

2017 THE MISTS OF TIME TO COME...

IT'S BEEN A LONG TIME SINCE THE INDUSTRY - AND THE COUNTRY - HAS FACED A YEAR OF SUCH UNCERTAINTY. JOEY GARDINER TRIES TO MAKE SENSE OF IT ALL WHILE SOME KEY INDUSTRY INSIDERS TELL US WHAT THEY THINK WILL BE THE BIG TALKING POINTS OF 2017

Predicting the future has become an increasingly fraught and risky enterprise - as any number of widely-derided opinion pollsters can testify. From the Tories' 2015 majority, to the Brexit vote and the election of Donald Trump, any number of people who confidently told you what was going to happen in the last couple of years have ended up on the receiving end of a hell of a lesson in modesty. Building is not immune. Last year we kicked off by forecasting the London mayoral election to be the stand-out political event of 2016 - important, sure - but it feels like small beer next to the game-changing referendum decision and its fall out. Given the hefty dose of humility consumed by pundits in 2016, it's little surprise that the major point of consensus for this year ahead is for continued and deepening

uncertainty, on both the political and economic level. Hence the Construction Products Association (CPA) refusing to make predictions beyond 2018 because of the lack of certainty over the trading conditions after exit from the European Union (EU). At this point, the stand out UK political event of the year looks likely to be the triggering of Article 50 in the spring, after which the UK's future relationship with Europe may start to become clearer. Nevertheless, by the end of the year it may actually be that the fallout from general elections in France, Germany and the Netherlands, where centrist parties are all facing growing "populist" movements, does much more to affect the political climate and economic sentiment - particularly if there are more 2016-style upsets.

The CPA's economics director Noble Francis, says: "Policy-wise it is difficult to ascertain what this disaffection of a significant proportion of the population means in practice but it will clearly increase uncertainty at a time when uncertainty, nationally and globally, is already high." Jack Pringle, London managing director at design firm Perkins + Will, says: "2017 could be politically the most turbulent year for a very long time - which could wash into the economy. It will potentially be very volatile on the economic front." With Theresa May's still very new government slowly defining (and seemingly inventing) its agenda as it goes along, while economists argue whether a Brexit-related economic slowdown has been avoided or merely postponed, there is much to be unsure of in 2017. Below Building does what it can to peek through the mist ...

ECONOMY

The Office for Budget Responsibility has already revised down the overall UK growth forecast for 2017 year from 2.2% to 1.4%, while revising up inflation expectations in the wake of the 20% plummet in the value of sterling. For construction, most forecasters expect this to translate into non-existent or very weak growth in output, with the CPA predicting output overall to rise by just 0.3%. However, things will look very different according to which sector you work in: the CPA expects infrastructure to show strong growth of more than 6%; housebuilding is expected to be flat, ending a run of four years of strong growth; commercial construction activity, particularly offices and possibly also retail, is expected to be weaker - office construction output is forecast to fall 3% - with the finishing off of existing schemes hiding a much weaker pipeline of new work

coming through.

Richard Young, director at project manager Buro Four, says: "The big commercial schemes of above 200,000ft²; there aren't going to be many wanting to push the button on those."

Analysts are divided, however, on the impact this weakening commercial market will have on construction prices, particularly given relative strength elsewhere. Simon Rawlinson, head of insight at consultant Arcadis, says



tender prices in the London commercial market will drop 4-5% this year.

"We can be pretty certain about that," he says. "There's been a slightly

artificial level of confidence since the vote. But if there's enough of a hiatus in new projects people will need to secure workload."

However, Iain Parker, partner at consultant Alinea, says

contractors and specialists have stronger current order books than many realise, and lingering financial worries from the recession mean most

will avoid taking on low priced work - at least until the second half of the year.

"We don't anticipate tender price cuts immediately. The more aggressive pricing hasn't come through yet, though we expect some to sharpen their pencils in the second half of the year," he says.

In the meantime, rising costs may be more of a concern to contractors than falling tender prices, with largely imported products such as cladding and M&E plant hit by the drop in sterling. This has already led to an increase in the cost of imported products, says the CPA's Francis. "Rather than a lack of demand," he says, "the key issue for construction in the next couple of years could well be cost inflation. In time the cost of UK manufactured products is also likely to increase as a consequence of international supply chains and energy price rises."

POLITICS

While Brexit is set to dominate domestic politics overall, for the construction community the most eagerly awaited political event currently is the publication of the housing white paper, expected later this month. The white paper will tackle a vast array of issues related to housing supply, encompassing the future of social housing, Starter Homes, the build to rent sector, and planning reform. Specific measures are expected to attempt to prevent housebuilders from land banking and to reform the operation of the Community Infrastructure Levy. There is even some talk of the issue of reducing the VAT charged for housing renovation being back on the agenda - dismissed for years by the Treasury, despite concerted campaigning, as being too difficult to do while within the EU. Ian Fletcher, policy director for real estate at the British Property Federation, said he hoped the white paper would announce plans to embed build to rent within the UK planning system at a national level in a similar way as recently proposed by London mayor Sadiq Khan in the capital. "A huge amount in policy terms lies on



what happens this month," says Fletcher. "We're hoping for strong support for build to rent and we've also had indications they're considering more resource for local authority planning departments."

Housebuilders will want to know if government funding for housebuilding may in future be directing back toward social housing. Later in the year they will also be looking to see how hard Theresa May's government clamps down on local authorities which have not produced local plans, with councils given a deadline of April to get their houses in order.

Regarding Brexit, the biggest concerns will be to what extent negotiations over leaving the EU will dampen economic growth, and the more specific issue of what future access UK firms will have to overseas workers to design and deliver UK construction projects.

Brian Berry, chief executive of the Federation of Master Builders (FMB), says: "We want clarity on how immigration will work post-Brexit. We just don't want anything to make exiting even more tricky."

Partially related to this, the other big

political issue for construction in 2017 will be training and apprentices. The government's large employer levy will start operating in April, forcing 900 firms to pay both that and the CITB levy, and there are concerns as to how it will operate. Former chief construction advisor Paul Morrell's review of industry training boards, which covers the CITB, will report at some point, though a time frame has not been given. This will determine the future operation of the industry's much-criticised levy to pay for apprentices. The FMB's Berry says: "The departure of the CITB's chief executive [Adrian Belton] at the end of last year could make it vulnerable under the review, so we're hoping for a quick transition to new leadership."

On the infrastructure side, news is expected following the Autumn Statement pledge to announce a pipeline of PF2 private finance projects "early" in the year. The government's infrastructure unit - the Infrastructure and Projects Authority - is also due to report on improving infrastructure productivity by the summer, and the National Infrastructure Commission will report on the use of new technology. >>

PROJECTS

Strange to say in a time of supposed spending austerity, but many expect the impetus for major new projects this year to come from the public sector, with Theresa May's government having given the go ahead to the three Hs – Heathrow, Hinkley and HS2 – in its first few months.

Contractors can expect work on Hinkley to ramp up quickly, while many of the headlines will be made by HS2, set to gain Royal Assent shortly. HS2 construction work is still slated to start this year, with £9bn of main civils contracts to be let in the next six months. Meanwhile design work on Heathrow will speed up in preparation for the submission of a planning application in 2019.

At the same time, other public projects are being worked up for approval, with the business case for Crossrail 2 to be submitted to the Treasury later this year, and the £7bn Palace of Westminster refurbishment still on the starting blocks. The £369m refurbishment of Buckingham Palace, on which Sir Robert McAlpine has a role, is supposed to start in April.

Arcadis' Rawlinson says: "Some areas



of the market feel quite strong. The government is being quite supportive of infrastructure and the likes of Thames Tideway and Crossrail 2 have momentum."

However, the industry will be sharply alert to any delays in moving projects from the drawing board to the building site. "To ensure growth for the construction industry overall in the next few years, it is essential that the previously announced projects feed

through into activity on the ground rather than focusing on new announcements," says the CPA's Francis. For many of the biggest building contractors, the spotlight will remain on private work, where the market is less certain. Many expect high end residential schemes that have not already been paused to come under threat, while funders are likely to think very hard about giving the go ahead to

speculative office projects. The decision last year to push ahead with the 1.3 million ft² 22 Bishopsgate means construction should start there this year, but it could also make it harder for rival schemes to find tenants to anchor big new buildings. Hence there is much scepticism that schemes such as 1 Undershaft and 40 Leadenhall – otherwise known as Gotham City – will get moving. Buro Four's Young says: "It's hard to see why an overseas investor would put 1 million ft² in the City right now. I'd be surprised if there was a lot of progress [on 1 Undershaft]."

Optimists, however, say investors and developers are finding other places to put their money. The BPF's Fletcher says: "The biggest ongoing issue will be the growing appetite to diversify in to other types of assets. If last year was the year of build to rent, the next two could be about providing for the elderly and their housing needs."

Following on from last year's Farmer report, the growth in use of off-site and prefabricated construction methods to build projects out is expected to continue.

COMPANIES

For many in the construction sector, 2017 looks likely to be a harder year to navigate than the last. Kevin Cammack, analyst at Cenkos, says: "It's going to be a more difficult year, but one in which it'll be quite hard to predict where the weakness will come from."

The surest forecast is of the appointment of a number of new chief executives of major firms after a rash of departures in the second half of last year – departures which to one degree or another represent the difficulties experienced by those businesses. As of today, contractors Sir Robert McAlpine, Interserve, Lakehouse and Laing O'Rourke are all without long term chief executives, though it is not known if Laing O'Rourke chair and chief executive Ray O'Rourke (pictured far right) is looking to appoint anyone at the moment. Either way, O'Rourke is likely to be among those facing the toughest challenges in

2017, with the proposed sale of the Australia business, announced exactly a year ago, still not completed, and with the previously announced big losses to stem from its design-for-manufacture projects and a Canadian Hospital PFI deal.

Meanwhile others, such as Mitie and, to a lesser extent, Carillion, are facing difficulties which will have to be addressed from their diversification into the increasingly problematic outsourcing market.

It will also be a big year for Balfour



Beatty, and particularly for chief executive Leo Quinn, (pictured left) who began his tenure in 2015 promising a two-year turnaround. While he has already hit the specific metrics he set himself for bringing cash in and cutting cost, he will need to do more to impress investors at full year results in March.

Cenkos' Cammack says: "Quinn will have to show significant progress on previous years." Stephen Rawlinson, analyst at Applied Value, says his track record shows he



may consider taking more drastic action than previously. "One tip is that Balfour considers demerging its infrastructure arm, which John Laing previously offered £1bn for. Quinn's performance plan comes up in 2018 so you know he's going to do something."

Elsewhere, analysts predict, there is little chance of mergers, acquisitions or new stock exchange listings. While it is possible that a private housebuilder, such as Cala, or retirement home developer like Churchill may attempt to float on the stock exchange, Cammack says it would mean accepting a lower valuation than in more auspicious times. Tony Williams, analyst at Building Value, says: "Outside of [product manufacturer] SIG, which I think is an acquisition waiting to happen, there is zero prospect of corporate activity this year. The climate's totally wrong."

WE ASKED SIX BIG NAMES IN THE INDUSTRY TO MAKE THEIR PREDICTIONS FOR THE YEAR TO COME...



Mark Farmer, chief executive, Cast, and author of report Modernise or Die

The big challenge

The big challenge for the industry is to refocus on modernisation, skills and productivity. This is crucial at a time when industry output is likely to come under pressure and perhaps a greater "survivalist" instinct becomes commonplace. The industry needs to think long term about investment in training and innovation but the post-Brexit volatility may hamper this cause.

The big opportunity

The single biggest opportunity sits in the residential sector through embracing pre-manufacture-led delivery. The use of digitally enabled, less labour-intensive techniques supported by government policy can be the basis of a transformational change in the industry.

The big story

For me it's probably "the Chinese are coming". This is a very real prospect. I suspect you will see moves into the supply chain through either M&A activity with UK housebuilders or contractors, or wholly overseas-led pre-manufacturing ventures arriving on UK shores.



Julie Hirigoyen, chief executive, UKGBC

The big issue

I'd say it's highly likely that the zeitgeist issue will continue to be the link between good sustainable design and the health and wellbeing of people using the buildings. Wellness and productivity have continued to enjoy a fairly meteoric rise in importance across both commercial and residential markets. The rapid acceleration of technologies providing relevant data on air quality, pollutants and CO₂ concentrations is central to this trend.

The big opportunity

The industrial strategy demonstrates the government's appetite to boost growth and productivity in the construction sector. The real opportunity here will be around the place-based execution of such an industrial approach, in particular the central role that cities and a sustainable built environment can play in that. This in itself throws up new opportunities for the public and private sector to work more closely together in the delivery of sustainable, healthy, liveable places that thrive well into the future.



John Tutte, chief executive at Redrow

The big challenge

Planning remains the number one barrier to building more homes and the biggest challenge facing the industry in 2017. Recent research shows that 87% of local authorities don't believe that the new government will reach their housebuilding target by 2020. Conditions associated with planning permission must be changed if we are to build more homes faster, while local authority planning departments must also be reformed, and adequately resourced, to ensure that all applications can be swiftly processed.

The big opportunity

The announcement of the £2.3bn Housing Infrastructure Fund to overcome local objections and unlock 100,000 new homes in areas of high demand presents a massive opportunity for the industry. Alongside the building of these homes, we must prioritise infrastructure that supports local communities and helps them to grow. But councils must implement local plans to ensure that community housing requirements are clear.



Philip Watson, design director, Atkins

The big issue

This time next year I'm sure we'll still be talking about the housing and schools shortage crisis. But my hopes are we'll be talking about real solutions and the impact they've had. 2017 needs to be the year that we stop talking and start taking action.

The big challenge

2017's challenge is building enough capacity using modern methods of construction and off-site industry so we can deliver the volumes we need to make a significant impact on meeting the demand for faster, more cost effective buildings.

The big opportunity

We have a real opportunity to capitalise on the move towards off-site construction. For manufacturers, it's about taking advantage of the huge market potential. For designers, it's about focusing on social challenges and collaborating to help make this approach not only the quickest option, but the best quality option. It's time we put our prejudices aside and find ways to make off-site buildings creative, flexible and aesthetically pleasing.



Ann Bentley, global chairman, Rider Levett Bucknall

The big challenge

Social infrastructure. The NHS, schools, social care, affordable housing, prisons; all are underfunded and oversubscribed. With digital information, greater levels of manufacturing and pre-assembly and a real emphasis on the long-term use of buildings we have the ability to model and address real needs and deliver cost-effective, long-term, people-focused solutions.

The big opportunity

"Place" is the word of the moment in government circles – it appears to mean anywhere other than London! There is clear messaging about rebalancing prosperity across the country and the opportunity for our industry to facilitate this is immense.

The big story

Political upheaval around the world and the global nature of businesses in the construction sector mean that many will be sailing in uncharted water next year. This could lead to some very positive, or very negative, headlines – depending on how good we are at reading the runes.



Al Watson, partner, Taylor Wessing

The big issue

Let's put to one side the Brexit debate – that is a given, and it is an overarching issue which will continue for the next goodness knows how many years. Instead, let's focus on the actual year itself. Among the ebb and flow of currency fluctuations and the availability of materials combined, just how can the construction industry work in partnership with landowners and developers in pricing jobs accurately for the benefit of all sides in the process?

The big challenge

Undoubtedly, the government is going to pick winners in its evolving beyond Brexit strategy and the government will listen to a single voice – so the industry needs a single voice. It's got to get its game together very quickly and whether it is an organisation set up simply to lobby government on Brexit in the future, or an existing trade body which is nominated by the wider industry, a single unified voice to represent the future of the industry, is, to my mind, the single biggest challenge. Kick the government's door in.

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