Building Repair Costs Review

Quarterly Update – Q2 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 of 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 caused unprecedented disruption and pressure on the construction industry – it's now adapting to new ways of working and the future remains very uncertain.

Headlines

- Q1 2020 – we recorded a 1.6% fall in costs, which includes some seasonal variances
- The COVID-19 pandemic has caused a sudden and dramatic recession – for many building firms, activity ceased for several weeks
- Large numbers of operatives had been placed on furlough, through the Government Coronavirus Job Retention Scheme
- Material shortages, PPE and cleaning requirements, together with losses of productive time, are leading to cost increases
- 2020 – we forecast inflation in the insurance repair sector to be c.5-6%

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 decreased over Q1 2020 by 1.61%. This reflects some seasonal adjustments and particular fluctuations in specific items, such as:
Insulation – 34%
Bricks – 13%
Plasterboard – 1%
Cement – no change

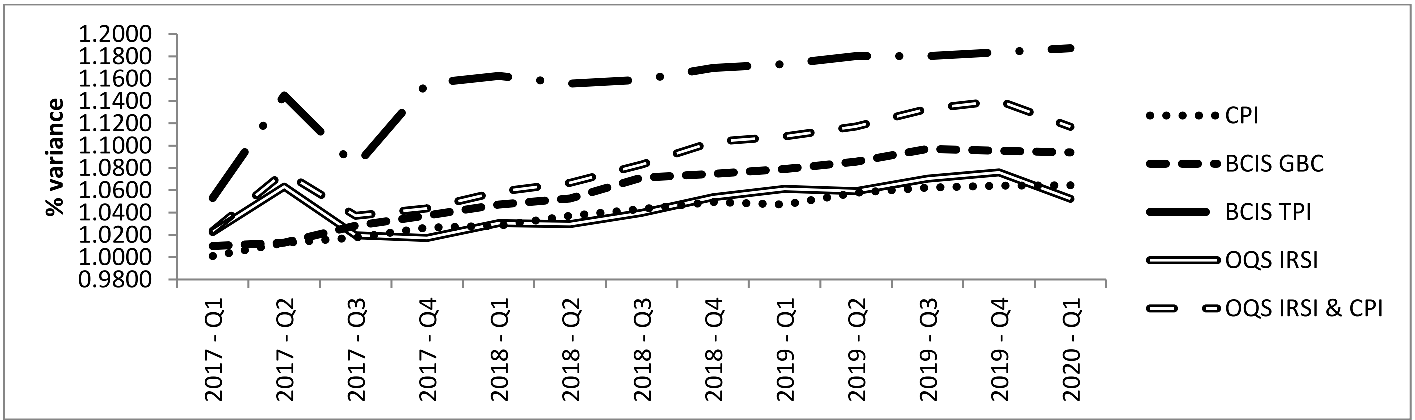
In summary, across the whole basket of items:

- **Materials** costs down by 1.61%
- **Plant** costs down by 4.73%
- **Labour** costs unchanged
- **Waste** disposal costs unchanged

Material costs
Before the arrival of COVID-19, there were already concerns over potential material increases post-Brexit. As highlighted in our previous report, several suppliers issued price increase notices earlier in the year that would be coming into effect during Q2. These increases were attributed to Brexit and above the current level of the Consumer Price Index. We are closely monitoring price changes, following the continued impact of COVID-19 and have already noted increases in some commodities – for example, at the time of writing the cost of plaster had risen by 4%.

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 the continuation of an upward trend in cost.

Table 1 – 2017 to Q1 2020



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.

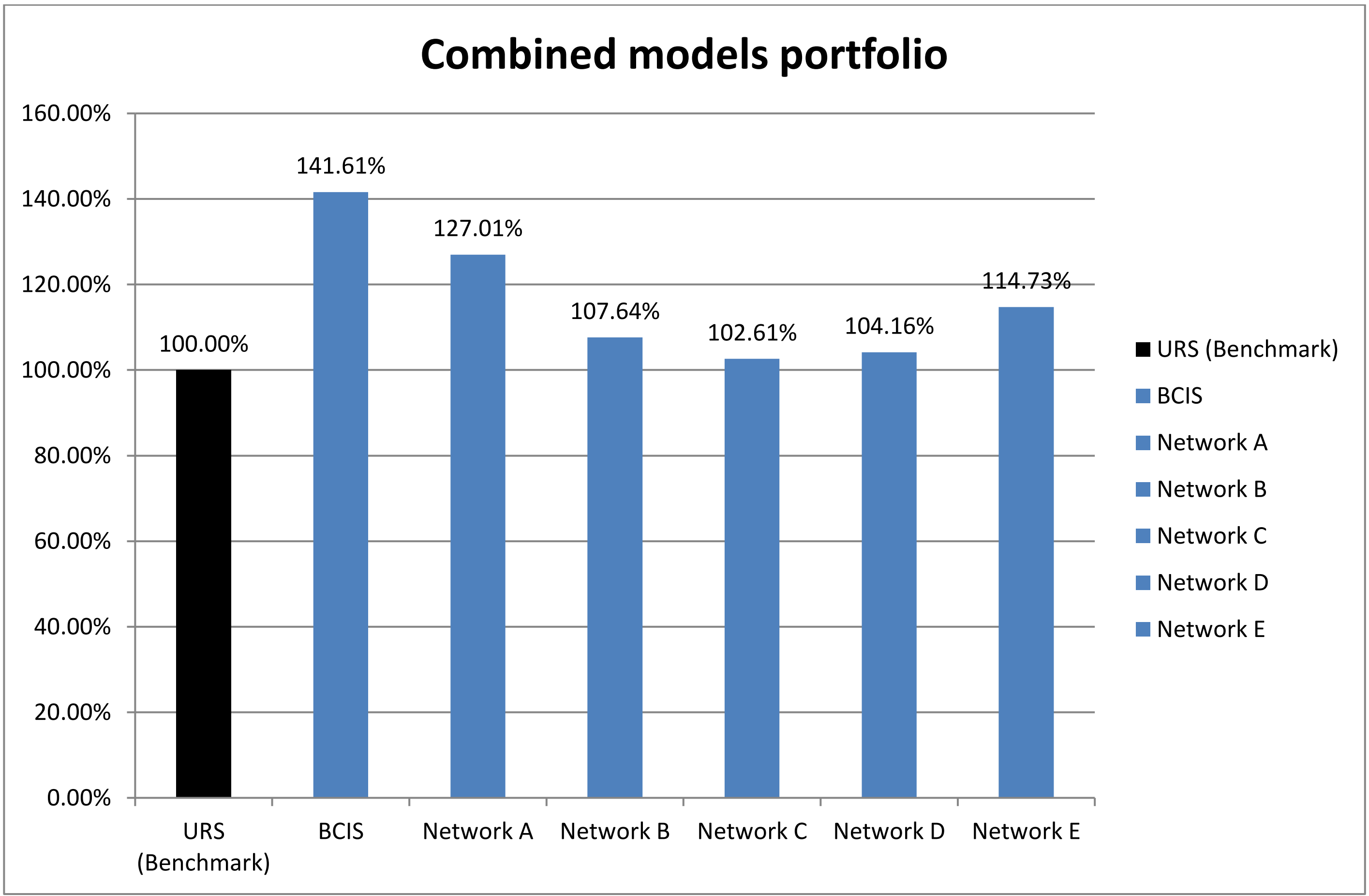
The URS is compared with published rates and those used by other networks in the insurance repair market. This benchmarking exercise combines:

- 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 and clearly shows that the URS remains extremely competitive.

For comparison purposes, URS is shown as 100% with other networks shown as a percentage cost compared to the URS.

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).

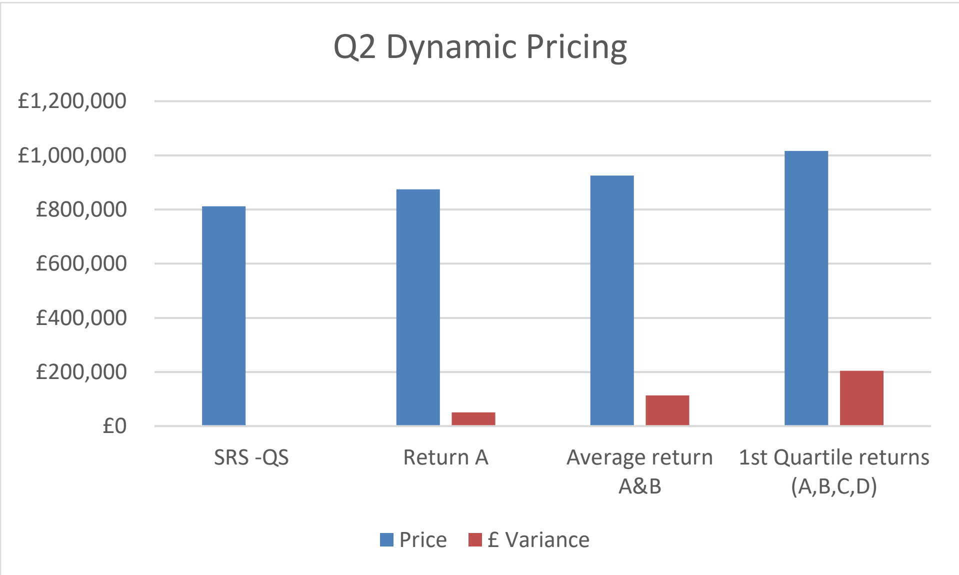
The annual portfolio review involves applying URS rates and rules and comparing the results with tenders received from panel contractors, or the customer's preferred building firm.

The analysis benchmarks the Sedgwick Repair Solutions cost 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	£811,573	£874,840	£925,262	£1,016,535.78
£ Variance		£50,398	£113,689	£204,963.10
% Variance		5.76%	12.29%	20.16%

The exercise demonstrates that, compared to free market tenders, the URS is competitive and is generating a saving of 6% compared to the lowest tendered cost.

Part 4 – cost increases and COVID-19

In Q1, we were considering factors that could affect construction costs in 2020. Two significant issues were highlighted – Brexit and skilled operative shortages. They haven't gone away.

Following the UK's departure from the EU, a period of uncertainty has begun – supply chains are affected and adjusted by trade deals. 64% of construction materials are imported, raising the possibility of increased costs through tariffs or re-pricing by manufacturers. The Office for National Statistics advised that 40% of the construction workforce in London are non-UK nationals and before the pandemic, concerns were raised about the loss of skills that could arise through border regulations. Coupled with that, the UK faces the need to replace an ageing and skilled workforce, following many years of underinvestment in training. We anticipated that cost inflation from these two issues are likely to be around 2%.

COVID-19 effect

The COVID-19 pandemic obviously wasn't anticipated, and the construction industry has been badly disrupted. Following the closing or restricting of workplaces, approximately 1.5m tradesmen were placed on furlough, as sites were forced to shut and the industry entered a rapid recession. Many builders merchants closed depots around the country, and some construction schemes were cancelled, and it's reported that many building firms have entered administration. The Construction Industry Trading Board (CITB) has reduced its levy on contractors to ease the financial burden. In addition to funding the furlough costs, the Government has announced its policy of Build, Build, Build – to stimulate the economy. This involves amending and simplifying the planning system and encouraging house building.

Economists have provided alternate views on a V (quick bounce back) or U (slow return) recessions in construction, considering that investment for future projects either remains available or is withdrawn. Insurance repair, however, isn't subject to all these recession pressures – insurers continue to intend to reimburse repair costs, thereby maintaining demand for capacity in the sector. A contractor who allocates all or a large proportion of their resource to working in the insurance repair market is then probably best placed to survive a construction industry downturn.

New cost pressures on insurance repair contractors are now taking effect. Firstly, material cost increases are slowly being noted, and we expect merchants to introduce COVID-19 related cost increases in the next few weeks. The current problem is a shortage of general building materials as stocks have been depleted. Builders are spending an inordinate amount of time trying to find the materials to complete insurance repairs, which is delaying the completion of some projects. This is best illustrated by an anecdotal example from one of our network contractors, who was trying to secure plaster.

"I chased X [merchant] for the 20 bags we had reserved for week commencing 22.6.20 as hadn't heard anything. They only received half the order they were expecting, which they had to share with another branch, and so we missed out. Although we're still on their list, they think it will be another 5-6 weeks before they have another delivery.

The order we have for 15 bags from Y, that we were hoping would be in this week, won't be. They think it will be Friday 10th before they see their order now, but that is provisional.

I have phoned around again, but it's the same story with all the merchants, they are given dates from the factory, which they are passing onto us, which then don't come to fruition. Unfortunately, all we can do is keep placing the orders and keep our fingers crossed that at some point our reservations of orders will be met. I know this doesn't help with planning of works that require this product, but I'm afraid my hands are tied – I have tried talking nicely!"

Monitoring the impact
The Construction Leadership Council has issued guidance on how safe construction work can be carried out – https://www.constructionleadershipcouncil.co.uk/news/clc-site-operating-procedures-guidance-v5/. This outlines how contractors can travel safely to site, the PPE that needs to be used and measures they need to take to keep sites safe and clean. All these elements impact the resources contractors now have to provide – and comes at a cost.

Secondly, the need for social distancing, safe travel, site cleaning, and amended site working practices, means that operatives' unproductive time has increased. Projects that before the pandemic could be completed in four weeks may now take five. The exact impact isn't yet known and, as with other areas of changing practices, we need to monitor exactly how things evolve.

We've discussed the situations faced with contractors. Some projects had to be suspended in March and then restarted following the easing of lockdown restrictions. The precise nature of any additional costs obviously varies from project to project, often depending on how close they were to completion, but analysis from our QS team suggest the additional costs are likely to be in the region of 5% for typical lower value repairs.

As far as new work is concerned, we're reviewing data and working with contractors to understand the actual costs incurred in this new way of working. We've suggested contingency costs of 3% will be allowed initially, but we're mindful that the real costs incurred could exceed this. Realistically it is difficult to get an accurate feel for this until projects are undertaken, thereby allowing information to be gathered on the actual impact on time and resource.

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