Glenigan
Constructing Insight

Construction Outlook to 2020

Special Report

Prepared by Glenigan

A 4C Service

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Construction outlook to 2020

Introduction

Following an uncertain 2013 for UK construction, with dismal weather hampering Q1 output before a remarkable turnaround at the end of the year, all signs indicate that the industry is finally finding firmer ground. The outlook for 2014 is positive, with activity set to pick up in housing, commercial, nuclear, rail and roads. But what challenges and opportunities lie ahead?

In this report, the Glenigan economics team present their UK construction forecasts for the critical next six years as the industry moves into predicted recovery.

Read on to learn more about the economic and political factors that are set to impact construction growth, with detailed information about recent sector performance, prospects for 2014 and the commercial, industrial and public non-residential drivers to 2020.

Recent construction performance

The value of new construction project starts rose by 5% during 2013, with momentum building through the year following a poor weather afflicted first quarter during which starts fell 13% on a year before. Positive signs emerged during the second quarter, which saw a 3% rise, followed by strong growth of 20% in the third quarter and 14% in the final quarter of 2013.

The positive trend of growth continued into 2014, with starts in the three months to January 4% up on a year ago – driven by continued rises in new infrastructure starts. However the rate of growth fell compared to the 14% rise recorded in the three months to December 2013, as the pace of industrial and retail activity decelerated.

Following strong growth during the second half of 2013, the value of the Glenigan non-residential index fell by 2% over the three months to January compared to a year ago, again attributed to a slowdown in industrial and retail expansion.

The sectors both saw double digit growth in project starts during the third and fourth quarters of 2013, however this rate slowed to 4% over the last three months.

Activity in the office sector, however, continues to rise at an increasing pace, with starts during the three months to January 63% higher than a year ago.

Project starts in the hotel and leisure sector were down 53% on a year ago and new activity in the sector has been subdued over the last two years. Starts are yet to pick up in line with the brightened economic outlook and the other commercial construction sectors.

The value of residential starts fell in the three months to January, as private housing project starts dropped by 26% compared to the same period a year ago. This contrasted with continued growth of social housing starts, up by 25%. These figures suggest that, in the short term, the value of new private housing projects is not keeping pace with the expansion of last year. However Glenigan figures suggest that output will remain strong as developers build out existing sites and look to accelerate new completions.

In the sectors most dependent on government funding, the underlying trends of last year continued to develop. Health project starts fell by 18%, following a 10% drop last year, while community and amenity starts were down by 44%, leading on from a flat 2013 for the sector.

In contrast, the education sector continued the strong growth seen during 2013, with a 24% increase in project starts over the last three months.

With the slowdown in Glenigan's residential and non-residential indices, growth has been primarily driven by further strength in the starts of new civil engineering projects.

The value of underlying infrastructure starts was 35% higher than a year ago during the three months to January 2014. In addition, the utilities sector showed 74% growth compared to the same period last year, during which period starts had declined by 23%, with further rises anticipated to support growth in civil engineering workloads.

Table 1: Underlying construction starts and planning approvals

	Detailed Planning Approvals (£m)	Detailed Planning Approvals (Change yoy)	Project Starts (£m)	Project Starts (Change yoy)
Private Housing	3299	3%	1504	-26%
Social Housing	969	-7%	1180	25%
Industrial	883	38%	352	4%
Offices	553	-13%	652	63%
Retail	609	0%	411	4%
Hotel & Leisure	655	-34%	295	-53%
Education	835	-29%	1072	24%
Health	402	-20%	395	-18%
Community & Amenity	149	-43%	172	-44%
Infrastructure	369	45%	818	35%
Utilities	937	49%	1123	74%

Note: Underlying projects are schemes with a construction value of £250,000 to £100 million. Source: Glenigan
Starts - 3 months to January 2014 and Planning approvals -3 months to December 2013 yoy – year-on-year.

Shelved projects at lowest level since 2008

In a clear indication of the rising confidence in the construction industry, the value of stalled projects in 2013 was the lowest since the start of the recession. In total, £12 billion of potential projects were put on hold last year, compared to £47 billion in 2012 and a peak of £80 billion in 2009.

In order to remove the influence of large developments, Glenigan uses an underlying measure which includes projects with a value between £250,000 and £100 million, providing a clear insight into market sentiment and developing trends within construction activity.

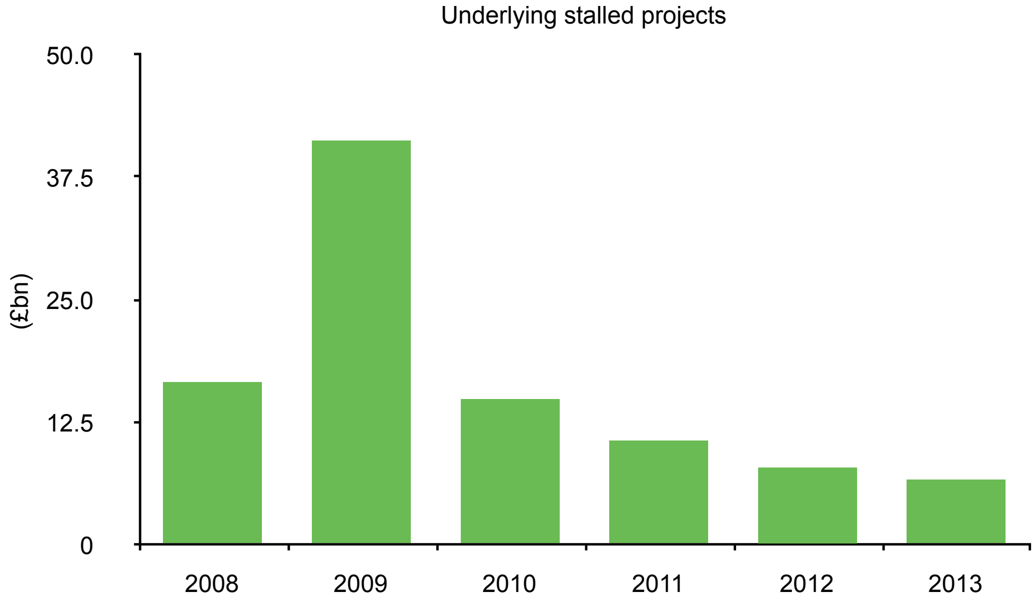
Projects being put on hold have been falling since the peak in 2009, and this year's figure shows continuation of an encouraging trend, with a 16% decline in the value of underlying projects.

The falls in stalled projects in part reflects the gradual recovery of confidence and activity from the shock that afflicted the industry and wider economy in 2008 and 2009. However the falls also indicate that the overall development pipeline remained subdued during 2011 and 2012, with speculative projects no longer being put through the planning system.

The value of stalled projects has continued to fall during the last 18 months alongside strong improvements in schemes receiving planning approval, suggesting these are progressing more quickly to start on site.

The total value of potential work going on hold, including projects worth over £100 million, continued to rise during 2012. The lack of confidence to progress major schemes caused the overall value of projects being shelved to rise by 39% compared to 2011. This trend reversed in 2013, with the overall value of shelved projects down 74% as the outlook for the wider UK economy improved.

Chart 1: Value of projects placed on hold



Source: Glenigan

Prospects for 2014

Glenigan has tracked a steady increase in projects receiving detailed planning approval through 2013, indicating a strong pipeline of work is now in place. The value of approvals during 2013 was 11% higher than during 2012, with increases within the housing, non-residential and civil engineering sectors. Wider economic conditions are improving, with early signs of an uplift in business investment and consumer confidence, and the construction industry is gearing up for continued growth through 2014.

The improvement in planning approvals picked up momentum in the final quarter of 2012, when they were up by 23% on a year before, and values have remained stable at this higher level throughout 2013.

Glenigan data indicates that the value of projects receiving detailed planning approval during the final quarter of 2013 was slightly down on the same three months a year ago, with housing approvals flat and a dip in non-residential approvals. However the steady flow of prospective projects through 2013 will feed through into higher levels of new project starts and output over the coming year.

Private non-residential project starts are set to improve strongly over the next six months. Supply of office space is already tight in many cities and further economic recovery will increase demand and encourage investment. Retail starts are set to continue to increase in response to increasing sales volumes and signs of consumer confidence. Growth in hotel and leisure starts is expected to strengthen later in 2014, with concerns over discretionary leisure spending so far having held back a continued trend of growth.

Starts in the civil engineering sectors are expected to strengthen further, supported by an increase in transport (especially road) and energy related projects. The March 2013 Budget improved the long term outlook for infrastructure funding; if the current coalition survives beyond 2015 increased infrastructure investment has been promised to the tune of £3 billion a year from 2015-16.

The Budget also provided shorter term support in the form of the government's Help to Buy scheme, aimed at supporting house purchases for both existing homeowners as well as first time buyers via mortgage support. The scheme, which launched at the beginning of April last year, received praise from house builders who reported increased levels of interest as well as rising sales and reservations.

Momentum in the sector disappeared in the first quarter of 2013, with starts 21% below the level seen during the first quarter of 2012. However a turnaround has seen private housing since lead the fledgling construction recovery; increasing house prices and high levels of mortgage approvals will continue to boost demand. Private housing is set to be a key driver of growth through 2014.

Weakness will continue come from those sectors reliant on public spending for growth, in particular health. Social housing construction has been one of the worst hit sectors over the recession, with output levels in the first quarter of the year at a three-year low. Starts remained firm in the sector last year as increases in repair and maintenance work drove gains from 2011 levels.

The prospects for social housing are uncertain. Starts are forecast to decline during 2014 but there has been a strong flow of planning approvals during 2013, a sign that the government's affordable housing programme may bring greater help to the sector as market conditions improve.

Table 2: Forecast change in the value of underlying construction starts (% change year-on-year)

	2012	2013	2014f	2015f
Private Housing	36%	2%	15%	8%
Social Housing	9%	13%	-3%	8%
Industrial	32%	-9%	39%	14%
Offices	39%	12%	-1%	10%
Retail	11%	-1%	7%	8%
Hotel & Leisure	-3%	-1%	9%	7%
Education	-27%	17%	5%	13%
Health	6%	-10%	0%	3%
Community & Amenity	-27%	0%	2%	11%
Infrastructure	7%	9%	-3%	10%
Utilities	-17%	9%	3%	-2%

Note: Forecast prepared in January 2014, f – forecast. Source: Glenigan

Construction drivers to 2020: Commercial, industrial and public non-residential

In the years leading up to 2020, the private sector is expected to remain the principal engine for growth (see Chart 2, below). In particular, commercial construction is forecast to be a growth sector over the next six years. Office construction is currently the key driver behind higher commercial sector output, having been strengthening over the last two years. Further growth is anticipated over the medium term, supported by UK economic recovery and rising employment.

London remains the central driver for the upturn in office project starts, but it is becoming more broadly based across the UK. While rising service sector employment should continue to underpin the demand for office accommodation, changing working practices such as hot desking and remote working is likely to curb the amount for floor space required per employee.

Increases in retail and hotel and leisure are expected to support sector output growth over the medium term, as improved consumer confidence supports increased investment in retail and leisure facilities. Retail construction will continue to be reshaped by structural change, as retailers restructure their property portfolio to accommodate growth of on-line sales and click and collect.

The next few years will see all of the supermarkets expanding their convenience networks and other retailers rationalising their stores and remodelling others to accommodate click and collect sales. Consumer retail spending will become increasingly polarised around on-line and local ‘top-up’ purchases. Longer term, increased investment in shopping centre developments is anticipated, especially the expansion and refurbishment of existing sites including the incorporation of more non-retail leisure facilities in order to attract ‘destination’ shopping trips.

Industrial sector output is forecast to grow strongly over the next three years, but is subsequently forecast to plateau. The pattern of growth reflects recent strong increases in detailed planning and project starts, with retailers investing in new logistic and warehousing premises as they develop their on-line offering. The pace of such investment is likely to slacken over the longer term.

Pressure on government finances will remain a constraint on public sector non-residential construction output over the next three years. This will impact most strongly on the health and community and amenity sectors, though continued demographic pressure from the care requirements of the UK’s ageing population will support output. While the number of care homes has been declining over the last eight years, an aging UK population is progressively increasing the potential demand for such facilities.

The government reforms to public sector support for social care provision, including the decision to cap the individual’s liability to fund their own social care costs, should allay individuals’ fears over the cost of going into residential care. Although the provision of greater support for individuals to stay in their own home is likely to raise the average age that people move into care, demographic trends are still likely to increase the number of people in need of such accommodation over the longer term.

Accordingly, Glenigan expects the stock of care facilities to grow over the longer term. The tighter regulatory regime and rising expectations is likely drive the demand for new, purpose-built facilities, with the continued closure of some existing premises.

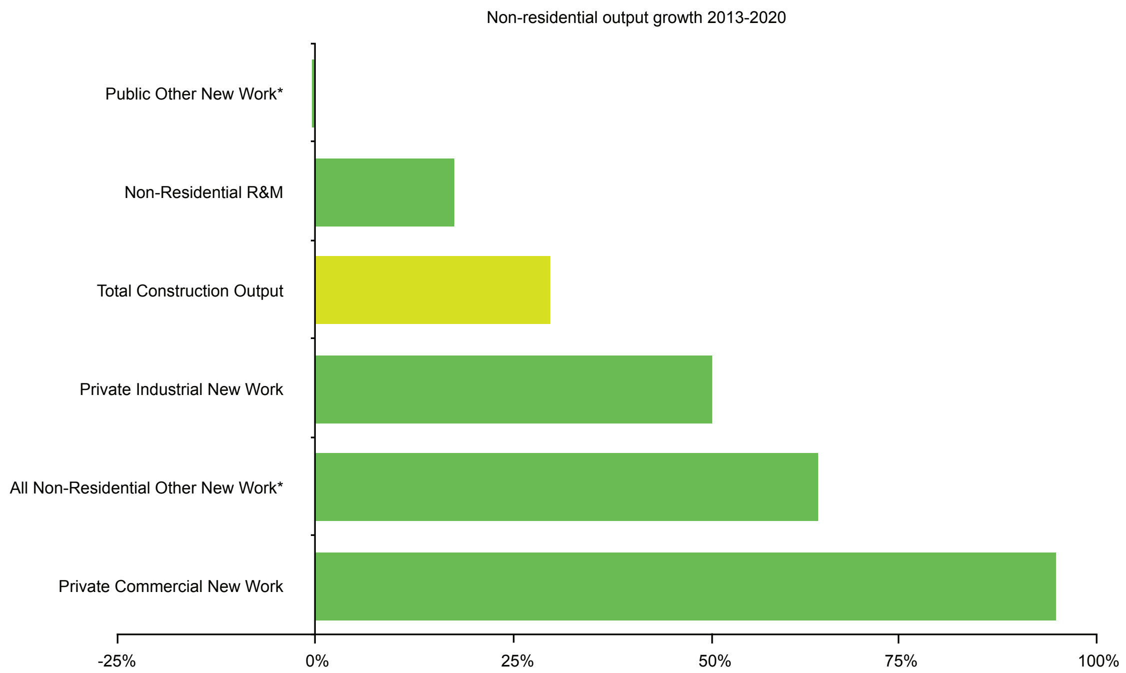
By contrast, education is predicted to be a bright spot as local authorities respond to demographic pressures and the government rolls out the Priority School Building Programme, which in large part is being funded through PF2. During the first half of the forecast period, rising primary school pupil numbers will remain the main source of pressure on the existing school building stock – especially in metropolitan areas.

The Department for Education projects the number of pupils at state-fund primary schools to rise by 10.2% between 2013 and 2018. However from 2018 the fastest area of growth will switch to secondary education. Eleven years of declining secondary pupil numbers are forecast to be reversed from 2016, with strong growth from 2017 onwards, and between 2017 and 2020 pupil numbers are set to rise by 12.3%.

Reforms to the funding of higher education temporarily disrupted the flow of investment by universities in new facilities and accommodation. However increased expenditure is expected over the forecast period, as leading institutions compete to attract domestic and overseas students. The Chancellor announced in the December 2013 Autumn Statement that the current cap on English student numbers was being lifted. Institutions are also competing to attract (more profitable) overseas students, although tighter immigration regulations for non-EU students could see UK universities lose out to institutions in other parts of Europe and the US.

Longer term public sector investment is projected to strengthen as the deficit narrows and the next government relaxes public sector funding restrictions in the run up to the 2020 general election, though this will serve only return public sector new work output to current levels.

Chart 2: Non-residential output growth 2013-2020



*Excluding Infrastructure

Source: Glenigan