Construction Outlook

FORECAST FOR 2018

PREPARED BY

Glenigan

Date: November 2017

Business Intelligence from Glenigan

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Executive Summary

2017 -5%   2018 -1%

Overall the market will be more stable next year, down just 1%, after a 5% drop in starts in 2017. Whilst overall growth will be negative, strong growth is forecast in the education, hotel and leisure, and industrial sectors. Growth will also be focused outside London and the South East, with project starts in the Midlands, the North of England and Scotland being the strongest performing regions.

- Business investment hit by slow UK economic growth and political uncertainty
- Weaker housing market activity and slowdown in office sector
- Rise in overseas visitors boosts hotel and leisure sector
- Logistics projects to lift industrial starts
- Major projects boost civil engineering workloads
- Proportionally, activity increases in North/Midlands at the expense of London & the South East

UK Construction Prospects

The value of underlying construction projects has fallen back this year amid continued political and economic uncertainty, delays to public sector projects and a weakening in the housing market. Overall construction activity is forecast to stabilise in 2018, as construction clients adapt their investment plans to the changing political and economic environment.

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

Change on previous year £m	2015	2016	2017f	2018f
Private Housing	15,134	15,140	14,576	14,099
Social Housing	6,447	6,675	6,570	6,518
Industrial	3,940	2,931	3,431	3,639
Offices	4,374	4,613	4,008	3,594
Retail	2,038	2,552	2,444	2,474
Hotel & Leisure	3,122	3,018	3,292	3,938
Education	7,125	6,913	5,622	6,167
Health	1,938	2,112	2,055	2,108
Community & Amenity	1,176	1,124	967	932
Civil Engineering	7,758	5,556	5,101	4,342
Total	**53,052**	**50,634**	**48,067**	**47,810**

The weak UK economy is forecast to constrain construction activity over the coming year. Real household earnings growth has stalled due to weak wage increases and higher inflation. This is forecast to slow housing market activity and to impact on private housing starts.

Conversely Sterling's depreciation has boosted UK tourism and is forecast to lift hotel and leisure investment.

Demographic changes are set to shape the pattern of construction activity. Increased investment is anticipated to expand the secondary school estate in order to accommodate rising pupil numbers, especially in the UK's major conurbations. Greater investment will also be required long term to meet the needs of an aging population.

The industrial sector is forecast to be a growth area as technological and social changes reshape consumers' retail habits and drive the demand for logistics space. Growth in these areas will help offset weakness in the private housing and commercial sectors.

Major infrastructure schemes, including Thames Tideway, HS2 and Hinckley Point, are forecast to drive civil engineering activity over the forecast period. The value of smaller scale projects starting on site have fallen back sharply this year and are expected to weaken further next year as investment is dominated by flagship projects.

Longer term construction should benefit from increased public sector investment as the Government seeks to increase capital spending to improve UK competitiveness. The recently unveiled £47 billion funding package for Network Rail from 2019 to 2024 is an illustration of the Government's commitment to greater investment in the built environment. Details of additional increases in public spending are also expected in this November's Budget, including potential measures to boost new house construction.

The construction industry is facing challenges from an aging workforce. The UK's impending departure from the EU has thrown the issue into sharper relief given the industry's reliance on overseas labour, particularly in London. Recruitment of overseas labour has already become more difficult following the referendum and the weakening in Sterling.

Reduced labour availability will add to contractors' costs and act as a spur for the greater use of off-site manufacture.

Table 2: *Value of Underlying New Work Project Starts by Sector* *Source: Glenigan*

Change on previous year	2015	2016	2017f	2018f
Private Housing	19%	0%	-4%	-3%
Social Housing	6%	4%	-2%	-1%
Industrial	24%	-26%	17%	6%
Offices	5%	5%	-13%	-10%
Retail	-17%	25%	-4%	1%
Hotel & Leisure	-3%	-3%	9%	20%
Education	21%	-3%	-19%	10%
Health	-22%	9%	-3%	3%
Community & Amenity	7%	-4%	-14%	-4%
Civil Engineering	-4%	-28%	-8%	-15%
Total	**7%**	**-5%**	**-5%**	**-1%**

Private Housing

2017 -4%   2018 -3%

Weak new house sales are forecast to hold back sector activity, but Build to Rent is predicted to be a rapidly growing niche market.

The value of private housing projects starting on site is forecast to dip by 4% this year, with a further 3% decline in 2018, as housebuilders prioritise building out developments and open fewer sites.

- Strong potential development pipeline
- Rapid growth in Build to Rent developments
- Consumer squeeze curbing property transactions and house prices
- Help to Buy extended to 2021
- Housebuilders expected to reduce site openings as new house sales slow

Private Housing Starts

	2016	2017f	2018f
£ million	15,140	14,576	14,099
Growth	0%	-4%	-3%

Strong growth in residential projects securing planning approval has created a healthier development pipeline. The value of planning approvals during the first nine months of this year were 21% up on a year earlier.

Chart 1: *Value of underlying detailed planning approvals for private residential projects*

Source: Glenigan N.B. 2017 to September - pro rata

Demand rather than supply is set to be the constraint on new private housing activity over the forecast period.

Property transactions and house price inflation have slowed since the start of 2017 and a further weakening in new housing activity is forecast for next year. Real household earnings are being squeezed by higher inflation and slower economic growth. This is forecast to hit the sale of new homes, although the Government's extension of Help to Buy support for purchasers of new homes to 2021 will temper the decline.

In response to slowing new house sales, housebuilders are reducing the number of new site openings as they focus on building out their existing developments.

In contrast the Build to Rent market is growing rapidly. Last year saw £750 million worth of Build to Rent projects start on site involving more than 5,500 residential units. Further strong growth is anticipated over the forecast period.

Social Housing

2017 -2% 2018 -1%

Student accommodation is an important growth area as activity weakens elsewhere in the sector

Project starts during the first nine months of 2017 were 6% down on 2016.

- Improved development pipeline following Government 'U-turn' on Right to Buy
- Safety work to existing estate immediate priority
- Disruption to planned development programmes post-Grenfell
- Student accommodation important growth area

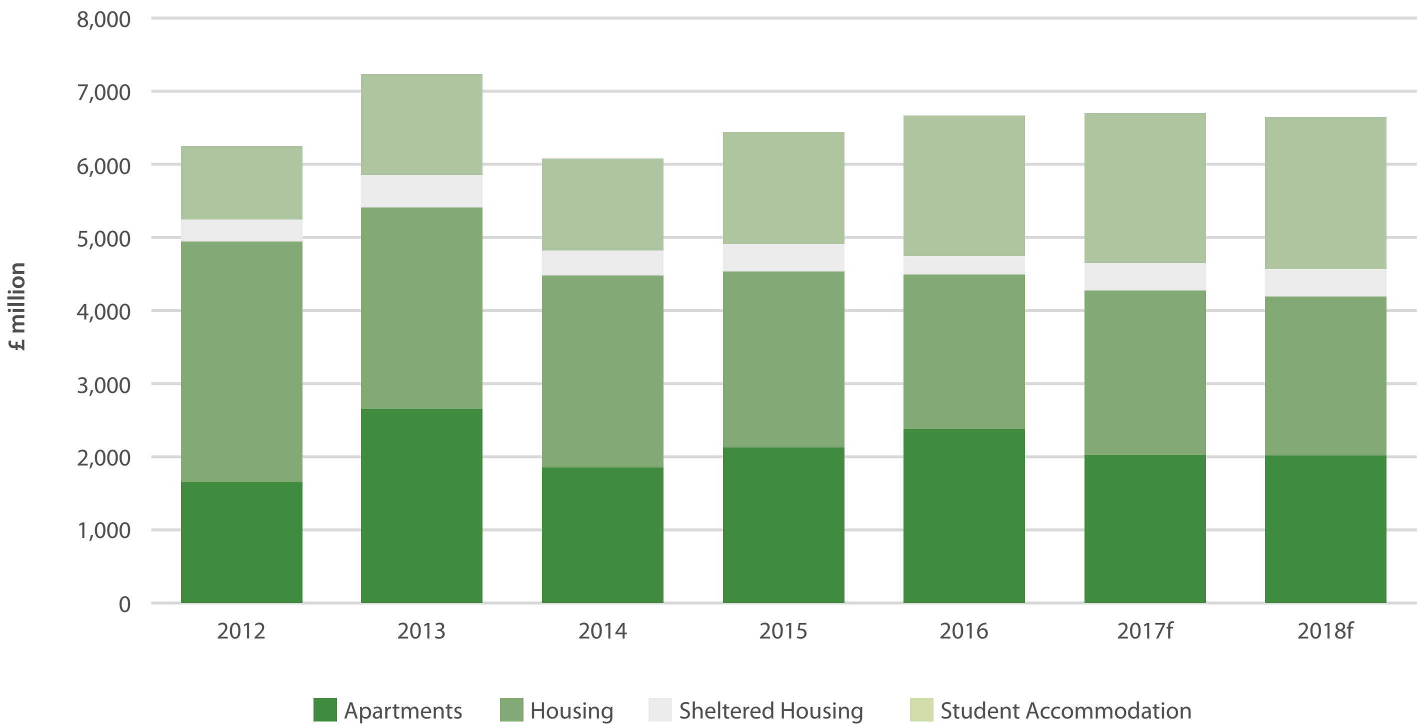
Social Housing Starts			
	2016	**2017f**	**2018f**
£ million	6,675	6,570	6,518
Growth	4%	-2%	-1%

Near term, the progress of planned developments is being disrupted as associations review the implications of the Grenfell fire for refurbishment and new build schemes.

The Government's decision to defer the extension of the "Right to Buy" to housing association tenants is encouraging associations to bring forward new projects.

The value of detailed planning approvals during the first nine months of 2017 was 13% up on a year ago. We expect this improved development pipeline to soften the decline in sector activity next year.

Chart 2: *Value of underlying social housing starts by type of development*



Student accommodation has been an important niche market for private sector developers. The value of student accommodation projects starting on site grew by 25% last year. The development pipeline is also strong, despite a drop in planning approvals in recent months. Student accommodation work is forecast to remain an important driver for sector activity during 2018.

Industrial

2017 +17%   2018 +6%

Strong demand for logistics space is driving significant sector growth.

Industrial project starts are forecast to recover during 2017 and 2018, driven higher by renewed investment in logistics facilities.

- UK manufacturers benefiting short- term from weaker pound
- Manufacturers' investment in new capacity and manufacturing premises delayed by uncertainty over domestic demand and access to Single Market
- Renewed investment in logistics space countering manufacturing weakness
- Midlands and North West prime areas for sector growth

Industrial Starts			
	2016	**2017f**	**2018f**
£ million	2,931	3,431	3,639
Growth	-26%	17%	6%

Chart 3: *Capital expenditure by UK manufacturers*

Source: ONS

Future investment in new capacity and premises will be determined by long term growth prospects. Manufacturers' investment in new buildings fell by 11% last year, while expenditure on plant and machinery also slipped by 4%. Manufacturers' concerns over the prospects for domestic demand as UK economic growth weakens and uncertainty over future access to the Single Market is expected to deter investment in new manufacturing capacity and building work over the forecast period.

Chart 4: *Value of underlying Industrial starts by category*

Source: Glenigan

Warehousing and logistics have been the fastest growing segment within the industrial sector in recent years. The value of starts quadrupled to £1.5 billion between 2009 and 2015. After a sharp fall in project starts in the immediate aftermath of the EU referendum, investor confidence and project starts have recovered.

Demand for logistics space is driven 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.

We expect this structural change to be a long term driver for warehousing and logistics projects as online retailing takes an ever larger share of retail sales and as retailers adapt to changing spending patterns and shopping habits. 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.

Offices

2017 -13%   2018 -10%

Regional developments will temper the impact of a declining London market on sector activity.

Political and economic concerns arising from the EU referendum depressed project starts during 2016 and 2017. These concerns are expected to persist during 2018 as investors appraise the implications of Brexit and of slower UK economic growth for the demand for office space and rental values.

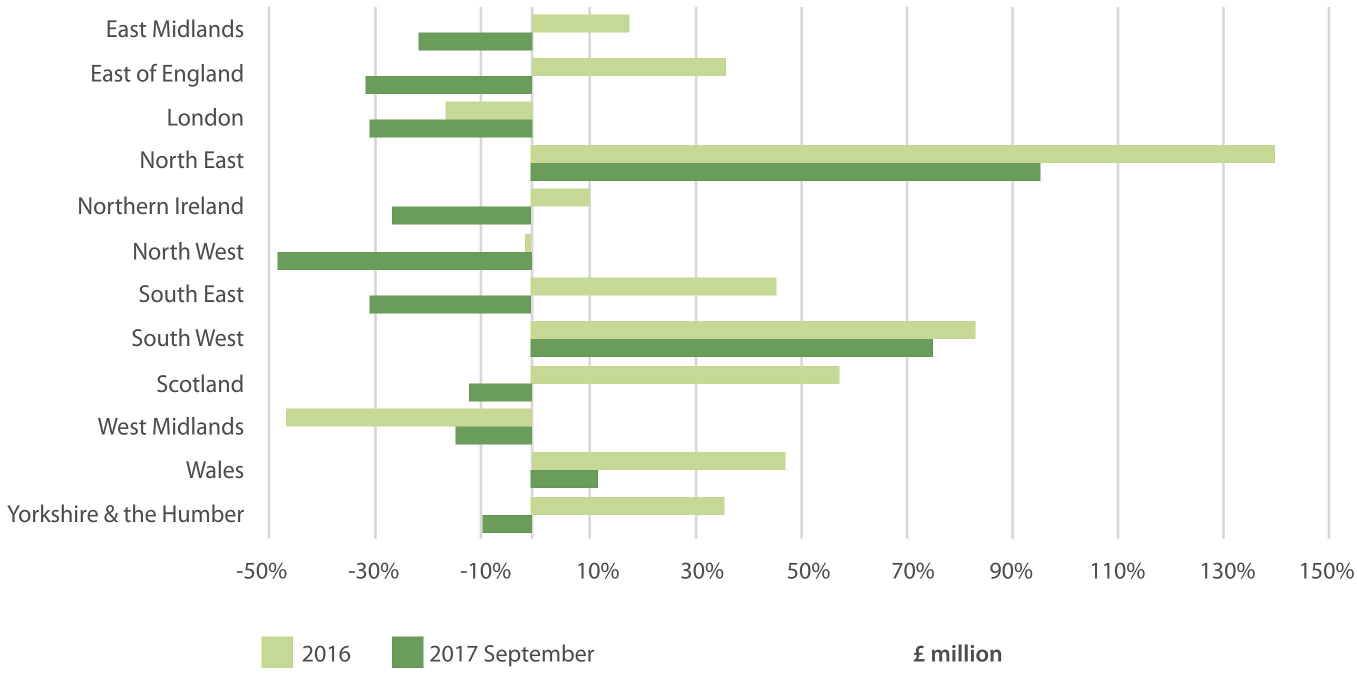
- Slower UK economic and employment growth to dampen demand for office space
- City & Dockland development activity vulnerable to uncertainty over UK financial sector's post-EU future
- Opportunities for refurbishment & conversion of secondary office accommodation

Office Starts			
	2016	**2017f**	**2018f**
£ million	4,613	4,008	3,594
Growth	5%	-13%	-10%

London dominates the office sector, accounting for around half of all activity. Although the capital still has a substantial development pipeline, the number of planning approvals has slipped back over the last two years. Starts in London during the first nine months of 2017 were 13% down on the last year and we anticipate a further weakening in starts during 2018. Developments in the City of London and Docklands will be especially vulnerable with weaker demand for accommodation as financial institutions consider relocating operations to elsewhere within the EU.

However, regional centres rather than the capital have been the recent focus for development activity. Demand for more high quality office space has been growing in the UK's 'core' cities. This rising demand for office accommodation and a previous lack of development activity has tightened the supply of available office space in Manchester, Birmingham, Leeds and other major regional centres.

Chart 5: *Value of underlying detailed planning approvals for office projects*



The East of England, North West, West Midlands, South East and Yorkshire and the Humber all saw a marked rise in the value of project starts last year.

Project starts outside of the capital have remained firm during the first nine months of 2017, in large part due to sharp rises in development activity in the Newcastle and Bristol office markets.

Whilst we expect that the regional centres will continue to outperform London over the forecast period, the value of project starts is still expected to weaken next year following a drop in detailed planning approvals. Nationally the value of underlying project starts will fall 13% this year. A further 10% decline is forecast for 2018.

Retail

2017 -4%   2018 +1%

Weak sector activity as investment in new retail developments is hit by faltering consumer spending and the growth of on-line retailing

Retailers face challenging market conditions over the coming year as rising inflation squeezes household budgets and on-line purchases take a growing slice of retail sales. Against this backdrop, new build retail projects will remain in short supply during 2017, as many retailers look to rationalise and refurbish their existing estate.

- Demand for retail space hit by weak household earnings and growth in on-line retailing
- Retailers rationalising estate as costs rise and sales volumes falter
- Refurbishment of retained premises to attract customers and support on-line offering
- Shopping centres increasing their leisure offer to capture footfall

Retail Starts

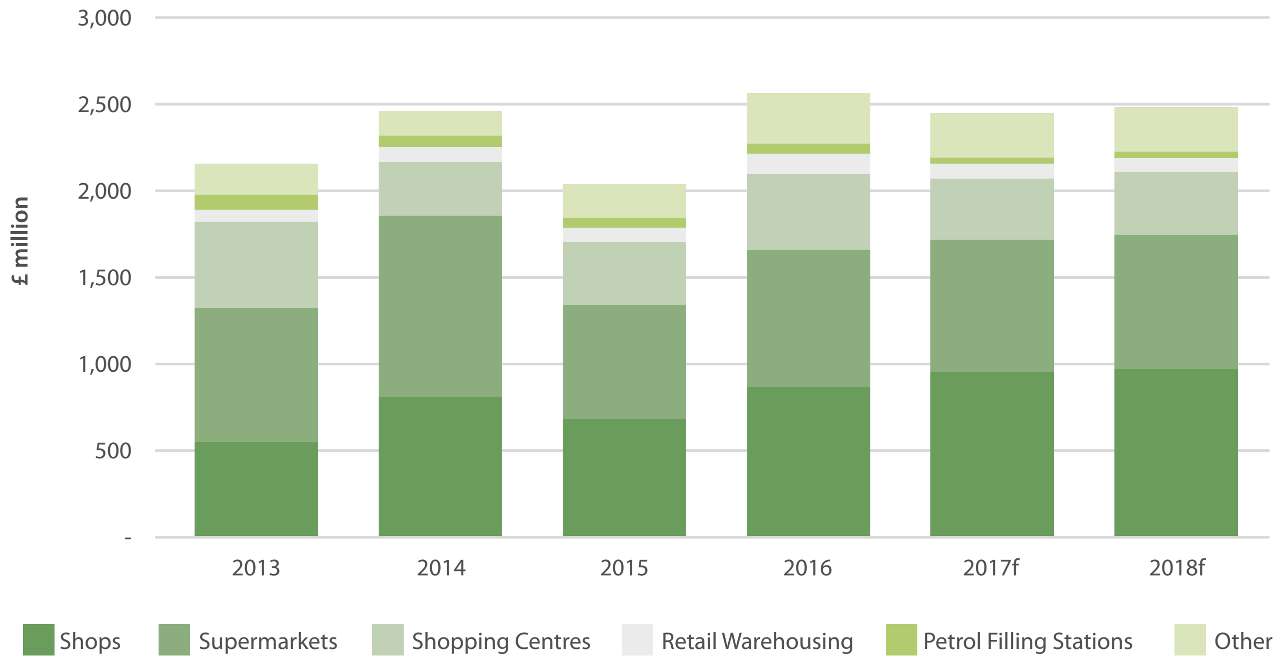
	2016	2017f	2018f
£ million	2,552	2,444	2,474
Growth	25%	-4%	1%

The retail development pipeline is subdued. Although last year saw a 25% jump in retail starts, this has proved short-lived with starts in the first nine months of 2017 13% down on a year ago.

Falling in-store sales have prompted retailers to review their retail estates as a growing proportion on their sales are generated on-line. The leading supermarket chains have scaled back and refocussed their investment programmes towards the convenience store format. This often entails the conversion of existing high street premises rather than the construction of new stores. Only the deep discounters, Lidl and Aldi, have substantial new store development programmes.

Other High Street retailers are similarly focused on store re-modelling, driven by high competition and efforts to accommodate click and collect services. The adaptation and re-fitting of existing stores will be a key area of activity in 2018.

Chart 6: *Value of underlying Retail starts by category*



Source: Glenigan

Rising on-line retail sales are also a spur to investment at established shopping centres with landlords seeking to enhance their attraction to consumers by investing in more leisure and dining facilities. Many of the larger projects to start on site last year were enhancements to established shopping centres and designer retail outlets.

Slower retail sales growth and the rise of on-line retail sales is forecast to feed through to a decline in the value of retail starts over the next two years. We expect project starts to fall by 4% this year after the spike in starts during 2016, with a small 1% rise forecast for next year.

Hotel and Leisure

2017 +9% 2018 +20%

Strong growth forecast as operators & investors benefit from increased tourism and press on with planned developments.

The Hotel and Leisure sector has emerged as an early beneficiary of the Brexit vote; the marked fall in Sterling since the start of 2016 has enhanced the UK's appeal as a tourist destination. The number of overseas visitors to the UK during the first half of this year was 9% up on a year ago, with spending 11% higher.

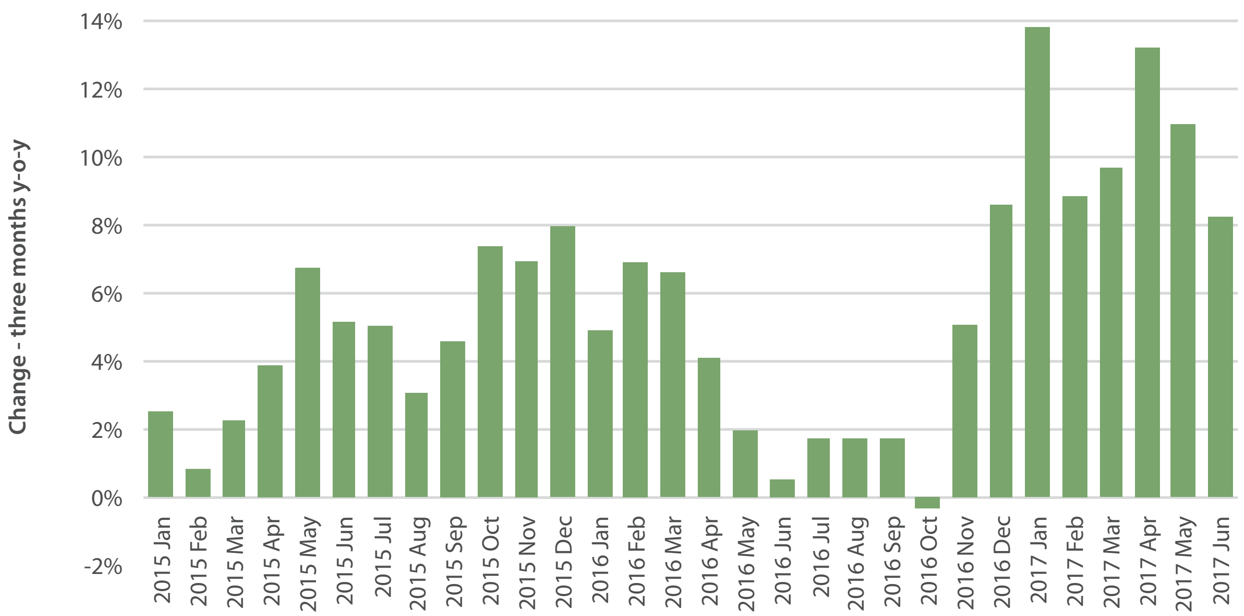
- Tourism boost from weaker pound
- More UK residents also expected to holiday in UK
- Hotel chains have significant expansion plans
- Strong development pipeline

Hotel & Leisure Starts

	2016	2017f	2018f
£ million	3,018	3,292	3,938
Growth	-3%	9%	20%

The renewed growth in overseas visitors bodes well for the hotel and leisure sector, with the rise in spending encouraging investors to press on with planned developments.

Chart 7: *Growth in Overseas Visitors to the UK*

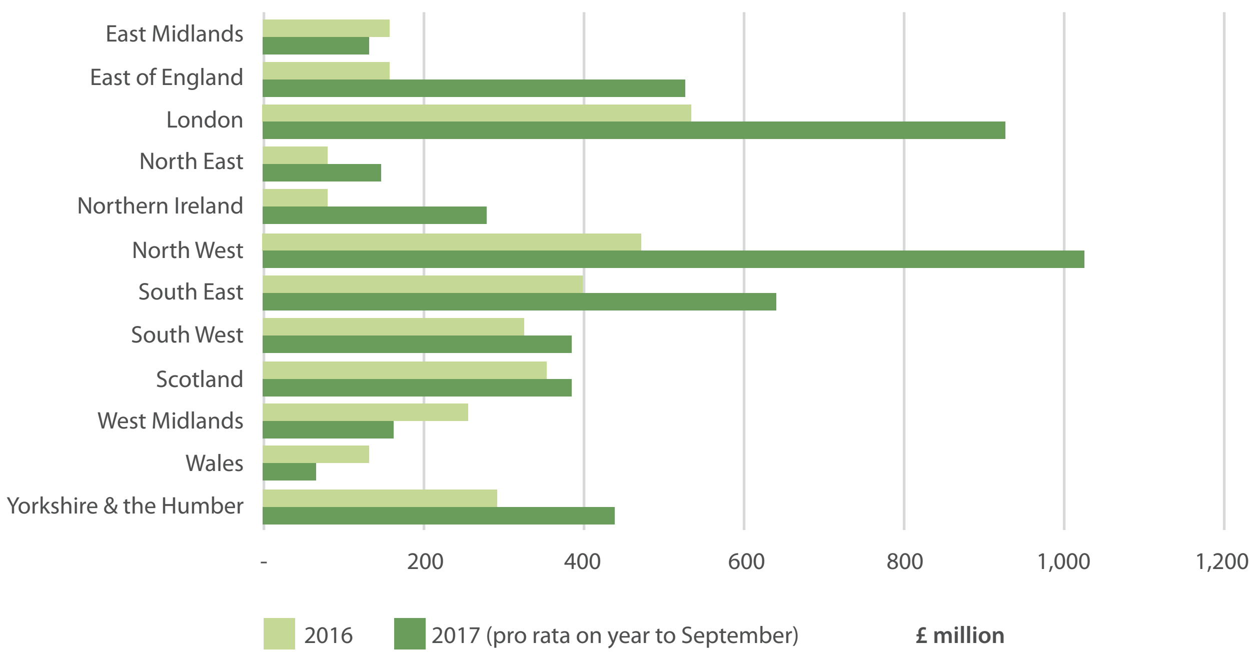


Source: ONS

Although overall consumer spending growth will be constrained over the coming year by weakening employment levels and higher inflation, the hotel and leisure sector is well placed to take a greater share of the available discretionary spending. The weaker pound is expected to prompt more UK consumers to holiday in the UK, providing a boost to hoteliers, restauranteurs and leisure facilities across the country.

The pre-construction development pipeline has been growing progressively since 2015. This growth has begun to feed through to project starts, which rose 8% last year. The expansion in proposals has accelerated since the start of the year, with the value of projects granted planning approval during the first nine months of 2017 being 52% up on a year ago. This strengthening pipeline combined with the tourism boost from the weaker pound is forecast to drive sector growth over the forecast period. We anticipate that projects starts will rise by 9% this year, with 20% growth anticipated for 2018.

Chart 8: *Value of underlying detailed planning approvals for hotel and leisure projects*



Source: Glenigan N.B. 2017 to September - pro rata for full year

Education

2017 -19% 2018 +10%

Increase in university and secondary school building projects forecast to drive sector growth from 2018.

Increased university investment and rising pupil numbers promise to drive investment in expanded and new higher education and secondary school facilities over the next five years.

- New & expanded secondary schools needed as pupil numbers rise
- Universities investing to attract UK and overseas students
- Threat to university research funding as UK leaves EU

Education Starts			
	2016	**2017f**	**2018f**
£ million	6,913	5,622	6,167
Growth	-3%	-19%	10%

Near term, councils constrained by limited funding and the availability of suitable sites are likely to accommodate rising pupil numbers through the expansion of existing schools.

Planning approvals for schools fell back sharply in 2016, reversing a progressive rise in approvals during the preceding two years. Approvals have weakened further during the first nine months of 2017, being 22% down on a year ago. This shrinking development pipeline will restrict new build starts in the near term.

Investment in higher education facilities has been a growth area as universities compete to enrol both domestic and overseas students. The value of university starts rose 14% to £1.5 billion last year. The rise followed a near doubling in the value of planning approvals during 2014 and 2015.

The EU referendum vote raised concerns over UK universities' future access to EU research funding and participation in related collaborative research. This may have contributed to the dip in projects securing planning approval last year which is currently feeding through to a decline in project starts. However, a sharp recovery in approvals during the first nine months of 2017 points to renewed growth next year.

Whilst a weakening in both school and university projects have contributed to an estimated 19% decline in education sector starts this year, the prospects for the sector in 2018 are brighter. The re-invigorated development pipeline is expected to help drive university project starts over the coming year. In addition the need for additional school capacity is expected to feed through to an increase in school building projects. Overall sector starts are forecast to grow by 10% next year.

Chart 9: *Value of underlying Education starts by category*

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

Health

2017 -3% 2018 +3%

Modest rise in starts forecast for 2018 following rise in planning approvals this year.

NHS funding remains high on the political agenda. However front-line services, rather than longer term capital expenditure, are likely to have first call on any additional resources.

- NHS capital budgets squeezed by wider funding pressures
- Increase in laboratory and research projects
- Social care in political spotlight, but little additional funding
- Longer term, investment needed in new, modern social care facilities

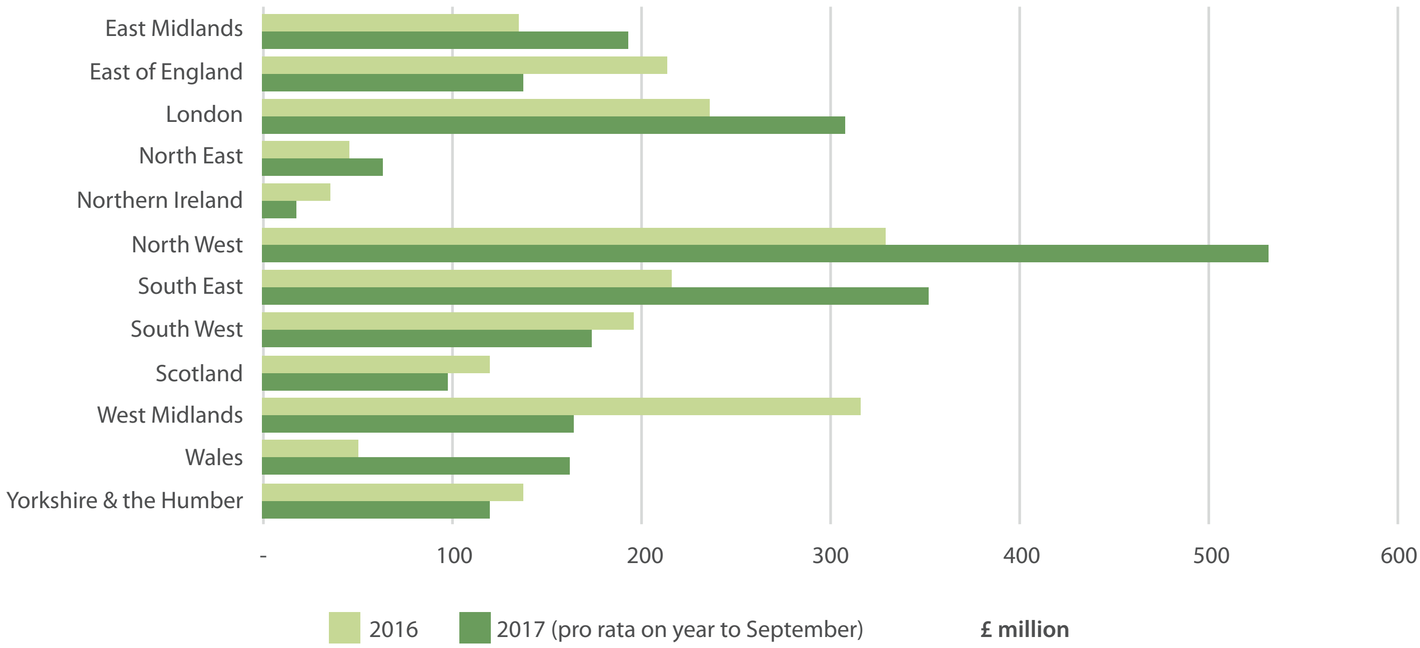
Health Starts			
	2016	**2017f**	**2018f**
£ million	2,112	2,055	2,108
Growth	9%	-3%	3%

Last year saw a recovery in starts as NHS trusts progressed schemes following an earlier election-related disruption to development programmes. Project starts have been slightly weaker than anticipated during 2017, with this year's snap election appearing to have a more disruptive impact on the timing of planned projects than we expected. The value of project starts during the first nine months of 2017 was 9% down against a year ago, in large part due to a sharp fall in starts during the third quarter, but we expect a stronger final quarter performance to limit the decline for the year to 3%.

Funding for social care is also in the political spotlight. Social care providers are being squeezed by limited public funding, rising costs and staff recruitment problems. Near term these pressures are likely to accelerate the closure of existing facilities and deter investment in new premises. Over the longer term, however, this may open up opportunities for investment in new modern facilities to provide support for a growing elderly population.

The current year has also seen an improvement in projects securing planning approval, after two years of little change. At £1.7 billion the value of approvals during the first nine months of 2017 was 7% up on a year ago. This is expected to support a 3% rise in project starts next year.

Chart 10: *Value of underlying detailed planning approvals for health projects*



Source: Glenigan N.B. 2017 to September - pro rata

Civil Engineering

2017 -8%   2018 -15%

Major infrastructure schemes, including Thames Tideway, HS2 and Hinckley Point, are forecast to drive sector activity over the forecast period. However the value of underlying project starts is forecast to fall back as investment in smaller scale projects is overshadowed by these major schemes.

Energy industry work currently dominates the civil engineering sector. The ONS estimate that energy projects accounted for 43% of sector output in 2016. Energy is set to remain a major driver for growth over the forecast period.

- Energy sector dominates sector workload
- Network Rail's current investment programme constrained, but increased investment planned from 2019
- Work on HS2 getting underway
- Highways England's development programme gathering moment
- Increased water industry investment

Civil Engineering Starts

	2016	2017f	2018f
£ million	5,556	5,101	4,432
Growth	-28%	-8%	-15%

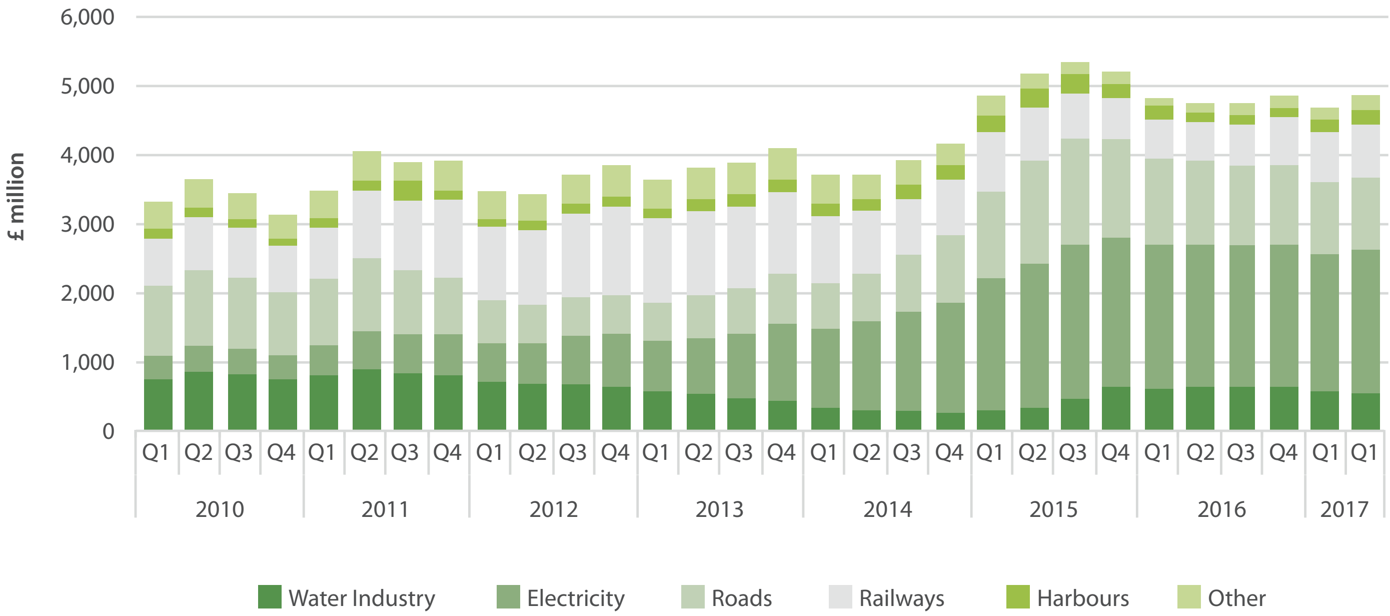
Major projects make up a significant proportion of energy industry workload, a trend that was amplified by the Government's decision to reduce support for smaller scale renewable schemes. The Government is now looking to new gas-fired plants as well as Hinckley Point 'C', and off-shore wind, to bridge the UK's generating capacity gap.

Work on HS2 is now contributing to sector activity as various contracts start on site. In contrast, Crossrail will make a diminishing contribution to sector activity as work on the line nears completion. Investment in the existing rail network is currently constrained following the scaling back of Network Rail's current capital programme (CP5) due to project cost overruns. Under the revised programme, priority has been given to the electrification of the Great Western line to Bristol and Wales. However, at £47.9 billion, Network Rail's CP6 programme promises to boost sector activity over the five years from 2019.

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

The current Water Industry investment cycle, AMP6, is also gathering momentum, with sector activity benefiting from major work packages for the £4 billion Thames Tideway Tunnel.

__Chart 11:__ Infrastructure Construction Output



Source: ONS

Key Recommendations

- Overall construction activity will weaken during 2018, but there will be a sharp divergence in workload across different sectors and parts of the country. Industrial, hotel and leisure, and education sectors are forecast to be areas of strong growth, with the North of England, Midlands and Scotland outperforming the UK as whole. Companies will need to closely monitor and respond to shifting market conditions to maintain and build their order books. Investment in an effective CRM system, digital marketing channels and a modernised salesforce will help firms to rapidly target emerging opportunities.
- The UK's departure from the EU is exacerbating the difficulty in recruiting skilled site labour. This threatens to increase construction costs and disrupt the timely delivery of projects. Companies should invest in design solutions, site operating practices and offsite manufacturing options that reduce the reliance on site labour to safeguard the timely and profitable delivery of projects.
- The fall in Sterling has increased UK product manufacturers' energy and raw material costs as well as increasing the price of imported products. Firms will need to adequately reflect rising labour and construction costs when tendering for projects.

Do you need reliable insight and statistics to help you budget, forecast, realise size of market or penetration?

Do you need a better understanding of your competitor's activities, or would you like to see the trends shaping the future of construction?

If so, then we can help.

Contact us today to discuss your strategic business requirements:

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