DECEMBER 2023

UK BUILDING REPAIR COST REVIEW

Quarterly update based on data from July to September 2023

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The review

Each quarter, the quantity surveyors from Sedgwick's UK repair solutions team 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 third quarter of 2023, we've recorded further increases in contractor input costs of labour materials and plant. Whilst prices have continued to rise, these have pleasingly been at a lower rate than our original forecast for the year of an anticipated 6% and prices are less volatile than seen last year. Material shortages have eased too. We'll have the final details of how much contractor costs have gone up over this whole 12 month period at the end of the next quarter, but we now expect contractor increases across 2023 to be in the region of 4%. Indications are that home emergency contractor costs have seen similar uplifts; however, further data analysis is underway to identify any differences from the general construction increases.

Whilst the rate of material cost increases has slowed, this is against the backdrop of significantly uplifted price levels in 2022. We expect that the price of materials won't return to levels more reflective of pre-pandemic times in the foreseeable future. Labour availability, however, remains the more pressing longer-term issue, with an aging workforce indicating probable future shortages in quality skilled tradesmen. We're working with contractors to alleviate this by helping ensure the work our contractors and their workforce carry out is attractive and meaningful, and by supplying support services including technical, and mental health and wellbeing training.

Trading conditions are therefore difficult for contractors in the insurance repair market. In the wider construction sector, pressures are leading to more reported insolvencies, up by over 8% compared to 2022. It's an unstable market, and recent experiences have shown how global supply chains could easily cause further problems in the sector in 2024.

Headlines

- We've recorded market cost increases of 1.45% in Q3, and therefore total cost increases of 1.88% in Q1 to Q3. This is lower than expected, as labour costs haven't yet increased as much as previously thought — but this'll likely follow. We expect total inflation in 2023 will be c.4%.
- Some materials prices continue to increase. This is against a backdrop of major uplifts in 2022.
- The availability of labour remains a major concern.
- We forecast construction inflation over the whole of 2024 to be c.3.5%, but this assumes limited relevance of other international factors.
- We are currently planning to review our building repair rates at the end of Q2 2024. Based on levels of inflation in 2023 and those expected next year, any increase shouldn't exceed 3%. This will respond to contractor input costs since our last rate increase, in February 2023, and reflects work we're doing to help increase contractor efficiencies.

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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 on a quarterly basis. We also track each month the prices of 144 of the most frequently used materials.

This highlights how contractor repair costs are changing. In the third quarter of 2023, we recorded an increase of 1.45% in labour, plant, materials and waste costs. This follows a recorded fall in costs of 0.83% in Q2.

In the year to date, we've seen an increase of 3.49% in materials alone. By comparison, the Building Cost Information Service's General Building Cost Index (GBCI) records a 3.13% increase of materials in the same period. Overall, the GBCI records a total cost increase of 2.3% in the first three quarters of 2023, with our data showing this is 1.88% in insurance repair. The retail price index (RPI) has been recorded at 4.3%.

Whilst we are still recording cost inflation, the rate of increase has slowed, as seen in chart 1. Table 1 shows the categories of materials tracked monthly, year to date, where the fluctuations in cost of different categories are recorded. For context, this also shows the increases recorded in 2022. Across this year to date, some further significant increases in the cost of materials widely used in insurance repair have been recorded. For example, gypsum products (e.g. plasterboard) have increased by 12.8% and cement by 9.3%. Notably, insulation products have fallen in cost by 4.27%. These falls are, however, against the backdrop of prior large increases. Reports from contractors confirm that there are not now any general problems with the supply of materials, so delays in projects caused by shortages aren't affecting repair durations.

The supply of certain materials does indicate a general slowdown in construction in the UK, and most notably new housing, which comprises c.40% of the UK construction market and has been affected by increases in mortgage rates. This is highlighted by the Department for Business and Trade, which has reported that brick and block deliveries in September were down 32.8% and 19.5%, respectively, over the past 12 months and ready mixed concrete sales were down 0.8%. In general, contractors aren't now finding any major delays with the availability of materials. This more positive position should help reduce the impacts that previous delays in material supply were having on claim costs, such as extended contract periods that meant alternative accommodation was required for longer periods.

Chart 1 – IRSI Q3 2023

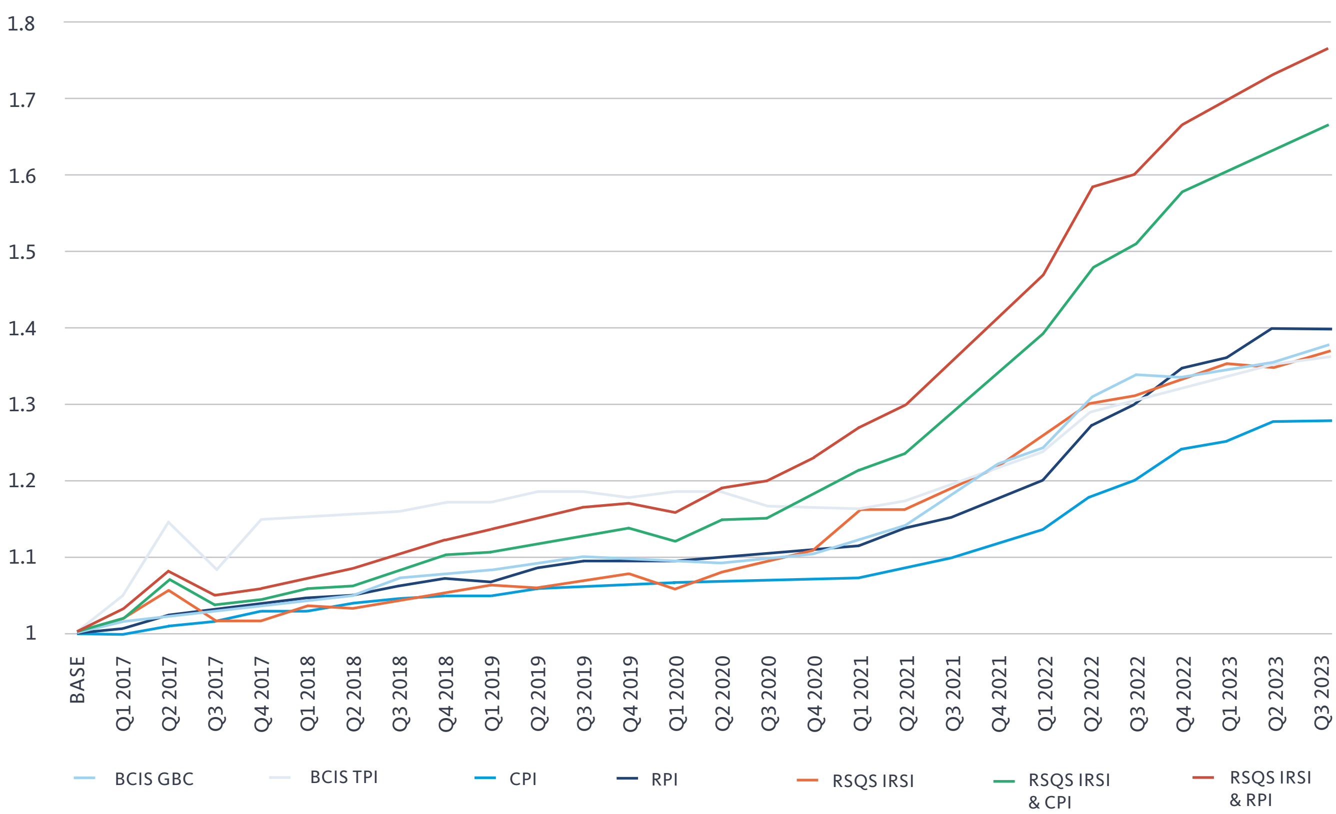
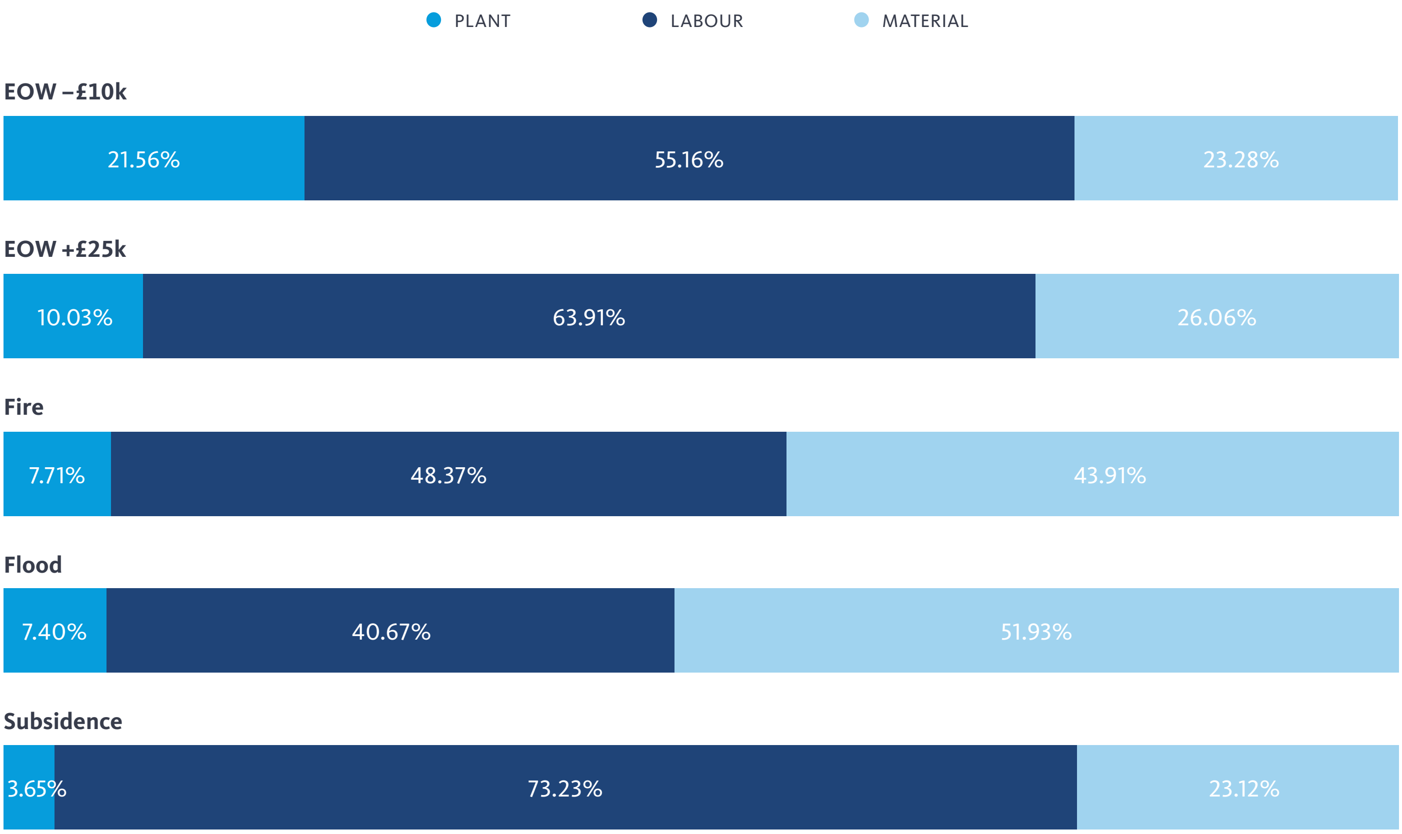


Table 1 – IRSI monthly material cost monitoring by category

Material category	YTD 2022	Jan 2023	Feb 2023	Mar 2023	Apr 2023	May 2023	Jun 2023	Jul 2023	Aug 2023	Sep 2023	YTD 2023
Adhesive/sealants	33.83%	0.00%	-2.84%	0.00%	-2.60%	-1.90%	-1.75%	-5.59%	3.17%	0.00%	-11.50%
Aggregates	28.96%	1.25%	4.58%	0.00%	0.00%	0.00%	-0.74%	0.00%	0.12%	0.00%	5.22%
Cement	14.40%	0.66%	0.53%	0.00%	0.12%	0.00%	2.09%	0.82%	3.46%	1.58%	9.26%
Decorations	13.26%	2.97%	1.44%	1.14%	0.00%	-4.69%	3.68%	2.28%	1.30%	0.00%	8.12%
Drainage	22.70%	0.00%	-0.20%	0.00%	0.00%	0.00%	0.00%	0.49%	0.00%	0.00%	0.30%
Electrical	9.42%	-2.39%	0.00%	0.00%	-0.38%	0.67%	0.00%	0.46%	1.18%	0.00%	-0.46%
Enablings	53.87%	4.45%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	-0.59%	3.86%
Floor covering	9.19%	6.35%	0.83%	0.00%	-3.36%	-1.60%	0.00%	-3.35%	1.07%	4.06%	3.99%
Gypsum	21.94%	12.86%	0.70%	0.12%	-0.51%	-0.93%	0.99%	-0.49%	0.07%	0.02%	12.81%
Heating	9.53%	0.74%	-3.09%	-5.66%	-0.55%	-1.84%	-1.32%	1.33%	-0.04%	-0.28%	-10.71%
Insulation	2.23%	1.65%	0.00%	0.00%	8.39%	-0.28%	-3.70%	0.00%	-8.40%	-1.93%	-4.27%
Ironmongery	10.45%	1.06%	-0.89%	0.84%	2.12%	-2.85%	0.00%	2.51%	-0.01%	0.00%	2.78%
Kitchens	15.58%	9.19%	-2.31%	0.00%	-2.97%	3.06%	-1.60%	-0.26%	0.00%	0.00%	5.12%
Lead	-4.33%	4.44%	-2.67%	0.53%	0.37%	-15.86%	11.32%	4.21%	0.60%	0.00%	2.93%
Masonry	12.74%	0.02%	-3.96%	0.00%	3.96%	-1.55%	0.40%	0.00%	1.89%	0.00%	0.76%
Pavings	34.56%	9.30%	0.00%	0.00%	0.00%	-1.86%	0.00%	0.00%	0.00%	0.00%	7.43%
Plumbing	26.02%	-0.04%	-4.59%	0.00%	0.03%	0.00%	0.00%	0.00%	-1.77%	0.00%	-6.38%
Roofing	25.22%	0.06%	-0.48%	0.39%	-0.03%	-0.97%	0.97%	1.47%	0.44%	0.03%	1.89%
Sanitaryware	8.70%	4.28%	-0.63%	-1.57%	15.24%	-5.49%	2.65%	4.89%	-0.03%	-3.75%	15.58%
Screws/nails	12.79%	-0.76%	0.95%	0.00%	0.38%	-5.83%	0.00%	0.00%	0.10%	0.00%	-5.16%
Taps	7.66%	0.00%	1.75%	0.00%	-1.86%	0.00%	0.00%	0.00%	-2.85%	0.00%	-2.96%
Tiles	25.59%	9.72%	3.40%	-0.87%	-1.33%	0.00%	-2.30%	0.42%	-1.27%	0.00%	7.77%
Timber	-8.52%	-1.58%	-2.25%	-3.84%	0.32%	0.34%	-1.07%	-0.75%	4.49%	-0.05%	-4.40%
uPVC window	40.11%	0.00%	0.00%	0.00%	0.00%	0.00%	-4.27%	0.00%	7.50%	0.00%	3.24%

In our portfolio inflation calculations, we apportion the elements of labour, materials and plant in a 60:35:5 split, applying the observed uplifts accordingly. This split is an average. More sophisticated analysis of the inflationary impact of different peril types is possible, and we've shown in chart 2 the actual labour, material and plant splits of the different peril types. For example, a typical subsidence repair comprises over 70% materials and 26% labour. The inflationary increase on different perils therefore varies, dependent on the peril, and different inflation impacts will be seen, depending on the mix of cases in a portfolio.

Chart 2 – Different proportions of labour, materials and plant by peril



In contrast to the housing sector, repair and maintenance, which are most similar to insurance repair, remain buoyant. The Federation of Master Builders has, however, noted that its members have reported a decline in new enquiries and a growing difficulty in recruiting labour, especially carpenters, joiners and bricklayers. These trades are widely used in the insurance repair sector, and this is evidence of the growing skills shortage highlighted previously. We've also had reports from our contractors of operatives now choosing to travel into London from distances of over 100 miles away, as the commuting cost and time is exceeded by the significantly higher wages of up around £250 a day being paid for some trades.

There are reports in the construction industry of growing levels of insolvency caused by high material and wage levels, increasing overhead costs, high interest rates (particularly relevant to those who took out loans during the pandemic), shrinking order books and low profit margins. Construction companies are reported as accounting for 30% of businesses in financial distress. In September, 16.9% (i.e. 332 registered businesses) of all insolvencies in England and Wales were construction companies. That marks an increase of 8.3% over the previous year. It's a challenging time to be a contractor, with some commentators now referring to a potential boom and bust. With this in mind, it's important that steps are taken to support contractors so they can maintain sustainable businesses. Some of these supportive measures include:

- Better cash flow to minimise debt issues by making payments as quickly as possible.
- Improved efficiency by issuing clear instructions of the work needed, avoiding variations, and ensuring understanding of the operating rules.
- Appreciation schemes and awards, as well as helping with training initiatives, which encourage to tradespeople retention.
- Providing support services for tradesmen in areas such as mental health and dealing with stress and anxiety.
- Reducing administrative burdens by procuring work through the simplest means with straightforward contractual appointments.

We have initiatives in place in each of these areas, which not only support contractors but also alleviate a few of their business costs and mitigate some of the impacts of continued inflationary pressures. This has also helped us maintain our current repair rates for a longer period, which we will now be looking to review at the end of Q2 next year. With the measures we have taken and the current forecast, we anticipate that any rate increase then will be less than 3%.

Rates benchmarking

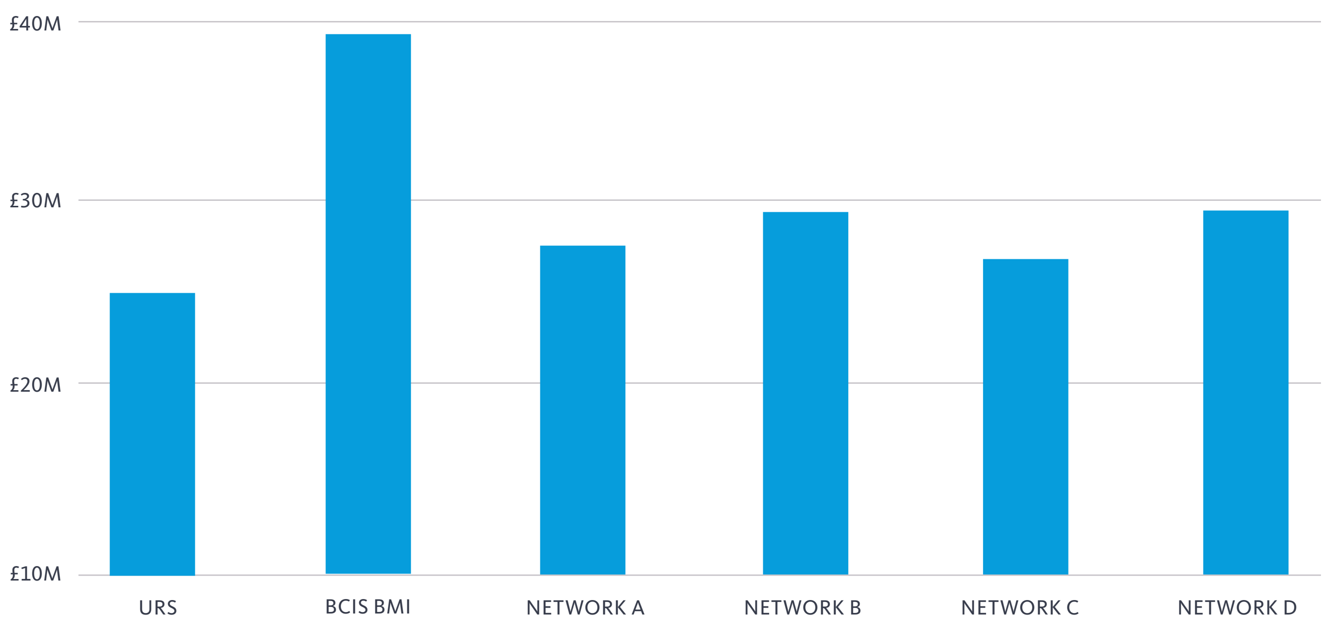
To ensure that the costs of Sedgwick's repair solutions are competitive, our quantity surveying team undertakes a quarterly rate review. Known as the universal rate set (URS), the review compares our rates with other market repair costs. This benchmarking exercise includes:

- 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 3 below. 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.

Benchmarking confirms the URS remains competitive.

Chart 3 – 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.

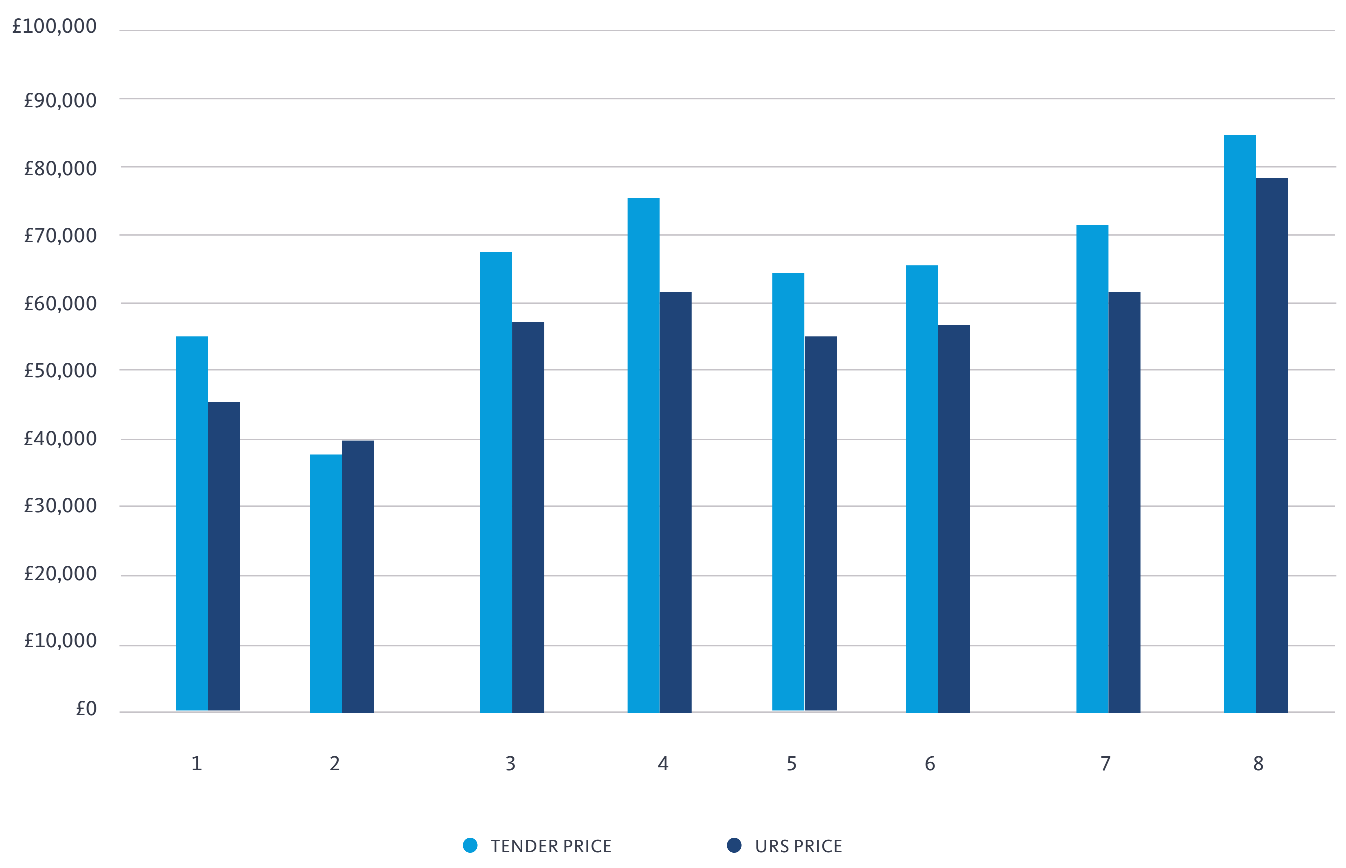
The analysis benchmarks Sedgwick's repair solutions QS figure, which is the cost of the repair priced using the repair solutions universal rates, compared with the lowest cost tender, which is a competitive tender market price. In this quarter, we compared a sample of projects from a portfolio where tenders were supplied by Sedgwick's repair solutions team and contractors whose primary market is general construction rather than insurance repair. Results are shown at right in table 2.

Table 2 – Dynamic pricing cost savings

	Lowest tender	Sedgwick QS rates price
Price	**£530,802**	**£456,950**
£ variance		£73,853
% variance		16.16%

Based on this review, the repair rates provide a lower cost of repair than the tender process. This highlights the competitiveness of the rates to value the repair projects and the competitiveness of the insurance repair sector. Chart 4 highlights the comparative project values.

Chart 4 – Dynamic pricing



Looking forward to 2024

We've considered the issues that may affect the cost of insurance repairs in our forecasting of 2024 inflation. Events over the past two years have demonstrated global dependence on the construction economy and how easily circumstances can drive significant inflation. We now have uplifted costs within the supply chain, and it's unlikely there'll be a reduction of material prices to align with pre-pandemic levels.

The political environment

It's likely there'll be a general election in the UK in 2024, and this could prompt a change in government policies directly affecting construction. These include the approach to infrastructure projects, housing targets and associated planning. Creating an environment that stimulates construction is likely to put pressure on the demand for labour and is a further factor that may increase wage costs.

The international geopolitical state continues to be a concern, with conflicts in Ukraine, the Middle East and, potentially, Taiwan having the potential to cause escalations. These can impact supply chain costs and fuel global inflation, driven by increases in energy, oil and technology components, respectively.

Sustainability

There is currently a great deal of emphasis on the decarbonisation of construction. However, the process at the moment isn't financially neutral, as low-carbon materials and technology are currently at a premium price and likely to remain so until their use becomes mainstream. Lower-carbon repairs may therefore be inflated by an environmental factor, in addition to general inflation uplifts.

Our 2024 forecast for inflation in insurance repair is 3.5%. This assumes the factors we've mentioned remain just possibilities.

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