Glenigan

# UK Construction Industry Forecast 2021-2023

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# About the authors

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Allan heads up Glenigan's Economics Unit and has over 30 years' experience in providing insightful market analysis and forecasts on UK construction and the built environment. Following 20 successful years as Economics Director at the Construction Products Association, Allan joined Glenigan 12 years ago. During this time Allan and his team have helped hundreds of businesses confidently develop their market strategies.

Allan sits on the Consulting Committee on Construction Industry Statistics for the Dept for Business, Energy & Industrial Strategy (BEIS), is member of a Construction Leadership Council working group and is a guest lecturer in construction at the University of Reading.

Integral to the Glenigan Economics team, Rhys' analysis and reporting of UK construction industry trends and performance regularly supports businesses in their key strategic decision-making.

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# Economic Background

The COVID-19 pandemic has dramatically reshaped the outlook for UK construction activity, as it has for the UK and world economies. The Glenigan forecasts take stock of the direct impact of the pandemic upon the industry and assess the industry's expected path to recovery.

The forecasts are built upon the analysis of Glenigan's database of current and planned construction projects which are modelled with other market and economic variables. The modelled data has then been further analysed to take account of the potential change in historic trends and relationships in light of the pandemic.

Construction industry growth over the forecast period will be shaped by the UK's and the global path out of the pandemic as well as the response by the private sector and in particular the Government.

The key assumptions around which the forecasts are based include:

> **Weak UK growth and the disruption to UK business revenues and confidence deters private sector investment in most non-residential sectors.**

> **Rising unemployment and weak earnings-growth cool housing market turnover from late 2021 and curb the rise in private housebuilding activity.**

> **Increased public sector investment is forecast to underpin the recovery in construction activity. Following the decision to defer the forthcoming Spending Review, the rise in government capital expenditure will build progressively over the forecast period.**

> **Post-Brexit customs regulations and non-tariff barriers are expected to disrupt supply chains both for the construction industry and across the wider UK economy. Brexit and the pandemic have intensified labour shortages both in construction and supporting industries such as logistics. This is expected to disrupt the economic recovery from the pandemic.**

> **The strength of the initial recovery in construction activity has thrown a spotlight on the impact of supply-side constraints on the pace of growth. We expect supply-side issues to be a factor tempering the pace of growth over the forecast period. The potential impact of supply-side constraints is explored in more detail below.**

## MATERIALS & LABOUR SUPPLY

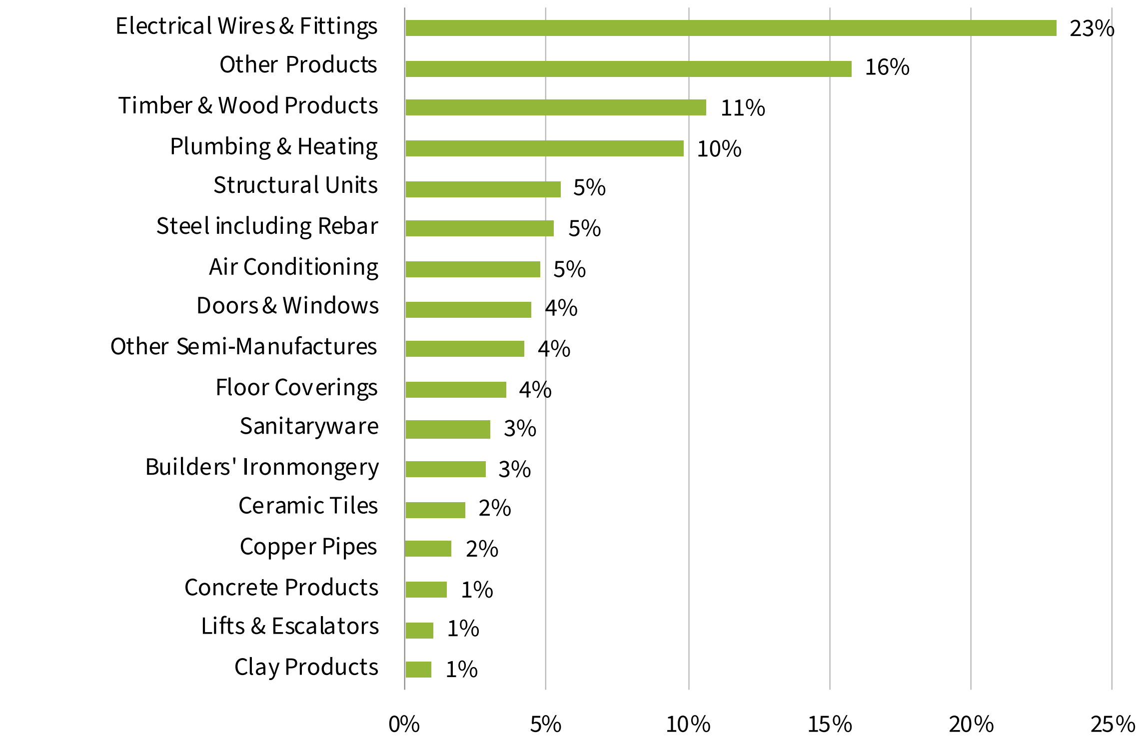
The limited availability of a diverse selection of construction products has prompted concerns over industry capacity and the cost and timely delivery of projects. Many of the current shortages will ease by 2022 as manufacturers operating-levels rise and the current disruption to global logistic networks dissipates. Post-Brexit structural changes, however, are expected to reduce the ready availability of EU sourced products.

Many construction product manufacturing operations have been disrupted over the last year by COVID-19-related suspension of operations and reduced staffing levels. Overseas manufacturers have similarly faced a disruption to their operations. After a brief suspension of site operations during the first lockdown the vast majority of construction sites have resumed operations. Whilst on-site staffing levels have been restricted, the productivity of those on-site has increased. Furthermore, there has been a marked recovery in the value of work starting on-site since last autumn and major projects such as HS2 have increased the demand for materials and labour.

Global trade patterns have also been severely disrupted by the pandemic. As economic activity has picked up across the developed economies this has intensified the demand for and increased the price of key commodities including oil, steel and timber. The delivery of manufactured products especially from the Far East has also been disrupted by a shortage of containers, shipping and port capacity due to the disruption to trade flows caused by the initial lockdowns. Closure of the Suez Canal exacerbated these problems.

Domestically produced construction products account for the vast majority of materials used by the UK construction industry. However, imported materials totalled £18.1 billion during 2019, accounting for 24% of construction products used in the UK. Overseas sourced products account for a high proportion of some materials including timber, electrical wires & fittings and plumbing & heating equipment. Extended lead times and restricted product availability in these areas can have a disproportionate impact upon project schedules and costs.

### Chart 1: Construction Product Imports

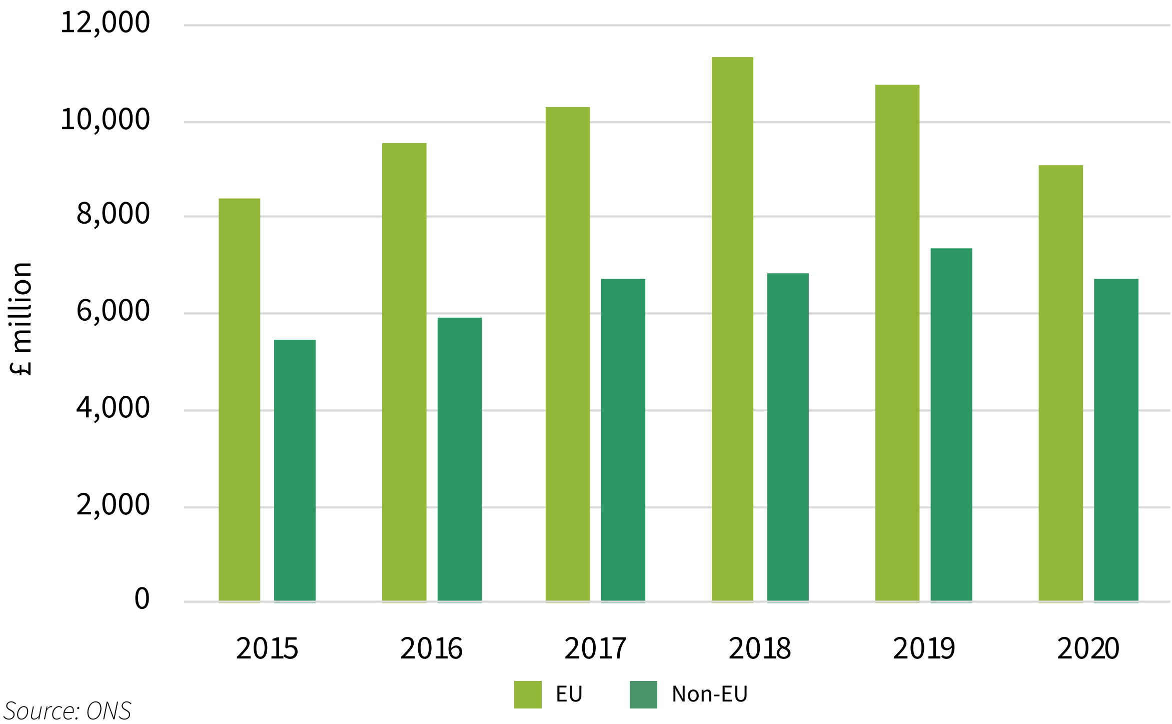



These factors resulted in extended lead times for a number of products and prompted increased ordering by some contractors seeking to ensure a certainty of supply for their projects.

We expect current shortages to ease as manufacturing operations and global trade-flows stabilise during the second half of this year.

However, post-Brexit arrangements have also impacted upon the cost and lead-times for EU sourced materials and are expected to be more permanent, with suppliers increasingly looking to domestic and other non-EU overseas suppliers. Indeed, UK imports of construction products from the EU were already in decline during the transition period. EU imports fell by 20% between 2018 and 2020 against a 2% dip in non-EU imports. The latest ONS data suggests that this shift accelerated during the first four months of 2021.

**Chart 2: Construction Product Imports for EU & Non-EU Countries**




*Source: ONS*

Nevertheless, the overall availability and supply of construction products is expected to improve over the forecast period.

In contrast, the availability of skilled labour, both on-site and in supporting industries is likely to be a growing constraint over the next two years.

Whilst official figures recorded a record 35,000 construction job vacancies during April, the industry still had 174,000 staff on furlough as of May. This should help ease any near-term staffing constraints with furloughed staff re-integrated into the workforce as site operating practices are eased.

Subsequent industry growth, however, will increase labour market pressures. The industry has an ageing workforce, with 21% of staff aged over 55.

The combined impact of Brexit and the pandemic has intensified these pressures with a sharp drop in EU nationals working in the UK. This has included a fall in skilled construction staff and a fall in related trades such as HGV drivers. The decline in the latter has exacerbated current material supply issues, disrupting the delivery of both products into the UK and on to construction sites.

Recruitment, retention and training of staff will be key to expanding industry capacity and firms' profitability over the forecast period, alongside the adoption of measures to reduce the call on on-site labour such as modern methods of construction.

# Executive Summary

| 2021 | 2022 | 2023 |
|---|---|---|
| +28% | +6% | +5% |

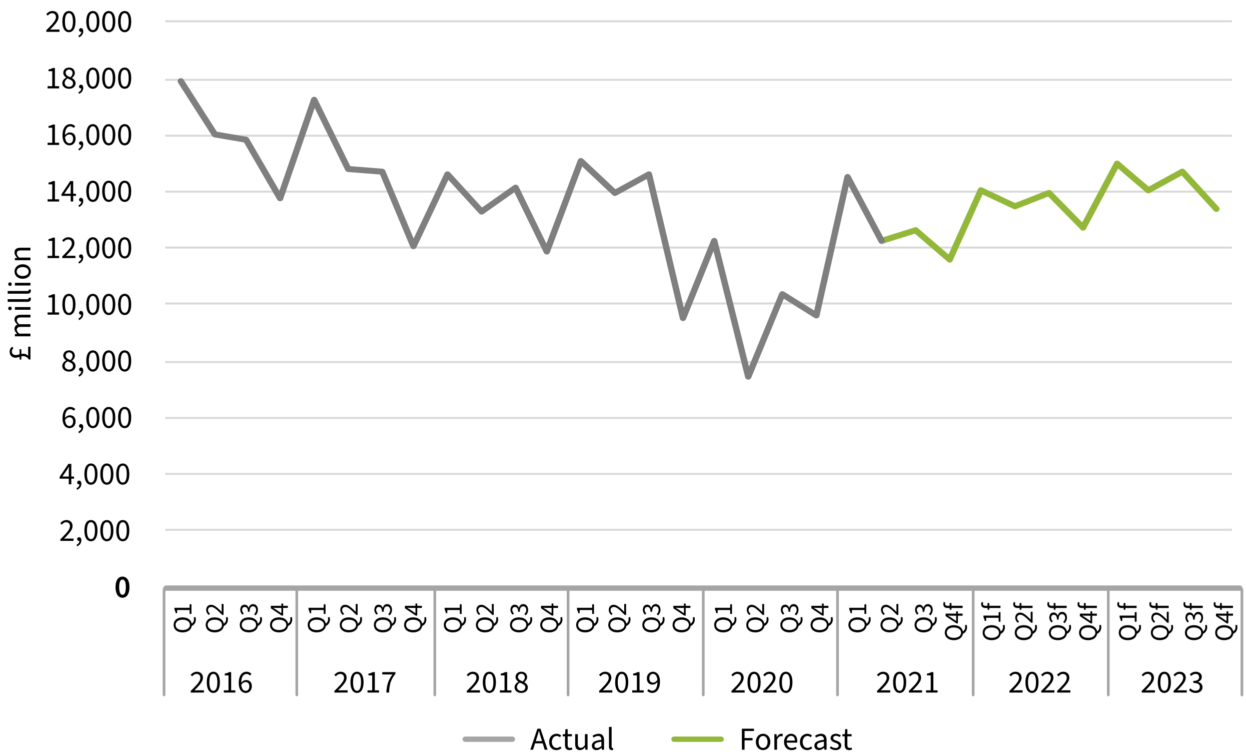
Construction activity has recovered strongly since the start of the year as the vaccine rollout and progressive unlocking of the economy have started to rebuild confidence. The value of underlying project starts during the three months to May rose by 20% and was 70% higher than when the UK was in the midst of the first national lockdown a year ago.

After this sharp initial upturn, a steadier progressive strengthening in project-starts is anticipated over the forecast period. By next year we now expect the value of underlying starts (projects with a construction value of less than £100 million) to total £54.2 billion, 3% above 2019 levels.

However, the recovery will not be evenly spread, with regional and sector champions and laggards reflecting a changing UK economic and social landscape. In addition, the current shortage of construction materials highlights the potential impact of supply-side constraints on the pace of the recovery over the next two years.

- **Private housing growth moderates as unemployment rises and temporary stamp duty reductions end**
- **Greater public sector investment fuels recovery in social housing, health, schools and civil engineering**
- **Rise in office refurbishment work as premises are remodelled**
- **Hotel & leisure sector slow to recover post-pandemic**
- **Online retailing boosts investment in logistics facilities**
- **Major projects boost civil engineering workloads**

## Chart 3: The Value of Underlying Project Starts




*f = forecast*

## Table 1: The Value of Underlying Project Starts by Sector

| £ million | 2019 | 2020 | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|
| **PRIVATE HOUSING** | 17,489 | 11,790 | 18,016 | 19,931 | 20,809 |
| **SOCIAL HOUSING** | 6,271 | 5,308 | 6,379 | 7,008 | 7,205 |
| **INDUSTRIAL** | 4,380 | 3,094 | 4,066 | 4,015 | 4,102 |
| **OFFICES** | 4,669 | 3,345 | 4,444 | 4,318 | 4,381 |
| **RETAIL** | 2,125 | 1,266 | 1,967 | 1,573 | 1,374 |
| **HOTEL & LEISURE** | 3,645 | 2,230 | 2,280 | 2,862 | 3,834 |
| **EDUCATION** | 5,534 | 4,079 | 4,157 | 4,636 | 4,794 |
| **HEALTH** | 1,930 | 2,374 | 2,364 | 2,687 | 2,848 |
| **COMMUNITY & AMENITY** | 811 | 779 | 750 | 907 | 989 |
| **INFRASTRUCTURE** | 4,247 | 3,653 | 4,669 | 4,262 | 4,596 |
| **UTILITIES** | 2,152 | 1,816 | 1,936 | 2,068 | 2,197 |
| **CIVIL ENGINEERING** | 6,399 | 5,469 | 6,606 | 6,330 | 6,793 |
| **TOTAL** | **53,254** | **39,734** | **51,028** | **54,267** | **57,129** |

## PRIVATE NON-RESIDENTIAL WORK

The rapid roll-out of the vaccination programme has supported a faster than anticipated upturn in both construction and the wider economy. The consensus of independent forecasters is that the UK economy will grow by 6.7% this year, while the Bank of England expects UK output to return to pre-COVID levels by the end of this year.

The speed of the initial recovery has generated pinch-points as some manufacturers' operational capacity has been restricted by COVID-19-safe working practices and logistics disruptions have hit just-in-time supply chains. Many, but not all, of these constraints should gradually dissipate during the second half of the year.

Whilst the initial recovery has boosted UK manufacturing activity, over the medium-term manufacturers face sluggish domestic sales growth and weak overseas demand. Although a free trade agreement with the EU is in place, UK manufacturers now have less favourable access to the EU single market, increased border and other administrative costs, and potential disruption to EU sourced supply chains. Against this background we anticipate a continued weakening in manufacturing investment over the forecast period.

In contrast, warehousing and logistics premises are forecast to remain a growth area. Savills estimate that the amount of large warehouse space has already grown by 24% over the last six years, bolstered by long-term growth in online retailing which is driving the demand for logistics space. The pandemic has accelerated the growth in online sales which will help ensure the further expansion of warehousing and logistics activity during the forecast period.

Whilst the pandemic and repeated lockdowns has boosted the demand for logistics space, it exacerbated the woes faced by more traditional retailing. Whilst consumers are now returning to high streets and retail parks, online purchases are expected to retain much of the increase in market share gained during the pandemic. Where consumers wish to shop off-line is also changing, with more households working remotely and potentially shopping locally. Nevertheless, overall retail sector activity is forecast to decline as an overhang of empty retail premises, weak consumer spending and the growth in online retailing accelerate the restructuring of the retail industry and depress the demand for retail premises.

The leisure and hospitality industries have been especially hard hit by the pandemic. The collapse in the number of overseas visitors to the UK and the COVID-19 regulatory restrictions on facilities' operations have damaged the financial viability of many operating in the sector. Many facilities are still unable to operate at full capacity and overseas visitor numbers will take considerable time to recover. Project-starts fell by 39% last year and investor confidence will be slow to return to the sector.

Office starts declined sharply last year, as the lockdown exacerbated a cyclical downturn in sector activity, but have bounced back sharply during the first five months of 2021. The sector will benefit over the forecast period from a rise in refurbishment projects as tenants and landlords adapt premises to accommodate changing working practices. In contrast, new build office projects are likely to be slower to recover as tenants and developers assess the impact of rising unemployment and a potential structural shift towards remote working on the long-term demand for office accommodation.

## PRIVATE HOUSING ACTIVITY

After the initial disruption of the first national lockdown, the housing market has experienced a 'mini-boom' as pandemic restrictions and remote working fuelled the demand for larger properties, especially in market towns and semi-rural settings. Transaction levels and house prices have also been buoyed by the temporary reduction in stamp duty rates. As suspended projects re-opened, housebuilders prioritised existing sites. This has been followed by a sharp rise in project starts since last autumn. The value of starts during the first five months of 2021 were 6% up on the pre-pandemic levels of two years ago. The current surge in housing market activity is expected to fade during the closing months of this year and in 2022, tempering the recovery in project-starts, as the temporary stamp duty reduction ends and homebuyers' confidence is dented by the weaker economic outlook.

## INCREASED GOVERNMENT INVESTMENT

Greater public sector investment is expected to be a major driver for construction growth over the forecast period, although the immediate priority of tackling the pandemic and the deferral of the Spending Review to later in 2021 are likely to temper the increase in government capital funding.

Whilst the pandemic caused a short-term hiatus in social housing starts last year, renewed growth is anticipated from 2021 supported by increased investment by housing associations. In contrast, student accommodation work faltered during 2019, having been an important growth area for the sector in recent years. The contraction in student accommodation work continued last year, with only a limited recovery for this sub-sector anticipated over the forecast period.

An increase in school building projects is forecast to drive a recovery in education sector activity during 2021 and 2022 as local authorities tackle a shortage of secondary school places. An increase in further education work is also anticipated as FE colleges press ahead with approved projects. A fall in universities capital spending is expected to temper the overall growth in education sector work.

The outlook for the health sector is brightening, with promised increases in NHS capital funding expected to lift project-starts over the forecast period. The Nightingale temporary hospital programme helped lift project-starts by 23% last year. Starts are expected to consolidate after last year's growth before rising by 14% in 2022 and 6% in 2023 as NHS trusts develop and implement their investment programmes.

The Government has pledged to significantly increase investment in the UK's infrastructure. While civil engineering project-starts, along with other sectors, were disrupted and delayed by the lockdown, the sector is set to recover strongly over the forecast period.

Additional public sector funding is potentially available in areas such as roads although it may take time before additional projects are 'shovel ready'. Therefore, we anticipate that, initially, the additional funding increases will be directed at starting smaller improvement schemes and areas such as tackling the maintenance backlog on the nation's roads.

Existing major infrastructure schemes, including Thames Tideway, HS2 and Hinkley Point, are also forecast to lift civil engineering output over the forecast period. The £1.4 billion Stonehenge Tunnel is now scheduled to start at the end of next year, although important planning and contracting hurdles have yet to be cleared.

### Table 2: Growth in the Value of Underlying Project Starts by Sector

| £ Million | 2019 | 2020 | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|
| **PRIVATE HOUSING** | -4% | -33% | 53% | 11% | 4% |
| **SOCIAL HOUSING** | 0% | -15% | 20% | 10% | 3% |
| **INDUSTRIAL** | -1% | -29% | 31% | -1% | 2% |
| **OFFICES** | 2% | -28% | 33% | -3% | 1% |
| **RETAIL** | -9% | -40% | 55% | -20% | -13% |
| **HOTEL & LEISURE** | -3% | -39% | 2% | 26% | 34% |
| **EDUCATION** | -10% | -26% | 2% | 12% | 3% |
| **HEALTH** | -21% | 23% | 0% | 14% | 6% |
| **COMMUNITY & AMENITY** | -7% | -4% | -4% | 21% | 9% |
| **INFRASTRUCTURE** | 27% | -14% | 28% | -9% | 8% |
| **UTILITIES** | 25% | -16% | 7% | 7% | 6% |
| **CIVIL ENGINEERING** | 27% | -15% | 21% | -4% | 7% |
| **TOTAL** | **-1%** | **-25%** | **28%** | **6%** | **5%** |

# Private Housing

| 2021 | 2022 | 2023 |
|---|---|---|
| +53% | +11% | +4% |

> **The first lockdown largely affected project-starts with the closure of many sites**

> **Strong potential development pipeline**

> **Weak household earnings and rising unemployment may overshadow housing market growth once the cut to Stamp Duty comes to an end**

> **Sharp growth in 2021 followed by a steady increase in 2022 and 2023**

The lockdown in the Spring of 2020 hit the private housing sector especially hard during the second quarter. As suspended projects were re-opened, housebuilders prioritised sites that were close to completion to meet the original deadline for the cut to Stamp Duty Land Tax, which has since been extended to June and September. Because of this, the ‘mini boom’ in the housing market continued into the summer but is now beginning to show signs of waning as the temporary reductions are gradually withdrawn.

PRIVATE HOUSING STARTS

| | 2019 | 2020 | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|
| **£ million** | 17,489 | 11,790 | 18,016 | 19,931 | 20,809 |
| **Growth** | -4% | -33% | 53% | 11% | 4% |

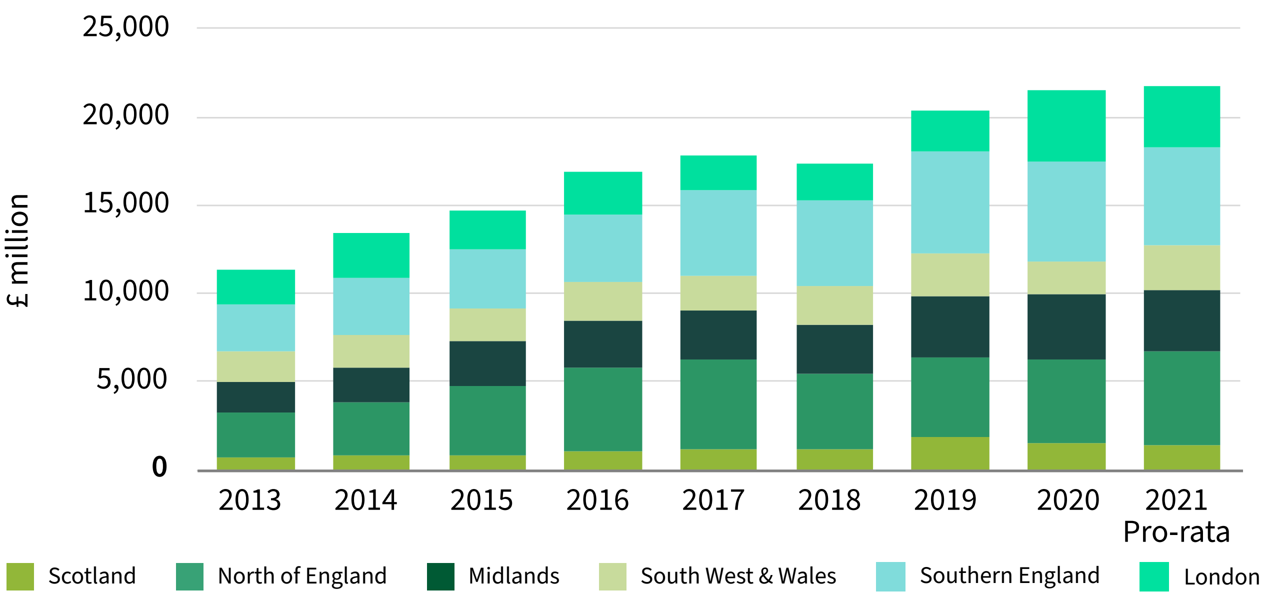
*f = forecast*

The value of private housing projects starting on-site fell for a third consecutive year during 2020, declining by 33% as housebuilders were largely affected by UK-wide site closures during the first national lockdown. Housebuilders also prioritised sites nearing completions as they required fewer people on-site and provided a more immediate source of revenue as completed homes were sold, particularly with the cut to Stamp Duty Land Tax.

However, project-starts have performed very well during the first five months to May, increasing 70% against the previous year. As existing sites were completed during the second half of 2020 and as housebuilders adapted to new working practices, housebuilders have switched their attention to new developments. Overall private housing starts are forecast to increase 53% this year and 11% in 2022. By the end of the forecast period, private housing project-starts are anticipated to reach 2017 levels.

The value of projects securing planning approval has strengthened in recent years with growth in every year since 2015 except for 2018 when project-approvals fell slightly by 3%. The value of project-approvals in 2020 held up despite the pandemic and increased 5% against the previous year. Detailed planning approvals in 2021 have been strong, with a 41% increase in approvals during the five months to May.

### Chart 4: The Value of Residential Approvals by Region and Year




*Source: Glenigan*
*N.B. 2021 based on January to May*

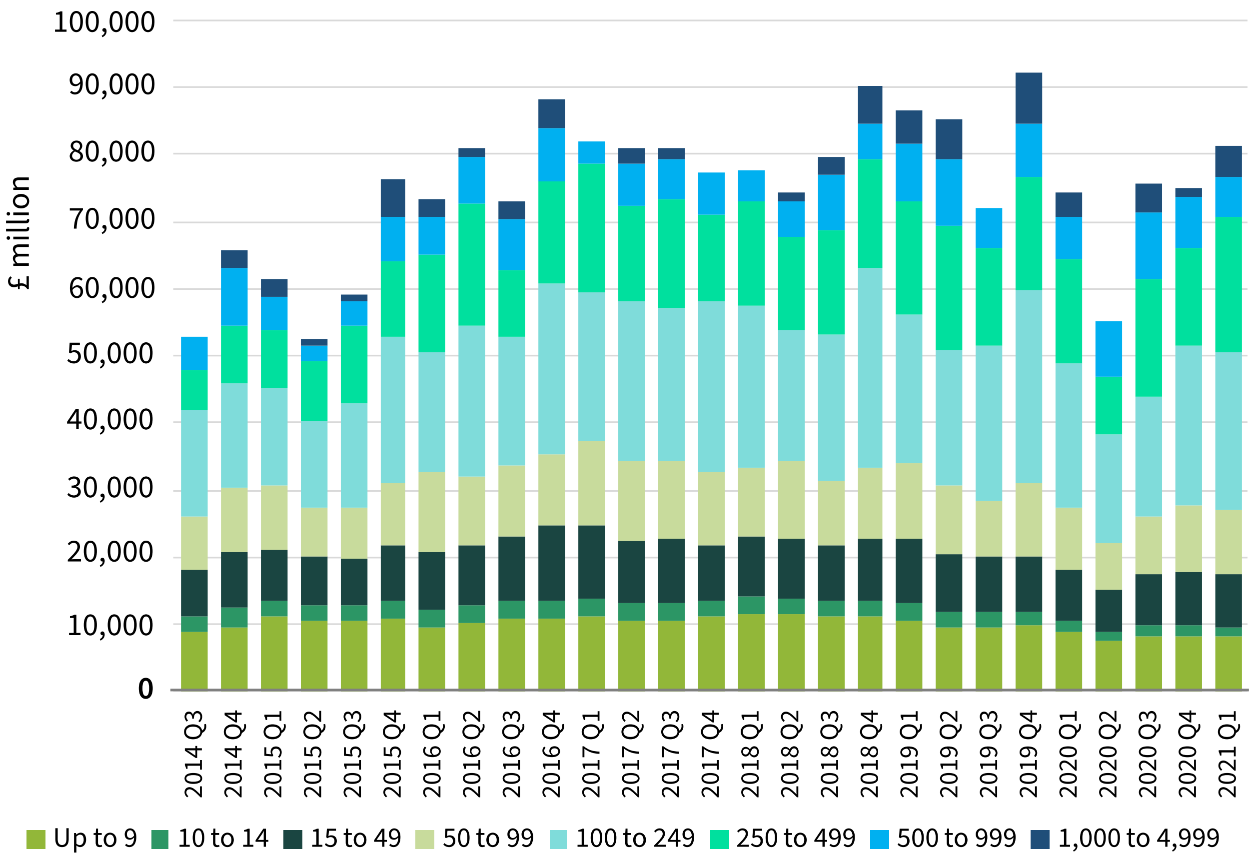
The wider housing market was effectively frozen a year ago but has been strong since the end of the first national lockdown. The number of mortgage approvals peaked in November 2020 at their highest level since late-2007. Mortgage approvals steadily declined during the first quarter of 2021 but returned to growth in April 2021. The Nationwide reported that in April 2020 housing transactions reached a record low of 42,000, but activity surged towards the end of last year and into 2021, reaching a record high of 183,000 in March 2021. The Nationwide also reported that annual house price growth increased to 10.9% in May 2021, the highest level in almost seven years.

The current 'mini boom' in the housing market and house prices has in large part been due to pent up demand and the temporary reduction in stamp duty rates. With the end of the Stamp Duty Land Tax cut approaching, house price growth has started to ease month-on-month and housing market transactions have fallen sharply.

Furthermore, there appears to be a shift in buyer interest out of larger cities towards smaller towns and villages. The 'race for space' in part reflects a change in lifestyle with more remote working expected, with less frequent but longer commutes to the office and a desire for more open spaces following the strict lockdowns in 2020 and 2021. In March 2021 property website Rightmove reported that Cornwall overtook London as the most searched location for UK movers. This was also reflected in house prices, with London returning the lowest annual growth for the fifth consecutive month in April 2021.

Demand and house price growth has also been strongest for larger properties that can better incorporate home offices. In contrast the sale and price of apartments has been declining, with the cladding crisis an additional deterrent for potential purchasers.

## Chart 5: The Value of Residential Approvals by Region and Year




*Source: Glenigan*

The wider housing market is expected to cool over the coming months as the temporary reduction in stamp duty is partially withdrawn from July before ending in September. Higher unemployment and economic uncertainty are subsequently expected to restrain property transactions and house price inflation during 2022 and 2023. We expect this to temper the rise in new activity, with project-start rising by 11% next year and 4% in 2023.

# Social Housing

2021 +20% 2022 +10% 2023 +3%

> **Student accommodation projects heavily affected by the pandemic**
> **Housing associations better-placed to finance new developments**
> **Increased support for shared ownership developments**

The pandemic caused a short-term decline in project-starts in 2020 but renewed growth is anticipated from 2021 supported by increased investment from housing associations. Student accommodation work has been weak during the last couple of years, falling sharply in 2019 and 2020 despite growth elsewhere in the sector. We anticipate student accommodation starts to gradually increase but remain below 2018 levels by the end of the forecast period.

**SOCIAL HOUSING STARTS**

| | 2019 | 2020 | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|
| **£ million** | 6,271 | 5,308 | 6,379 | 7,008 | 7,205 |
| **Growth** | 0% | -15% | 20% | 10% | 3% |

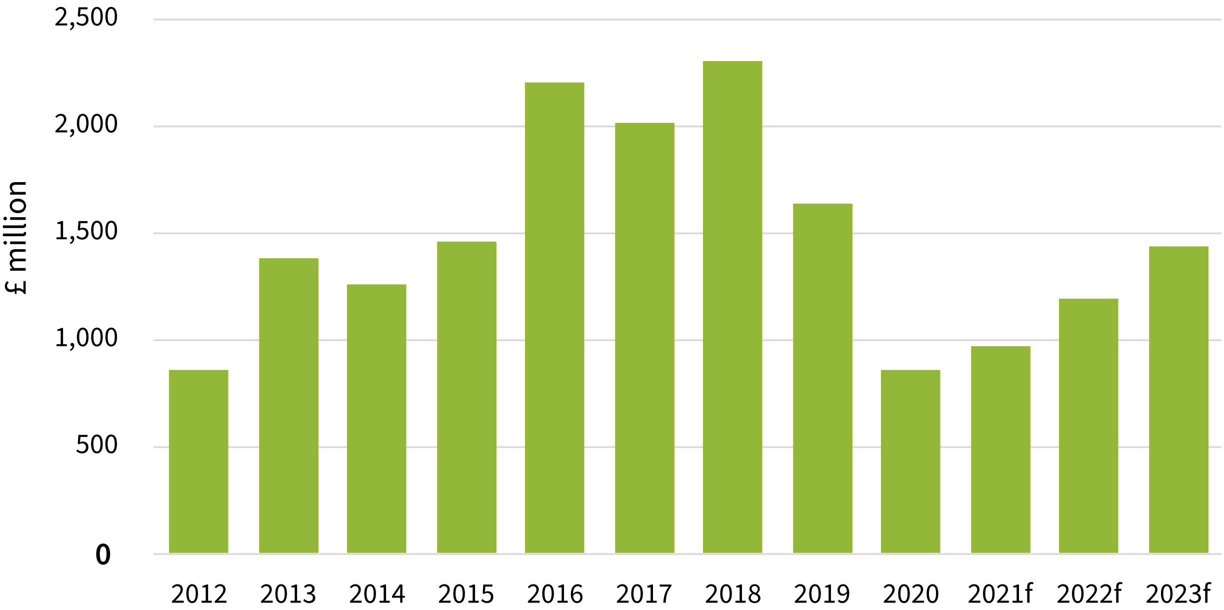
*f = forecast*

The value of affordable housing project-starts climbed 17% in 2019 and remained firm during 2020 with the value only falling 3% against the previous year.

Housing associations are now better placed to finance and take forward new developments than in recent years. Government requirements limiting association's rent increases to 1% below the rate of inflation have been lifted, providing associations with greater flexibility to increase their borrowing to fund new developments.

In addition, last year saw a sharp rise in capital funding for MHCLG housing and communities projects to £10.4 billion. Whilst, lower funding of £8.8 billion is available during 2021/22, it remains up on earlier levels. Together these two measures are expected to support a strengthening in housing association development activity over the forecast period. We anticipate affordable housing work starting on-site to climb more than by a fifth in 2021 and by 8% next year, before stabilising in 2023.

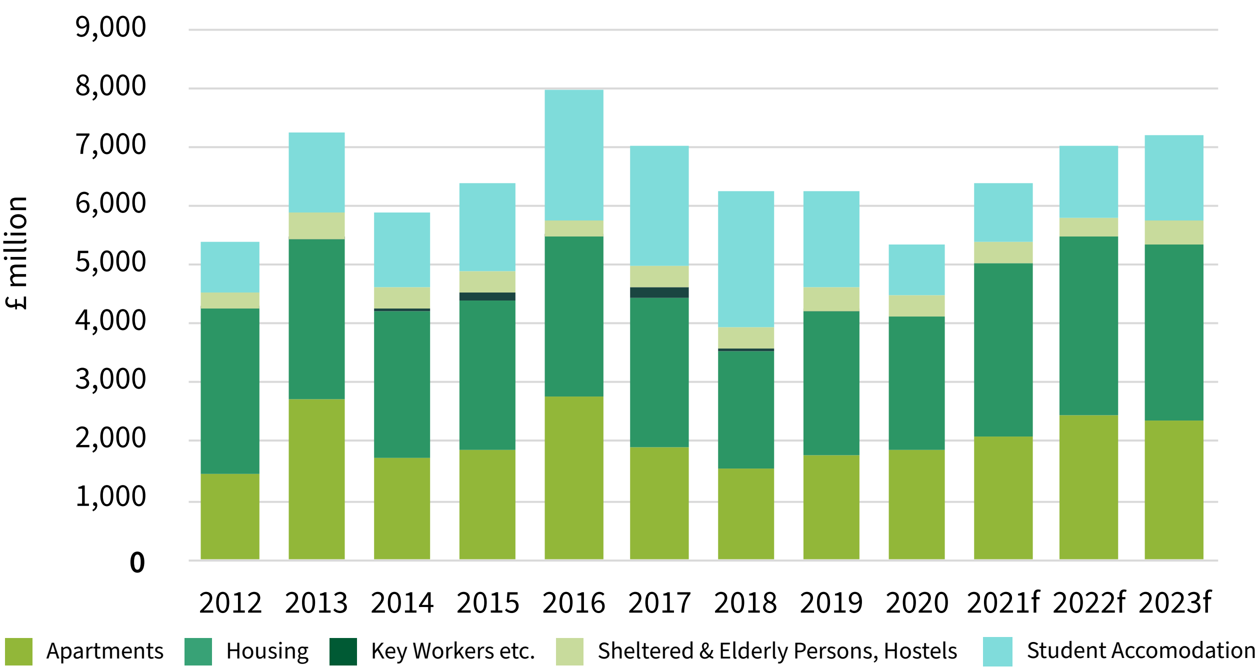
## Chart 6: The Value of Student Accommodation Project Starts by Year




*Source: Glenigan*

For much of the past decade, student accommodation work has been a bright spot within the housing sector, with project-starts growing by 65% over the five years to 2018. However, student accommodation starts declined heavily between 2019 and 2020 as the sector entered a period of consolidation and activity was disrupted by the pandemic last year. The pandemic and Brexit are expected to have longer term implications for the purpose-built student accommodation market which is disproportionately dependent upon lettings to overseas students. Overall student numbers are projected to decline over the medium term and overseas student numbers are expected to be especially vulnerable. While we anticipate the value of student accommodation starts to improve over the next two years, by the end of the forecast period they will still be 12% below their 2018 peak.

## Chart 7: The Value of Social Housing Project Starts by Year




*Source: Glenigan*

# Industrial

2021 +31% 2022 -1% 2023 +2%

> **Increasing demand for warehousing and logistics space as shopping habits adapt during the pandemic**
> **Manufacturers' investment in additional capacity and manufacturing premises deterred by increasing costs and weakened demand**
> **Strong development pipeline as project-approvals experienced strong growth in 2020 and 2021 to May**

The sector is being boosted largely by a rising demand in distribution and warehousing space. Manufacturing investment has been disrupted in the short term by recession and Brexit but the future looks brighter.

Industrial project-starts declined sharply during the second quarter of 2020 (-47%) as the first national lockdown disrupted work on-site and delayed project-starts. Ongoing uncertainty during the third quarter led to many firms' deferring investment decisions and project-starts remained low. Project-starts also fell 6% during the fourth quarter but started 2021 strongly, increasing 23% against the previous year to stand at their highest for two years. The sector is forecast to largely recover during 2021 due to an increasing demand for warehousing and logistics space.

**INDUSTRIAL STARTS**

| | 2019 | 2020 | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|
| **£ million** | 4,380 | 3,094 | 4,066 | 4,015 | 4,102 |
| **Growth** | -1% | -29% | 31% | -1% | 2% |

*f = forecast*

The warehousing and logistics sub-sector was the fastest growing segment within the industrial sector between 2017 and 2019 and was the best performing segment in 2020, despite experiencing a heavy decline.

Structural changes in the retail sector, accelerated by the COVID-19 pandemic, has fuelled increased demand for logistics space. According to the ONS, internet sales as a percentage of total retail sales increased from 20.2% in January 2020 to 36.3% a year later. This has since slipped back to 27.3% in May 2021 with the easing of restrictions and opening up of non-essential retail, but is still substantially above pre-pandemic levels. The rise in online purchases has intensified the demand for logistics space, as online retailers continue to grow their customer base.

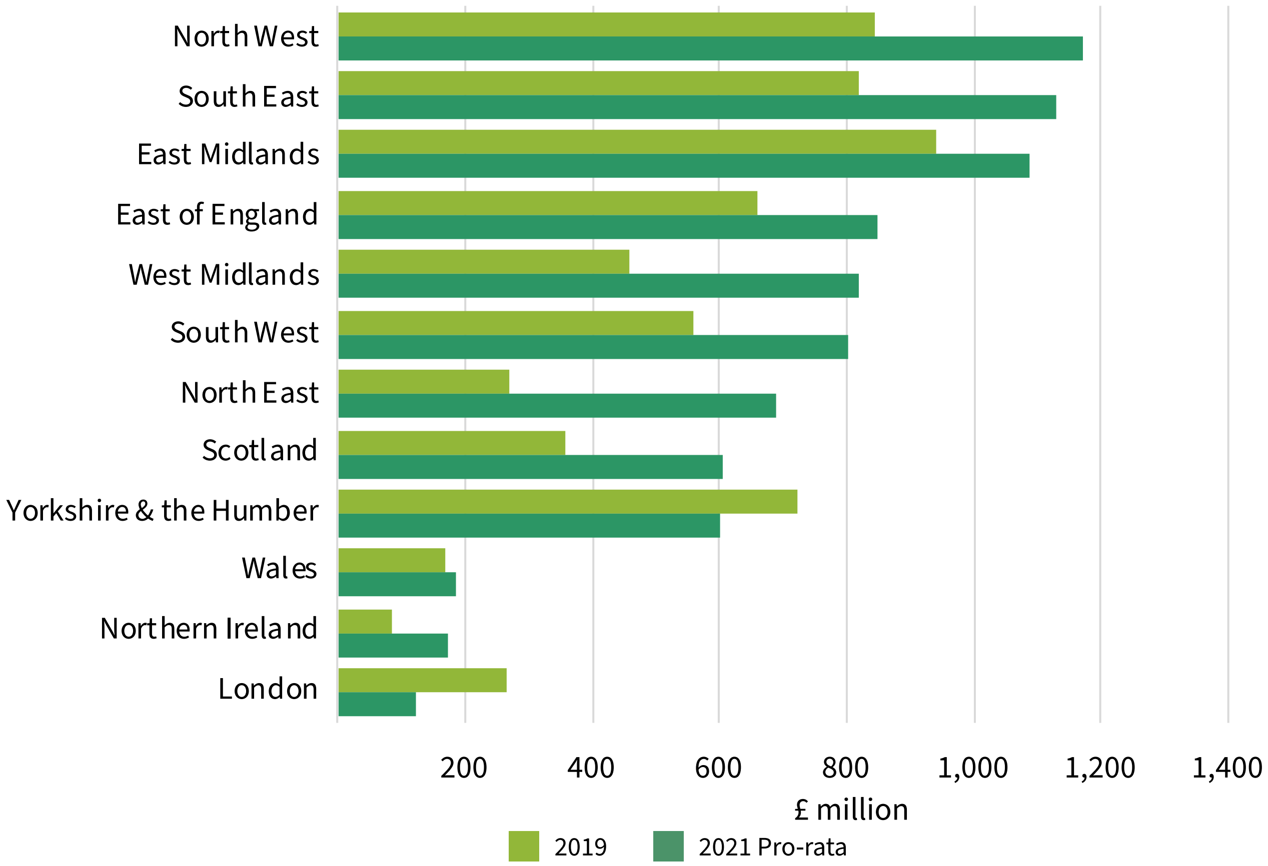
Investment in warehousing and logistics space has been very strong, with take-up in the UK increasing 64% against the previous year to hit record levels in 2020, according to property consultancy JLL. Take-up in 2020 was also 43% higher than the 5-year annual average. Demand was largely driven by online retail, parcel delivery businesses and third-party logistics.

Disruption to supply chains following the introduction of customs controls with the EU single market, as well as supply issues as a result of the pandemic, is likely to fuel additional demand for precautionary warehousing space. Warehousing and logistics project-starts are forecast to be a strong area of growth within the industrial sector in 2021 and are forecast to remain high during 2022 and 2023.

The North West, South East and Midlands have all been growth areas for the sector, offering good access to national transport networks and major population centres in the UK. There is also continuing growth in demand across the UK for smaller distribution facilities to service the 'final mile' delivery of products to the customer.

In contrast, poor growth prospects are likely to restrict manufacturers' need to invest in additional operating capacity including new premises. Ongoing restrictions during the pandemic, rising costs of materials as well as increasing freight costs as a result of Brexit have meant many manufacturers struggled to make a profit during 2020.

**Chart 8: The Value of Industrial Projects Securing Detailed Planning Approval in 2020 and 2021 Pro-Rata**



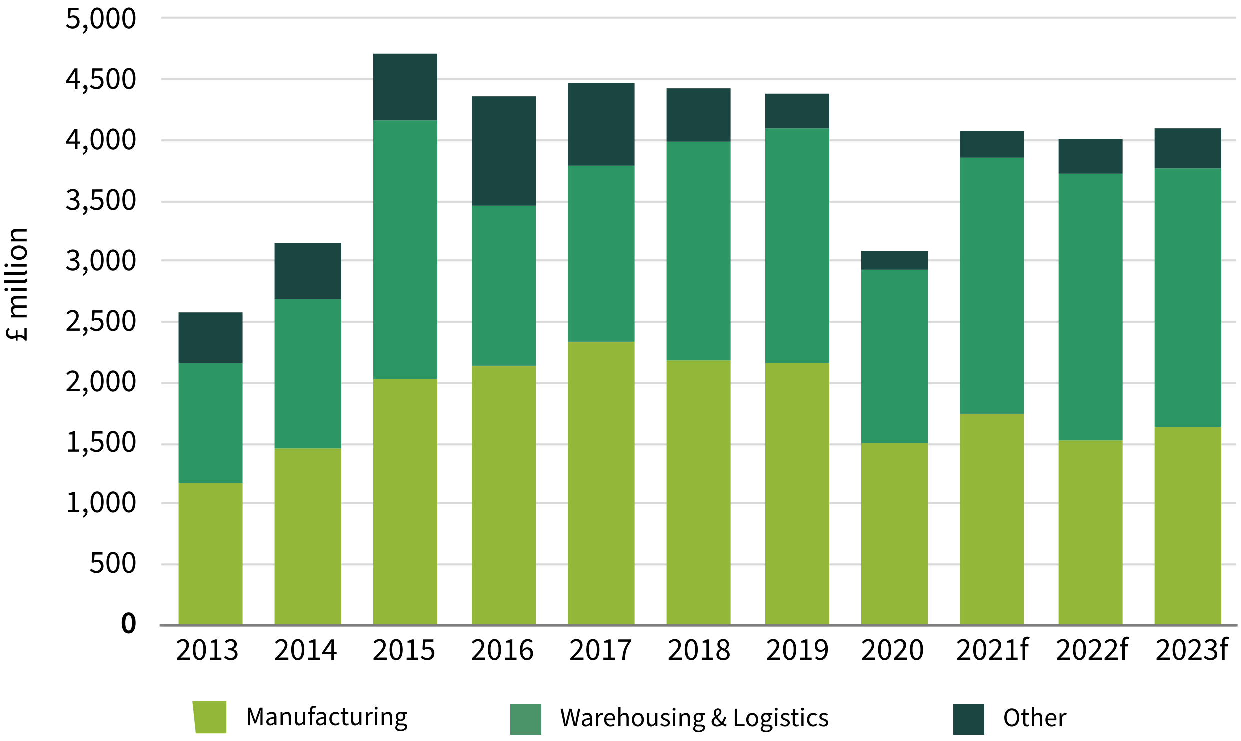

*Source: Glenigan*
*N.B. 2021 data is based on January to May*

Recent months have seen a sharp rebound in manufacturing activity as the UK has emerged from lockdown and the rapid roll-out of the vaccination programme has boosted confidence. Industry body Make UK said in June 2021 that manufacturing output volumes reported during the past quarter rose at the fastest pace since the series started 30 years ago, as restrictions have been eased and economies around the world have started to open-up again. In addition, the UK Manufacturing PMI by IHS Markit was the highest since the survey began in 1992, with new orders increasing at the fastest rate on record.

However after the initial bounce back the pace of growth is anticipated to moderate sharply over the forecast period. More subdued UK economic growth is expected to dampen domestic demand for manufacturers' products. In addition exporters now face less favourable access to the EU single market and COVID-related issues in accessing other major economies.

Crucially though, manufacturing output is not set to return to pre-pandemic levels until the end of the forecast period. Against this adverse economic background, investment in new premises is expected to be weak over the forecast period as manufacturers prioritise efficiency improvements over additional capacity.

**Chart 9: Value of Industrial Project Starts by Year**




*Source: Glenigan*
*f = forecast*

# Offices

2021 +33% 2022 -3% 2023 +1%

> **Office occupiers re-assessing their long-term accommodation needs**
>
> **Opportunities for refurbishment and conversion of secondary office accommodation**
>
> **Potential growth in regional 'hubs' in response to changing working practices office accommodation**

Office-starts are forecast to largely recover this year from the sharp decline experienced as a result of the pandemic but are forecast to remain flat for the rest of the forecast period. A rise in refurbishment projects are expected to boost project-starts in 2021 as tenants and landlords adapt premises to accommodate changing working practices. New build office projects will be slower to recover as tenants and developers assess the impact of rising unemployment and a potential shift to remote working on the long-term demand for office accommodation.

**OFFICES STARTS**

| | 2019 | 2020 | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|
| **£ million** | 4,669 | 3,345 | 4,444 | 4,318 | 4,381 |
| **Growth** | 2% | -28% | 33% | -3% | 1% |

*f = forecast*

The widespread use of remote working during the pandemic has prompted many organisations and individuals to review their need for the daily commute to the office. Further to this, it is currently being considered by government ministers to enshrine in law a default right to work from home, with the Government leaning against ordering a return to the office after restrictions come to an end. This may further contribute to firms requiring less office space in different locations.

Whilst more remote working is expected to hold back new office construction activity, it is also set to be a spur for refurbishment work as firms remodel existing premises to create more collaborative spaces and downsize and sub-let existing accommodation.

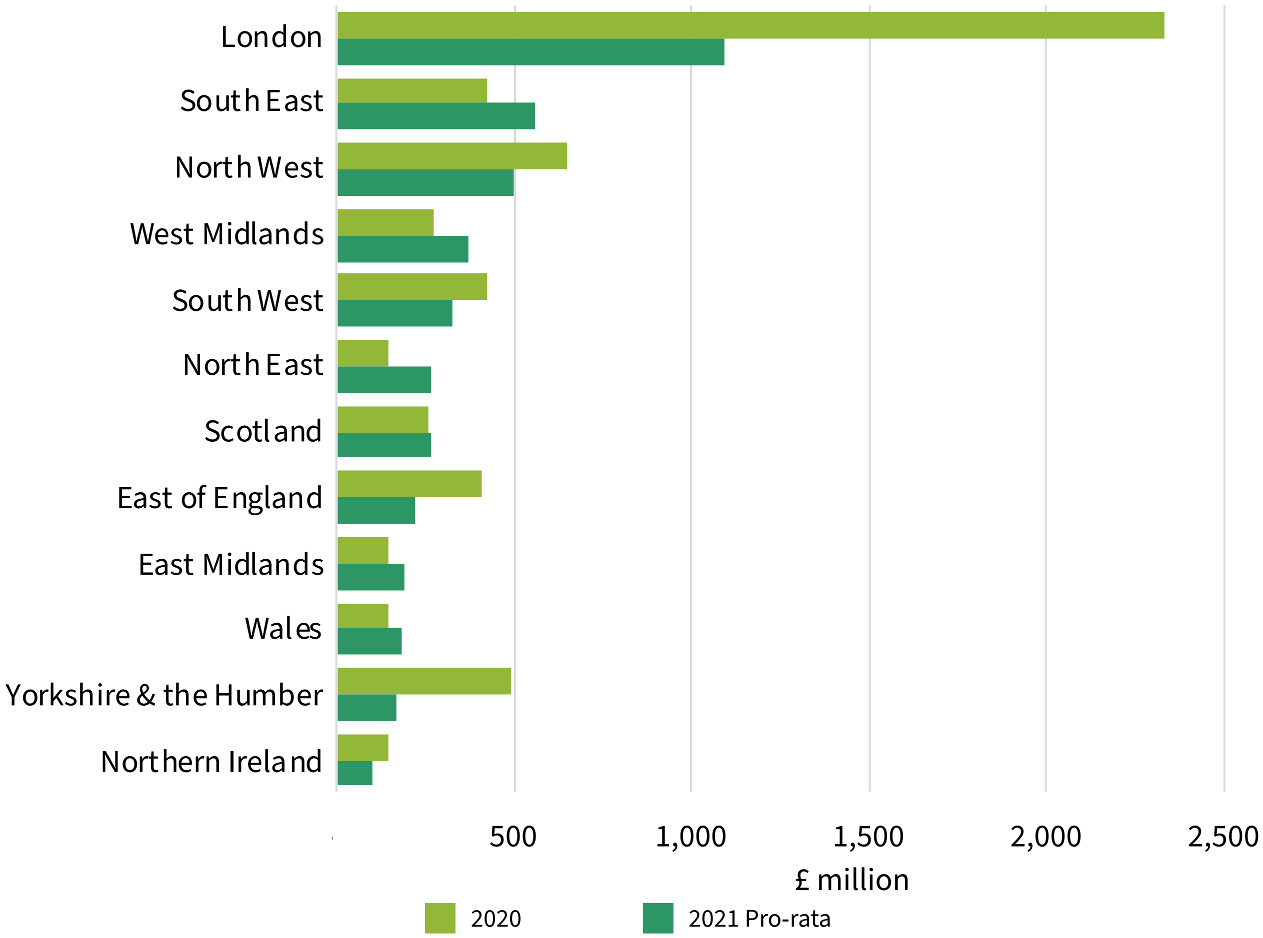
The changing nature of working practices may also spur more activity in regional centres. Demand before the pandemic for high-quality office space had been growing in UK 'core' cities such as Manchester, Leeds and Birmingham. However, recently completed projects and those currently under construction have improved the supply of available floorspace. This, coupled with the pandemic forcing firms to assess their need for office space, is expected to dampen new-build project-starts during the forecast period.

The value of underlying project-starts in London declined between 2015 and 2018 as Brexit concerns dampened development activity in the Capital's financial quarters. Despite a significant slowdown towards the end of 2019, office-starts in London increased 4% compared to the previous year. Underlying-starts fell 32% in 2020 but started 2021 strongly, with a 48% increase during the five months to May, against the previous year.

Positively, the underlying development pipeline is strong and remained especially high throughout the pandemic. The value of underlying project-approvals in London climbed 63% in 2020 following growth of 46% in 2019 and 47% in 2018. However, weaker economic conditions and potential structural changes in occupiers' accommodation requirements are expected to prompt the delay or reappraisal of a number of projects currently in the development pipeline.

Overall, we anticipate that the value of office project-starts will largely recover from the fall experienced last year, before slipping 3% in 2022 and increasing 1% in 2023.

**Chart 10: The Value of Office Project Approvals in 2020 and 2021 Pro-Rata**




*Source: Glenigan*
*N.B. 2021 data is based on January to May*

OFFICES
RETAIL
HOTEL & LEISURE
EDUCATION
HEALTH
CIVIL ENGINEERING
KEY RECOMMENDATIONS

# Retail

2021 +55% 2022 -20% 2023 -13%

- **Demand for retail space hit by a sharp increase in online retailing, weak household earnings and closure of non-essential retail over the course of the pandemic**
- **Retailers rationalising their estates as costs increase and in-store sales decline**
- **Potential boost to local high streets from greater home-working**
- **Refurbishment opportunities as retailers seek to attract customers to retained premises and to support online offering**

The pandemic has intensified pressure on traditional retailers as many stores were forced to close throughout 2020 and early 2021, leading to a substantial increase in online retail sales. 'Bricks & Mortar' retailing faces continued pressure over the next two years from weak consumer spending growth and the erosion of market share to online retailing. Retail development activity is expected to remain weak as retailers rationalise their stores in the face of faltering consumer spending and the growth of online sales.

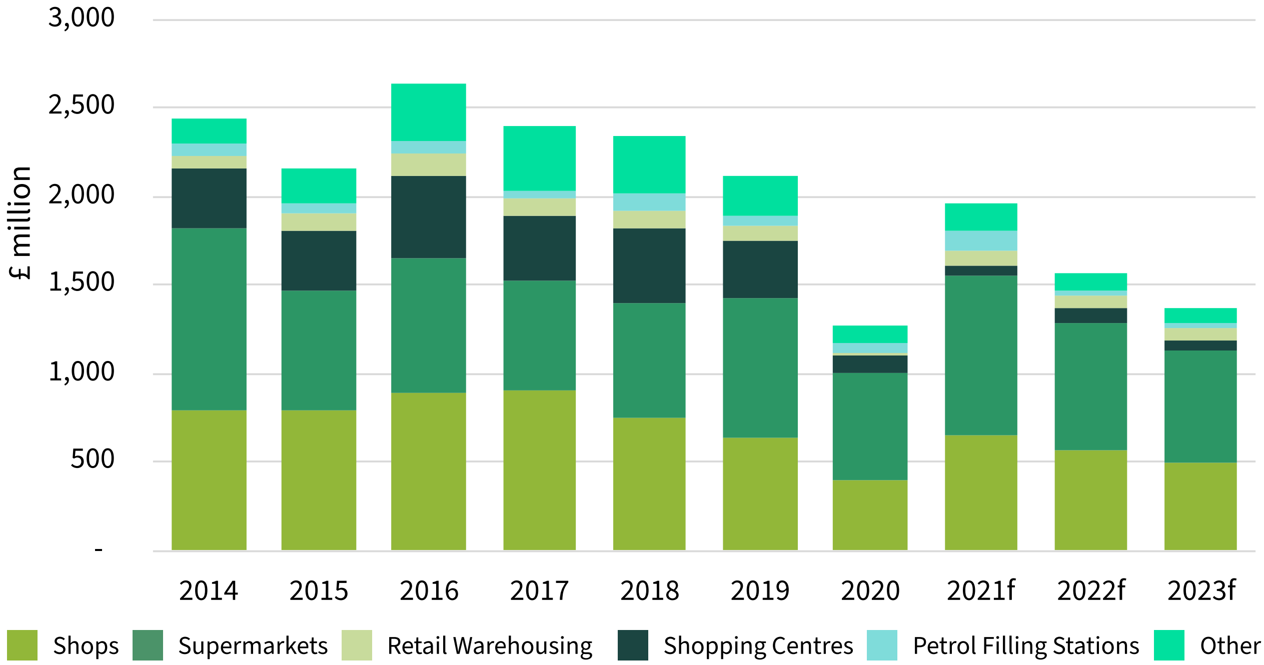
**OFFICES STARTS**

| | 2019 | 2020 | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|
| **£ million** | 2,125 | 1,266 | 1,967 | 1,573 | 1,374 |
| **Growth** | -9% | -40% | 55% | -20% | -13% |

*f = forecast*

Retailers have faced very challenging conditions in recent years and will remain under pressure over the forecast period. Although overall retail sales have largely recovered from enforced store closures during the latest lockdown there has been a marked shift in consumers' shopping habits. The latest data from Springboard showed that shoppers footfall in May across all UK shopping destinations was 28.7% lower than the same period in 2019 and data from the ONS showed that the proportion of online sales as a percentage of all retail sales was 27.3% in May, up from 18.8% two years ago. At its peak in January 2021, online sales made up 36.3% of all retail sales.

## Chart 11: The Value of Retail Project Starts by Year




*Source: Glenigan*

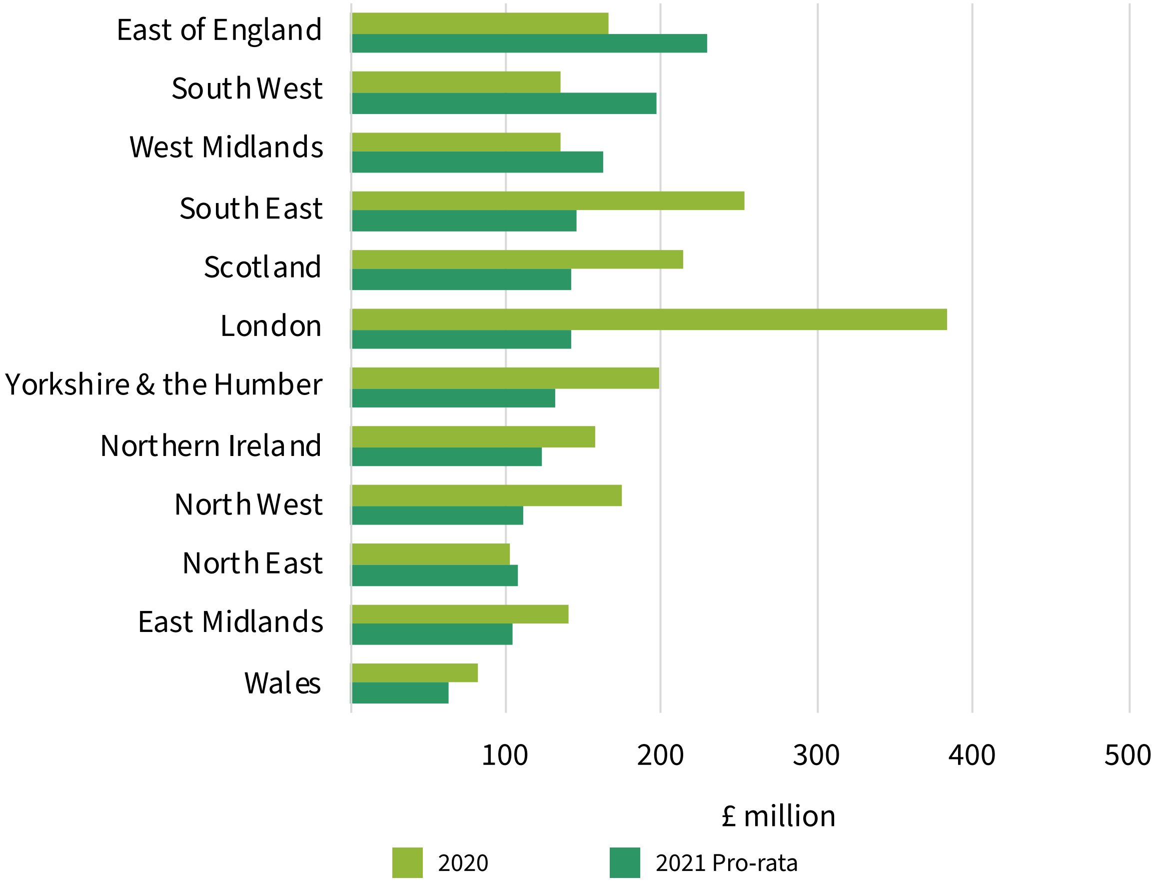
Grocery stores performed well during the pandemic as households were eating out far less frequently. While overall grocery sales dropped 5.7% between April and May 2021, largely due to the re-opening of restaurants and hospitality, sales are still relatively high with Tesco reporting that sales were up 8.1% against the same period two years ago.

Non-food sales have been slower to recover, with results being largely mixed. While household, DIY, sports equipment and toy sales have performed well, clothing and department store sales have struggled, largely due to strict trading conditions throughout the previous lockdowns.

Against this backdrop, the retail property market faces weakening demand for retail space and softening rental values as some retailers fail, such as Arcadia Group and Debenhams in recent months, and others look to rationalise their existing estate and renegotiate rental terms.

Slow retail sales growth and the rise of online sales are predicted to feed through to a decline in new retail starts over the forecast period. While we expect project-starts to increase 55% this year against the poor performance a year ago, we anticipate that work starting on-site will fall by a fifth in 2022 and by 13% in 2023.

### Chart 12: The Value of Retail Projects Securing Detailed Planning Approval in 2020 and 2021 Pro-Rata




*Source: Glenigan*
*N.B. 2021 data is based on January to May*

However, opportunities may arise from the changing nature of shopping habits. Greater remote working arising from the pandemic has encouraged households to shop more locally which could provide a boost to local high street retailing. Retail refurbishment and fit-out activity is also likely to benefit, as retailers rationalise their estate and re-model their retained stores to lure back customers and better accommodate services such as click & collect.

Supermarket development activity, despite falling 23% in 2020, remained relatively firm last year compared to other segments within the sector. The combination of rising online sales and more frequent local 'top-up' shopping trips is expected to lift investment by major supermarket chains in their stores over the forecast period. We expect project-starts to climb 49% in 2021.

# Hotel & Leisure

2021 +2% 2022 +26% 2023 +34%

- Strong potential development pipeline, but investors remain very cautious as pandemic and travel restrictions impact the sector
- Slump in overseas visitors is likely to continue until at least 2022, but more UK residents holiday closer to home
- Hotel construction particularly hard hit by the pandemic

The hospitality and leisure industries have been hit particularly hard by the pandemic. The collapse in the number of overseas visitors to the UK and the regulatory restrictions on hospitality have damaged the financial viability of many operating in the sector. Investor confidence is likely to remain low and a return to the sector is expected to be slow.

**HOTEL & LEISURE STARTS**

| | 2019 | 2020 | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|
| **£ million** | 3,645 | 2,230 | 2,280 | 2,862 | 3,834 |
| **Growth** | -3% | -39% | 2% | 26% | 34% |

*f = forecast*

The value of project-starts in 2020 fell by 39% against the previous year, the second sharpest fall of any sector, despite a firm development pipeline of planned projects.

Prior to the pandemic, the hotel & leisure sector appeared to be strengthening, benefitting from a rise in the number of overseas visitors and related expenditure. However, the steep decline in overseas visitor numbers during the pandemic, and the enforced closure and restrictions on the operation of leisure and hospitality facilities, have damaged the financial viability of many operating in the sector.

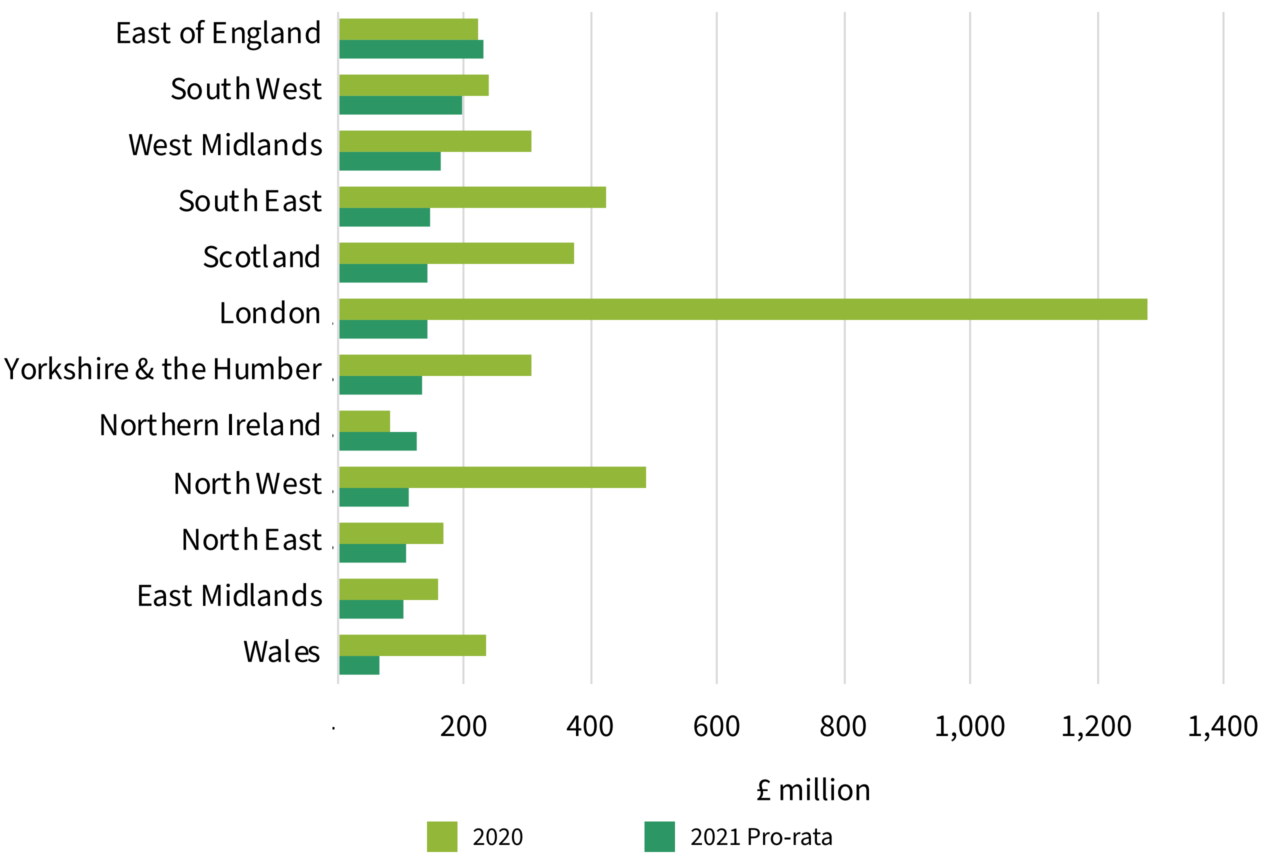
Hotels have faced continued restrictions during the latest lockdown and investors are likely to remain cautious throughout the forecast period given the harsh conditions faced. Whitbread, owner of Premier Inn hotels, recently announced that during the 13 weeks to 27 May, hotel bookings were down 60% compared to the same period in 2019 and food and drink sales fell 86%.

Hotel project-starts fell 35% in 2020 and are forecast to fall by a further 49% in 2021 while much of the sector recovers. This is anticipated to hold back growth of the hotel & leisure sector overall in 2021.

However, as lockdown restrictions are eased this summer, the hotel & leisure sector should be able to take a greater share of discretionary spending by UK households as a weaker pound and travel restrictions prompt more UK consumers to holiday in the UK. Overseas visitors are not likely to recover for some time, preventing the sector from significant recovery until 2022.

A more certain outlook is expected to encourage investors to push back projects to 2022 and 2023, with the upturn in hotel & leisure driven by investment in facilities directed at capturing UK households' discretionary spending.

### Chart 13: The Value of Hotel & Leisure Project Approvals in 2020 and 2021 Pro-Rata




*Source: Glenigan*
*N.B. 2021 data is based on January to May*

# Education

2021 +2% 2022 +12% 2023 +3%

**> University project-starts forecast to remain low**

**> School project-starts to drive growth for the sector**

**> Increase in further education projects**

The pandemic influenced a 26% fall in education project-starts in 2020 following a 10% decline in 2019 compared to the previous year. The value of detailed planning approvals also declined in both years.

Increased public sector investment in school and further education work is expected to support a recovery in sector activity. However, project-starts are not forecast to fully recover from the fall in 2020 until at least 2023.

EDUCATION STARTS

| | 2019 | 2020 | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|
| **£ million** | 5,534 | 4,079 | 4,157 | 4,636 | 4,794 |
| **Growth** | -10% | -26% | 2% | 12% | 3% |

*f = forecast*

An increase in school building projects is forecast to lead to a recovery in education sector activity during 2021 and 2022 as local authorities tackle a shortage of secondary school places. The number of secondary school pupils is predicted to rise 15% by 2027, according to the Department of Education.

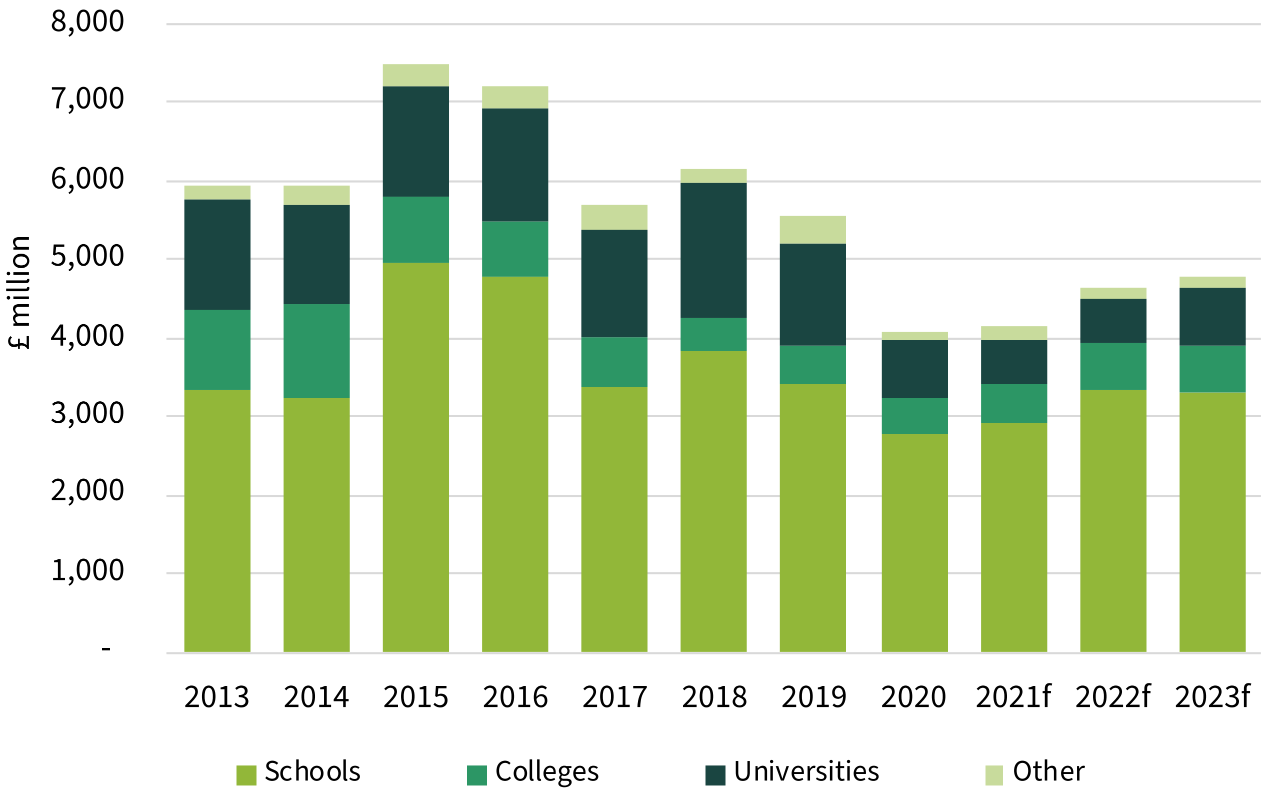
Investment in additional capacity to accommodate the rise in pupil numbers has been slow and sporadic, reflecting local authorities' tight financial positions and the regulatory hurdles to creating a new school. Cash-strapped councils have sought to accommodate the initial rise in pupil numbers through the expansion of existing schools, however new schools will also be required, especially in areas of high growth such as London and other major metropolitan areas.

The pandemic largely contributed to an 18% decline in school projects commencing on-site in 2020. More positively, school project-starts are forecast to rise 5% in 2021 and 14% in 2022. Greater financial support is expected to help accelerate the delivery of much-needed school places and lift school project-starts in the longer term.

Work to deliver further education facilities is also forecast to rebound over the next two years due to increased government investment. The value of project-starts is forecast to climb 8% in 2021 and 22% in 2022. Further education project-starts experienced the smallest decline of any segment within the education sector (-10%) in 2020.

Investment in higher education facilities had been a growth area in recent years as universities competed to attract domestic and overseas students. The value of project-starts climbed 28% in 2018, with the majority of investment being undertaken by a wide range of institutions, particularly by the Russell Group of Universities.

### Chart 14: The Value of Education Project Starts by Year




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

However, universities have faced increased funding pressures from a weakening in UK student numbers. In addition, the Augar Review proposed changes to graduate funding, and against this backdrop university project-starts fell by a quarter in 2019. The pandemic exacerbated financial issues, with the number of higher fee-paying overseas students falling and the number of drop-outs increasing. Furthermore, the pandemic has sharply impacted the revenues universities have been able to generate from retail and leisure spaces on campus, putting debt repayments under further pressure according to the New Street Consulting Group. This has led to many universities embarking on cost-cutting measures.

Following a decline of 45% in 2020, we forecast university project-starts to decline a further 19% in 2021 and 4% in 2022. We do not expect project-starts to rise again until at least 2023.

Overall, the forecast rise in school and further education projects is expected to lift education project-starts by 2% in 2021 and 12% in 2022.

# Health

2021 0%

2022 +14%

2023 +6%

## > Strengthened development pipeline in 2020

## > NHS capital budget increased for 2021/22 following the Spending Review

## > Continued increase in NHS funding over the next two years

The outlook for the health sector remains positive. The Nightingale hospitals programme lifted project-starts in 2020, and increased NHS capital funding is set to lift project-starts further over the forecast period.

**HEALTH STARTS**

| | 2019 | 2020 | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|
| **£ million** | 1,930 | 2,374 | 2,364 | 2,687 | 2,848 |
| **Growth** | -21% | 23% | 0% | 14% | 6% |

*f = forecast*

The NHS continues to be extremely high on the political agenda. The Government had already promised additional funding for the NHS, with an extra £20 billion committed over the next five years. In the latest Government spending review, NHS capital funding for 2021/22 was increased to £6.2bn, from £5.8bn in 2020/21.

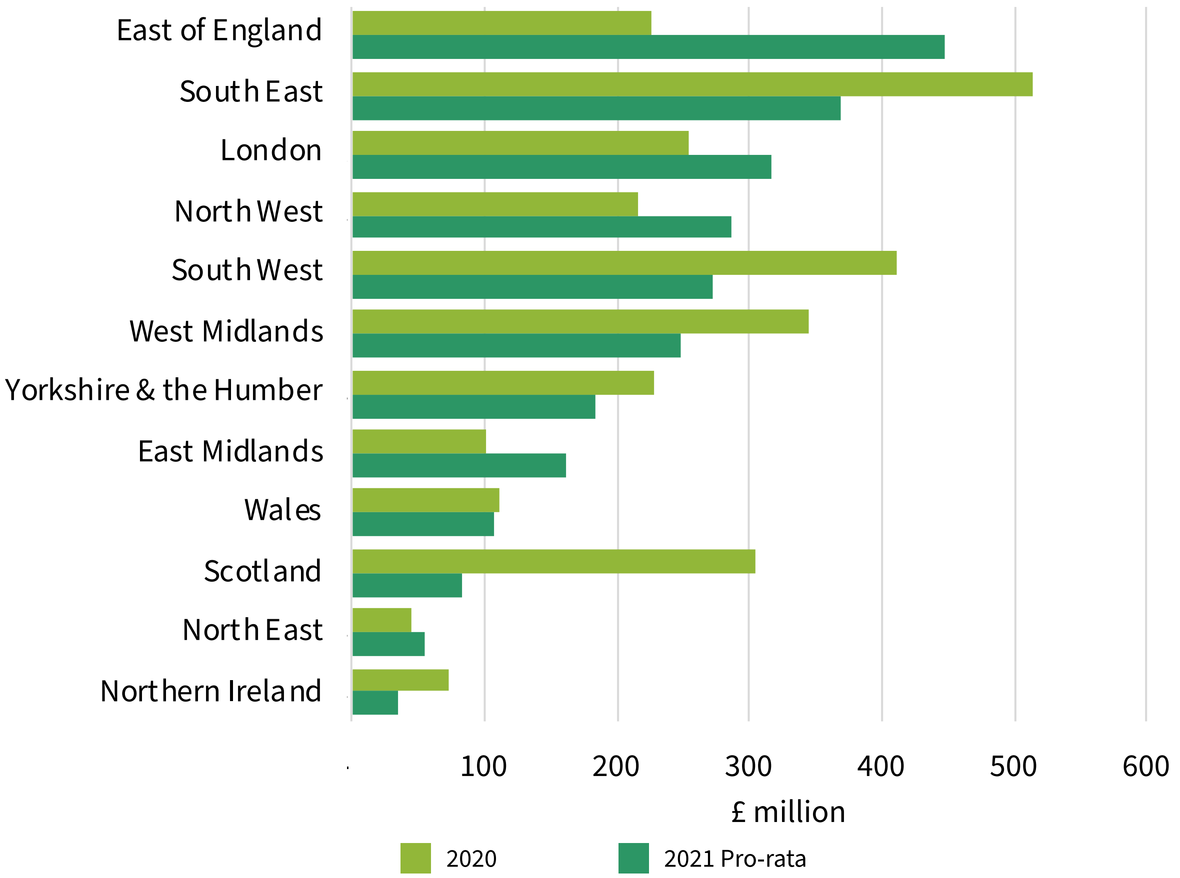
While an increase in capital investment in NHS facilities can deliver efficiency improvements and better health outcomes, it will take time to bring forward new projects, therefore, in the short term, front-line services are likely to take priority.

The Nightingale temporary hospital programme boosted project-starts in 2020, with the value of health construction work starting on-site achieving growth of 23% against the previous year.

The value of detailed planning approvals for the Health sector fell 7% in 2018 but has strengthened since then, with project-approvals increasing 3% in 2019 and 26% in 2020. The value of project-consents during 2021 to May remained high and was unchanged on the previous year.

Looking ahead, additional government funding will begin to feed through to sector activity from 2022. Starts are forecast to remain unchanged this year after the strong-performance in 2020, before rising by 14% in 2022 and 6% in 2023 as new projects come forward and as NHS trusts develop and implement their investment programmes. This includes the work to deliver the 40 'new' hospitals promised by the Government over the next ten years.

### Chart 15: The Value of Health Projects Securing Detailed Planning Approval in 2020 and 2021 Pro-Rata




*Source: Glenigan*
*N.B. 2021 data is based on January to May*

# Civil Engineering

2021 +21% 2022 -4% 2023 +7%

> **HS2 boosts the sector**
> **Jump in infrastructure investment in 2021**
> **Utilities projects underpin growth over forecasts period**

Significant infrastructure schemes, such as Thames Tideway, HS2, Hinkley Point and the Stonehenge Tunnel will be important drivers for sector activity over the forecast period. The value of underlying main contract awards has risen steadily in recent months and we anticipate a strengthening in the value of project-starts.

**CIVIL ENGINEERING STARTS**

| | 2019 | 2020 | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|
| **£ million** | 6,399 | 5,469 | 6,606 | 6,330 | 6,793 |
| **Growth** | 27% | -15% | 21% | -4% | 7% |

*f = forecast*

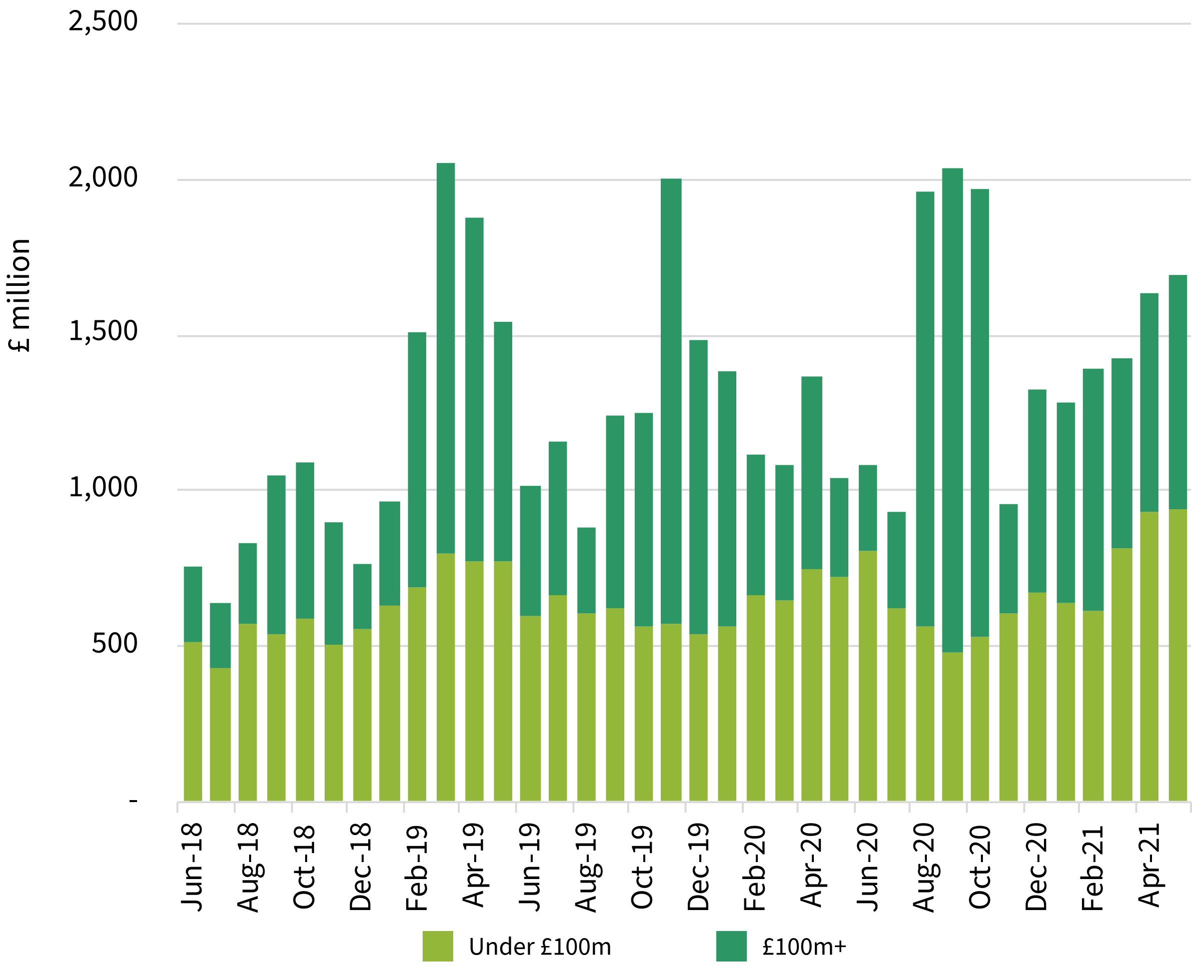
The civil engineering sector grew sharply in 2019 with the value of underlying work (less than £100 million in value) commencing on-site increasing by 27% against the previous year. Whilst major project-starts performed strongly in 2020, the pandemic disrupted underlying-starts with the value falling 15% against the previous year. A renewed strengthening in project-starts is expected from 2021 as investment programmes increase activity.

The Government has promised record investment in UK infrastructure, with £100 billion capital spending plans being announced for the next year. The Government has pledged £5 billion to accelerate the roll-out of UK-wide gigabit broadband, with much of this work being delivered by the private sector.

The second Road Investment Strategy (RIS2) will spend £27.4 billion between 2020 and 2025 to build new road capacity and to improve the quality of existing roads. RIS2 will take forward schemes such as the dualling of the A66 Trans-Pennine route and construction of the Stonehenge Tunnel which is due to start on-site at the end of 2022. Many projects included in RIS2 will take time to start on-site but many will boost the sector towards the latter months of the forecast period.

Near term, a 50% increase to local road maintenance budgets, announced as part of the March 2020 Budget, will deliver additional funding of £500 million a year to starting smaller improvement schemes.

## Chart 16: The Value of Civil Engineering Main Contract Awards




*Source: Glenigan*
*f = forecast*

Highways England is currently looking to appoint a contractor for the £1.7 billion Stonehenge Tunnel which was granted planning approval in November 2020. Tenders have been returned and construction is scheduled to commence on-site at the end of 2022.

HS2 is making a significant contribution to sector activity as work on Phase 1 gathers momentum. Work has begun on-site on the £1.3 billion Chiltern & Colne Valley scheme in recent months. Many other HS2-related schemes, such as the HS2 Euston and Birmingham Curzon Street stations, have main contractors appointed and are expected to start within the forecast period.

Network Rail's five year investment programme (CP6) is now approaching the halfway stage. Over the five year period Network Rail is scheduled to invest £19.2 billion in renewals and £8.9 enhancement works.

A significant proportion of the energy industry's current workload and pipeline is made up of major schemes (over £100 million in value), with a focus on projects such as new gas-fired plants, Hinkley Point 'C' and off-shore wind farms.

Water industry project-starts declined during 2018 and 2019 as the industry investment period (AMP6) came to an end. The new investment programme (AMP7) is set to lift industry spending over the forecast period. In addition sector activity will continue to benefit from major work packages on the £4 billion Thames Tideway Tunnel.

# Key Recommendations

## TARGET NEW AREAS OF GROWTH

The pattern of UK construction activity is changing post-pandemic. As construction workloads are rebuilt over the next two years, the best performing sectors will differ from those prior to the outbreak. The types of opportunities are also likely to evolve. Structural changes are expected to create new opportunities in warehousing & logistics, office and retail refurbishment and fit-out, and the repurposing of redundant commercial premises.  The residential sector is also likely to see a trend away from high rise city centre residential developments towards low rise family housing.

Increased Government funding will drive growth in the Education, Health, Civil Engineering and Community & Amenity sectors. Regionally, construction markets in the northern half of the country are set to outperform London and the South East over the forecast period reflecting a shift in Government funding and policy.

Firms will need to target these new emerging opportunities, ensuring that they have the expertise and resources to increase their exposure to growing markets.

## RISK MITIGATION

COVID-19 working restrictions reduced the number of personnel on-site. Construction schedules are likely to be extended as a result with implications for workload, turnover and cash flow. The slow pace of site development will delay stage payments from clients and push back the timing of when late trades are required onsite. Contractors and subcontractors may wish to offset the lower monthly revenues generated per site by spreading their workforce across a greater number of projects.

A diversified client base will reduce exposure to any one client with a work pipeline spread more evenly over a larger number of customers. This can help reduce a business's exposure to a financial crisis or adverse change of payment by any one firm. Supply chains should also be reviewed to ensure that firms are similarly not over exposed to a few clients.

## SUPPLY SIDE CONSTRAINTS

Construction's recovery from the pandemic's disruption has been rapid, but this has exposed supply-side constraints. Shortages of a range of construction materials are a potential risk to the cost and timely delivery of projects. Contractors and subcontractors should seek to identify and mitigate any potential interruption to product supply, including from overseas sources, due to the COVID-19 pandemic and new trading arrangements with the EU.

Material and labour shortages (see page 7) are likely to increase cost pressures. Contractors and subcontractors should factor in the impact of increased cost pressures accompanying material and labour shortages when bidding for work.

## WORK MORE EFFICIENTLY

Whilst current product supply disruption should subside over the forecast period, the supply of skilled labour is likely to emerge as an additional constraint.

On-site working restrictions to contain COVID-19 transmission rates are currently exacerbating the need for the industry to use on-site labour more sparingly and effectively. With the UK's departure from the EU shrinking the pool of available skilled site labour, this will remain a priority as restrictions are eased and firms seek to expand their onsite workforce over the next two years. 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. In many cases this will involve a more collaborative approach and the use of digital solutions to cut waste and accelerate design and construction processes.

## DIGITAL OPPORTUNITIES

The pandemic has accelerated the adoption of digital systems both pre-construction and onsite as more traditional ways of working have been disrupted. Investment in an effective CRM, digital marketing channels and a modernised salesforce will help firms to rapidly identify and target emerging opportunities, sustain their workload, cut the cost of winning work, improve efficiency and enhance profitability.

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?

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