JUNE 2023

UK BUILDING REPAIR COSTS REVIEW

Update based on data from January to June 2023

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The review

Each quarter, the quantity surveyors from Sedgwick's repair solutions team in the UK review the building and construction market to understand the primary drivers of cost and ensure that our rates remain fair and competitive. This report provides an overview of the current situation and looks at factors that could affect insurers' building repair costs in the months ahead.

In the first quarter of 2023, we recorded further increases in costs, but the second quarter saw a reduction due to falling material prices. We've created a new index for comparison called the HESI, which looks at costs specific to home emergency work. This has shown an inflationary increase in the period October 2022 to April 2023 of 11.48% — a higher inflationary increase than general repairs.

Whilst there's now optimism of a slowing down of material cost increases, we have concerns about availability in the short and medium terms of sufficient quality tradesmen as the construction industry in the UK, and internationally, predicts a requirement for more operatives to maintain demand.

Headlines

- We've recorded cost changes of +1.26% in Q1 and (provisionally) -0.83% in Q2. The latter, however, does include seasonal variations.
- Some materials prices continue to increase, most notably where the items have a high energy input in manufacturing (e.g. plaster). However, drops in the costs of other materials are now being recorded.
- Labour shortages are likely to be the cause of continued rising labour rates, and therefore, total repair costs.
- In line with our last report, we are still currently forecasting that construction inflation will be circa 6% in 2023.

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Building cost inflation

To track the impact of inflation on insurance repair work within the building industry, we use our own index that focuses specifically on this market. The Insurance Repair Specific Index (IRSI) monitors the four main cost components typically found in insurance repairs — labour, plant, materials and waste disposal — and takes account of the frequency of use of different materials. The IRSI is calculated quarterly. We also track each month the prices of 144 of the most frequently used materials.

This highlights how contractor repair costs are being affected in the current high inflation environment. In Q1, an increase of 1.26% was recorded, while Q2 saw a provisional -0.83% change. This is due to documented decreases in material and plant costs, whilst labour costs have continued to increase. There are, however, seasonal reductions in some materials, which we'd expect to rise later in the year.

The continued trend of cost fluctuation, but where the trend of increase is slowing, is shown in chart 1. Table 1 shows the categories of materials tracked monthly, year to date, where the fluctuations in cost of different categories of material are recorded.

Chart 1 – IRSI Q2 2023

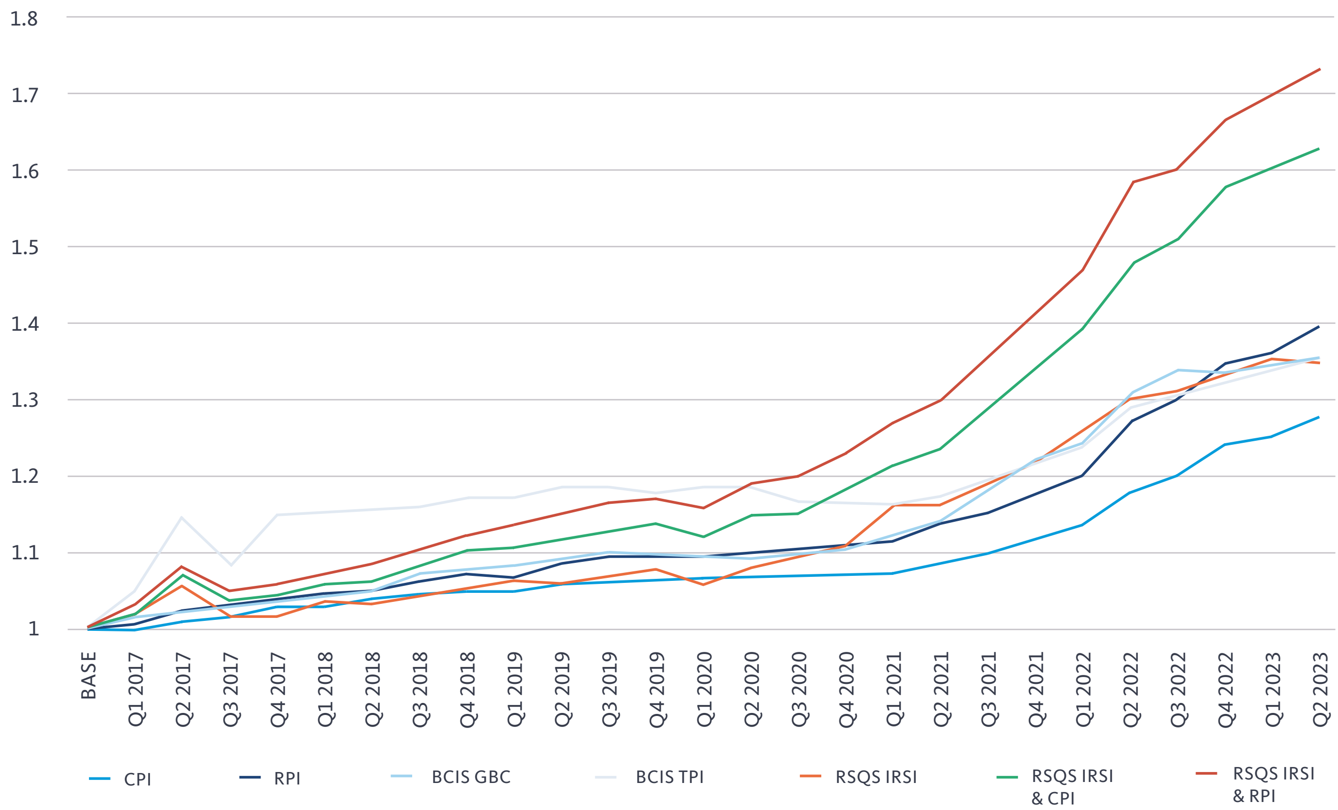


Table 1 – IRSI monthly material cost monitoring by category

Material category	January 2023	February 2023	March 2023	April 2023	May 2023	June 2023	Total
Adhesive/sealants	0.00%	-2.84%	0.00%	-2.60%	-1.90%	-1.75%	-9.09%
Aggregates	1.25%	4.58%	0.00%	0.00%	0.00%	-0.74%	5.09%
Cement	0.66%	0.53%	0.00%	0.12%	0.00%	2.09%	3.40%
Decorations	2.97%	1.44%	1.14%	0.00%	-4.69%	3.68%	4.54%
Drainage	0.00%	-0.20%	0.00%	0.00%	0.00%	0.00%	-0.20%
Electrical	-2.39%	0.00%	0.00%	-0.38%	0.67%	0.00%	-2.10%
Enablings	4.45%	0.00%	0.00%	0.00%	0.00%	0.00%	4.45%
Floor covering	6.35%	0.83%	0.00%	-3.36%	-1.60%	0.00%	2.21%
Gypsum	12.86%	0.70%	0.12%	-0.51%	-0.93%	0.99%	13.22%
Heating	0.74%	-3.09%	-5.66%	-0.55%	-1.84%	-1.32%	-11.71%
Insulation	1.65%	0.00%	0.00%	8.39%	-0.28%	-3.70%	6.05%
Ironmongery	1.06%	-0.89%	0.84%	2.12%	-2.85%	0.00%	0.28%
Kitchens	9.19%	-2.31%	0.00%	-2.97%	3.06%	-1.60%	5.38%
Lead	4.44%	-2.67%	0.53%	0.37%	-15.86%	11.32%	-1.88%
Masonry	0.02%	-3.96%	0.00%	3.96%	-1.55%	0.40%	-1.13%
Pavings	9.30%	0.00%	0.00%	0.00%	-1.86%	0.00%	7.43%
Plumbing	-0.04%	-4.59%	0.00%	0.03%	0.00%	0.00%	-4.61%
Roofing	0.06%	-0.48%	0.39%	-0.03%	-0.97%	0.97%	-0.05%
Sanitaryware	4.28%	-0.63%	-1.57%	15.24%	-5.49%	2.65%	14.47%
Screws/nails	-0.76%	0.95%	0.00%	0.38%	-5.83%	0.00%	-5.26%
Taps	0.00%	1.75%	0.00%	-1.86%	0.00%	0.00%	-0.11%
Tiles	9.72%	3.40%	-0.87%	-1.33%	0.00%	-2.30%	8.61%
Timber	-1.58%	-2.25%	-3.84%	0.32%	0.34%	-1.07%	-8.09%
uPVC window	0.00%	0.00%	0.00%	0.00%	0.00%	-4.27%	-4.27%

In addition to building work, Sedgwick's repair solutions network carries out responsive home emergency repairs, predominantly involving plumbing. We've developed a specific home emergency repair cost index (HESI) that each month tracks specific labour and material fluctuations. This is based on a basket of frequently used components and labour costs.

We've recorded combined increases of 11.48% during the period of October 2022 to April 2023. We'll report in Q3 how the costs have fluctuated. The index highlights, however, that the home emergency sector specifically has been subject to the effects of inflation over the last few months.

Whilst we're now seeing reductions in the cost of some materials, the cost of labour remains a concern. We've previously reported on the findings of the Construction Industry Training Board's research into the labour requirements of construction. They forecast that 225,000 new trade operatives will be needed by 2027 if construction demand is to be met. Cost consultant Currie and Brown has described this as a "cliff edge" that threatens the delivery of key infrastructure projects. Whilst insurance repair operates in a different sector, we find that skills shortages in other areas directly affect contractors focusing on this work, as tradesmen are pulled away into other sectors with higher wages. Currie and Brown predicts labour costs will rise by 8.3% this year, and Mace, a major commercial contractor, forecasts that its construction costs will rise by at least 3.5% each year over the next five years. Hudson Contracts, a construction payroll provider, has reported that average wages rose by 5.4% in April to £941 per week.

Whilst concerns remain about general construction labour availability and cost increases, the drive to reach a net carbon zero economy is adding to the general labour difficulties. The UK government's Climate Change Committee has published its net zero workforce report, concluding that:

"There is potential for the net zero transition to create more jobs than will be lost. Between 135,000 and 725,000 net new jobs could be created by 2030 in low-carbon sectors, such as buildings retrofit, renewable energy generation and the manufacture of electric vehicles... Nine percent of the UK workforce are in sectors expected to grow and which are not exposed to international competition. For example, buildings construction and retrofit are expected to grow significantly and are relatively geographically dispersed across the UK. Growth in these sectors is not guaranteed and relies, alongside long-term policy certainty and regulations, on the availability of skilled workers in the right place at the right time."

Competition for construction labour is likely to increase, and we anticipate this will impact the cost of employing tradesmen working in insurance repair. Whilst material costs may stabilise, particularly as energy costs fall, labour costs look set to increase and therefore lead to continued inflation in insurance repair. For this reason, we're currently maintaining our forecast that insurance repair costs will rise by 6% in 2023.

Rates benchmarking

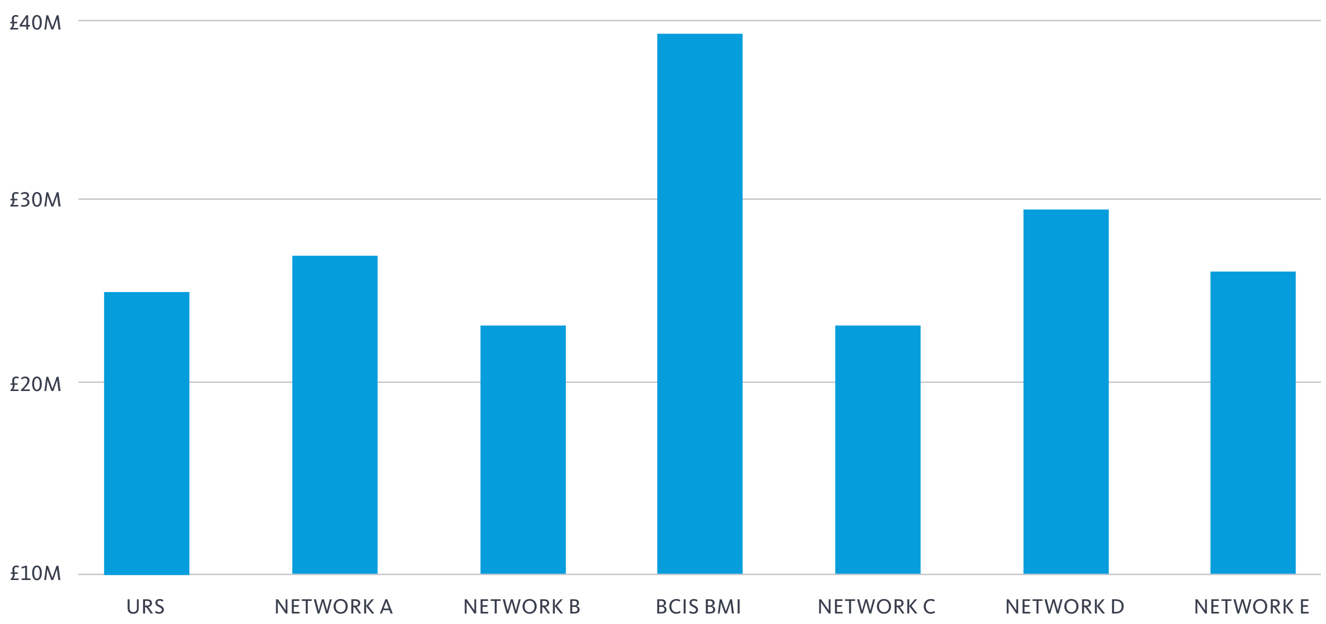
To ensure that the costs of Sedgwick's repair solutions are competitive, our quantity surveying team undertakes a quarterly rate review. Known as the universal rate set (URS), the review compares our rates with other market repair costs. This benchmarking exercise includes:

- A cost review of 25 of the most frequently used repair rates
- A review of the output costs of repairs on typical escape of water, fire, flood and subsidence claims

The results of this review are shown in chart 2 below. The URS remains competitive. The results include the recent increase in the URS rates and amendments made to other pricing. It's important to note that Sedgwick's repair solutions rates include all network management costs or fees. To allow comparison, 10% for management costs has been included with the net rates of other networks.

We increased Sedgwick's repair solutions rates by 6% on 1 February, which is reflected in the benchmarking. We're continuing to monitor costs to accommodate future adjustments to the rates as needed.

Chart 2 – Benchmarking



Dynamic pricing

Sedgwick's quantity surveying (QS) team also conducts a specific benchmarking exercise to compare the URS with wider market tenders. This provides a good indication of the competitive nature of URS against tendered repair jobs, which are typically at the higher value end (greater than £50k), and how market costs are changing.

The annual portfolio review involves applying URS rates and rules and comparing the results with tenders received from panel contractors or customers' preferred building firms. The analysis benchmarks Sedgwick's repair solutions QS figure against:

- The lowest cost tender
- An average of the lowest two tenders
- An average of all four tenders (lowest quartile). This indicates market pricing of repairs by evidencing the spread of tenders presented

The most recent analyses are shown below in table 2 and chart 3.

The dynamic pricing shows the increase in tender cost compared to rates. We have six cases in the sample, and the trend of tender prices being higher than the schedule of rate prices continues.

We've recorded a 13.8% difference between the return A price and the QS price (the value of the tenders where priced on rates). Results confirm that the tender market remains strong, with contractors able to price generously and indicating the supply of work remains high.

Table 2 – Dynamic pricing cost savings

	Sedgwick quantity surveying	Return A	Average return A&B	1st quartile returns (A, B, C, D)
Price	**£651,704**	**£741,774**	**£805,776**	**£877,506.49**
£ variance		£90,070	£154,072	£225,802.39
% variance		13.82%	23.64%	34.65%

Chart 3 – Dynamic pricing

International labour comparison

We've highlighted the growing problem of labour shortages in UK construction. This isn't, however, confined to the UK. A recent analysis of international construction markets conducted by Arcadis showed that four of the 15 most expensive cities in the world in which to complete construction are in the UK. London ranked as the world's second-most expensive city in which to build, with only Geneva having higher construction costs. In Bristol, Manchester and Birmingham, construction is currently more expensive than in Sydney, Paris, Beijing and Los Angeles. The shortage of labour is fueling cost rises. Further noted detail includes:

- The highest inflation reported was experienced in regions of Europe exposed to disruption related to the conflict in Ukraine. These cities saw inflation ranges of 10–20%.
- Regional analysis shows that, across the UK, U.S., Australia, Europe and Hong Kong, labour shortages are problematic. The U.S. Associated Builders and Contractors (ABC) industry group suggests a shortage of up to 540,000 tradesmen, with Australia facing a shortage of 470,000 in the next four years.
- Through 2022, China's construction sector grew by 6.4% — a trend that is set to continue through 2023 due to the approval of 109 infrastructure projects covering transportation, energy and water schemes and totaling $213 billion (CNY1.48tn) in value. Chinese construction saw a reduction in costs of 2% in 2022 as material costs fell.
- A European Commission survey found that 25% of European contractors are struggling to find enough labour to meet demands, with problems being particularly serious in France, Germany and Austria. Attracting foreign workers is seen as a potential solution.

A review of the labour issues faced internationally indicates that the availability of tradesmen is likely to be the dominant factor driving construction costs in the foreseeable future.

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