Construction Outlook

MID-YEAR FORECAST 2017

PREPARED BY

Glenigan

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Introducing Glenigan

Established in 1973, Glenigan currently invests over £3million and makes over a million research telephone calls per year to provide details on every construction project in the UK. This enables us to provide the most up-to-date and comprehensive construction sales leads and analysis, to help companies win new business.

We also have exclusive partnerships with key industry associations such as the Builders' Conference, Considerate Constructors Scheme and the Building Research Establishment (BRE), enabling us to offer project data that's not available elsewhere in the market.

Glenigan's detailed insight is used across all levels of our customers' businesses. Different departments have much to gain from using our industry knowledge and product features to deliver results for their specific job role.

Further information

For further information, visit glenigan.com or contact us on the details below.

Phone +44 (0)1202 786700
info@glenigan.com

5th Floor, 80 Holdenhurst Road
Bournemouth BH8 8AQ

Subscription Sales

Phone 0800 373 771
info@glenigan.com

Account Management

Phone 0870 443 5373
customer@glenigan.com

Executive Summary

2017 +1% 2018 +2%

Forecast values of underlying new project starts

- Political uncertainty the 'new norm' as minority government negotiates Brexit
- Slower economic growth forecast for 2017 and 2018
- Weak business investment
- Weaker housing market activity forecast for 2017 & 2018
- Logistics projects to lift industrial starts
- Slowdown in office development activity
- Retail property facing weak consumer spending and structural change
- Renewed growth in civil engineering starts
- Weak growth in construction project starts during 2017 & 2018

UK Construction Prospects

This report analyses Glenigan's latest data on construction activity and provides an assessment of the industry's prospects for 2017 and beyond.

The UK construction industry has been buffeted over the last three years by political uncertainty. A series of elections and referendums have disrupted industry workload and order books as investors and clients have delayed and re-appraised their plans.

Table 1: *Value of Underlying New Work Project Starts by Sector* *Source: Glenigan*

Change on previous year £m	2015	2016	2017f	2018f
Private Housing	15,134	15,140	14,974	14,435
Social Housing	6,447	6,688	6,648	6,788
Industrial	3,940	2,931	3,534	3,823
Offices	4,374	4,613	4,390	3,662
Retail	2,038	2,552	2,342	2,127
Hotel & Leisure	3,122	3,018	3,511	3,775
Education	7,125	6,913	6,040	7,088
Health	1,938	2,112	2,596	2,235
Community & Amenity	1,176	1,124	1,073	1,183
Civil Engineering	7,758	5,556	6,059	7,224
Total	**53,052**	**50,647**	**51,167**	**52,340**

Political uncertainty appears to be the new norm and is set to persist over the forecast period as a minority government negotiates the UK's departure from the EU. Uncertainty over the outcome of the Brexit negotiations and the survival of the current administration are likely to disrupt industrial and commercial sector investment over the next two years.

The Government has already relaxed its targets for reducing the deficit following the EU referendum vote and announced increased capital spending to improve UK competitiveness. Further increases in public spending are likely following June's election result, however spending is likely to be directed to areas of immediate political pressure, from NHS front line services to addressing safety measures in the social housing stock in the wake of the Grenfell fire, rather than sustained long term capital investment.

Slower UK economic growth is also forecast to constrain construction workloads over the next two years. Real household earnings growth has stalled as household budgets are squeezed by weak wage growth and higher inflation. This is forecast to impact upon private housing and retail construction activity. Conversely Sterling's depreciation over the last 18 months is forecast to provide a lift to UK tourism and hotel & leisure investment.

Demographic changes are set to shape the pattern of construction activity. Increased investment is anticipated over the forecast period to expand the secondary school estate in order to accommodate rising pupil numbers, especially in the UK's major conurbations. Greater investment will also be required long term to meet the needs of an aging population.

The construction industry is also facing challenges from an aging workforce. The UK's departure from the EU has thrown the issue into sharper relief given the industry's reliance on overseas labour, particularly in London. Anecdotal evidence suggest that recruitment of overseas labour has already become more difficult following the referendum and the weakening in Sterling. Reduced labour availability is expected to add to contractors costs and may act as a spur for the greater use of off-site manufacture over the forecast period.

Table 2: *Value of Underlying New Work Project Starts by Sector* — *Source: Glenigan*

Change on previous year	2015	2016	2017f	2018f
Private Housing	19%	0%	-1%	-4%
Social Housing	6%	4%	-1%	2%
Industrial	24%	-26%	21%	8%
Offices	5%	5%	-5%	-17%
Retail	-17%	25%	-8%	-9%
Hotel & Leisure	-3%	-3%	16%	8%
Education	21%	-3%	-13%	17%
Health	-22%	9%	23%	-14%
Community & Amenity	7%	-4%	-5%	10%
Civil Engineering	-4%	-28%	9%	19%
Total	**7%**	**-5%**	**1%**	**2%**

The value of underlying construction projects fell 5% last year as political and economic uncertainties surrounding the EU referendum adversely affected the private non-residential sectors in particular. Although political and economic uncertainties will persist over the next two years, the overall flow of projects is forecast to stabilise.

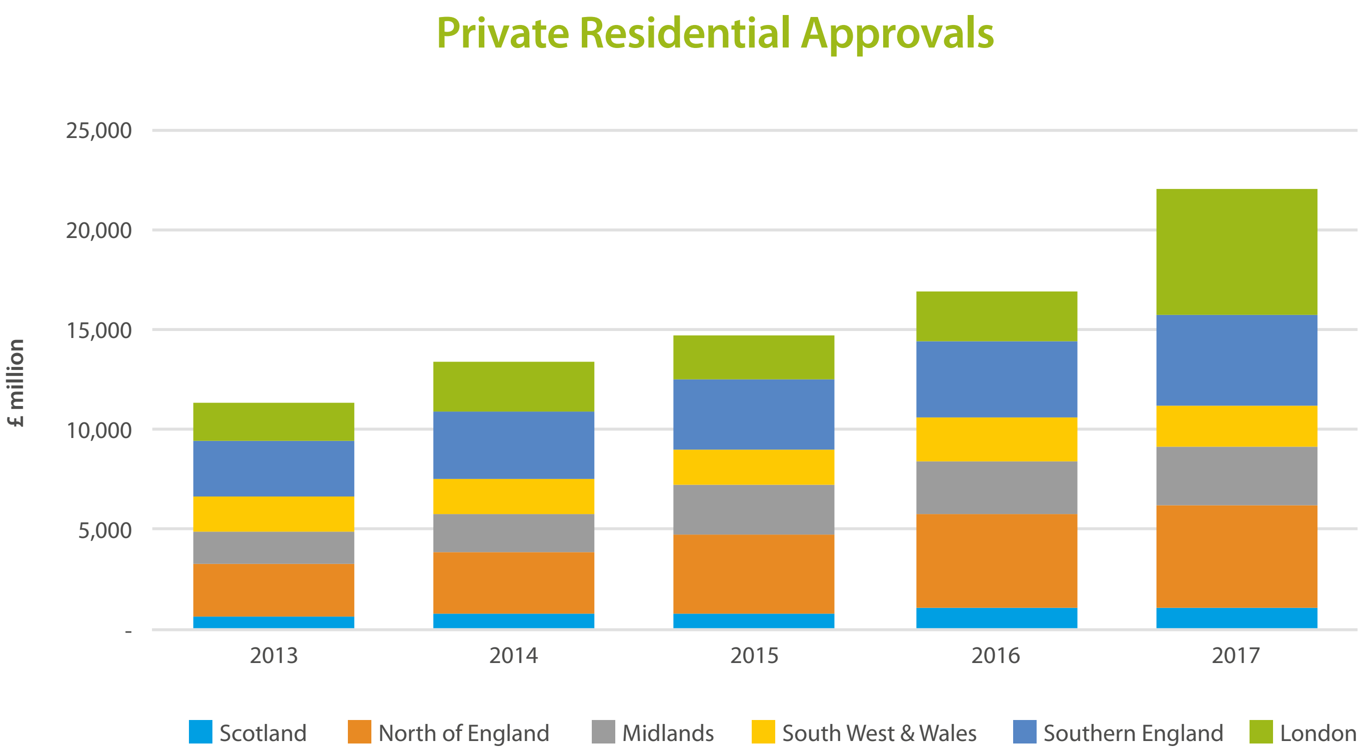
Civil engineering activity in particular is forecast to be an area of strength, driven by greater investment by the regulated industries, Highways England and the contribution of major projects such as HS2, Thames Tideway and Hinckley Point 'C'. The industrial sector is also forecast to be a growth area as technological & social changes reshape consumers' retail habits and drive the demand for logistics space. Growth in these areas is expected to help offset weakness in the private housing and commercial sectors.

Private Housing

- Strong potential development pipeline
- Rapid growth in Build to Rent developments
- Consumer squeeze curbing property transactions and house price
- Housebuilders expected to reduce site openings as new house sales slow

Private Housing Starts			
	2016	2017f	2018f
£ million	15,140	14,974	14,435
Growth	0%	-1%	-4%

Chart 1: *Value of underlying detailed planning approvals for private residential projects*



The supply of sites available for development has improved progressively over the last three years. Strong growth in residential projects securing planning approval has created a healthier development pipeline. In addition the Build to Rent market is generating fresh opportunities for contractors and product suppliers.

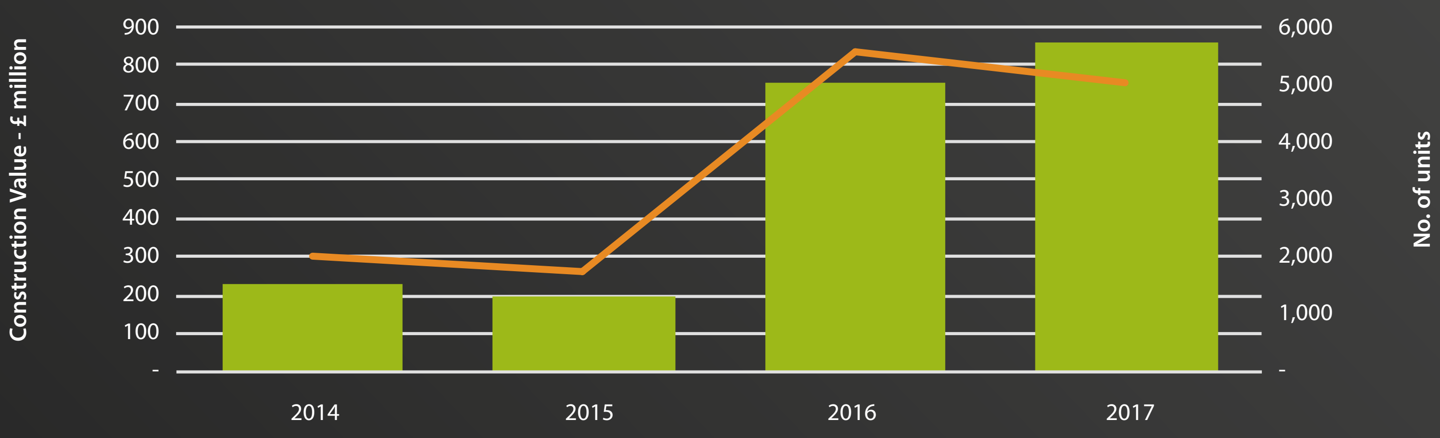
Build to Rent

Last year saw £750 million worth of Build to Rent projects start on site involving more than 5,500 residential units. Although this accounts for only 3% of private sector projects started during the year, Build to Rent is growing rapidly. The value of project starts was treble the level in 2015 and the sector is set for a further growth during the current year.

Build to Rent developments are being brought forward by a variety of clients including housing associations and new entrants to the private new housing sector, such as REITs and financial instructions. This offers new opportunities for main contractors to oversee the delivery of these projects in contrast to the build for sale sector which is dominated by housebuilders that directly manage the construction of their developments.

Near term an expanding Build to Rent sector will provide a welcome boost to new housing supply. Longer term, strong institutional investment in Build to Rent property has implications for traditional housebuilders for whom first-time buyers and Buy-to-let investors have been important purchasers of their output.

Private Rented Sector Developments



Source: Glenigan N.B. 2017 to May - pro rata

Demand rather than supply is set to be the more immediate constraint on new private housing activity.

Property transactions and house price inflation have slowed since the start of 2017 and a further weakening in housing market activity is anticipated over the forecast period. Real household earnings are currently being squeezed by higher inflation and slower economic growth. In addition mortgage availability is set to become more difficult following the Bank of England's move to require banks to increase their capital reserves.

In response to a slowing in new house, sales housebuilders are expected to increase their focus on building out their existing developments rather than opening new sites. The value of private housing projects starting on site is forecast to slip back 1% this year with a further 4% decline anticipated for 2018.

Social Housing

- Expanded development pipeline following Government 'U-turn' on Right to Buy
- Safety work an immediate priority for any additional Government funding
- Potential disruption to planned development programmes post-Grenfell
- Student accommodation remains engine for growth

Social Housing Starts			
	2016	**2017f**	**2018f**
£ million	6,688	6,648	6,788
Growth	4%	-1%	2%

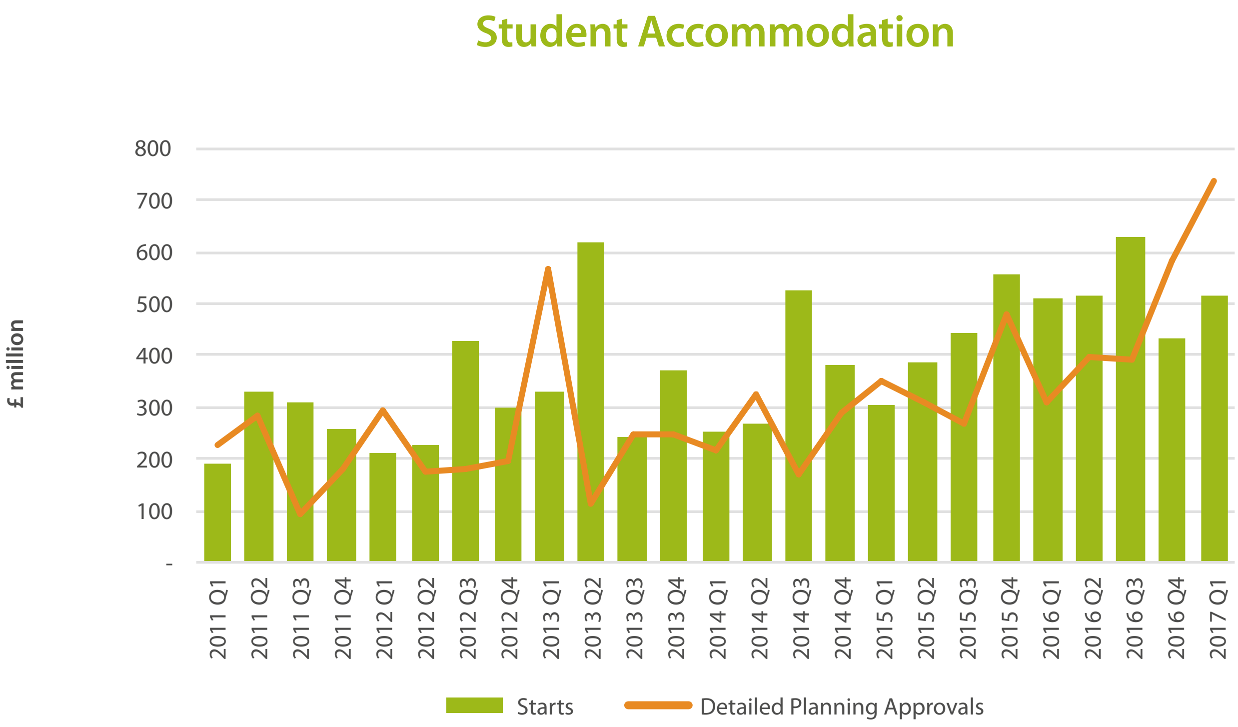
Project starts during the first half of 2017 were little changed on a year ago. However, a strengthening development pipeline is forecast to support sector activity during the second half of the year and during 2018.

The Government's decision to defer the extension of the "Right to Buy" to housing association tenants appears to have encouraged associations to bring forward new projects. The value of detailed planning approvals during the first five months of 2017 was 39% up on a year ago. We expect this improved development pipeline to lift sector activity over the next 18 months.

Grenfell Tower

Near term, however, the tragic event of the Grenfell fire is likely to disrupt the progress of planned developments. The immediate need to review and address any safety issues on the existing high rise stock is likely to divert associations' internal resources. In addition associations will wish to review the implications of the fire for any planned refurbishment and new build schemes.

__Chart 2:__ Value of underlying planning approvals and starts for student accommodation



Student accommodation has become an important niche market for private sector developers. The value of student accommodation projects starting on site grew by 25% last year. The pre-construction pipeline is expanding even more rapidly, with planning approvals up 55% during the 12 months to March 2017 against the preceding period. This firm development pipeline is expected to drive project starts during 2017 and 2018, despite a weak start to the current year.

Industrial

- UK manufacturers benefiting near term from weaker pound
- Investment in new capacity and manufacturing premises hit by fears over domestic demand and access to Single Market
- Renewed investment in logistics space countering manufacturing weakness
- Midlands & North West prime areas for sector growth

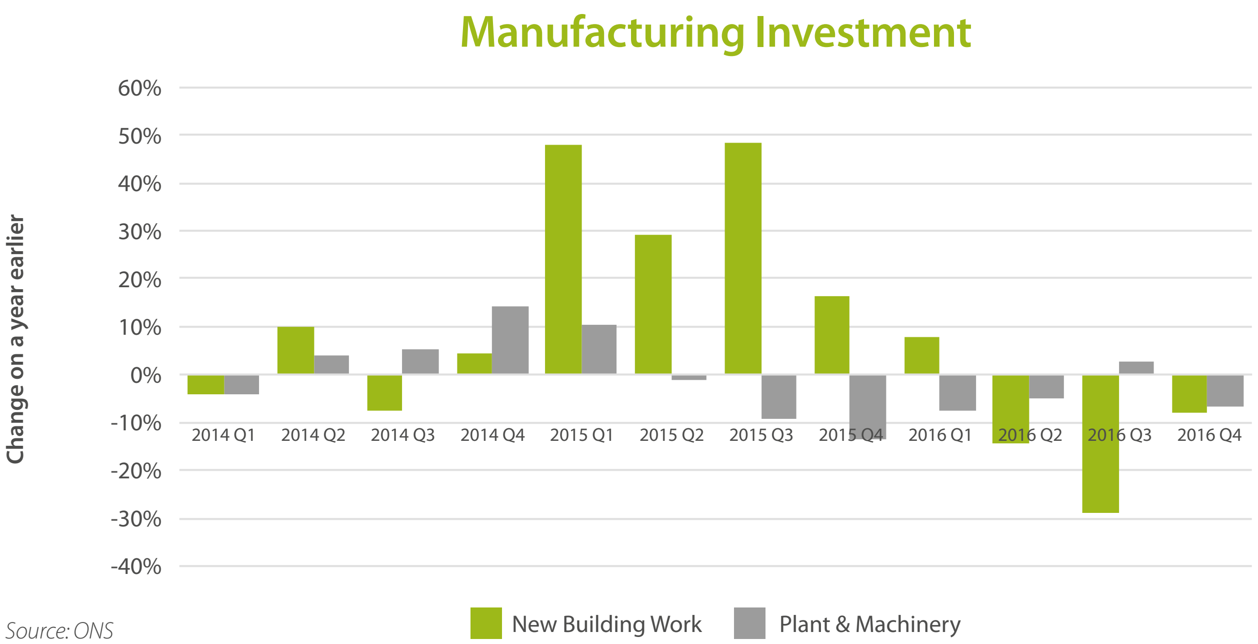
Industrial Starts			
	2016	2017f	2018f
£ million	2,931	3,534	3,823
Growth	-26%	21%	8%

The industrial sector was hit hard last year following the EU referendum result, with the value of project starts slumped 26% as investors & developers reviewed their development plans.

The sharp decline in Sterling over the last year has boosted UK manufacturers' export earnings and strengthened their position in the home market.

However, investment in new capacity and premises will be determined by long term growth prospects. Manufacturers' investment in new buildings fell by 11% last year, while expenditure on plant & machinery slipped by just 4%. Manufacturers concerns over the prospects for domestic demand as UK economic growth weakens and over future access to the Single Market are expected to deter investment in new manufacturing capacity and building work over the forecast period.

Chart 3: *Capital expenditure by UK manufacturers*



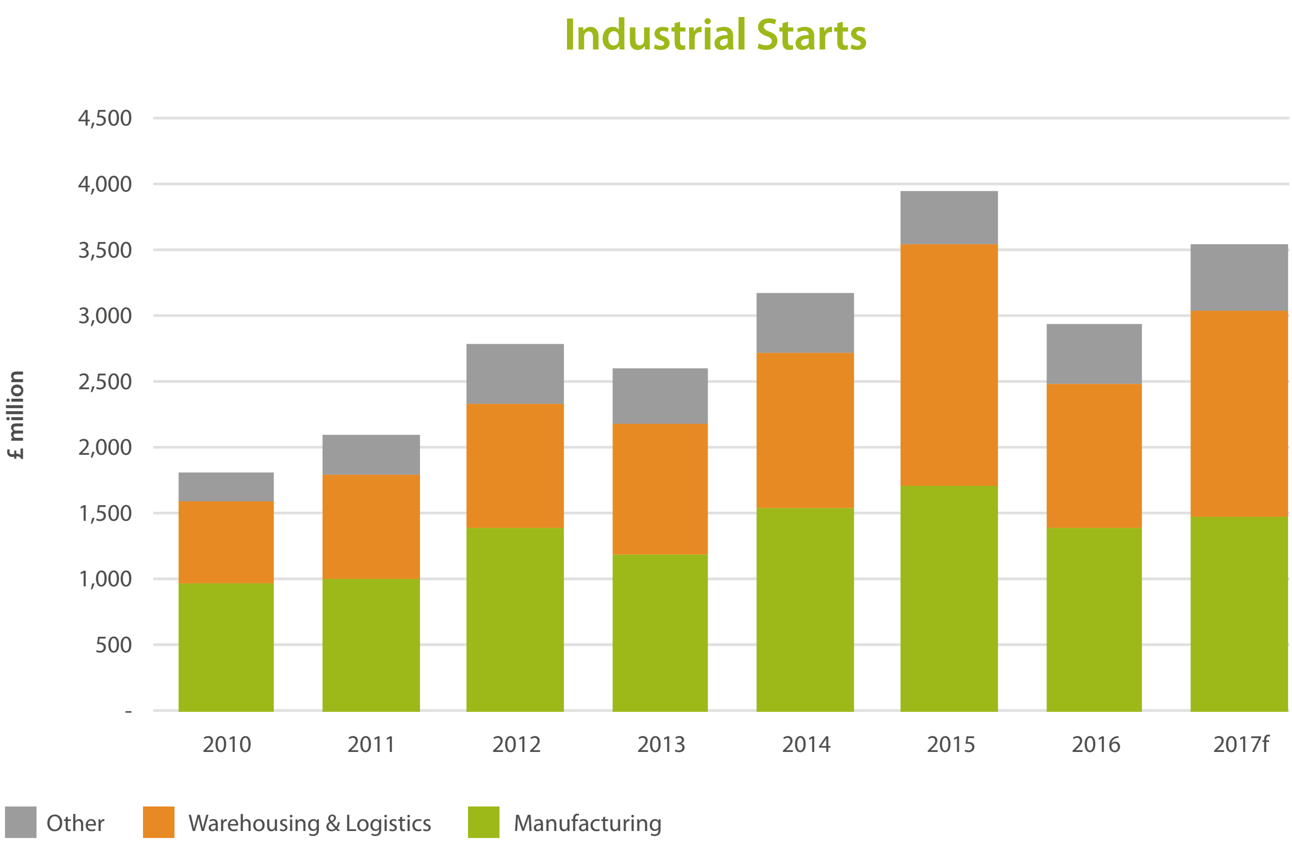
Source: ONS

Warehousing & logistics have been the fastest growing area within the industrial sector in recent years. The value of such projects starting on site quadrupled to £1.5 billion between 2009 and 2015. Whilst there was a sharp fall in project starts in the immediate aftermath of the EU referendum, investor confidence and project starts have recovered.

Demand for logistics space is being driven in large part by structural change in the retail sector, with the relentless growth of on-line retailing, 'click & collect' and home deliveries fuelling demand for warehousing and distribution premises. These fundamental changes in the retail sector will continue to drive the demand for logistics space as retailers adapt to consumers changing spending patterns and shopping habits.

We expect this to be a long term driver for warehousing & logistics projects as online retailing takes an ever larger share of retail sales. The Midlands, North West and parts of the South East of England are favoured locations for such facilities, offering good access to national transport networks and the UK's major population centres.

Chart 4: *Value of underlying Industrial starts by category*



Source: Glenigan

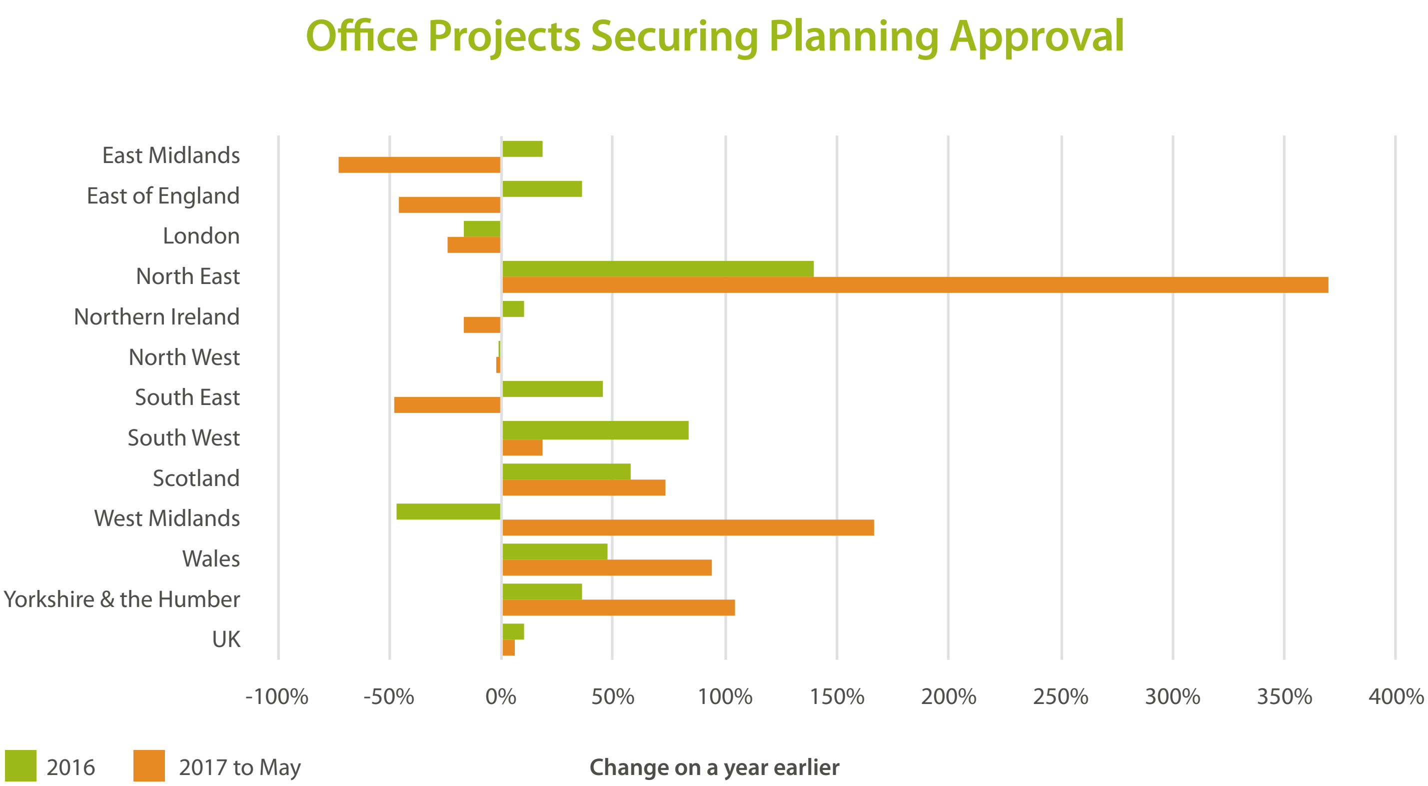
Offices

- Demand for office accommodation dampened by slower UK economic and employment growth
- City & Dockland development activity vulnerable to uncertainty over UK financial sector's post-EU future
- Opportunities for refurbishment & conversion of secondary office accommodation

Office Starts			
	2016	**2017f**	**2018f**
£ million	4,613	4,390	3,662
Growth	5%	-5%	-17%

Whilst the planning pipeline remains firm, political & economic concerns surrounding the EU referendum depressed the flow of projects to site during 2016. These concerns are expected to persist during the forecast period as investors appraise the implications of Brexit and slower UK economic growth for the demand for office accommodation and for rental values.

Chart 5: *Value of underlying detailed planning approvals for office projects*



London dominates the office sector, accounting for around half of office sector activity. Although the capital still has a substantial development pipeline, the number of projects securing planning approval has slipped back over the last two years. Project starts in London during the first five months of 2017 were 11% down on a year ago and we anticipate a further weakening in starts over the forecast period. Developments in the City of London and Docklands will be especially vulnerable as financial institutions relocate operations to elsewhere within the EU.

However, recent sector growth has been in regional centres rather than the capital. Demand for more high quality office space has been growing in the UK's 'core' cities. This rising demand for office accommodation and a previous lack of development activity has tightened the supply of available office space in major UK office markets.

The East of England, North West, West Midlands, South East and Yorkshire & the Humber all saw a marked rise in the value of project starts last year. A growing development pipeline has the potential to sustain sector growth outside of the capital, with the value of projects securing detailed planning consent increasing 23% last year and rising by a further 22% during the first five months of 2017. However, we do not anticipate that the relative strength of regional markets will be sufficient to offset a weakening in activity in the capital.

Nationally we estimate the value of underlying project starts will slip back 5% this year and we are forecasting a sharp 17% decline for 2018.

Retail

- Demand for retail space hit by weak household earnings and growth in on-line retailing
- Retailers rationalising estate as costs rise and sales volumes falter
- Refurbishment of retained premises to attract customers and support on-line offering
- Shopping centres increasing their leisure and dining offer to capture footfall

Retail Starts			
	2016	2017f	2018f
£ million	2,552	2,342	2,127
Growth	25%	-8%	-9%

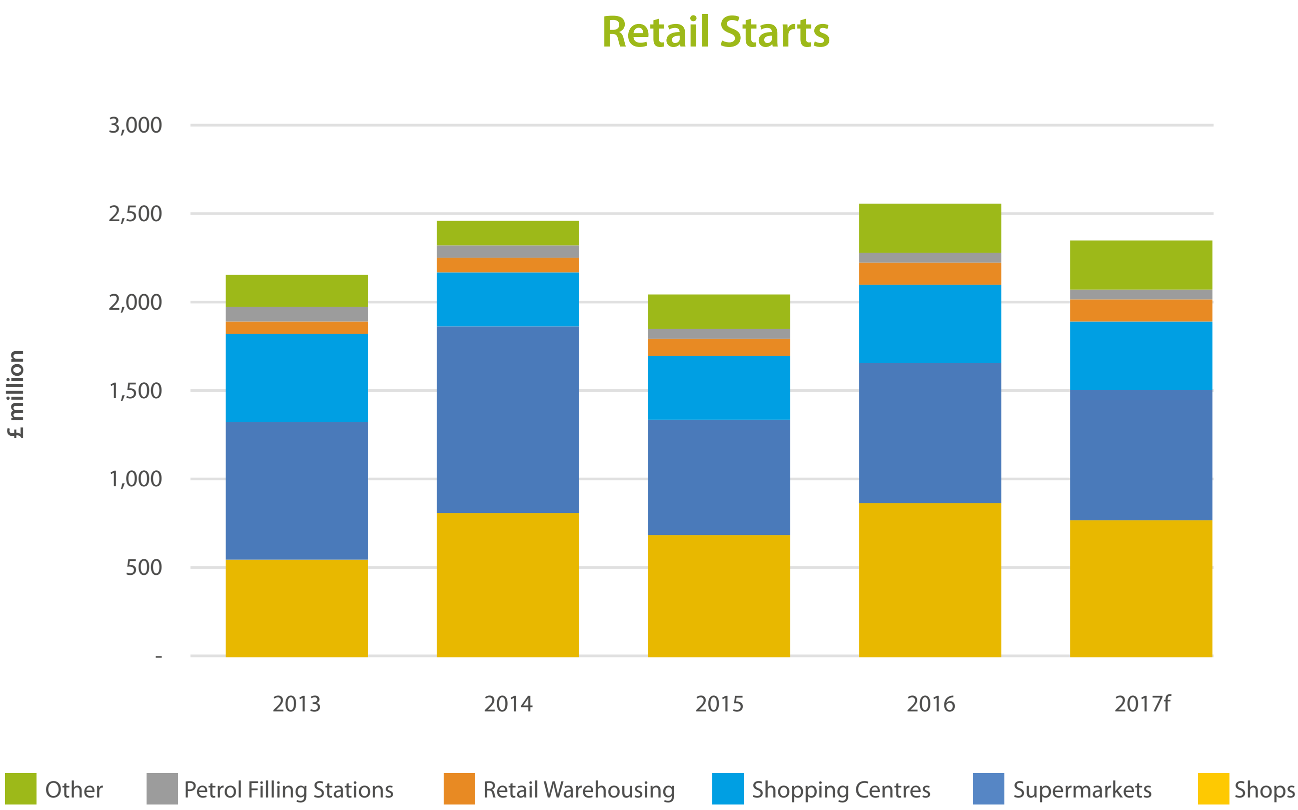
Retailers face challenging market conditions over the next two years as rising inflation squeezes household budgets and on-line purchases account for a growing proportion of retail sales. Against this backdrop, new build retail projects will remain in short supply during 2017, as many retailers look to rationalise and refurbish their existing estate.

The grocery sector illustrates current retail construction activity. The top four supermarket chains have all scaled back their investment programmes, redirecting funding towards the convenience store market, which more often entails conversion of existing high street premises. Only the deep discounters, Lidl & Aldi, have substantial new store develop programmes.

Other high street retailers are also similarly focused on store re-modelling, driven by high levels of competition and efforts to accommodate click and collect services. The adaptation and re-fitting of existing stores is expected to remain a key area of sector activity during the next two years.

The retail development pipeline is subdued, with the value of retail projects securing detailed planning approval flat during 2015 and 2016. Whilst last year saw a 25% jump in retail project starts, this is proving short-lived with the value of starts in the first five months of 2017 12% down on a year ago.

Chart 6: *Value of underlying Retail starts by category*



Source: Glenigan

The growth in on-line retail sales is also presenting a challenge to established shopping centres with landlords seeking to enhance their attraction to consumers by investing in more leisure and dining facilities. Many of the larger projects to start on site last year were enhancements to established shopping centres and designer retail outlets.

Looking ahead the prospect of slower retail sales growth and the weak development pipeline are forecast to feed through to a decline in the value of underlying retail project starts over the next two years. We expect project starts to fall by 8% this year after the spike in starts during 2016, with a further weakening in starts forecast for next year.

Hotel & Leisure

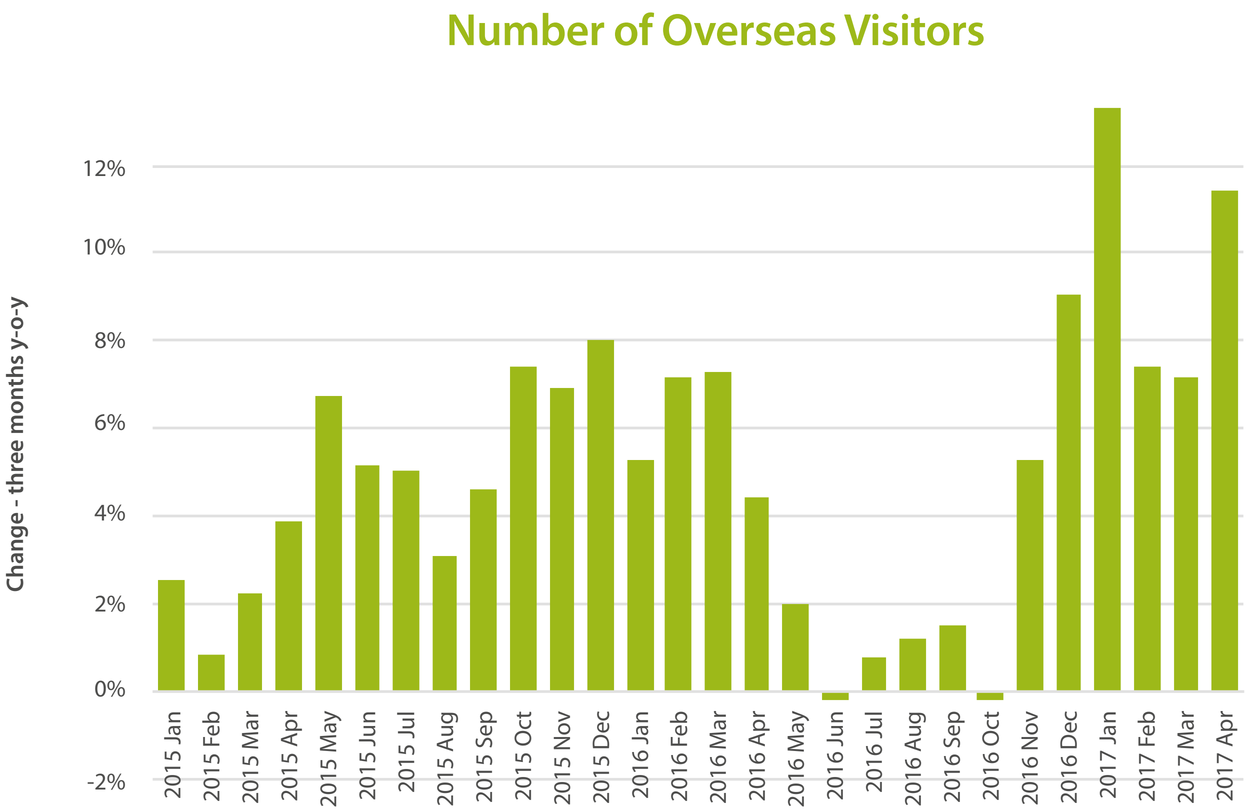
- Tourism boost from weaker pound
- More UK residents also expected to holiday in UK
- Hotel chains have significant development plans
- Strong development pipeline

Hotel & Leisure Starts			
	2016	**2017f**	**2018f**
£ million	3,018	3,511	3,775
Growth	-3%	+16%	+8%

The Hotel & Leisure sector is emerging as an early beneficiary of the Brexit vote. The marked fall in Sterling since the start of 2016 has enhanced the UK's appeal as a tourist destination. Rising overseas visitor numbers over the next two years are expected to spur investment in hotel & leisure facilities.

Official data reveals that during the three months to April the number of overseas visitors to the UK was 11% up on a year ago, with spending 14% higher. The renewed growth in overseas visitors bodes well for the hotel & leisure sector, with the rise in spending encouraging investors to press on with planned developments.

Chart 7: *Growth in Overseas Visitors to the UK*

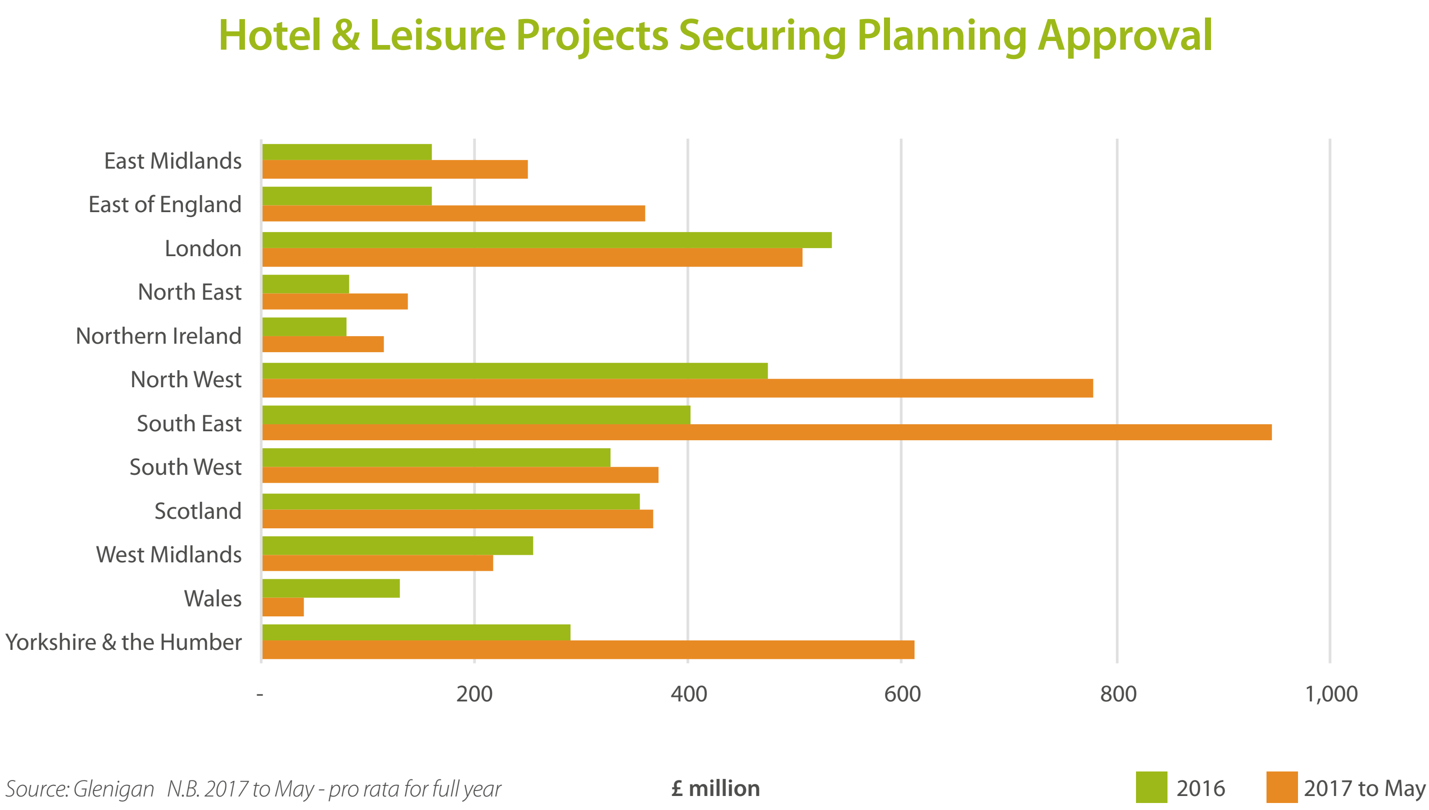


Source: ONS

In addition, although overall consumer-spending growth is expected to be constrained over the next two years by weakening employment levels and higher inflation, the hotel & leisure sector is well placed to take a greater share of the available discretionary spending. The weaker pound is expected to prompt more UK consumers to holiday in the UK this summer. This will provide a boost to the hoteliers, restaurateurs and leisure facilities across the country.

The pre-construction development pipeline has been growing progressively since 2015. The increase in planning approvals has begun to feed through to project starts, which rose 8% last year. The expansion in the development pipeline has accelerated since the start of the year, with the value of projects granted planning approval during the first five months of 2017 being 42% up on a year ago. This strengthening development pipeline combined with the tourism boost from the weaker pound is forecast to drive sector growth over the forecast period. We anticipate that projects starts will rise by 16% this year, with 8% growth anticipated for 2018.

Chart 8: *Value of underlying detailed planning approvals for hotel & leisure projects*



Source: Glenigan N.B. 2017 to May - pro rata for full year

Education

- New & expanded secondary schools needed as pupil numbers rise
- Government's grammar school plans dashed by election result
- Universities investing to attract UK & overseas students
- Threat to university research funding as UK leaves EU

Education Starts			
	2016	**2017f**	**2018f**
£ million	6,913	6,040	7,088
Growth	-3%	-13%	17%

Rising pupil numbers promise to drive investment in expanded and new secondary education facilities over the next five years. Despite these demographic pressures, the immediate prospects for statutory education provision are less certain. The Government's retreat on plans for new grammar schools has removed one area for political conflict and delay over how this needed additional capacity should be created.

Near term, however, investment will be constrained by limited local authority funding and the availability of suitable sites. Councils are likely to accommodate rising pupil numbers through the expansion of existing schools, although with 60% of secondary schools now academies, councils need to persuade these schools to expand to accommodate the rise in pupil numbers.

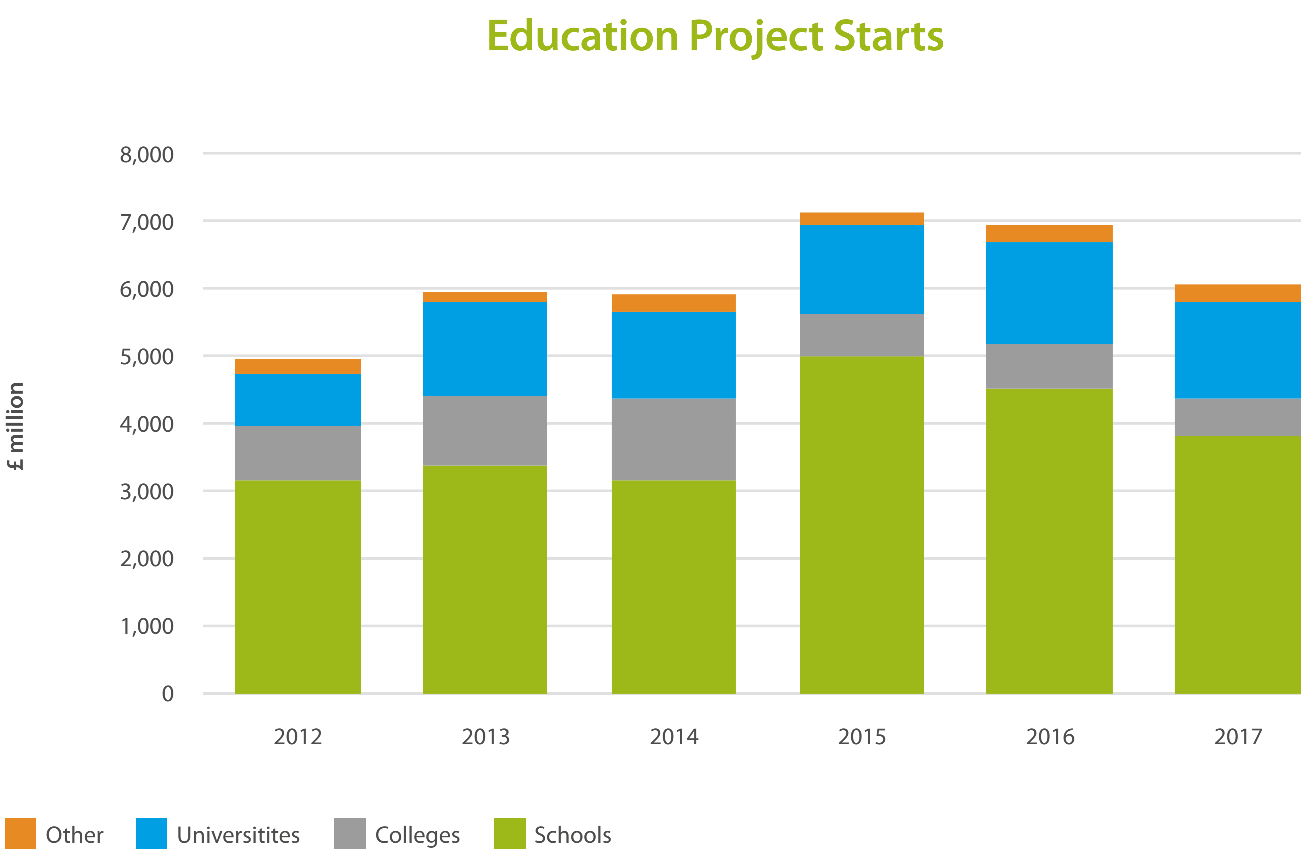
Planning approvals for schools fell back sharply in 2016, reversing a progressive rise in approvals during the preceding two years. Approvals have weakened further during the first five months of 2017, being 25% down on a year ago. This shrinking development pipeline is expected to restrict project starts in the near term.

Investment in higher education facilities has been a growth area within the education sector as universities compete to enrol both domestic and overseas students. The value of university project starts rose 14% to £1.5 billion last year. The rise followed a near doubling in the value of projects securing detailed planning approvals during 2014 and 2015.

The EU referendum vote has raised concerns over UK universities' future access to EU research funding and participation in related collaborative research. This may have contributed to a dip in projects securing planning approval last year that is currently feeding through to a decline in project starts. However, a recovery in approvals during the first five months of 2017 points to renewed growth next year.

Near term we expect the current weakening in both school and university project starts to contribute to a 13% decline in education sector this year. The longer term prospects for the sector are brighter, with the need for additional school capacity forecast to drive growth, including a 17% rise in project starts in 2018.

Chart 9: *Value of underlying Education starts by category*



N.B. Excludes projects with a construction value in excess of £100m. Source: Glenigan

Health

- NHS capital budgets squeezed by wider funding pressures
- Increase in laboratory & research projects
- Social care in political spotlight, but little additional funding
- Longer term, investment needed in new, modern social care facilities

Health Starts			
	2016	**2017f**	**2018f**
£ million	2,112	2,596	2,235
Growth	9%	23%	-14%

Following the 'snap' general election, NHS funding appears destined to remain high on the political agenda. Whilst the Government is likely to find additional NHS funding during the forecast period, any additional resources are expected to be primarily directed at funding services rather than longer term capital expenditure.

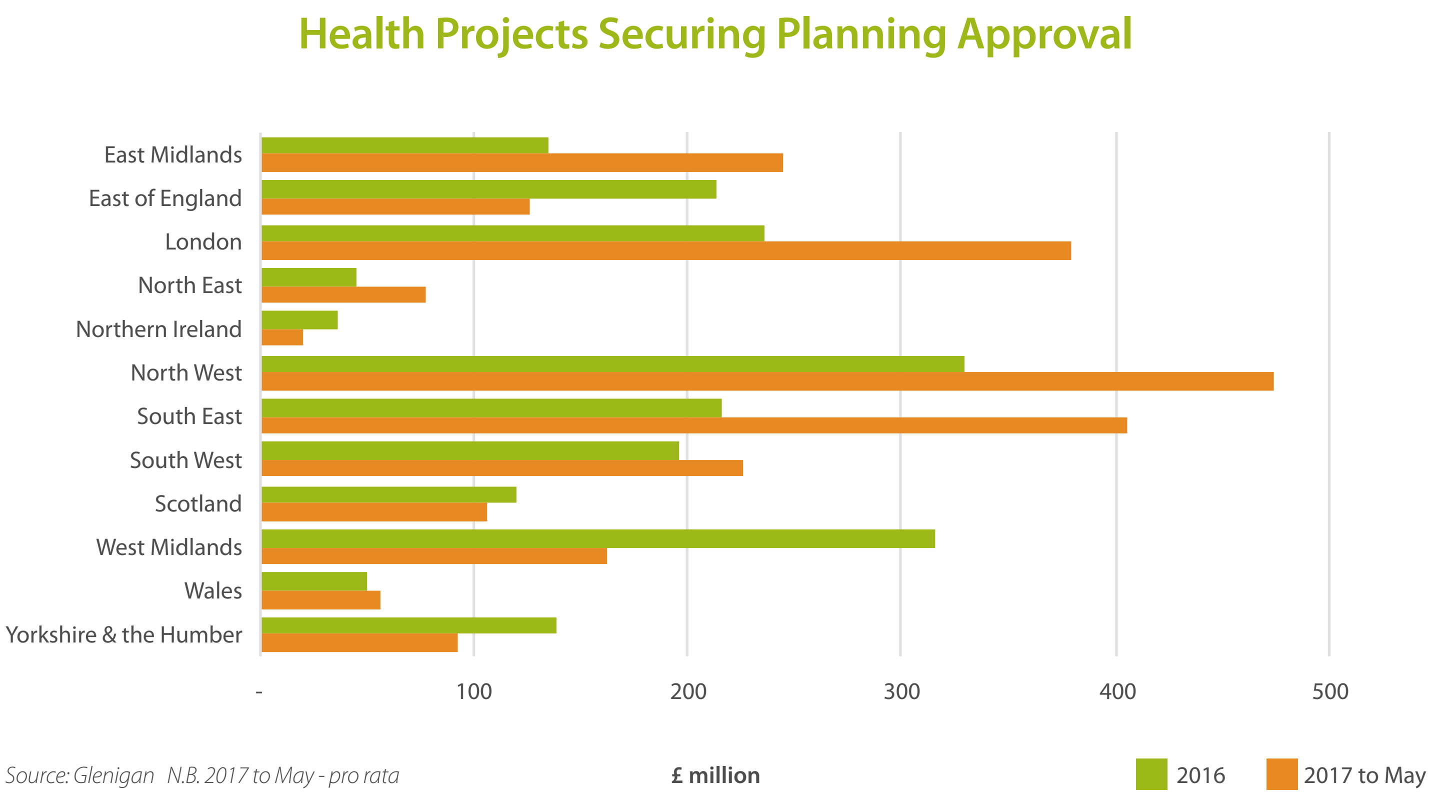
Last year saw a recovery in starts as NHS trusts progressed schemes following election related disruption the previous year to development programmes. We expect a further modest recovery during 2017, with this year's 'snap' election having a relatively limited impact on the timing of planned projects.

Funding for social care has similarly been under the spotlight during the election campaign. Social care providers are being squeezed by limited public funding provision, rising costs and staff recruitment problems. These pressures are likely to accelerate the closure of existing facilities. Over the longer term this may open up opportunities for investment in new modern facilities to provide support for a growing elderly population.

The first five months of 2017 has seen a 28% rise in the value of project starts against a year ago, in part driven by a sharp increase in laboratory and research projects. Overall we anticipate that project starts will rise by 23% this year.

The current year has also seen a marked improvement in projects securing planning approval, after two years of little change. At £1.2 billion the value of projects securing planning approval during the first five months of 2017 was 26% up on a year ago. Whilst we anticipate some retrenchment in project starts during 2018, the current upturn in approvals is expected to provide some support for sector activity.

Chart 10: *Value of underlying detailed planning approvals for health projects*



Source: Glenigan N.B. 2017 to May - pro rata

Civil Engineering

- Energy sector dominates sector workload
- Network Rail's CP5 programme restrained by cost overruns
- Work on HS2 getting underway
- Highways England's development programme gathering moment
- Increased water industry investment

Civil Engineering Starts			
	2016	2017f	2018f
£ million	5,556	6,059	7,224
Growth	-28%	9%	19%

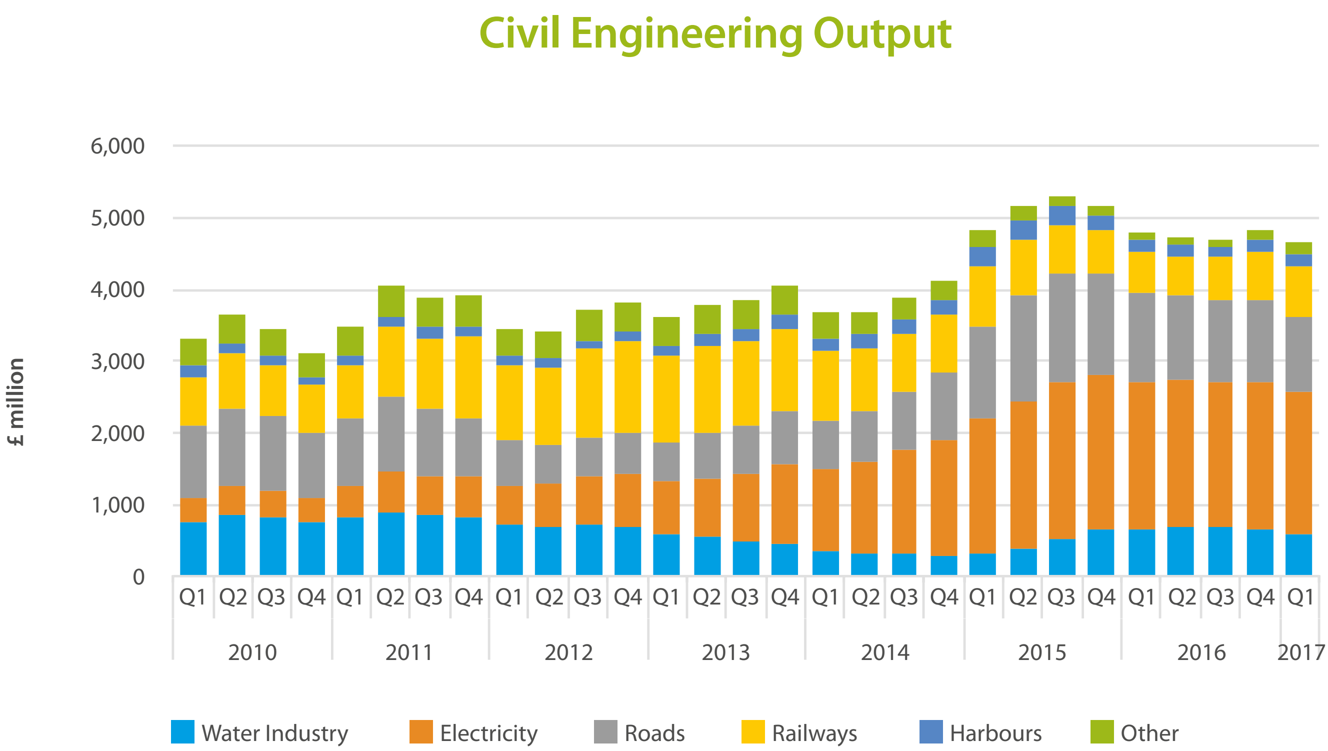
Energy industry work has come to dominate the civil engineering sector. The ONS estimate that energy projects accounted for 43% of sector output. The energy sector is set to remain a major driver for growth over the forecast period. Major projects make up a significant proportion of energy industry workload, a trend that was amplified by the Government's decision to reduce support for smaller scale renewable schemes. The Government is now looking to new gas-fired plants as well as Hinckley Point 'C' and off-shore wind to bridge the UK's generating capacity gap.

Work on HS2 will begin to contribute to sector activity during the forecast period. Investment in the existing rail network is more constrained following the scaling back of Network Rail's current capital programme (CP5) due to project cost overruns. Under the revised programme priority has been given to the electrification of the Great Western line to Bristol and Wales, while the electrification of both the TransPennine and London Midland routes have been delayed and the rest of the programme reconfigured. In addition Crossrail will make a diminishing contribution to sector activity as work on the line nears completion.

Increased investment in the national road network is anticipated in 2017 and 2018 as Highways England brings forward projects under its collaborative framework. The Chancellor has pledged additional funds to bring forward projects that can be quickly brought to site and the national road network appears set to remain a growth area over the medium term.

The current Water Industry investment cycle, AMP6, is gathering momentum, with sector activity benefiting from major work packages for the £4 billion Thames Tideway Tunnel.

Chart 11: *Infrastructure Construction Output*



Source: ONS

Business Intelligence from Glenigan

Do you need reliable insight and statistics to help you budget, forecast, realise size of market or penetration?

Do you need a better understanding of your competitor's activities, or would you like to see the trends shaping the future of construction?

If so, then we can help.

The Glenigan economics team have over 30 years' experience delivering tailored construction industry insight, analysis and recommendations to corporations, businesses and government agencies alike.

Our key planning and construction industry insight has been built up over years of impartial data gathering and our economics team combine this with their commercial expertise to provide in-depth strategic analysis and statistics to give you the insight you need to make key budgeting and strategic planning decisions.

Our reporting and analysis includes:

- Data and analysis of market size
- Trends and opportunities
- Competitive landscape
- Industry forecasts
- Whatever insight you need to guide your business, we can provide it.

If this sounds of interest then please do get in touch in order that we can discuss in more detail.

Call Allan Wilén on **0207 715 6433** or **0751 579 4625**. Alternatively, email **allan.wilen@glenigan.com**.

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