MARKET IN MINUTES
Savills Research

Savills ProgrammE and Cost Sentiment Survey

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Perfect storm for costs and timescales

Since the last update to our index wider macro economic and global issues have conspired to place almost unprecedented pressure on the availability of key construction materials.

A much improved global economic outlook has meant that construction and infrastructure projects have rebounded quicker than forecast. Having not anticipated this up-tick in demand many suppliers have been working at a reduced output, having potentially furloughed workers during the lockdown periods over the last 18 months. When we then add in other externalities such as new policy governing international trade, the fact that many shipping lines are still running at reduced capacity and congestion at our ports it is clear a perfect storm has been created where demand can not be met by existing supply.

Many sectors of the occupational market, such as logistics and life sciences are seeing record level of occupational demand and the residential sector, which we examine in more detail on the second page of this report, is keen to deliver more units to the market as demand remains high.

We expect materials shortages to remain in place for at least six months but for some sectors, such as logistics, where steel is a core material the delays may be up to 12 months. Developers should therefore expect costs to increase by up to 5% in 2021 and should factor in longer build and fit-out programmes.

This is reflected in our S.P.E.C.S index for Q2 2021 with a score of 43, meaning that in all markets we cover our sector specialists are seeing upward pressure on build costs and project timescales. It is likely that we will continue to see elevated S.P.E.C.S scores for at least 18 months until supply and demand reach equilibrium.

S.P.E.C.S Q2 2021

Source Savills Research

Q2 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	↑	↑	↑	↔

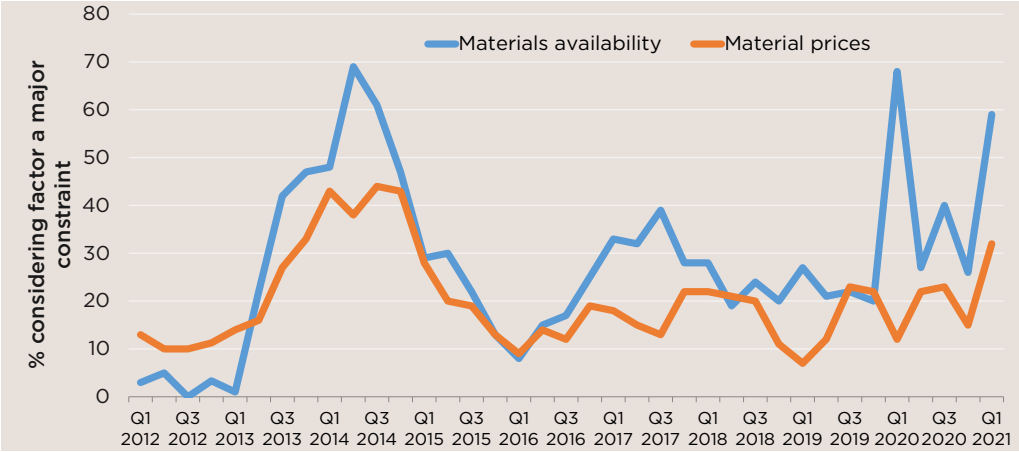
Source Savills Research **Note** *Time taken from project sign off to commencement including procurement and delivery of building components

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.

HBF Survey concern increases with regard to construction materials



Source Home Builders Federation quarterly survey

Limited availability of materials put pressure on residential build costs

The impact of Covid-19, Brexit and a global surge in demand as construction recovers from the pandemic have all driven build cost inflation across the sector. With high levels of demand and shortages of key materials anticipated to continue throughout the rest of the year, players in the market will have to contend with upward cost pressures. However, rising build costs have so far largely been offset by strong house price growth over the last year.

The availability of materials was cited as a major development constraint by 59% of respondents in the Q1 2021 HBF survey, up from 26% the previous quarter. Global demand for raw materials has outstripped supply resulting in disrupted supply chains and inflated prices. Material prices rose by 5.6% in the year to Q1 2021 and are forecast to increase by 7.2% in the year to Q2 2021, according to the BCIS Materials Cost Index, with materials such as timber, steel and concrete witnessing the greatest price increases.

Timber has experienced a significant spike in popularity driven by global demand from countries such as the US. Many developers are also using the material as an effective means to reduce embodied carbon emissions in construction and new development, tying in with the Government target of net zero carbon emissions by 2050.

Material shortages are one of the most significant challenges facing the sector, as warned by RICS. Advice from suppliers emphasises forward planning and ordering in advance to minimise disruption. Cost pressures and the scarcity of supply of raw materials will have the biggest impact on smaller and medium sized players with less ability to forward plan supply chains. Housing associations have faced unprecedented development delays of up 10 weeks on completion as a result of material shortages, according to Inside Housing.

Labour shortages could also prove another fundamental obstacle for the sector with the construction industry facing shortages in specific trades as a result of EU workers leaving the UK, the increasing demand for construction workers to retrofit buildings and the scale of workers required for large infrastructure projects such as HS2.

Despite the current strength of the residential market, cost inflation and material and labour shortages will continue to impact the sector, especially as increasing costs to meet building regulations under the Future Homes Standard come into effect from 2022. The Future Homes Standard will require a 75-80% reduction in emissions in new build homes by 2025 and estimates of additional costs to meet the standard are predicted to be in the range of 1-2.5% per house, according to figures published by some of the major housebuilders. Pressures on better design and placemaking under the National Model Design Code published at the start of 2021 will further drive up build costs.

WILL CHANGES TO PLANNING POLICY CHANGE THE MARKET FOR WAREHOUSE DEVELOPMENT?

Savills recently released a research paper examining how local authorities are implementing policies around biodiversity net gain and clean air, specifically in relation to the speculative development of new warehouse space. Regulations will start to tighten as we aim to reach net zero by 2050, meaning warehouse developers can expect to make more capital contributions to off-set the environmental impact of construction.

Whilst many mitigation measures may be away from the warehouse, such as green travel plans, others are directly related to the construction of new facilities. Given that 22% of warehouse demand comes from speculative development it is crucial that developers work closely with their project management teams to ensure how advances in construction techniques can assist when considering new development which may reduce the need to claw back any additional costs through higher rents.

More about this topic can be found in our Big Shed Briefing - Topic Response series.

Savills team

Please contact us for further information

Simon Collett
Head of Professional Services
020 7409 5951
scollett@savills.com

Kevin Mofid
Director
Commercial Research
020 3618 3612
kmofid@savills.com

Lucy Greenwood
Director
Residential Research
020 7016 3882
lgreenwood@savills.com

James Wickens
Director
Building & Project Consultancy (logistics)
020 7409 8041
jwickens@savills.com

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