UK Commercial – January 2022

MARKET IN MINUTES

Savills Research

Savills ProgrammE and Cost Sentiment Survey

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Projects costs and duration continue to rise

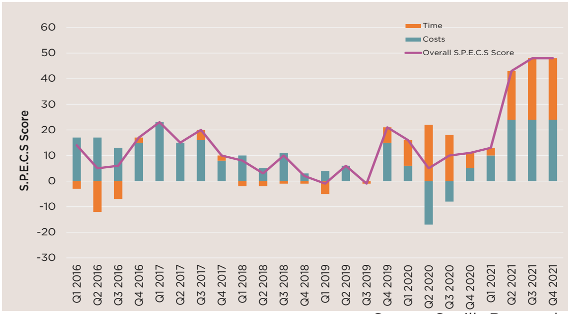
Since the last update to our index there has been little in the way of news that would point to a let-up in the pressures currently being faced by the construction sector. Indeed, with no obvious quick-fix solution to current global supply issues, many expect that upward pressure on lead times will be maintained.

As a result we are witnessing some longer programme durations due to increased material lead times and difficulty securing skilled and specialist labour. Whilst 2022 may see some of the pressures related to the procurement of materials stabilise it is likely that the pressures in the labour market will remain amplified. The combination of Brexit and the pandemic has led to many European workers leaving the country and it is unclear whether they can or will return. This will leave the UK short of labour and the challenge will be securing workers for projects and keeping them on site in an improving market.

These issues are meaning that contractors are showing an unwillingness to tender on projects with higher risk profiles such as single stage tenders and the supply chain is also unwilling to fix prices and take the risk of inflation on packages in two-three years' time.

This is reflected in our latest S.P.E.C.S index with a score of 48, the highest level we have ever recorded, this means that in all markets we cover our sector specialists are seeing upward pressure on build costs and project timescales. Whilst activity is some sectors may dissipate in 2022, it is likely that we will continue to see elevated S.P.E.C.S scores for at least another 12 months until supply and demand reach equilibrium.

S.P.E.C.S Q4 2021



Source Savills Research

Q4 2021 S.P.E.C.S Indicators

	New build and refurbishment costs	New build and refurbishment timescales*	Occupier fit-out costs	Occupier fit-out timescales*
Offices - Central London	↑	↑	↑	↑
Offices - Regional	↑	↑	↑	↑
Warehousing <100,000 sq ft	↑	↑	↑	↑
Warehousing 100,000 - 500,000 sq ft	↑	↑	↑	↑
Warehousing 500,000+ sq ft	↑	↑	↑	↑
Central London prime residential	↑	↑	↑	↑
Central London mid-market residential	↑	↑	↑	↑
Regional mid-market residential	↑	↑	↑	↑
Foodstores	↑	↑	↑	↑
High street retail	↑	↑	↑	↑
Out of town retail	↑	↑	↑	↑
Shopping centre	↑	↑	↑	↑

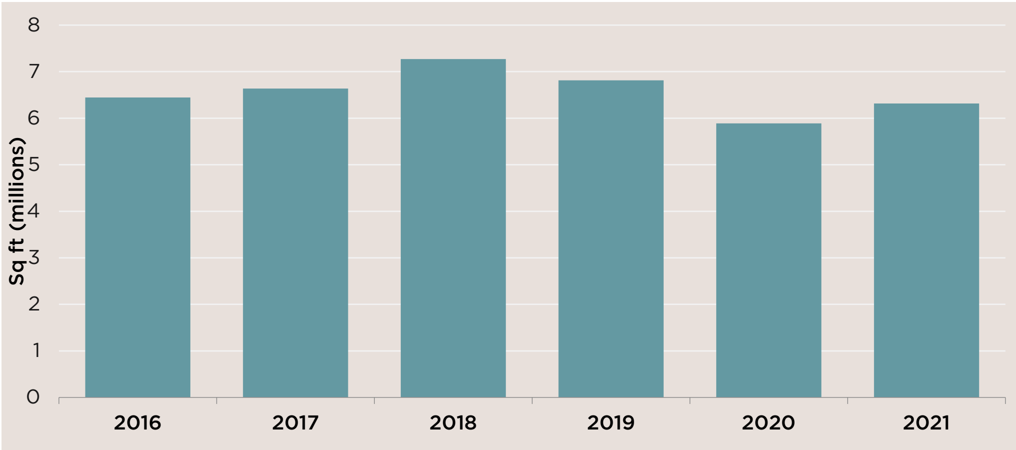
Source Savills Research **Note** *Time taken from project sign off to commencement including procurement and delivery of building components

The combined impact of surging demand and a heavily constrained supply chain has taken many by surprise and it is inevitable that we will see increases in build costs and project timescales. We should also prepare for issues regarding labour availability for certain types of contractor, which may further impede projects once materials availability issues are resolved. However, steps can be taken to mitigate the current situation by sourcing alternative materials or by changing the build programme to suit the availability of materials or labour.
Simon Collett, Head of Professional Services

METHODOLOGY & APPROACH

Savills Building and Project Consultancy sector experts track build cost and programme timescales sentiment across 48 separate markets and sectors. A high S.P.E.C.S score would mean that most sectors are experiencing upward cost and timescale pressure whereas a highly negative score would suggest that most markets and sectors are experiencing downward pressure. A score around zero suggest that build costs and programme timescales are largely static.

Central London office development starts rise in 2021



Source Savills Research

Increased development starts and refurbishments in Central London

As the world continues to edge closer to a post pandemic reality it is interesting to observe that the Central London office market has not performed in a similar fashion to previous shocks such as the Global financial crisis and dot-com bubble at the start of the century.

Take-up for Central London offices has reached 9m sq ft, which whilst not as high as the immediate pre-pandemic years is significantly higher than 2008, when take-up slumped to 6.9m sq ft. Perhaps more interesting is also the level of unsatisfied demand currently in the market which currently stands at 9.8m sq ft and has been trending upwards since mid 2020.

A further anomaly with the past is that we have not witnessed a fall in development starts which have edged upwards in 2021 and now stand at 6.8m sq ft. This has been driven by the fact that prime supply continues to remain constrained as occupiers look to secure modern facilities with the double aspiration of improving their ESG credentials and providing a work space fit for the post-pandemic employee.

Developers are also increasingly looking at bringing forward large scale refurbishment projects, with the aim of delivering higher grade office space, but also change of use refurbishments to alternative sectors, such as residential.

From a building and project management perspective the buoyancy of the occupational and development market is combining with the well publicised issues in Global supply chains which mean that material prices are rising, products are taking longer to source, and contractors are unable to hold prices post tender for longer than 30 days.

Despite optimism on future workload, tendering, particularly in the London fit out market, is extremely competitive if not aggressive in some cases as contractors look to ensure they have full order books. The competitive nature of tendering is likely to absorb a proportion of the price increases and material shortages in the short term but this will present risks as contractors operate at very low margins. Larger contractors with stronger supply chains and greater volume of orders are more likely to be able to manage this situation. Smaller contractors could be at the risk of higher exposure to cost increases and delays which could impact on projects negatively.

Data from our S.P.E.C.S index shows that sentiment around pricing and project duration remains at an elevated level, both for fit out and new build projects, a situation we expect to see continuing for at least the next 18 months. With occupier demand rising, grade A supply remaining constrained and the added headwinds of rising development costs it is likely that prime rents will continue to rise in Central London, albeit we are now witnessing a widening rental gap between prime stock and the remainder of the market. How older stock is re-purposed against the backdrop of an occupier flight to quality, greater emphasis on ESG and the issues in construction supply chains will be fascinating to observe.

IS THE COMMERCIAL SECTOR EASIER TO GREEN?

Savills recently released a research paper to coincide with the COP 26 conference held in Glasgow.

The paper examines what policy drivers are needed to drive real estate investors in the pursuit of carbon reduction in the built environment. The paper covers all sectors, including rural and residential, but for the commercial sector the outlook is a generally positive one, for a number of reasons. The commercial property sector is much smaller than the residential one, but the size or value of individual assets is generally larger. This means that fewer decisions and interventions will be needed to improve the stock quality. Moreover, investors have always factored in the costs of obsolescence to ensure that their asset remains lettable at the best market rates. This means that in certain parts of the market, for example, City of London offices, up to half of the entire stock has been refurbished or redeveloped in the last 20 years.

You can read the report in full on the Savills website here.

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