

Strategic Market Insights

UK Construction – 2010 and Beyond Difficult times ahead – Seeing the opportunities

Executive Briefing Paper

“This report clearly identifies the issues of key importance in the market regarding the speed of the recovery and the long-term needs of the country.”

Noble Francis, Economic Director, Construction Products Association

“Very relevant reading. It covers forecasting elements with intelligent analysis in an easy-to-read format.”

Mark Oliver, Managing Director, H+H UK Limited

“Impressive. The information is clear and concise, supported by thorough research, which builds a compelling story... very insightful.”

Darren Waters, Executive Commercial Director, Tarmac Building Products

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In association with Barbour ABI – the Leading Provider of Sales Leads and Construction Contract Data for the UK Market.

Barbour ABI

ISSUES FACING THE INDUSTRY

“If you owe the bank £1,000, then you have a problem, but if you owe the bank £1,000,000, then the bank has a problem,” so the saying goes. But what happens if you owe the bank a trillion pounds, or £1.4 trillion to be precise? That will be the size of UK national debt by the year 2015. The answer: the nation has a problem – we will all have to deal with the cost.

So:

- What impact will deficit reduction have upon the construction industry?
- Where will public sector investment be concentrated?
- Will private investment grow? Will it offset reductions in the public sector?
- Will housing activity continue to grow?
- How will changes to planning policy affect new housing development?
- Should we be worried about inflation?

For specific industries:

- How long will the expected growth in civils last? What will happen to new roads, will we see private investment?
- How far will residential new build increase and will this be sustained? What will happen to the mix of new housing, apartments v houses?
- Will commercial building resume activity and if so, when?
- What is the outlook for masonry v timberframe?
- Is facilities management an area for growth, as the public sector restructures?
- Will the Decent Homes Initiative continue? Will the school build programme continue? Will regeneration activities continue? What will happen with social housing?
- Will the housing DIY and improvement markets resume growth?

Now is the time to review business strategy. There will be winners and losers – but how will these changes affect your business?

Reacting to change and focusing on cost reduction will no longer be sufficient: companies need to look to the future.

Read on to find out our views on some of these key areas.

DIFFICULT TIMES AHEAD, BUT WHERE ARE THE OPPORTUNITIES?

We now know the colour of the new Government, but the sheer size of the economic challenge facing the UK is difficult to comprehend. The impact upon the economy and everyday life will be profound. This is not just about a new political era, but a new economic era.

In this issue of *Strategic Market Insights* we consider:

1. How far will public investment fall?
2. Will housing supply increase?
3. Will private investment gain momentum?

The public sector cuts will fall heavily on construction. The UK has had a decade of strong growth in public investment, reaching an all-time high in 2009/10. This puts the expected cuts in sharp contrast to the past – spending has a long way to fall and we may not see the same level of public sector investment for a very long time.

How will this affect the economy and what will be the impact on construction?

Residential construction is a long-term investment opportunity. There is an overwhelming political, economic and social case for investment in residential construction. The current level of supply is pitiful in relation to the needs of the nation and it will need significant investment over many years.

Will we see significant increases in housebuilding and will this be sustained?

Expect volatile markets where changes in demand are significant from one year to the next. The prospects for private sector investment have changed from one of complete collapse to tangible signs of growth. But markets are fickle and the experience of the past 16 years – of steady growth – is unlikely to be repeated in the near future. We should expect a more volatile and variable pattern to the economy.

Will private investment be sufficient to drive growth in construction?

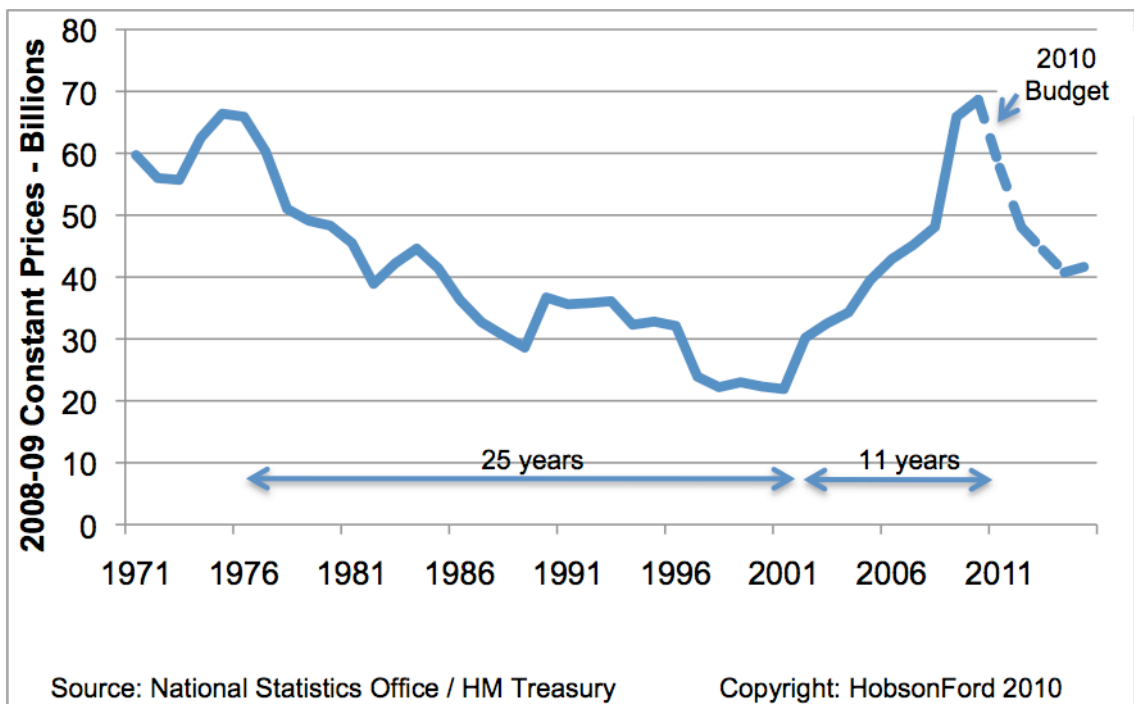
HOW FAR WILL PUBLIC INVESTMENT FALL?

Chart 1 summarises Government gross investment from 1971. This includes the 2010 Budget assumptions to 2014/2015 and values are stated in 2008/09 prices.

It is clear that the current level of public investment is at a peak and equivalent to the previous high point seen in the mid-1970s. The 2010 Budget forecasts a reduction for the next five years, but we should not be under any false impressions – 2009/10 marks a peak that is unlikely to be seen again for at least a decade, if not longer.

The pattern during a recession is similar: strong growth in public spending for a few years to help offset the recession and then significant reductions. Combine this fact with the exceptional growth seen over the past 11 years and the extent of reduction will be dramatic and lengthy. This will be a sea-change in policy, not a minor adjustment.

Chart 1: Government Gross Investment, 1971–2015



Reductions in public investment will bring a cold chill to many markets and many companies, but do not spell disaster for UK construction.

Private sector demand was severely cut in the recession – in commercial and residential building – and therefore these are likely to be the most attractive markets.

The new Government will focus its support on certain areas, but we will have to wait until the new Budget is delivered to gain clarity on these priorities.

WILL HOUSING SUPPLY INCREASE?

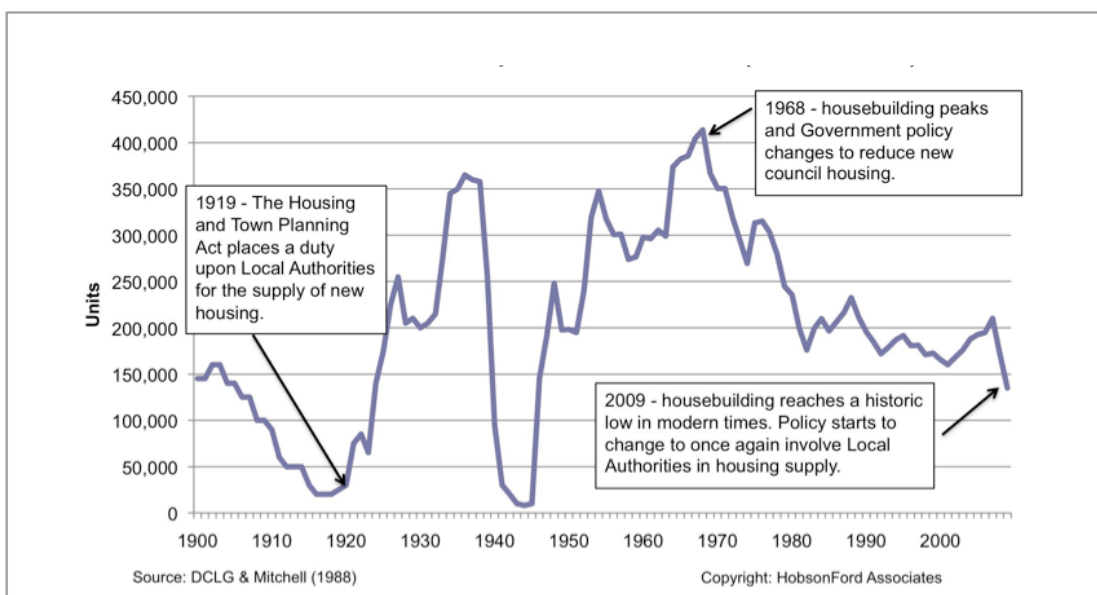
It is clear that housing was not a Government priority over the past 11 years – and to be frank, over the past 30 years. In contrast to record levels of public investment and a strong economy since the early 1980s, we have seen a drastic fall in housing supply.

Chart 2 summarises new house completions from 1900 through to 2009. This clearly highlights the shortage of supply.

The implications of this situation will become acute over the coming years. The shortage of housing in the UK is already having widespread consequences for the population at large. This has been made worse by the recession, with reduced access to finance and reduced supply of new housing. Public spending cuts, increases in taxation and rises in interest rates will only make matters worse.

We also have the issue of a growing and ageing population, which will increase demand for housing. The social, political and economic impact of an acute shortage of housing will become immense.

Chart 2: New House Completions from 1900 (Great Britain)



There will be a modest lift in private housing output in the short term, as some normality comes back to the market.

But the sheer lack of housing – and problems around affordability – will continue to drive policy towards increased housing provision.

Innovative solutions will be required, because the fact remains that people will need to live somewhere and many will struggle to afford private sector housing. Political leaders will need effective solutions that do not require major investment by Government.

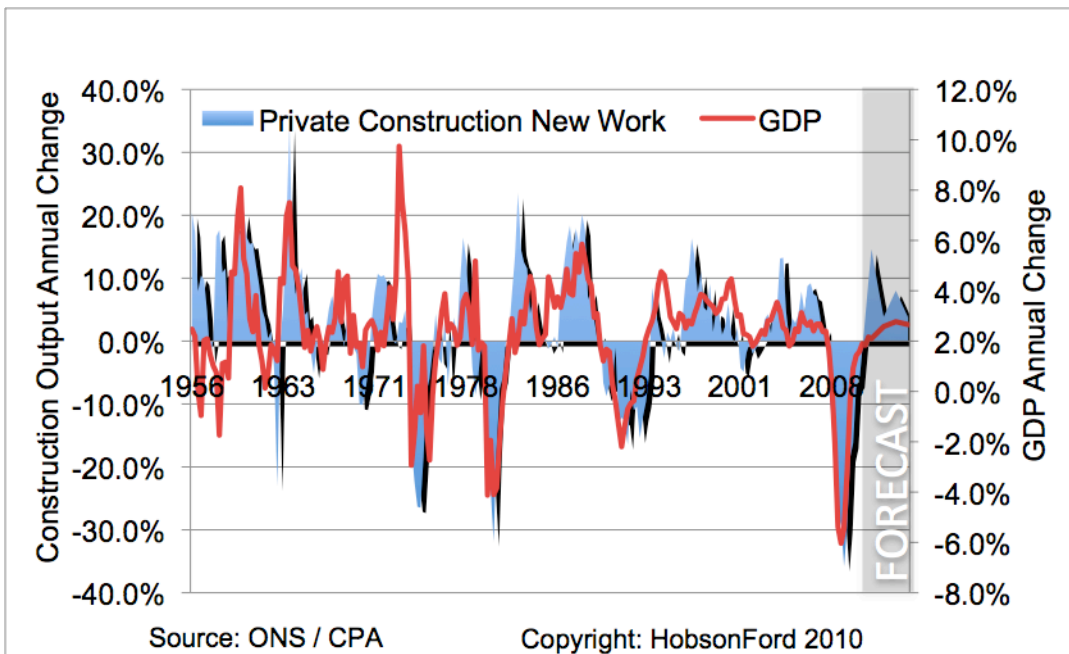
WHEN WILL PRIVATE INVESTMENT GAIN MOMENTUM?

Private investment is showing signs of growth, helped by low interest rates, quantitative easing and Government support. But will this offset the expected squeeze across the public sector?

Chart 3 compares changes in GDP to private construction new work from 1956 through to 2015, with forecast figures used for 2010 to 2015.

This analysis clearly shows a strong link between economic growth and private sector new-build construction. The pattern of sustained growth over the past 16 years is unlikely to be repeated and we should expect more volatile markets.

Chart 3: Private New Construction Output v GDP Growth Rates



There are signs of renewed growth in private investment, with builders active once more and indications of growth in the commercial sector. However, there are concerns over the impact on the economy from the expected cuts in public spending and future tax rises.

Private investment holds the key to construction activity and there will be an inevitable switch from public to private investment. This switch will have a major impact on the construction industry, favouring some sectors whilst hurting others.

Companies should expect variable and volatile market conditions over the next five years. The performance of individual market segments will vary according to the specific circumstances for these markets and companies will need to have a flexible and more market-focused approach to their commercial strategy.

WHAT ARE THE KEY OPPORTUNITIES?

Effective strategy: the future winners will be those that correctly identify the key dynamics of the market and correctly position their business to exploit these changes.

Strong leadership: will be needed to ensure that the industry has an effective voice with policy-makers and is able to adapt to change.

New solutions: adversity is the mother of invention. Now is the time to consider alternative strategies and creative solutions.

Key points:

- ~ **Public investment will be cut** drastically over the next 10 years, at national and regional levels. Government has to get more from less and there will be pressure to maintain 'front-line services'. This will throw up opportunities and risks for construction.
- ~ **The Government will prioritise some areas for investment:** certain investment projects and areas will be ring-fenced. Aligning capacity around these areas will be key.
- ~ **The economy is still fragile and inflation remains a possible threat.**
- ~ **There will be renewed private sector investment:** private sector investment will gain ground over the coming months and years, in residential and non-residential construction. But companies should expect variable and volatile market conditions, with growth in some areas and decline in others.
- ~ **There will be supply shortages in certain sectors:** substantial shifts in demand are likely to remain a constant theme over the coming years. This could mean shortages of supply in certain industries.
- ~ **There is a long-term opportunity in the housing market:** the housing market remains a key opportunity. The shortage of housing is clear and beyond question. However, changes in housing policy and the lack of public funds will require new approaches to fulfil the housing needs of the nation.

ABOUT STRATEGIC MARKET INSIGHTS

Strategic Market Insights is a bespoke service to enable companies to increase their market know-how whilst maintaining tight control of overheads.

We can help your business succeed by:

1. **Bringing proven expertise in market and strategic analysis**
2. **Identifying the implications for specific markets and companies**
3. **Developing effective market-led strategies**

OUR TEAM – PROVEN EXPERTISE

Glen Ford, Director and founder of HobsonFord, has a track record in strategic development and market analysis.

Peter Whittle has held P&L responsibility for multi-million turnover businesses, with key roles in sales, marketing, M&A and operations.

Mike Aves has a track record in sales across the materials sector, including new business development.

Frank Gaiger has a wide range of commercial management experience, including FD of an £80m p.a. business and Regional Director for a £60m p.a. business.

Colin Marshall has over 30 years' experience in the building industry, working as a Technical Manager in a major building products company.

ABOUT THE AUTHOR

Glen has led a number of market reviews in the construction sector, including extensive research into the UK housing market in 2008/09, where he accurately predicted renewed growth, as seen in 2009H2 and 2010 – despite widespread pessimism across the industry.

An MBA graduate, he started his career as a management trainee in the construction sector, followed by 14 years' experience in operational management and 6 years as a business analyst for a blue-chip company, working on market analysis and M&A activity.



He formed HobsonFord in 2004 and has worked with a number of clients since this time on strategic development, turnaround and market insight.

FURTHER DETAILS

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