Building repair cost review

Quarterly update: Based on data from May 2022 to July 2022

August 2022

sedgwick

The review

Each quarter, Sedgwick Repair Solutions' quantity surveying team reviews the building and construction market to understand the primary drivers of cost and ensure that our rates remain competitive. This report provides an overview of the current situation and looks at the issues that could potentially impact insurers' building repair costs over the months ahead.

We previously forecasted that the cost inflation of insurance repairs over 2022 would be in the region of 10%. This remains unchanged. However, we continue to receive evidence of material price increases charged by builders merchants, citing ongoing inflationary factors such as the war in Ukraine.

In a recent survey, where we asked questions about how contractors view the current market and their level of optimism, they reported continued difficulties in retaining labour. Our inflation forecast of 10% is therefore optimistic. The war in Ukraine has shown how global events impact industry costs, and recent tensions in Taiwan highlight that the situation could quickly change. Although, as one of our contractors reminds us in their responses, we remain optimistic.

HEADLINES

- January to the end of June, we recorded an increase in costs of 8.81%
- Merchants continued to notify material increases, e.g. Jewsons increased concrete tiles by 9.5% from 1st August
- There are reports of suppliers only holding prices for 24 hours
- Data indicates that rising tender costs continue to reflect rising market costs
- The CITB has reported a significant demand for labour in the construction industry if output is to be maintained

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PART 1 – 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. We call this the Insurance Repair Specific Index (IRSI). It monitors the four main cost components typically found in insurance repairs: labour, plant, materials and waste disposal.

Positive cost inflation has continued, and the latest IRSI review shows that input costs increased from January to the end of June by 8.18%. One national merchant advised:

"Similar to previous months, our suppliers continue to experience extreme cost price inflation. These factors remain very much unchanged and include the increased cost of fuel (which is impacting production and freight) as well as packaging, foreign exchange rates, and the price of raw materials. Additionally, some suppliers are now stating that the Russia-Ukraine conflict is beginning to impact their supply chains further."

The war in Ukraine is the main reason given for price increases. While direct imports of construction materials from Ukraine to the UK are small, we're impacted by the reduced availability of raw materials used in manufacturing these supplies, together with rising costs of importing other European finished materials, which, as stocks fall, are being retained in the country of origin.

Large construction businesses, e.g. house builders, can stockpile materials and buy at scale, reducing the impact of inflation on their costs. Smaller contractors, such as those working in insurance repairs, aren't able to do this and so bear the full inflationary cost. In our survey in section 4 below, one contractor commented:

"At times, we have no idea what we are paying as we almost have to agree to the supply first – costs increase because the supplier knows we are stuck with little or no options."

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The BCIS expects material inflation to peak mid-year and then fall back in quarters 3 and 4, reducing to 10.6%.

There are signs of the potential for a recession, with some industry commentators considering this likely in the medium term. The recent interest rate rise may reduce the amount of domestic repair work that customers might be considering and possibly slow the housing market.

Table 1 – BCIS forecast of inflation trend

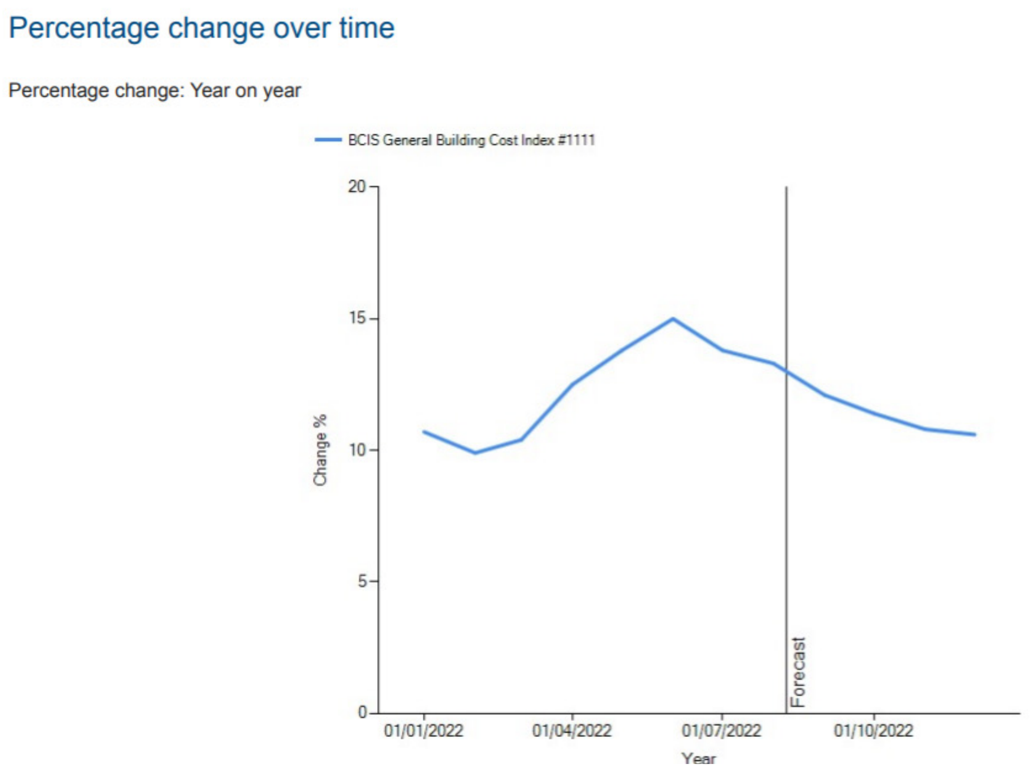

Table 2 below shows how the IRSI compares to the other key indices – the Building Cost Information Service General Building Cost Indices (BCIS GBC) produced by RICS, the Consumer Price Index (CPI), and the BCIS Tender Price Index. All indices show the continuation of an upward trend in cost to the end of Q2.

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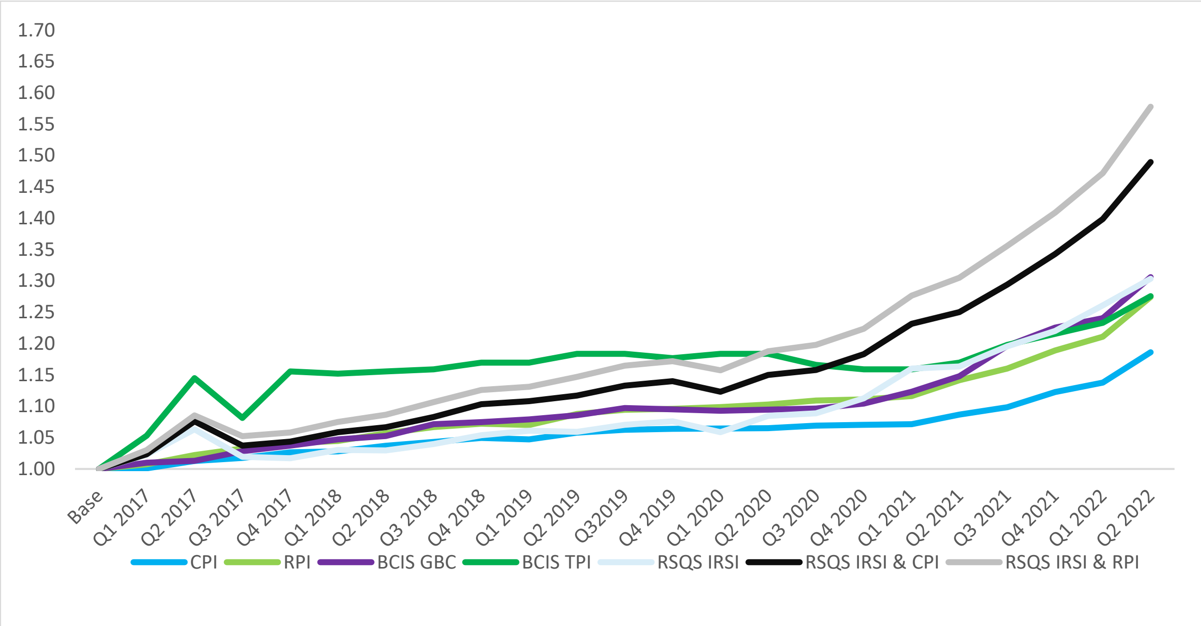
Table 2 – Inflation increases 2017 Q1 – 2022 Q2



We previously reported on the reduced availability of skilled workers and the difficulties contractors face retaining and recruiting suitable tradespeople to carry out challenging insurance repair work. In June, the Construction Industry Training Board (CITB) released their construction skills outlook report, and three key extracts are shown below. Notably, they recorded that the industry needs an additional 266,000 workers between now and 2026 if demand is to be met, and the repair and maintenance sector is the most difficult in which to recruit. This highlights the comments by the contractors in the survey (section 4) that these shortages are affecting costs now.

Extracts from CITB survey findings:

266,000

Additional workers will be required to meet UK construction demand by 2026 (53,200 workers per year, up from last year's figure of 43,000)

UK-wide growth

All nine English regions plus Scotland, Wales and Northern Ireland are set to experience growth resulting in increased demand for workers

Recruitment

As demand soars most affected sectors:

- Private housing
- Infrastructure
- Repair and maintenance

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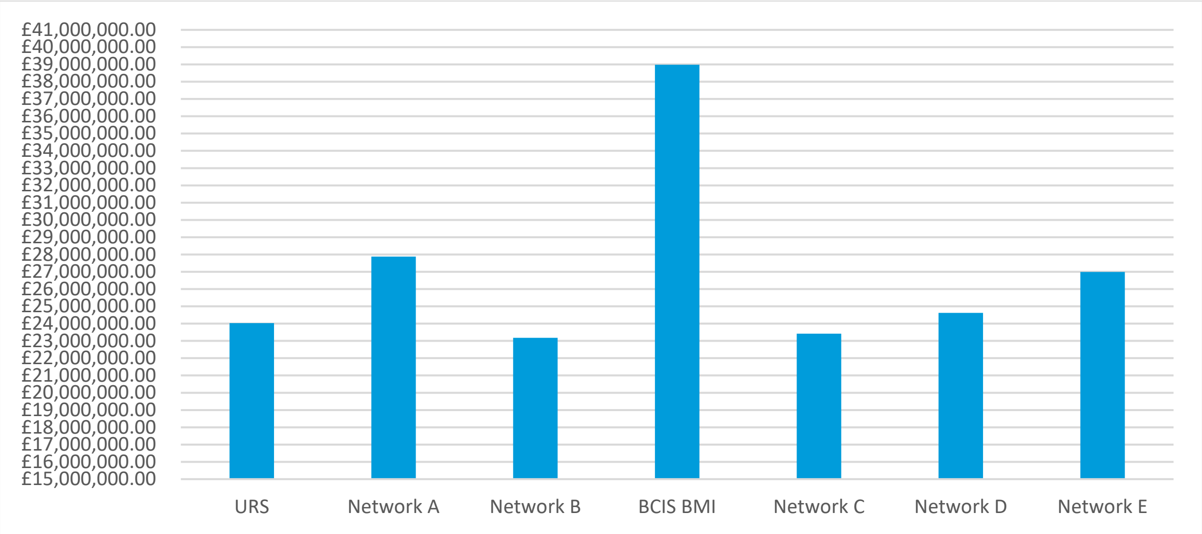
PART 2 – RATES BENCHMARKING

To ensure that Sedgwick Repair Solutions repair costs are competitive, our quantity surveying team undertakes a quarterly review of our repair rates – known as the URS. The URS is compared 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 £5k and £25k escape of water claims
- A review of the output costs typical of flood, subsidence and fire repairs

The results of this review are shown in table 3 below. The URS remains competitive. It's important to note that the Sedgwick 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.

Table 3 – benchmarking



The increasing contractor costs require an increase in some repair rates.

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PART 3 – DYNAMIC PRICING

Sedgwick's quantity surveying 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 increasing.

The annual portfolio review involves applying URS rates and rules and comparing the results with tenders received from panel contractors or the customer's preferred building firm. The analysis benchmarks the SRS 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 analysis (as shown in tables 4 and 5 below) is as follows:

Table 4 – Dynamic pricing cost savings

	Sedgwick QS	Return A	Average return A&B	1st Quartile returns (A, B, C, D)
Price	£422,408	£453,001	£461,242	£520,310.94
£ Variance		£30,593	£38,834	£97,903.25
% Variance		**7.24%**	**8.57%**	**21.23%**

The dynamic pricing shows the increase in tender cost compared to rates. We have a sample of a rising level of tender submissions. In the sample, we have five cases in this quarter two period. The comparison continues to show that contractors' pricing reflects the availability of profitable work and contractors selecting projects. The increase is, however, slightly higher than found last quarter, and results are very similar, suggesting some stability now in pricing.

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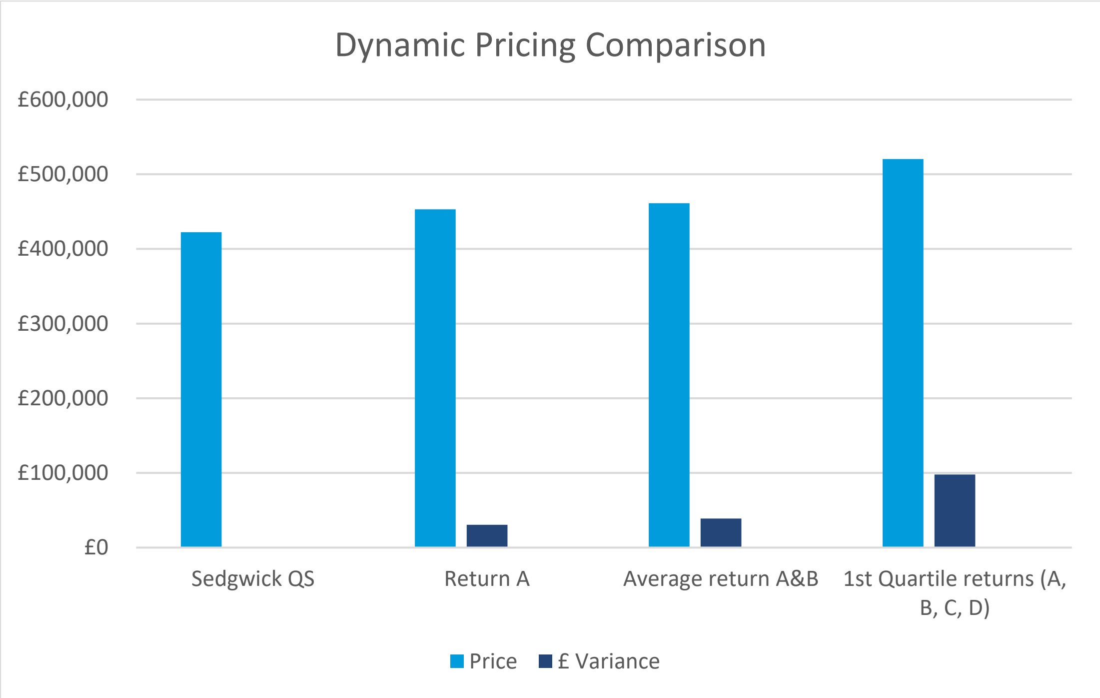
The use of rates also indicates a saving of around 20% compared to the open market. Table 5 illustrates the variances.

Table 5 – Dynamic pricing comparisons



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PART 4 – CONTRACTOR CHALLENGES

As mentioned previously, the construction sector is facing challenges – some not seen before. We surveyed the proprietors of a number of our contractors – all of whom have worked in partnership with us for up to twenty years – to gather their opinions and current views on the market. A selection of their insightful thoughts is shown below.

Question: In your experience, how unique are the factors the industry is now working through?

"Utterly off the scale on most levels. I have been through numerous recessions and moments of high activity. What makes this set of variables so unusual is the unpredictability…. At times we have no idea what we are paying as we almost have to agree to the supply first – costs increase because the supplier knows we are stuck with little or no options."

"Materials are difficult; however, we can manage this by good communications and pushing costs up the ladder. The labour issue is much harder. This is exacerbated by Brexit, with a large proportion of labour migrating away from England has really put massive pressure on the housing market, which is now trying to fill this gap. All my trades are approached every week by agencies and larger house builders. While we are heading this off at the moment, I am not too sure how long my trades will continue to turn down very lucrative wages. The COVID delays in the housing market seem to have created the perfect storm. Until the housebuilders have caught up, we will all risk losing good trades. This is then exacerbated by Putin's invasion of Ukraine and the souring fuel charges. What a wonderful world!"

"Throughout my whole working career, I've never experienced the [current] level of hardship hitting construction. Construction inflation is well into double figures, yet many insurance-related clients don't seem to want to acknowledge this as we battle to maintain current rates. I list some factors that bring about such difficulty as we navigate through impossible times:

- *Material increases – we cannot keep up with the weekly rise. Our suppliers know we have little choice, and I sense they, too, add their slice of uplift to material charges.*

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- *Labour – trades/staff – Businesses cannot retain staff……. tradespeople being paid more than staff who are professionally qualified isn't right. Tradespeople obviously know this and no longer fear losing their jobs. Labour simply isn't available.*
- *Fuel – As a business owner, it's impossible to logically invest monies to acquire new van technologies. We are being squeezed into retaining an older fleet of vehicles than we would like."*

Question: How optimistic are you for the next 12 months, and what are the key challenges you think your business faces?

"I'm praying that some form of levelling takes place. However, fuel volatility and the world/UK uncertainty breed a scare factor on prices, which are raised based on the fear of what's happening. There is no optimism at this stage as I feel squeezed."

"I am very confident we will be busy, lots of work out there, but will we be busy fools and not make a profit? The aforementioned labour issue is definitely our biggest challenge and will be for some time."

"[I was] optimistic for stability, but this is not happening. Consequently, I'm more confident that a recession will hit. We need a halt and correction in our industry, and hardship might just do that. Hardship will, of course, hit our business, but easement may come from stability around people and material.

"Another challenge for businesses like ours is the continuous boom in the house build market – it needs to slow and free up trades."

"We are always optimistic about the future as you cannot waste time looking backwards – time is too short to waste."

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Question: What is your area of focus?

"The commercial imperative must be profitability, bearing down on costs."

"As ever, we need to find ways to do more with less!"

"The biggest challenge and most certainly the biggest focus for our business is profit. After that comes training."

"Our focus is to partner with clients who understand the market, are supportive, pay their bills on time and create little friction as we all waste too much management time."

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