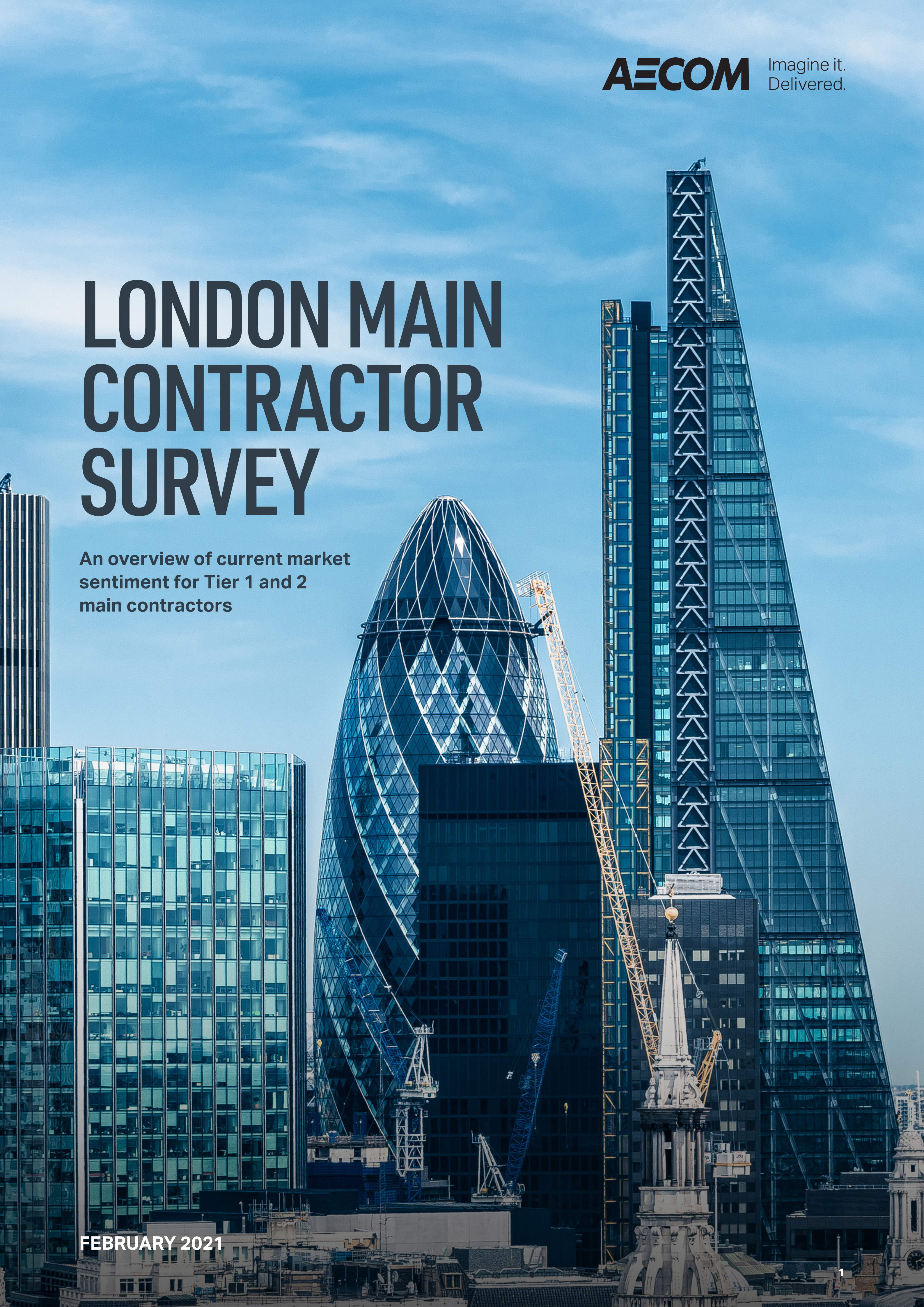

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LONDON MAIN CONTRACTOR SURVEY

An overview of current market sentiment for Tier 1 and 2 main contractors

FEBRUARY 2021

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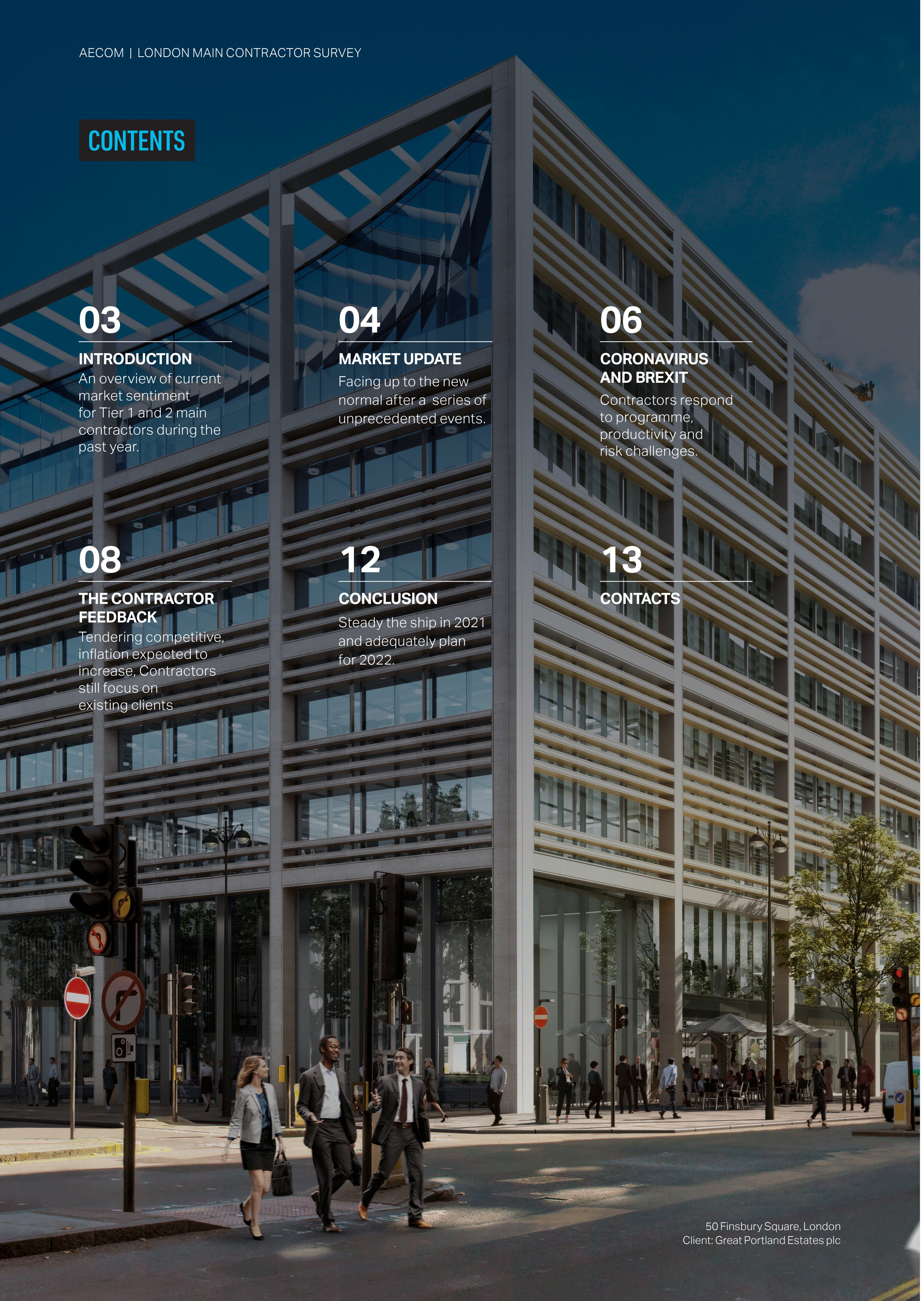


50 Finsbury Square, London
Client: Great Portland Estates plc

INTRODUCTION

AECOM's London main contractor survey provides an overview of current market sentiment for Tier 1 and 2 main contractors during this past year. Our survey gauges their attitude towards risk and provides a general overview of order book and pipeline health for the near future.

Our report is structured around key feedback gained from main contractors, including organisations working predominantly in the commercial sector, supported by residential and public sectors.

2020 has been a year of multiple challenges. The dramatic and unexpected emergence of the coronavirus pandemic added to ongoing uncertainty around the UK's exit from the European Union (EU).

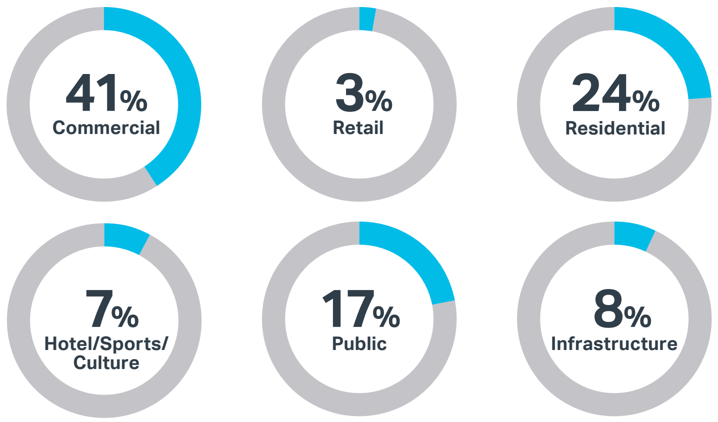
Yet the construction industry is showing admirable adaptability. Modified ways of working on site are helping developers, contractors and suppliers get back to work after an initial period of coronavirus shutdown. And astute commercial agreements have enabled them to size up Brexit/ Coronavirus risk in their contracts.

It may be some time before the turbulence of these combined threats to the industry recede. But in the meantime, the construction industry is doing what it does best in difficult times: getting on with the job with the minimum of panic.

Roll on 2021.

2020 has been a year of multiple challenges. The dramatic and unexpected emergence of the coronavirus pandemic added to ongoing uncertainty around the UK's exit from the European Union (EU).

Figure 1: Sector split of contractors taking part in the survey



MARKET UPDATE

Facing up to the new normal

No-one should be surprised that overall construction volume decreased in 2020. 2019's lack of clarity over Brexit was compounded by the coronavirus pandemic — the latter of which resulted in almost all projects in London being impacted as initial lockdown measures kicked in.

Activity levels were strong for the first quarter of the year. Construction fell sharply during the second quarter of 2020. There was a marked increase from June on as activity levels started to rise as contractors found their feet. When compared to 2019, we have seen construction activity return to a sustainable position, albeit one which is below the activity levels seen in previous years (see figure 2 and 3).

Contractors noted a drop in commercial orders for 2020 which was driven in part by developers re-assessing their strategy for maximising the use of their assets given the change in market conditions. Tenants also took the opportunity to reassess what their future workplaces will look like. While many employees are now working from home, a proportion at least will need to return to the office in the medium term.

The biggest change noted in the commercial market was the strong growth of refurbishments over new builds.

Figure 2: Construction PMI

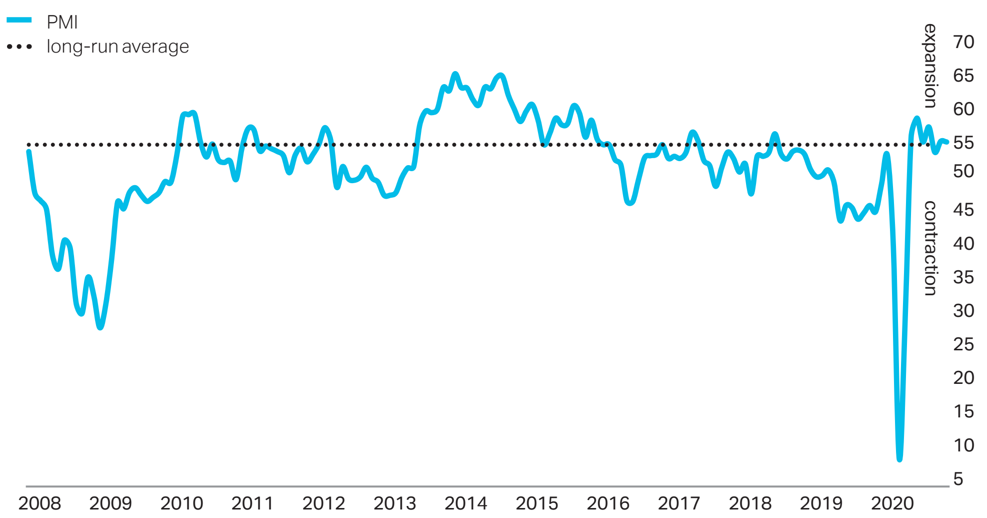
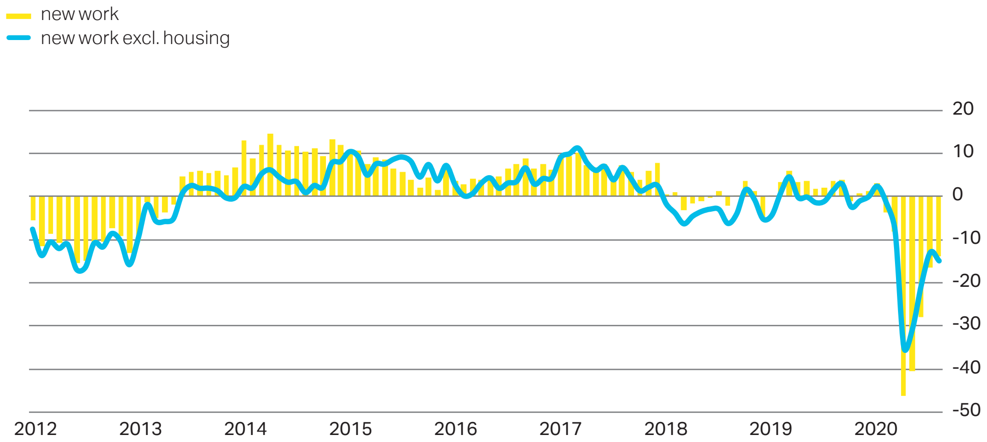


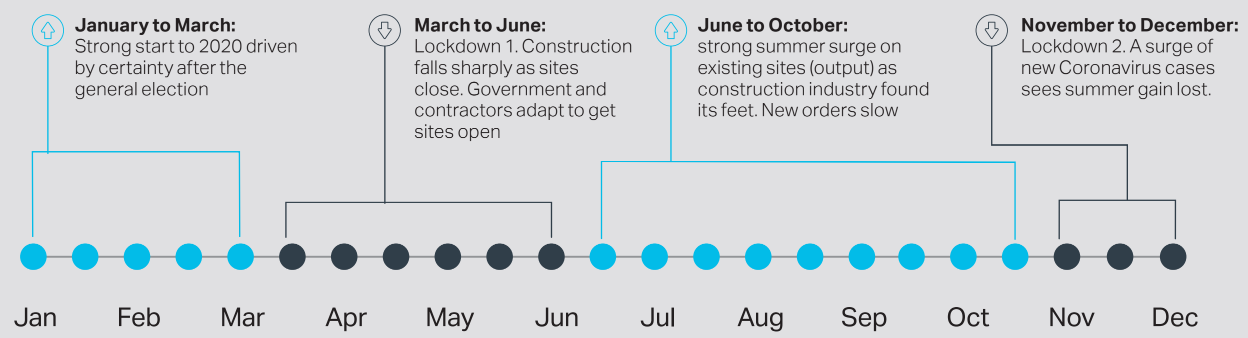
Figure 3: UK New Work Construction Output



The biggest change noted in the commercial market was the strong growth of refurbishments over new builds. Contractors recognise the opportunity in the refurb market but highlight the risk associated with these works, which in their view point, should be a shared risk approach with the developer. This is generally managed within a two stage procurement route.

Overall, contractors have reported an increase in the competitive nature of the market which has resonated down to the trade contractors and the supply chain. Several contractors reported a nervousness about the release of new projects into 2021 so were keen to secure guaranteed work at tender.

Figure 4: 2020 Timeline



CORONAVIRUS AND BREXIT

Productivity and programme

In 2020, 90 per cent of contractors saw their productivity affected by coronavirus. Initially, labour and materials were hard to come by, exacerbated by the lockdown and social distancing rules.

However, the construction industry was very quick to adapt. Extra safety measures were introduced which allowed contractors to ramp up productivity on site. New ways of working, supported by digital tools (such as wearable tech, connected devices, drones tracking progress and managing the site), introduction of Coronavirus marshals on site and improved welfare facilities have reduced transmission risk. Issues around having limited trades working in the part of the building have been negated by improved planning and extended working hours on site.

The drop in productivity equated to an increase in cost across commercial projects. Contractors saw an increase of 5 per cent up to 10 per cent on their prelims cost — thanks to labour costs and longer vertical hoisting times to move labour, leading to longer hours on site.

There was a similar impact on programmes. The first lockdown in March 2020 resulted in many sites being closed, with a knock-on effect on the programme of up to 10 per cent.

All reported that as of the end of 2020, cost associated with productivity and updated working conditions/increased programme had returned to normal. Any cost associated with a change in the daily construction activities has been offset by the competitive nature of the market. It is expected that once the market returns to a less competitive environment, we expect the increase in cost to be felt at project level.

> “Internal elements have been most affected, with productivity losses due to limitations on the number of operatives/trades within enclosed areas. This has been off-set by increased site operational hours. The increase in cost is purely associated with increased prelims rather than specific commercial allowances for coronavirus.”

Managing risk

Almost three quarters (75 per cent) of contractors said that a shared approach to coronavirus was adopted between the client and the main contractor. Given the unique situation the industry found itself in, a logical approach has proved to be sensible.

Although contractors are appointed on different contract types — JCT, NEC etc. — the contracts have generally been flexible enough to deal with this unprecedented event.

Most contractors (82 per cent) have been able to resolve coronavirus related claims, with most treated as ‘relevant events’ that grant the contractor an extension of time with no cost. For projects currently out to tender, contractors told us they have seen new clauses introduced into bespoke tender agreements, to outline a process to be followed should a recurrence of the pandemic affect the construction industry in the future.

Brexit continues to be a risk, with emphasis on material supply. Trading (import/export) of construction materials comes with a string of red tape which will lead to changes in availability.

Contractors are looking to maximise the use of consolidation centres for future projects to stockpile material in order to negate this risk. They will need to work with project design teams to approve and issue appropriate specifications, enabling early materials procurement to take place.

In 2021, collaboration between the main contractor, supply chain, trade contractors, suppliers and merchants will be key to mitigate major project risk. Contractors will need robust planning, logistics and risk functions to ensure they can manage the period from contract award to materials delivery (and through to project completion) efficiently. Clients and design teams will also need to be flexible if contractors are to offer alternative materials for consideration.

> “Early procurement, stick close to our best supply chain for openness. The thing that is catching us is smaller specialists such as steel doors etc. That is harder to de-risk and yet still is often on critical path — common trades are fine.”

> “In the vast majority of cases we have been able to reach a ‘neutral event’ approach, with risk shared proportionately. On current tenders, we are allowing for current restrictions, with most clients opting to take the risk on more onerous restrictions being imposed.”

THE CONTRACTOR FEEDBACK

Pipeline

Many trade contractors are feeling insecure about their pipeline for 2021 and so are competing aggressively for work. The exceptions are facades, internal blockwork and dry lining who credit an acute skills shortage, large upfront investment (in the case of commercial facades) and a booming Frankfurt market to their availability. Some of the smaller trades have found that their ability to deliver has been affected by furlough.

The downturn in new project starts has been present since 2019. Initially this affected groundworks, demolition and frame contractors, although now trades that are engaged later in the project delivery cycle, such as finishing and fit-out, are starting to feel the pressure too.

Main and trade contractors are streamlining their businesses and are considering projects or tiers which they would not typically have targeted in the past. Contractors prefer to work with tried and tested clients, but this could be challenged in 2021.

Table 1: How contractors streamlined their businesses in a turbulent 2020 for 2021?

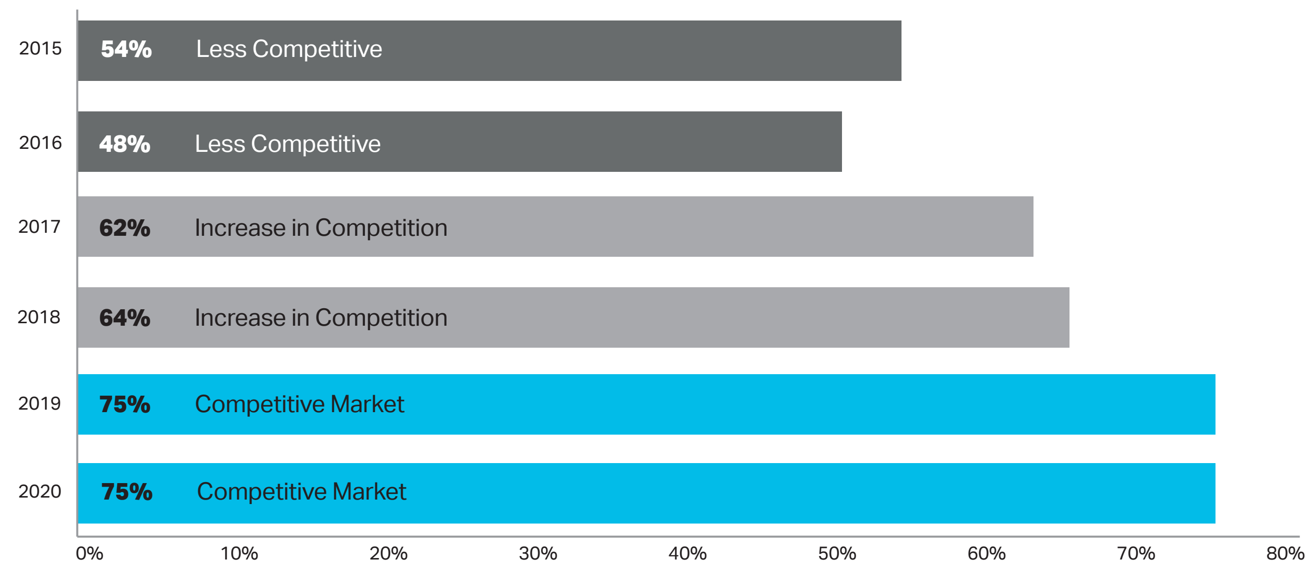
Minimal reductions in staff – usually not more than 10% office-based staff.	Limited use of the furlough scheme (usually only for three months).	Temporary reduction in salaries and/or removal of annual bonuses.
Reviewing their business structure, reducing office space required and encouraging working from home.	Compiling COVID-19 Response Plan strategy for dealing with site closures etc.	Rationalising staff profile for 2021.

Tendering activity

Tendering has been broadly flat across 2020. Contractors have reported that the number of opportunities have remained broadly the same, but the market has become more competitive with contractors looking to secure work and diversify.

There was a notable spike in competition levels in the third and fourth quarter (post initial lockdown) as contractors displayed nervousness in the market and targeted developments which were likely to proceed. Supply chain/trades also reporting a similar trend.

Figure 5: Rate of tendering opportunities by main contractor



Procurement

In 2020, the commercial office sector saw a neutral position on procurement with the greater demand still favouring two-stage tendering. Given the increase in refurbishment projects in this market, we expect two-stage tendering to continue to be the preferred route into 2021.

With refurbishment projects, clients are aiming for a quick turnaround while effectively managing the risk which is generally only realised once the contractor is on site and stripping the building down.

Although contractors prefer two-stage routes, some have taken the opportunity to price a single-stage tender where they might not have done so in the past. However, contractors who have strong relationships with their clients continue with two-stage routes, as both have sufficient trust in one another to deliver the project on time and within budget.

In the residential sector, we saw a marked increase in the single-stage design and build route.

Going forward, we have seen a larger range on tender pricing. Contractor selectivity has reached its peak.

There is going to be less work available over the first few months of 2021, so contractors will be tested. Contractors have reported a high value of work secured for 2021 — however we should be sceptical about what "secured" actually means as economic impacts from coronavirus continue to reverberate.

Table 2: Percentage of procurement split

Year	Single Stage	Two Stage	Other
2016	11%	44%	45%
2017	34%	37%	29%
2018	41%	40%	20%
2019	34%	32%	34%
2020	44%	43%	13%

Table 3: What do Contractors see as the main drivers of Procurement Risk?

Quality of tender documentation	Onerous contractual conditions	Complexity of project	Disproportionate levels of main contract risks being passed directly onto the supply chain.

Inflation

Contractors are expecting some upward pressure in the next 12-24 months, mainly due to issues arising from Brexit and coronavirus.

Contractors have reported that the greatest pressures for tender price inflation will be felt by the following:

- Raw materials from outside the UK may become more expensive. Supply chains are starting to, and have, set up consolidation centres to support bulk import of materials and account for this in their pricing.
- Skilled labour costs will increase and become harder to source now that freedom of movement has ceased. Resourcing strategies will need to be in place to mitigate these issues with growth of lucrative European nodes such as Frankfurt.

Contractors and suppliers may also experience friction at customs and delays at the UK border, additional administration paperwork, and the requirement for coronavirus testing for drivers. These risks should be — as far as is practicable — quantified and included in pricing structures.

At present, these inflation drivers are increasing costs but have been suppressed by a reduced demand in the market and a cut in contractors margins as contractors look to ensure they secure at least one large project to keep the business ticking over.

Contractors forecast inflation at 1 per cent for 2021 and 2.4 per cent/3.4 per cent for 2022/2023 respectively.

Figure 6: Inflation drivers reported by contractors surveyed

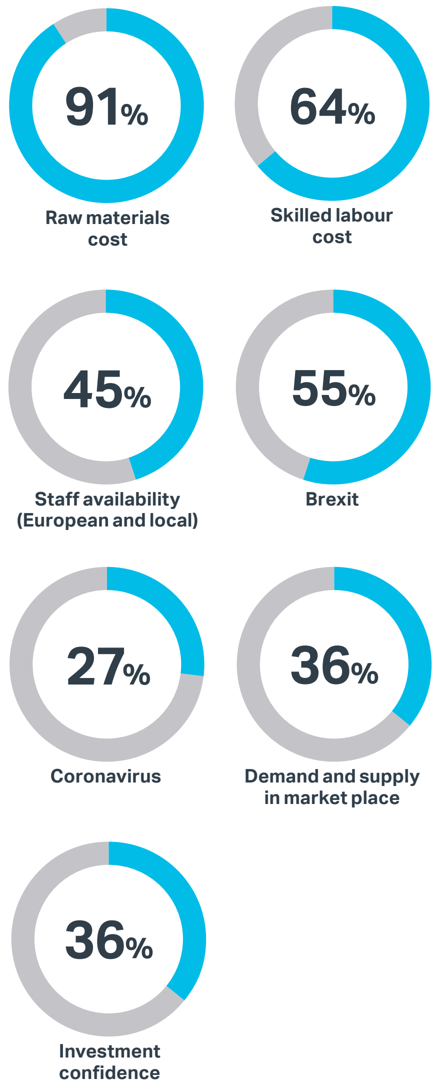
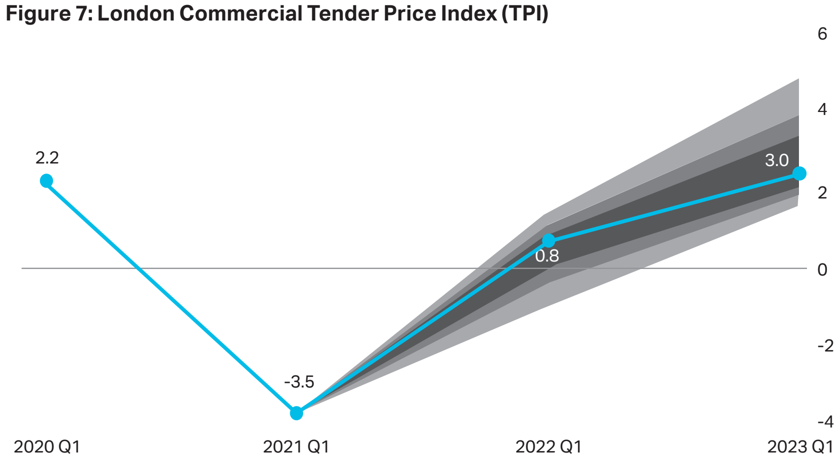


Figure 7: London Commercial Tender Price Index (TPI)



CONCLUSION:
Let’s get to work

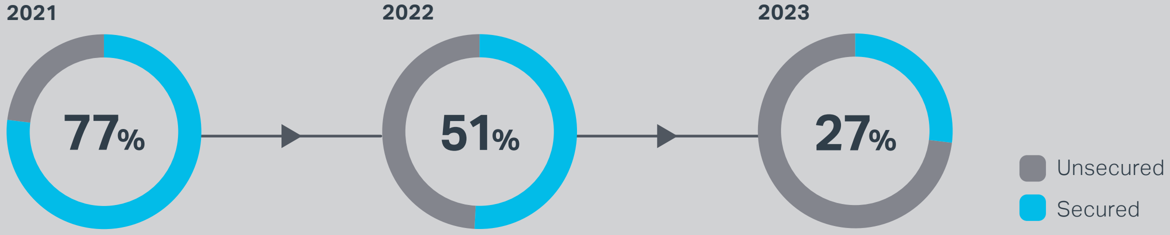
Construction is never an easy life. Every day brings hurdles that need to be overcome to complete a project or run a complex organisation.

True, the challenges of 2020 were a little out of the ordinary, but contractors, developers and the supply chain faced them with determination and a new way of thinking.

- Contractors expect the market to remain competitive.
- Contractors continue to follow a selective approach with preference for work with tried and tested clients.
- Whilst output and orders are down, there is not a lot of spare capacity in the short term as contractors complete projects which were delayed.
- Developers still need to get the basics right to get the best price. This includes good quality information, adequately warming up the market, and equitable T&C’s/transfer of risk.

All the main contractors we surveyed have had to adapt to the difficult market conditions in 2020. But all are predicting a 2021 where they will look to steady the ship followed with a positive outlook for 2022 and beyond. The continued roll-out of the coronavirus vaccines will support this, enabling the construction industry to do what it does best — deliver demanding projects on time and on budget.

Figure 8: Main contractors secured work (Dec 2020)



Contacts

Brian Smith
Director
+44 (0)7885 592 117
brian.smith1@aecom.com

Wayne Stathakis
Project Director
+44 (0)7823 354 890
wayne.stathakis@aecom.com

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