MARCH 2023

BUILDING REPAIR COST REVIEW

Quarterly update: based on data from October 2022 to December 2022

The review

Each quarter, the quantity surveyors from Sedgwick's 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.

We previously forecasted that the cost inflation of insurance repairs over 2022 would be in the region of 10%. Quarter four material and labour costs continued to increase at an accelerated rate and final cost inflation is recorded at just over 13%.

We expect a slowing down of the increase in costs in 2023, albeit the year has started with some merchants announcing increases of over 10% across all stock. The cost of energy remains a key factor in the cost of materials and is particularly affecting those with high energy demands in manufacture. We're optimistic however that the rate of increases will be noticeably slowing in Q1 and we're forecasting increases across the year of 6%.

Headlines

- In 2022, we recorded an increase in costs of 13.12%
- Materials prices continue to increase, most notably where the items have a high energy input in manufacturing (e.g. plaster)
- Contractors continue to face challenges with recruitment and retention of labour
- We forecast construction inflation in 2023 to be about 6%

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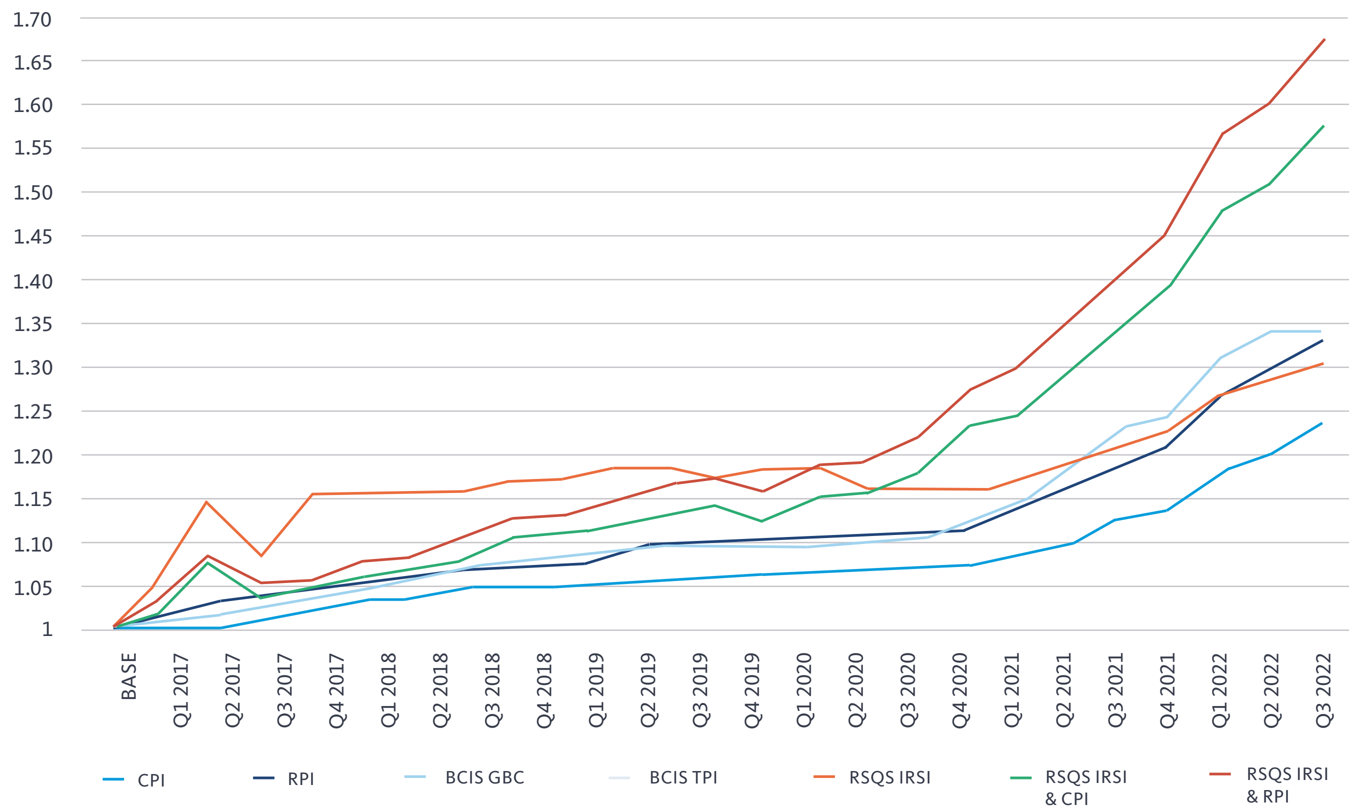
Building cost inflation

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 spikes and trends in the costs of materials, and over the last year we've recorded the impact of the increases manufacturers and merchants have brought to the industry.

Positive cost inflation has continued, and the latest IRSI and material review show that input costs increased from January to the end of December by 13.12%. That's an increase of 2.3% over the quarter. There are some provisional values, and a seasonal adjustment to be applied when all data is finalised, but these will be fixed in our report featuring data from 2023 Q1. The continued trend of cost increases is shown in the illustration of the IRSI below (table 1).

Table 1 – IRSI 2022



Merchants have continued to introduce cost increases throughout the quarter. Increases from one merchant are shown below as an example.

Notified increases October 2022

Product category	Price increase
Foil insulation	Up to 7%
Cement	14%
Postfix	10%
Bricks	Up to 20%
Aggregate blocks (not including aerated blocks)	*Varies by branch
Aggregates	*Varies by branch

*This increase will vary depending on your location, please speak to your nearest branch for more information. Please note, the above increases do not apply to all products within the same categories and only highlight the most relevant price increases.

Notified increases December 2022

Product category	Price increase
PIR insulation	Up to 14%
Abrasives	Up to 6%
Clay roofing tiles	UP to 18.9%
Concrete roofing tiles	Up to 17%
Bricks	Up to 18.9%

Please note, the above increases do not apply to all products within the same categories and only highlight the most relevant price increases.

Further increases have also been introduced in January 2023, as shown in the example below from the same merchant.

How much are prices increasing?

We want to reassure you that we have been working hard to mitigate where there are increases with our suppliers but many of the building materials we buy will go up in price in January, the price increase across all materials will go up on average 10.1%. However, these increases do vary by supplier and product category, so you will find all the increases enclosed.

Materials which have a high energy input in manufacture are most notably increasing in cost. Some materials, such as structural timber products, have seen decreases, and we'll highlight the impact of these in our Q1 report.

Contractors working in insurance repair are currently dealing with wet peril surge cases following the UK's December cold spell. A second repair surge of subsidence projects will be presented to contractors in 2023. We've shown below the typical subsidence repair material increases recorded over 2022, which highlights how this peril repair cost has changed. The materials-only costs of a typical repair increased by 27% over the 12-month period.

Material	Cost increase in 2022
uPVC window	45%
Pavings	39%
Adhesive/sealants	38%
Aggregates	32%
Roofing	28%
Plumbing	27%
Tiles	27%
Drainage	25%
Gypsum	24%

Contractors have reported that supply issues that began during the pandemic are now largely resolved. They are, however, still dealing with issues of labour retention and recruitment. In its salary survey, Hays reported that site wages rose by 12.8% in Q3 2022 — much more than the nationally agreed increases of approximately 5%. This is in the context of a 7% reduction in the total UK construction workforce since 2019, including a loss of 25% of self-employed tradesmen.

As one contractor recently commented on his experience with managing today's workforce:

"The biggest problem is trying to hold labour costs down. With the cost-of-living pressures, my office door is almost worn out with the number of knocks it's had of late. Other than that, it's finding and retaining good quality staff … but that's a perennial."

In its latest quarterly survey, the Federation of Master Builders reported that 70% of its members have had to raise prices again; however, there are reports of a slowing down of new enquiries, with the exception of the repair and maintenance sector. That's confirmed by our network contractors, who haven't reported any slowdown in new private work but are hearing reports that builders' merchants of very small companies are having jobs cancelled, presumably as customers respond to the cost of living crisis and decide not to proceed with home improvements.

Further, there are signs of a possible construction recession, but costs continue to rise. We still expect that the rate of increases will slow, particularly as the anticipated fall in energy prices materialises. We're mindful that social and political developments could easily bring changes to this market. These may include a resurgence of COVID-19, an emerging threat of avian flu, an escalation of the Russia/Ukraine conflict and changes in UK government policy. We're therefore maintaining our current forecast of 6% construction inflation in 2023, based on expected relative stability.

Rates benchmarking

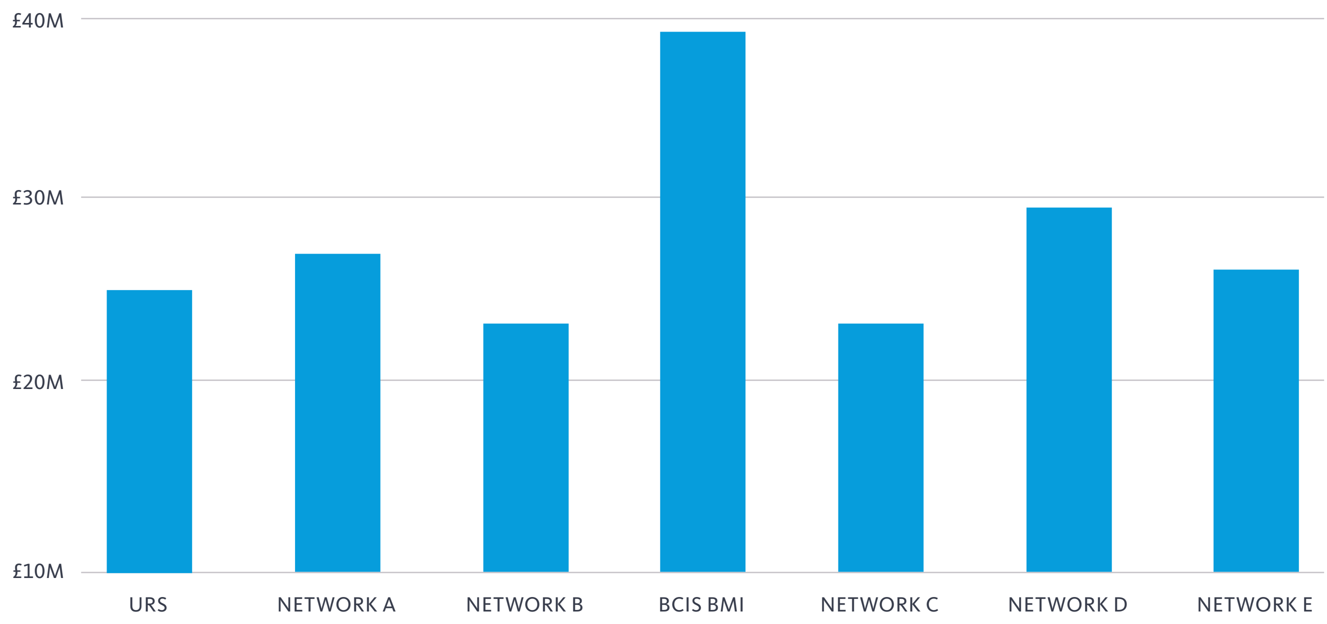
To ensure that the costs of Sedgwick's repair solutions are competitive, our quantity surveying team undertakes a quarterly rate review. Known as the URS, the review compares our rates with other market repair costs. This benchmarking exercise includes:

- 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 table 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 allow future adjustments to the rates as needed.

Table 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

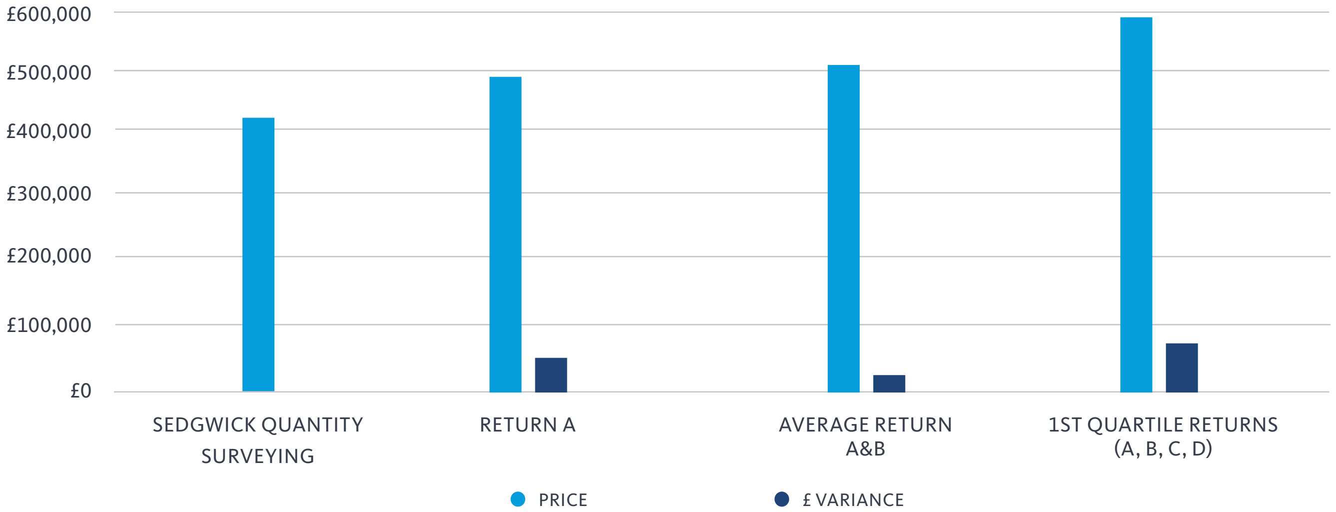
The most recent analyses are shown below in tables 3 and 4.

The dynamic pricing shows the increase in tender cost compared to rates. While six cases represent a small sample, the trend of tender prices being higher than the schedule of rates prices continues. Last quarter, we recorded a 9.94% difference between the return A price and the QS price (the value of the tenders where priced on rates), so we have a slight increase this quarter between the pricing types. However, the tender pricing in this quarter's sample show less overall variance with the rates than last quarter. This may be an indication of contractors starting to price more competitively as the pipeline of general work slows. Table 4 illustrates the variances.

Table 3 – Dynamic pricing cost savings

	Sedgwick quantity surveying	Return A	Average return A&B	1st quartile returns (A, B, C, D)
Price	**£429,457**	**£481,827**	**£511,129**	**£579,895.30**
£ variance		£52,369	£29,302	£68,766.60
% variance		12.19%	6.82%	16.01%

Table 4 – dynamic pricing



The environmental challenge

Sedgwick is proud to be among the UK insurance repair organisations working towards net carbon zero status. Our target completion date is 2030, and we're including our repair contractors in our efforts. That's because construction plays a significant role in reducing carbon emissions. According to the UK Green Building Council, the sector is responsible for 25% of the country's greenhouse gas emissions. Globally, concrete production accounts for 8% of the world's annual worldwide CO^2 emissions, totalling 32 billion tonnes.

Small-to-medium contractors that predominantly undertake insurance repairs in the UK will have to change their structures, procedures and policies if the industry is to have a beneficial long-term environmental impact and success in carbon emission reduction. Trade bodies have also highlighted the need for investment in training and development, driven by government, if we are to have capacity to make UK properties more energy-efficient and save energy and carbon waste. This environmental challenge comes at a time when contractors are facing the multipronged economic and workforce challenges mentioned above. The insurance industry must support the contractors with whom we work, as without them, we won't reach our environmental targets or effectively meet the needs of clients and their policyholders.

We've surveyed our network contractors to gauge where they are on their environmental journey. We're seeing that much work is being carried out and impacts are already being made.

Nearly 80% of our contractor respondents consider it important that their businesses limit their negative impact on the environment. Whilst only 25% currently hold ISO 14001 certification, 73% have environmental objectives and targets they are pursuing. These are largely focussed on travel and include introducing electric vehicles, reducing waste, and increasing recycling.

Contractor strategies can be summed up in the words of one respondent, and they are applicable to everyone involved in insurance repair:

> *Overall, to limit the impact on the environment as best as we possibly can. We are aware that we are not going to change the world, but the little impact that we make is a step towards the greater good.*

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