exigere

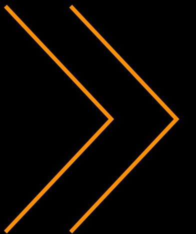
Q4 2024
Market Update

In our Q2 2024 market update, development viability remained challenging, however, improving inflation trends created a more favourable backdrop for interest rates to be cut more swiftly than projected.

That said, October's sharp rise in consumer price inflation could slow the pace of further rate reductions, potentially dampening fragile optimism. While the outlook for 2025 appears brighter, challenges are expected to persist.

Against this backdrop, the financial impact of the recent inflationary spike and the exceptional volatility of recent years remains significant, with the extent of the damage still being uncovered. Delivery risk continues to be elevated, and procurement remains challenging in some markets and sectors, largely due to capacity constraints and supply chain volatility.

Together, the message remains that we need to be part of the solution – not complicit in exacerbating the problem. This requires fairness and accountability on all sides, working with trusted partners to de-risk projects as much as possible, while adopting a pragmatic approach to the distribution of remaining risks throughout the supply chain.



Investment conditions are becoming increasingly supportive, although headwinds persist.

Autumn brought a slight economic chill, as business and household confidence weakened ahead of the government's first Budget. The full impacts of this are yet to be fully understood. So far in 2024, the UK economy has delivered modest growth, with GDP increasing by 0.1% in the third quarter. Annual growth is now projected to range between 0.7% and 1.1%, according to the International Monetary Fund (IMF). Despite this subdued performance, the outlook for 2025 remains cautiously optimistic.

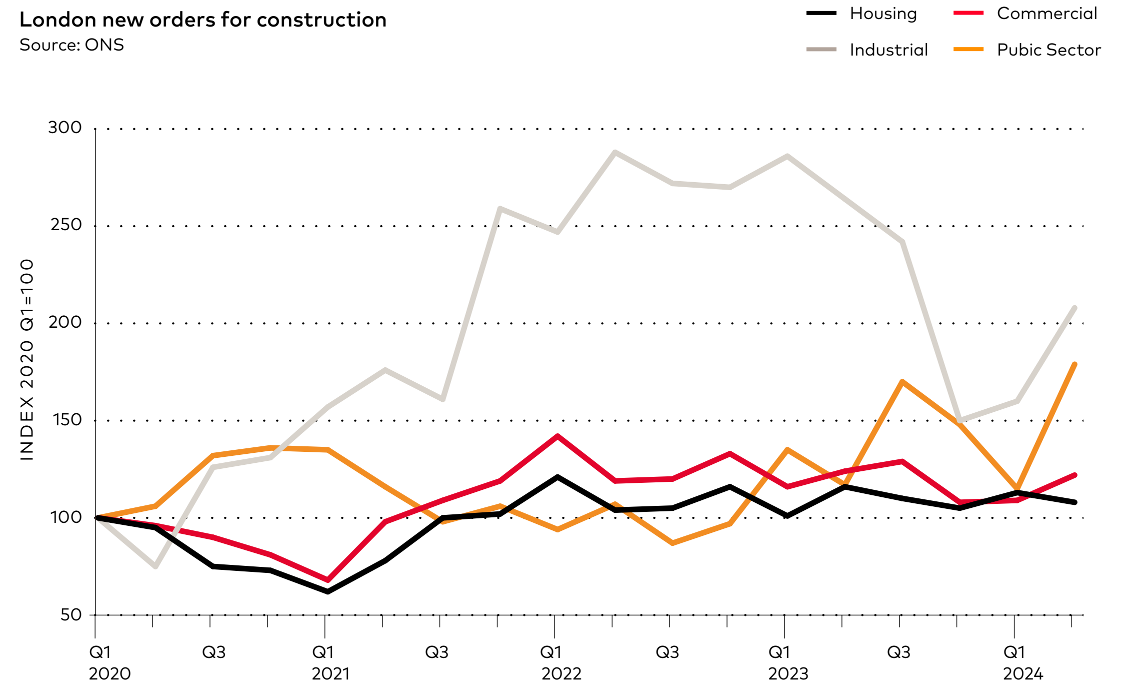
Business investment has been slow to recover, and the recent increase in inflation from 1.7% in September to 2.3% in October may slow the pace of further interest rate cuts in 2025.

As always, opinion is divided regarding the extent of potential base rate reductions. While some city institutions had previously forecast that rates could fall to as low as 3.50% by the end of 2025, the recent Budget has sparked speculation that rates will decrease more slowly than expected due to short-term inflationary fiscal policies.

Improving end-user demand and the reduction in borrowing costs have boosted confidence that the investment market will improve in 2025. Development projects are progressing, albeit at a slower pace than pre-downturn levels. In terms of commercial projects, London is leading the way, with notable activity also occurring in cities across the East and South-East. Official ONS orders data recorded a 27% increase in commercial orders in the first half of 2024. Commercial office leasing activity has strengthened, with prime rents across Central London showing 10% annual growth in Q3, driven by intensified demand for best-in-class spaces. Agents report a positive outlook for demand in both the City and the West End heading into 2025. Yields remain stable, but investment volumes are still at a decade low.

A moderation in borrowing costs should support investment, and with high-profile, high-value assets now on the market, the true strength of investment sentiment will soon be tested. Debt levels are relatively low across UK commercial real estate, with around 90% of outstanding loans secured at a loan-to-value ratio of less than 70%, according to Bayes Business School—a relatively cautious position.

London new orders for construction
Source: ONS



Overall, investment volumes are low, but overseas investor appetite for UK real estate is strengthening. CBRE data shows that foreign investors have increased their holdings of UK real estate since 2022, with asset purchases totalling £50 billion compared to asset sales of £29 billion during the same period.North American investors contributed the most, with Asian investors coming in a close second.

1. St. Pancras Campus ©Jack Hobhouse

Strong population growth and economic performance underpin Central London property demand. London's population grew by over 20% between 2010 and 2024 and is forecast to suppass 10 million—a further increase of around 9%—by 2030, and London's projected growth is set to surpass that of global peers such as Singapore, Paris, Berlin, and New York. This reflects the UK's strongest population growth in half a century, driven by a diverse workforce driving economic expansion and supporting demand across sectors.

For the construction industry, London's rapid growth presents both opportunities and challenges: increased demand for housing, infrastructure, and commercial spaces, alongside heightened competition for resources, skilled labour, and materials amid rising costs and regulatory pressures. Investment yields remain stable across most major London asset classes, with positive momentum building in warehousing and budget hotels.

Residential sector activity is showing signs of improvement, but the cost of meeting building safety requirements continues to affect project viability. This impact is felt both directly, through enhanced specification and management costs, and indirectly, through delays and programme disruptions.

'London's population grew by over 20% between 2010 and 2024 and is forecast to suppass 10 million—a further increase of around 9%—by 2030. Its economic growth rate consistently outpaces the national average.'

A recent Freedom of Information (FOI) request revealed that only 15% of planning applications submitted to the Building Safety Regulator have been approved. This equates to roughly 150 applications for new buildings classified as high-risk buildings (HRBs) successfully passing Gateway 1 in the past 12 months.

Build-to-rent (BTR) development in the capital has slowed in response to these challenges, as well as the abolition of Multiple Dwellings Relief in June. The number of homes under construction in London fell by 11% in the third quarter, according to the British Property Federation.

Wage inflation poses the greatest cost risk

Signs of tightness in the construction labour market have re-emerged. Wage inflation has accelerated to 5%, and firms are finding it increasingly difficult to fill vacancies. Since early 2019, the industry's workforce has shrunk by nearly 350,000, driven by factors such as overseas workers returning home, early retirement, and individuals moving to different sectors. Recent engagement with supply chain partners has highlighted challenges in sourcing labour with expertise in welding, cladding, and mechanical and electrical engineering.

The domestic age demographic challenge in construction is set to exacerbate the skills shortage over the medium term. Over a quarter of the UK-born workforce is aged between 50 and 64, many of whom are likely to retire within the next 10 to 15 years.

Attempts to boost domestic skills capacity have, so far, fallen short, and bold action is essential. Over the past five years, construction apprenticeship starts have averaged 31,000 per year, but the dropout rate remains high, estimated at over 40% by the CITB. Skills England, a new government body established in September, has been tasked with addressing the country's acute skills shortage. Apprenticeship programme reform is on the agenda, but in an industry characterised by highly cyclical demand, enabling skilled overseas workers to contribute to the UK industry must form part of the solution.

Overall, construction material price inflation remains low in the UK, but fiscal stimulus in China, combined with anticipated interest rate cuts in the US, has recently fuelled speculative price inflation in global metals markets. In recent months, the World Bank tracked double-digit annual inflation in aluminium, copper, tin and zinc prices. However, prices of iron ore, lead and nickel were still down by over 10% in September relative to 2023.

ANDREW BAILEY, THE BANK OF ENGLAND'S GOVERNOR, SAID:

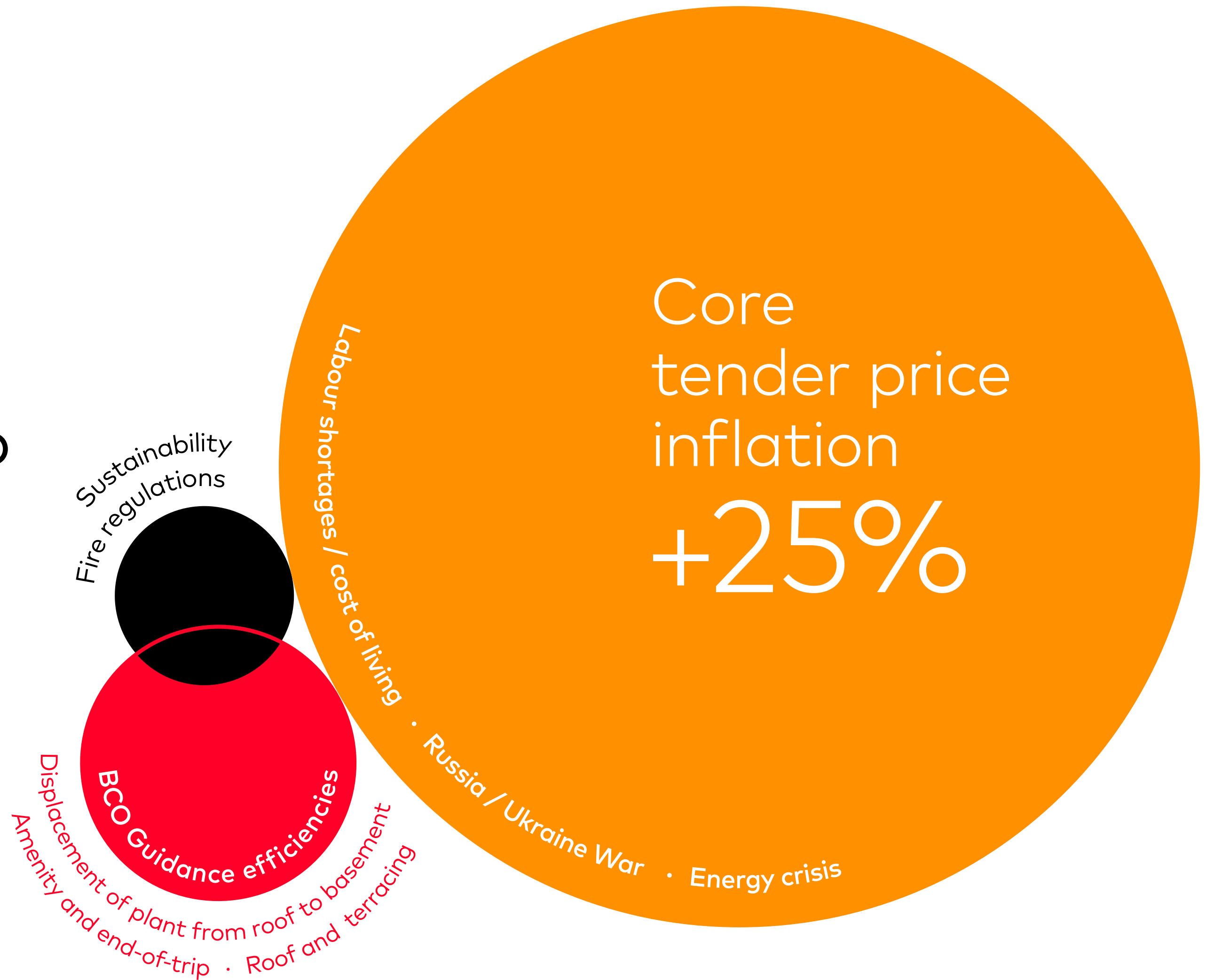
'We need to make sure inflation stays close to target, so we can't cut interest rates too quickly or by too much. But if the economy evolves as we expect it's likely that interest rates will continue to fall gradually from here.'

This speculation, coupled with the threat of oil production disruption due to escalating geopolitical tensions in the Middle East, poses an upside risk to construction cost inflation. However, uncertainty about the strength of global demand, buoyant stock levels, and OPEC+'s planned production increase in December have so far kept oil price inflation in check. Current market dynamics suggest that activity in global commodities markets is predominantly speculative, with no significant shift in demand fundamentals.

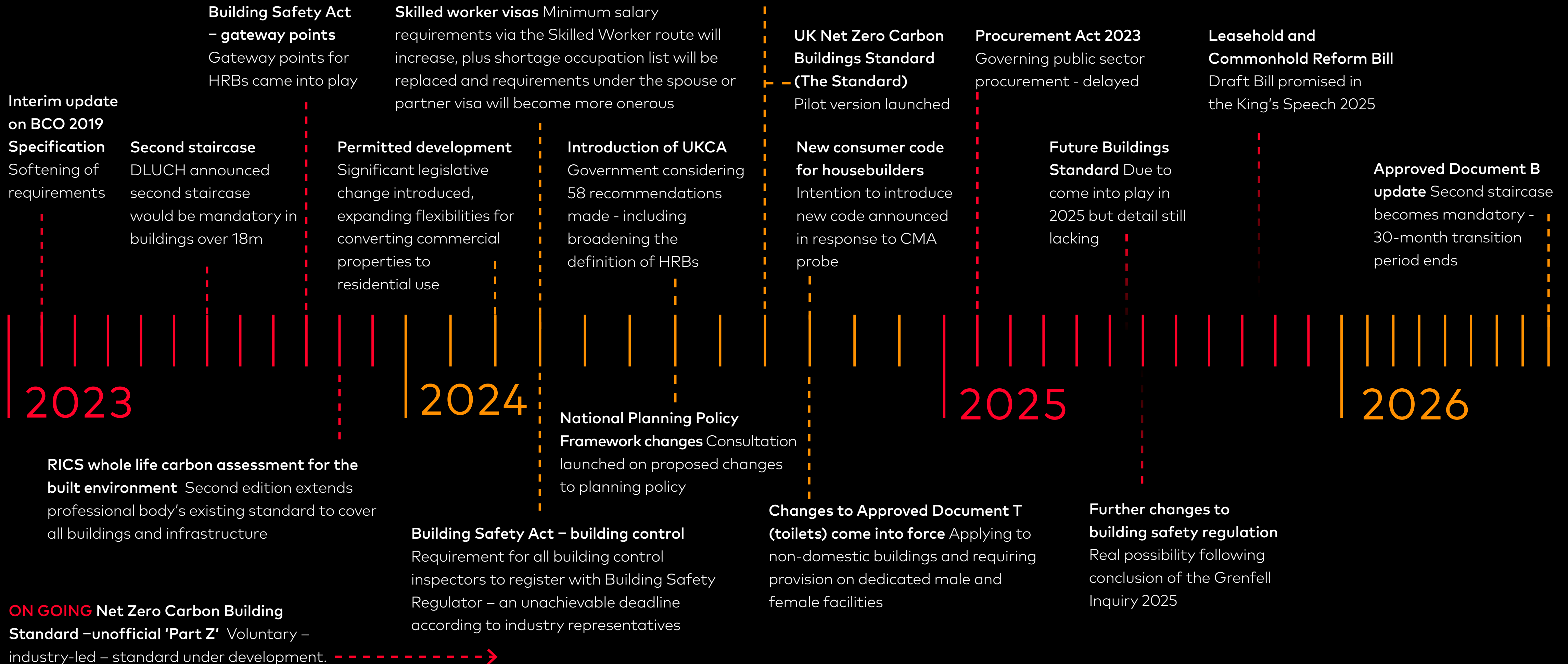
In addition to tender price inflation, rapid regulatory changes, sustainability and decarbonisation targets, and tenant-led design enhancements have all impacted costs in recent years. Furthermore, the Future Homes Standard, a consultation on minimum energy efficiency standards for rented residential properties, and a further programme of planned changes to Approved Document B are in the pipeline.

But this is not all. The government has pledged to consider all 58 recommendations made following the public inquiry into the Grenfell tragedy. These recommendations include proposals to broaden the definition of higher-risk buildings, establish a single regulator for the construction industry, and introduce a licensing system for principal contractors constructing or refurbishing higher-risk buildings.

Central London office cost escalation Q1 2020 - Q4 2024

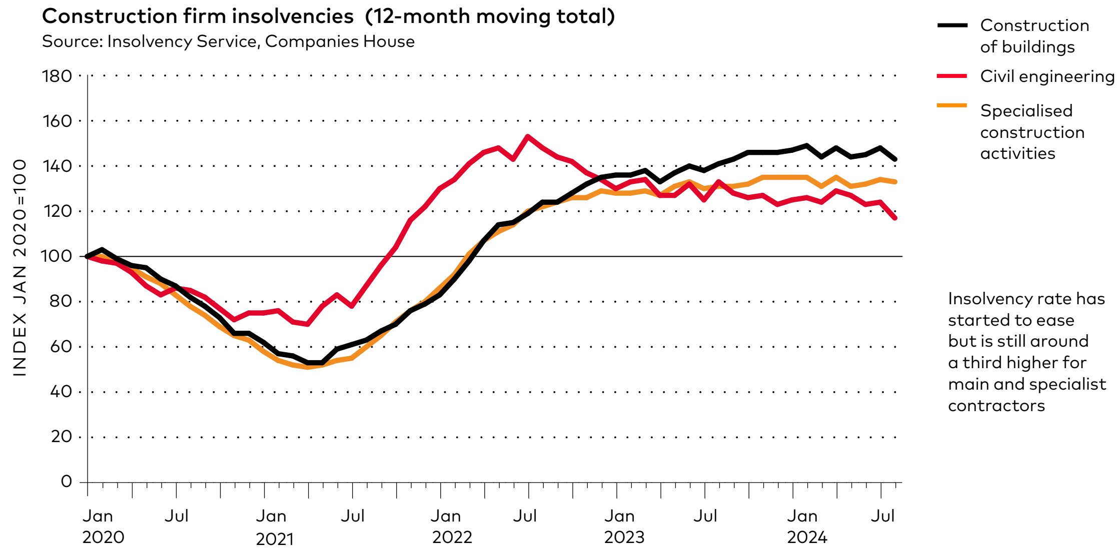


Policy changes timeline 2023 – 2026



Supply chain challenges

The past 18 months have been turbulent for the construction supply chain, with confidence in the sector significantly shaken. Fixed-price contracts combined with inflationary shocks form a toxic mix in a low-margin industry where cash flow is king. But this is only part of the problem. Legal disputes over substandard workmanship and misguided strategic decisions to enter new sectors without appropriate expertise have also affected profitability.



Then there's the domino effect. In such a fragmented sector, every business failure creates a complex web of impacts and collateral damage that takes time to fully unravel. While construction firm insolvencies have finally peaked, levels remain elevated. In the 12 months leading up to August, 4,310 construction firms ceased trading—significantly higher than the pre-Covid average of 2,775 recorded between 2014 and 2019. The sector has been battered by Covid, Brexit, the Ukraine war, and an acceleration of regulatory changes that have fundamentally altered the delivery landscape. These figures include big industry names—ISG, Henry, Buckingham, Michael J Lonsdale, and Osborne—while other stalwarts have posted significant losses.

The threat of supply chain insolvency continues to pose heightened delivery risks. Changes to accounting practices following Carillion's collapse in 2018 sought to strengthen rules on reporting future profits and liabilities. However, circumstances surrounding ISG's collapse suggest further reform is necessary, with audit and corporate governance reform already on the 2025 regulatory agenda.

'While construction firm insolvencies have finally peaked, levels remain elevated.'

The domino effect remains a serious risk to the supply chain, and the full impact of ISG's failure will take time to understand. When Buckingham collapsed in September 2023, the financial impact on their supply chain was initially estimated at £108 million. A year later, this figure had almost trebled to £302 million. ISG's situation is on another scale. At the time of its collapse, the firm carried nearly £1 billion of debt, and the supply chain impact was initially estimated at £300 million—though this figure is almost certain to rise.

In the London commercial market, key contractors have started reassessing their appetite and exposure to certain types of projects. Over recent years, many contractors have become far more selective, which has further constrained the market—particularly for larger, more complex developments.

MEP – the capacity challenge

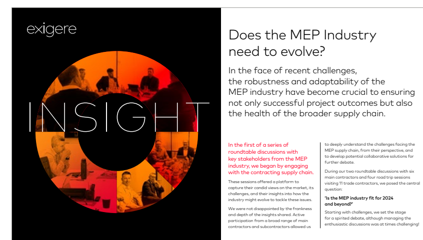
Rapid growth in data centre capacity is forecast for London and across the UK, driven by demand from artificial intelligence and quantum computing.

Cushman & Wakefield estimates that London's planned data centre pipeline exceeds its current capacity, with 1,209 MW planned compared to the existing 1,062 MW. Outside London, Blackstone recently confirmed £10 billion investment to develop one of Europe's largest hyperscale data centres in Northumberland. Additionally, Amazon Web Services has committed £8 billion to UK investment through to 2028, focusing on building, operating, and maintaining data centres nationwide. To coincide with the government's International Investment Summit in early October, a further £6.3 billion in data centre investment was announced by other US investors.

The rapid increase in data centre provision is only part of the demand story. Gigafactories and projects supporting the Great Grid Upgrade are also driving significant demand.

The collapse of Michael J Lonsdale, a £250 million business, around a year ago—caused in part by the 2022 inflationary spike and fixed-price contracts—had already dented capacity. The anticipated uplift in demand now poses a clear risk, not only at the trade contractor level but also across tiers further down the supply chain.

MEP pricing remains volatile, with capacity constraints affecting the entire MEP industry. In our recent publication, 'Does the MEP industry need to evolve?', we explore how these challenges can be addressed through meticulous pre-construction planning, design scrutiny, and collaborative working.


exigere

INSIGHT

Does the MEP Industry need to evolve?

In the face of recent challenges, the robustness and adaptability of the MEP industry have become crucial to ensuring not only successful project outcomes but also the health of the broader supply chain.

In the first of a series of roundtable discussions with key stakeholders from the MEP industry, we began by engaging with the contracting supply chain.

These sessions offered a platform to capture their candid views on the market, its challenges, and their insights into how the industry might evolve to tackle these issues.

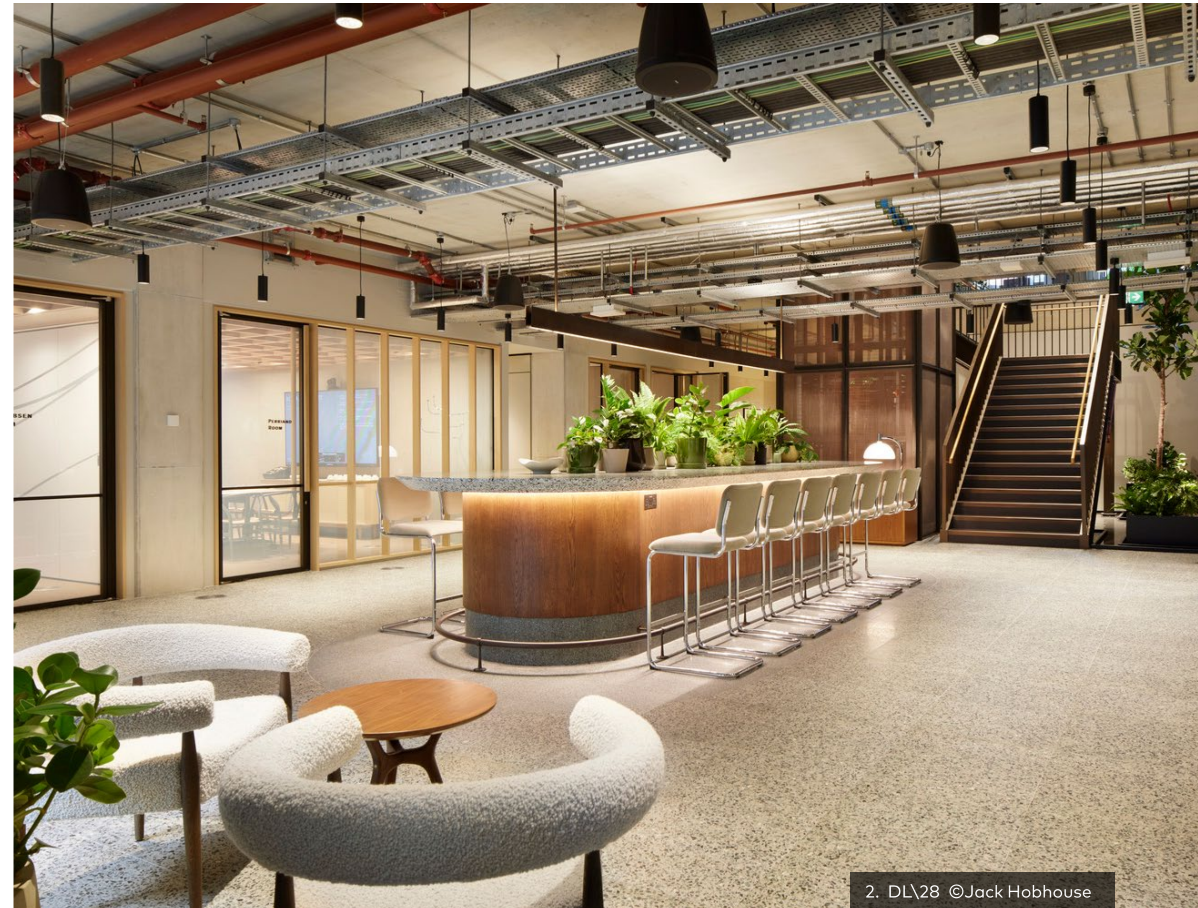
We were not disappointed by the frankness and depth of the insights shared. Active participation from a broad range of main contractors and subcontractors allowed us to deeply understand the challenges facing the MEP supply chain, from their perspective, and to develop potential collaborative solutions for further debate.

During our two roundtable discussions with six main contractors and four road trip sessions visiting 11 trade contractors, we posed the central question:

'Is the MEP industry fit for 2024 and beyond?'

Starting with challenges, we set the stage for a spirited debate, although managing the enthusiastic discussions was at times challenging!

Click to read


2. DL\28 ©Jack Hobhouse

3. 63-66 Coleman Street ©Emrys

So what does this all mean for development?

Successful projects are built on robust teamwork and adherence to the principles outlined in the Construction Playbook, which advocates an outcome-focused approach that fosters cohesive teams with shared values and transparent communication.

High-quality design, combined with balanced procurement strategies that embrace these principles, will create a flexible, collegiate, and robust delivery framework capable of responding collaboratively to the challenges ahead.

Contractor capacity has been depleted, with constraints emerging in niche areas—particularly in MEP. Early engagement with main and key specialist contractors is essential to raise the profile of schemes and to understand the business challenges and constraints faced by preferred supply chain partners.

Delivery risk is heightened, making it critical to fully understand the true financial picture before entering into contracts. Red flags should not be ignored. Leadership reshuffles, shifts in strategic direction, and exceptionally strong growth can be indicators of healthy businesses with strong ambition, but equally, they can signal underlying issues. Elevated risk aversion across the supply chain is understandable in the current market.

Nonetheless, we believe there are clear green shoots of recovery for the coming year and beyond. The industry is evolving, with a growing recognition of the need for positive change and a willingness to embrace new approaches that drive better outcomes for all.

FEATURED PROJECTS

1. **St. Pancras Campus** W.RE
2. **DL\28** Derwent London
3. **63-66 Coleman Street** CLI Dartriver
4. **Hill House** Landsec

Budget 2024 – a game of two halves

The Autumn Budget 2024 delivered a significant, sustained increase in spending, taxation, and borrowing. The total impact amounts to almost £70 billion of additional annual spending over the next five years, the majority (two-thirds) of which is allocated to current rather than capital expenditure.

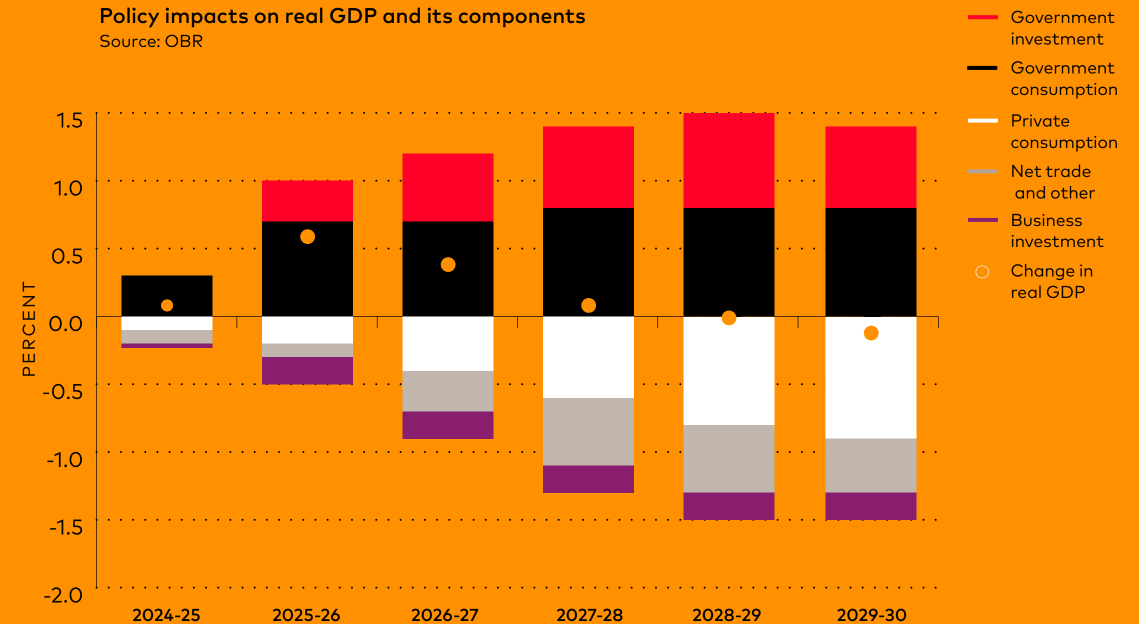
There were some definite positives for construction—not least the confirmation that the government will fund HS2 tunnelling from Old Oak Common to Euston station. Indicative departmental capital expenditure limits also point to nearly 10% real-terms growth in 2025/26. However, this comes at a cost—a cost likely to make private sector investment viability harder to achieve.

Extra investment in social infrastructure is welcome, but as always, the devil is in the detail. As markets digested the Office for Budget Responsibility's (OBR) analysis of the Chancellor's plans, red flags quickly emerged.

Markets expressed concern about the near-term inflationary impact of increased current spending, alongside scepticism over whether projected tax revenue increases were overly optimistic.

The OBR predicts that budget policies will add half a percentage point to peak CPI in 2025 before inflation gradually falls back to the Bank of England's 2% target. Higher near-term inflationary pressure is expected to slow the pace of base rate reductions. Additionally, any shortfall in projected tax revenues would require further tax increases or increased public borrowing.

As a result of the Budget, the OBR expects GDP to grow by an additional 0.5% in 2025. However, business investment and private consumption are forecast to decline through to 2030. The return of Donald Trump to the White House in January 2025 adds further uncertainty, particularly regarding his intentions around tariffs. The broader implications of such tariffs are inflationary, with the Grantham Institute on behalf of the London School of Economics estimating



a potential -0.14% impact on the UK economy. While the immediate effect on UK construction may be limited, the uncertainty surrounding Trump's policies clouds the broader outlook.

Publicly funded capital investment remains crucial, but policy stability and a supportive fiscal environment are essential for unlocking the private sector's potential to deliver facilities that drive long-term economic growth and productivity gains. In recent years, the rapid pace of policy change has added complexity to the construction landscape. With ongoing uncertainty around the Future Buildings Standard, minimum energy performance certificates, solutions to the acute skills shortage, and building safety requirements following the Grenfell Inquiry's final recommendations, the sector is unlikely to see respite from policy changes anytime soon. This Budget, unfortunately, made conditions slightly less favourable for private sector investment.

Our TPI predictions

↑ 2.5% for 2024

Q4 2024 – December: December change (%)

SENSITIVITY RANGE	2023	2024	2025	2026	2027
LOW	3.75%	1.5%	1.5%	2.0%	2.0%
BALANCED	**4.0%**	**2.5%**	**3.0%**	**3.5%**	**3.5%**
HIGH	4.0%	2.5%	4.5%	6.0%	6.0%

4. Hill House ©WAX

exigere

+making projects happen

Author

David Thornley
Partner

07834 257188
david.thornley@exigere.co.uk

exigere.co.uk