Mid-Year Construction Review & Forecast for 2016 & 2017

REVISED SINCE THE EU REFERENDUM RESULT

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.

Glenigan's detailed insight is used across all levels of our customers' businesses. Different departments have much to gain from using our industry knowledge and product features to deliver results for their specific job role.

Further information

For further information, visit glenigan.com or contact us on the details below.

Phone +44 (0)1202 786700
info@glenigan.com

5th Floor, 80 Holdenhurst Road
Bournemouth BH8 8AQ

Subscription Sales
Phone 0800 373 771
info@glenigan.com

Account Management
Phone 0870 443 5373
customer@glenigan.com

Executive Summary - Construction prospects for 2016 & 2017

This report analyses the latest data on construction activity for the first half of 2016 and provides an assessment of the industry's prospects for the second half of 2016, for 2017 and beyond in light of the vote to leave the EU.

- Economic & political outcome prolonged by Brexit vote
- Slower UK economic growth
- Business investment hardest hit by Brexit
- Weak housing market growth forecast for 2016 & 2017
- Slowdown in office development activity
- Industrial starts lower
- Retail property facing structural change
- Renewed growth in civil engineer starts
- Construction back in recession – falls in project starts & output

UK construction faces a period of intense political and economic uncertainty following the Brexit vote. As we saw in the aftermath of the 2008 financial crisis, such 'market shocks', disrupt, suspend and reshape established market relationships. We expect industry workload pipelines and order books to be disrupted over the coming months as investors and clients re-appraise the rational of their existing plans against the new political and economic environment.

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, UK economic growth is likely to slow during the second half of 2016, with capital expenditure particularly weak.

During the first six months of this year the construction industry has seen the flow of projects starting on site disrupted by a combination of poor weather and investor nerves ahead of the EU referendum. Following the Brexit vote, with political uncertainties persisting, we anticipate a continued hiatus in private project starts on site during the remainder of 2016 and into next year.

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

Change on previous year	2014	2015	2016f	2017f
Private Housing	13%	12%	5%	2%
Social Housing	-1%	-6%	-7%	-21%
Industrial	49%	4%	-10%	-2%
Offices	20%	9%	-5%	-5%
Retail	8%	-11%	-12%	5%
Hotel & Leisure	20%	2%	-18%	7%
Education	10%	5%	-4%	6%
Health	8%	-27%	6%	13%
Community & Amenity	-6%	-17%	17%	5%
Civil Engineering	2%	-12%	4%	12%
Total	10%	0%	-2%	1%

Source: Glenigan

Construction output fell 1.1% during the first quarter of 2016 and was 1.9% lower than a year ago, according to official statistics published by ONS. This drop follows the weakening 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 weak levels of project starts during the first half of this year and forecast through to 2017 is expected to prolong the current dip in construction output volumes, with the industry forecast to slip into recession.

The Brexit vote has clouded the outlook for the housing market activity and private housebuilding Over the last two years rising consumer confidence, improved household incomes and government initiatives to support homeownership) have lifted property transactions and new house sales. Looking ahead, weaker economic growth and increased inflationary pressures are expected to dampen house purchasers' confidence. In addition the more uncertain economic prospects are likely to prompt financial institutions to tighten their lending criteria for new mortgage applications.

Government capital funding for new social housing provision will remain tight, while new Government measures, including extending the "Right to Buy" to all housing association tenants, will restrict associations' capacity to secure the necessary private funding to bring forward these projects into physical development. As a result, we are forecasting a sharp decline in the value of project starts for social housing this year and during 2017.

Industrial construction remained a bright spot for growth last year, building on the rapid rise in starts seen in 2014. However, the flow of new project starts faltered in the run-up to the EU referendum; we calculate that project starts in the second quarter were around 20% lower than a year ago. Whilst the growth of on-line retail should ensure that warehousing & logistic space remains a growth area in the long term, project starts are forecast to remain weak during the second half of this year as investors re-assess the prospects for consumer spending. In addition we anticipate a further retrenchment in planned capital investment by manufacturers during the forecast period due to concerns over access to the single market. Overall we expect the value of underlying project starts to fall 10% this year and 2% during 2017.

Similarly ahead of the EU referendum private investors continued to progress office and hotel & leisure schemes through their planning stages, but had been wary of making a final commitment to schemes. Project starts are now expected to remain weak during the final six months of 2016. The value of underlying office starts are also forecast to fall further next year. In contrast the hotel & leisure sector is expected to benefit from the recent depreciation in Sterling, with starts forecast to pick up in 2017.

The retail sector continues to be buffeted by structural change as retailers struggle to accommodate consumers' changing shopping habits, with BHS and Austin Reed being the sector's latest high profile casualties. The more uncertain outlook for the economy and consumer spending will exacerbate the pressures faced by retailers. The value of underlying retail project starts fell 11% last year and we are forecasting a further 12% decline in 2016.

Investment in higher education facilities is forecast to be a growth area within the wider education sector during 2016 and 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 4% drop in the value of education sector starts this year, before returning to growth in 2017.

Last year saw a sharp decline in the health sector, with starts dropping 27% year-on-year. NHS capital funding will remain tight and the development pipeline has also weakened, with the value of planning approvals during the 12 months to May 9% down on a year earlier. However from this low base we do anticipate some uptick in project starts during the second half of 2016, with further growth anticipated for next year.

Squeezed public finances similarly impacted on the community and amenity sector last year as projects were re-appraised following the election. However, the value of projects securing approval has strengthened over the last 12 months and we are forecasting a partial recovery in starts for 2016 as a whole.

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 government has substantially reduced the support for many renewable energy projects, including PV and on-shore windfarms. In contrast the current Water Industry investment cycle, AMP6, is gathering momentum. Increased investment in the national road network is also anticipated during the second half of 2016 and into 2017 as Highways England brings forward projects under its collaborative framework. After declining by 12% during 2015, the value of underlying civil project starts is forecast to rise by 4% this year. This excludes the impact of high value schemes of £100m of more such as the Thames Tideway Tunnel.

Overall, the value of underlying project starts were unchanged in the first half of this year against a year ago. Project starts are forecast to weaken during the final six months of the year as private sector investors hold back from committing to new projects amid the current political and economic uncertainty. However, a return to modest growth is anticipated for 2017 with the value of underlying project starts rising 1%.

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 flattened out last year and are forecast to fall back during 2016. In contrast modest growth is anticipated in the North West of England and the Midlands benefiting from improved housing market activity.

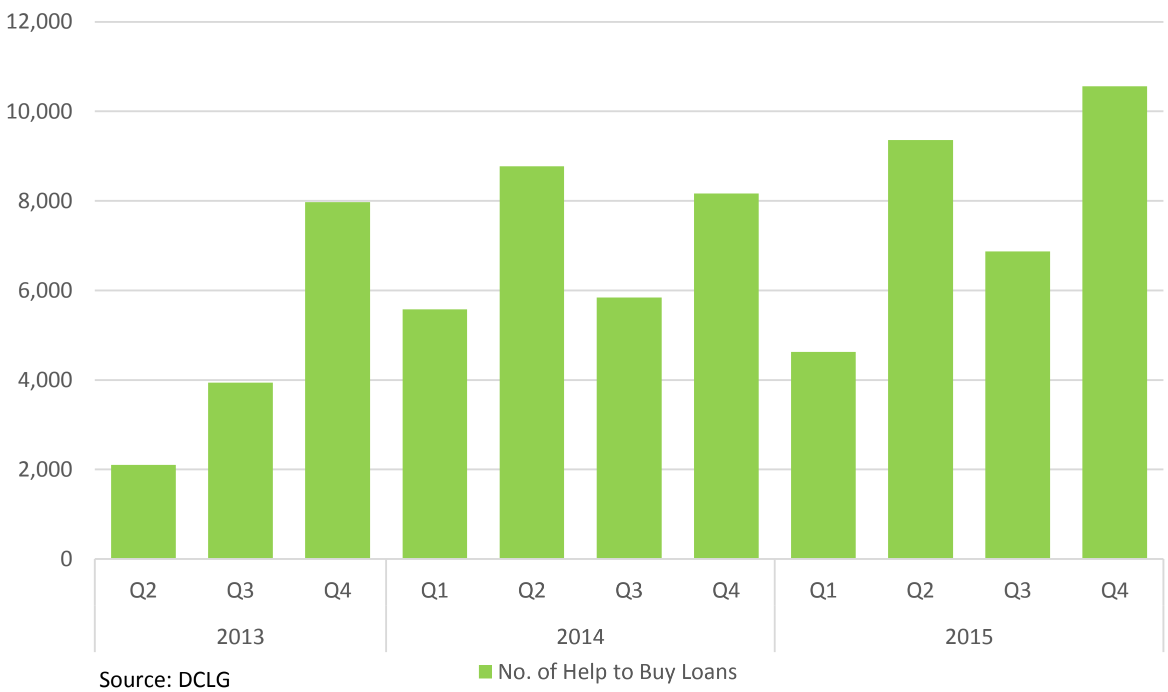
Private Housing

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.

Housing market activity has been temporarily disrupted in recent months by the introduction of a Stamp Duty surcharge on buy to let and second home purchases, together with purchaser nervousness in advance of the EU referendum.

Looking ahead the prospects for the sector during the remainder of this year and into 2017 have been clouded by the outcome of the EU referendum. Household expenditure is forecast by the OBR to rise by 2.4%, buoyed by rising employment and low inflation. This, together with government homeownership initiatives, will provide some support for property transactions and new house sales during the second half of 2016. However, average earnings growth is likely to moderate next year given the anticipated slowing in UK economic growth, while increased inflationary pressures are expected to constrain households' real income growth and house purchasers' confidence. A tightening in mortgage lending criteria is also likely to dampen market activity.

Chart 1: Number of "Help to Buy" loans completed



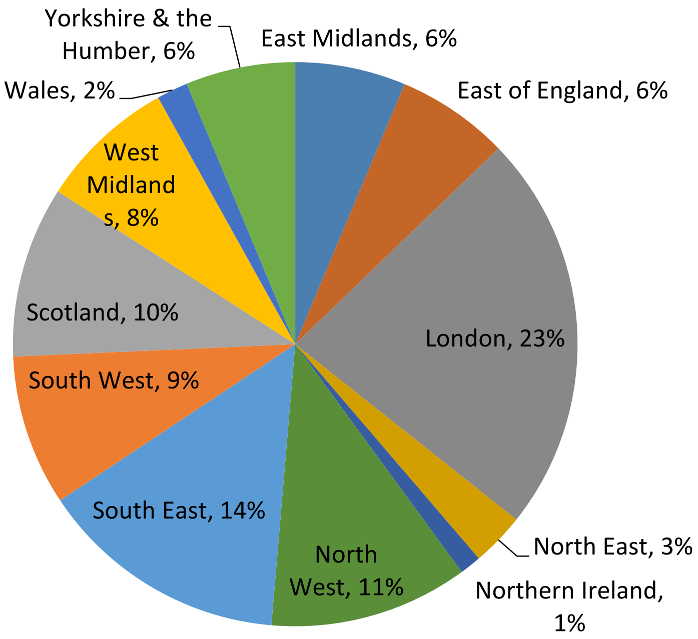
Source: DCLG

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. Over 10,500 new homes were purchased during the final quarter of 2015 with support from the “Help to Buy” scheme, taking to 73,813 the total number of loans for new-build homes purchased since the scheme’s introduction in April 2013.

Housebuilders 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 20% in 2014 to 225,000. The number of units approved a further 5% to 236,000 last year and remained firm during the first quarter of 2016.

The progressive rise in detailed planning approvals demonstrates that housebuilders have an improved pipeline of projects that they can bring to site. Housebuilders will be watching housing market activity and their own sales especially closely over the coming months to gauge the extent of any faltering in purchaser confidence. We are forecasting a moderation in sector growth, with the value of project starts rising 5% this year and 2% in 2017.

Chart 2: Value (£m) of Private Housing Detailed Planning Approvals by Region, 2015



Source: Glenigan. NB: Includes all projects for 10 residential units or more.

Social Housing

Last year saw an encouraging rebound in detailed planning approvals, which were up 31% on 2014. However we anticipate that housing associations will struggle to bring forward all of the planned schemes. Government capital funding for new social housing provision in England remains tight and the Government has announced measures that we expect to restrict housing associations' capacity to secure the necessary private funding to bring forward these projects into development.

The Government has announced that social housing rent increases are to be capped at 1% per annum below the rate of inflation. This is aimed at checking the rise in housing benefit costs. However it also conflicts with the Government's expectation that Registered Social Landlords (RSLs) capital programmes will be met through private sector borrowing serviced by higher, 'near market rents'.

In addition the extension of the "Right to Buy" to housing association tenants in England is likely to reduce the capital value of the association's estate and their potential collateral for funding new developments.

Accordingly we expect that the value of project starts to fall 7% during 2016, continuing last year's downward trend with a marked decline forecast for 2017.

Industrial

Industrial construction was a bright spot in 2015. The value of underlying project starts grew by 4%, building on the near 50% rise seen in 2014. The development pipeline remains strong, with the value of projects securing approval during the twelve months to May 2016 being 21% up on a year ago.

In contrast the first five months of 2016 saw an 8% decline in project starts as investors and developers held off making the final commitment to projects until after the EU referendum.

Last year's sector growth was driven by an increase in warehousing and logistics space work, which was 31% up on 2014. Structural change in the retail sector, with the continued growth of on-line retailing, click & collect and home deliveries, is 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 the 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.

However, warehousing and logistics starts during the first five months of 2016 were half the level of a year ago. The downturn is forecast to persist in the short term as investors reassess their plans in the light of the UK's impending EU exit.

Chart 3: Value of underlying warehousing & Logistics projects started in 2015 by region

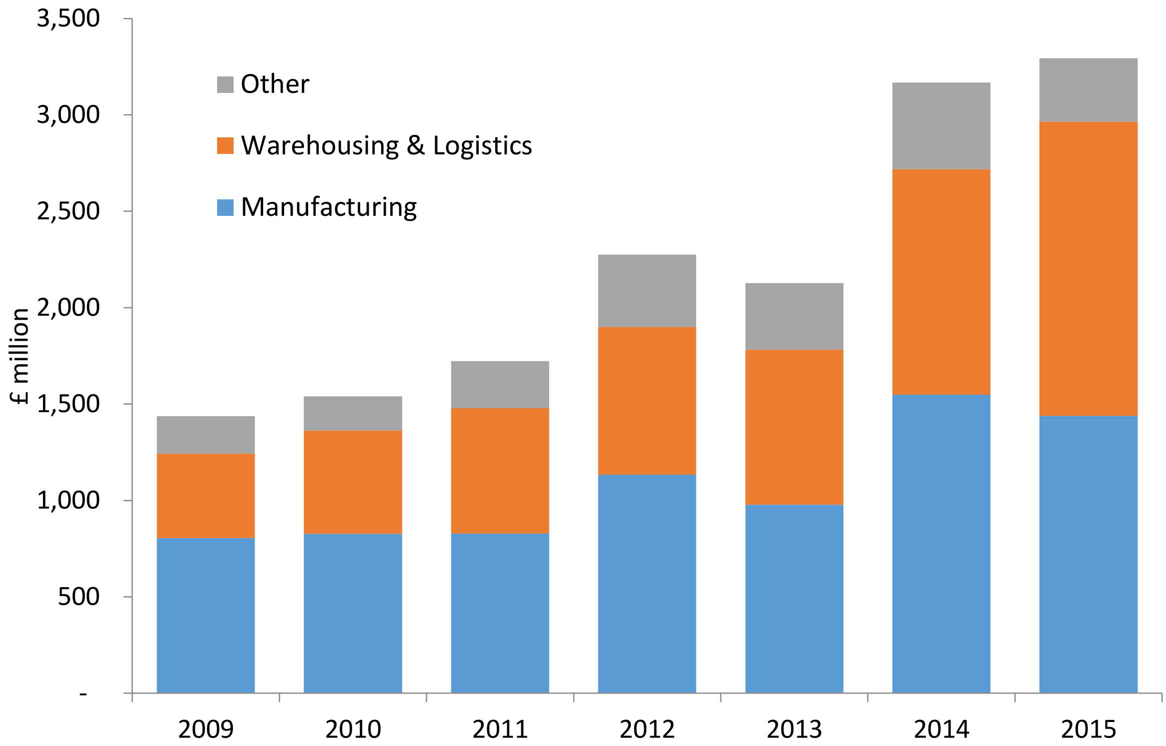
Source: Glenigan

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 depressed project starts during the first five months of 2016; the value of underlying manufacturing starts were 23% lower than a year ago. UK exporters should benefit in the near term from the current weakening in Sterling. However 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 single market.

Overall we expect retrenchment in the industrial sector during the forecast period, with the value of underlying project starts falling 10% this year and 2% during 2017.

Chart 4: Value of underlying Industrial starts by category

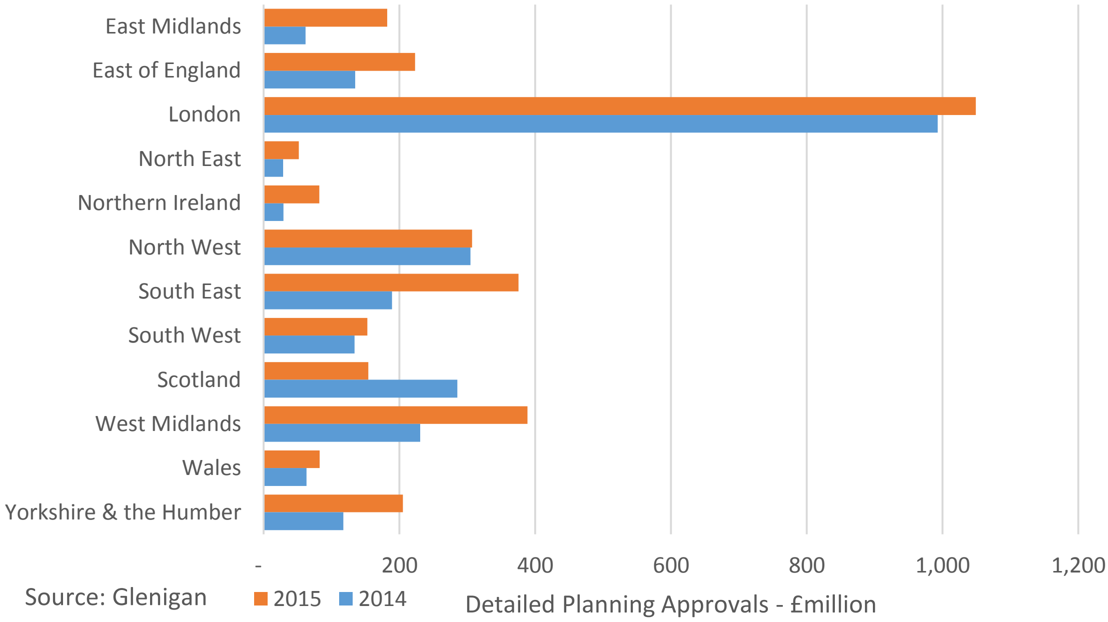


Source: Glenigan

Offices

Office project starts picked up sharply during the second half of 2015, shaking off the impact of pre-general election nerves on investor confidence. Whilst the planning pipeline remains firm, political concerns returned to dampened starts in the immediate run-up to the referendum during the first half of this year. These concerns are now set to persist as investors appraise the implications of Brexit for the future demand for office accommodation and rental values.

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



Source: Glenigan

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.

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. Unfortunately, we anticipate that, overseas investors in particular may adopt a more cautious approach over the forecast period following the Brexit vote and the prospect of further weakening in Sterling.

Overall we expect the value of underlying project starts to slip back 5% this year, with a similar decline in 2017.

Retail

Increased household incomes and rising consumer confidence have failed to lift retail construction activity. The retail sector continues to be buffeted by structural change as retailers struggle to accommodate consumers' changing shopping habits, with BHS and Austin Reed being sector's latest high profile casualties.

Whilst volumes are on the rise, retailers' turnover and profitability are being squeezed by falling prices and cost pressures. This is particularly evident in the grocery sector, where falling food prices, aided by a supermarket price war, have been a key factor behind the recent fall in inflation.

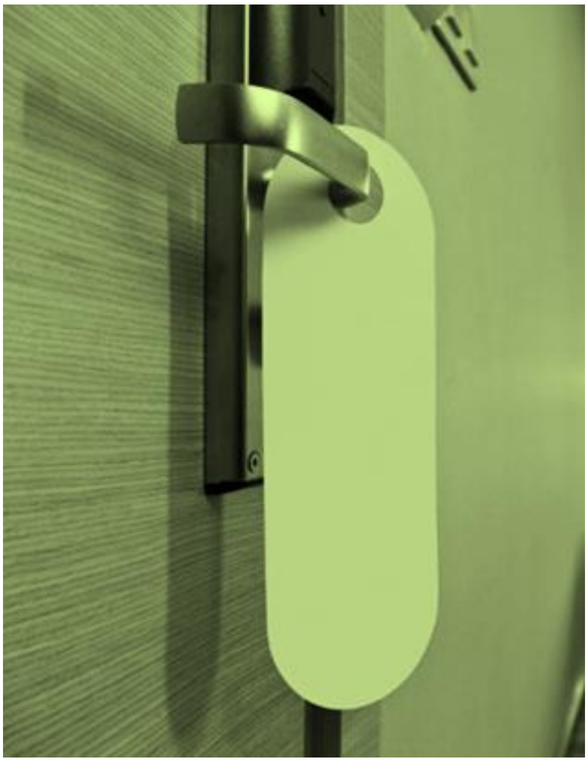
Job opportunities in the retail sector are expected to fall to their lowest level for five years as shop owners claw back the costs of the government's new living wage. About a third of employers in the retail sector intend to restrict the number of new jobs as higher pay packets for the lowest-paid staff eat into profit levels and cut dividends according to a recent survey by the recruitment firm Manpower.

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 value of underlying retail project starts fell 11% last year and the development pipeline is weak. Looking further ahead, the value of retail projects securing detailed planning approval during the 12 months to May was 14% down on the preceding period. Against the background of continued rationalisation and structural change in the retail sector, we expect the value of underlying project stars to drop by a further 12% in 2016.

Whilst the adaptation and re-fitting of existing stores is expected to be a key area of sector activity during over the next two years, the sector is also likely to benefit from a number of large scale projects. 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.

Hotel & Leisure



The UK's hotel and leisure industries have benefited from improved consumer sentiment, coupled with rising employment and emerging growth in real earnings. Domestic consumer demand has been improving.

Strengthening employment, earnings growth and 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 output may knock consumer sentiment and discretionary spending. However the weakening exchange rate will generate greater demand for hotel accommodation from overseas visitors and encourage UK households to holiday 'at home'.

After a 20% increase in starts during 2014, the sector entered a period of consolidation last year, project starts edging just 2% higher. A further weakening in project starts is forecast for the current year, with underlying projects starts forecast to decline 18%.

The medium term prospects for the sector are more positive. An 11% increase in the value of planning approvals in the 12 months to May 2016 points to a brightening outlook for the sector for 2017 onwards. In addition the sector is already benefiting from several high profile major developments, including Tottenham FC's £400 million redevelopment of White Hart Lane.

Education

Post-election universities have renewed confidence in their future funding streams and are pressing ahead with planned schemes. In contrast our expectations are less positive near term for work on the UK's state schools which account for the majority of work carried out in this sector.

Investment in higher education facilities is forecast to be a growth area within the education sector during 2016 and 2017 as Universities compete to enrol both domestic and overseas students. There is a strong development pipeline for further & higher education work, with detailed planning approvals rising by around 50% last year after a 28% rise in 2014.

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.

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

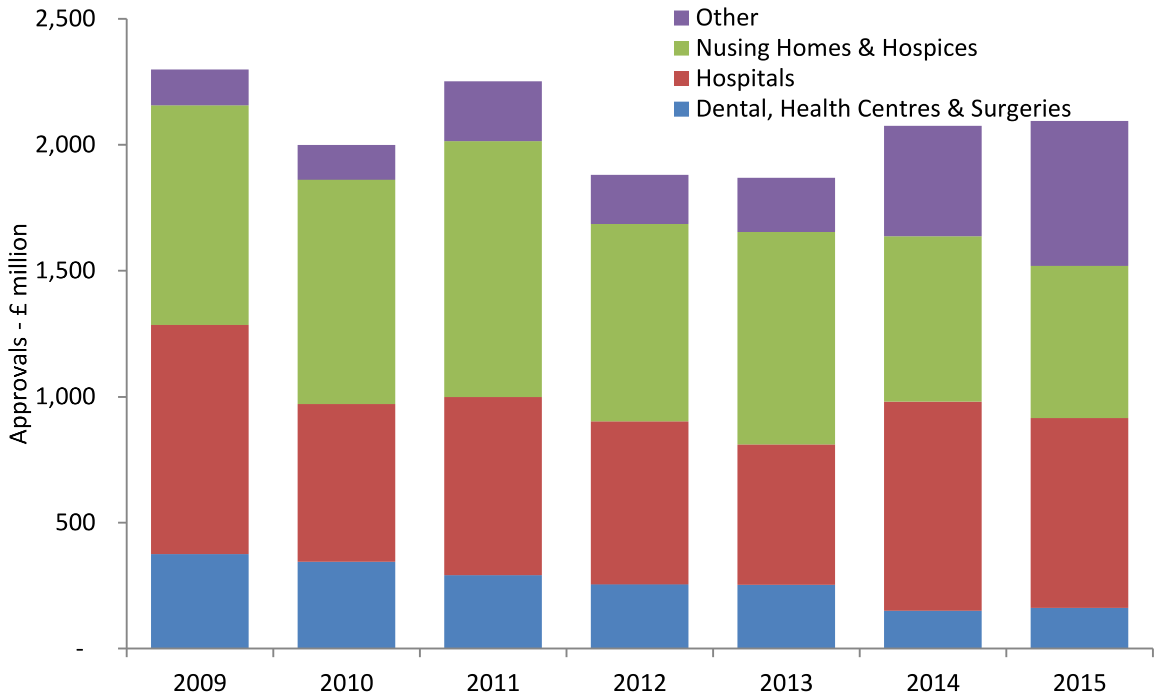
Near term, councils are likely to accommodate rising pupil numbers through the expansion of existing schools, although with 60% of secondary schools now academies, councils need to persuade these schools to expand to accommodate the rise in pupil numbers. In addition any new schools must also be "free schools", outside local authority control. The recent 'turf war' over the Government's aborted plans to convert all existing local authority run schools into academies has added to political uncertainty.

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 five months of 2016. Project starts also fell during H1 2016 and we expect this weakness to persist during the remainder of the year. This is forecast to feed through as 4% drop in the value of education sector starts in 2016 as a whole, before returning to growth in 2017.

Health

Last year saw a sharp decline in the health sector. The value of underlying project starts fell 27%; the sharpest sector decline during the year. The fall was in part due to the general election disrupting the commencement of projects on site. In contrast the value of projects securing planning approvals was little changed on the previous year. We anticipate a modest recovery in project starts during the current year as NHS trusts progress with schemes currently in their development pipeline.

Chart 6: Value of underlying detailed planning approvals for health projects



Source: Glenigan

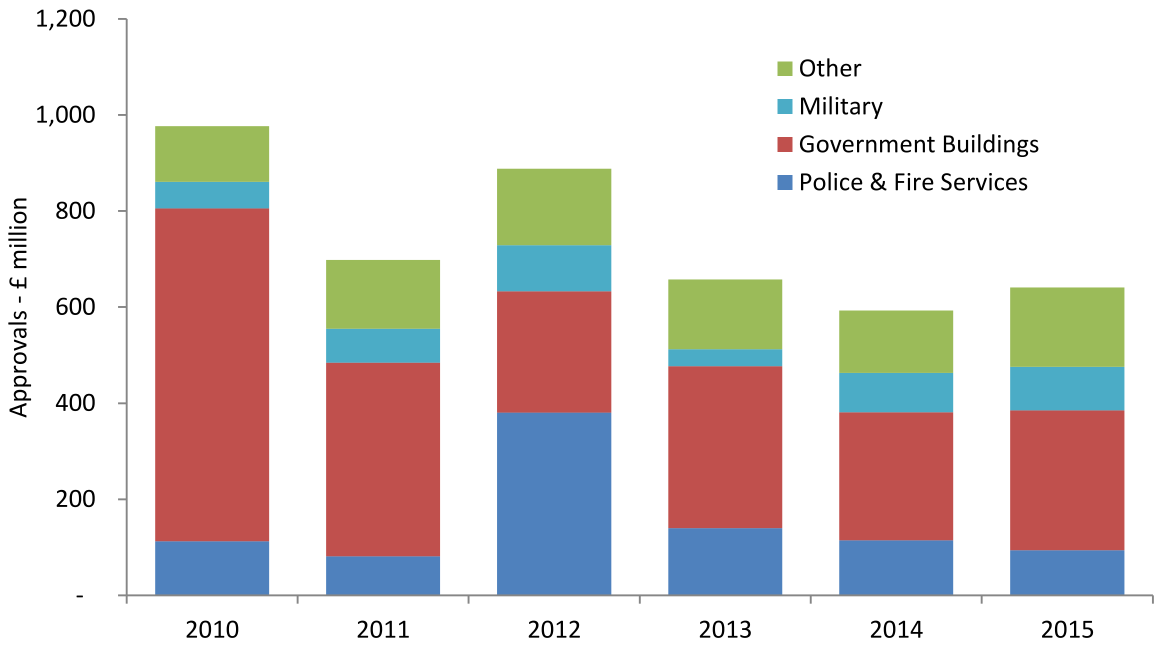
Nevertheless NHS capital budgets remain under pressure, squeezed by rising costs elsewhere in the service. Although the government has pledged an extra £8 billion for the NHS budget, the Government is also looking to the NHS to find a further £22 billion through efficiency savings by 2020/21.

Despite this tough financial background, we do anticipate a partial recovery from the sharp decline in project starts seen last year and are forecasting a 6% rise in the value of underlying project starts during 2016 compared to the depressed 2015 level, with further growth forecast for next year.

Community & Amenity

Squeezed public finances similarly 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 May 2016, being 12% up on the preceding period and we are forecasting a partial recovery in starts this year.

Chart 7: Value of underlying detailed planning approvals for community & amenity projects



Source: Glenigan

We expect sector growth to be supported by an increase in MoD work and 'other' projects such as religious buildings. 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 in the first five months of 2016 saw a spectacular 150% 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 2016. 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 2016 and 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 is forecast to have 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 increase in water and sewerage activity is not expected to be sufficient to offset the downturn in the energy sector. We are forecasting a 5% drop in the value of underlying starts in the utilities sector during 2016. However overall sector activity is also benefiting from major work packages let on the £4 billion Thames Tideway Tunnel which is now underway.

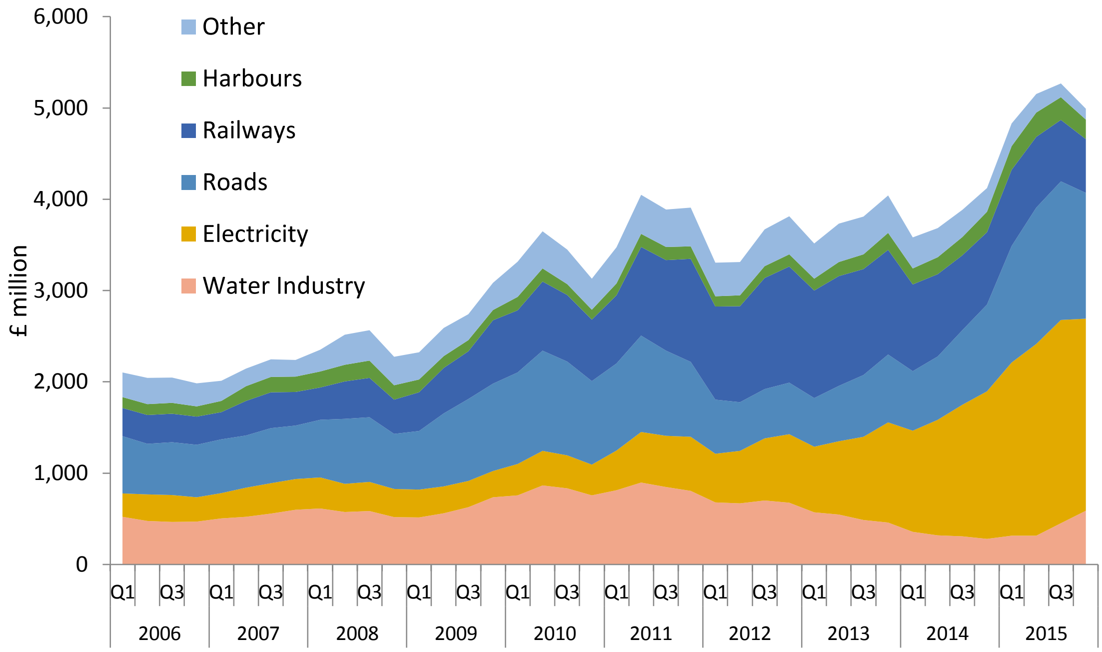
Whilst transport investment is also expected to continue to boost new activity, the emphasis is swinging away from the rail sector towards the national road network. A number of major rail projects are coming to a close, most notably Crossrail where the focus of activity has moved to fit-out and passenger infrastructure, although construction is now underway on the Northern line extension to Battersea.

Network Rail's current capital programme (CP5) has been scaled back due 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.

Increased investment in the national road network is anticipated during the second half of 2016 and in 2017 as Highways England brings forward projects under its collaborative framework. The national road network appears set to remain a growth area over the medium term, with the bulk of funding increases planned for later in this parliament and beyond the next election.

Political uncertainty in the aftermath of the Brexit vote is likely to delay the progress of some major capital projects. The Government's announcement on extra runway capacity in the south east, which was due over the summer, has been delayed until after the new Prime Minister is in post, while the downgrading of the UK's credit rating could potentially impact on the overall cost and timing of HS2.

Chart 8: Infrastructure Construction Output



Source: ONS. Values are in current prices.

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