IMPACT OF BREXIT AND COVID-19 AND PREDICTIONS FOR 2021

OVERBURY WEBINAR REPORT 18TH FEBRUARY 2021

overbury

INTRODUCTION

At our recent Market Insights webinar, we were delighted to welcome industry experts, Professor Noble Francis, Economics Director for the CPA, and Simon Rawlinson, Head of Strategic Insight at Arcadis.

We asked Simon and Noble to help us understand some of the key factors that are influencing the economy as a result of two of two seismic shifts that have challenged us all; Covid-19 and Brexit.

Whilst it's evident that we need to remain alert in a shifting market, if we ensure we are flexible, we look to government for new opportunities, and we commit to making the decisions that keep cash flowing through our supply chain, we might just see the construction industry make the greatest escape of our lifetime.

"THE COMPANIES THAT WILL DO BEST GOING FORWARD ARE THE ONES THAT ARE FLEXIBLE, THAT ADJUST TO THE MARKET OPPORTUNITIES QUICKLY AND THAT FOLLOW THE LATEST DATA."

- NOBLE FRANCIS, CPA

ECONOMIC OVERVIEW

The U.K. economy is facing a W shape recession and recovery, we accumulated unprecedented debt in the first half of 2020, followed by a sharp recovery as we reopened the economy throughout the summer and Autumn. A dip has occurred in 2021 owing to the third lockdown, however this won't be as bad as it was during the initial lockdown because we still have a high degree of business continuity, and construction and manufacturing has continued.

A sharp recovery in economic activity in the second quarter of this year is predicted as we reopen the economy. But there are uncertainties around what will happen in terms of employment as during 2020, despite the sharp fall in GDP, employment levels were sustained by furloughing and the self-employment income support scheme. These are set to end in the next couple of months, which means unemployment is likely to rise very sharply and that is likely to hinder the rate of economic growth.

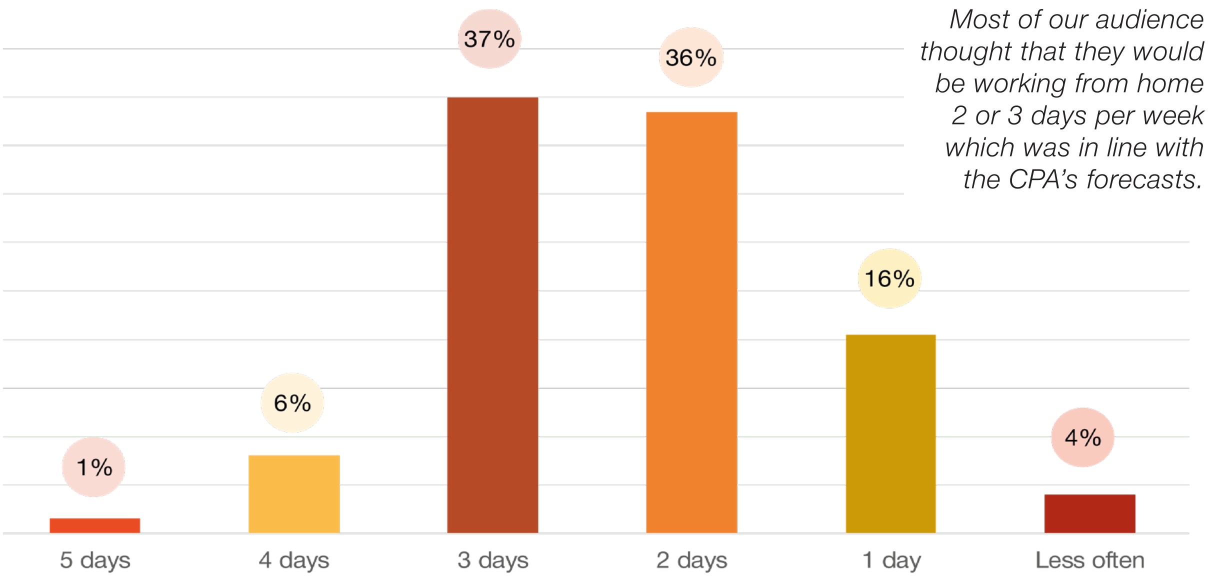
These schemes have been extended three times already and if the government extends these schemes again, the rate of economic recovery going forward is going to be heavily dependent on consumer spending. This is potentially good news considering households have accumulated an extra £125b with savings on commuting, holidays, hospitality, and shopping.

The chancellor has some very difficult decisions to make for the budget on 3rd March. It's expected that there will be a focus on ensuring economic recovery and so focus on stimulus. However, there's an accumulation of public debt because of government stimulus last year. So, at some point, there will have to be tax rises which could in turn impede the recovery.

There's also concern about what is going to happen to our cities, particularly London; what they will look like in the post pandemic period, not just offices, but also the associated retail and other services that are reliant on commuters.

WEBINAR POLL:

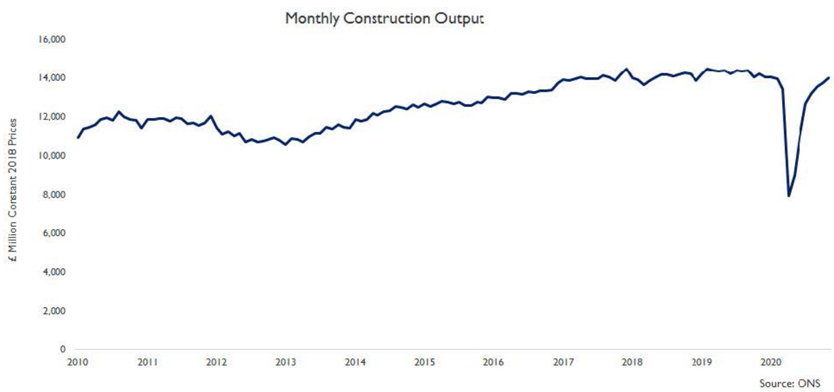
Once we can return to the office, how often do you think you will work from home?



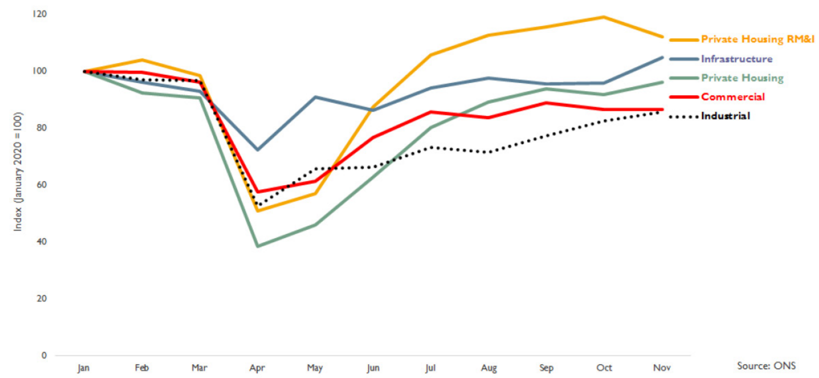
Most of our audience thought that they would be working from home 2 or 3 days per week which was in line with the CPA's forecasts.

CONSTRUCTION SECTOR RECOVERY

While the UK economy is set for a W shaped recovery, so far, it's been a V shape recovery for construction. We lost over 40 per cent of activity across all construction in April 2020, but it's been largely unaffected by the second and third lockdowns in November and January.

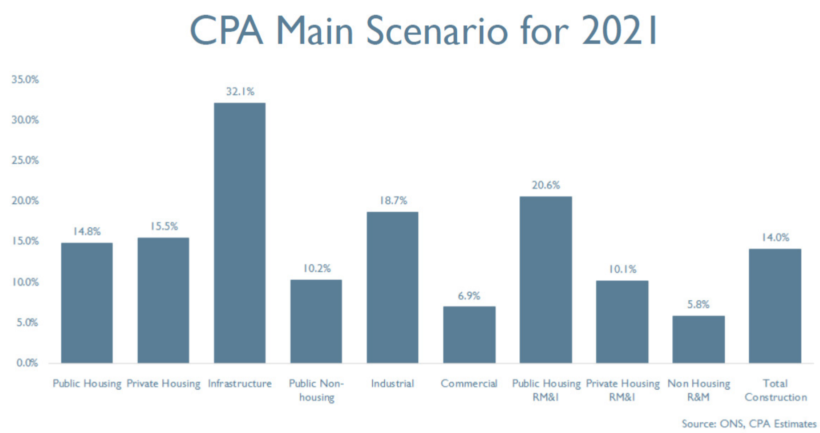


By indexing the activity in each of the key construction sectors, it's possible to see how each of the sectors was affected by the initial lockdown and their respective recoveries.



What's noticeable is that by November 2020, infrastructure and private housing repairs, maintenance and improvement is already higher than it was pre pandemic. However, if you look at the commercial sector, activity in November was still 14 percent lower than it was pre pandemic.

The CPA's main forecast for 2021, anticipates a 14 percent growth in construction output, however that's compared with 2020 as a whole, and across the sectors the growth rate is skewed by strong growth in infrastructure.



Key Drivers of Growth
Infrastructure:
Public housing rm&i
Industrial

KEY RISKS

There are numerous risks associated with both Covid 19 and Brexit, including:

- Unemployment and the end of the Furlough scheme
- Potential tax increases
- Potential labour shortages (especially from EU countries)
- Procurement – price increases
- Two speed housing market – even if housing isn't your key sector, it's worth considering the fact that there's currently very high demand for housing outside urban centres and for houses that have large spaces, but there is a shortfall in demand for flats within cities - particularly in London.
- Productivity has fallen on sites, primarily due to operating procedures and other safety measures which particularly impacts activity on commercial towers, given that you've got different groups of trades operating in tight spaces.
- Sharp rises in insurance costs.

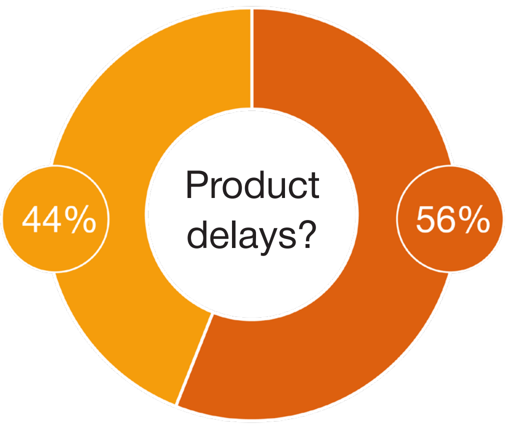
We asked our audience if they had experienced significant delays receiving products on site in the last three months:

A slight majority said that to date they had not experienced significant delays which could be down to the sector that we operate in. Only 24 per cent of products that are used in UK construction are imported, but some of those key imported materials are timber, roofing materials, steel paint.

This poll wasn't in line with the experience of CPA members who have been reporting significant delays and cost rises, but this could relate to the fact that they are operating in sectors that have recovered very sharply to such as housing.

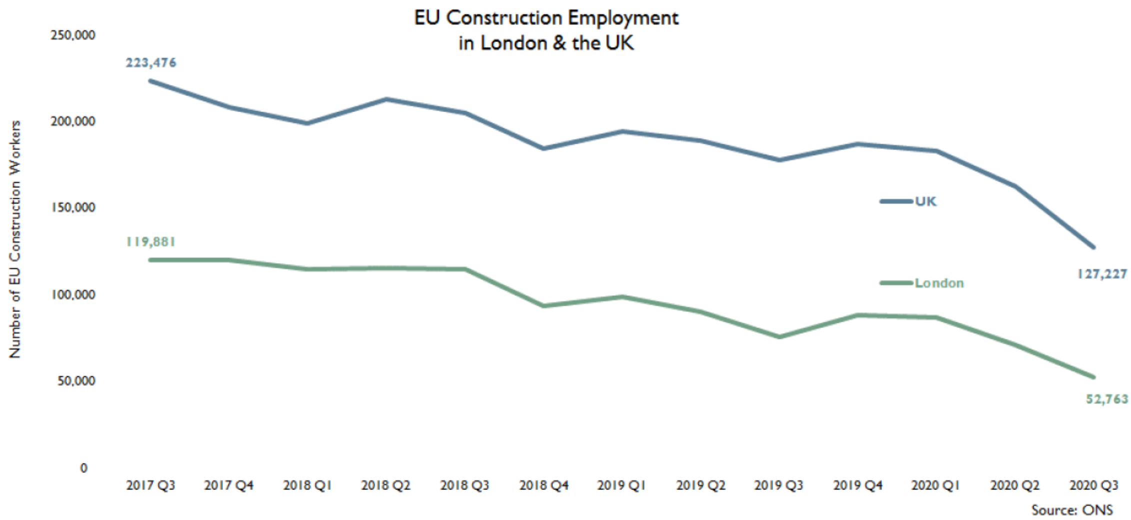
The consequences are not solely down to Brexit, there's also rising global demand, particularly from China and from American. Brexit has led to increased administration costs and certification costs, which is likely to lead to cost inflation, but there are also issues around shipping costs.

Shipping costs have risen very sharply. There's a lack of container capacity in China, in addition a lot of container ships have been decommissioned over the past 12 months. Consequently, the cost of a 40-foot container from China to northern Europe has risen from $2000 in late 2020 to over $8000 in January. These cost rises will likely filter through into construction costs in the next few months.

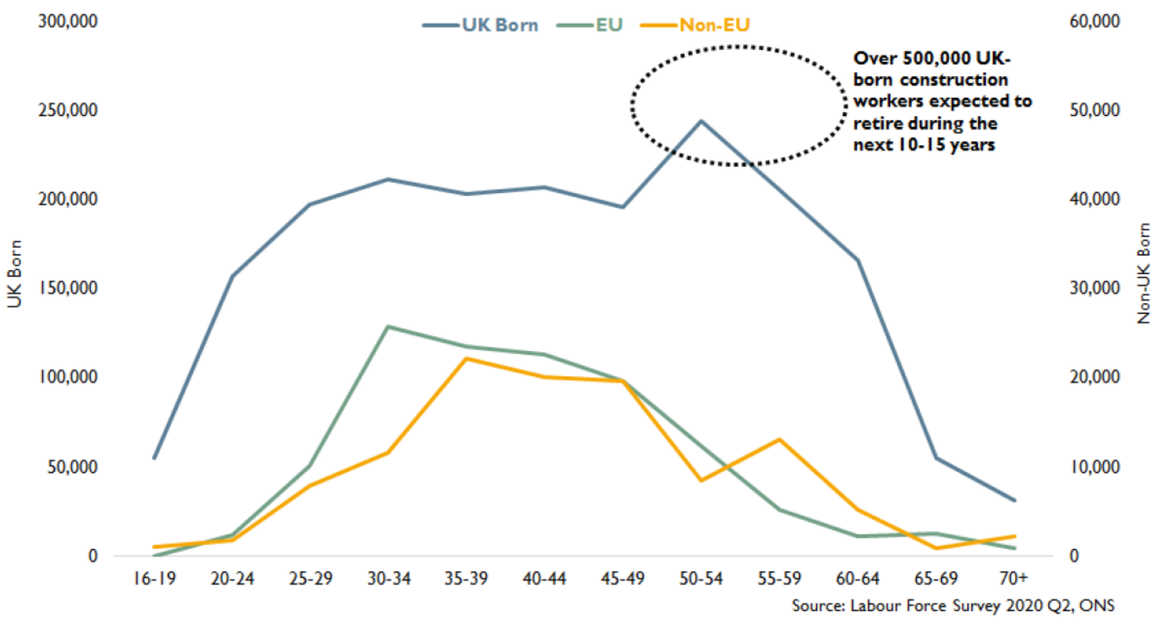


LABOUR

Overall, EU construction workers in London have fallen by 56 per cent in the last three years, which raises serious questions about what happens when construction output recovers.



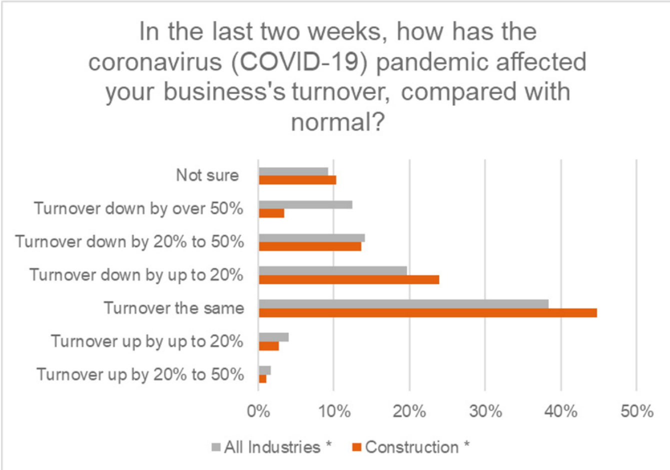
This is especially pertinent since January 1st, as our points-based immigration system doesn't suit most trades given that 41 per cent of construction workers are self-employed. On top of this, we will be losing half a million UK construction workers to retirement in the next 10 to 15 years.



On the positive side, this may provide opportunities for modern methods of construction, such as off-site manufacturing and digitalisation.

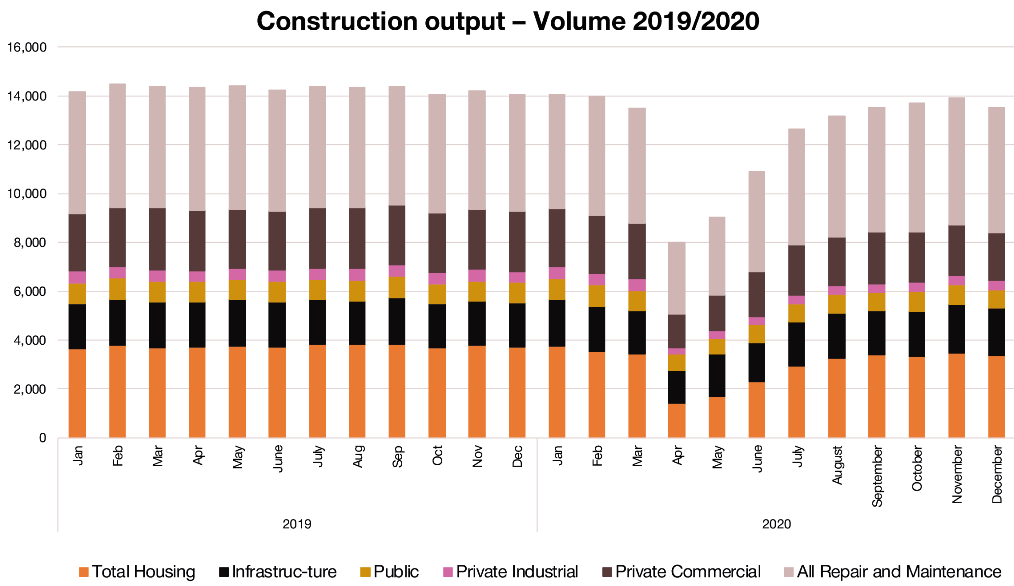
CONFIDENCE

There's a complicated matrix of issues that people in the industry need to deal with now, and for the next two or three years. Whilst it's positive that the industry didn't respond to the 2020 decline in workload by dropping prices, there's still uncertainty around the consequences of the decisions that were made during this period. Despite reduced turnover, people are feeling more positive than not and positivity within the construction sector exceeds that of all industries combined.



Source: ONS / Arcadis

The V shaped recovery indicates genuine resilience, the continued support of the government in keeping sites open has helped sustain the industry. It's promising to see that even with the impacts of productivity on the operating procedures, activity levels are almost back to normal.

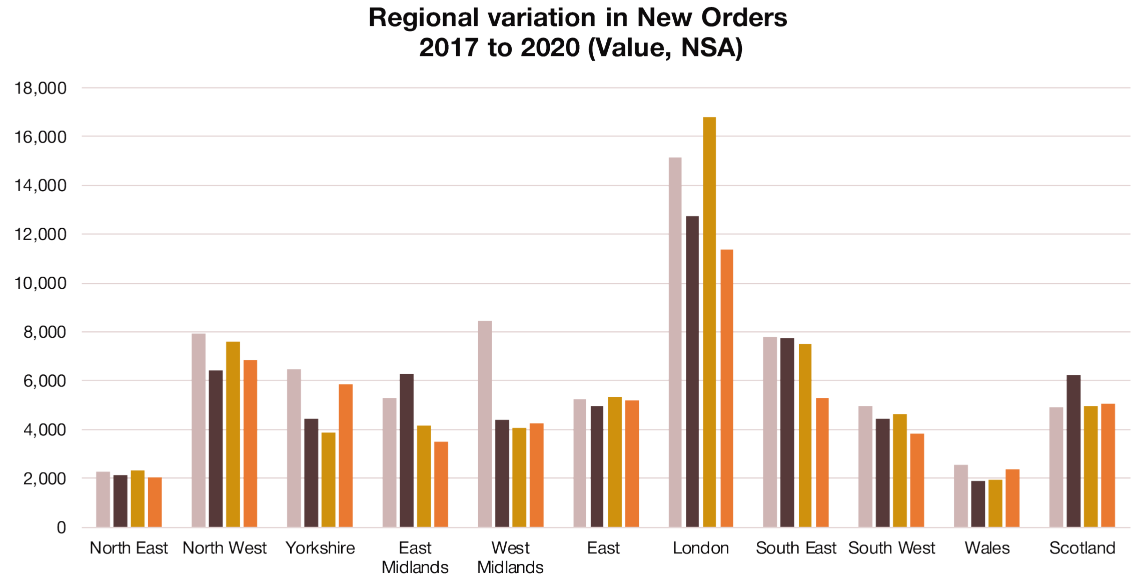


Source: ONS / Arcadis

Construction output fell by 40 per cent in the second quarter of 2020. It has recovered, although orders may not have bounced back as we'd anticipated, and whilst the forecasted rebound in activity in 2021 does seem likely, the sector split may change seeing greater reliance upon long term infrastructure work.

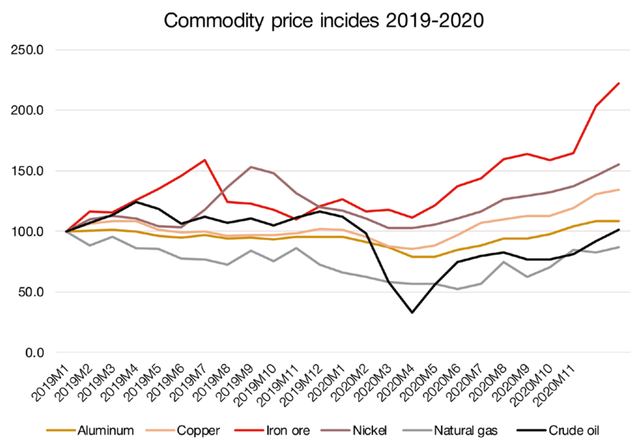
Order volumes in 2020 were down by over 10% compared to levels seen in 2018 and 2019, suggesting that the bounce back in new opportunities was not as strong as had been hoped, potentially leaving some contractor order books weaker as we head into 2021.

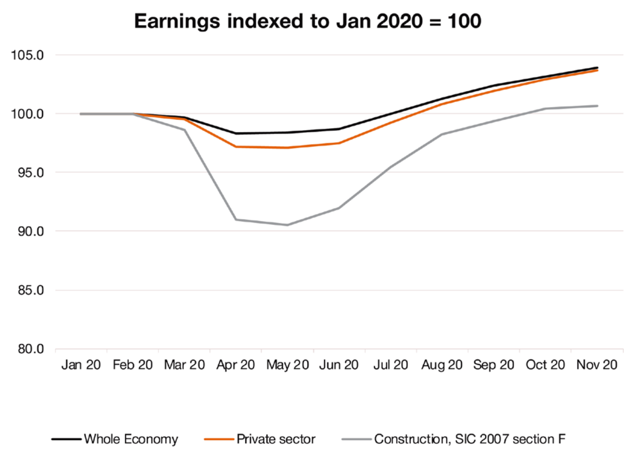
By looking at future pipeline down into regions, we can see that most regions in the North, and the West Midlands have seen orders stay stable or increase marginally. Whereas in London and the South East and South West it seems that workload is declining which could be a reflection of both the sector focus in these regions and the impact of people moving out of London.



Source: ONS / Arcadis

Commodity prices have increased some raw materials have gone up by over 100 per cent in a year. Main contractors are not seeing the impact of steel increases yet, but it's beginning to be felt in the supply chain.



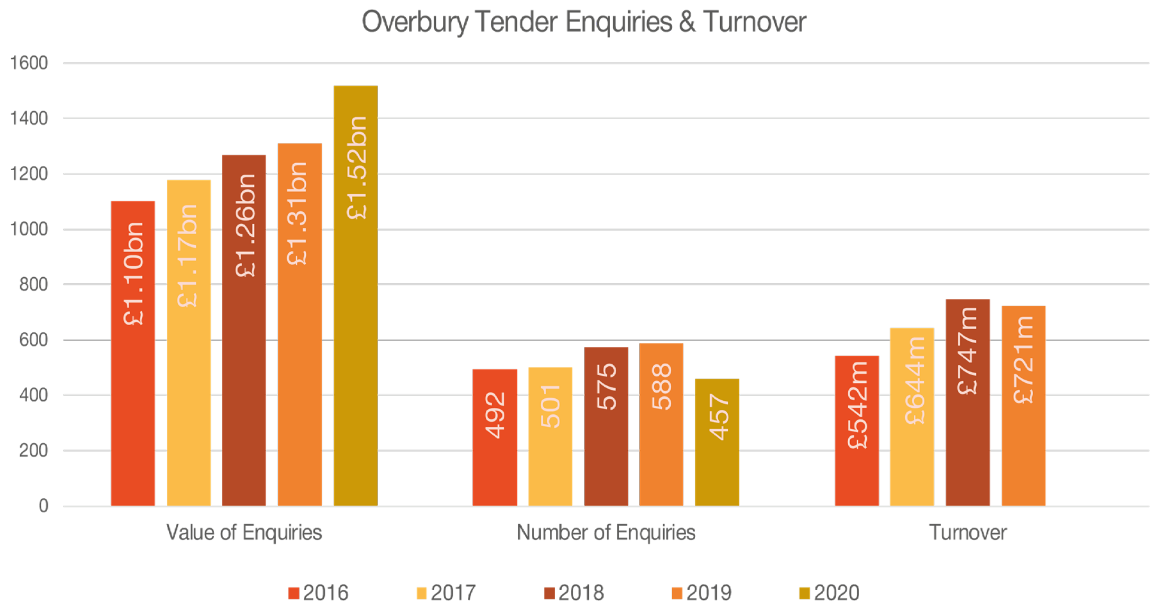


Source: ONS / Arcadis

Inflationary and deflationary issues facing the industry:

Inflationary Issues	Deflationary Issues
Confidence	Weak orders pipeline
Lower productivity	Delayed project starts
Fixed costs on longer programmes	Shift in workload away from sector
Materials	Reduced demand for labour and materials
Access to migrant labour	Increased competition for available opportunities
Project cashflow	

FIT OUT MARKET - OVERBURY VIEW



It's potentially surprising to see that Overbury saw an increase in the value of projects tendered (up to £1.5bn), however there was a 20 per cent decrease in the number of enquiries, which of course, has had an impact on turnover. In addition, Overbury has experienced slow decision making, which is highlighted when we compare the number of pending projects at the end of 2019 and 2020.

OVERBURY TENDERS IN PENDING

Q4 2019	Q4 2020
36	55

Along with some of the key inflationary and deflationary pressures that may impact on the economy identified earlier, we can also identify planned cost increases for 2021 in key fit out materials. As a result, production costs will rise, however we are yet to see if market conditions will force contractors to retain this.

Product	Increase
British Gypsum	2.5-7.5%
European Steel Profiles drywall products	10%
Kingspan Insulation	15-20%
SAS International Ceilings	5-17.5%
Doorset materials	8.5%
Dulux paint	3%

FUTURE OUTLOOK

In conclusion, there is cause for cautious optimism when considering the outlook for 2021 and beyond. The key highlights include:

FINANCIAL STABILITY: Financial stability and solvency of construction companies will be a vital pre-requisite of stability and growth. Furthermore, financial transparency is what client's will be increasingly seeking when developing and consolidating business relationships.

INFLATION: There are signs that inflationary pressures are returning and construction won't be immune from this. Arcadis anticipate that inflation of around 3-5% per annum could be seen from 2023 onwards as workload recovers and as labour markets tighten.

MANAGING RISK: Greater collaboration is needed to manage risk and secure future pipeline.

PROCUREMENT: The ability for companies to bulk buy products and materials to offset the increase in commodities may prove decisive. Also, it is hoped that post Brexit procurement reform will have a positive effect on the industry now that the UK is not bound by the OJEU process.

NEW TECHNOLOGY AND DECARBONISATION: Planning for these developments will be vital, as they are likely to get increased focus once the pandemic is brought under control.

REMAINING COMPETITIVE: To ensure future competitiveness, businesses must be agile and respond to niches within the market.

"IF YOU THINK ABOUT TYPICALLY HOW THE INDUSTRY RESPONDS TO A SIGNIFICANT DECLINE IN WORKLOAD, AS WE SAW LAST YEAR, IT DOES THAT BY DROPPING PRICES TO SECURE WORK. THAT DIDN'T HAPPEN IN 2020, AND THAT'S GREAT NEWS."

- SIMON RAWLINSON, ARCADIS

QUESTIONS & ANSWERS

Q WHAT OPPORTUNITIES DO YOU SEE FROM BREXIT?

A The initial issues surrounding Brexit have been administration and bureaucratic in nature. Once these have been rectified the short-term benefit might be cheaper imports due to sterling appreciation. Medium to long term benefits will depend on what other trade agreements are made with other countries, this may leader to cheaper materials from areas outside the EU. It also offers export opportunities if the UK becomes a leader in digitalisation and the decarbonisation effort.

Noble Francis

Q DO YOU THINK THERE WILL BE A BALANCE / OFF-SET OF LESS OFFICE SPACE REQUIRED DUE TO HOT DESKING / WORKING FROM HIM WITH THE FACT THAT MORE OFFICE SPACE REQUIRED DUE TO OCCUPATION DENSITY WILL INCREASE FROM 1:8M2 TO PERHAPS 1:12M2 TO SUPPORT GREATER SOCIAL DISTANCING BETWEEN DESKS?

A Good question. I agree that the reconfiguration of office space will offset some of the headcount reduction. However, I think that there is a growing trend of organisations seeking to reduce footprint. Arcadis is reducing our London footprint by 25%.

Simon Rawlinson

Q WHAT DOES INFRASTRUCTURE REALLY MEAN? AIR, RAIL, ROADS OR OTHER?

A Road, Rail and Utilities - they are all seeing significant growth. Airports is the one outlier at the moment

Noble Francis

Q SHOULD WE ALL BE FOCUSING ON THE PUBLIC SECTOR RATHER THAN THE PRIVATE SECTOR FOR GROWTH IN THE NEXT 2-5 YEARS?

A Yes, most manufacturers shut down in the initial lockdown, which meant that as soon as construction activity there were issues around many UK manufactured products, particularly plaster and plasterboard. Manufacturing was back up and running and has largely dealt with most backlogs so there so the longer lead times should largely only be on the imported products, plasterboard (plaster should be fine now) or products that feed into sectors in which activity is already above pre-pandemic levels so demand is outstripping supply such as the ones I highlighted in the presentation.

Noble Francis

A That's a really good question. For firms that have positions on public sector frameworks, it is likely that work will expand particularly in sectors like health that have seen their long-term capital allocations increase. I think that there will be opportunities in the private sector - particularly around repurposing assets - however, I think that these opportunities will be more difficult to predict in terms of timing and location.

Simon Rawlinson

THE PANEL

Noble Francis
Economics Director
Construction Products Association

Noble Francis is the Economics Director at the Construction Products Association, where he oversees one of the most respected teams of economists in the construction industry, producing the quarterly Construction Forecasts, Construction Trade Surveys and bespoke construction economics research. With a master's degree and PhD in applied economics, Noble has over 15 years of experience producing economic forecasts. He and his team's work are regularly featured in the Financial Times and other national newspapers, construction trade press, television and radio.

In 2018 Noble was also appointed as a Professor of Construction Economics at The Bartlett School of Construction and Project Management at UCL.

Simon Rawlinson
Partner - Head of Strategic Research & Insight
Arcadis

Simon heads the Arcadis Strategic Research and Insight team. He has over 20 years' experience in construction and built environment research and innovation. He is a well-known commentator in the construction industry, has regularly contributed to Building magazine and other publications and is an active speaker on the construction sector conference circuit.

Simon has been closely involved in numerous government initiatives to improve construction industry performance. He actively participated in the development of the UK Government's digital design strategy and served on the Executive Board of the CLC. Simon previously chaired the research committee of the British Council for Offices.

A member of the Construction Leadership Council Board, he has played a key role in the development of the Construction Industry Sector Deal focused on digital, manufacture and whole life performance and is currently part of the task group dealing with Covid 19 recovery.

Bob Banister
Managing Director, Frameworks & Education
Overbury

Bob became managing director of the London based team devoted to frameworks and developing long term relationships with our clients, in April 2010. During his 11 years in this position he has built the division into a strong, reliable workforce, where teamwork and dedication to quality have enabled a number of frameworks to be renewed, and new contracts achieved.

Bob has worked for Overbury for over 20 years and was previously our customer experience director.

WEBINAR DETAILS

- 1 hour in duration
- 319 attendees
- 3 presentations

This one-hour webinar was attended by 319 people from across the construction sector including end user clients, consultants and developers. Attendees completed a series of polls throughout the hour and the results give a wider view of the concerns about managing projects in a pandemic.

"NOBLE AND SIMON HAVE GIVEN US AN OPTIMISTIC ASSESSMENT FOR GROWTH IN THE SHORT TO MEDIUM TERM. IN ORDER TO CAPITALISE ON THIS WE ARE GOING TO NEED TO CHOOSE FLEXIBLE, COLLABORATIVE AND FINANCIALLY STABLE PARTNERS TO BUILD ON THESE OPPORTUNITIES AND ENSURE A GREAT ESCAPE FROM THE CLUTCHES OF COVID 19."

– BOB BANISTER, OVERBURY

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