Building Repair Costs Review

Quarterly Update – Q4 2020

The review

Each quarter, Sedgwick Repair Solutions Quantity Surveying team reviews the building and construction industry market to gain an understanding of the primary drivers of cost, and make sure that our rates remain competitive.

This quarterly report provides an overview on the current situation and looks at the issues that could potentially impact on insurers' building repairs costs over the months ahead. Since our previous report the COVID-19 pandemic has continued to cause disruption and cost pressure on the construction industry. The Brexit transition period has ended, but the effects may not yet be fully felt. Following the introduction of the COVID-19 vaccination progamme and promises of a return to normality, the way ahead looks possible – but currently, the future remains uncertain and challenging for insurance repair work.

Headlines

- In Q4 2020 we recorded an increase in costs of 2.2%, with a twelve month increase of 3.4%
- Contractors are being notified of significant material price increases well above the CPI rate of inflation
- We forecast costs may increase by up to 7% over the course of 2021
- Comparisons of rates compared to tenders continue to demonstrate that rates provide a value for money form of procurement
- Contractors are optimistic in the short term, but pessimistic for the next five years. This next year will be difficult, with one contractor suggesting that 2021 will be "one of the most challenging in recent history"

Part 1 – building cost inflation

To track the impact on insurance repair work within the building industry, we use a bespoke index that focuses specifically on this market sector. Known as the Insurance Repair Specific Index (IRSI), it monitors the four main cost components that are typically found in insurance repairs: **labour, plant, materials and waste disposal**.

The latest IRSI review shows that input costs increased during Q4 2020 by 2.2%. Contractors have been notified of multiple upcoming price increases, which will take effect Q1 and Q2 2021.

In summary, across the whole basket of items:

- **Materials** costs up by 2.77%
- **Plant** costs down by 5%
- **Labour** costs unchanged
- **Waste** costs unchanged
- **Special costs** – COVID-19 additional working costs are assessed at 3% above standard costs

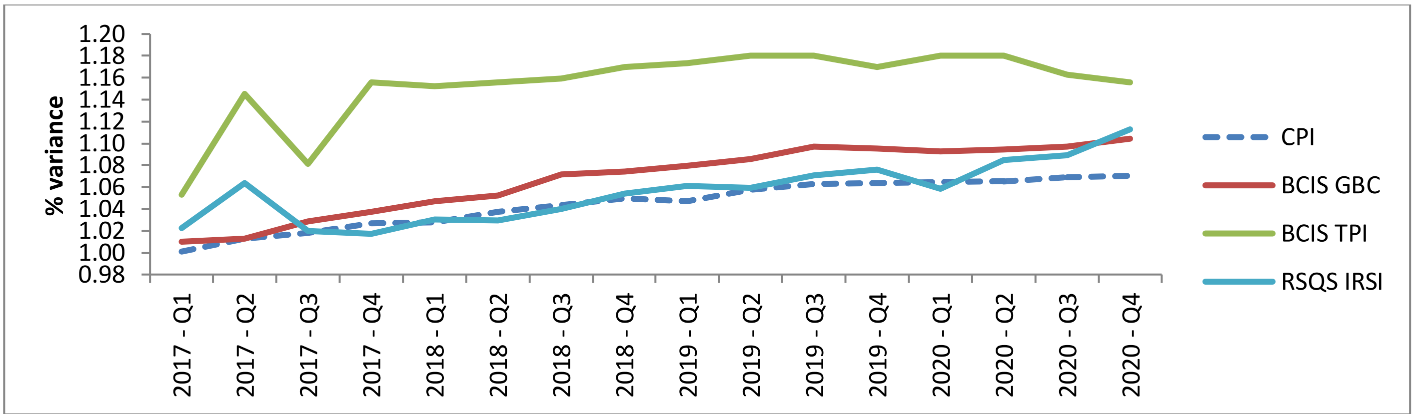
Following the conclusion of Q4, we've calculated an increase in costs of 3.4%. By comparison, the BCIS recorded material increases of 1.4% over the quarter and forecast a 22% increase over the next 5 years. In Q4 the CPI rose by 0.2%.

Material costs
Contractors have been receiving monthly notifications of price increases over Q4 including advance notification of 2021 increases, for example:

December	– Plastic drainage pipework 8%
January	– Insulation 7.5% – 15%, timber 5% – 12%
February	– Bricks 3% – 5%
March	– Plywood 15% – 30%, cement 5% – 12%, machined timber 5% – 10%

The table below shows how the IRSI compares to the other key indices being 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 a continuation of an upward trend in cost with the exception of tender costs, which reflect COVID-19 activity.

Table 1 – 2017 to Q4 2020



While Brexit negotiations have avoided tariffs being applied to material imports, we are seeing some shortages and delays in deliveries. For example, sanitary fittings and certain timber products have become harder to obtain.

Labour
While we haven't yet seen significant labour cost increases, contractors are concerned over the longer-term availability of skilled labour.

Forecast
2021 is likely to see significant increases for contractors in material prices, wage costs and general overheads. The BCIS forecasts cost increases of 4.2%. However, we estimate it could be as high as 7% when looking specifically at the insurance repair sector.

Part 2 – rates benchmarking

To ensure that Sedgwick Repair Solutions repair costs are competitive, our quantity surveying team undertake a quarterly review of our managed contractor network repair rates – known as the URS.

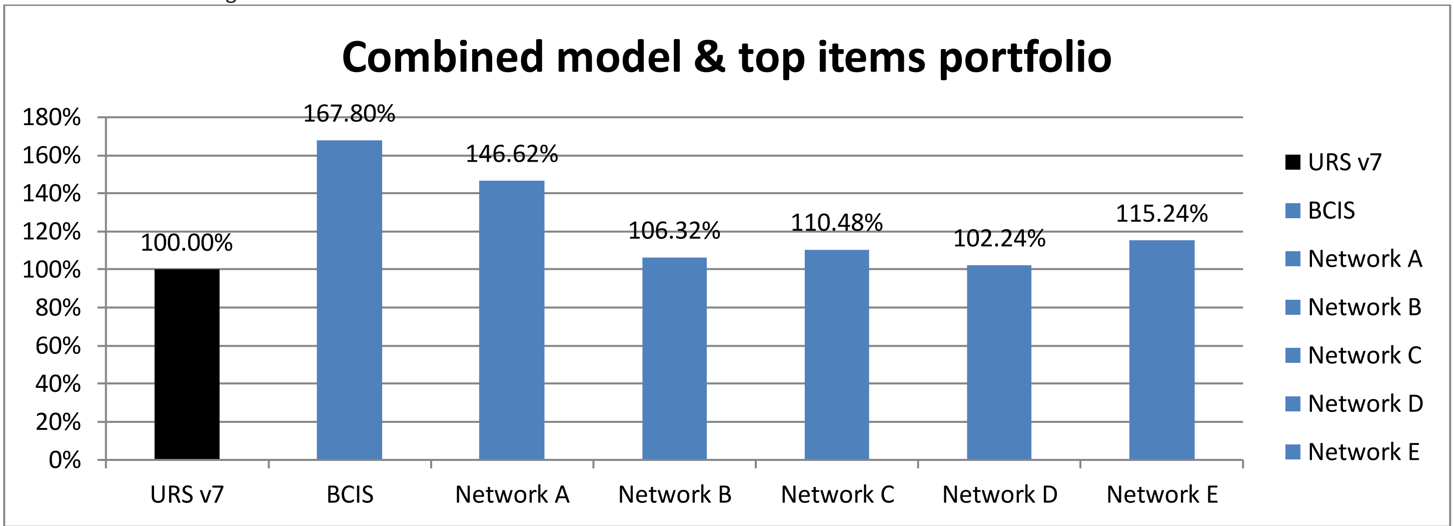
The URS is compared with published rates and those used by other networks in the insurance repair market. This benchmarking exercise combines:

- 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

The results of this review are shown in table 2 below – it shows that the URS remains competitive.

For comparison purposes, URS is shown as 100% with other networks shown as a percentage cost compared to the URS. We've recorded no changes in Q4 benchmarking.

Table 2 – benchmarking



Part 3 – dynamic pricing

Sedgwick Repair Solutions Quantity Surveying team also carry out 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).

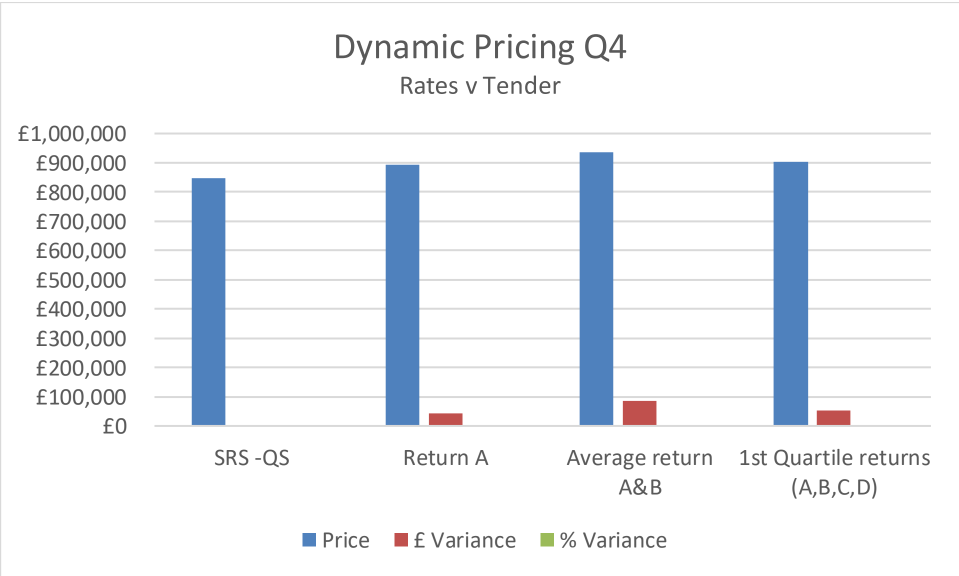
The annual portfolio review involves applying URS rates and rules, and comparing the results with tenders received from panel contractors, or the customer's preferred building firm.

The analysis benchmarks the OQS figure against:
a) The lowest cost tender
b) An average of the lowest two tenders
c) An average of all four tenders (lowest quartile)

The most recent analysis (as shown in table 3 below) is as follows:

Table 3 - Dynamic Pricing Cost Savings

	SRS -QS	Return A	Average return A&B	1st Quartile returns (A,B,C,D)
Price	£848,299	£892,422	£934,543	£902,105.00
£ Variance		£44,124	£86,244	£53,806.00
% Variance		5.20%	10.17%	6.34%



The exercise demonstrates that compared to free market tenders the URS is competitive, generating a saving of 5% compared to the lowest cost tender.

Part 4 – 2020 and what's in store for 2021

As we slowly begin to recover from the effects of the COVID-19 pandemic, we've considered what issues contractors and insurance repairs will face, looking at the last year and the twelve months ahead.

2020 has been a difficult time for contractors working in insurance repairs. Falls in profit of between 25- 30% have been reported, and some contractors have noticed large reductions in turnover. Previously we've reported on the cost increases due to dealing with COVID-19 requirements, including:

- Increased costs of managing works – PPE, additional vehicles to site, H&S management
- Extended durations of projects
- Working out how to manage works safely within customers' homes
- Disruption of the labour force and customers, through infection and visits from police, trading standards and the environment agency to sites

There's a view however, that some sectors of construction, including new-build, have paid lip service to properly managing COVID-19 on-site and may not have suffered to this financial extent. We've worked with contractors to ensure that their workforce, customers and insurers reputations have been protected by making sure regulations and guidance have been adhered to.

2021 poses challenges and opportunities. We've highlighted that contractors are already being notified of material price increases well above the general rate of inflation. We expect further increases to be seen throughout the year. Labour costs are likely to rise in line with an increase in demand for skilled labour across all construction sectors, as the effects of Brexit labour movement take effect.

Construction generally will see an uptake in demand. Developers will be turning their attention to converting redundant office blocks into flats, and some contractors have already set up specialist divisions to carry out these refurbishments. The private construction market will remain strong as people are expected to use spare funds saved during lockdowns to spend on home improvements. Government infrastructure projects (HS2, for example) and the Build Back Better Council schemes are likely to accelerate.

Insurance repair may not benefit from these positive moves in the wider market. Cash settlements may be rejected by customers, if they can't find local contractors willing to undertake repairs at the same level as some insurance market rates, pushing more work to contractors with less attractive profit margins. There are likely to be challenges as contractors try and retain their labour force, which may be tempted away by higher wages other sectors can offer. Insurance repair contractors will find a continued flow of repair projects as the cycle of losses continues. Many have also enhanced their operations during the pandemic. For example, contractors have adapted their IT and working arrangements of office staff, which may bring financial benefit. One contractor summed up his view of the coming 12 months – considering the various issues, it *"will make this year one of the most challenging in recent history."*

The challenges are likely to continue for the construction sector beyond 2021, as repayments become due on government initiatives, such as the Coronavirus Business Interruption Loan Scheme (CBILs) and Bounce Back loans. Sadly, it is likely that further liquidations will follow as a result.

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