Construction Outlook

FORECAST FOR 2018 & 2019

PREPARED BY

Glenigan

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Executive Summary

2018 -6%   2019 -4%

Overall the market is forecast to contract this year and next, falling by 6% in 2018 and 4% in 2019.

Whilst overall starts will decline this year, growth is forecast in the education, health and civil engineering sectors. Growth will also be focused outside London and the South East, with project starts in the Midlands and the North of England being the strongest performing regions.

- Business investment hit by slow UK economic growth and political uncertainty
- Weaker housing market activity and slowdown in office sectors
- Increase in logistics projects
- Major projects boost civil engineer workloads
- Overall weakening in construction project starts during 2018 & 2019

UK Construction Prospects

The value of underlying construction projects are forecast to fall back over the next two years amid persistent political and economic uncertainty and a weakening in housing market activity.

Overall the value of project starts is expected to fall by 6% this year. A further 4% decline is forecast for 2019.

Table 1: *Value of Underlying Project Starts by Sector*

£m	2016	2017	2018f	2019f
Private Housing	21,031	21,212	18,444	17,061
Social Housing	7,974	6,996	6,316	6,406
Industrial	4,364	4,460	4,275	3,880
Offices	5,273	4,444	4,124	4,129
Retail	2,636	2,405	2,128	2,093
Hotel & Leisure	3,305	4,165	3,752	3,545
Education	7,208	5,689	6,329	6,217
Health	2,602	2,155	2,474	2,334
Community & Amenity	1,221	1,513	1,098	1,262
Civil Engineering	7,953	5,663	6,139	6,115
Total	**63,565**	**58,703**	**55,078**	**53,042**

Source: Glenigan

The weak UK economy is forecast to constrain construction activity during 2018 and 2019. Real household earnings growth had stalled due to weak wage growth and higher inflation. Whilst real earnings are now rising, growth is weak. This is forecast to slow housing market activity and to impact on private housing starts.

Universities investment programmes are forecast to help drive growth in the education sector this year. Increased investment is also anticipated to expand the secondary school estate in order to accommodate rising pupil numbers, especially in the UK's major conurbations.

Warehousing & logistic premises are forecast to be a growth area as technological and social changes reshape consumers' retail habits and drive the demand for logistics space. Growth in this area will partially offset a weakening in manufacturing investment in factory premises.

The retail sector will decline further during the forecast period as weak consumer spending and the growth in on-line retailing accelerate the restructuring of the retail industry.

Commercial office starts will also weaken this year, especially in London. However a recent rise in planning approvals suggests renewed confidence among investors in the longer term prospects for the sector.

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 civil engineering projects starting on site is also expected to improve, having fallen back sharply last year. Heathrow's third runway development, recently given the go-ahead, is not expected to contribute during the period covered by this report with initial works potentially commencing in 2023.

Longer term construction should benefit from increased public sector investment as the Government seeks to increase capital spending to improve UK competitiveness. Network Rail's £47 billion funding package for 2019 to 2024 is an illustration of the Government's commitment to greater investment in the built environment.

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: *Growth in the Value of Underlying Project Starts by Sector*

Change on previous year	2016	2017	2018f	2019f
Private Housing	25%	1%	-13%	-8%
Social Housing	25%	-12%	-10%	1%
Industrial	-7%	2%	-4%	-9%
Offices	14%	-16%	-7%	0%
Retail	22%	-9%	-12%	-2%
Hotel & Leisure	2%	26%	-17%	-6%
Education	-4%	-21%	11%	-2%
Health	13%	-17%	15%	-6%
Community & Amenity	12%	24%	-27%	15%
Civil Engineering	-16%	-29%	8%	0%
Total	**9%**	**-8%**	**-6%**	**-4%**

Source: Glenigan

Private Housing

2018 -13%   2019 -8%

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 fall back 13% this year, as housebuilders prioritise building out developments and open fewer new sites. A further 8% decline is anticipated for 2019 as housebuilders respond to a slowing in the general housing market.

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

Private Housing Starts

	2017	2018f	2019f
£ million	21,212	18,444	16,378
Growth	1%	-13%	-8%

Strong growth in residential projects securing planning approval over the last five years has created a healthier development pipeline. The value of planning approvals rose by 6% last year and are forecast to stabilise near this higher level during 2018.

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

Source: Glenigan N.B. 2018 to May - pro rata

Demand rather than supply will be the principal 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 the housing market is forecast for this year and 2019. Real household earnings have been squeezed by higher inflation and slower economic growth. This is forecast to hit the sale of new homes, although the Government's Help to Buy scheme for purchasers of new homes 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, with London, Manchester and Birmingham favoured locations of major schemes. Last year saw £700 million worth of Build to Rent projects start on site involving more than 4,500 residential units. During the first five months of 2018, projects with a combined value of £324 million and involving 2,100 units started on site. Further strong growth is anticipated over the forecast period.

Social Housing

2018 -10% 2019 +1%

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

Project starts during the first five months of 2018 were 14% down on 2017.

- Slowdown in affordable housing projects starting on site
- Disruption to planned development programmes post-Grenfell
- Safety work to existing estate immediate priority
- Student accommodation important growth area

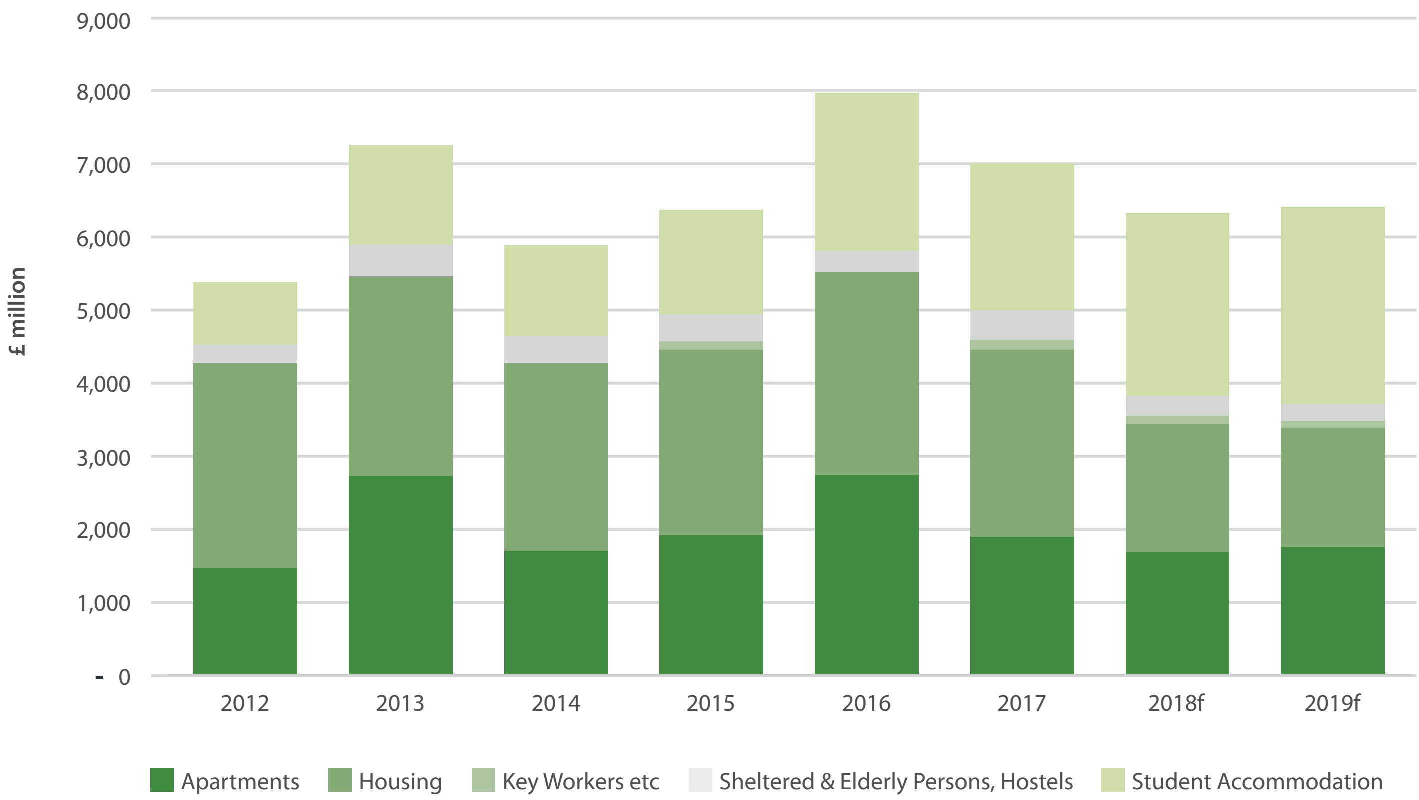
Social Housing Starts			
	2017	**2018f**	**2019f**
£ million	6,996	6,316	6,406
Growth	-12%	-10%	1%

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 value of detailed planning approvals slipped back 12% during the first five months of 2018, reversing the growth seen last year. We expect this weakening development pipeline to feed through to a decline in affordable housing project starts and sector activity over the forecast period.

In contrast student accommodation will remain a growth area within the sector during 2018 and 2019. Student accommodation has become an important niche market for private sector developers and the development pipeline is strong. The value of student accommodation projects starting on site grew by 24% during the first five months of this year.

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



Source: Glenigan

Industrial

2018 -4% 2019 -9%

Strong demand for logistics space is driving sector activity.

Industrial project starts are forecast to slip back during 2018 and 2019 as the uncertain economic outlook deters manufacturing investment.

- Manufacturers' investment in new capacity and manufacturing premises delayed by uncertainty over domestic demand and access to the European Single Market
- Renewed investment in logistics space countering manufacturing weakness
- Midlands and North West prime areas for sector growth

Industrial Starts			
	2017	**2018f**	**2019f**
£ million	4,460	4,275	3,880
Growth	2%	-4%	-9%

Future investment in new capacity and premises will be determined by long term growth prospects. Manufacturers' investment in new buildings fell by 4% last year, while expenditure on plant and machinery rose 4%, suggesting that manufacturers are prioritising efficiency improvements over additional capacity. Manufacturers' clearly have concerns over the prospects for domestic demand as UK economic growth weakens. This, coupled with uncertainty over future access to the EU markets and supply chains post-Brexit, is expected to deter investment in new manufacturing capacity and building work over the forecast period.

Chart 3: *UK Manufacturers' capital expenditure on buildings has weakened over the last 18 months*

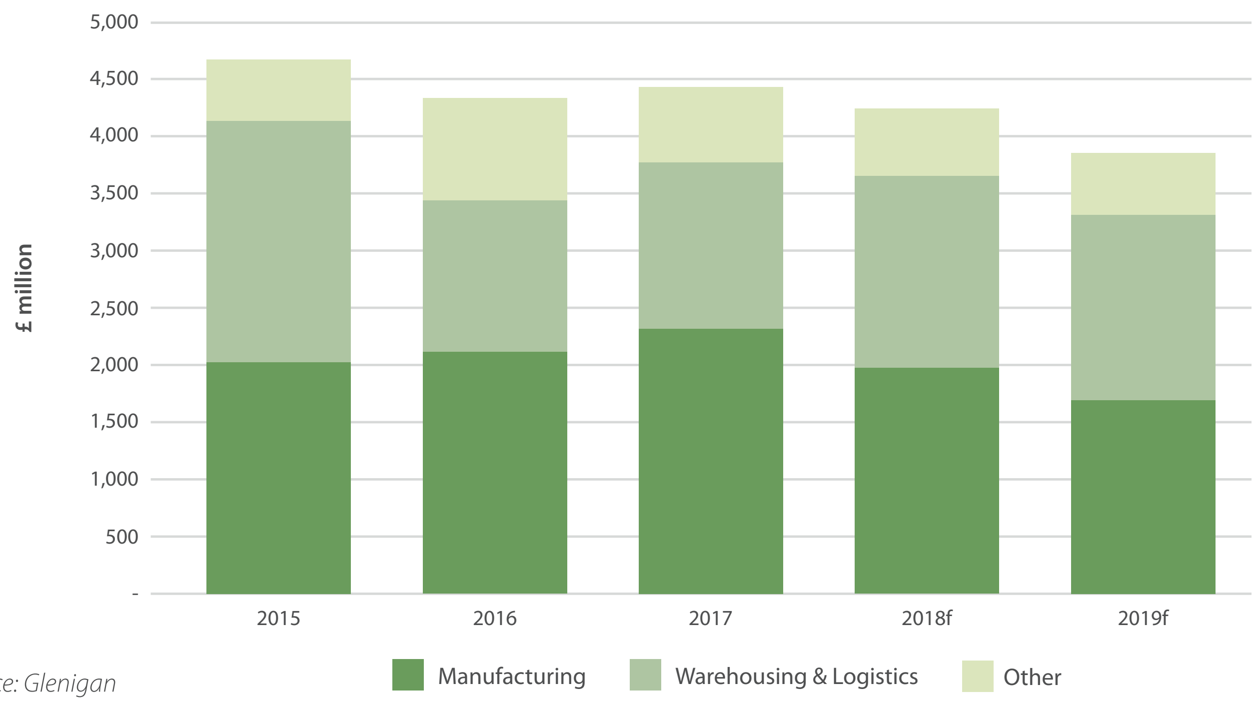
Source: ONS

Warehousing and logistics have been the fastest growing segment within the industrial sector in recent years. The value of starts grew rapidly to reach £2 billion in 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. Despite a weak start to the year, we anticipate that the value of warehousing & logistics projects starting on site will rise by 15% during 2018, with start figures remaining firm next year. 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.

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



Source: Glenigan

Offices

2018 -7%   2019 no change

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

Political and economic concerns arising from the EU referendum depressed project starts during 2016 and 2017 as investors appraise the implications for the demand for office space and rental values of Brexit and slower UK economic growth. Whilst these concerns are expected to weigh upon starts during 2018, a recent recovery in detailed planning approvals suggests that sentiment over longer market prospects has begun to improve.

- 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

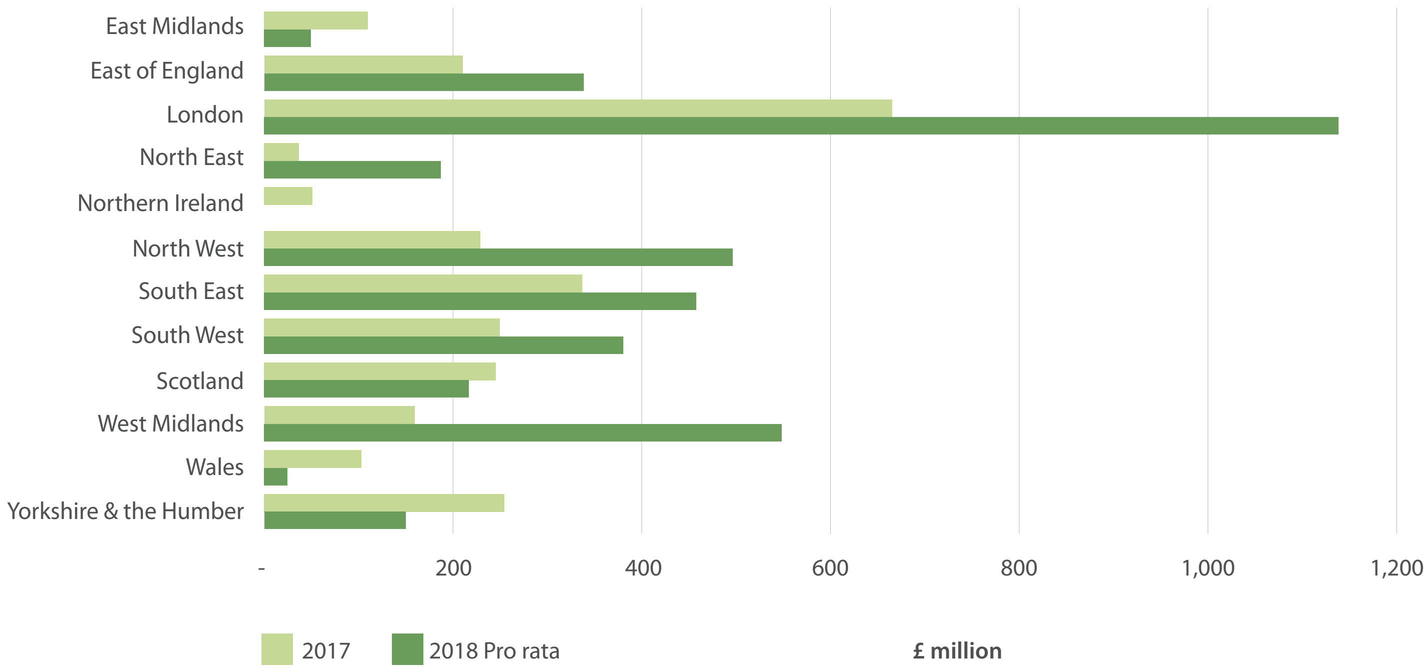
	2017	2018f	2019f
£ million	4,444	4,124	4,129
Growth	-16%	-7%	0%

London dominates the office sector, accounting for around half of office sector activity. The number of planning approvals has slipped back over the last two years. Starts in London during the first five months of 2018 were 25% down on the last year and we anticipate a further weakening in starts during the remainder of the year.

Developments in the City of London and Docklands have been seen as vulnerable with weaker demand for accommodation as financial institutions consider relocating some operations to elsewhere within the EU. However the first five months of 2018 also saw a sharp 85% rise in planning approvals in the capital, pointing to a recovery in projects starts over the longer term.

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



Source: Glenigan N.B. 2018 data is based on Jan to May pro rata

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

The North West and West Midlands have both seen a sharp rise in project starts during the first five months of 2018 and a growing development pipeline is expected to ensure that the key regional centres will continue to outperform London during the forecast period. Nationally the value of underlying project starts will fall 7% this year, before stabilising in 2019.

Retail

2018 -12%   2019 -2%

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. Household incomes are growing only slowly and on-line purchases are taking a growing slice of retail sales. Against this backdrop, the retail property market faces weakening demand for retail space and softening rental values 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

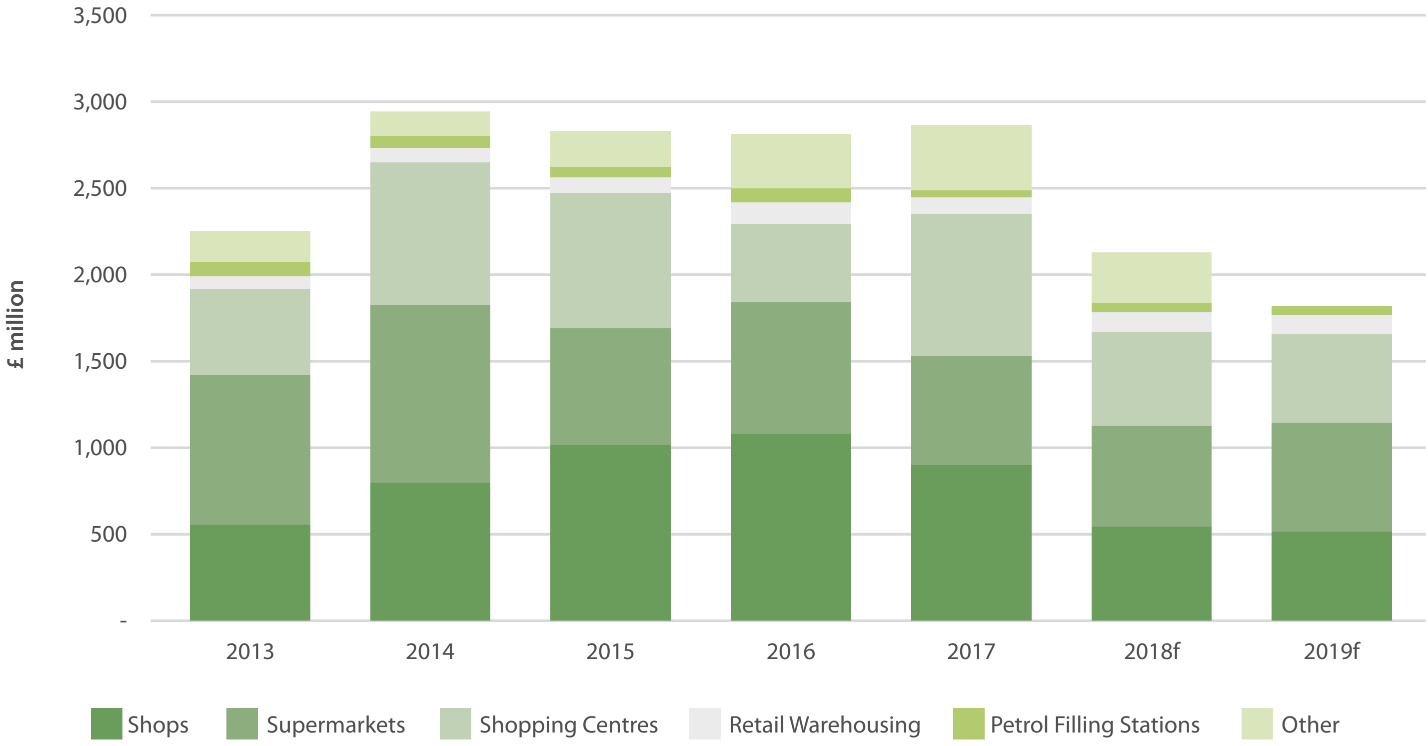
	2017	2018f	2019f
£ million	2,405	2,128	2,093
Growth	-9%	-12%	-2%

The retail development pipeline is subdued. Project starts fell 9% last year and were 22% lower during the first five months of 2018 than a year ago.

Falling in-store sales have prompted retailers to review their retail estates as a growing proportion of 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, driven by declining in-store sales and efforts to accommodate click and collect services are similarly focused on rationalising their estate and re-modelling their retained stores.

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 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 12% this year, with a smaller 2% fall forecast for next year.

Hotel and Leisure

2018 -17% 2019 -6%

Weakening in project starts after recent rapid growth. Investors and operators more cautious as UK consumer spending weakens and recent growth in tourism stalls.

The Hotel and Leisure sector emerged as an early beneficiary of the Brexit vote; the marked fall in Sterling since the start of 2016 enhanced the UK's appeal as a tourist destination. The number of overseas visitors to the UK during the first half of last year was 9% up on a year ago, with spending 15% higher. Visitor numbers slipped back however during the final six months of 2017, suggesting that the boost from the weaker pound has run its course.

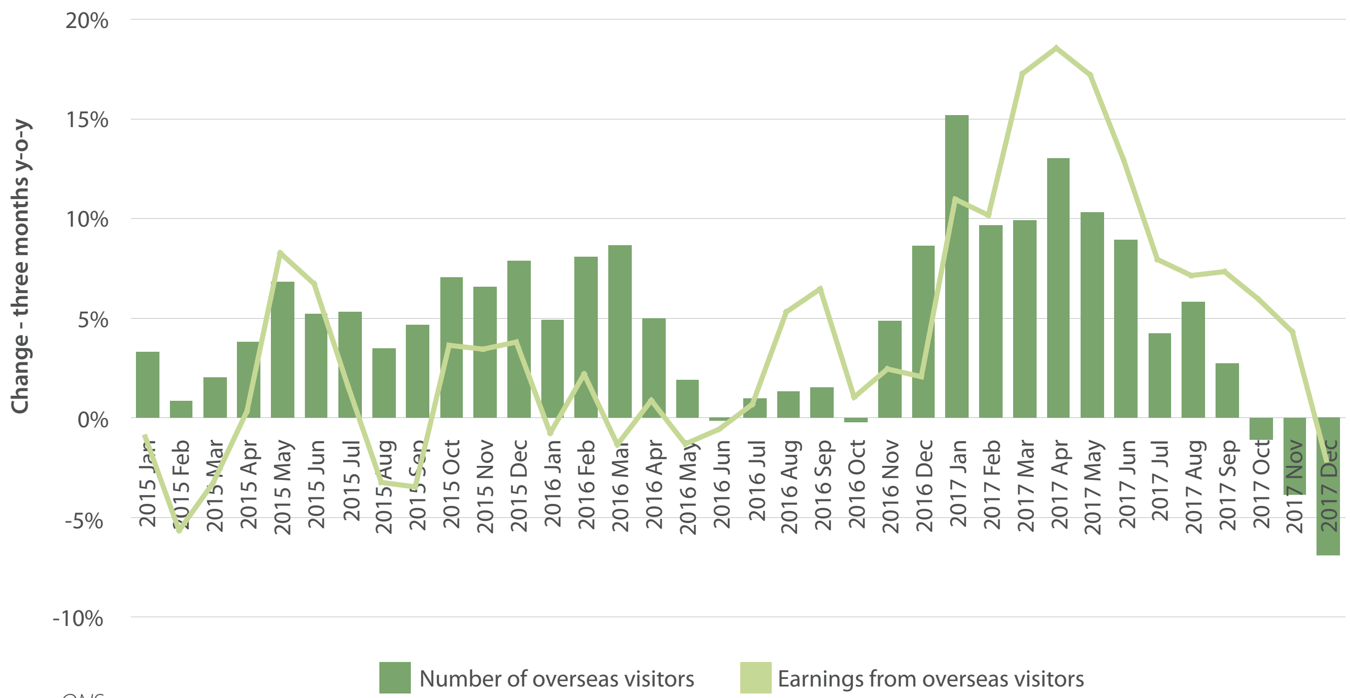
- Tourism boost from weaker pound
- More UK residents also expected to holiday in UK
- Hotel chains have significant expansion plans
- Strong development pipeline

Hotel & Leisure Starts

	2017	2018f	2019f
£ million	4,165	3,752	3,545
Growth	26%	-17%	-6%

The slowing in overseas visitor numbers may have prompted increased caution amongst investors. The value of projects commencing on site has turned down sharply since the start of the year, despite a strong pipeline of projects securing detailed planning approval.

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

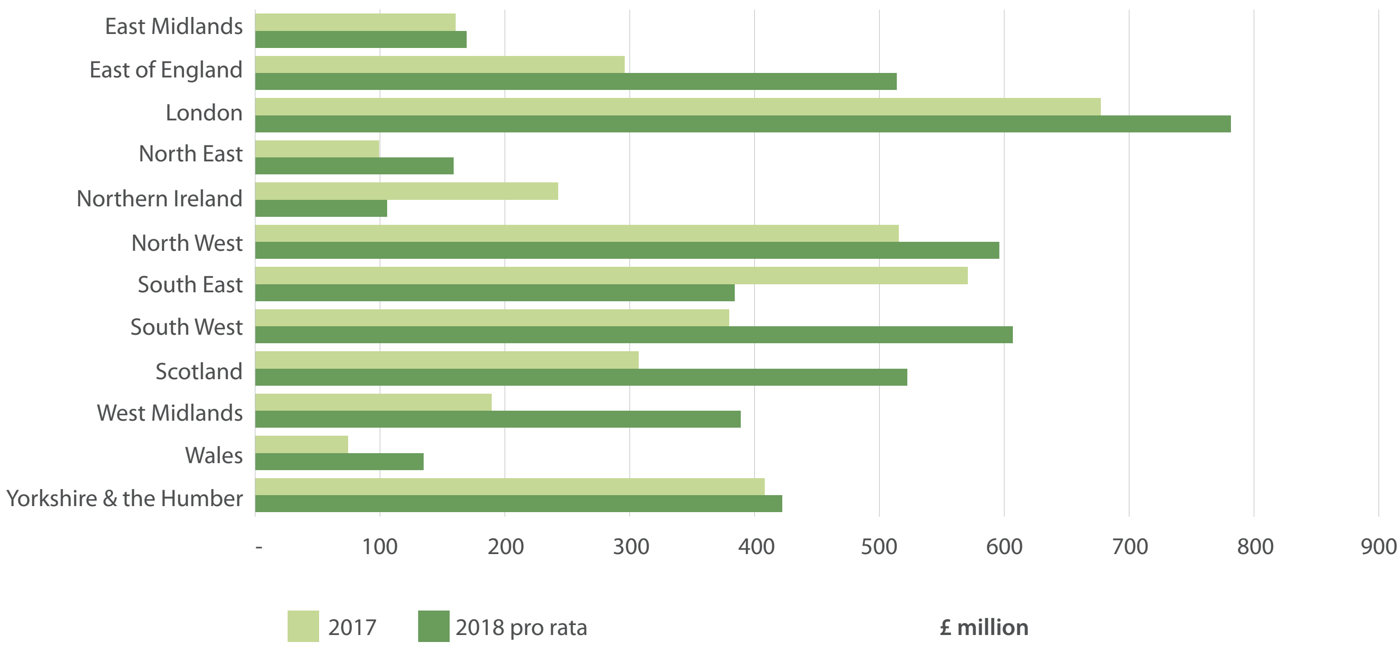


Source: ONS

Overall consumer spending growth will be constrained over the forecast period by weakening employment levels and higher inflation, although the hotel and leisure sector should be able to take a greater share of the available discretionary spending. The weaker pound is prompting 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 fed through to project starts in 2016 and 2017, with starts jumping 26% last year. However starts have fallen back 21% during the first five months of this year. A further weakening is anticipated over the forecast period despite the strong development pipeline.

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



Source: Glenigan N.B. 2018 is based on Jan to May - pro rata

Education

2018 +11%   2019 -2%

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			
	2017	**2018f**	**2019f**
£ million	5,689	6,329	6,217
Growth	-21%	11%	-2%

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 and 2107, reversing a progressive rise in approvals during the preceding two years. This shrinking development pipeline will restrict new build starts in the near term.

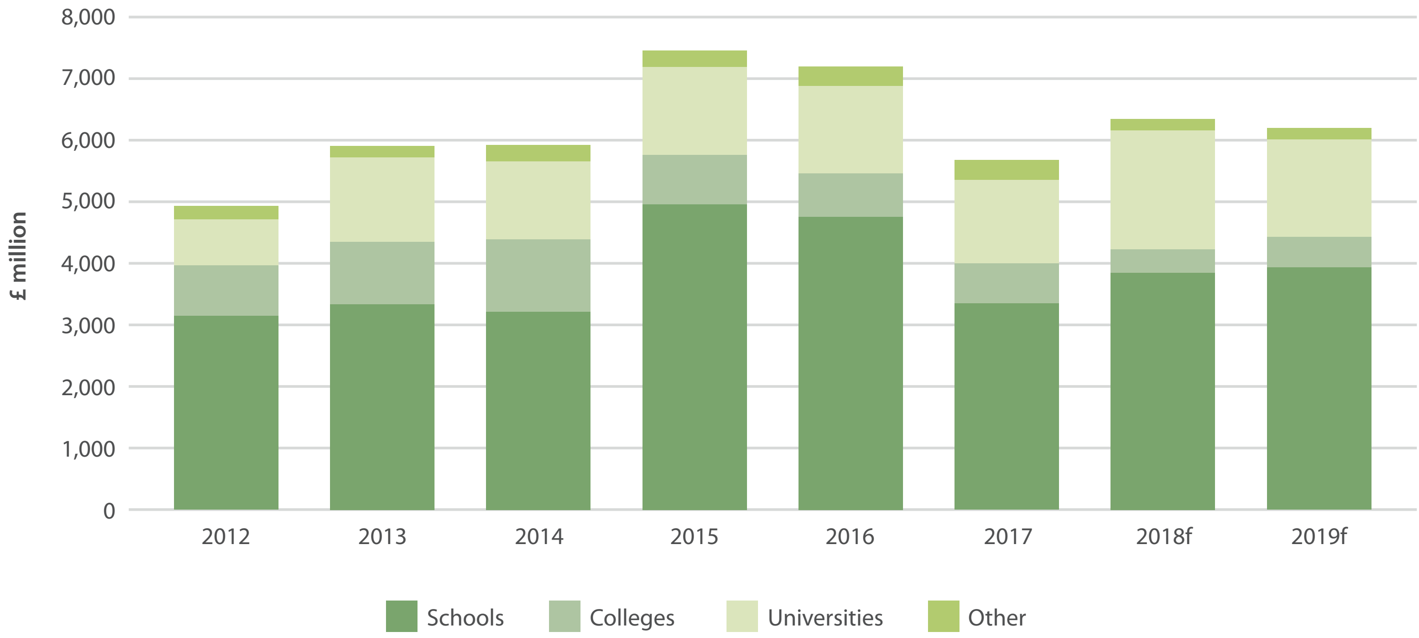
However the first five months of 2018 have seen a 50% rise in the value of school projects securing detailed planning approval. This is expected to support school starts next year.

Investment in higher education facilities has been a growth area as universities compete to enrol both domestic and overseas students, with the value of university starts averaging £1.4 billion a year since 2013. 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 fall in projects securing planning approvals that fed though to a dip in project starts last year. However, a sharp recovery in approvals during 2017 and the first five months of this points to renewed growth.

Whilst a weakening in both school and university projects have contributed to a 21% decline in education sector starts last 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 11% this year, before slipping back 2% in 2019.

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



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

Health

2018 +15%   2019 -6%

Modest rise in starts forecast for 2018 following rise in project approvals last 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

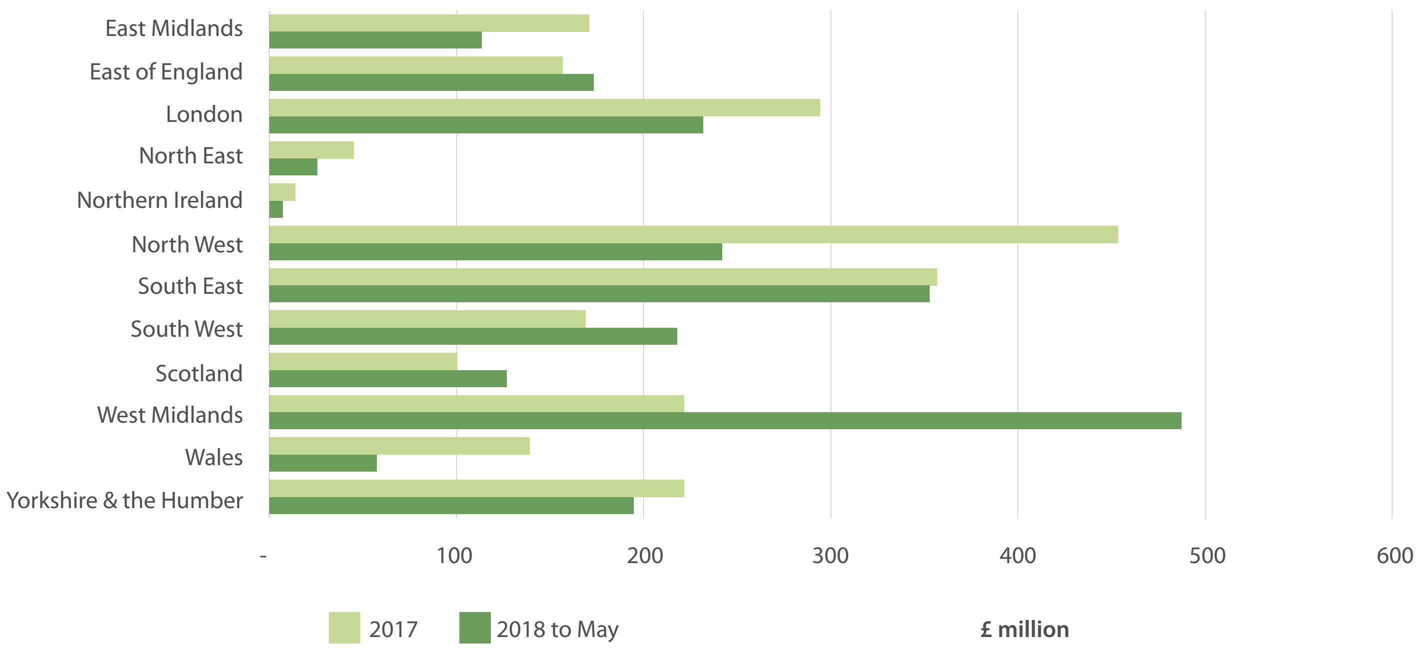
Health Starts			
	2017	**2018f**	**2019f**
£ million	2,155	2,474	2,334
Growth	-17%	15%	-6%

Project starts weakened 17% last year, with the snap election appearing to have had a more disruptive impact on the timing of planned projects than we initially expected. Delayed projects now appear to be progressing to site. The value of project starts during the first five months of 2018 was 14% up against a year ago.

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. These pressures are likely to accelerate the closure of existing facilities and deter investment in new premises during the forecast period. Over the longer term, however, this may open up opportunities for investment in new modern facilities to provide support for a growing elderly population.

At £2.3 billion the value of approvals during 2017 was 16% up on the previous year. This is expected to sustain growth in project starts into the second half of this year. A more recent decline in approvals during the first five months of this year is expected to feed through to a 6% decline in project starts for 2019.

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



Source: Glenigan N.B. 2018 data is based on Jan to May - pro rata

Civil Engineering

2018 +8%   2019 no change

Major infrastructure schemes, including Thames Tideway, HS2 and Hinckley Point, will be important drivers for sector activity over the forecast period. However the value of underlying project starts is expected to edge higher as investment in smaller scale projects improves.

Energy industry work currently dominates the civil engineering sector. The ONS estimate that energy projects accounted for 43% of sector output in 2017. Energy is set to remain a major driver for the sector 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 momentum
- Increased water industry investment

Civil Engineering Starts

	2017	2018f	2019f
£ million	5,663	6,139	6,115
Growth	-29%	8%	0%

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.

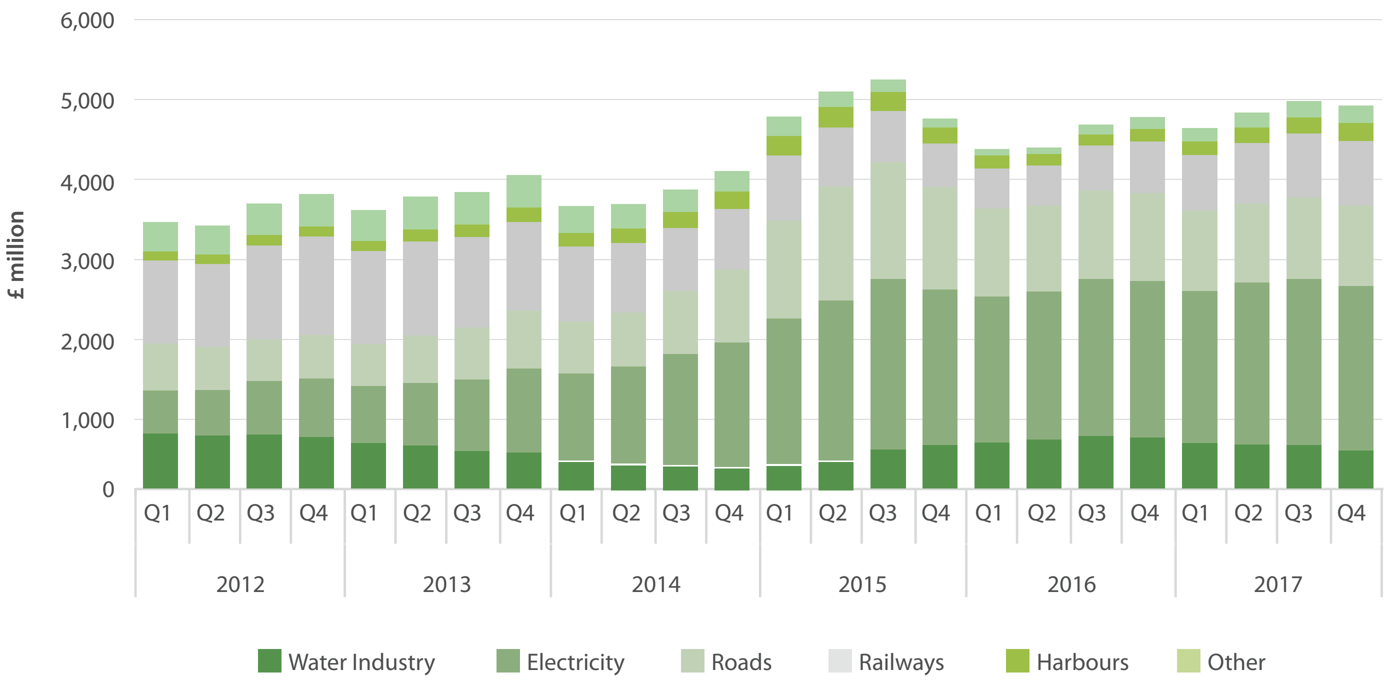
Heathrow's third runway development, recently given the go-ahead, is not expected to contribute during the period covered by this report with initial works potentially commencing in 2023.

Work on HS2 is now contributing to sector activity as various contracts start on site. 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 over the forecast period, but there will be a sharp divergence in workload across different sectors and parts of the country. Logistics premises, build to rent, student accommodation, health, education and civil engineering are forecast to be areas of strong growth, with the North of England and Midlands outperforming the UK as a 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, 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.

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