Rising construction costs in the UK

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Following a rise in prices of 10–13 per cent from the lows of 2010, AECOM's 2015 London Contractors' Survey estimated that construction cost inflation had risen by 10 per cent during 2015, with predicted increases of 7 per cent in 2016. It remains to be seen whether this 7 per cent increase will actually happen but the trend of rising costs is still an issue in the construction sector. This article considers why construction prices are rising and how employers can mitigate these costs.

Why are prices rising?

The prime reason why prices are rising is the lack of supply in the market. Skilled labour has always been the industry's biggest constraint and with demand increasing, this can only continue. Skilled construction workers have found themselves in a strong bargaining position, which is reflected in the rate of wages growth in the construction sector.

Market trends

Although construction input price growth is moderating after two years of strong growth, this moderation is not reflected in the growth of tender prices as many contractors are increasing their margins. Contractors are also increasing their tender sums to reflect the risk of insolvency which is still present at all levels of the market.

There has also been a decrease in single-stage tendering; whether the employer is following a negotiated or two-stage process, it is clear that contractors are unwilling to take on all of the risk that they would have done previously. Contractors are also refusing to commit to a price until a later stage and when they do, there is a premium on that price.

The increased demand for skilled labour means that contractors are stretched to their limits. Employers may therefore not be receiving the undivided attention of a contractor's best team. Additionally, contractors are showing an unwillingness to tender. AECOM's report has found that contractors are refusing to submit tenders on up to 50 per cent of projects offered to them, with some of the main contractors only considering 25 per cent of opportunities presented to them. With a potentially weaker team and a price that is not market tested to the maximum degree, employers can no longer be sure that they are getting the value they were once accustomed to receiving.

The balance of the project management triangle

Time, cost, management - received wisdom is that one can only ever manage two of the three parameters at any one time. As construction costs are unlikely to start decreasing any time soon and as increased demand is compromising quality, only one factor of the project management triangle remains properly controllable; time. Further, with costs rising quarter on quarter, it is logical that the quicker the project can commence, the lower the outturn cost of the project will be.

Focus on programme

One way to fast track procurement is by using early works contracts with smaller contractors or remediation specialists ahead of agreeing the final requirements and getting the main contractor on site. Alternatively, a two-stage process can be used to bring the main contractor on site to do the early works whilst also helping to agree the final requirements. This will involve the contractor and supply chain early in the process.

Furthermore, construction management is becoming more popular as employers are appreciating that it is no longer possible to obtain all of the quality and risk benefits of a design and build contract that were once possible. A construction manager will be paid his fee regardless, meaning he has no interest in growing the project cost and can share the employer’s objectives. Further, his experience and assistance can be put to good use from an early point in the project.

Other ways to mitigate the effects of rising construction costs

In addition to fast tracking procurement, there are other ways in which employers can try to mitigate the effect of rising costs.

1. Avoid variations: It has already been established that contractors are in a strong bargaining position due to a lack of supply in the market. This position is further strengthened should any mid-project variations arise. Avoiding a late change of mind will avoid payment of inflated and unnecessary extra costs.
2. Value engineering and shared savings: Value engineering with shared savings may be a way of reducing costs as it provides the contractor with the motivation to seek savings in the works.

Conclusion

With a constrained supply of workers in the market, contractors are able to focus on higher margin work and lower risk projects. As contractors are becoming increasingly selective over which projects they bid for, it is paramount that employers consider how best to balance the need to attract quality contractors whilst also mitigating their costs.