Industry in Focus

PwC Construction Outlook

August 2024

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We are excited to publish the third edition of our PwC Construction & Housebuilding Outlook as we look ahead to the second half 2024.

This article provides a quantified view on the UK's spend outlook and a summary of drivers by segment, as well as insight into how to best position for growth in the sector.

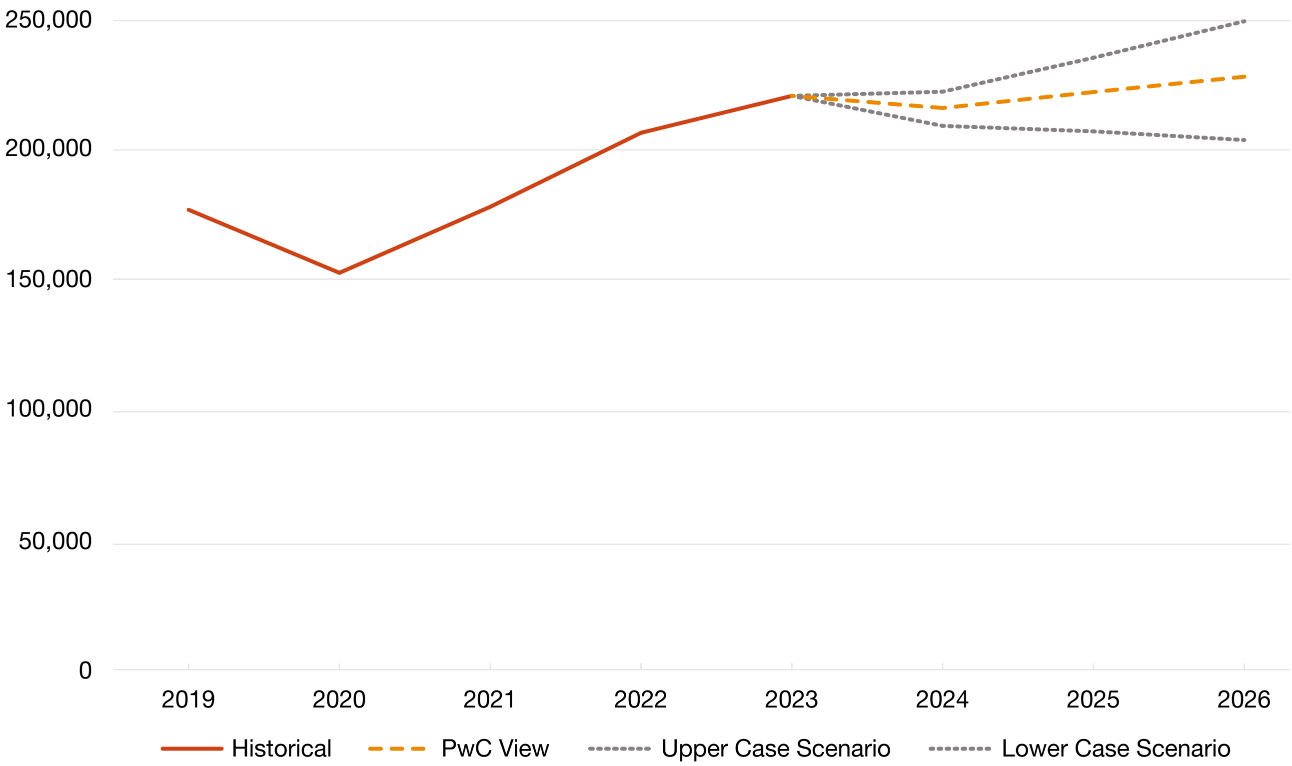
Our forecast is triangulated across publicly available information, 3rd party reports and our regular touch points across the built environment value chain.

Note that forecasted figures remain subject to change and that all charts are presented at 2023 constant prices.

Please contact us via Sam Edwards (samuel.edwards@pwc.com) if you have any observations or questions. The next iteration of our outlook will be published in Q1 2025.

Overall Construction Market

UK total construction output forecast
£m, 2019-2026F (2023 constant prices)



	2019-2020	2020-2023	2023-2024	2024-2025	2025-2026
CAGR	-13.8%	13.2%	-2.1%	2.9%	2.7%

The UK's construction sector has rebounded strongly from a c.15% COVID-driven decline in 2020, exceeding 2019 activity levels in 2022 and 2023 in real terms. This return to growth is leading relative to European markets. Note that 2023s actual performance exceeded our and wider forecasters' previous expectations, reflecting a strong level of activity in H2 – see additional detail on this amendment below.

Despite this positive backdrop, a range of headwinds continue to impact the sector (namely a sustained high interest rate environment and investor caution on investments in Commercial and Industrial settings) and 2024 is expected to result in a small YoY contraction of c.2%.

While we anticipate this small contraction in 2024, the outlook for 2025 is promising and is testament to the sector's adaptability and the evolving landscape of opportunities, from new build projects to growth in RMI spend to improve the quality of stock. We cautiously expect some potential upside to our forecast from the Labour Government's announced housebuilding targets which if achieved would result in a significant activity uptick vs. current levels.

Comparison to our previous forecast
Percentage point change, 2023-2025

		2023	2024	2025
Forecasted growth for overall construction market	Summer 2024 Outlook	6.9%	-2.1%	2.9%
	H2 2023 Outlook	-4.3%	-1.5%	2.8%
Percentage point difference Summer vs H2 2023 outlooks by sub-segment	Residential	11.6%	-4.5%	1.6%
	NR – Commercial	15.0%	-3.8%	-1.0%
	NR – Industrial	0.0%	-0.6%	1.8%
	NR – Other	19.8%	0.5%	0.2%
	Infrastructure	7.4%	-3.1%	-0.4%
	Total New Built	11.1%	-3.3%	0.4%
	R&M Residential	9.4%	6.3%	-2.0%
	R&M Other	13.3%	1.6%	1.1%
	Total R&M	11.3%	3.9%	-0.4%

Our H2 2023 Outlook forecast a YoY contraction of c.4% in 2023, broadly in line with wider market commentator expectations. However the ONS has since confirmed an in-year real growth of 7%. This turnaround is testament to the unstable UK economic environment at the time, with speculation for a potential recession.

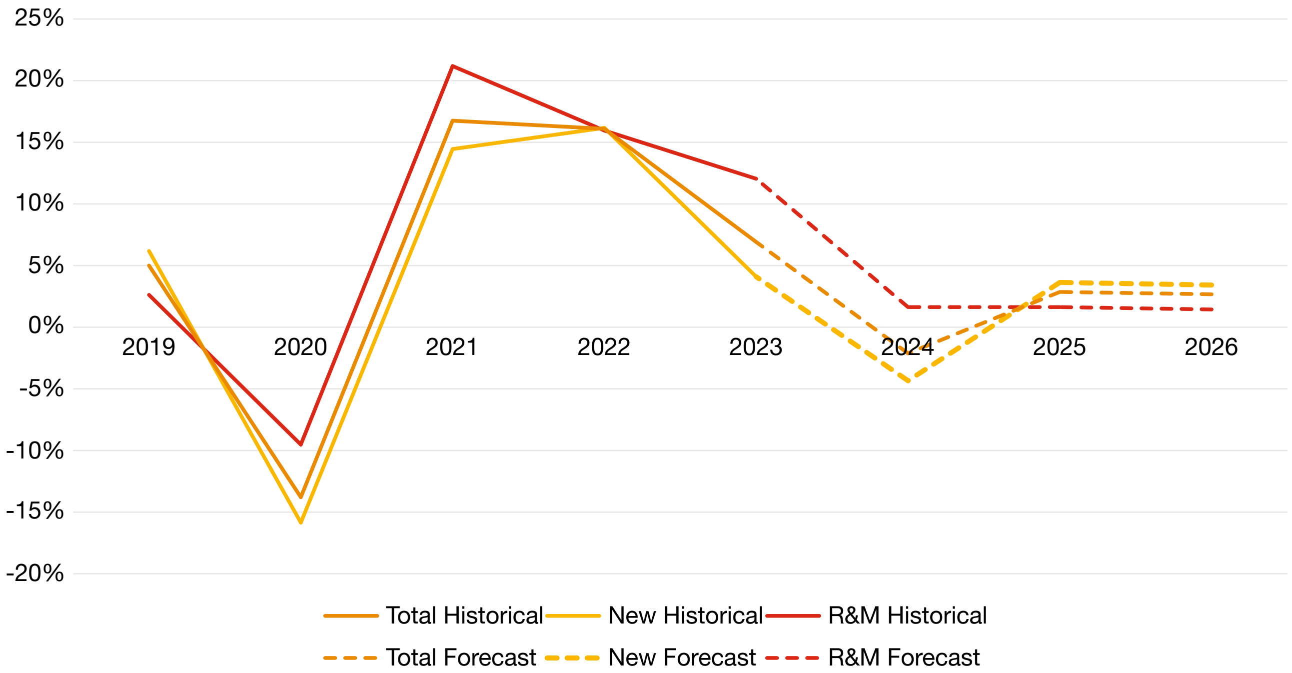
This did not transpire, with the economy stabilising faster than expected and as outlined in the PwC Economic Outlook "the worst of the current crisis is behind us".

Despite this, the market remains cautious on 2024 outturn, particularly in relation to new build residential and commercial output, driven by a variety of factors, but primarily involving sustained high interest rates (despite the first reduction in August 2024) and lower competition for office leases. Below we expand on the rationale for the outlook by segment.

R&M vs New Build

UK total construction output forecast by New Build (NB) vs. Repair & Maintenance (R&M)

Annual % growth, 2019-2026F (2023 constant prices)



Repair and Maintenance (R&M) has historically and continues to demonstrate greater resilience during downturn periods. Since 2021, R&M spend has consistently outperformed the new build construction market and this trend is expected to continue in 2024.

The resilience of this segment is driven by its mix of necessary works (e.g. to support / enhance deteriorating infrastructure) and potentially as a cost-effective alternative to enhance existing structures. R&M activity also benefits from an 'E'SG (Environmental) tailwind as we seek to; (i) improve the safety of our built environment, e.g. via the Building Safety Act; (ii) enhance the efficiency of our infrastructure (e.g. via electrification and improved water network efficiency); (iii) enhance the efficiency of our building stock (e.g. via retrofit of insulation, transition to use of underfloor heating and installation of heat pumps); and (iv) increase planning permission constraints on demolition and rebuild in lieu of focus on repurposing existing stock.

The Government is supportive of such initiative, as demonstrated by its introduction of a number of initiatives, including the:

- Energy Company Obligation (ECO4) facilitates funding for energy-efficient home improvements, including insulation and renewable energy solutions
- Great British Insulation Scheme (GBIS) and Home Upgrade Grants (HUG) provide financial assistance for enhancing energy efficiency in homes
- Social Housing Decarbonisation Fund

New Build Market Segments

UK new build construction output by residential vs. non-residential sectors
£bn, 2019-2026F (2023 constant prices)

	Historical Data					S & Outlay Estimate	S & Forecast	
Market Segment	**2019**	**2020**	**2021**	**2022**	**2023**	**2024F**	**2025F**	**2026F**
Residential	9.5%	-20.1%	20.9%	22.9%	-5.9% £bn 53	-7.1%	6.9%	4.7%
NR – Comemrcial	1.5%	-21.2%	-4.5%	8.0%	12.3% £bn 29	-4.6%	1.1%	2.1%
NR – Industrial	8.0%	-17.8%	6.1%	57.1%	3.8% £bn 8	-7.9%	-0.3%	1.5%
NR – Other	1.5%	-7.2%	1.6%	-2.0%	17.7% £bn 12	1.7%	2.7%	3.6%
Infrastructure	8.1%	-3.3%	32.0%	11.2%	10.8% £bn 37	-1.2%	2.2%	2.9%
Total New Build	**6.2%**	**-15.9%**	**14.5%**	**16.2%**	**4.1%**	**-4.3%**	**3.6%**	**3.4%**

Residential

Residential construction accounts for c.40% of the UK's total new build activity, with spend and drivers typically segmented by the Private (c.75%) and Public (c.25%) segments.

Housebuilding activity in the Private sector has been dampened by high relative mortgage costs and building material, product and labour inflation. While inflation now appears to have subsided (and is reversing in a number of relevant categories), mortgage rates remain high and the delayed impact due to fixed rate effects increase the longevity of this step-change shock and reducing market liquidity for existing homeowners. Despite this, sentiment is improving due to the Bank of England's first base rate reduction and the new Government's aim to reform planning and broader housing policy to enact a step-change in supply.

In the Public sector, the Affordable Housing Programme is set to be renewed in 2026, with Rachel Reeves and Angela Raynor discussing an affordable housing rent settlement and other measures (including potential grants and the introduction of target levels of Social Rent Accomodation through the NPPF) that are expected to be laid out in the Autumn budget.

While unlocking the UK's housing shortage is a publicised priority for the Government, investors remain cautious on its ability to enact real change in the short-term due to a number of structural constraints, which include how to; (i) unlock planning constraints; (il) incentivise volume housebuilders to increase their output; (iii) create the conditions to enable SMEs to thrive; (iv) develop a viable labour force, skills and productivity strategy. These challenges are reflected in our outlook which expects a second year of contraction in 2024, with real spend declining by 7% vs. 2023.

Commercial

Commercial construction returned to strong growth in 2023 (+c.12%), as supply constraints eased and price inflation started to reverse, unlocking a backlog of previously delayed projects. Areas of particular growth included Hotels & Leisure (e.g. c.£250m Therme Manchester and c.£450m Hilton Kensington projects) and Data Centres (e.g. Virtus in Slough and Camro Plus in Cambridgeshire). This backlog has artificially supported the market, while underlying demand conditions remain soft due to a range of factors…

- Hybrid working impact on demand for office space, albeit peak usage days create challenges in reducing footprint
- Continued growth in eCommerce vs. brick and mortar high-street retail
- Increased cost of debt reducing landlord returns and creating distress

…and we expect a contraction in spend of c.5% in 2024. Despite this, strong growth is expected to continue in certain segments, including Private Healthcare, Life Sciences (including repurposing existing office real estate and the Canary Wharf North Quay building which is a c.£500m project and will be the largest commercial wet-lab enabled life sciences building in Europe) and Data Centres (e.g. the Humber Tech Park which will be the UK's largest data centre campus to date). While Office activity is generally subdued, The Republic (a c.£90m scheme) and Sherford Business Park North (a c.95m) scheme are due to begin in 2024.

General pressure on new build activity in Office and Retail estates is also creating an uptick in refurbishment / repurposing projects as landlords and tenants seek to maximise the impact of their existing spaces while also seeking to improve their energy efficiency.

Industrial

The Industrial sector benefited from high growth in 2022/23 due to new build warehousing activity to fulfil a step-change in eCommerce penetration due to COVID driven changes in consumer buying behaviour. The Government published its Industrial Strategy in September 2023 with a focus on revitalising the UK's manufacturing sector. The expected c.8% decline in 2024 will primarily be driven by softening of warehouse build activity relative to recent years. In line with the Government's strategy and an improving economic environment (with lower inflation), manufacturing related activity is expected to recover in the coming years.

Other Non-Residential

Other non-residential activity is largely driven by Public and Private (i.e. University) Education and Military activity. Growth in this segment is expected to be broadly stable in the coming years following historical underinvestment and dilapidated condition of existing stock, alongside the need to address safety concerns relating to the use of Reinforced Autoclaved Aerated Concrete (RAAC) which is estimated to affect c.230 schools.

Infrastructure

Ongoing large infrastructure projects (such as HS2 Phase 1 and Hinkley Point C) continue to underpin the UK's Infrastructure activity. However, 2023 saw a c.[illegible] reduction in new infrastructure project orders and the Government has announced the curtailment of some previously confirmed projects, such as HS2's Phase 2 extension to Manchester. This is reflected in a lower growth outlook for the segment than seen in recent years.

Despite this, we see significant long-term tailwinds for investment in the sector, related to Transport, Power and Water. Such tailwinds have led to significant M&A activity for Infrastructure Services assets which is expected to continue given strengthening of conviction from e.g. AMP8 draft determinations.

Framework for Growth

The construction sector has demonstrated its resilience during COVID and since in the face of significant headwinds from material and labour inflation, while evolving to support the UK's new build and retrofit activity requirements to fulfil its growth and net-zero ambitions.

Successful companies have proven their ability to turn these challenges into a competitive environment by:

- Enhancing talent acquisition strategies
- Developing skills in line with new market demands
- Integrating environmental considerations into their services

Government policy uncertainty remains a concern, but there is hopeful expectation for stability and supportive regulatory changes to support housing and infrastructure projects. Firms that are proactive in supporting and preparing for these changes are likely to benefit.

PwC's Growth Framework provides insight into the foundation for successful strategy by identifying the components business leaders believe are most effective in unlocking productivity gains and growth.

Value Creation

Companies across the value chain are focused on ensuring they have the capacity and capability to meet evolving demand across the sector. Internal value creation projects, seeking to optimise margin, right-size enabling functions and supplement service areas have been a focus in light of this.

Recent public examples of this include:

- Travis Perkins' comprehensive review of its supply chain
- Bellway's ongoing programme to optimise build costs and margin
- CALA Homes acquisition of a timber frame specialist to reduce its lead time for superstructure construction and to capture further margin
- Wickes acquisition of Gas Fast, a solar and boiler installation service provider to enter the higher-growth fit-out value chain and improve its margin mix

These projects aim to elevate margins but also to mitigate potential future supply constraints and budget overruns that stem from preventable delays. We believe that as stakeholders navigate the evolving landscape, a continued focus on value creation and targeted acquisitions will be required to drive success.. Proactive measures taken today will not only enhance competitive edge but also pave the way for sustainable growth in this dynamic environment.

Contact us

Do not hesitate to get in contact if you would like to discuss any of the explored themes.

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