UK Commercial – May 2024

MARKET IN MINUTES

Savills Research

Savills ProgrammE and Cost Sentiment Survey

savills

“Whilst we continue to see some downward pressure on build costs, the picture is not uniform, and a myriad of externalities are continuing to challenge the industry. With occupiers continuing to gravitate to prime units across all sectors, Savills GreenFiT is enabling investors to ensure their assets are future-proofed to benefit from this demand”

SIMON COLLETT, HEAD OF PROFESSIONAL SERVICES

Stable costs but prolonged timescales see index up-tick

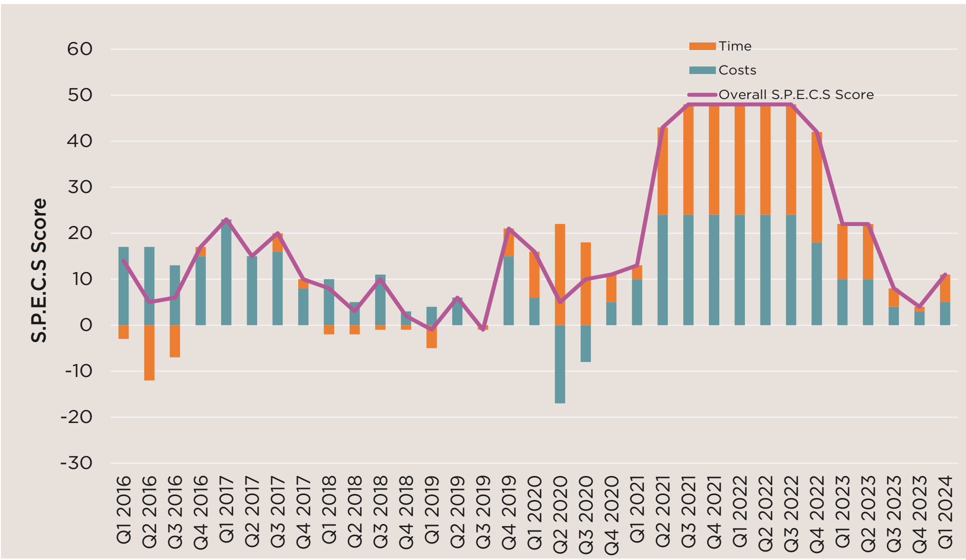
In line with the general climate covering inflation, our S.P.E.C.S index has seen consecutive falls for the last five quarters. However, the first quarter of this year has surprised on the upside, seeing the overall index rise to give a S.P.E.C.S score of 11.

In the most part, the increase is not driven by rising costs, albeit some sectors are still experiencing upward pressure, but rather increases in timescales, specifically the logistics and residential sectors. In the logistics sector, continued weather-related disruption following a wet start to the year has pushed out timescales, whereas, in the residential sector, refurbishment projects of flats and apartments that fall into the category of “High Risk Buildings” are starting to see some disruption as the industry adjusts to a new statutory process with the new Building Safety Regulator. All things being equal, we expect these time pressures to appease as the year progresses.

In the wider market, whilst we are witnessing some material changes in the prices of raw materials, steel being a good example, which has seen a cost fall of c.33% since July 2022, there is an overall continued state of flux. Labour availability remains constrained, overall construction output is rising, according to the latest data from the S&P Global UK Construction Purchasing Managers’ Index, and we are continuing to witness contractor failure.

In Central London, we are expecting a record 8m sq ft of development completions, of which 57% are new developments, as opposed to extensive refurbishments. In the wider market, we continue to see refurbishments across all sectors come forward as investors look to future-proof their assets with a focus on ESG and maintaining the prime status of their assets. With rising demand tendering into a smaller pool of companies, it is likely we will see more volatility in our S.P.E.C.S index for the foreseeable future.

S.P.E.C.S Q1 2024



Source Savills Research

Q1 2024 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	↑	↔	↑	↔

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 suggests that build costs and programme timescales are largely static.

LATEST DATA FROM SAVILLS RESEARCH SHOWS RECORD LEVELS OF OFFICE COMPLETIONS IN CENTRAL LONDON

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

Residential HBF survey shows materials availability now of limited concern

Source Savills Research using HBF

Residential: Improved availability of materials has done little to improve costs

Residential build costs have increased substantially over the past five years. External global factors, including Brexit and the coronavirus pandemic, have made it more challenging to access materials and labour. Separately, ongoing conflicts in Ukraine and the Middle East have driven the price of fuel and energy, further increasing costs for residential development.

Prior to 2019, residential build cost inflation followed a steady and consistent growth pattern, with annual growth of 3.3% per annum in the five years to February 2019, according to the 'Build Cost Information Service All-in Tender Price Index' (BCIS All-in TPI). Disruption to the construction sector since then has created some degree of volatility, and a departure from these longer term trends.

The strength of the housing market and greater demand for construction components generally drove the cost of building over the past five years, particularly between 2021 and 2022 with peak annual growth of 10.3% in the 12 months to May 2023 according to BCIS. Lockdowns around the world during this period lead to major logistics delays and shortages in the supply of goods; this was compounded by wider cost inflation that fed through into general construction costs.

The BCIS index has since returned to a rate of growth more in line with the previous decade, with growth of 2.9% recorded in the year to February 2024. BCIS anticipate a return to longer-term trends, with annual growth of 3.3% forecast in the five years to February 2029 after short term slower growth (1.5% in the 12 months to Nov-24).

The availability of materials has been a notable constraint to new home delivery since 2019, according to the HBF housebuilder survey. Supply chain disruption caused by the coronavirus pandemic, and further exacerbated by the Russian invasion of Ukraine, restricted the supply of materials to the UK. By Q1 2022, almost 90% of respondents to the HBF survey quoted the reduced availability of bricks, steel and timber as key constraints to new home delivery.

Supply chains have since responded to the surge in demand, with key export hubs ramping up output, eventually satiating requirements across the construction sector. By the end of 2023, just 3% of survey respondents were having difficulty accessing the materials needed to build new homes, reflecting a rapid recovery in supply chains recorded globally across almost all sectors.

However, despite the improvements in supply and tempering of build cost growth, the cost of materials still remains a barrier to new home delivery, according to over 40% of respondents to the HBF survey. While pricing power is no longer in the hands of those supplying or transporting goods around the world, the sharp cost increase between 2021 and 2022 is still affecting activity in the sector.

Alongside existing development cost, housebuilders respond and adapt to existing and emerging policy, often paying more in the process. Habitat creation and maintenance to achieve biodiversity net gain, low carbon heating systems to meet the Future Homes Standard, and additional measures implemented to mitigate nutrient neutrality each amplify development costs, creating further challenges for new home delivery.

FIRST QUARTER INVESTMENT VOLUMES SURPRISE ON THE UPSIDE

Whilst economic data remains volatile, there remains a general consensus that a path to a 'soft landing' is achievable. The narrative regarding base rate cuts remains a cause for debate within economic circles but, all things being equal, markets are expected inward movements this year, which should therefore stimulate higher investment volumes in the second half of the year.
That said, with many markets reaching their expected low points in pricing, it is pleasing to report that investment volumes for March reached £4.7bn, the highest level since March 2023 and representing a 56% increase month-on-month. This places Q1 at £10.7bn, exceeding previous expectations, and is the second quarter in a row with rising volumes.
Overall, and assuming this trend continues, this bodes well for the construction industry as it should stimulate higher levels of development and refurbishment. For more insight on this topic and to download our research, please visit here.

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