The true cost of construction price rises

Construction costs have been soaring, putting investors, developers, and contractors under pressure. Here, international real estate consultant, Hollis, outlines the inflationary issues from first-hand experience...and some tactics to mitigate them

BY **ROBIN MARRIOTT**

These are not normal times. Developers and construction firms are facing unprecedented costs increases for projects. So much so that the financial viability of some schemes is being tested, according to international consultant, Hollis.

But while the company says there is no "silver bullet" to neutralise the phenomenon, some tactics can be deployed leading to better outcomes.

Talking with PropertyEU, Mark Smith, head of cost management at Hollis with global responsibility for the service said in H2 2021 hyperinflation saw spikes in construction material prices, with unrelenting rises ever since. Forecasts for the full year 2022 range from +2.2%-4.5% depending upon the source of the materials. The RICS trade body reports in its "All In Tender Price Indices" and "Regional Tender Price Indices for London" a 6.7% rise.

Smith says a triple whammy has occurred. First it was Brexit, then supply issue calamities due to Covid lockdowns, and more recently 2022 energy price rises.

Just one live issue faced by clients is to do with the challenge of fixing prices for contracts. A lot of investors and contractors like fixed price contracts. Naturally, they make allowances for inflation – prices always tend to go up a little each year. But in a sign of how unnatural things have become, some contractors are coming back to say they simply cannot tender a fixed price any longer because their suppliers cannot do so in the first place.

Says Smith: 'There's been a real change. I've done this job for getting on for 30 years, and I've never been in a position whereby contractors are turning around to say they cannot fix the price.'

'There's been a real change. I've done this job for nearly 30 years, and I've never been in a position whereby contractors are turning around to say they cannot fix the price'

MARK SMITH, DIRECTOR AND HEAD OF COST MANAGEMENT

He continues: 'It's been totally unprecedented, and the issue our clients are having is pretty obvious – some projects have a narrow margin. I think we are starting to see the viability of some of these schemes being tested.'

'In some sectors such as industrial, there is a huge amount of demand. The three key components you've got are concrete, steel and cladding, but the rent is going up as well, so the viability still works. But I think there are some other sectors, potentially office and residential for example, where returns are going to get a knock because of the input prices. This is combined with how finance rates are going up for developers.

He relates how the war in Ukraine has added uncertainty, leading to one contractor stating recently why it was increasing its tender. The same firm reported that when fixing prices in the last few weeks alone, suppliers had added around £1.4 mln (€1.62 mln) in notified or fixed price allowances on top of inflation already factored in.

The stats on price rises for materials are startling (see box). Anecdotally, Hollis' Smith says he has just left a site where the parties are attempting to agree on additional works. But the costs of tarmacking have rocketed since it was first priced in November 2019. It has since gone up by 100%! The next price increase is expected in September and the next one in January 2023 and then June, and the prices keep rising.

Smith also says he recently had a conversation with a contractor about the cost of Rebar, the steel bar or mesh of steel wires used in reinforced concreate and masonry. 'The contractor thinks the cost might start to come down a bit, but I would be very surprised because energy prices are still going up.'

Without trying to depress readers too much, labour costs are rising as well. In H1 of 2021, there was a moderate increase, but since then there has been a jump of 2.2%, according to the Building Cost Information Service (BCIS).

Remember, the industry was still grappling with legacy issues from Covid. For example, during lockdowns, gypsum factories were closing. Suddenly, no plaster boards could be provided for interior walls and ceilings. Explains Smith: 'It was a similar story for a number of other products and materials because of lockdown and we have never really seen the prices come back down since then.'

'It's about collaboration and proper due diligence at an early stage'

DANIEL FERRAO, ASSOCIATE AND COST MANAGEMENT LEAD IN THE NETHERLANDS

Dan Ferrao, cost management lead for the Netherlands based in Hollis' Amsterdam office, says all the cost issues in the UK are witnessed across Continental Europe too.

SOLUTIONS

'It is happening everywhere, and we see it across all of our offices. The resilience of the construction sector is being tested. I also think escalating costs are resulting in more contractors coming back with higher tender prices and they're also increasing their risk, putting risk on risk, which they are passing on.'

'We get involved in projects at various stages, and it is about doing the right things at the right time.'

He says collaboration is absolutely key. 'There are projects already in flight – already being built – and the costs are going up, so it is about managing that. It's about collaboration and proper due diligence at an early stage. If material costs are expensive, potentially early orders can be made and the materials stored after negotiating with the contractor. For projects at an early stage, we carry out feasibility estimates and ensure enough flexibility is built in to allow for price increases.'

He says typically it is a good idea to find ways to better procure and manage material waste and inefficiencies. Especially for projects lasting more than a year, analysing material costs can be crucial, and then reacting quickly to issues that arise.

'Procurement and timing of material ordering is paramount in a volatile market. Understanding your supply chain is key and sometimes, new arrangements involving bulk purchases or greater discounts can be achieved. If the origin of materials can be analysed, so too can the lead-in time and the possibility to find an alternative source.'

Ferrao explains there will also be times when reviewing design specifications of a project should be carried out to assess if modifications can be made. Prefabricated elements of a building might also be an option. Also, labour and material management software can be brought in to keep a closer eye on costs, material use, and any price increases.

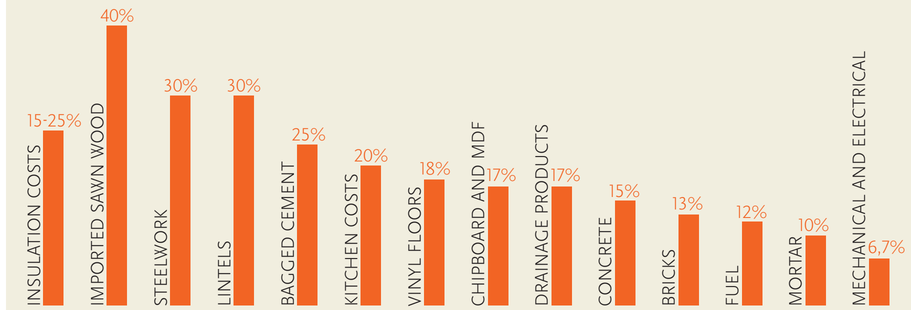
Smith adds: 'One of the really key lessons for us is to stay close to the supply chain, particularly on large projects where we do a lot of market testing with subcontractors and their supply chain. We talk to them about what is coming down the line to assess what we can do to avoid some of these price increases that will ultimately help our clients secure the best price.'

'A lot of our clients are quite risk adverse and go for fixed price tenders because they get that price certainty. But one of the big things we found over the last 8-10 months particularly on big projects is contractors coming back to say they simply cannot fix their price because their suppliers cannot fix their prices. Or if they did, they are adding so much risk into the price that the budget is getting blown out of the water. That is starting to lead us towards two stage tenders, but then that risk is transferred onto the client, and they are not always comfortable with that.'

At one Hollis project, a fluctuation clause has been agreed to address rising costs of diesel used by machinery moving soil. Across the board, Hollis' Smith does not yet see an end in sight to the rapid price increases, so for the moment developers and contractors are caught in the crossfire, and collaboration is key.

Staggering price rises for materials and equipment threaten project viability

Steelwork costs jumped 30% and concrete 15% in 2021. Both are being further driven up by energy costs given the huge amount of energy both require for production. Fuel costs are up 12%. From 1 April, contractors in the UK can no longer use tax-efficient red diesel in plant and machinery. Mechanical and electrical systems are said to be up 6.7% in 2021, but Hollis believes the true rises could be steeper as Brexit and the global shortage of containers have conspired to worsen things. A lot of mechanical and electrical plant/systems come from Europe where container costs have rocketed from around £2,500 pre-Brexit to over £10,000 now, and prices are still rising).



CORPORATE SUMMARY *Hollis is a leading international, independent real estate consultancy. We work with owners, occupiers, developers and funders, across both private and public sectors, to help them get more out of their real estate, at every stage of the property lifecycle. We're a multi-skilled team of surveyors, engineers, technical specialists, consultants and project managers operating across the UK, Ireland and mainland Europe.*

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