Construction Review & Forecast for 2017

PREPARED BY

Glenigan

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Introducing Glenigan

Established in 1973, Glenigan currently invests over £3million and makes over a million research telephone calls per year to provide details on every construction project in the UK. This enables us to provide the most up-to-date and comprehensive construction sales leads and analysis, to help companies win new business.

We also have exclusive partnerships with key industry associations such as the Builders' Conference, Considerate Constructors Scheme and the Building Research Establishment (BRE), enabling us to offer project data that's not available elsewhere in the market.

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Executive Summary - Construction activity and prospects for 2017

This report analyses the latest data on construction activity and provides an assessment of the industry's prospects for 2017 and beyond.

- Weaker economic growth forecast for 2017, accompanied by political uncertainty
- Renewed growth in civil engineer starts
- Business investment forecast to slow
- Strong long-term pipeline of planning submissions
- Weaker housing market activity forecast for 2017
- Industrial starts recover
- Slowdown in office development activity
- Retail property facing structural change
- Overall weakening in construction project starts & output

UK construction activity has been buffeted during 2016 by economic and political uncertainties. Industry workload pipelines and order books have been disrupted as investors and clients have delayed and re-appraised their development plans in the light of the EU referendum vote.

The new administration is similarly revisiting and reviewing the Government's commitments, priorities and spending plans.

The most immediate challenge is that, whilst the UK has voted out of the EU, it may be several years before it becomes clear what the UK has voted into.

Against this uncertain background, the UK economy has initially fared better in the immediate aftermath of the referendum vote than was widely predicted. Economic growth slowed during the third, in part due to a fall in construction activity, but was still 0.5% ahead of the previous quarter. Looking ahead UK economic growth is forecast to weaken further next year, with capital expenditure particularly weak.

During the course of this year the construction industry has seen the flow of projects on to site moderate as political and economic uncertainties surrounding the EU referendum adversely affected the private non-residential sectors in particular. Overall Glenigan estimates that the value of underlying project starts declined by 4% this year and a similar decline is anticipated for 2017.

Table 1: Value of Underlying New Work Project Starts by Sector

Change on previous year	2014	2015	2016e	2017f
Private Housing	14%	19%	-2%	-3%
Social Housing	-16%	6%	0%	-17%
Industrial	21%	24%	-22%	9%
Offices	17%	5%	-9%	-10%
Retail	14%	-17%	32%	-17%
Hotel & Leisure	27%	-3%	-5%	2%
Education	-1%	21%	0%	-10%
Health	5%	-22%	25%	-12%
Community & Amenity	-17%	7%	1%	-2%
Civil Engineering	11%	-4%	-21%	12%
Total	7%	7%	-4%	-4%

Source: Glenigan

Construction output growth weakened during the first eight months of 2016, Official ONS statistics recorded a 0.5% rise in output during January to August 2016 against the same period last year. This compares to growth of 4.9% during 2015. This drop follows the reduction in project starts forecasted and reported by Glenigan last year, with the earlier drop in starts reducing the volume of work currently underway on sites across the country. The further weakening in project starts experienced during the current year and forecast for 2017 are expected to prolong the current dip in construction output volumes.

Over the last two years rising consumer confidence, improved household incomes and government initiatives to support home ownership have lifted property transactions and new house sales. Looking ahead, weaker economic growth and increased inflationary pressures are expected to constrain households' real income growth and house purchasers' confidence. In response we anticipate that housing market activity and private housing starts in 2017 will both be little changed on the current year, with the value of project starts slipping 3% following a 2% decline this year.

Government capital funding for new social housing provision will remain tight. However the new administration appears to be reviewing the government's social housing strategy and there are indications that the extension of Right to Buy may be delayed. Furthermore the sector, with its strong development pipeline of approved projects, is well placed to benefit from any increase in public sector capital funding. Accordingly, whilst we anticipate that the current funding restriction will feed through to a 17% decline in project starts next year, we expect projects to subsequently strengthen from 2018 onwards.

Industrial construction remained a bright spot for growth last year, building on the rapid rise in starts seen in 2014. The flow of new project starts faltered this year as investors have reappraised schemes in light of the EU referendum vote. However we anticipate a partial recovery in industrial project starts next year, led by a rise in warehousing and logistics projects, as some of the delayed schemes progress to site.

Whilst the planning pipeline remains firm, political & economic concerns surrounding the EU referendum have depressed the flow of projects to site during 2016. These concerns are expected to persist during the forecast period as investors appraise the implications of Brexit for the future demand for office accommodation and rental values.

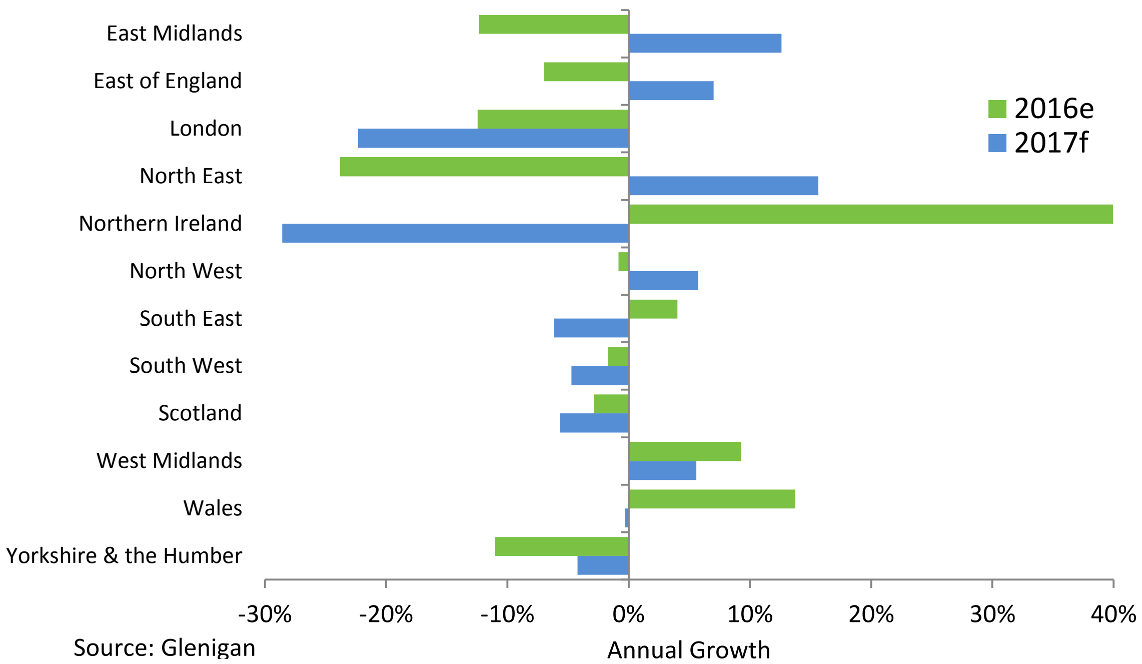
In contrast the prospects for the hotel & leisure sector over the coming year are substantially more positive. The development pipeline remains firm; having grown by 22% in 2015 the value of planning approvals in the 12 months to October 2016 were 3% up on a year earlier. We anticipate that the relatively positive outlook for hotel & leisure sector, in particular the prospect of increased tourism thanks to the cheaper sterling exchange rate, to support increased investment in the sector and project starts are forecast to grow by 7% during 2017.

Investment in higher education facilities is expected to remain another growth area within the wider education sector in 2017 as universities compete for students. In contrast we anticipate that the flow of statutory education projects will be dampened by political uncertainties and funding restrictions, despite pressure from rising pupil numbers. This is forecast to feed through as a 10% drop in the value of education sector starts next year.

This year has seen a sharp rebound in the health sector, with starts rising 25%. After the strong growth seen during the current year and with NHS capital funding remaining tight, sector starts are forecast to consolidate next year.

The profile of civil engineering activity is changing. Energy and rail work have driven growth in the utilities and infrastructure sectors in recent years. However the reduced government support for renewables, including PV and on-shore windfarms, has prompted a sharp fall in energy projects starting on site during 2016. In contrast the current Water Industry investment cycle, AMP6, is gathering momentum, with the value of water industry projects growing by 150%. Increased investment in the national road network is anticipated during 2017 as Highways England brings forward projects under its collaborative framework.

Chart 1: Value of Underlying New Work Project Starts by Country and English Region



Source: Glenigan

Geographically, construction growth is forecast to become more broadly based across the UK than in recent years. Having led the initial upturn in construction activity, project starts in the capital fell back this year and a further decline in forecast for 2017. In contrast modest growth is anticipated in the North West of England and the Midlands.

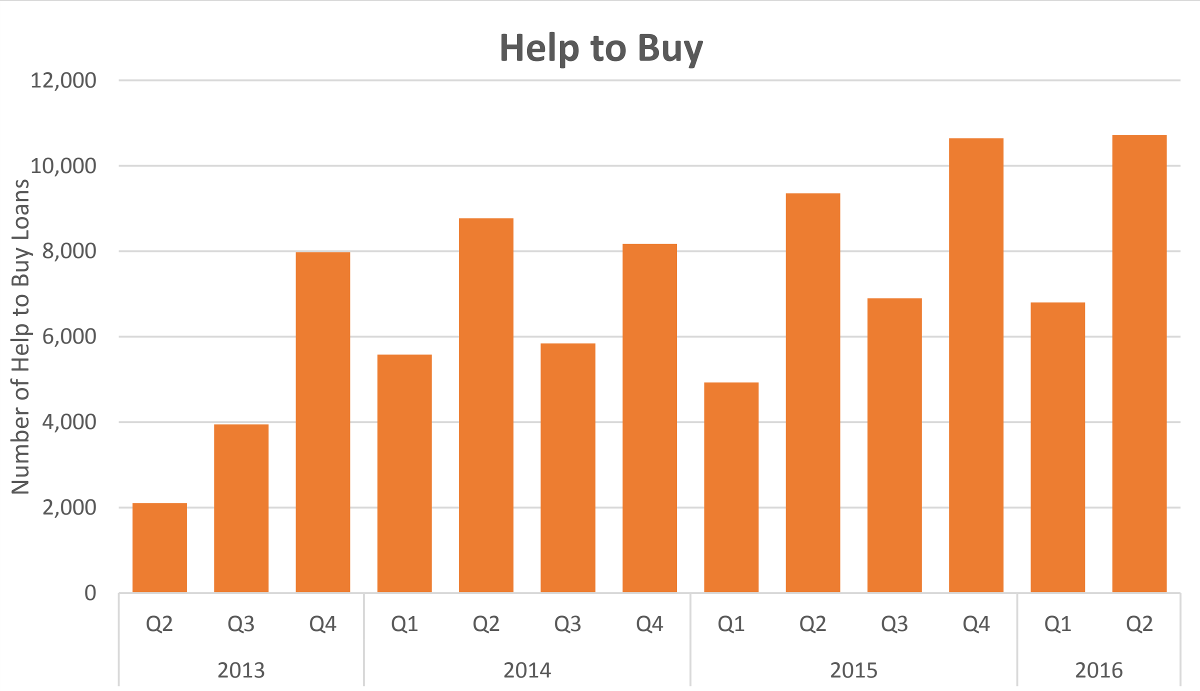
Private Housing

Rising consumer confidence, improved mortgage availability and Government initiatives to support homeownership (in particular the "Help to Buy" scheme) have combined to lift housing market activity and new house sales over the last two years.

The current year has seen activity in the wider housing market disrupted first by the introduction of a Stamp Duty surcharge on buy to let and second home purchases and subsequently by purchaser nervousness over the EU referendum vote. The recent slowing in house price inflation recorded by the Nationwide and Halifax appears to reflect the weakening in property transactions since the spring.

However the latest mortgage approval data released by the Bank of England suggests that market conditions are now stabilising, while estate agents responding to the third quarter RICS survey report that market confidence is returning following a significant drop in the aftermath of the EU referendum.

Chart 2: Number of "Help to Buy" loans completed



Source: DCLG

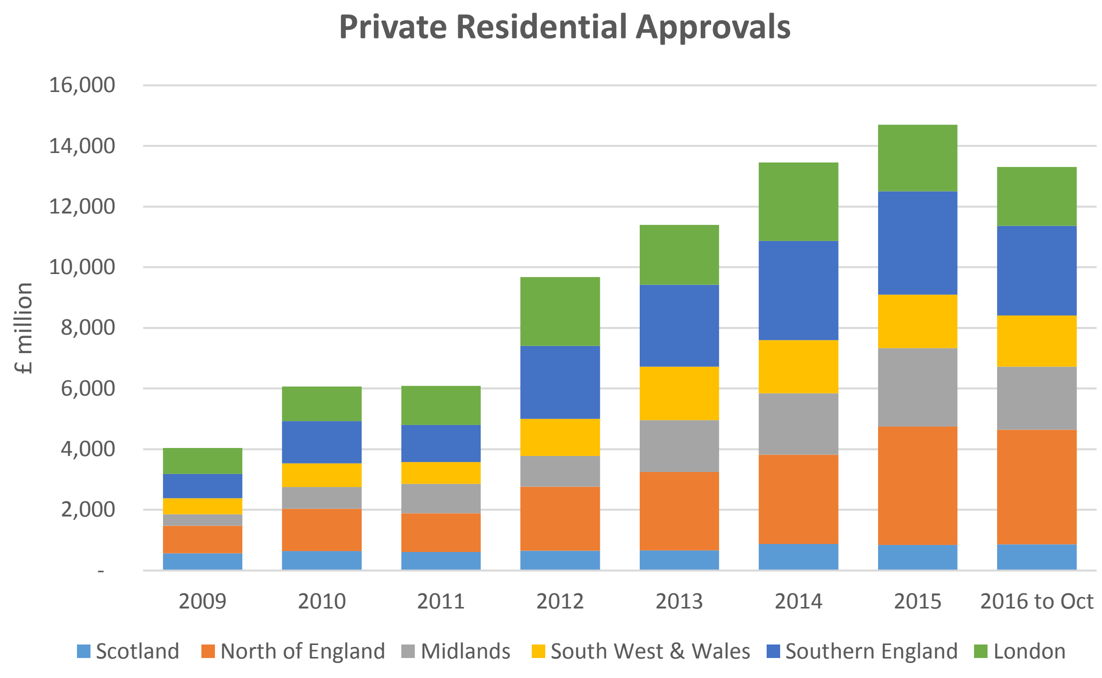
A variety of government initiatives have worked to improve market sentiment and increase transactions over the last two years. In particular the "Help to Buy" scheme has helped to boost housing market activity and has been credited by major house builders for increasing their confidence to invest in new sites. The number of homes purchased with support from "Help to

Buy" continued to climb during the first half of 2016, despite the cooling in activity in the wider housing market. At 17,500 the number of new homes purchased through the scheme during the first six months was 23% higher than a year ago.

House builders have secured permission on a growing number of sites across the country in anticipation of a broad based upturn in demand. Planning reforms, most notably the introduction of the National Planning Policy Framework (NPPF) in 2012 have improved their success rate in gaining permissions. The number of dwellings approved on private sector projects (of 3 or more units) climbed progressively during 2014 and 2015. The number of units approved continued to advance during the first nine months of 2016, at 200,000 units, being 22% up on the same period a year ago. The expanding development pipeline should ensure that house builders are well placed to respond to any strengthening in market activity over the medium term.

Looking ahead to 2017 average earnings growth is likely to moderate given the anticipated slowing in UK economic growth, while increased inflationary pressures are expected to constrain households' real income growth and house purchasers' confidence. In response we anticipate that housing market activity and private housing starts in 2017 will both be little changed on the current year, with the value of project starts slipping 3% following a 2% decline this year.

Chart 3: Value (£m) of Private Housing Detailed Planning Approvals by Region



Source: Glenigan

Social Housing

Last year saw an encouraging rebound in detailed planning approvals, which were up 31% on 2014. However as anticipated housing associations have struggled to bring forward all of the planned schemes. Government capital funding for new social housing provision in England remains tight.

In addition Government moves to cap social rent increases to 1% below inflation and to extend the "Right to Buy" to housing association tenants have hampered associations' ability to privately fund capital projects.

However the new administration appears to be reviewing the government's social housing strategy and there are indications that the extension of "Right to Buy" may be delayed.

Furthermore the sector, with its strong development pipeline of approved projects, is well placed to benefit from any increase in public sector capital funding. Accordingly, whilst we anticipate that the current funding restriction will feed through to a 17% decline in project starts next year, we expect projects to subsequently strengthen from 2018 onwards.

Industrial

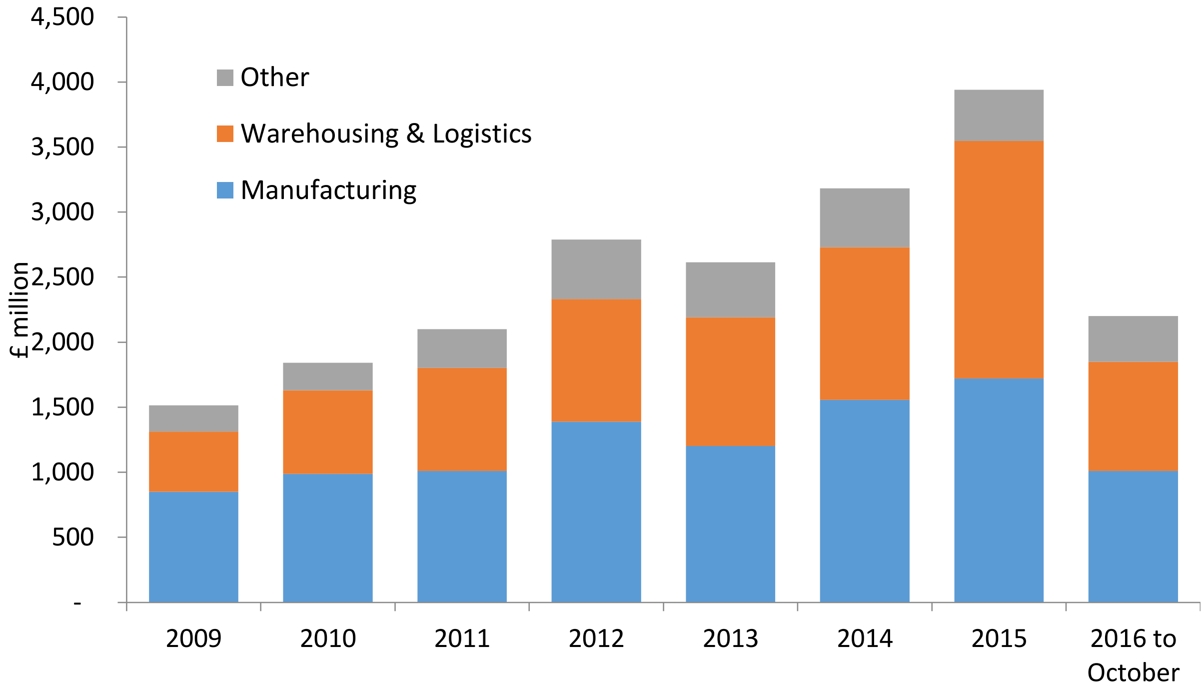
Industrial construction was one of the fastest growing construction markets in 2014 and 2015, supported by a rapidly expanding pipeline of planned projects. Whilst the development pipeline remains firm, the value of project stars has fallen sharply during 2016 as investors and developers have delayed making the final commitment to projects while they re-assessed their plans in light of the EU referendum.

Recent sector growth has been primarily driven by an increase in warehousing and logistics space work; an area that enjoyed six consecutive years of growth from 2009 and 2015 with the value of starts quadrupling to £1.5 billion over the period.

The demand for logistics space has been driven in large part by structural change in the retail sector, with the relentless growth of on-line retailing, “click & collect” and home deliveries, fuelling demand for warehousing and distribution premises. With online retail forecast to take an ever larger share of retail sales, we expect this to be a long term driver for warehousing & logistics projects. The Midlands, North West and parts of the South East of England are favoured locations for such facilities, offering good access to national transport networks and the UK’s major population centres.

Accordingly, whilst warehousing and logistics starts halved during first ten months of 2016 as investors reassess their plans in the light of the UK’s impending EU exit, we expect this to remain a longer term growth area for the sector. Although the prospect of weaker household earnings growth and higher inflation points to a weakening in retail sales growth over the next two years, the structural changes in the retail sector will continue as retailers adapt to consumers changing spending patterns and shopping habits.

Chart 4: Value of underlying Industrial starts by category



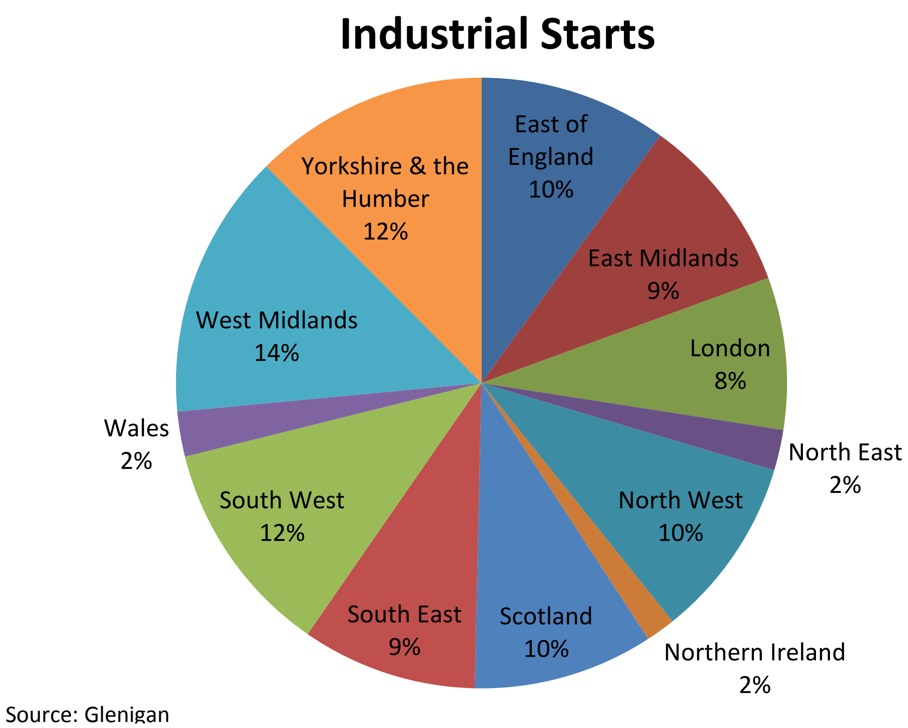
Source: Glenigan

The manufacturing sub-sector slipped back 7% last year, having grown strongly in 2014, as prospects for the UK's manufacturing sector were dampened by weakening world economic growth.

Subsequently the EU referendum appears to have further dampened project starts during the first ten months of 2016; with the value of underlying manufacturing starts 34% lower than a year ago. UK exporters are currently benefitting from the recent falls in Sterling, although manufacturers will also face higher input costs due to the weaker pound. Looking ahead we anticipate a further retrenchment in planned capital investment by manufacturers during the forecast period due to concerns over the terms of the UK access to the European single market.

Overall we estimate that the value of underlying project starts will have fallen by 22% this year in large part due to projects being re-appraised following the EU referendum. However we anticipate a partial recovery in industrial project starts next year, led by a rise in warehousing and logistics projects, as some of the delayed projects finally progress to site.

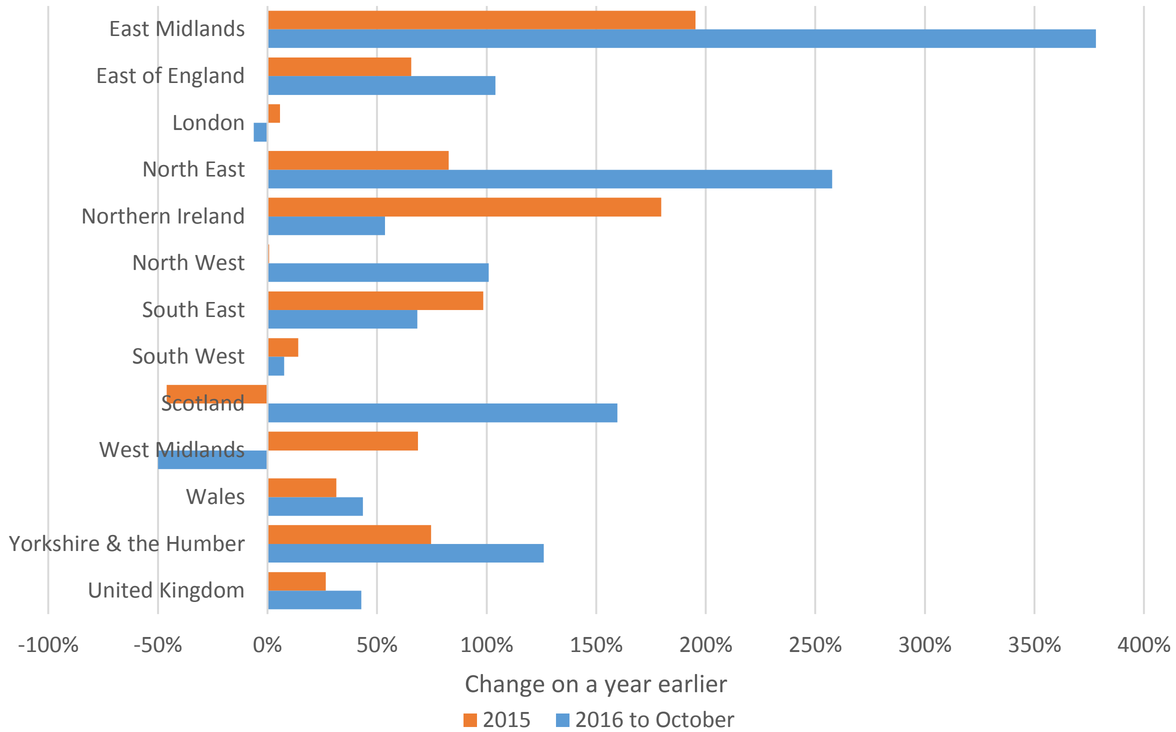
Chart 5: Value of underlying industrial projects started during January to October 2016 by region



Offices

Whilst the planning pipeline remains firm, political & economic concerns surrounding the EU referendum have depressed the flow of projects to site during 2016. These concerns are expected to persist during the forecast period as investors appraise the implications of Brexit for the future demand for office accommodation and rental values.

Chart 6: Value of underlying detailed planning approvals for office projects by region



London accounts for around half of office sector activity. Although the capital has a strong development pipeline, we anticipate that the recent dip in project starts will be sustained over the forecast period. Developments in the financial district are likely to be especially vulnerable as institutions assess whether some of their operations will have to be re-located to within the EU.

However, the strongest growth rates have recently been seen outside of the capital. All parts of the UK, bar Scotland, saw a rise in detailed planning approvals last year, with the sharpest growth being in the Midlands, South East and Yorkshire & the Humber. This regional shift in the development pipeline has continued during the first ten months of 2016, with London and the West Midlands the only parts of the UK to see a fall in approvals.

Investors and developers have been responding to the change in market conditions. Demand for more high quality office space has been growing in the UK's 'core' cities over the last two years. This rising demand for office accommodation and a previous lack of development activity has tightened the supply of available office space in major UK office markets.

Overall we estimate the value of underlying project starts will slip back 9% this year and we are forecasting a similar 10% decline for 2017.

Retail

Increased household incomes and rising consumer confidence have been slow to lift retail construction activity. The value of underlying retail project starts fell 17% last year and the development pipeline is weak. The value of retail projects securing detailed planning approval during the 12 months to October 2016 was 5% down on the preceding period.

However, despite the weak development the current year has seen an estimated 32% rise in the value of retail projects starting on site, suggesting the rise in consumer spending has finally begun to feed through to project starts.

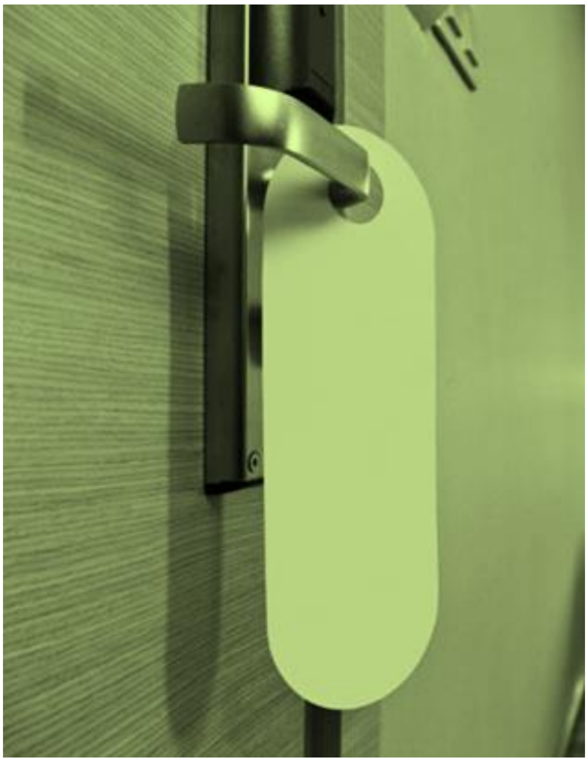
The growth in project starts in part reflects retailers and landlords investing to exploit structural change in the sector due to consumers' changing shopping habits.

Retailers are rationalising and adapting their outlets to accommodate the growth of on-line shopping; refitting stores to offer consumers an attractive retail environment and to provide "click & collect" facilities. The adaptation and re-fitting of existing stores is expected to remain a key area of sector activity during the next two years.

In response to the e-commerce challenge, developers are looking to safeguard their investments by expanding established shopping centres, such as Westfield in west London. In many cases, the plans include an enhanced leisure offering in order to increase dwell time and their attraction as a "destination" shopping location. Many of the larger projects to start on site during 2016 have been enhancements to established shopping centres and designer retail outlets.

Looking ahead the prospect of slower retail sales growth and the weak development pipeline are forecast to feed through to a decline in the value of underlying retail project starts over the next two years. We expect project starts to fall by 17% in 2017 after the spike in starts during the current year, with a further weakening in starts forecast for the following year.

Hotel & Leisure



The UK's hotel and leisure industries have benefited from improved consumer sentiment, coupled with rising employment and an increasein real earnings growth.

Strengthening employment and earnings growth coupled with inflation falling further in recent months have helped loosen consumers' purse strings and lifted leisure operators' and hoteliers' revenues.

Visitors from overseas have also helped to boost the sector; with London being the main beneficiary. The number of overseas visitors has continued to climb at around 5% per annum, although the rise in spending by overseas travellers has slowed from a growth rate of 14% in 2013 to 3% in 2014 and just a 1% rise last year.

Looking ahead the more uncertain economic outlook may knock consumer sentiment and discretionary spending. However the weakening exchange rate will generate greater demand for hotel accommodation from overseas visitors and should encourage UK households to holiday "at home".

After a 27% increase in starts during 2014, the sector entered a period of consolidation last year, project starts edging just 3% higher. Project starts are estimated to have weakened by a further 5% this year.

The prospects for the sector over the coming year are more positive. The development pipeline remains firm; having grown by 22% in 2015 the value of planning approvals in the 12 months to October 2016 were 3% up on a year earlier. We anticipate that this relatively positive outlook for hotel & leisure sector, in particular the prospect of increased tourism, to support increased investment in the sector and project starts are forecast to grow by 7% during 2017.

Education

Renewed confidence in their future funding streams post-election have enabled universities to press ahead with planned schemes. In contrast the UK's state schools, which account for the majority of work carried out in this sector, have seen project starts falter. Accordingly we remain cautious about the near term outlook for the education sector.

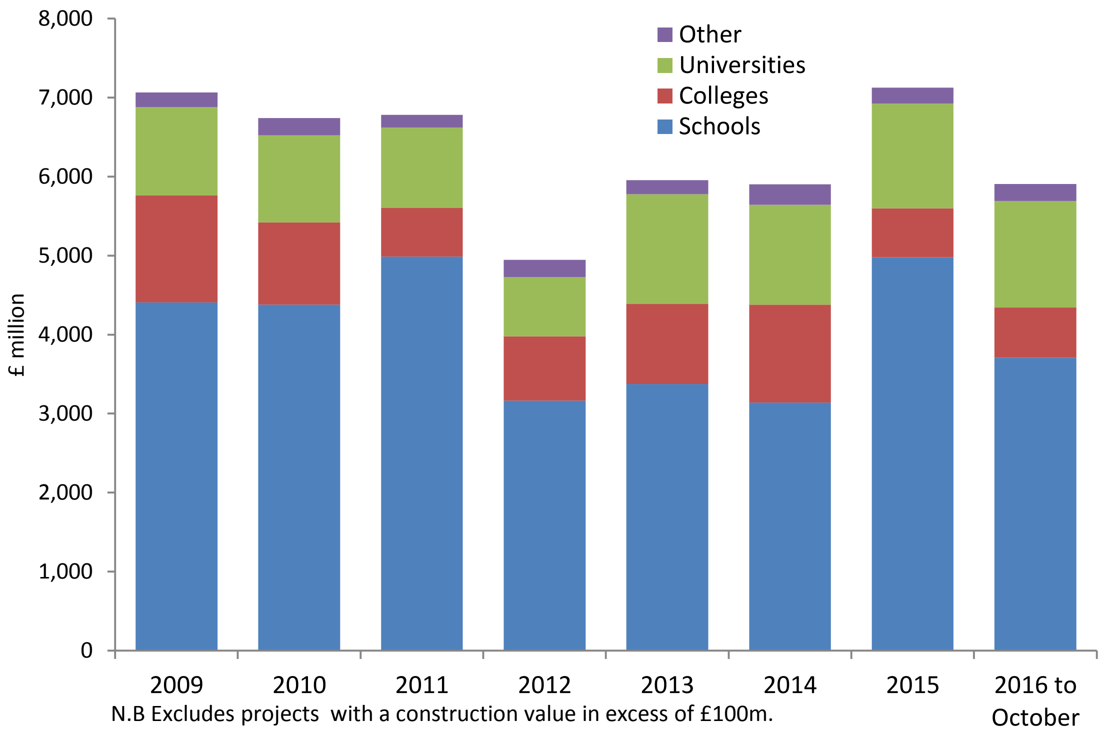
Investment in higher education facilities has been a growth area within the education sector as universities compete to enrol both domestic and overseas students. At £1.3 billion the value of project starts during the first ten months was 24% higher than during the same period last year.

The rise in project starts, follows a near doubling in the value of projects securing detailed planning approvals during 2014 and 2015. Whilst there has been a retrenchment in planning approvals during the first ten months of 2016, the universities are expected to be an important source of work for the sector over the forecast period.

In contrast we anticipate that the flow of statutory education projects, which account for the majority of work in the sector, will be dampened by political uncertainties and funding restrictions, despite pressure from rising pupil numbers.

Recent years have seen strong growth in primary education provision in response to rising pupil numbers. As these pupils age, the rise in demand for places is now beginning to increase pressure on secondary schools capacity. Growing school rolls promise to drive investment in expanded and new secondary education facilities over the next five years. Despite these demographic pressures, however, the immediate prospects for statutory education provision are less certain.

Chart 7: Value of underlying Education starts by category



N.B Excludes projects with a construction value in excess of £100m.
Source: Glenigan

Councils have argued that current Government policy can frustrate their ability to ensure that there are sufficient pupil places in their area.

Near term, councils are likely to accommodate rising pupil numbers through the expansion of existing schools, although with 60% of secondary schools now academies, councils need to persuade these schools to expand to accommodate the rise in pupil numbers. In addition any new schools must also be "free schools", outside local authority control.

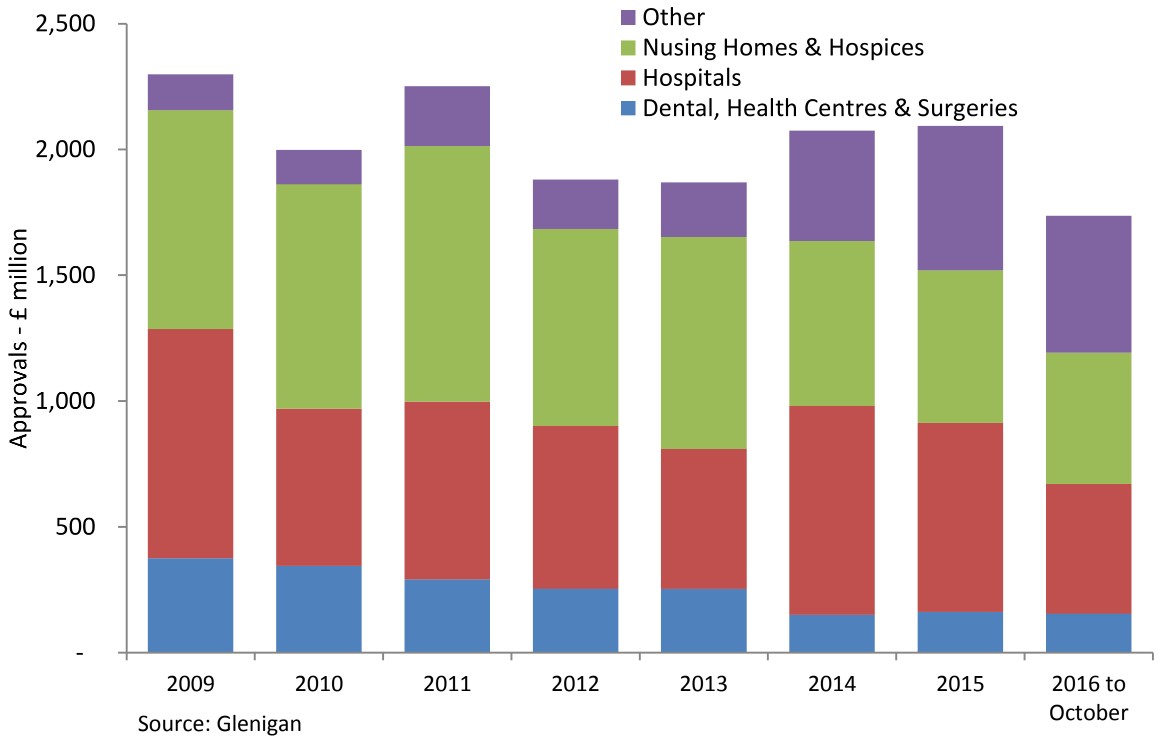
There had been a progressive rise in planning approvals for secondary school projects during 2014 and 2015. However approvals fell back sharply during the first ten months of 2016.

Project starts also fell by 16% during the same period and we expect this weakness to offset the rise in the value of university project starts in 2016. Given the weak development pipeline of school building projects, we anticipate a 10% decline in education project starts 2017, before the sector returns to growth in 2018.

Health

Last year saw a sharp decline in the health sector. The value of underlying project starts fell 25%; the sharpest drop in any sector during the year. The fall was in part due to the general election in May of that year disrupting the commencement of projects on site. In contrast the value of projects securing planning approval was little changed on the previous year. The current year has seen a rebound in project starts as NHS trusts progress with schemes currently in their development pipeline.

Chart 8: Value of underlying detailed planning approvals for health projects



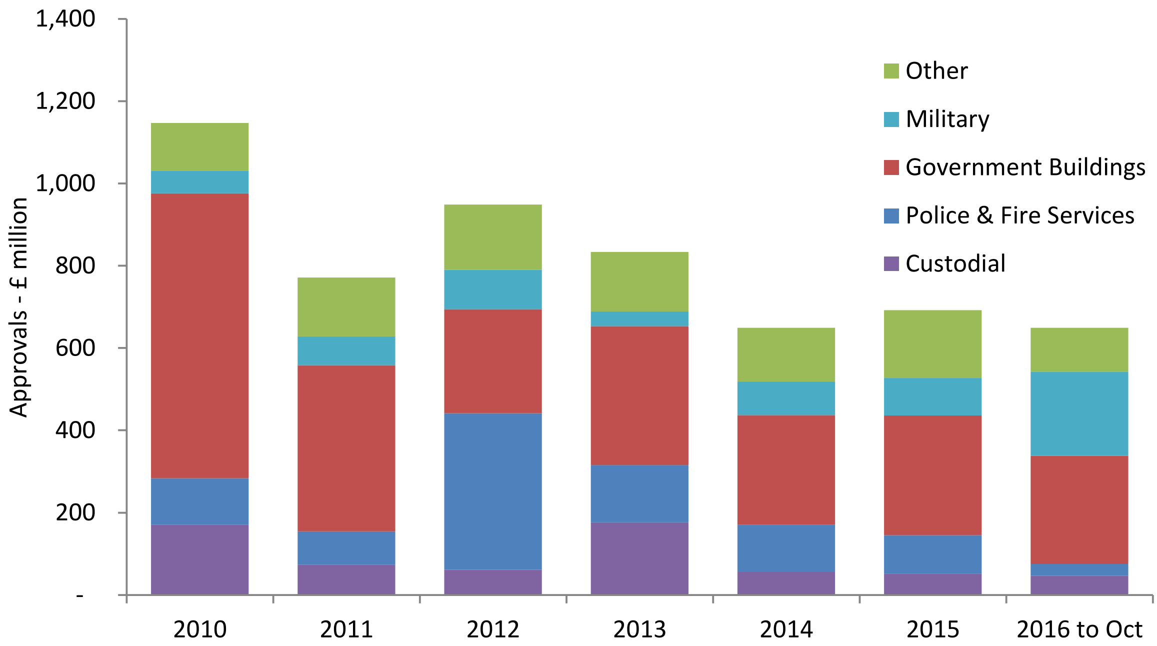
Nevertheless NHS capital budgets remain under pressure, squeezed by rising costs elsewhere in the service. Although the Government has pledged an extra £8 billion for the NHS budget, the Government is also looking to the NHS to find a further £22 billion through efficiency savings by 2020/21.

Against this tough financial background, we anticipate some retrenchment in health sector activity with the value of underlying project starts forecast to decline by 6% next year.

Community & Amenity

Squeezed public finances impacted on the community and amenity sector last year as projects were re-appraised following the election. However, the value of underlying projects securing approval has strengthened over the year to October 2016, being 6% up on the preceding period. This has been accompanied by a small 1% rise in project starts.

Chart 9: Value of underlying detailed planning approvals for community & amenity projects



Source: Glenigan

Looking ahead to 2017 we expect sector growth to be supported by an increase in MoD work. A number of on-going frameworks awarded during 2013 and 2014 are facilitating redevelopments of military bases and improvements and maintenance to the military housing estate. Detailed planning approvals for military building rose 11% last year and the first ten months of 2016 saw a dramatic 160% increase on a year ago.

In contrast, a shrinking pipeline of custodial and emergency service projects indicates that investment in law & order facilities will remain weak during 2017. However, longer term the Government's prison reform plans promise the construction of new modern prison facilities and the release of aging Victorian facilities, such as Wandsworth prison, for re-development.

Civil Engineering

Energy and rail work have driven growth in recent years. However the profile of civil engineering activity is changing, with roads and water industry investment emerging as the growth areas during the current year and for 2017.

The Government substantially reduced the support for many renewable energy projects, including PV and on-shore windfarms, as it "reset" UK energy policy last November. This policy shift has had an adverse impact on the value of underlying project starts during 2016. The Government is now looking to new gas-fired plants as well as off-shore wind to bridge the generating capacity gap. We anticipate that overall sector activity will remain firm over the medium term as large scale generation schemes start on site.

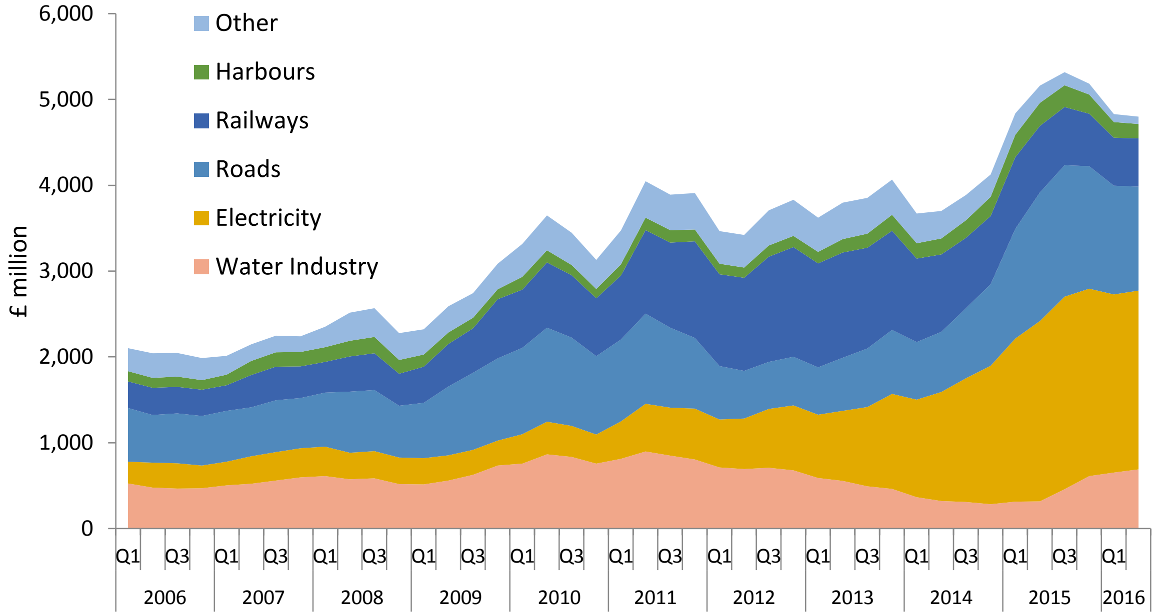
In contrast the current Water Industry investment cycle, AMP6, is gathering momentum, although the sharp increase in water and sewerage activity has not been sufficient to offset the downturn in the energy sector during 2016. We estimate that the value of underlying starts in the utilities sector will fall by around 35% during 2016. However, the sector is forecast to return to growth next year. Overall sector activity is also benefiting from major work packages for the £4 billion Thames Tideway Tunnel, while Hinckley Point C will also begin to contribute to sector workload during the forecast period.

Whilst transport investment is also expected to continue to boost new activity, the emphasis is swinging away from the rail sector towards the national road network. Network Rail's current capital programme (CP5) has been scaled back due to projected cost overruns. Under the revised programme priority has been given to the electrification of the Great Western line to Bristol and Wales, while the electrification of both the TransPennine and London Midland routes have been delayed and the rest of the programme reconfigured.

A number of major rail projects are also coming to a close, most notably Crossrail where the focus of activity has moved to fit-out and passenger infrastructure, although construction is now underway on the Northern line extension to Battersea and enabling works for phase 1 of HS2 are due to start in 2017.

Increased investment in the national road network is anticipated in 2017 as Highways England brings forward projects under its collaborative framework. The Chancellor is pledging additional funds to bring forward projects that can be quickly brought to site and the national road network appears set to remain a growth area over the medium term.

Chart 10: Infrastructure Construction Output



Source: ONS. Values are in current prices.

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