

Construction Spring 2023



Sector overview

Following a period of buoyant trading for the industry, construction output now looks set to soften in 2023. Inflation-inducing headwinds have been the key theme behind the wave of insolvencies seen during the second half of 2022 and in the year to date of 2023. Contractors have had to contend with the unanticipated challenge of soaring costs, whilst trying to manage the impact this has on liquidity and contract performance. These headwinds were initially felt hardest by the SME market, and this has since impacted trading and cashflows further up the supply chain. Higher interest rates and falling real wages look set to stay for the short to medium term, which is weighing considerably on demand through the residential and private RMI (Repair, Maintenance and Improvement) supply chains. The current trading environment in the UK also presents new tests for businesses that are looking to refinance, with higher borrowing costs now inevitable and with government-backed initiatives no longer an option to aid businesses. Encouragingly, commercial works continue to grow through 2023, well above expectations, and the outlook for infrastructure works remains steady, while material availability and lead times are beginning to improve.

Economic data

- > **ONS Data:** Construction output increased by 5.6% in 2022, following a 12.8% increase in 2021. However, the total number of new orders in construction decreased by 12.4% in the first quarter of 2023 compared with the fourth quarter of 2022 (a 5.7% year-on-year decline).
- > **IHS Markit/ CIPS UK:** A score of 51.1 was posted in April 2023 (values >50 indicate growth, whereas values <50 indicate reduction).
- > **The Gazette:** In 2022, construction sector insolvencies rose by 62% to 4,143. This accounts for nearly one in five (19%) of all insolvencies in England and Wales (despite contributing to an estimated 7% of the UK's GDP).
- > **CPA:** A contraction in output of 6.4% is forecasted in 2023 (recently downgraded in May 2023 from the January 2023 estimate), with growth of 1.1% forecasted in 2024. Contraction in private housing being the main contributor, with a 17% fall in output forecast for 2023.
- > **Insolvency Service:** 4,165 construction-related insolvencies were lodged in the 12 months to March 2023, again accounting for nearly one-fifth (19%) of all cases.

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Strengths - Regional spotlight

> Commercial work outperforms previous-year forecasts.

Healthy outlook reported for 2023, with further growth recorded in April 2023 reflected in a PMI reading of 53.9 (the rate of expansion in PMI was the second strongest recorded since October 2022).

> Resilience in major UK cities:

- **London** - a particularly buoyant start to 2023, with an 80% increase in new project starts across Q1 2023 versus the previous quarter and a 46% increase on Q1 2022. More stringent EPC ratings being a key driver in stimulating demand for office refurbishments, with the current volume of these jobs now at the highest volume since Deloitte began recording this data in 2005.
- **Birmingham** - total schemes under construction were up by 33% compared to 2021, meaning three consecutive years of growth, aided by the hosting of the Commonwealth Games.
- **Leeds** - Year of Culture in 2023, with 22 new project starts (second highest since records began in 2007), with a stable outlook for this year with sustainable transport upgrades.
- **Manchester** - 2022 saw 25 new project starts recorded, and 17 new residential developments (highest recorded since 2018).

> **Pipeline remains stable for infrastructure work.** Output in 2023 is supported by key projects such as HS2, Hinkley Point, Thames Tideway, amongst a range of other utility, road and rail projects. Civil engineering PMI stats recorded a 53.9 PMI in April, indicating further growth - although forecasted growth for 2023 was recently downgraded to 0.7%, due to significant delays in major government-led projects.

Challenges

> **Unprecedented supply-chain inflation.** Inflation in prices of materials, products, and labour has undoubtedly been the most challenging and widespread headwind facing contractors across the UK, particularly due to fixed-price contracts continuing to be commonplace. The material price index for all work increased by 8.7% in March 2023, compared to the same month in the previous year (Department for Business and Trade). Whilst this is now expected to ease through 2023 (signs of this are evident), many legacy contracts have caused and are causing losses and a cash drain for businesses.

> Poor outlook for housebuilding in 2023.

Current forecasts suggest a 17% contraction (CPA) for housebuilding in 2023 (the main driver behind an expected contraction for full sector output this year). The UK CPI peaked at 8.7% in April 2023, following a decline from March 2023 - though this was higher than European peers and higher than the earlier forecast by the Bank of England, which later hiked the base rate up to 4.5% in May 2023. The impact on mortgage rates, coupled with a fall in real wages, has led to falling reservation rates and housebuilders scaling back on new project starts. A sudden dip in new starts for these supply chains may also be likely in Q3, as new building regulation changes come into effect.

> Reduced spending in the private RMI market.

A combination of weak consumer confidence, falling real wages (and therefore less disposable income), higher borrowing costs and increasing materials/construction costs, means that the third largest subsector within the industry (by output) is expected to see a 9% fall in 2023 (following two strong years in the UK's working-from-home period).

> **Insolvencies in the northeast of England.** A number of high-profile failures concentrated within the northeast region may have a knock-on impact on cashflows for several businesses operating in the area.

> **Labour shortages.** ONS stats suggests that vacancies for labour in construction are still 50% ahead of pre-pandemic levels.

Underwriting Approach

> **Stable underwriting stance in place for construction, with closer emphasis on residential supply chains:** case-by-case underwriting approach with each business to be assessed on their own individual merits.

> **Information remains key:** keeping financial records, order books, bank forms, covenant visibility and details on contract performance (and inflation-mitigating factors) up to date remains vital when assessing challenging credit risks in construction.

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Construction PMI for April 2023

UK construction companies remained in expansion mode during April, but the latest survey data indicated uneven growth across the sector. Rising volumes of commercial work and civil engineering activity helped to offset the steepest decline in residential construction output since May 2020.

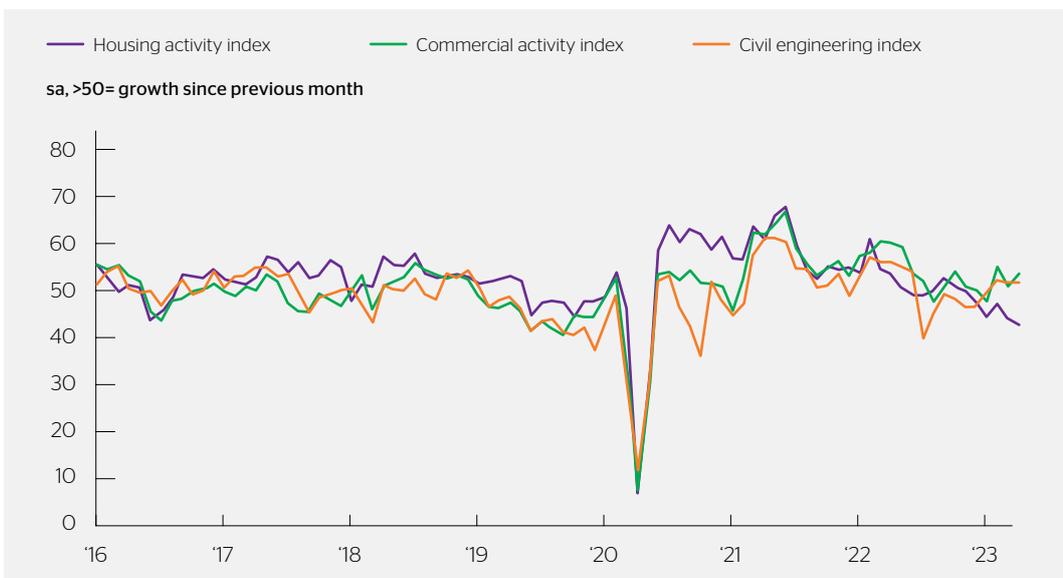
Meanwhile, supply conditions improved to the greatest extent since September 2009, reflecting an upturn in materials availability and fewer instances of transport delays. Input price pressures also eased in April, with

the rate of inflation on costs at the lowest for almost two-and-a-half years.

At a reading of 51.1 in April, the headline seasonally adjusted S&P Global / CIPS UK Construction Purchasing Managers' Index® (PMI®) - which measures month-on-month changes in total industry activity - was up slightly from 50.7 in March and above the neutral 50.0 value for the third month in a row. However, the latest reading signalled only a marginal overall expansion of construction activity.

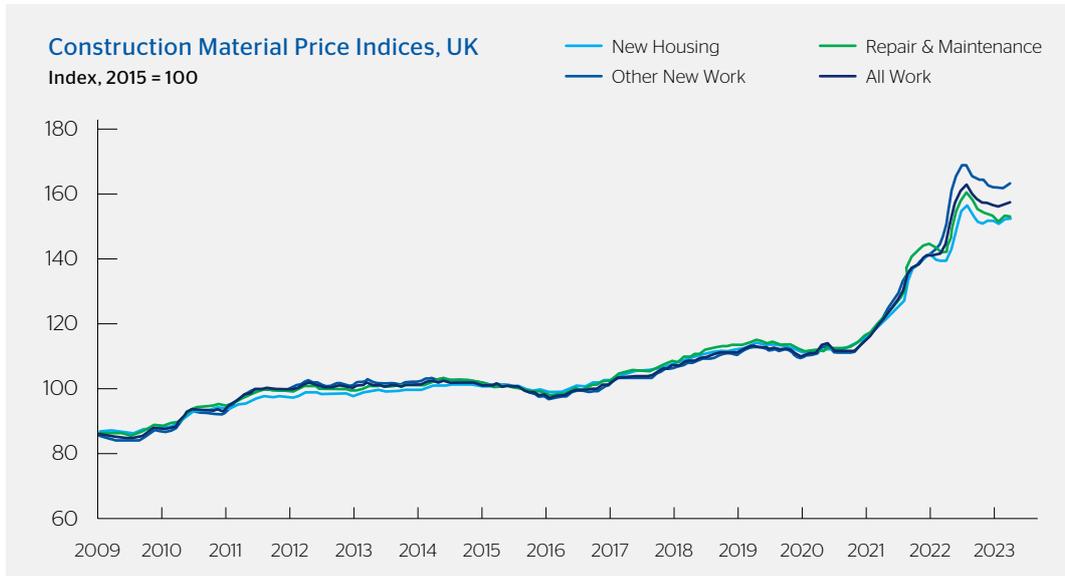


Sources: S&P Global, CIPS (Data were collected 12-27 April 2023)



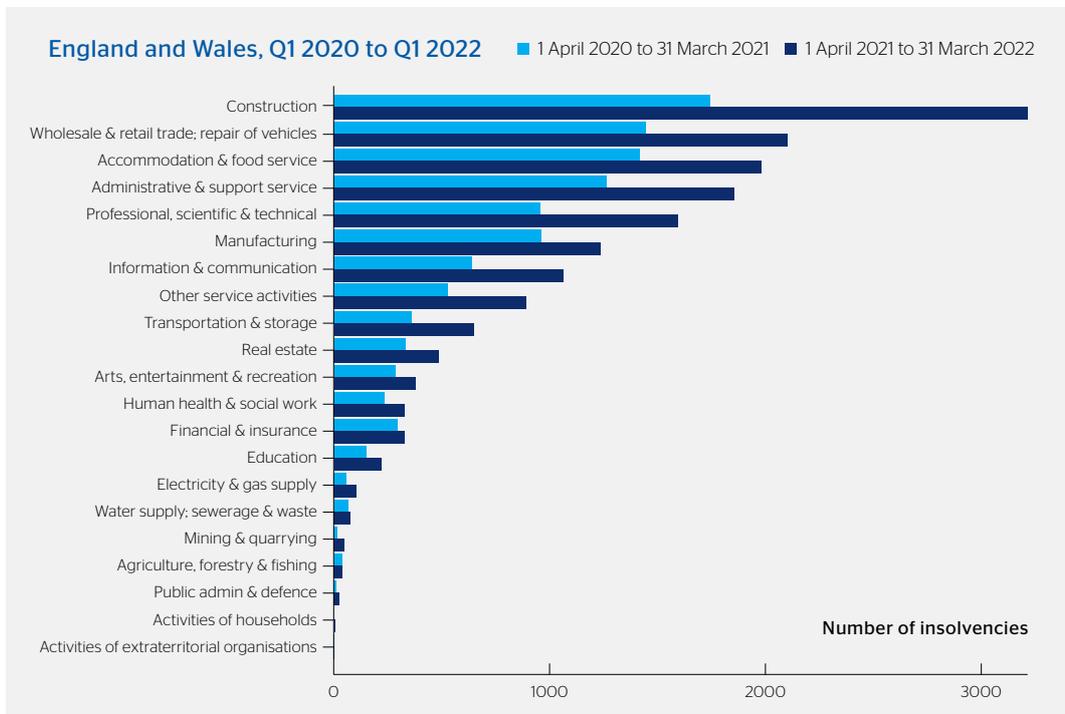
Sources: S&P Global

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Sources: Monthly Statistics of Building Materials and Components

All industries saw increased insolvencies in the four quarters ending Q1 2022 compared to the period ending Q1 2021



Sources: Insolvency Service (compulsory liquidations only); Companies House (all other insolvency procedures)

Notable insolvency events

- > **SD Samuels (Special Projects) Ltd (January)** - building envelope / façade contractor, c. £20m T/O
- > **Dako Construction Ltd (January)** - building contractor, £8m turnover
- > **S&I Groundworks (January)** - civils and groundworks, £42m T/O
- > **Malin Industrial Flooring (January)** - concrete flooring, £50m T/O
- > **Outco Surfacing (January)** - surfacing and maintenance, £19m T/O
- > **Tolent Plc - (February)** - commercial and residential contractor, £198m T/O
- > **Metnor & Norstead (February)** - commercial contractor, £81m T/O
- > **Floorcraft Contractors (London) Limited (February)** - floor laying, £332k equity
- > **Lane End Developments (February)** - developer, £81m T/O
- > **R. L. Davies & Son Limited (February)** - developer, £15m T/O
- > **J.W. Hughes Building Contractors (February)** - building contractor, £380k equity
- > **XCAV8 (SW) Ltd (February)** - civils and groundworks, £842k equity
- > **Jarvis Contracting Ltd (March)** - building contractor, £44m T/O
- > **Newpool Construction Ltd (March)** - civils and groundworks, £10m T/O
- > **Castlehouse Construction (March)** - building contractor, £24m T/O
- > **E J Civils Limited (March)** - civils and groundworks, £13m T/O
- > **J M Scully (March)** - retail contractor, £23m T/O
- > **Tony Kirwan Contractors (March)** - civil and groundworks, £769k equity
- > **Me Construction & MEC Groundworks (April)** - civil and building contractor, £30m T/O
- > **Clement Dickens & Sons (April)** - building contractor, £401k equity
- > **Topside Group Limited (April)** - facades specialist, £1.5m equity
- > **Stewart & Shields (April)** - building contractor, £1m equity
- > **Garenne Group (April), includes Garenne, Camerons, Sterling** - contractor, £100m T/O
- > **Quantum Construction (April)** - building contractor, £1.1m equity
- > **Howard Russell (May)** - building contractor, £44m T/O

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