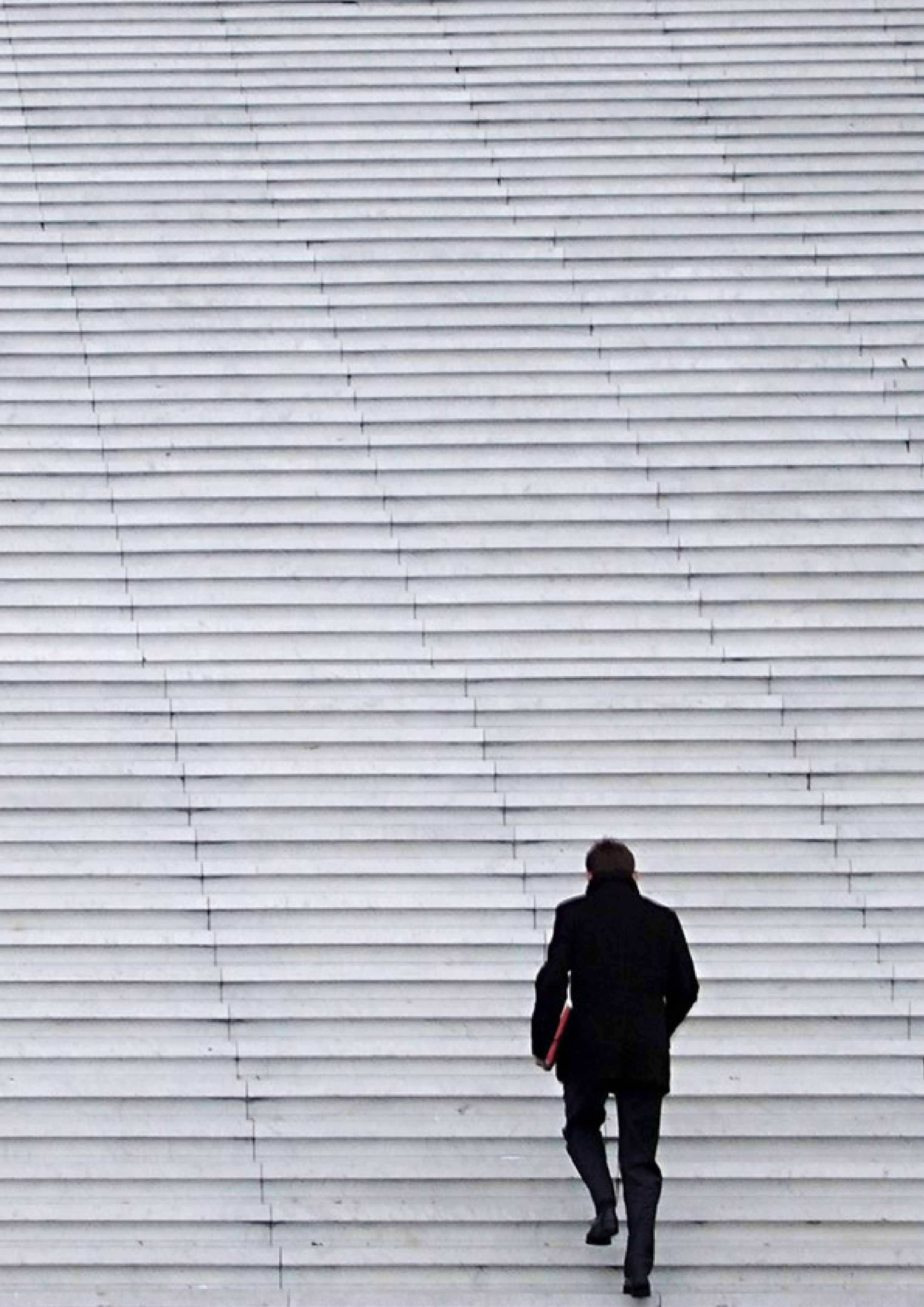
Construction Industry Forecasts 2024-2025

Winter 2023/24 Edition - £250




cpa construction products association



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DISCLAIMER

All construction figures (starts, completions, orders and output) refer to Great Britain.

All output figures are in 2019 constant prices using the historic figures from the Office for National Statistics (ONS) – as at 10 January when the Forecasts were finalised.

All new orders figures are in 2019 constant prices using the historic figures from the Office for National Statistics (ONS).

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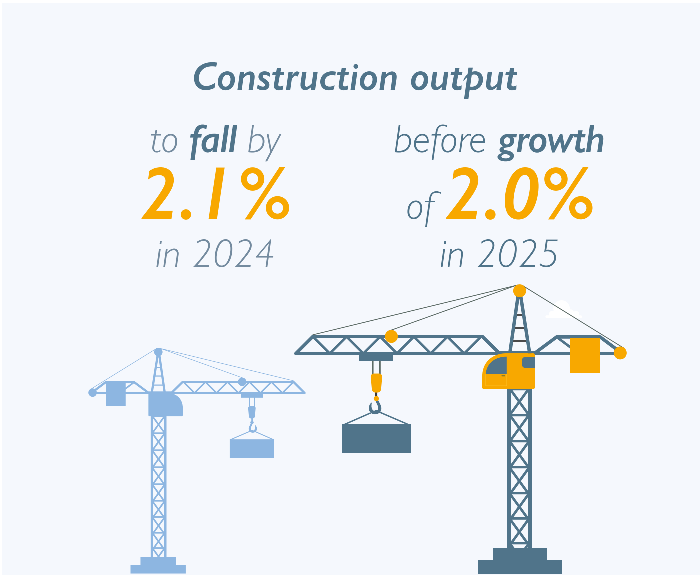
Overview

Construction activity continues to endure a challenging environment with sharp falls in private housing new build and repair, maintenance and improvement (rm&i) during 2023 now expected to extend into 2024, with recovery now only anticipated in 2025. Construction output is forecast to fall by a further 2.1% after last year's decline before growth of 2.0% next year, leaving output at the end of 2025 still 6.5% lower than at the beginning of 2023. Output levels remain strong in the infrastructure and industrial sectors after reaching their highest levels on record in 2021 and 2022 respectively but, even here, activity is expected to continue to fall away from peak levels this year. In terms of key risks to the forecasts, on the positive side UK economic prospects are looking slightly brighter than in forecasts over the past year suggested as inflation slows and interest rates slightly fall earlier, which could ease the challenges in the housing and rm&i sectors. Conversely, on the negative side, supply issues could once again become an issue for imported products if blockages in the Red Sea persist.

In terms of the UK economy, previous forecasts have highlighted that the UK economy has largely been flatlining, despite a strong labour market and wage growth, primarily due to stubborn inflation. CPI inflation in Autumn slowed considerably more than macroeconomic forecasters were anticipating although the risk of it remaining stubborn in Winter remains. Directly, the broad trend of slowing inflation is likely to boost household incomes and spending but, indirectly, the greater boost to the economy will come from the Bank of England lowering interest rates earlier than anticipated. In addition, measures in the government's Autumn Statement aimed at cutting National Insurance, raising the National Living Wage and 'full expensing' should boost consumer spending and business investment respectively over the forecast period.

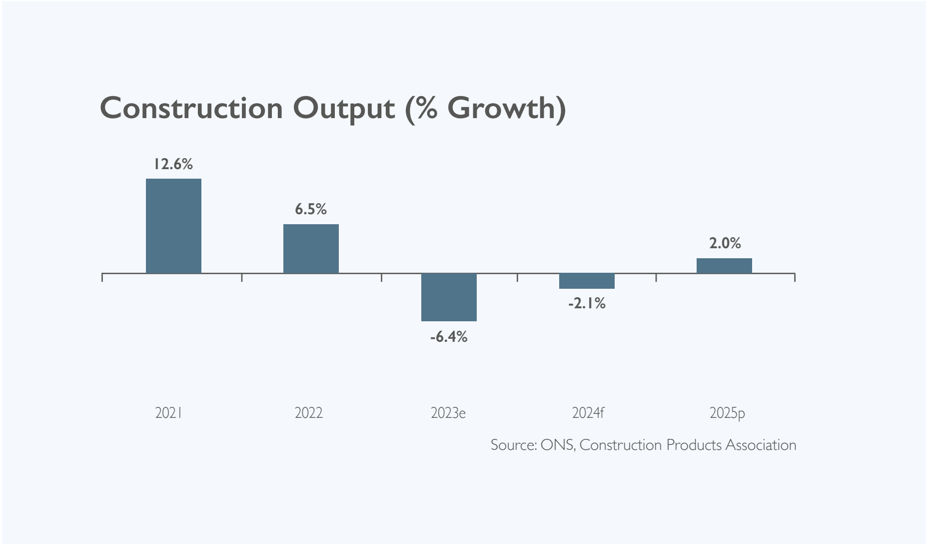
The key problem for construction is that whilst economic activity has been flatlining, construction activity has fallen away significantly due to sharp falls in the two largest sectors, private housing and private housing rm&i. Both these sectors appear to have hit their nadir in the second half of 2023, significantly



Key Points

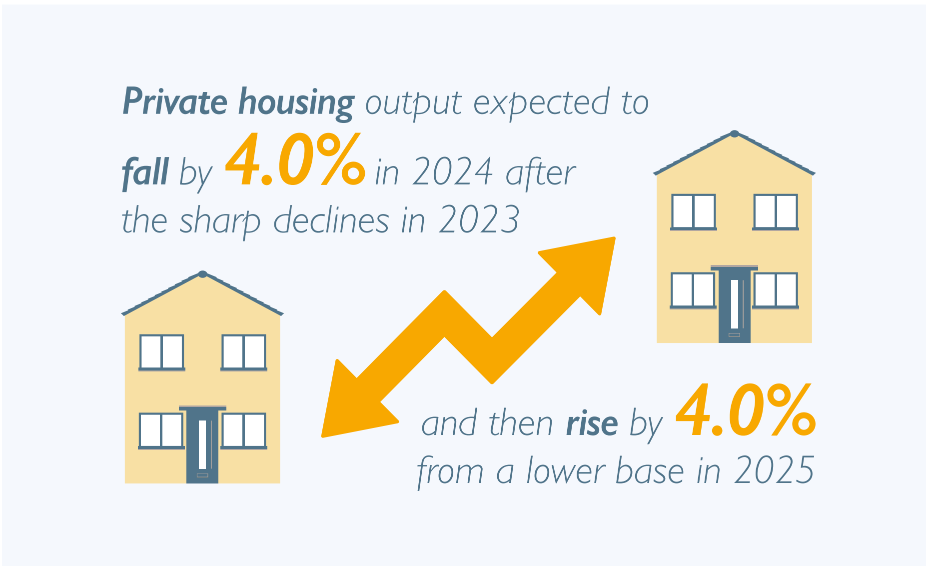
- Construction output falls by **2.1%** in **2024** and rises by **2.0%** in **2025**
- Private housing output falls by a further **4.0%** in **2024** and rises by **4.0%** in **2025**
- Private housing repair, maintenance and improvement to fall by **4.0%** in **2024** before rising by **3.0%** in **2025**
- Infrastructure output to fall by **0.5%** in **2024** and rise by **1.2%** in **2025**
- Industrial output to fall by **7.5%** in **2023** and by **3.6%** in **2025**

lower than in the first half of the year. The key question, however, is how long it will remain at that level. If activity in private housing and rm&i remains at 2023 H2 levels in the first half of year then it will already be significantly lower than a year earlier. So, if output continues at 2023 H2 levels for the whole of 2024, then construction output would be lower than in 2023 due to a full year at this low point at the bottom of a U-shaped recovery curve.



Total construction output is forecast to fall by 2.1% in 2024, which is a revision down from the -0.3% in the Autumn forecast whilst output is forecast to rise by 2.0% in 2025, a slight upward revision from the 1.8% previously forecast three months ago. Within the overall forecast figures for next year, there are mixed fortunes across the different sectors but the key driver of changes to the 2024 forecast for total construction output is a downward revision to both private housing new build and rm&i from flat to -4.0% in both private housing and private housing rm&i as the effects of falls in property transactions in 2023 H2 and 2024 H1 have a knock-on effect onto housing activity. There are both positive and negative risks to the forecast for the UK economy and construction given the number of political and economic uncertainties currently. As a result, alongside the forecast it is important to note the CPA's Key Risks as well as the Upper Scenario and Lower Scenario, in addition to the forecast.

Private housing is the largest construction sector worth £41.1 billion in 2022 and it has been though an extremely volatile period over the last 18 months. As recently as Summer 2022, demand in the housing market and house building sectors remained strong. However, the housing market was already slowing down from the volatile peaks of 2020 H2 and 2021 after the end of Help to Buy, the stamp duty holiday and the 'race for space', especially given gradual increases in interest rates and mortgage rates. However, after the government's Mini Budget in September 2022, there was an initial spike in mortgage rates in 2022 Q4 and collapse in mortgage approvals, which started to fade as the government reversed its Mini Budget policies and there was a slight improvement in mortgage rates and the housing market in 2023 Q1, giving some optimism briefly to house builders. However, with the Bank of England raising interest rates again in Summer 2023 and consequently, mortgage rates spiking again in August 2023, housing market demand and house builder activity fell



Construction Output

e = estimate, f = forecast, p = projection

Source: ONS, Construction Products Association

sharply. Mortgage rates have been falling gradually since then as hopes have risen that the Bank of England will reduce interest rates from 5.25% on several occasions and at the end of 2023 mortgage approvals started to recover. Despite this, house builders have found that demand has fallen by around 25-35%. This unduly affects starts as house builders in a declining market focus on completing existing developments and cutting costs rather than starting new developments. There are exceptions, in some very selected hotspots where demand has been maintained or for affordable housing, where demand has not dropped off as many first-time buyers switch to shared ownership properties given a lack of affordability due to both high deposits and mortgage payments in the private market. Some of the major house builders have benefitted from cash buyers and bulk (investor) purchasers but these are niche parts of the housing market and have not been sufficient to offset the sharp fall in wider demand. In addition to the demand-side issues, house builders still face issues regarding planning, which unduly affects smaller house builders, plus the water and nutrient neutrality issues remain almost five years on despite government attempting to deal with it on countless occasions. One bright spot, however, is that house builders are finding that cost inflation is moderating considerably, which, given that house prices have not fallen significantly on new build as yet, is helping to sustain margins despite the

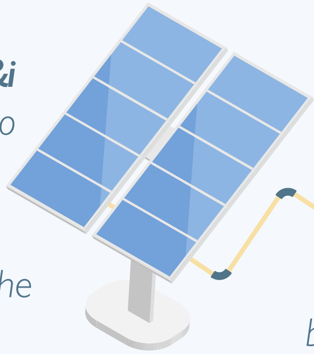
Public & Private Sector Construction Output

£ million	2021	2022	2023	2024	2025
Change on previous year	Actual	Actual	Estimate	Forecast	Projection
Public Sector inc. PFI	41,369	40,084	40,048	39,786	40,519
	9.0%	-3.1%	-0.1%	-0.7%	1.8%
Private Sector	129,094	141,436	129,900	126,651	129,179
	13.7%	9.6%	-8.2%	-2.5%	2.0%
Total Construction	170,463	181,520	169,948	166,437	169,698
	12.6%	6.5%	-6.4%	-2.1%	2.0%

Source: ONS, Construction Products Association

sharp fall in demand, although house builders are increasingly having to use incentives to sell at those prices. After the double-digit fall in output last year, private housing output is forecast to fall a further 4.0% this year before growth of 4.0%, from a lower base, in 2025.

Private housing rm&i *anticipated to* ***decline*** *by* ***4.0%*** *in 2024 after the falls in 2023*



and then ***rise*** *by* ***3.0%*** *from a lower base in 2025*

Private housing repair, maintenance and improvement (rm&i) is the second largest construction sector worth £28.7 billion in 2022 after reaching historic high levels at the end of 2021 and in early 2022. This growth was primarily due to the 'race for space' boosting improvements work, which is the part of the sector that historically provides growth or endures contractions given that the majority of repairs and maintenance work cannot be delayed for a prolonged period. The sector saw a sharp fall away from Spring 2022 due to a contraction in smaller improvements work as the rising cost of living made many homeowners either reprioritise constrained spending or become more risk averse and focus on saving rather than discretionary spending. Larger projects activity was broadly maintained in 2022 as homeowners already had planning approval, savings built up to fund the projects and contracts in place with concerns that pauses to projects due to uncertainty would just lead to further cost rises. However, simultaneously, new contracts for larger improvements work posted double-digit falls and, consequently, this led to a fall in larger improvements projects in 2023. Going forward, smaller project work is likely to continue to remain flat in the first half of the year whilst larger project work contracts before both see positive growth in 2025 as conditions for households and the wider economy improve. Outside of this, activity on energy-efficiency retrofit, primarily insulation, and solar photovoltaic work, remains strong and is expected to be sustained over the forecast period whilst government initiatives such as ECO4, GBIS and the BUS will add slightly to activity in the sector but are unlikely to cause a major uplift given their scale. In addition, cladding remediation continues to provide a steady stream of activity and is likely to do so into the long-term. Overall, private housing rm&i output is expected to fall by 4.0% in 2024 before growth of 3.0% in 2025.

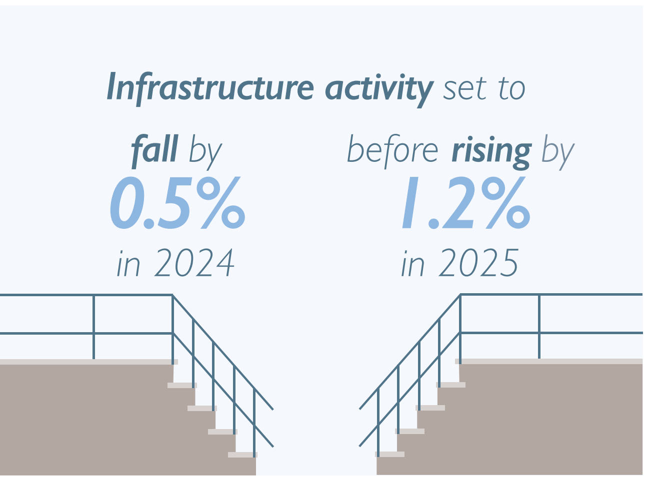
Infrastructure is the third largest construction sector and was worth £27.6 billion in 2022. Despite the most recent increases in cost estimates of HS2 Phase One by between £8 billion and £10 billion to a total of up to £66.6 billion and, further cost rises expected down the line, activity continues apace. Work also continues on the two other major projects down on the ground, Hinkley Point C and the Thames Tideway Tunnel. Frameworks activity in the regulated sectors of roads, rail, water and electricity provides sustained and relatively stable levels of activity in the infrastructure sector too. Concerns remain, however, over pauses and delays to National Highways projects in RIS2. In addition, there are increasing questions regarding whether plans to urgently increase capital expenditure in the water sector to deal with water quality issues are deliverable given water companies' intentions to accelerate delivery on 31 investment schemes between 2023 and 2025, especially in the light of potential financial issues for Thames Water. Furthermore, at a local level, councils are financially constrained and despite government announcing £8.3 billion of funding for potholes, resurfacing and roads projects to 2034, there is little evidence to suggest that this will lead to any uplift over the forecast period. There also remain questions over whether the capacity is there to ramp up activity quickly given skills and products constraints. As a result, this is not built into the main forecast for water & sewerage or roads. Overall, infrastructure output is expected to fall by only 0.5% in 2024 before rising by 1.2% in 2025.

The **commercial** sector was worth £21.7 billion per year in 2022. London accounts for almost one-third of the commercial construction sector and the Deloitte London Office Crane survey published in December 2023 pointed to rapid growth in refurbishment work during 2023 that is likely to continue with detailed planning approvals in 2023 Q3 that were 12% higher than in Q2 and 32% higher than a year earlier. In addition, Deloitte also reported in December that in the six months to September 2023 there was the highest volume of schemes for almost 20 years, with 5.1m sq. ft of new construction started in London but, conversely, London's office vacancy rate was 9.9% in 2023 Q3 and CoStar reported in November that the £2 billion of investment in London office properties recorded in 2023 Q3 was 20.0% lower than a year ago and considerably lower than pre-pandemic levels. Overall, the recent information points towards a similar view to Autumn, in which commercial activity remains buoyant for the fit-out and refurbishment of existing office space as demand for grade A office space remains strong. The conversion of existing commercial developments into residential or industrial and logistics also continues to be strong as well. In addition, activity on data centres and biotech facilities is also robust. The majority of work in the commercial sector, however, has traditionally been on commercial towers. There are a few large projects in the pipeline, certainly more than was the case in 2021, but the number of new towers projects remains lower than pre-pandemic and one-third lower than when the new commercial construction market peaked in 2017. Furthermore, rising financing costs due to interest rate rises both in the UK and globally are acting as a hindrance for new, large investment in commercial towers projects. As a result, the future of the sector near-term will be in the fit-out and refurbishment as well as conversions. Longer-term, the potential for 'stranded assets' as minimum energy-efficiency standards are introduced for commercial properties will continue to drive fit-out and refurbishment as well as conversions. Overall, commercial output is forecast to fall by 2.9% in 2024 due to a lack of new towers activity offsetting new work on fit-out and refurbishment of existing commercial developments. Next year, output is now forecast to rise by 0.9% due to the impacts of interest rates falling on financing new offices and better economic prospects fuelling a slight recovery in towers construction.

Latest Information

Overall, since the CPA's last forecasts three months ago, firms across the supply chain report activity unsurprisingly slowed towards the end of 2023 as the industry entered the Winter shutdown. Firms also reported that it was a slow start in the first half of January due to extended holidays for some households and, especially, due to poor weather with persistent rain and flooding in some areas of the UK.

Within public housing, housing associations report affordable housing demand still remains strong but that their priorities continue to be on dealing with basic living conditions, building safety and decarbonisation on their existing stock, as highlighted in previous forecasts. In private housing, house builders reported that demand since Autumn 2023 has fallen by up to one-third overall and, as a result, their focus remains on completing existing developments and cutting costs rather than starts. However, they are now more optimistic than 3-6 months ago that demand may recover earlier if interest rates fall significantly from Spring 2024. In addition, they are also hopeful that the Chancellor's Budget in March will see policies aimed at enabling demand in the housing market such as, potentially, extended (25-year) fixed-rate mortgages or 99% LTV mortgages although this would still take time to have a significant impact on mortgage approvals. Infrastructure activity remains strong on both major projects and large frameworks according to firms down on the ground



despite all the negative noises and mixed messages from government although firms working on roads projects are increasingly concerned about projects being pushed back from RIS2 to RIS3 and there is currently little evidence of the potholes funding helping to boost local authority roads activity. Public non-housing has slow progress on the School Rebuilding Programme and the New Hospital Programme. Slower client decision-making is currently delaying new projects in both sub-sectors according to the supply chain although activity is likely to speed up on both programmes as schools and hospitals with Reinforced Autoclaved Aerated Concrete (RAAC) are prioritised for renewal works. Industrial demand for larger projects in both warehouses and factories appears to have fallen away sharply, albeit from a large spike in activity a year ago, but there remains an array of smaller warehouse projects on the ground and in the pipeline. Commercial activity remains strong for fit-out and refurbishment whilst conversions to residential in urban centres or industrial and logistics activity on the edge of cities also remains high. In addition, activity on data centres and biotech facilities is buoyant. New commercial towers projects and large commercial developments such as film studios, outside of the capital appear to have paused due to financial viability concerns given the increase in construction and financing costs. Firms in public housing rm&i report that activity continues to rise due to housing associations and local authorities focusing on basic living conditions, building safety issues and decarbonisation, which has taken finance away from their previous new build plans. Private housing rm&i activity fell away in particular in the second half of 2023 and it remains subdued with a very slow start to work in the new year. This may be partly due to the poor weather and so firms are anticipating that there may be a significant pickup in activity in February and March if weather and household finance allows. Insulation and other energy-efficiency work continues to be buoyant and there is little sign of this falling away near-term.

Construction output in November 2023 was 0.2% lower than in October and still 0.9% higher than a year earlier plus 5.8% higher than in January 2020, pre-pandemic, according to the Office for National Statistics (ONS) but the CPA continues to highlight the persistent overestimation issues in the ONS construction output volume data since Spring 2022. The concerns affect output in most construction sectors but, in particular, appear to affect the housing and repair and maintenance sectors.

Private housing output in November was 3.9% lower than in October and 20.1% lower than a year earlier according to the ONS. Year-to-date, the ONS reports that private housing output in 2023 was 11.1% lower than a year earlier but, other data, such as product sales that feed into house building point towards a considerably greater fall in private housing activity. For example, UK brick sales year-to-date in 2023 were 29.5% lower than a year earlier. Furthermore, reports from some major house builders such as Persimmon point towards completions being between 27% and 33% lower than a year earlier.

The issue of the ONS construction output data being overestimated is most visible in the private housing repair, maintenance and improvement (rm&i) data. According to the ONS, private housing rm&i output in November was 0.8% higher than in October and 9.4% higher than a year earlier plus it was 49.5% higher than in January 2020, pre-pandemic, at its highest level on record. This is not in line with what is reported by firms operating in the sector (SME contractors, builders merchants and product manufacturers).

The issue in the ONS r&m volume of output data mainly appears to occur as the ONS is underestimating price inflation in r&m, which it uses to deflate construction output value and turn it into volume of output. As it is underestimating price inflation, it is overestimating volume of activity. To illustrate this, inflation in new housing peaked at 12.2% after the spikes in energy and commodity prices in 2022 according to the ONS (when construction materials price inflation peaked at 26.8%). The ONS, however, estimated that inflation in housing r&m peaked at only 5.9% whilst firms in the sector (SME contractors, merchants and manufacturers) stated to the CPA that inflation in the sector was more than double the ONS estimate. As a result, the ONS has been consistently underestimating price inflation in r&m since Spring 2022 and overestimating the level of r&m output. However, the ONS may also have a survivor bias problem in that it surveys 8,000 firms per month and grosses up to get the whole industry view. If it uses the same factor to gross up for the industry view, as there has been a sharp rise in insolvencies then it is overestimating activity due to it surveying the firms still surviving and assuming that they represent the same proportion of the industry as one year earlier despite the insolvencies. The ONS has told us that it is now looking into these potential issues.

Infrastructure output in November was 1.9% lower than in October and 2.7% lower than a year ago according to the ONS. Activity remained strong on both major projects and large frameworks down on the ground despite government announcements earlier in the year of projects in the pipeline being paused and delayed. Activity on these major projects and frameworks has driven recent activity although the paused and delayed projects have restricted growth in the sector as previous projects finish and are not replaced at the same rate. A rising number of local authorities are, as highlighted previously, switching finance away from new projects to rm&i and also reducing infrastructure budgets due to financial constraints and the rising costs of social and health care.

Industrial output in November was 0.2% higher than in October but 12.9% lower than a year ago according to the ONS as activity continues to fall from its highest ever level early in 2023. Activity still remains strong by historical standards for warehouses and logistics. New investment has peaked already and output will continue to fall due to a lack of larger projects but smaller new projects continue to come through. Factories activity from investment decisions made in 2021 has largely now finished and activity down on the ground has already been slowing since 2022 Q4. Factories projects that finished last year were not replaced at the same rate as manufacturers' investment decisions in Autumn 2022 were put on hold due to the economic and political uncertainty following the Mini Budget last year.

Commercial output in November was 1.8% lower than in October but 5.5% higher than a year earlier with activity still strong on the fit-out and refurbishment of existing commercial developments whilst conversions to residential in urban centres or industrial and logistics activity on the edge of cities also remains high. Activity on data centres and biotech facilities remains strong but there remain relatively few new commercial towers projects and new large commercial developments outside of a few high-profile projects in London whilst some of the new large entertainment (film studios) projects in counties surrounding Greater London have been put on hold due to financing and construction cost concerns.

In terms of construction new orders, which only cover new construction work, in 2023 Q3 the volume of new orders was 3.9% lower than in Q2 and 20.0% lower than a year earlier. Construction new orders have been falling for four consecutive quarters since the Government's Mini Budget at the end of September 2022 and in 2023 Q3 new orders were 7.8% lower than the average level in 2019 (although note that orders in 2019 were affected by economic and political uncertainty due to the postponed Brexit deadlines and General Election) and 17.7% lower than the average level of orders between 2015 and 2018.

New orders by sector can be volatile on a quarterly basis and distort the forward looking picture given that different sectors have different lags between order and activity down on the ground but looking at the four-quarter total to 2023 Q3, orders were 14.1% lower than a year earlier with falls across most sectors but the most pronounced were in infrastructure (-25.6%), private housing (-13.1%), commercial (-16.1%) and industrial (-15.1%). The only increases in orders were in public housing (21.3%) and public non-housing (0.4%).

Looking at the latest survey data, UK construction activity fell in December 2023 according to the latest S&P Global UK Construction PMI data (46.8) but it fell at a slower rate than in November (45.5) where 50=no monthly change (and below 50 represents a decline in activity).

Unsurprisingly, the fall in UK construction activity in December was mainly driven by further falls in house building but civil engineering and commercial construction activity also fell. The S&P Global UK Construction PMI for housing was 41.1, another sharp fall in house building, as house builders continued to focus on completions for the subdued level of demand after the mortgage rates rises that have priced out many new buyers. For major house builders, cash buyers and bulk (investor) purchasers have had a slight offset to the sharp fall in demand particularly from first-time buyers, but the broader decline in housing market demand means that house builders are not starting new developments in the main and continue to focus on the low level of completions and cost minimisation.

Civil engineering activity in December was 47.0 according to the S&P Global PMI, so a further decline, albeit a slower fall than the previous month. Despite strong activity on major projects such as HS2 Phase One and Hinkley Point C, plus relatively stable work on long-term frameworks in regulated sectors, the majority of infrastructure work is on smaller and medium-size schemes where new project pauses, delays and cancellations hinder activity as previous schemes finish. This is particularly the case for local authorities, which are financially-constrained as finance gets redirected to more urgent areas such as social care. UK commercial construction activity in December fell (47.6) although it was the slowest fall of all the sectors.

Overall in the UK Construction PMI, construction new work fell in December and it has been falling since August, which points to further falls in construction activity in 2024 H1 (especially in house building). But, according to the PMI in December, around 41% of the survey panel anticipated an increase in business activity overall in 2024 whilst only 17% expected a decline. However, it is difficult at this stage to see whether this is optimism bias given that construction activity in the 2023 Q1 had not fallen sharply, so if activity continues throughout this year at 2023 H2 levels then, overall in 2024, activity will be lower than in 2023 just by the arithmetic of the annual percentage change alone.

Construction Industry Forecasts - Winter 2023/24

	2021	2022	2023	2024	2025
% annual change	Actual	Actual	Estimate	Forecast	Projection
Housing					
Private	37,176	41,131	33,316	31,983	33,263
	16.4%	10.6%	-19.0%	-4.0%	4.0%
Public	4,713	5,227	5,122	4,610	4,841
	-0.5%	10.9%	-2.0%	-10.0%	5.0%
Total	41,889	46,358	38,439	36,594	38,104
	14.2%	10.7%	-17.1%	-4.8%	4.1%
Other New Work					
Public Non-Housing	9,493	8,602	8,615	8,762	8,945
	-1.3%	-9.4%	0.2%	1.7%	2.1%
Infrastructure	27,777	27,621	27,306	27,176	27,502
	27.4%	-0.6%	-1.1%	-0.5%	1.2%
Industrial	4,761	6,773	6,930	6,407	6,176
	1.2%	42.3%	2.3%	-7.5%	-3.6%
Commercial	21,986	21,749	21,408	20,787	20,971
	-7.3%	-1.1%	-1.6%	-2.9%	0.9%
Total other new work	64,017	64,745	64,259	63,132	63,595
	7.0%	1.1%	-0.8%	-1.8%	0.7%
Total new work	105,906	111,103	102,698	99,726	101,698
	9.7%	4.9%	-7.6%	-2.9%	2.0%
Repair and Maintenance					
Private Housing RM&I	25,488	28,703	25,546	24,524	25,260
	25.7%	12.6%	-11.0%	-4.0%	3.0%
Public Housing RM&I	7,200	7,064	7,347	7,493	7,643
	6.2%	-1.9%	4.0%	2.0%	2.0%
Private Other R&M	14,584	16,973	16,803	17,139	17,482
	16.3%	16.4%	-1.0%	2.0%	2.0%
Public Other R&M	5,777	6,112	5,990	5,990	6,050
	10.9%	5.8%	-2.0%	0.0%	1.0%
Infrastructure R&M	11,508	11,565	11,565	11,565	11,565
	13.7%	0.5%	0.0%	0.0%	0.0%
Total R&M	64,557	70,417	67,250	66,711	68,000
	17.5%	9.1%	-4.5%	-0.8%	1.9%
TOTAL ALL WORK	170,463	181,520	169,948	166,437	169,698
	12.6%	6.5%	-6.4%	-2.1%	2.0%

Source: ONS, Construction Products Association

Key Risks

Red Sea Disruption

2023 ended with disruptions to trade and supply chains after security issues in the Red Sea. To avoid attacks on vessels in the Gulf of Aden and the Red Sea, shipping companies are avoiding the Suez Canal route, which handles around 12% of global trade, and rerouting vessels around the Cape of Good Hope with delays of around 7-14 days. Almost half of vessels in January have so far been rerouted.

At this stage, the CPA has not seen major impacts on construction product supply as yet but it is still too early to see the effects. Clearly, if disruptions persist, it will significantly affect some imported products through the delayed supply and rises in freight prices (that have already risen in less than a month from $1,467 for a 40ft container from China to Northern Europe on 15 December 2023 to $4,758 on 12 January 2024 according to Freightos). It is worth noting that the majority (76%) of products used in UK construction are made in the UK and so are largely unaffected, unless components in machinery used to make the products are affected. From the 24% of construction products that are imported, two-thirds are from EU countries so are also largely unaffected. However, the country that the UK imports the most construction products from is China and imports from Asia will be affected, especially products such as electrics, white goods, lighting, kitchen and bathroom products, ironmongery and plywood.

UK construction products prices have been falling recently and in November were 2.3% lower than a year ago so the situation is different to when the Evergiven blocked the Suez canal, which occurred at a time when there were already supply issues. Now, products supply is not an issue. However, construction products prices are still 38.5% higher than in January 2020, pre-pandemic. Many small house builders and contractors are also suffering from the falls in private housing and rm&i demand whilst UK contractor insolvencies are already at their highest levels since the financial crisis. So, if disruptions persist in the Red Sea, this could lead to supply issues for some products and construction product price rises again, exacerbating problems for house builders and contractors in 2024.

UK Economic Growth and Inflation

As highlighted in the CPA's previous forecasts, UK economic activity continues to be volatile on a monthly basis and flatline on a quarterly basis, a surprise on the upside given that interest rate rises were initially anticipated to lead UK GDP to fall in the second half of 2023. Households have used savings accumulated during the pandemic to finance spending and to sustain higher mortgage payments. As these savings are decreasing, the concerns is whether households can continue to sustain spending, particularly in 2024 with a weaker labour market and as more mortgage holders come off low fixed-rates onto higher rates.

UK CPI inflation fell to 4.6% in October and there was a more significant slowdown in inflation in November. CPI inflation slowed to 3.9% in November compared with the consensus forecasts of 4.3%. The slowdown in inflation in Autumn pointed strongly towards the Bank of England interest rate being cut earlier than forecasters had expected but, given that both the Bank and financial markets have been reacting strongly to each monthly inflation data point, interest rates remaining at peak for longer cannot be ruled out and would adversely affect consumer spending and business investment. This was underlined by inflation in December, in which CPI rose marginally from 3.9% to 4.0%.

UK General Election

The CPA does not forecast political outcomes for General Elections or model different political scenarios. However, analysis of time series over the past 30 years suggests that general elections do not significantly affect the UK economy. However, the election does provide both potential positive and negative risks. The CPA assumes an election will take place in Autumn 2024 with a clear majority and although there may be a hiatus in project and programme signoffs prior to an Election, it is not expected to impact activity significantly due to projects already down on the ground.

Any stimulus for the UK economy or for construction in advance of a General Election would have needed to have been announced last year, either in the Budget or at the latest in the Autumn Statement, to have a practical effect on households, firms and the economy prior to an election. As a result, although there may be an array of announcements in Spring Budget 2024, they are likely to be more focused on public relations than on practical impacts or be policy, reviews and strategy for the longer-term that could be paused or reversed if there were to be a change in government.

If there is a new government, public sector investment would be unlikely to change significantly over the forecast period as it would take time to assess the fiscal situation, develop financially viable plans and implement them. The most recent example of a government having been in power for a considerable period of time, implementing an austerity package and then being replaced with a new government that increased capital investment considerably was in 1997 but even then it took till 2000 before capital expenditure increased significantly.

The Availability and Cost of Labour

Given that overall construction materials price inflation is now falling (albeit with materials prices remaining high), the greatest issue facing UK construction industry medium-term will be the skills shortages and the large number of construction workers that have left the industry. UK construction employment in 2023 Q2 was 1.1% higher than in Q1 but 2.4% lower than a year ago and 11.3% lower (274,000 fewer construction workers) than at the recent peak in 2019 Q1. It is worth noting that UK construction still hasn't seen the full impacts of the 20-25% fall in private house building (the largest construction sector) demand on employment as house builders were focused on completions. As a result, the full effect of the sharp decline in starting new private housing developments will affect activity and employment in the second half of 2023 and 2024 H1. The drop in UK construction employment since 2019 Q1 also does not include the effect of government's announcements in Spring 2023 of delays, pauses and cancellations to roads and rail projects that will also affect employment over the next 12-18 months.

It is worth highlighting that the largest loss in construction employment since the recent peak in 2019 Q1 has been in self-employment, primarily older age-demographic workers in specialist trades. Self-employment in construction in 2023 Q2 was 0.9% lower than a year ago but 20.9% lower (over 200,000 fewer self-employed UK construction workers) than in 2019 Q1. What this means is that, overall, UK construction lost 274,000 workers between 2019 Q1 and 2023 Q2 whilst apprenticeship starts averaged 31,000 per year in the last five years according to CITB and the dropout rate is over 40%.

As the CPA has consistently been highlighting, the UK construction workforce has an age-demographic problem but, critically, the age-demographic problem has been rapidly accelerating since 2019 Q1 based on the latest detailed breakdown of the construction employment data from the Office for National Statistics (ONS). This is particularly apparent in the UK-born workforce, with a spike in employment in the 50-64 age range that means construction will lose over 500,000 workers (over one-quarter of the workforce) in the next 10-15 years.

The age-demographic problem has accelerated since 2019 Q1 (the recent peak) and 2023 Q2. There has been a loss of over 250,000 workers in just over four years. The UK-born workforce main losses were between 45 and 59 years old. The EU worker losses have been between 20 and 29 years old and 35 and 39 years old, with EU workers going to home countries or other countries where activity remains strong plus those who return to the EU after projects finish haven't been replaced in the normal churn as employer-sponsored visa requirements make it more difficult, particularly for self-employed workers.

Given the loss of construction workers and as construction apprenticeship starts averaged 31,000 per year in the last five years but with a dropout rate over 40%, new entrants will not address the issue. And, without a skilled construction workforce then 300,000+ homes per year, Levelling Up, transition to Net Zero and £600 billion infrastructure pipelines will be very difficult to achieve.

Materials and Products Prices

UK construction materials prices in November 2023 were 2.3% lower than a year ago according to the ONS as materials price inflation continues to slow, a year and a half on from the spike in energy, commodity and materials prices when materials inflation peaked at 26.8% in June 2022 after Russia's invasion of Ukraine. Materials inflation has been falling for six consecutive months as a slowdown in housing new build and improvements activity has led to further falls in demand for construction materials. Looking forward, subdued house building and improvements demand will continue to lead to deflation although this may be offset by price increases in some products on 1 January as rises in energy costs over Winter feed through and a fall in imports of other products over Winter, especially imports of some products that have had significant price falls over the past year such as timber.

Building materials inflation in November was **-2.3%**

As UK construction materials annual inflation has been falling, it is unsurprising that materials prices on a monthly basis have been falling for six months but materials prices remain at high levels and in November 2023 materials prices were still 38.5% higher than in January 2020, pre-pandemic, which continues to have cost implications for fixed-price projects signed up to years before, especially for smaller specialist sub-contractors, particularly those who are also under pressure from some major house builders and main contractors to cut prices.

Although construction materials prices fell by 2.3% in the year to November 2023, the prices of some materials are still rising at double-digit rates whilst the prices of other materials are falling at double-digit rates so how house builders and contractors find the impacts of the changes in construction materials prices on their cost base will depend on the product-mixes that they are primarily using. The fastest rates of UK construction materials price rises in the year to November 2023 were in Doors and Windows (17.5%), Ready-mixed Concrete (14.6%), Kitchen Furniture (12.2%), Pre-cast Blocks (8.7%) and Electric Water Heaters (6.0%).

Conversely, the sharpest annual falls in materials prices in the year to November 2023 were primarily in steel-related products such as rebar (-24.4%) and fabricated structural steel (-22.0%) as well as timber-related products such as imported softwood (-12.0%) and imported plywood (-8.2%).

It is important to note, however, that the reason that the sharpest annual declines have been in steel-related and timber-related product prices is that their prices peaked higher than other materials and, for timber, prices peaked earlier than other materials due to supply chain issues in 2021, before the energy and commodity price spikes in 2022. So, even though the prices of steel-related products and timber-related products are falling at double-digit rates, they still remain high because they are coming from a high peak. For instance, rebar prices in November were still 46.3% higher than in January 2020, pre-pandemic, and softwood prices were still 20.4% higher.

Contractor Insolvencies

According to the Insolvency Service, 4,317 construction firms in the UK went out of business in the year to October, which is 9.1% higher than a year ago and 36.2% higher than in the year to January 2020, pre-pandemic. The number of firms that went under in the year to October has been higher than pre-pandemic for 20 consecutive months. Insolvencies were at their highest level since the financial crisis, surpassing the previous high in September as we continue to see the impacts of the declines in private housing new build and repair, maintenance and improvement (rm&i), the two largest construction sectors, on insolvencies.

4,317

construction firms in the UK went out of business

in the year to October 2023

The biggest impacts remain on smaller specialist sub-contractors and 58% (2,480) of the firms that went under in the year to October were specialist contractors. As we have highlighted previously, in addition to the downturns in private housing and private housing rm&i demand, specialist sub-contractors have also had to deal with higher materials prices, IR35, reverse charge VAT, skills shortages and planning delays that have hit financial viability. Whilst specialists were the worst hit, main building contractors still accounted for 37% (1,628) of construction insolvencies in the year to October 2023 so they are clearly affected by the demand and supply issues as well. Civils contractors accounted for only 5% (209) of the insolvencies as major infrastructure project and framework activity has been stronger plus public sector clients have tended to be more understanding of cost inflation and delays on site (and less stringent in enforcing fixed-price contracts) than some private sector clients and major house builders. Given the continued slowdown in house building and rm&i plus the persistent impact of labour and material costs, contractor insolvencies are likely to rise further in 2024.

Upper Scenario

Assumptions

- UK economic activity rises by 1.0% in 2024 as consumer spending and services growth remains strong as inflation slows
- Unemployment remains flat at historically low rates due to the persistence of skills shortages and growth in consumption
- Interest rates fall from May 2024 to 4.0% by the end of 2024
- House prices remain flat in 2024 as the number of properties coming on the market falls and there are few forced sellers
- Consumer spending on non-essential and big-ticket items grows as wage growth and savings help to sustain spending volumes
- Lending to businesses remains strong due to stronger economic prospects and lenders reducing rates
- Business investment grows this year as stronger economic growth leads to an improvement in medium-term manufacturing prospects

Key Effects

- Total construction output rises by 1.4% in 2024 and 3.9% in 2025 as stronger economic growth drives private construction activity
- Private housing output rises by 2.0% as house prices do not fall and mortgage approvals recover from a low base in 2023 H2 whilst property transactions and output rise in 2024 H2
- Commercial output rises by 1.0% in 2024 and 3.5% in 2025 due to continued strong fit-out activity with paused towers projects and large developments in the pipeline coming back online as construction inflation continues to slow and financing costs fall in line with interest rates
- Private housing rm&i output remains flat in 2024 and rises by 5.0% in 2025 as general housing market recovery in 2024 H1 leads to a recovery in rm&i activity in H2. In addition, homeowners increasingly focusing on energy prices and security leads to further energy-efficiency retrofit and solar photovoltaic work, boosted by activity from the ECO4, Boiler Upgrade Scheme and the Great British Insulation Scheme

Construction Industry Forecasts - Winter 2023/24 - Upper Scenario

		2021	2022	2023	2024	2025
% annual change		Actual	Actual	Scenario	Scenario	Scenario
Housing						
Private		37,176	41,131	34,961	35,661	37,444
		16.4%	10.6%	-15.0%	2.0%	5.0%
Public		4,713	5,227	5,227	4,809	5,001
		-0.5%	10.9%	0.0%	-8.0%	4.0%
Total		41,889	46,358	40,188	40,469	42,445
		14.2%	10.7%	-13.3%	0.7%	4.9%
Other New Work						
Public Non-Housing		9,493	8,602	8,774	9,037	9,399
		-1.3%	-9.4%	2.0%	3.0%	4.0%
Infrastructure		27,777	27,621	28,450	29,019	30,034
		27.4%	-0.6%	3.0%	2.0%	3.5%
Industrial		4,761	6,773	7,044	6,762	6,762
		1.2%	42.3%	4.0%	-4.0%	0.0%
Commercial		21,986	21,749	21,966	22,186	22,963
		-7.3%	-1.1%	1.0%	1.0%	3.5%
Total other new work		64,017	64,745	66,234	67,004	69,158
		7.0%	1.1%	2.3%	1.2%	3.2%
Total new work		105,906	111,103	106,422	107,474	111,603
		9.7%	4.9%	-4.2%	1.0%	3.8%
Repair and Maintenance						
Private Housing RM&I		25,488	28,703	26,120	26,120	27,426
		25.7%	12.6%	-9.0%	0.0%	5.0%
Public Housing RM&I		7,200	7,064	7,629	7,934	8,093
		6.2%	-1.9%	8.0%	4.0%	2.0%
Private Other R&M		14,584	16,973	17,143	17,828	18,541
		16.3%	16.4%	1.0%	4.0%	4.0%
Public Other R&M		5,777	6,112	6,112	6,235	6,422
		10.9%	5.8%	0.0%	2.0%	3.0%
Infrastructure R&M		11,508	11,565	11,680	11,914	12,391
		13.7%	0.5%	1.0%	2.0%	4.0%
Total R&M		64,557	70,417	68,684	70,031	72,872
		17.5%	9.1%	-2.5%	2.0%	4.1%
TOTAL ALL WORK		170,463	181,520	175,107	177,505	184,475
		12.6%	6.5%	-3.5%	1.4%	3.9%

Source: ONS, Construction Products Association

Lower Scenario

Assumptions

- UK GDP contracts in 2023 Q4 and 2024 Q1 as the lagged impact of interest rate rises affects spending
- Interest rates remain at 5.25% throughout 2024 as inflation remains stubborn in the first half of the year
- Unemployment gradually rises to 5.2% in 2025 as slower economic activity leads to increases in job losses in the customer-facing services
- House prices fall by 5.0% in 2024 after the falls in 2023 and property transactions fall by 20.0% peak to trough as the lagged impacts of higher mortgage rates lead to lower demand and an increase in forced sellers
- Consumer spending volume falls in 2023 Q4 and 2024 Q1 despite marginal rises in spending value due to the lagged impacts of inflation
- Lending to businesses falls as lenders increase borrowing rates in response to greater uncertainty over economic growth and consumer spending
- Business investment falls as firms focus on near-term cost minimisation at the expense of medium-term investment plans

Key Effects

- Construction output falls by 4.2% in 2024 as demand, particularly in private housing and private housing rm&i, responds to a decline in the wider UK economy as well as financial constraints for homeowners and potential new home buyers before gradual recovery with growth of only 0.8% in 2025
- Private housing output falls by 6.0% in 2024 before rising by 6.0% in 2025 from a lower base as slower housing demand and stronger house price falls lead to a house building recovery only in 2025 H2
- Commercial output falls by 5.0% in 2024 and 1.0% in 2025 as fit-out activity remains flat at historically high levels but new towers starts continue to be pushed back in response to investor concerns about the rate of return after the rise in financing and construction costs
- Private housing rm&i output falls by 6.0% in 2024 as fewer property transactions and rising unemployment leads to declines in rm&i next year and rises by only 2.0% in 2025 following the gradual recovery in property transactions in 2025 H1

Construction Industry Forecasts - Winter 2023/24 - Lower Scenario

	2021	2022	2023	2024	2025
% annual change	Actual	Actual	Scenario	Scenario	Scenario
Housing					
Private	37,176	41,131	31,260	29,384	31,147
	16.4%	10.6%	-24.0%	-6.0%	6.0%
Public	4,713	5,227	5,122	4,405	4,493
	-0.5%	10.9%	-2.0%	-14.0%	2.0%
Total	41,889	46,358	36,382	33,789	35,640
	14.2%	10.7%	-21.5%	-7.1%	5.5%
Other New Work					
Public Non-Housing	9,493	8,602	8,430	8,346	8,346
	-1.3%	-9.4%	-2.0%	-1.0%	0.0%
Infrastructure	27,777	27,621	27,069	26,527	26,262
	27.4%	-0.6%	-2.0%	-2.0%	-1.0%
Industrial	4,761	6,773	6,773	6,096	5,730
	1.2%	42.3%	0.0%	-10.0%	-6.0%
Commercial	21,986	21,749	21,097	20,042	19,841
	-7.3%	-1.1%	-3.0%	-5.0%	-1.0%
Total other new work	64,017	64,745	63,368	61,010	60,179
	7.0%	1.1%	-2.1%	-3.7%	-1.4%
Total new work	105,906	111,103	99,750	94,800	95,819
	9.7%	4.9%	-10.2%	-5.0%	1.1%
Repair and Maintenance					
Private Housing RM&I	25,488	28,703	24,111	22,664	23,117
	25.7%	12.6%	-16.0%	-6.0%	2.0%
Public Housing RM&I	7,200	7,064	7,135	6,992	6,992
	6.2%	-1.9%	1.0%	-2.0%	0.0%
Private Other R&M	14,584	16,973	16,464	16,464	16,464
	16.3%	16.4%	-3.0%	0.0%	0.0%
Public Other R&M	5,777	6,112	5,868	5,751	5,693
	10.9%	5.8%	-4.0%	-2.0%	-1.0%
Infrastructure R&M	11,508	11,565	11,333	11,107	10,996
	13.7%	0.5%	-2.0%	-2.0%	-1.0%
Total R&M	64,557	70,417	64,910	62,977	63,262
	17.5%	9.1%	-7.8%	-3.0%	0.5%
TOTAL ALL WORK	170,463	181,520	164,660	157,776	159,081
	12.6%	6.5%	-9.3%	-4.2%	0.8%

Source: ONS, Construction Products Association

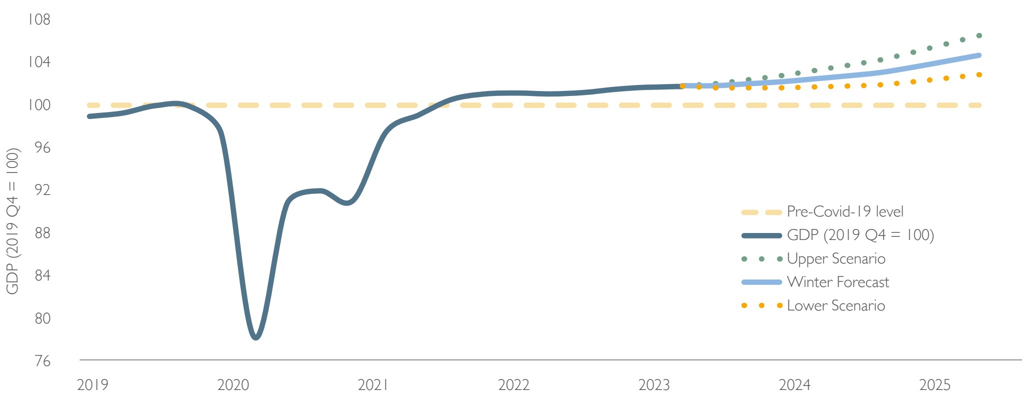
Economy

The UK economy has largely been flatlining over the past 18 months due to the impacts of interest rate rises and inflation. Although rates are likely to have peaked and inflation is gradually slowing, the drag effect of these on households and businesses is likely to mean only marginal growth for the economy in 2024. In addition, there is likely to be a slight rise in unemployment. The slowing of inflation in Autumn pointed to financial markets revising expectations heavily that the Bank of England will cut interest rates this year, earlier than previously anticipated, but we are more cautious and inflation is likely to be stubborn over Winter. In addition, government announcements of stimulus for households and businesses in the Autumn Statement are also likely to boost growth in the next two years. As a result, there has been a slight upward revision to our UK GDP forecast, which is expected to rise by 0.6% but disruptions to trade and supply through the Red Sea may see inflation accelerate again and increase fears that interest rate cuts will be delayed.

***UK GDP** anticipated to **rise by** 0.6% in 2024*

The CPA's Autumn forecasts were published at a time when CPI inflation was still 6.7% in September, after stubborn inflation surprised financial markets in Spring and Summer and there were concerns that UK inflation was more stubborn than in many other competitor countries. However, CPI inflation fell to 4.6% in October and there was a more significant slowdown in inflation in November. Inflation slowing faster than the Bank and financial markets expected in Autumn 2023 led to considerably less pressure for the Bank of England to keep interest rates at the current peak of 5.25%. On the contrary, the pressure was for the Bank

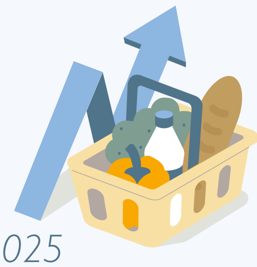
CPA UK Economic Scenarios (Quarterly UK GDP)



Source: ONS, CPA Estimates

to cut interest rates earlier. However, the CPA has consistently warned against the backdrop of financial markets overreacting to each monthly data point on inflation and this was underlined by the most recent CPI inflation figure of 4.0% in December, a marginal rise. The general trend is still one of slowing inflation but it is unsurprising to see it stubborn over the Winter period. The Bank continues to maintain that inflation is still considerably above the target and it has been pushing back against speculation that interest rates will fall in 2024. Financial markets priced in interest rate cuts from Spring 2024 with rates ending the year at 4.0% followed by further interest rates cuts in 2025, to end the year at 3.0%. This appeared an overreaction at that point and even more so after December's inflation figure. Financial market expectations for interest rate cuts are likely to be revised in the first half of 2024 if inflation starts the new year being more stubborn than in Autumn 2023. This is particularly the case in the light of Winter energy price rises and particularly Red Sea disruptions, which, if persistent, threaten to delay supplies of imported products and lead to inflationary pressure (see Risks).

CPI Inflation
set to ***average***
2.6% *in 2024*
and ***1.6%*** *in 2025*



At this point, the most likely scenario for interest rates in 2024 is halfway between the Bank's stance and the view of financial markets at the start of 2024. If inflation slows significantly in early 2024 then interest rates may start to fall gradually from Summer 2024, which may boost prospects for the economy in the second half of the year. Given that inflation has been slowing, but economic growth has remained weak, the key question this year for policy makers is likely to be when to reduce interest rates and how quickly. The Bank of England is likely to reduce interest rates in 2024 but is unlikely to move quickly and risk that inflation remains stubborn. This remains a difficult balance and the Bank tends to be cautious by nature. It is likely to wait before cutting interest rates so as to ensure that the price trends of the past six months are sustained. In addition, it is likely to want to see pay growth slow. However, given that monetary policy takes time to have an impact, the longer it waits, the more it risks constraining economic growth. Financial markets have already priced in at least two interest rate cuts and after November's slowing inflation some banks anticipated four interest rate cuts this year, although the latter appears very optimistic given the Bank of England's historic caution. This is particularly the case given that in recent years macroeconomic data have been volatile on a monthly basis

Economic Indicators

	2021	2022	2023	2024	2025
	Actual	Actual	Estimate	Forecast	Projection
GDP	8.7%	4.3%	0.5%	0.6%	1.7%
Fixed Investment	7.4%	8.0%	2.5%	-2.0%	1.4%
Household Consumption	7.5%	4.8%	0.5%	0.4%	1.7%
Real Household Disposable Income	1.1%	-1.6%	1.0%	0.0%	1.6%
Government Consumption	14.9%	2.3%	0.5%	2.5%	1.4%
CPI Inflation	2.7%	9.1%	7.4%	4.5%	2.2%
RPI Inflation	4.1%	11.6%	9.8%	2.9%	2.4%
Bank Base Rates - June	0.10%	1.25%	5.00%	5.25%	4.50%
Bank Base Rates - December	0.25%	3.50%	5.25%	4.75%	4.25%

Source: ONS, Construction Products Association

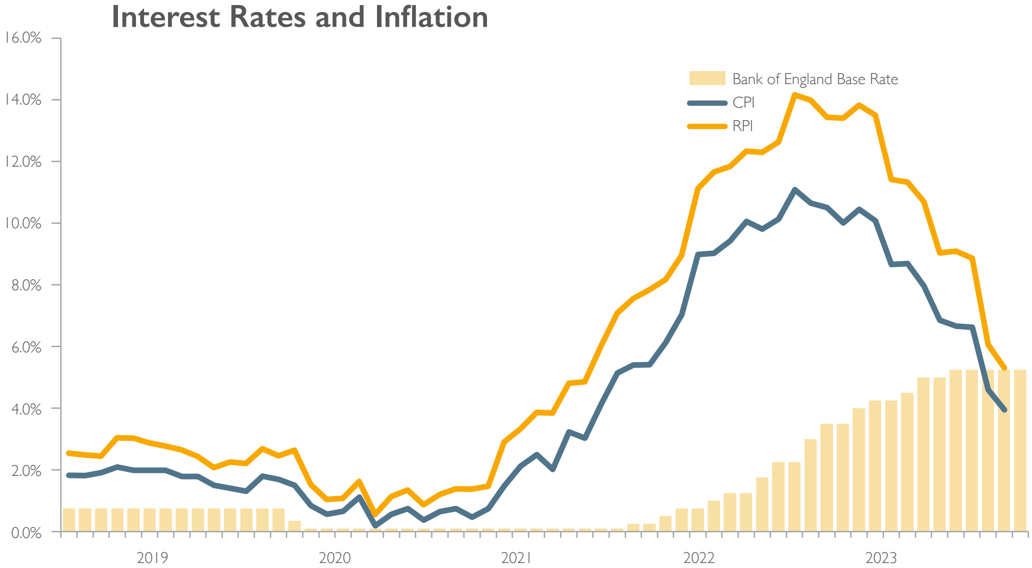
***The Bank of England's** base rate is assumed to have already **peaked** at 5.25% and will start to **fall gradually** in 2024 H2*

and, furthermore, the number of different political, economic and social external shocks that have an impact on the economy has been unprecedented. As a result, policy makers are likely to be cautious and will need to be flexible given the high degree of uncertainty regarding economic forecasting and, as a consequence, the extent to which interest rates should fall and over what time period.

The latest HM Treasury consensus of economic forecasters compiled in December 2023 highlighted that the average estimate for CPI inflation in 2023 Q4 was 4.4% compared with 4.8% three months ago and 5.0% one year ago. Within this the most pessimistic forecaster anticipated CPI inflation of 5.1% in 2023 Q4 whilst the most optimistic forecaster expected 2.6%. Looking to this year, the average estimate for CPI inflation in 2024 Q4 was 2.6% compared with 2.7% three months ago. Within this the most pessimistic forecaster anticipated CPI inflation of 3.9% in 2024 Q4 whilst the most optimistic forecaster expected 1.2%.

In terms of the impacts of politics on the UK economy, the CPA does not model different political scenarios but there will be a UK General Election by January 2025 and, as with previous CPA forecasts, it has been assumed that it will be in Autumn 2024. A clear majority for one of the two major parties is expected, with capital expenditure and policy direction assumed to continue along current lines during 2024 and 2025. Even with a change in government, a new regime would need to take time to assess the current public finances in detail and publish a Spending Review before outlining any new major policy direction over time. The most recent example of a sustained period of public sector austerity followed by a change in government and a significant change in policy direction was in 1997 when the incoming government still largely followed capital expenditure plans during 1998/99 before capital expenditure changed.

Interest Rates and Inflation



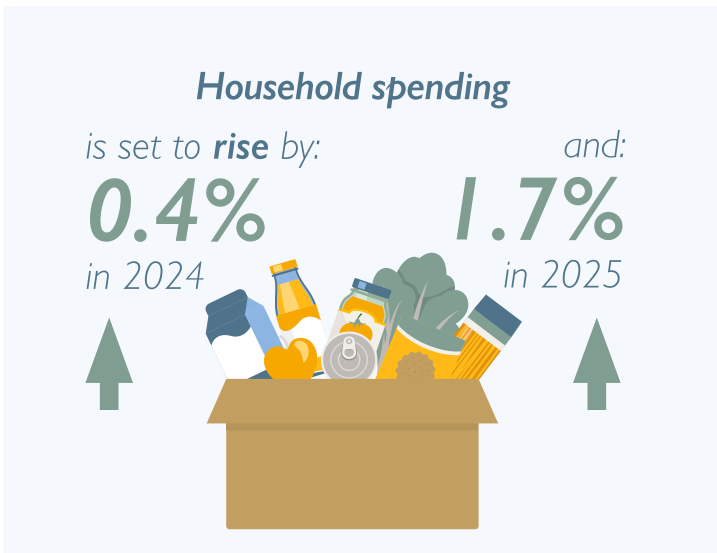
Source: Bank of England, ONS

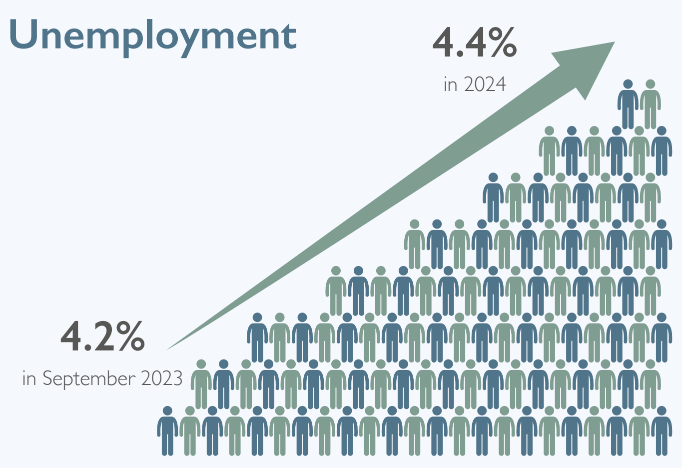
A negative risk for the economy would be if there was a hung parliament following the election and significant time attempting to form a sustainable coalition or, worse, a rerun of a General Election to find a majority. These may delay project and programme signoffs as well as increase uncertainty and may impact upon consumer and business confidence. In turn, this could affect consumer spending and business investment.

On the positive side, with an upcoming General Election, it was no surprise that the Chancellor's Autumn Statement in November focused on stimulus for households and businesses in the near-term, albeit at the expense of tax rises, public sector spending cuts or substantial rises in public sector debt after 2025/26. The key policies to stimulate the economy were based around a cut in the National Insurance rate from 12% to 10%, a rise in the National Living Wage (NLW) by 9.8% to £11.44 an hour and 'Full expensing' for businesses. The National Insurance cut and the rise in the National Living Wage will boost household incomes, particularly for those in lower-earning occupations that have been particularly affected by the cost of living rises over the past two years. In addition, as lower income earners tend to spend a higher proportion of their income, it is likely to boost consumer spending. However, it is worth noting that whilst the rise in the NLW will help low earners, it will conversely hit businesses with extra costs. The extra costs will not only be due to those workers on the NLW but also the workers on the two wage bands above this, who will be keen to ensure that the premium above the NLW continues. 'Full expensing' allows companies to invest in the UK to reduce their tax by up to 25p for every £1 they spend on plant and machinery, which should be a significant boost to business investment in the medium-term and the Office for Budget Responsibility anticipates that business investment between 2023 and 2027 will be 4.5% higher than it forecast in March 2023 as a result of this change.

In terms of UK GDP data, the ONS made major revisions to the data published in September 2023 that meant that by the end of 2021 the UK economy was 0.6% larger than its pre-pandemic level, rather than 1.2% smaller, which is a boost to the state of the economy but also points to less scope for catch-up subsequently. Since 2021 Q4, UK GDP on a monthly basis has been volatile but on a quarterly basis it has largely been flatlining and this is likely to continue for the majority of 2024. In terms of more recent ONS data, on a quarterly basis, UK GDP fell by 0.1% in 2023 Q3, revised down from a first estimate of 0.0% according to the ONS. Although the revision to GDP in the third quarter was marginal, the -0.1% has raised concerns that if 2023 Q4 is also marginally negative, then technically the UK economy would be in recession given that its definition is based upon two consecutive quarters of contraction in UK GDP. However, more realistically, the UK economy continues to flatline on a quarterly basis but with volatile monthly changes in GDP that have been subject to significant revisions over time. There was a 0.2% fall in the services sector in 2023 Q3, which offset a 0.4% increase in construction output and a 0.1% increase in industrial production.

UK GDP on a monthly basis rose by 0.3% in November 2023, following a fall of 0.3% in October. Services output grew by 0.4% in November and was the main contributor to the monthly growth in GDP, unsurprisingly given that it accounts for over three-quarters of the UK economy. The rise in services followed a fall of 0.1% in October, which was an upward revision from the 0.2% fall published a month earlier. Industrial production output increased by 0.3% in November, following a fall of 1.3% in October, which was revised down from a 0.8% fall a month ago. Output in construction fell by 0.2%





Source: ONS, Construction Products Association

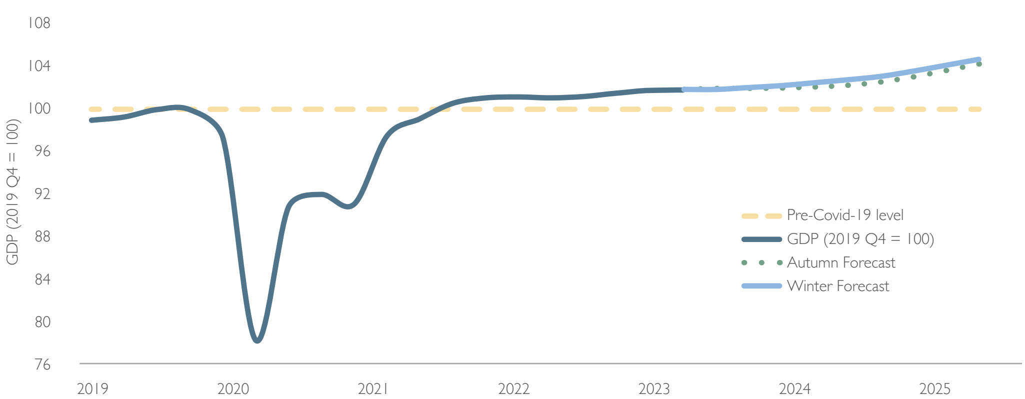
in November after a fall of 0.4% in October according to the ONS. In the three months to November 2023, GDP fell by 0.2%, pointing towards a flat or slightly negative final quarter to last year.

In terms of more recent economic data, the S&P Global Purchasing Managers' Indices (PMI) point to a more mixed picture for the UK economy. In the PMI data, a figure of 50 means no monthly change and figures above this highlight a rise in activity compared with the previous months whilst figures below 50 indicate a fall in monthly activity.

The PMI for UK services activity was 53.4 in December 2023, up from 50.9 in November. This highlights growth in services activity in December, at a quicker pace than in November and at its strongest rate for six months. This growth in activity was linked to a turnaround in demand, particularly from firms in technology and financial services. Some firms also noted higher consumer spending on leisure and hospitality services at the end of 2023. The data also pointed to the fastest upturn in new work since June 2023. Survey respondents reported a boost to sales from rising business optimism, despite lingering concerns about weak UK economic growth prospects. This optimism was spurred on by expectations of lower borrowing costs, improving global economic conditions and forthcoming business expansion plans. Some survey respondents, however, reported weak projections for spending among construction and real estate clients. Furthermore, staff hiring remained subdued at the end of 2023, in part due to strong concerns about wage pressures.

The PMI for UK manufacturing was 46.2 in December, after rising to a seven-month high of 47.2 in November but it has been below 50.0, and showing continual contractions in activity, for 17

CPA UK Economic Scenarios (Quarterly UK GDP)



Source: ONS, CPA Estimates

consecutive months. Furthermore, the PMI showed a contraction in December for all five of the PMI sub-indices of new orders, output, employment, stocks of purchases and suppliers' delivery times. The downturn in production volumes, for the 10th consecutive month, accelerated due to a fall in both domestic and export demand. Lower demand from key trading partners such as the US, mainland China, mainland Europe and Canada led to a further retrenchment in new export business in December. New export orders declined for the 23rd month in a row. The contraction in output volumes reflected manufacturers reducing excess stocks plus clients' current inventory. Job losses were recorded for the 15th month running in December, which were linked to efficiency gains, hiring freezes and cost controls. Looking forward, manufacturing business optimism dropped to a 12-month low point in December, reflecting a faltering economy, client closures and high interest rates.

Despite this, companies still expect production to rise over the coming 12 months due mainly to sales drives and new product launches.

The PMI for UK construction activity was 46.8 in December, representing a fall but at a slower rate than in November, which was 45.5. The fall in UK construction activity in December was mainly driven by further falls in house building but civil engineering and commercial construction activity also fell. The S&P Global UK Construction PMI for housing was 41.1, another sharp fall in house building, as house builders continued to focus on completions for the subdued level of demand after the mortgage rates rises that have priced out many new buyers. For major house builders, cash buyers and bulk (investor) purchasers have slightly offset the sharp fall in demand particularly from first-time buyers, but the broader decline in housing market demand means that house builders are not starting new developments in the main and continue to focus on the low level of completions and cost minimisation.

Civil engineering activity in December was 47.0 according to the S&P Global PMI, so a further decline, albeit a slower fall than last month. Despite strong activity on major projects such as HS2 Phase One, Thames Tideway and Hinkley Point C plus relatively stable work on long-term frameworks in regulated sectors, the majority of infrastructure work is on smaller and medium-size schemes where new project pauses, delays and cancellations hinder activity as previous schemes finish. This is particularly the case for local authorities, which are financially-constrained as finance gets redirected to more urgent areas such as social care. UK commercial construction activity in December fell (47.6) although it was the slowest fall of all the sectors. Offices construction continues to be buoyed by major refurbishment, fit-out and energy-efficient retrofit activity on existing developments but this continues to be offset by a lack of new commercial towers and new major retail developments that traditionally dominate value of activity in the sector, especially given the sharp rise in financing (interest rate) costs. Hence, the decline in commercial activity in December.

Overall in the UK Construction PMI, construction new work fell in December and it has been falling since August, which points to further falls in construction activity in 2024 H1 (especially in house building). But, according to the PMI in December, around 41% of the survey panel anticipated an increase in business activity overall in 2024 whilst only 17% expected a decline. However, it is difficult at this stage to see whether this is optimism bias given that construction activity in the 2023 Q1 had not fallen sharply, so if activity continues throughout this year at 2023 H2 levels then, overall in 2024, activity will be lower than in 2023 just by the arithmetic of the annual percentage change alone.

Going forward, GDP will be highly dependent on the paths of inflation and interest rates but given current expectations the CPA forecasts growth of 0.6% in 2024.

The HM Treasury consensus of economic forecasters highlights the most recent forecasts from City and non-City forecasters compiled in December 2023. There was a high degree of variation reflected across the forecasters for 2024 as would be expected, given different expectations for interest rates. Of the main City and non-City macroeconomic forecasters, the average estimate for GDP growth in 2024 was 0.4%, compared with 0.6% three months ago. Within the 0.4% average, the most pessimistic forecaster anticipated a recession and a fall of 0.7% in 2024 whilst the most optimistic forecaster expected 1.9% growth this year. This is clearly a wide range of forecasts but this reflects different assumptions and uncertainty regarding not only the impacts of previous interest rate rises and the extent of subsequent cuts, and different assumptions dependent on the extent to which inflation continues to slow, as well as the extent to which unemployment rises and, consequently, the effects of this on consumption.

Whilst inflation has broadly continued to slow in recent months, concerns remain around the impacts of energy prices and oil prices. For households, for energy a typical household using gas and electricity uses, the price cap rose by 5.1%, from £1,834 to £1,928 per year from 1 January. Cornwall Insight reported in December, however, that the subsequent price cap from 1 April would fall to £1,660. For businesses, with no energy price cap, prices are likely to rise over the Winter period although the extent to which they will rise is uncertain and the impacts of these rises, as they feed through the economy, may mean that going forward CPI inflation is more stubborn than in Autumn 2023 would suggest. Even greater uncertainty revolves around oil prices. The peaks in oil prices were in June 2022 following Russia's invasion of Ukraine and Brent Crude oil prices hit $120.1 per barrel before gradually falling back to $78.5 per barrel in March 2023, which was below levels seen before Russia's invasion of Ukraine, despite sanctions placed on Russian oil exports by several major nations. The 24 members of OPEC+ announced in April, however, that it would be cutting oil production by 1.0 million barrels a day in a deliberate effort to sustain oil prices. Brent Crude oil prices consequently rose to $84.1 per barrel in April before prices fell once again to $74.9 per barrel in June due to lower demand from China. As a result, members of OPEC+ announced further cuts in production equivalent to 1.5% of global supply to boost prices in June and Saudi Arabia announced it would reduce crude oil production by an additional 1.0 million barrels per day in July. In September, it announced that these cuts would be extended through to the end of 2023 and prices rose to $94.0 per barrel in September. However, despite this, the oil price gradually fell back to $83.2 per barrel in November and $77.9 per barrel in December despite the rise in political strife in the Middle East, as OPEC+ controls less than half of global oil supply whilst the US increased 1.4 million barrels per day in 2023. The likelihood is that this means Brent Crude is likely to average between $75.0 and $85.0 per barrel during 2024 compared with the CPA's previous forecast of $80-$90 per barrel excluding external political factors. The previous forecast range of oil prices was based on the impact of the initial production cuts on prices but it appears that recent production cuts have had little impact. However, the impact on uncertainty after trade after the disruptions in the Red Sea may mean that oil prices rise once again. If so, higher oil prices than forecast would be dependent on how long the disruptions to trade continue.

The unemployment rate for August to October 2023 was 4.2%, which was largely unchanged compared with the previous quarter. The UK employment rate was estimated at 75.7% in August to October 2023, which was also similar to the rate between May and July.

The economic inactivity rate was 20.9% between August and October, unchanged compared with the previous quarter but remained at a historically high level. The economic inactivity in recent quarters was driven by people aged 16 to 24 years. The number of people economically inactive because of long-term sickness reached 2.5 million during 2023.

The estimated number of vacancies in September to November 2023 was 949,000, a decrease of 45,000 and 4.5% since June to August 2023 with vacancies falling in 16 of the 18 industry sectors. Vacancy numbers fell on the quarter for the 17th consecutive period in September to November 2023, the longest consecutive run of quarterly falls ever recorded. In September to November 2023, vacancies were down by 229,000 from the level of a year ago but remained 148,000 above their pre-pandemic levels.

Persistent CPI inflation has meant that workers have continued to demand significant nominal wage increases as they strived to minimise real wage falls since the spikes in energy and commodity prices during 2022. This is especially the case in parts of the economy where there are acute skill shortages, which may mean that firms need to increase prices further if there is scope to. However, as inflation slowed over a year on from the price spikes, real wages have started to rise again.

Annual growth in regular earnings excluding bonuses was 7.3% in August to October 2023. This growth continues to remain strong but it is not as high as in recent periods whilst annual growth in employees' average total earnings including bonuses was 7.2% in August to October 2023. The finance and business services sector saw the largest annual regular growth rate at 8.3%, followed by the manufacturing sector at 7.4%. Using CPI in August to October 2023, annual growth in real terms for total pay was 1.2% on the year. Growth was last higher in August to October 2021 when it was 1.5%. Regular pay rose by 1.2% on the year in real terms; growth was last higher in July to September 2021 when it was 2.2%. Given the flatlining UK economy, however, as inflation broadly eases, and unemployment ticks upward, nominal wage growth is likely to slow meaning that the cost of living will remain a key issue for many households.

This is particularly the case for homeowners that have a mortgage with an increase in mortgage costs. The impact of higher interest rates is only gradually passed through the economy. Around half of the impact of higher mortgage rates has passed through as yet and the remaining half will pass through during the forecast period with the majority of the impact on homeowners felt by mid-2025. Around 1.5 million homeowners will be coming off fixed-rate mortgages during 2024 alone and these households will experience a significant increase in mortgage payments. According to the Bank of England's Stability Report in December, around 900,000 homeowners in 2024 will see their monthly mortgage payments rise by over £500 per month.

Real household income is expected to rise marginally in 2024 as inflation generally slows more than wage growth and may sustain consumption. KPMG highlighted in Spring 2023 that there was a key risk going forward that consumption may be harder to finance given that the excess savings accumulated during the pandemic had been rapidly diminishing due to the rising cost of living. However, more recent data on savings suggests that the general slowdown in inflation and strong wage growth has meant that, overall, households have been able to sustain spending and increase savings progressively last year. The household saving ratio at the end of 2022 was 9.1% and 2023 Q1 data pointed to the factors highlighted by KPMG, with the saving ratio falling to 7.6%. However, since then it has risen and in 2023 Q2 it was 9.5% and in 2023 Q3 it was 10.1%.

GfK's Consumer Confidence Index continues to surprise on the upside despite all the economic uncertainty and headwinds. It reached its nadir in September 2022, the same month as the Government's Mini Budget, at -49. It gradually improved before briefly falling back to -45 in January 2023 due to concern regarding the UK economy. Since, then however, it has risen in each month except for brief falls in July and October. UK consumer confidence rose in December 2023 to -22, which is the second highest recorded since January 2022, prior to the spikes in energy, commodity and consumer prices. Although the -22 figure means confidence is still in negative territory, optimism for households' personal finances for the next 12 months displayed a notable recovery to -2 from the -29 reported in December 2022. Recovery in this is clearly important given that it reflects household financial optimism and control over personal budgets in the UK economy where 80% of GDP is consumption.

Consumers continued to show resilience despite the rising cost of living, as slowing inflation and strong wage growth have helped ensure stability even as increasing numbers of households are facing rising housing costs due to mortgage rate rises or increases in rents.

Also in December's GfK consumer confidence indices, the measure for the general economic situation of the country during the last 12 months was five points higher at -44, which is 22 points higher than in December 2022. Expectations for the general economic situation over the next 12 months increased by one point to -25, which is 28 points better than a year earlier. The Major Purchase Index was one point higher, at -23, which is 11 points higher than in December 2022. The Savings Index was two points lower, at +27, which is seven points higher than a year ago.

According to the ONS, UK business investment decreased by 3.2% in 2023 Q3 but it was 2.3% higher than a year earlier. The 3.2% fall in business investment in Q3 was primarily driven by a decrease in transport although it is worth noting that business investment in transport still remained 26.5% above its level in 2022 Q3, a year ago. Business investment in all other sectors of the economy decreased in 2023 Q3 compared with Q2, including buildings, information and communication technology (ICT) as well as other machinery and equipment.

Whilst the majority of announcements in the Chancellor's Autumn Statement were focused on households, the UK government also announced that 'full expensing' would be made permanent. 'Full expensing' allows firms to deduct the full cost of any new investment in productivity-enhancing equipment from their corporate tax bill in a similar manner to other day-to-day expenses. This means that for every £1 that firms invest in qualifying plants and machinery, they can reduce their tax bill by £0.25. The Office for Budget Responsibility (OBR) forecast in November 2023 that would increase real business investment by approximately £3 billion a year over its forecast period (to 2028/2029). It is worth noting, however, that making this permanent, when it was previously temporary, means that near-term additional benefits of bringing forward investment may not occur.

UK business investment in 2024 is still expected to fall, by 2.0%. Overall, anaemic UK GDP growth combined with economic and political uncertainty during this year is likely to override investment and expansion plans in many sectors. In addition, rising costs, despite the rate of inflation generally slowing, are likely to hinder margins. This is particularly the case for energy-intensive manufacturers that will be hit by increases in energy costs or firms that will be hit by the upcoming rise in the National Living Wage. As a result, there is limited incentive to invest until it is clear that revenue and profit are rising and medium-term rates of return are likely to provide increasing opportunities for growth.

Upper Scenario:

- Economic activity and real wages grow from 2024 H1
- Interest rates fall four times by 0.25% from May 2024
- Consumer confidence and spending rise as inflation slows and the labour market remains resilient
- Lending to business increases as better economic growth prospects lead to increased business optimism
- Business investment recovers sharply in response to increased business confidence

The upper scenario envisages that the strong labour market, savings and credit availability sustain consumption and household spending and business investment recover in 2024 H1. Robust demand leads to a manufacturing and services recovery in 2024, whilst interest and mortgage rate falls lead to a sharp improvement in housing and rm&i demand, from a low base.

Lower Scenario:

- Economic activity contracts in 2024
- Interest rates continue at peak throughout 2024 due to an upward blip in inflation
- Consumer confidence flatlines and spending falls in volume terms in 2024
- Unemployment rises significantly in the light of rising prices and falling spending
- Lending to households and businesses tightens and becomes more expensive due to rate rises and additional risk
- Business investment falls sharply during 2023 and only recovers slowly in 2024 due to uncertainty regarding the sustainability of economic growth

The lower scenario envisages that the UK economy slows in 2024 H1 as households become more risk averse as unemployment rises and both households and businesses suffer from reductions in the availability of finance and increases in the cost of finance. As a result, the economy falls at the start of next year and there is only a subdued recovery in 2024 H2.

Private Housing

The CPA's forecast for private housing in 2024 has been revised down slightly as house builders adjust to the short-term decline in housing demand that appears to have now hit its nadir. After a recovery in mortgage approvals, property transactions and house price growth during 2025, both starts and completions are likely to recover but the rate of recovery will heavily depend on not only mortgage rates but also policymaker stimulus. As a result, after the double-digit fall in completions and output during 2023, completions are forecast to fall by a further 4.0% in 2024 with no growth until 2025. Furthermore, despite the recovery in the housing market and house building expected in 2025, with mortgage rates even in the medium-term likely to be higher than at any point than in the decade previous to 2022, the recovery is likely to take time and it is unlikely that 2022's level of house building will be reached until the end of the decade. Whilst the CPA has focused in previous publications on the negative demand and supply risks for house builders, there are also positive risks if government focuses on policies aimed at boosting both demand and supply rather than the usual stream of announcements, which deliver little, that the house building industry has got used to in recent years.

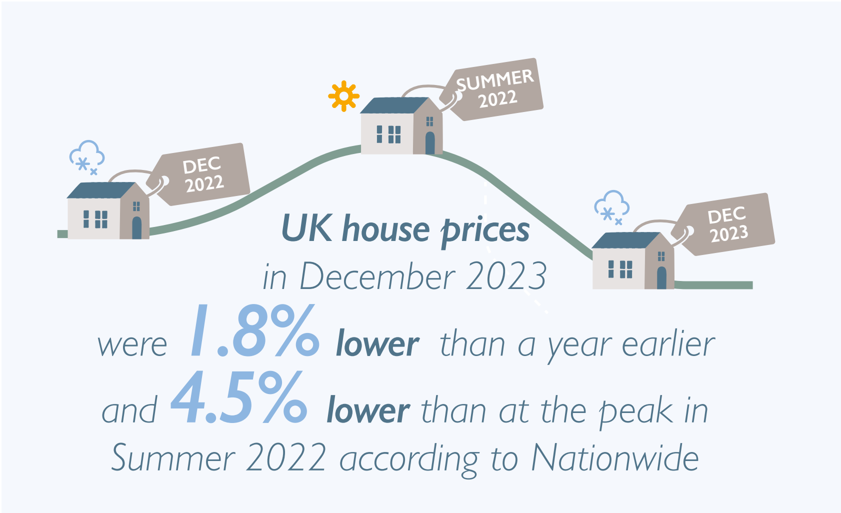
Recent results from publicly-listed house builders highlight the travails of the both the housing market the private housing sector over the last 18 months. The initial spike in mortgage rates after the government's Mini Budget in September 2022 led to the first sharp drop in housing market demand in 2022 Q4 and January 2023. But, following the government going back on its Mini Budget policies, mortgage approvals briefly started to recover in February and March 2023 before strong, stubborn inflation and the reaction from the Bank of England to increase interest rates. This consequently led to sharp increases in financial markets' expectations of peak interest rates and mortgage rates, which peaked in August. In 2023 Q4 it appeared that

Private Housing Starts and Completions Great Britain

	2021	2022	2023	2024	2025
	Actual*	Actual*	Estimate	Forecast	Projection
Starts	162,824	162,872	125,411	120,395	128,822
	37.2%	0.0%	-23.0%	-4.0%	7.0%
Completions	161,448	165,964	134,431	129,053	134,215
	19.7%	2.8%	-19.0%	-4.0%	4.0%
Output (£m)	37,176	41,131	33,316	31,983	33,263
	16.4%	10.6%	-19.0%	-4.0%	4.0%
RM&I Output (£m)	25,488	28,703	25,546	24,524	25,260
	25.7%	12.6%	-11.0%	-4.0%	3.0%

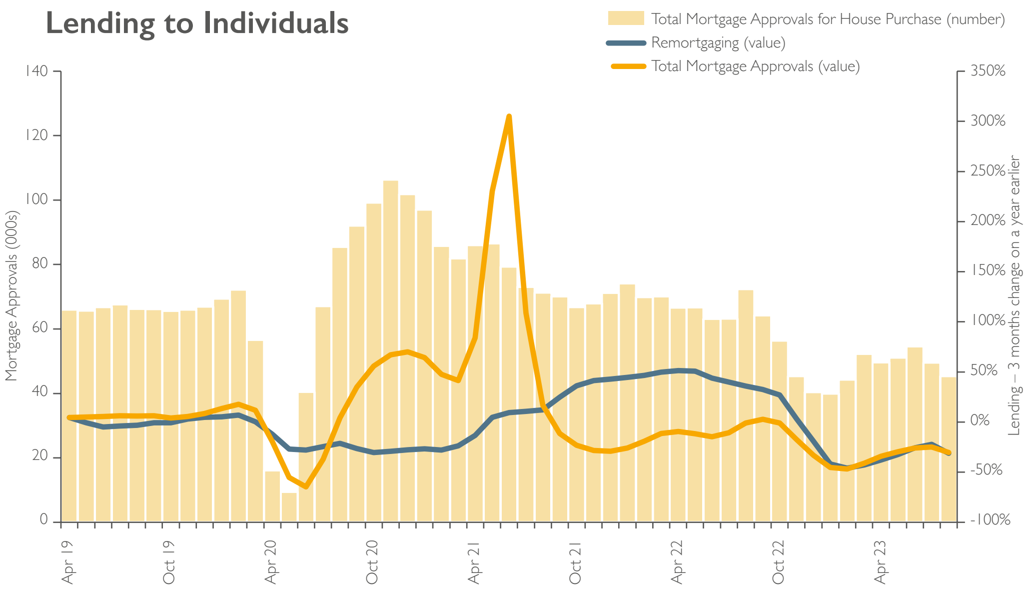
*Data for 2020-2022 for Wales was released on a financial year basis only

Source: DLUHC, ONS, Construction Products Association peak rates had been reached, lower than expected three, and particularly six, months ago. This has led to slight falls in mortgage rates and rates may fall further if inflation slows faster than market expectations early in 2024. Despite this, however, mortgage rates are likely to remain high in comparison to rates over the past decade. As a result, whilst mortgage approvals rose in October and November, in response to falls in mortgage rates and, for house builders, an increase in the use of incentives, property transactions have still not hit the nadir and with mortgage rates unlikely to fall back to the historic lows seen as recently as 2021 Q4, house building is likely to remain at subdued levels in 2024 H1 and potentially even in H2 with a recovery in starts and completions most likely in 2025.



As highlighted in previous forecast publications, UK homeowners are among the most exposed in Europe due to the combination of higher interest rates than in the EU and the reliance on short-term fixed-rate mortgage offers in addition to some mortgage holders relying on interest-only mortgages. Around 1.5 million households will be affected by much higher mortgage costs this year alone after 1.4 million households came off fixed-rate mortgages in 2023 according to the Office for National Statistics. Over the last twenty years, since 2003, the proportion of mortgages on a variable rate has fallen from 70.0% to 13.0% This suggests that the impacts of rate rises are likely to be a long-term, slow burn effect rather than a sharp cliff edge. The largest impacts on existing homeowners are for the 702,000 interest-only homeowner mortgages outstanding at the end of 2022, which is 6.9% per cent fewer than in 2021 as borrowers chose to pay ahead of schedule with a further 222,000 homeowner mortgage that were a part-interest-only homeowner mortgages, an 11.9% fall compared with

Lending to Individuals



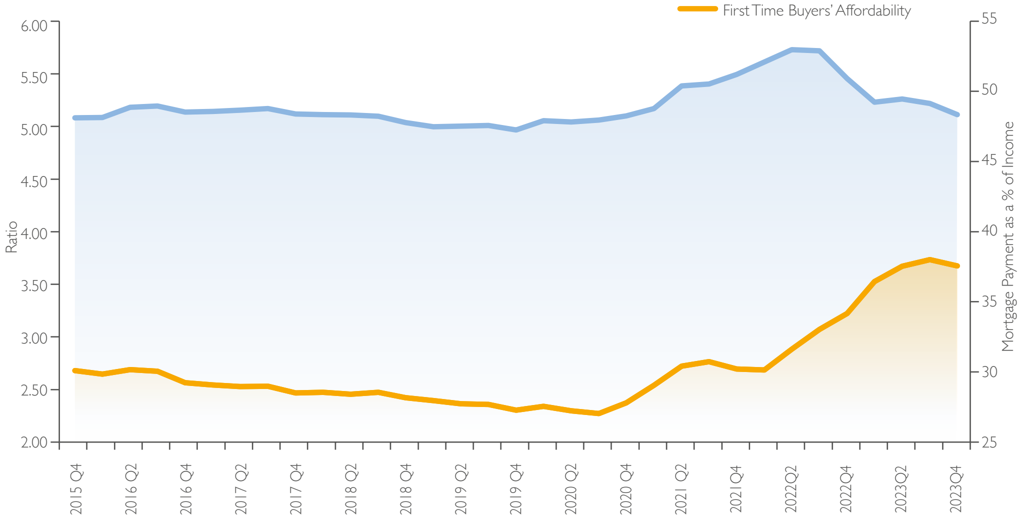
Source: Bank of England

a year earlier. However, there were a total of 8,501,000 residential mortgages outstanding, the bulk of which (81%) are fixed-rate mortgages. These borrowers will only feel the impacts of interest rate rises when their term ends so, the majority of issues in the general housing market are likely to be more of a slow burn issue rather than a cliff edge. Even for buy-to-let mortgages, where there has been a particular focus given their disproportionate use by small landlords, questions have been raised as to whether there would be a sharp rise in forced sellers, in a declining market, leading to an acceleration in house price falls. Two-thirds of the total of 2,033,512 buy-to-let mortgages outstanding are also on fixed rates.

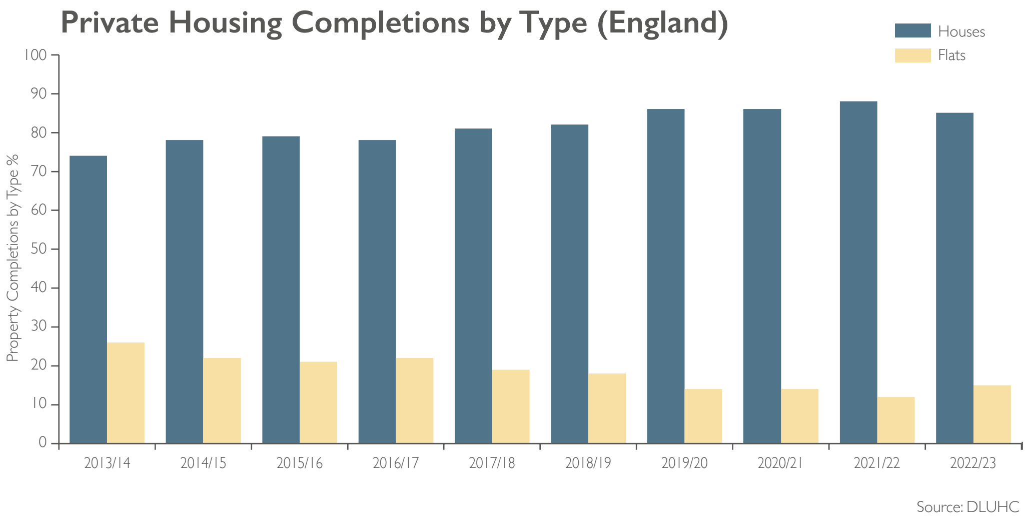
The CPA's view continues to be that most homeowners are likely to reprioritise spending to ensure that mortgage payments are kept up, rather than becoming a forced seller in a slowing market, if at all possible. For the vast majority of those on fixed-rate mortgages, the rise in mortgage payments even for those homeowners whose fixed-rate term is ending this year will be manageable, particularly given the strong labour market currently.

The average cost of a three-year fixed-rate 75% LTV mortgage rose to 6.02% in August according to the Bank of England, rising above 6.0% for the first time since November 2022, immediately following the government's Mini Budget. The most recent statements from the Bank of England and financial markets' current view that interest rates are at peak already have started to have an impact on reducing mortgage rates and in November the five-year fixed-rate had fallen to 5.27% but clearly this contrasts sharply with the 1.12% as recently as October 2021. During January 2024, some lenders started tentatively dipping below the 5.0% rate for the first time since last Summer but whether the majority of lenders follow will be dependent on whether the Bank starts to signal clearly that it is ready to reduce interest rates. At the beginning of January, Goldman Sachs forecast that the Bank of England would start cutting interest rates from May with cuts of 0.25 percentage points at each quarterly policy meeting until the base rate reaches 3.0% in May 2025, which is very much on the optimistic side. The majority of forecasters anticipate two interest rate cuts this year and, furthermore, it is worth noting that the Bank is generally on the cautious side (see Economy) given the extent to which the most recent economic data have been volatile and the large number of uncertainties, particularly in the light of the disruptions in the Red Sea in January that may affect inflation, initially through a delayed supply of imports, dependent on current stocks, and through

Affordability



Source: Nationwide



increased freight costs but indirectly if there are consequent rises in oil and product prices. The CPA has cautiously assumed two interest rates cuts by the Bank of England in 2024 but the uncertainty around this remains high, highly dependent on inflation data in the first half of this year.

In terms of mortgage rate predictions, as much as they are worth, the Bank of England governor Andrew Bailey stated in December that he anticipated that the base rate will remain at its current level of 5.25% for some time with no cuts for the foreseeable future although this is likely to be an attempt to manage expectations cautiously rather than realistically signal to the financial markets. S&P Global Ratings forecast that the Bank of England will not start cutting interest rates until the second half of 2024. Capital Economics stated in December that the Bank of England will not cut interest rates from 5.25% until late in 2024 but, facing a stagnant economy, that cuts will accelerate and interest rates will fall to 3.0% in 2025.

*UK **house prices** are forecast to **fall** by **2.0%** or remain broadly flat in 2024*

*as **declining demand** is partially offset by a **reduction in supply of homes** onto the market*

On the buyer side, there were 50,067 mortgage approvals in the UK in November 2023 according to the Bank of England, which is 4.6% higher than in October and 9.9% higher than a year earlier (during the post-Mini Budget spike in mortgage rates and slump in mortgage approvals).

However, the number of mortgage approvals in the UK in November 2023 was also still 27.8% lower than in January 2020 and 23.5% lower than the 2018 to 2019 average, pre-pandemic 'race for space' and rate rises. UK mortgage rates have been falling since August's peak (from 6.02% for a three-year fixed-rate 75% LTV mortgage in August to 5.27% in November) but clearly rates remain high and contrast sharply with 1.12% as recently as October 2021. UK mortgage rates are likely to continue to fall this year due to greater certainty over interest rates already being

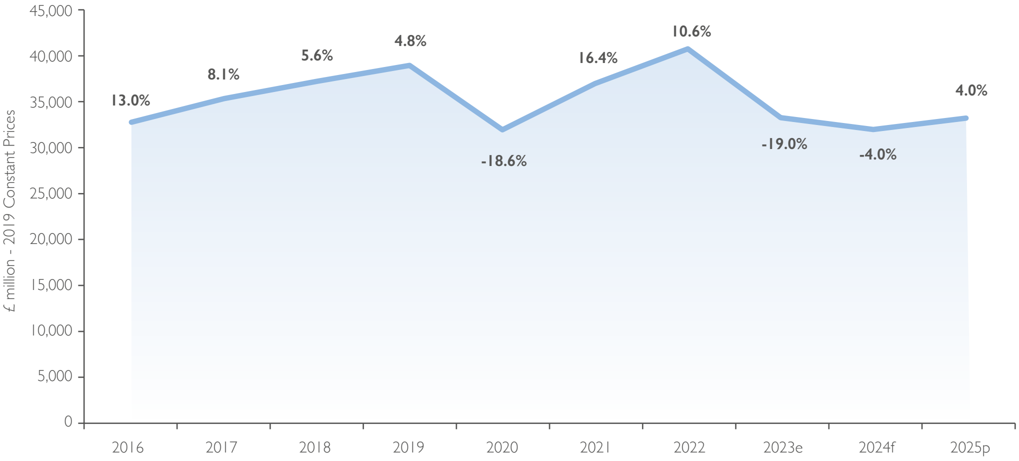
at peak and the increasing likelihood that interest rates will begin to fall earlier this year, and earlier than anticipated last year.

Despite the falls in mortgage rates so far and expected falls during 2024 as interest rates gradually fall, mortgage rates clearly won't return to levels seen up until October 2021 even in the medium-term and so, consequently, the UK housing market (mortgage approvals and property transactions plus, as a derived demand, house building) will not return to 2021 and 2022 levels even medium-term, particularly as the housing market was also helped by government demand-side stimulus at that time.

It is also worth noting that, unsurprisingly, since mortgage rates rose sharply, the housing market has been increasingly reliant on cash buyers and investor purchases as implied by mortgage approvals accounting for a smaller proportion of property transactions. However, at least the recent rises in mortgage approvals do point towards a partial recovery in property transactions during 2024 H1 so 2022 Q4 and 2023 H2 are likely to have been the nadir for the housing market.

The key questions going forward are what mortgage rates settle at in 2025/26 and, so, what level mortgage approvals settle at, given that mortgage approvals in November 2023 were still 24.5% lower than the 2014-19 average, before the recent distortions.

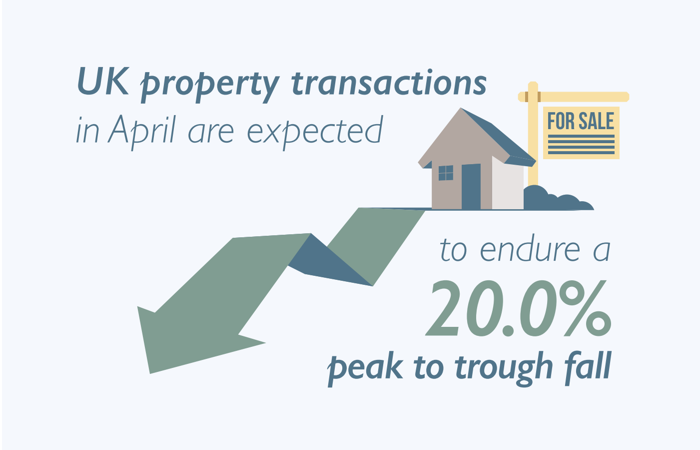
Private Housing Output



e = estimate, f = forecast, p = projection

Source: ONS, Construction Products Association

There were 80,780 residential property transactions in the UK in November 2023, which is 1.2% lower than in October and 21.5% lower than a year ago (just before the full effects of last year's Mini Budget), according to HMRC. UK residential property transactions in November 2023 were also 16.4% lower than in January 2020, pre-pandemic 'race for space' and before the stamp duty holidays but with the unconstrained version of Help to Buy in place.



It is worth noting that whilst UK residential property transactions in November 2023 fell 21.5% compared with a year ago, mortgage approvals rose by 9.9%, albeit approvals having fallen more sharply before. Because property transactions lag mortgage approvals, UK residential property transactions are likely to start to rise during the first half of 2024. It is worth noting that property transactions have not fallen as sharply as mortgage approvals because transactions have been partially sustained by cash buyers, from those wealthy enough to not need a mortgage, and bulk purchases from investors that see long-term rental demand.

Year-to-date (January-November), transactions in 2023 were 19.3% lower than in 2022 (which was a very strong housing market before the Autumn Mini Budget) and were also 32.0% lower than in 2021, which was a temporary spike due to delayed transactions from 2020, when the housing market was shut in initial lockdown and also UK property transactions in 2021 were boosted by the 'race for space', itself boosted by the stamp duty holiday and Help to Buy directly but also by their deadlines bringing forward residential property transactions.

The official ONS/Land Registry house prices have only fallen 2.3% since peak so far as sharp falls in demand have been partially matched by falls of homes onto the housing market, which means that the falls in demand are reflected more clearly in mortgage approvals and property transactions. In addition, the latest ONS/Land Registry house price data is largely based on transactions before the rises in interest rates and mortgage rates in Summer 2023. In addition, the ONS/Land Registry house price data has also been sustained by cash sales and institutional investment unlike the Nationwide and Halifax house price indices.

The average UK house price in November 2023 fell by 2.1% compared with a year earlier, according to the ONS/Land Registry latest data. House prices in November were also 1.9% lower than in August and 2.3% lower than at the pre-Mini Budget peak. As the CPA has previously highlighted, the ONS/Land Registry house price index is based on all property transactions including cash buyers and investor purchases, unlike the Nationwide and Halifax house price indices, which are based only on their mortgage offers and will have been affected more by the rising interest rates than the ONS/Land Registry house prices. It is also worth noting that as the number of mortgage approvals and property transactions has fallen significantly, cash buyers and bulk purchases at the higher end of what is a smaller housing market may skew the ONS/Land Registry average house price.

Across the regions, the fastest annual house price falls were in London (6.0%) and the South West (4.1%) whilst the only region with annual house price growth was Scotland (2.2%) according to the ONS/Land Registry.

According to lender Nationwide, UK house prices ended 2023 down 1.8% compared with December 2022, leaving them almost 4.5% below the all-time high recorded in late Summer 2022. Prices were flat compared with November. Housing market activity was weak throughout 2023. The total number of transactions has been running at around 10% below

pre-pandemic levels over the past six months, with those involving a mortgage down even more (around -20%), reflecting the impact of higher borrowing costs. Conversely, the volume of cash transactions has continued to run above pre-pandemic levels.

Housing affordability has remained stretched and a borrower earning the average UK income and buying a typical first-time buyer property with a 20% deposit would have a monthly mortgage payment equivalent to 38% of take-home pay, considerably higher than the long run average of 30%. At the same time, deposit requirements remain prohibitively high for many of those wanting to buy – a 20% deposit on a typical first-time buyer home equates to around 105% of average annual gross income – down from the all-time high of 116% recorded in 2022, but still close to the pre-financial crisis level of 108%.

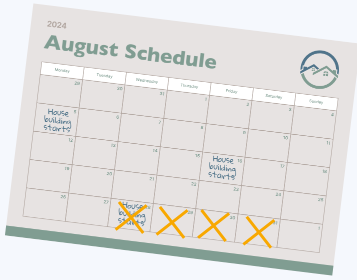
Looking forward, Nationwide stated that there have been encouraging signs for potential buyers recently with mortgage rates edging down. Investors have become more optimistic that the Bank of England has already raised rates far enough to return inflation to target and will reduce rates in the years ahead. This shift in view is important, as it has brought down longer-term interest rates, which underpin fixed mortgage rate pricing. Nevertheless, it also highlighted that a rapid rebound in activity or house prices in 2024 appears unlikely. While cost-of-living pressures are easing, with the rate of inflation now running below the rate of average wage growth, consumer confidence remains weak and surveyors continue to report subdued levels of new buyer enquiries. Moreover, while markets are projecting that the next Bank Rate move will be down, there are still upward risks to interest rates. Inflation is generally slowing, but measures of domestic price pressures remain far too high.

It appears likely that a combination of solid income growth, together with modestly lower house prices and mortgage rates, will gradually improve affordability over time, with housing market activity remaining fairly subdued in the interim. If the economy remains sluggish and mortgage rates moderate only gradually, as we expect, house prices are likely to record another small decline or remain broadly flat (perhaps 0.0 to -2.0%) over the course of 2024.

According to the HM Treasury consensus of macroeconomic forecasters published in December 2023 there is an unsurprisingly high variance for house price forecasts amongst the macroeconomic forecasters with forecasts differing considerably based upon when the forecasts were determined, which determines what peak interest rate they would have assumed, how long they assume that interest rates will remain at peak and the extent to which they fall this year. In addition, their house price forecasts will be determined by their assumption of the extent to which unemployment rises and, consequently, the extent of forced sellers. The average forecast for UK house prices in the year to 2024 Q4 is for a fall of 2.9% with the most optimistic forecaster anticipating house prices rise by 5.5% in 2024 Q4 compared with a year earlier whilst the most pessimistic forecaster anticipates falls of 12.1% in in the year to 2024 Q4.

Away from the macroeconomic forecasters, property consultancy CBRE revised up its forecast from a 2.2% fall to a 0.9% fall in 2024 due to an improved macroeconomic backdrop and expectations of falling interest and mortgage rates. Property portal Rightmove was one of the more optimistic forecasters for house prices last year and it predicts that the average UK asking price, rather than sold house price, will only drop 1.0% in 2024. It stated that the average time to sell has increased from 45 days in November 2022 to 66 days in November 2023 as sellers have been reluctant to drop their prices. Another property portal, Zoopla anticipates a 2.0% fall in UK house prices, assuming that the average mortgage rate is 4.5% at the end of 2024 with cash buyers in the market keeping the transactions level broadly flat this year after the falls last year. Estate agency Hamptons is predicting no change in house prices during 2024 followed by 3.0% growth in 2025. Nationwide stated that it expects housing market activity to be subdued despite a wider economic recovery with house prices likely to record another small low single-digit decline or remain broadly flat over the course of 2024. Savills stated in December that it expects prices to hit the nadir in 2024 with a 3.0% fall in house prices based on interest rates at 4.75% by the end of 2024. Estate agency JLL is in line with Savills in forecasting a 3.0% fall in prices in 2024 but Knight Frank forecasts a 4.0% fall.

Private House building starts
are expected to ***fall*** *by* **4.0%** *in 2024 after the double-digit decline in 2023*



However, the future path of house prices is far from certain and will clearly be dependent on both mortgage rate rises and also the number of forced sellers, the latter of which will be heavily influenced by the extent of, or lack of, rises in unemployment. So far, the labour market remains robust and the unemployment rate for August to October 2023 was 4.2%, broadly similar to the previous quarter and it remains historically low (see Economy).

The CPA UK house price forecast is for a fall of 4.0-6.0% peak to trough based on the ONS/Land Registry index with the peak in September 2022, before the impacts of the spike in mortgage rates after the government's Mini Budget. However, it is worth noting that the Nationwide and Halifax house price indices are based on their mortgage lending only so they will not include the impacts of cash sales and investor purchases so they are likely to show greater falls than the official ONS/Land Registry data. It is also worth highlighting that the ONS/Land Registry house price index has surprised on the upside due to a lack of willing sellers in a market where demand has fallen and a lack of forced sellers, due to the strong labour market and homeowners reprioritising spending to ensure mortgage payments have been kept up, plus lenders being more flexible with homeowners that are behind on payments.

According to UK Finance, by the end of 2023 there were 105,600 cases with arrears, which accounts for just over 2.5% of the outstanding mortgage balance and represents an increase of 30.0% compared with December 2022. In 2024 it expects that the existing pressure on payments will persist and it forecasts that arrears will rise to 128,800 by the end of 2024. In 2025, it predicts arrears will rise more modestly to 137,800 cases, as the pressure on mortgage payments begins to recede. However, it also states that over 99% of the 10.8 million UK mortgages are not now in arrears and repossessions remain low. This is because, firstly, the affordability tests for new lending since 2014 have ensured that customers can afford their mortgage payments, even at a higher interest rates. In addition, secondly, unemployment, which has historically been the main cause of mortgage arrears and repossessions, remains at historically low levels. Furthermore, where customers have been struggling with mortgage payments, lenders have forbearance options to ensure that repossession is a last resort. There were an estimated 4,400 possessions in 2023 and it only expects a small increase to 5,100 this year.

Looking at affordability, both the house prices to earnings ratio and mortgage payments as a proportion of income have increased since the end of the initial national lockdown in Spring 2020 according to Nationwide. However, the key changes since Summer 2022 have been the unsurprising fall in the house price to earnings ratio, contrasting sharply with the equally unsurprising rise in mortgage payments as a proportion of income.

A dip in house prices, combined with rising earnings, in the light of economy-wide skills shortages and inflation concerns, has theoretically helped affordability in terms of the house price to earnings ratio, which peaked at house prices 5.9 times higher than average earnings in 2022 Q2 and Q3 before falling to 5.6 times higher than average earnings in Q4, the same as a year earlier, as demand started to fall post-Mini Budget and fell to 5.4 times higher than average earnings in 2023 Q1 before rising, marginally, to 5.5 times higher than average earnings in Q2. It remained, however, significantly higher than 5.0 times higher than average earnings that was the norm prior to the pandemic and even with further falls in house prices expected over the course of this year, it is unlikely that the house price to earnings ratio will fall substantially below 5.0, particularly as wage growth is likely to slow.

Given the sharp rise in mortgage rates in October and November, affordability in terms of mortgage payments as a proportion of income deteriorated for first-time buyers. In 2021 Q4 it was 30.3%, before interest rates began to rise from historic lows but even in 2022 Q2, prior to the Mini Budget, mortgage payments as a proportion of income were still 31.7%. However, post-Mini Budget, it reached 34.3% in 2022 Q4. Since then, further rises in interest rates and increases in peak interest rates as well as lenders having to price in additional risk and uncertainty, have meant that mortgage payments as a proportion of income for first-time buyers rose once again to 37.8% in 2023 Q2 and to 38.2% in Q3 before falling back slightly to 37.8% but, clearly, it remains at historically high levels.

Affordability-wise, mortgage repayments had previously kept within affordable levels due to historically low interest rates. However, to sustain this, first-time buyers in a sustained period of rapid house price growth but stagnant or falling real wages have had had to take out longer mortgages. In 2005, the average term for a first-time buyer was 25.8 years but by 2022 this had risen to 30 years. The latest data from UK Finance highlights that mortgage terms in excess of 35 years have become more popular for first-time buyers since the start of last year. In January 2022, around 8% of first-time buyers had a mortgage term longer than 35 years. By December 2022, however, after the average mortgage rate for a five-year fix increased from 1.6% to 5.1%, 17% of first-time buyers had a mortgage term longer than 35 years. The lack of housing-related measures in the Chancellor's Autumn Statement was of no surprise as it focused on working household tax and incomes plus business investment measures. However, it would not be a surprise if government were to moot longer-term measures as the norm, particularly for first-time buyers, as a policy option to enable greater demand in the housing market. In terms of other government policies aimed at the housing market, there is still little news from DLUHC regarding the potential for a new policy aimed at helping with deposits in a similar vein to Help to Buy, which was ended by HM Treasury in March 2023. Speculation abounds that measures will be announced in the Chancellor's Budget in March 2024 but, with little time for a significant impact before the expected General Election, the majority of policies are more likely to focus on, primarily, public relations or, potentially, longer-term structural changes in the housing market that would not have significant impact on the house building sector over the forecast period. There was an update on one key housing policy from government, the Housing Infrastructure Fund, in January 2024 based of a Freedom of Information request submitted to government. The £4.2 billion Housing Infrastructure Fund was announced in 2017 in an attempt to increase house building by providing local authorities with grant funding for key infrastructure such as transport and utilities connections. However, in the six years since the policy was announced, only 31.0% has been spent to date. It also confirmed that work started on fewer than 10.0% of the homes in its target, which was 340,000 but had been downgraded to 270,000 homes. Key reasons for the lack of delivery were the rise in construction costs and the difficulty of accessing, and resource needed to access, the funds. Furthermore, many of the developments that had grant funding, stated that they were unable to continue with the projects due to the rise in cost inflation making the projects financially unviable.

The government did, finally, publish its new National Planning Policy Framework (NPPF) in December 2023. The new NPPF is critical for setting the framework under which councils take decisions and establish local plans but it is likely to lead to fewer homes being built. Most of the changes in it were already proposed in the NPPF consultation in December 2022 so were unsurprising. However, local authorities with plans will no longer need to demonstrate a five-year supply of housing land and those that do need to demonstrate a five-year supply will not have to add additional contingency to ensure that they can realistically be met. However, house builders have persistently stated that five-year land supplies are crucial to justifying the unlocking of development sites. In addition, neighbourhood plans have been given more protection from speculative development, and the government's standard method for calculating housing need is now an advisory starting point for local housing numbers, not a local housing target specifically.

In practice, the key change means a downgrading of the requirement for local authorities to objectively assess their housing needs, which effectively means that it is confirmation that gives further license to local authorities to withdraw their plans and deliver fewer new homes despite noises from government that what is needed is more homes at the national level.

There were 53,530 house building starts in England in 2023 Q2, which is 86.5% higher than in Q1 and 25.6% higher than a year ago according to DLUHC as major house builders did the minimum necessary to register a start so that they could get ahead of the end of the one-year grace period for the uprated building regulations (Parts F, L, O and S) that add significant cost to building a new home. However, this is an issue we have highlighted in previous CPA forecast publications.

These starts are merely what we refer to as 'technical starts' as they do not reflect the level of house building or even what house builders intend to build going forward near-term. Consequently, product manufacturers feeding into early parts of house building would not have seen sales increase in line with starts given that house builders were solely doing the minimum necessary foundations work to register properties as a start.

Private housing completions in 2023 Q2 were 1.2% higher than in Q1 (as many house builders were finishing properties for their year-end in Summer based on pre-sales last year) but they were 17.1% lower than a year earlier. It is worth noting, however, that the full impact of the sharp fall in new housing demand since the Mini Budget last Autumn is only likely to be seen in private housing completions in the second half of 2023 and first half of 2024. Data on 2023 Q3 starts and completions were still not available at the time of writing.

UK brick deliveries are a useful proxy for house building starts in the absence of monthly starts data. UK brick deliveries in November 2023 were 9.2% lower than in October and 32.5% lower than a year ago according to the Department for Business and Trade (DBT). Note that November 2022, a year ago, was already after the Mini Budget that led to the initial spike in mortgage rates and the sharp fall in housing demand so November 2023's 32.5% annual fall is not from a high pre-Mini Budget base, which was the case in September.

Brick deliveries in November being 32.5% lower than a year ago is in line with house builder reports, stating Summer was poor, September did not have the usual pick up, October had a marginal improvement and activity slowed in November, going into the Winter.

Through brick deliveries we can see the lagged impact of mortgage rate rises on house building starts but whilst mortgage rates have fallen since August, they remain high relative to recent years and house builders are still focused on completing existing developments not starts, except in a few key areas and affordable housing, where demand has not fallen.

Given that monthly brick deliveries and starts data can be volatile, UK brick deliveries year-to-date (January-November) in 2023 were 29.5% lower than a year ago. They were also 30.4% lower than in 2019, pre-pandemic, and of even greater concern, 2023's UK brick deliveries year-to-date (January-November) were at lower levels than in 2020, which was adversely affected by the shutdown of the housing market and with construction not permitted to take place during the initial national lockdown.

The fall in UK brick deliveries for 2023 year-to-date is, however, broadly in line with the 28-33% fall in demand that many major house builders are reporting. For instance, Persimmon, the third largest house builder by volume reported that its completions in the calendar year 2023 were 33% lower than a year ago and that its build out rates in 2023 were 28% lower than a year ago.

As another reference point for brick deliveries and house building starts in 2023, if deliveries continued at November levels for the rest of the year (i.e. December) then, overall in 2023, deliveries would be 27.5% lower than in 2022 and 29.8% lower than in 2019, pre-pandemic (pre-'race for space', stamp duty holiday, with Help to Buy still in place etc.), implying house building starts more than a quarter down compared with last year and almost one-third lower than in 2019. Plus, UK brick deliveries in 2023 (and consequently house building starts) would even be 9.0% lower than in 2020, which was affected by the initial lockdown when the housing market was shutdown and construction activity was not permitted to occur.

Going forward, the concern is that 2024 is likely to see a flat, or negative, house building market (outside of affordable housing where demand has remained strong) after the declines this year with a pick up at the end of next year at best or, more likely, in 2025.

House builder recent trading statements are often a useful guide to the state of house building down on the ground.

Persimmon, the third largest house builder by volume and largest by market capitalisation, reported for the year ending 31 December 2023 that it completed the sale of 9,922 new homes, 33% lower than in the previous year. Its private average selling price increased by around 5% to £285,770 compared with £272,206 a year earlier, which largely reflects the mix of developments and house types sold. Pricing was firm in the first half of the year with softness and increased use of incentives experienced during the second half. Overall, incentive use was around 4% in the year compared with around 2% a year earlier. Its partnerships average selling price increased by 8% to around £152,850 compared with £142,017 a year ago. Full year operating margins are expected to have been in line with those delivered in the first half at around 14%. This reflects the build cost inflation, coupled with the effects of lower volume, one-off costs associated with the remediation of a small number of completed sites and accelerated exit from two sites, along with further investment. Overall build rates in the year were around 28% lower than the prior year.

It stated that it saw a sustained pick up in interest in its homes from the lows of 2022 Q4 but with demand still lower due to high interest rates and the removal of Help to Buy. Overall, average private net sales were 0.58 per outlet per week for the year compared with 0.69. Its forward sales position was up 2% on the prior year at £1,060 million compared with £1,040 million a year earlier of which £499 million relates to private forward sales, up 4% compared with £478 million a year ago. It anticipates that market conditions will remain highly uncertain during 2024, particularly for first-time buyers and with an election likely this year. However, it stated that mortgage rates are beginning to ease and build costs continue to moderate, which will benefit completions in 2024.

The UK's second largest house builder by volume, Taylor Wimpey reported results for the year ended 31 December 2023. Its completions including Joint Ventures (JVs) were 10,848 compared with 14,154 a year earlier. UK home completions (including JVs) were 10,438 compared with 13,773 a year ago, which included 2,388 affordable homes compared with 2,920 a year earlier equating to 23% of total completions compared with 21% a year earlier. Its net private reservation rate for 2023 was 0.62 homes per outlet per week compared with 0.68 in 2022. Excluding the impact of bulk deals, its net private sales rate was 0.54 compared with 0.65 a year earlier. The cancellation rate for the full year was 18%, the same as in 2022. UK average selling prices on private completions increased by 5.1% to £370,000 compared with £352,000 a year earlier with the overall average selling price increasing by 3.5% to £324,000 compared with £313,000 in 2022. Its order book value was £1,772 million compared with £1,941 million a year earlier, excluding joint ventures, which represents 6,999 homes compared with 7,499 homes a year ago, of which 2,565 are private 2,943 compared with a year earlier and 4,434 are affordable compared with 4,556 a year ago.

It also stated that prevailing build cost inflation continued to moderate throughout 2023 H2 and is now running at 0-1% on new tenders. It expects underlying build cost inflation of around 4% on 2024 H1 completions. Looking forward, it stated that it is too early in the year to gauge customer behaviour but that recent mortgage rate reductions which will improve affordability. It also highlighted that the planning environment remains challenging and will continue to impact outlet openings.

An interesting point to note was the change in business model in 2023 of Vistry Group, which is the combination of Bovis Homes and the housebuilding and partnerships divisions of Galliford Try and Countryside Partnerships. Given the downturn in housing demand, it stated in September that it would be focusing on partnerships demand and affordable housing, part-funded by Homes England as housing associations have increasingly reported that affordable demand has not dropped off to the same extent since the rate rises, and partly benefitted from the lack of affordability in the general housing market particularly for shared ownership (see Public Housing). It is unlikely that many major house builders can do the same, given that it would saturate the market and it does revolve around a substantial change in business model. In addition, it is difficult to know at this stage how profitable it would be medium-term compared with the private house building market once demand returns.

Vistry Group reported for the year ending 31 December 2023 that its total completions were down 5.4% to 16,124 units compared with 17,038 a year earlier, primarily due to its focus on partnerships and the affordable housing market rather than relying solely on the private housing market. Completions in the former Partnerships business were 3.3% higher than a year earlier at 9,422 units compared with 9,118 a year ago. It stated that it is seeing high levels of demand for homes from Registered Providers and Local Authorities, with an increasing demand profile from the PRS sector. In addition, it has been awarded an additional £20 million of affordable housing grant funding under the Strategic Partnership with Homes England, taking its total public funding to £170 million.

The former Housebuilding business delivered completions of 6,702 units compared with 7,920. It stated that demand in the open market has remained suppressed throughout the year reflecting the higher interest rate environment and inflationary cost pressures on household income. Incentives have been used to support open market sales and have been running at around 5% of open market price. It stated that the easing of mortgage rates in recent weeks was encouraging and that it is optimistic that this will help stimulate demand in FY24.

Vistry Group's sales rate averaged 0.96 sales per week per site compared with 0.71 a year earlier. It reported that its forward sales position was 12.4% higher than a year earlier at £4.5 billion compared with £4.0 billion a year earlier. It also stated that it agreed cost reductions for all existing and future contracts in the second half of 2023. Its timber frame operation, Vistry Works, delivered 2,500 timber frame units as planned and it expects output to double this year as it increases production towards its overall capacity of around 7,000 units from its three factories medium-term.

As highlighted in the CPA's previous forecast, demand for new flats in England remained on a downward trend for most of the past 15 years. It historically reached a peak in 2008/09 with flats accounting for 46.0% of total completions according to DLUHC from which it steadily fell to 22.0% between 2014/15 and 2016/17, prior to the Grenfell Tower fire. After this, the proportion of flats fell further to 14.0% in 2020/21 and to 12.0% in 2021/22 during the 'race for space', skewing demand to houses on the outskirts of cities rather than flats in cities, before rising back up to 15.0% in 2022/23. One minor positive for flats construction in October 2023 was that government finally provided a degree of certainty regarding whether, and from when, developers would need to ensure that towers above 18 metres would be required to have a second staircase. Government had mooted this early last year but had provided no timeframe or detail, which had led both private and public developers to put schemes on hold. In October, the Secretary of State for Housing stated that transitional arrangements for the new rules would provide a 30-month grace period that will run from the date the government formally publishes and confirms the changes to Approved Document B in building regulations, which implies that the second staircase rule would not effectively apply until 2026 at the earliest. As a result, current towers schemes in the pipeline can go ahead but, without the lack of critical technical guidance on second staircases, architects and developers still cannot plan in advance for medium-term projects.

In addition to concerns regarding demand house builders are also facing supply issues. In particular, planning issues that house builders consistently report as problematic have been exacerbated by the issue of nutrient neutrality as highlighted by the CPA in previous forecasts and there appears to be no easy, quick solution near-term. It had appeared in Summer 2023 that the government was easing requirements on water and nutrient neutrality but its legislation was halted in the House of Lords. The Home Builders Federation stated in July that interventions by Natural England are delaying an estimated 180,000 homes over the disputed contributions of housing work to high levels of nutrients in waterways. It also stated that the costs of the growing number of new taxes, regulations and policies are adding at least £20,000 to the cost of building a new home. Although this affects all house builders, the largest impacts near-term are clearly for smaller house builders given that majors at least have land in different parts of the country already with planning permission that they can build out on near-term whilst they deal with the additional burdens of nutrient and water neutrality. In November 2023, the Chancellor confirmed plans in the Autumn Statement to make £110 million available through a Local Nutrient Mitigation Fund, which the government states will support local planning authorities affected by nutrient neutrality rules to deliver local nutrient offsetting schemes with an aim of this is to unlock 40,000 homes over the next five years although a lack of detail means that it is difficult to see whether this will make a tangible difference at this stage given many false dawns already on dealing with water and nutrient neutrality issues that have been around since 2018.

Looking at planning approvals, there was a downward trend in 2022 and this continued into 2023. The latest Housing Pipeline report from the Home Builders Federation (HBF) highlights that the number of planning permissions being granted for new homes continued to decline in the third quarter of 2023, falling to another record low. The number of sites granted planning permission in the past 12 months in England was the lowest quarterly figure recorded since the Housing Pipeline Report began in 2006. 2,447 projects were granted planning permission, 3% lower than in 2023 Q2 and 19% lower than a year earlier. At 50,316, the number of housing units granted permission in England during 2023 Q3 was 12% lower than in the previous quarter and 28% lower than 2022 Q3. In the year to September 2023, the number of units gaining permission was 245,872, which is 15% lower than in the previous year and the lowest for a 12-month period since 2015 Q3.

Whilst the focus tends to be on the largest house builders, which provide more than three-quarters of house building volumes, the largest issues are for the smaller and medium-size house builders, which are cash-flow reliant and don't subcontract out the majority of cost, activity and risk. Furthermore, they also do not have land assets with planning permission and multiple developments around the country that activity can be shifted to based upon where demand remains relatively strong. Plus, they suffer more greatly from issues in the planning system, given their lack of resource and the lack of resource in local authority planning departments. In addition, they are also more affected by cost inflation issues than larger house builders, that have greater market power and can push issues onto the supply chain. The FMB House Builders Survey 2023, published in November, highlights that not only was buyer demand at its lowest level since 2015, when the survey began but that the planning system was rated as the top major barrier holding back the delivery of new homes, even beyond restricted mortgage availability, which was the second largest barrier. Lack of available land was the third largest barrier for small and medium-size house builders whilst materials costs were the fourth largest barrier.

The Build to Rent sector covers new build developments for private rent that aim to generate a long-term return on investment and is typically financed by institutional investors. Given the long-term nature of the investment and returns institutional investment in Build to Rent has the potential to provide an uplift to house building activity, although despite strong growth in recent years, Build to Rent still only accounts for a small proportion of the 5.0 million privately-rented housing stock in Great Britain. Given the slowdown in demand in the private housing market and house building sector, institutional Build to Rent is likely to be less affected by short-term demand falls given that it is based on longer-term returns on the asset at a higher customer price point and higher quality asset, particularly as rental demand remains strong due to a lack of supply. However, it is not immune to the impacts of the housing market and the wider economy, particularly the rise in interest rates that increase funding costs.

The British Property Federation stated in November 2023 that the Build to Rent sector continued to expand over the past twelve months but sharp increases in build and financing costs have stalled delivery in London. The total number of Build to Rent homes completed or in the pipeline across the UK rose to 263,694 at the end of 2023 Q3, 11% higher than a year earlier (from 237,554). The number of completed homes increased by 11% to 92,140 whilst the number of units under construction rose by 12% to 59,043 and units in planning increased and by 10% to 112,511. Regional cities accounted for 60% of all completed and pipeline Build to Rent homes and activity remained robust with the number of units under construction increasing by 16% in 2023 Q3 compared with a year ago, to 40,231, and new starts in 2023 Q3 totalled 3,339 units. However, in London, increases in build and financing costs have had a severe impact on the delivery of larger, more capital-intensive schemes. New starts in the capital totalled just 266 units in 2023 Q2 and 434 units in 2023 Q3. Units under construction increased by only 4% in 2023 Q3 compared with a year earlier.

Upper Scenario:

- Residential property transactions rise in 2024 H1
- Single-digit house price growth
- Cost inflation eases
- Strong labour market

Although demand in the housing market fell in 2023 H2 due to the lagged effect of interest and mortgage rate rises, demand may rise, albeit from a low base, as mortgage rates fell away at the end of 2023. If sustained, this could see a recovery in property transactions, house prices and house building earlier than anticipated, particularly given that slower cost inflation could help to ensure that a recovery in margins is also available for house builders.

Lower Scenario:

- UK economy contracts in 2024 H1
- Inflation resistant to slowing further in 2024 H1
- Interest rates remain at 5.25% throughout the year
- Mortgage rates start to rise again
- Higher unemployment leads to house price falls

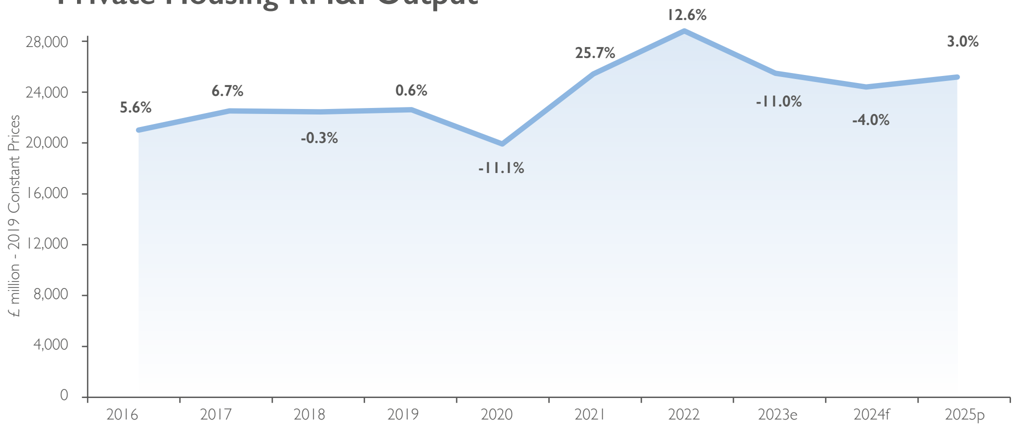
If inflation does not slow further in 2024 H1 and the UK economy technically enters a recession with two successive marginal contractions in GDP then unemployment may rise more significantly than expected, with a rise in forced sellers. This is particularly the case if inflation remains stubbornly above the Bank of England's target and financial markets re-adjusting to interest rates staying at peak for longer may lead to rises in mortgage rates after the falls in Autumn 2023. This would likely see falls in house prices and a sharper decline in private house building in 2024 before recovery in 2025.

Private Housing RM&I

Output in the private housing repair, maintenance and improvement (rm&i) sector continues to remain subdued as the rising cost of living and the rising cost of construction hit demand for improvements projects despite the general slowdown in inflation in Autumn 2023 and rises in the consumer confidence indices. Activity in private housing rm&i was buoyed temporarily, between 2020 Q3 and 2022 Q1, by a spike in activity due to increased working from home and a 'race for space' as highlighted in previous forecasts. However, the economy has broadly settled into the 'new normal' and, as a result, sector activity continues to fall back. Output is forecast to fall by 4.0% in 2024 after the double-digit fall in activity last year, which is a revision down from flat activity in the previous forecast. Activity is likely to rise by 3.0% in 2025 as the general housing market recovers. It is worth noting, however, that in spite of falls in improvements activity over the past two years, energy-efficiency retrofit and solar photovoltaic work has continued to remain strong in the light of energy security and price concerns.

Note that the CPA has major concerns regarding the ONS's historic data on rm&i output (see Overview). It is worth noting that the ONS construction output data continues to be inflated by issues in the repair and maintenance data, which particularly affected private housing repair, maintenance and improvement (rm&i) and the CPA has been highlighting for over one year. According to the ONS, private housing rm&i output in October was 1.3% higher than in September and 8.1% higher than a year ago but it reported that it remained 47.7% higher than in January 2020, pre-pandemic. This is not in line with firms operating in the sector (SME contractors, builders merchants and product manufacturers). As construction inflation slows, this is likely to become less of an issue in terms of the change in private housing rm&i output but it will still leave the output level at an artificially high level. The issue in the ONS r&m volume of output data appears to occur as the ONS is underestimating price inflation in r&m, which it uses to deflate construction output value and turn it into volume of output. As it is underestimating price inflation, it is overestimating volume of

Private Housing RM&I Output



e = estimate, f = forecast, p = projection

Source: ONS, Construction Products Association

activity. To illustrate this, inflation in new housing peaked at 12.2% after the spikes in energy and commodity prices in 2022 according to the ONS (when construction materials price inflation peaked at 26.8%). The ONS, however, estimated that inflation in housing r&m peaked at only 5.9% whilst firms in the sector (SME contractors, merchants and manufacturers) stated to the CPA that inflation in the sector was more than double the ONS estimate. As a result, the ONS has been consistently underestimating price inflation in r&m since Spring 2022 and overestimating the level of r&m output. In addition, the ONS construction output data also appears to have a survivor bias issue due to the large number of contractors that have become insolvent over the past year. As a result, the CPA is forecasting activity down on the ground to help inform firms regarding what is likely to be upcoming rather than trying to match the ONS figures that will published later for the forecast period.

***The fall in property transactions** in 2023 and 2024 H1 is expected to lead to further **falls in improvements activity** this year*

Firms down on the ground (merchants and small residential improvements contractors) report to the CPA that the start of 2024 has been poor so far, although a significant proportion of this is likely to be due to the poor weather affecting the UK with many areas affected by persistent rain, floods and snow during the first half of the month. Activity at the start of 2023 also saw a poor start due to rain but activity improved in February and March due to a degree of catch-up in delayed activity so the extent of this will be key to fortunes overall for Q1. Given that activity in the first quarter of last year was relatively strong and activity fell away significantly over the course of the rest of the year, if activity in 2024 continues at the levels seen in the second half of 2023 then, overall, output this year would end up around 4.0% lower than a year ago. Positive risks remain as inflation in Autumn 2023 slowed more than anticipated three and six months ago. This is particularly important as inflation directly reflects the cost of living issues homeowners have faced and, indirectly, led to upward pressure on interest rates from the Bank of England, which has placed added pressure on homeowner finances. Interest rate expectations themselves have changed considerably, however, in the last three and six months. Nevertheless, many households are still likely to be financially-constrained and many of the households that still have considerable finance for improvements works may have already done these projects during the 'race for space' boom period. Or, these homeowners are more likely to be doing these projects in the energy-efficiency retrofit space, given the rising emphasis on energy security and prices, plus the increasingly high profile nature of the transition to net zero.

The majority of rm&i output (approximately 60% per year) covers general repairs and maintenance, which provides the general level of activity and tends to be relatively stable. The volatility in the sector tends to be due to the improvements part of the sector. In the CPA's model for private housing rm&i, the key explanatory variables are residential property transactions, real wage growth, consumer spending and unemployment. In addition, housing wealth and household savings enable activity in the sector as they are used as sources of finance for rm&i activity with house price growth also providing an incentive to invest in increasing the value of their asset.

Looking at property transactions, there has historically been a 70% positive correlation between property transactions and private housing rm&i activity with a three-quarter lag. This means that within 6-9 months of purchasing a property, there is often improvements work when the purchased property is an existing property, as opposed to new build, which tends to have little in the way of significant size improvements works when purchased. In addition, the relationship is stronger when the existing property is a house rather than a flat given the average age of the housing stock compared with flats and the extent of indoor and outdoor refurbishment work that can be conducted on a house compared with a flat. The 'race for space' and government stimulus to boost an already-strong housing market during the pandemic meant that not only was there a sharp rise in property transactions between 2020 Q4 and 2022 Q3 but that this demand was skewed towards houses rather than flats and also in areas of greater affordability, generally outside cities. However, conversely, the decline in the housing market since the government's Autumn Mini Budget and sharp increases in Bank of England base interest rates to try mitigate robust inflation have led to rises in mortgage rates and declines in property transactions. It is worth noting, however, that the sharpest falls have been in mortgage approvals rather than property transactions so far. This is firstly because the mortgage approvals are directly affected by the mortgage rate rises whilst property transactions are slightly protected by a part of the housing market being cash buyers and bulk (investor) purchases. However, mortgage approvals are also considerably earlier in the process of the home move and, consequently, are, to a certain extent, an indicator of transactions to come in subsequent months.

There were 80,780 residential property transactions in the UK in November 2023, which is 1.2% lower than in October and 21.5% lower than a year ago (just before the full effects of last year's Mini Budget), according to HMRC. UK residential property transactions in November 2023 were also 16.4% lower than in January 2020, pre-pandemic 'race for space' and before the stamp duty holidays but with the unconstrained version of Help to Buy in place.

It is worth noting that UK residential property transactions in November 2023 fell 21.5% compared with a year ago whilst mortgage approvals rose by 9.9%, albeit approvals having fallen more sharply before. Because property transactions lag mortgage approvals, UK residential property transactions are likely to start to rise during the first half of 2024. It is worth noting that property transactions have not fallen as sharply as mortgage approvals because transactions have been partially sustained by cash buyers, from those wealthy enough to not need a mortgage, and bulk purchases from investors that see long-term rental demand.

Year-to-date (January-November), transactions in 2023 were 19.3% lower than in 2022 (which was a very strong housing market before the Autumn Mini Budget) and UK residential property transactions year-to-date (January-October) in 2023 were also 32.0% lower than in 2021, which was a temporary spike due to delayed transactions from 2020, when the housing market was shut in initial lockdown and also UK property transactions in 2021 were boosted by the 'race for space', itself boosted by the stamp duty holiday and Help to Buy directly but also by their deadlines bringing forward residential property transactions.

There were 50,067 mortgage approvals in the UK in November 2023 according to the Bank of England, which is 4.6% higher than in October and 9.9% higher than a year earlier (during the post-Mini Budget spike in mortgage rates and slump in mortgage approvals).

However, the number of mortgage approvals in the UK in November 2023 was also still 27.8% lower than in January 2020 and 23.5% lower than the 2018 to 2019 average, pre-pandemic 'race for space' and rate rises. UK mortgage rates have been falling since August's peak (from 6.02% for a three-year fixed-rate 75% LTV mortgage in August to 5.27% in November) but clearly rates remain high and contrast sharply with 1.12% as recently as October 2021. UK mortgage rates are likely to continue to fall this year due to greater certainty over interest rates already being at peak and the increasing likelihood that interest rates will begin to fall earlier this year, earlier than anticipated last year.

Private housing rm&i *is expected to* ***fall 4.0%*** *further in 2024 after a double-digit decline in 2023*

Despite the falls in mortgage rates so far and expected falls during 2024 as interest rates gradually fall, mortgage rates clearly won't return to levels seen up until October 2021 even in the medium-term and so, consequently, the UK housing market (mortgage approvals and property transactions plus, as a derived demand, house building and housing rm&i) will not return to 2021 and 2022 levels even medium-term, particularly as the housing market was helped by government demand-side stimulus.

It is also worth noting that, unsurprisingly, since mortgage rates rose sharply, the housing market has been increasingly reliant on cash buyers and investor purchases but at least the recent rises in mortgage approvals do point towards a partial recovery in property transactions during 2024 H1 so 2022 Q4 and 2023 H2 are likely to have been the nadir for the housing market.

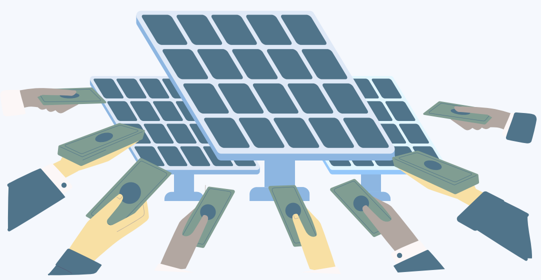
After real wage falls every month since November 2021, wages rose in real terms in August 2023 and, more recently, real average weekly earnings in August to October 2023 rose by 1.2% compared with a year ago for total pay, which includes bonuses, which was its highest increase since August to October 2021 when it was 1.5%. Similarly, real average weekly earnings in August to October 2023 rose by 1.2% compared with a year ago for regular pay, which excludes bonuses, which was its highest increase July to September 2021 when it was 2.2%. Almost two years of falling real wages directly meant less finance for non-essential spending and small, discretionary improvements activity as well as a lower likelihood of doing larger improvements activity. The return of persistent real wage growth means finance available for homeowners to do improvements work although whether they are confident enough to do so this year is questionable given that the cost of living and economic uncertainty remain key issues.

Indirectly, the reaction to inflation between 2021 and 2023 from the Bank of England was to raise interest rates, which has put further pressure on household finances through higher mortgage rates and higher finance costs. The CPA's assumption in the Autumn forecasts, in line with the majority of forecasters, was that interest rates were already at peak but that they would remain at peak for longer, throughout 2024. However, the significant slowdown in inflation in Autumn 2023 led to financial markets revising their view of interest rate forecasts once again. The most optimistic forecasters anticipate the Bank of England cutting interest rates from May 2024 with subsequent cuts in interest rates at the Bank's quarterly policy meetings leading to interest rates falling to 3.0% by the end of 2025. This is likely to be overoptimistic given that the Bank's reputation is to be cautious, particularly given that the most recent substantial revisions to interest rate expectations were based on data points in October and November 2023 whilst the Bank tends to take a longer view. This was underlined by December's CPI inflation rising marginally from 3.9% to 4.0% despite market expectations that it would slow marginally to 3.8%. The CPA anticipates that interest rates fall to 4.75% by the end of 2024 and then to 4.25% by the end of 2025 but even still, alongside rises in real wages, it means that homeowners will be financially better off than they were in 2023. The exception to this is likely to be the homeowners that have fixed-rate mortgages coming to the end of their term this year, of which there are approximately 1.5 million, who will still have a substantial increase in mortgage payments. As in 2023, most homeowners will be able to deal with higher mortgage payments by reprioritising spending or utilising savings. The majority of those remortgaging are not on interest-only mortgages, who are the only homeowners facing the two or threefold increases in mortgage payments. Furthermore, given a strong labour market, there is unlikely to be a lack of forced sellers or repossessions (see Private Housing).

Despite concerns that consumption going forward may be harder to finance given that the excess savings accumulated during the pandemic appear to be rapidly diminishing as households struggle to sustain spending, savings appear to be rising once again. The household saving ratio in 2023 Q1 was 7.6% but this rose to 9.5% in 2023 Q2 and to 10.1% in 2023 Q3, which is considerably higher than the 8.0% savings ratio a year earlier, which was before the spikes in mortgage rates so households overall appear to have sufficient finance.

In addition, the incentive for improvements work was boosted by double-digit house price inflation in 2021 and early 2022, given the increased rate of return on the sale of the home by investing in increasing the value of the home, particularly at a time of historic low interest rates. This made it particularly favourable compared with saving or other, riskier investments. However, falling house prices and rising interest rates make this less of an attractive proposition albeit still potentially worthwhile compared with many other investments. The CPA assumes house price falls of 4.0-6.0% peak to trough although given a lack of forced sellers then a lack of supply of homes onto the market appears to have, so far, sustained house prices. Consequently, this is unlikely to lead to further sharp falls in the sector but, equally, is unlikely to lead to a rapid recovery in activity this year.

Given that house prices experienced double-digit rises in both 2021 and 2022, the house price falls would not return prices back to 2020 levels but that is primarily due to the sharpest downturns in housing market demand expected to be seen in mortgage approvals and property transactions. However, this implies that the house price falls give less of an incentive for investment in rm&i whilst fewer property transactions mean fewer refurbishments within the 6-9 months after moving home. The expectation that property transactions fall at the end of 2023 and in 2024 H1, implies that, overall, private housing rm&i activity is likely to endure a single-digit percentage fall in activity.



Demand for ***energy-efficient retrofit*** *and* ***solar/PV*** *activity remains* ***strong***

GfK's Consumer Confidence Index continues to surprise on the upside despite all the economic uncertainty and headwinds. It reached its nadir in September 2022, the same month as the Government's Mini Budget, at -49. It gradually improved before briefly falling back to -45 in January 2023 due to concern regarding the UK economy. Since, then however, it has risen in each month except for brief falls in July and October. UK consumer confidence rose in December 2023 to -22, which is the second highest recorded since January 2022, prior to the spikes in energy, commodity and consumer prices. Although the -22 figure means confidence is still in negative territory, optimism for households' personal finances for the next 12 months displayed a notable recovery to -2 from the -29 reported in December 2022. Recovery in this is clearly important given that it reflects household financial optimism and control over personal budgets in the UK economy where 80% of GDP is consumption. Consumers continued to show resilience despite the rising cost of living, even though inflation was slowing in Autumn 2023, due to strong wage growth despite increasing numbers of households facing rising housing costs due to mortgage rate rises or increases in rents.

In December's GfK consumer confidence indices, the forecast for personal finances over the next 12 months increased one point to -2, which is 27 points higher a year earlier. The measure for the general economic situation of the country during the last 12 months was five points higher at -44, which is 22 points higher than in December 2022. Expectations for the general economic situation over the next 12 months increased by one point to -25, which is 28 points better than a year earlier. The Major Purchase Index was one point higher, at -23, which is 11 points higher than in December 2022. The Savings Index was two points lower, at +27, which is seven points higher than a year ago.

Looking back, the 'race for space' during the pandemic had a two-fold effect benefitting private housing rm&i. Directly, it led to a sharp rise in demand for rm&i work as homeowners, spending more time at home, desired better quality indoor and outdoor space. This is particularly the case given that rm&i is increasingly seen as worth doing, as an investment, when house prices are rising rapidly. In addition, many households that were working from home also spent on better quality home office and storage facilities. Indirectly, the 'race for space' also led many households to move home as they desired more space and did not need to be as close to their offices as previously so they could move to more affordable parts of the country where they could buy a larger home. This increase in property transactions also benefitted rm&i given that many home buyers, purchasing a home, tend to do refurbishments within the first 6-9 months of moving into a new property. However, clearly the 'race for space' spike in activity ended during 2022 and 2023.

The ONS measurement of the volume of private housing rm&i output does not reflect it but the indications from small contractors and builders merchants are that private housing rm&i output began to fall in Spring 2022. The cost of living increasingly became an issue and many households' concerns about both their own economic circumstances and the general health of the economy rose in the light of rising interest rates, increasing inflation and falling real wages. Households' response to this was often putting on hold and delaying or cancelling small, discretionary, non-urgent rm&i activity and this appears to have been the case throughout 2023. The indications are that after the falls in 2022, the volume of these smaller rm&i projects has broadly flatlined in 2023. Larger improvements projects appear to have followed a different trend since the spike in projects during the pandemic. Larger improvements work requiring planning applications continued throughout 2022, primarily as homeowners that could afford the work had pencilled in the finance for it at the start of the year and already had planning with homeowners concerned that delaying projects would only lead to the cost rising further. However, whilst the impacts of the rising cost of living, real wage falls and heightened economic uncertainty did not appear to affect larger improvements work on the ground last year, it did affect new planning applications for larger improvements work in 2023 and that primarily drove the sharp fall in rm&i activity during 2023.

The private housing rm&i sector continues to be challenging for the majority of contractors and merchants working on improvements activity. The BMBI builders merchants index reports sales of construction products by builders' merchants primarily to small contractors operating in the private housing rm&i sector. The value of construction product sales in 2023 Q3 was 3.3%

lower than a year earlier but, after taking account of their estimated 8.0% increase in prices, the volume of sales of products was 10.5% lower than a year earlier. Whilst materials inflation is slowing, benefitting the volume of sales, on the other hand the value of sales appears to have been deteriorating and in September the value of sales was 6.1% lower than a year earlier. In September, the sharpest falls in value of sales compared with a year ago were in timber & joinery products and landscaping. Conversely, the sharpest rises in sales compared with a year ago were in kitchens & bathrooms, where price inflation remains strong, as well as renewables & water saving and plumbing, heating & electrical products.

Outside of the main drivers of private housing rm&i activity in the CPA's model, government programmes also fund activity in private housing sector, aiming at energy-efficiency retrofit and fire-safety (primarily cladding remediation) of the private housing stock.

The ECO4 scheme came into force on 27 July 2022 covering almost a four-year period until 31 March 2026. The scheme focuses on lower-income households, providing support for improving heating efficiency. ECO4 incentivises the repairing of efficient heating systems where possible. Any boiler or electric systems that cannot be repaired will focus on alternative sources such as heat pumps, biomass boilers, solar/photovoltaics (PV) or a District Heat Network. By September 2023, 70,846 households had measures installed in households over 18 months, working out at just under 4,000 households with measures installed per month (3,936) according to the Department for Energy Security and Net Zero (DESNZ). However, it is worth noting that this includes what DESNZ refers to as repeat households. These are households that have had measures installed under ECO4 having already had measures installed in previous phases of ECO schemes. Without these, only 57,991 households had measures installed in the first 18 months of the scheme, averaging out at just 3,222 households with measures installed per month. This contrasts sharply with the previous phases of ECO programmes. 32,887 households per month had measures installed on average under ECO1 and ECO2, 12,002 households per month had measures installed on average under ECO: Help to Heat and there were 9,963 households per month that had measures installed under ECO3. To be fair to DESNZ, it is worth noting that even the previous phases of ECO schemes took time to build up momentum so the number of measures installed under ECO4 would be expected to rise significantly over the forecast period. Despite this, however, as highlighted in CPA forecasts before the scheme came into effect, ECO4 will still be a considerably smaller programme than ECO3, which itself was smaller than ECO: Help to Heat and ECO1 and ECO2.

However, according to the Energy Efficiency Infrastructure Group (EEIG) in Autumn 2023, ECO4 continues to be dogged by delivery issues. These are primarily four key problems identified. Firstly, the difficulty and costs associated with finding properties that meet the minimum requirements. Installers and energy suppliers reported to the EEIG that they found around 90% of qualifying fuel poor households cannot have works delivered, as either their properties cannot meet the requirements or it would be economically unviable to meet the requirements. Secondly, the installation cost assumptions in the ECO4 impact assessment do not reflect current market conditions given the sharp increase in construction costs in the last three years. Thirdly, the costs compliance under the PAS 2035 British standard for retrofitting dwelling remain high, with installers reporting to the EEIG that they are approximately £0.45 from every £1.00 on ECO delivery. Fourthly, installers are moving away from ECO, reducing supply chain capacity to deliver due to the cost and compliance issues, according to the EEIG, particularly given that funding and activity has ramped up on other schemes such as the Social Housing Decarbonisation Fund (see Public Housing RM&I).

Government announced a Boiler Upgrade Scheme (BUS) in 2021 that began in 2022 with £450 million of funding over three years to 2025 in England and Wales, so effectively £150 million per month. It was aiming at replacements of boilers with a grant towards the cost of an installation of an air source heat pump (ASHP), a ground source heat pump (GSHP) or a biomass boiler. Installations from 1 April 2022 were available with grants of £5,000 for an ASHP or biomass boiler and £6,000 for a GSHP. The government target of the BUS scheme was initially to achieve 30,000 boilers replacements per year. However, during the first year of the programme, between 23 May 2022 and 31 March 2023 only 15,768 applications were received for the scheme and only 13,739 vouchers were issued, less than half of the 30,000 target. In response to this government announced that from 23 October 2023, grant levels for the installation of ASHPs and GSHPs were to be increased to £7,500. Grants for biomass boilers remained at £5,000. Given fixed funding for the current financial year, that means fewer replacements than targeted but, as previously stated, the replacement rate in its first year so low that the larger grant and lower target is more realistic. Between May 2022 and November 2023, there have been a total of 30,000 applications for grants with 25,589 grants issued so far but, given that the larger grants only began towards the end of October, it will take time to see the full impacts of the increase in grant on increases in boiler replacements. Current estimates still suggest that air source heat pumps cost between £7,000 and £14,000 to purchase and install whilst ground source pumps can cost between £15,000 and £35,000, so the extent to which the voucher changes homeowners' decisions regarding heat pumps and the extent to which government meets its revised target remain uncertain in the near-term. Medium-term, however, the prospects are brighter. Funding for the Boiler Upgrade Scheme (BUS) is set to increase to over £1.5 billion spread over three years starting from April 2025, which equates to approximately £500 million per year. The new funding package should provide enough money for around 66,000 heat pump subsidies per year in England and Wales until March 2028. In Scotland, its heat pump grant was already increased to £7,500 in December 2022, with an extra £1,500 for rural households. Scotland also offers interest-free finance alongside its subsidy, while a Home Energy Scotland scheme provides support and advice to households.

In addition to ECO4 and the BUS, in November 2022 the government announced a £1.0 billion ECO+ scheme. ECO+ came in on 1 April 2023 and was then rebranded as the Great British Insulation Scheme (GBIS). It currently runs to 31 March 2026. Government is focusing on two key groups; low-income groups that already qualify for existing energy-efficiency retrofit schemes (such as ECO4) and then households in lower council tax bands, which may or may not be able to afford energy-efficiency measures (all homes in Council Tax bands A-D in England, A-E in Scotland and A-C in Wales with an EPC of D or below). However, the target for homes that government expects to be retrofitted under the GBIS is of the scale of just 70,000 over three years with activity focusing on cavity wall installations, which is not the case for ECO4. So far, between May and November 2023, 2,566 measures across 2,194 measures have been installed and as the CPA has not factored in a significant uptick in activity as a result of the GBIS but, if this were to occur, it could represent an upside risk to the forecasts and is included in the CPA's Upper Scenario.

Near-term, a larger driver of additional activity continues to be the stream of urgent cladding remediation work on privately-owned residential towers that are taller than 18 metres, which is progressing at a slower rate than for public residential buildings.

At the end of November 2023, the Department for Levelling Up, Housing and Communities (DLUHC) reported that there were 238 private sector buildings with ACM cladding systems that are unlikely to meet current Building Regulations. Work has started on 93% of these buildings but only completed on 179, despite the initial deadline of 31 December 2019 over four years ago. This leaves 59 private sector residential buildings yet to be remediated. Of these, 14 are complete and awaiting signoff whilst 16 have started with cladding removed and 13 more have started. A further 11 buildings have plans in place with 5 buildings awaiting further advice or without a clear plan.

Going forward, after cladding remediation issues on private residential blocks, fire safety activity will begin to extend work to buildings above 11 metres with ACM cladding as well as buildings above 18 metres with other types of cladding in addition to addressing other key safety issues such as fire stops and fire doors plus other non-essential general issues discovered during remediation. As a result, addressing fire safety issues will provide a long pipeline of activity in the sector over the next decade. However, as highlighted in previous forecasts, even with finance, skills shortages for essential remediation works as well as availability and cost inflation issues for some products, such as pre-coated aluminium and steel, which will be medium-term, will constrain the rate of growth of activity. At this stage, the extent of work on buildings above 11 metres is unknown. The total number of residential buildings between 11 metres and 18 metres is estimated to be 78,000 but what is unknown is the number of these that have fire safety issues.

Overall, private housing rm&i output is now forecast to fall by 4.0% this year after the double-digit fall last year. This is a revision down as some of the anticipated fall in property transactions, which leads to lower rm&i activity within 6-9 months, is expected to now feed through in 2024 H1, In 2025, with lower interest rates, stronger economic growth and a growing housing market, growth of 3.0% is expected.

Upper Scenario:

- Strong labour market
- Inflation eases in 2024
- Lower interest rates and mortgage rates
- GBIS and BUS ramps up activity in response to larger vouchers

With a strong labour market, real wage growth and with homeowners less affected by the cost of living, the UK economy may enjoy significant growth in 2024 after flatlining over the past 18 months. With lower inflation, interest rates and mortgage rates, the housing market could recover quicker than anticipated in the forecast and not only would the recovery in property transactions boost private housing new build but also private housing rm&i activity. Furthermore, if the GBIS starts generating energy-efficiency (insulation) retrofit activity as government states and the increased value of the vouchers for the BUS increases installations then this would benefit the sector at a time when private housing rm&i demand has been easing, albeit insulation demand has not been easing.

Lower Scenario:

- Stubborn inflation
- Interest rates remain at 5.25% throughout 2024
- Increasing unemployment

If inflation were to remain stubborn and interest rates remain at 5.25% throughout 2024, as financial markets expected in Autumn 2023, and then all but the most essential maintenance could be paused or cancelled as job insecurity, rising homeowner costs and falling real wages would continue to hit consumer confidence and spending power.

Public Housing

Housing associations and local authorities are prioritising investment in their existing stock and this, combined with a slowdown in the wider housing market, rising debt servicing costs and lower surpluses, points to public sector house building being constrained over the forecast period.

New house building by housing associations and local authorities has been held back in recent years by strong inflation eroding grant funding, which, in turn, had fallen on a per unit basis since 2010. In addition, below-inflation rent increases that were implemented in April 2023 across the nations have lowered revenues, and have been eroding surpluses along with the rising cost for providing operational services and higher debt servicing costs for new and existing borrowing. As the general housing market began weakening in 2022, demand for affordable tenures initially held up but as interest rates have risen above 5.0%, a slowdown emerged in Summer. Trading updates in Q3 highlighted a sharp reduction in starts, sales and completions among large housing associations. Over the medium-term there has also been a growing focus among housing associations and local authorities on increasing spending to address issues on the existing public housing stock, from legacy fire safety measures to basic repairs and maintenance after high-profile cases and the introduction of the Social Housing (Regulation) Act have drawn attention to quality and basic upkeep (see Public Housing RM&I). This picture of constrained finances for new build public housing, and a lack of additional funding from central government, has resulted in reductions to development plans, especially as fire safety, basic repairs and maintenance, as well as decarbonisation and energy efficiency improvements, remain the priority for finance and resource. The downturn in starts, completions and output is expected to worsen in 2024, reflecting the contraction in activity that began in the second half of 2023. Growth is forecast to return in 2025, however, as a streghtening economy and housing market improve confidence to continue building out affordable schemes already committed.

Directly publicly-funded housing activity occurs through the Affordable Homes Programme (AHP), which covers starts until March 2026 and its predecessor, the Shared Ownership and Affordable Homes Programme (SOAHP), which covered starts up to March 2023 and

Public Housing Starts and Completions Great Britain

	2021	2022	2023	2024	2025
	Actual*	Actual*	Estimate	Forecast	Projection
Starts	42,551	39,481	38,691	35,983	37,062
	23.3%	-7.2%	-2.0%	-7.0%	3.0%
Completions	40,502	42,005	41,585	37,427	39,298
	27.0%	3.7%	-1.0%	-10.0%	5.0%
Output (£m)	4,713	5,227	5,122	4,610	4,841
	-0.5%	10.9%	-2.0%	-10.0%	5.0%
RM&I Output (£m)	7,200	7,064	7,347	7,493	7,643
	6.2%	-1.9%	4.0%	2.0%	2.0%

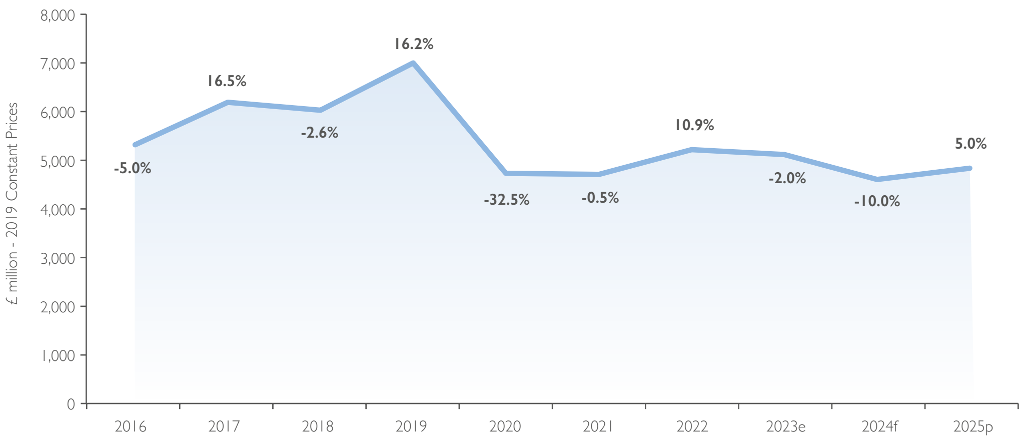
*Data from 2020-2022 for Wales was released on a financial year basis only

Source: DLUHC, ONS, Construction Products Association completions by March 2025. A government policy focus on increasing home ownership means that there has been a greater focus on the delivery of housing such as shared ownership and private sale by housing associations and private house builders rather than more traditional affordable and, in particular, social rent homes, which aligns demand more closely with private housing market drivers. Consequently, public housing demand will be susceptible to constrained household incomes, house price uncertainty and high mortgage interest rates that are affecting the general housing market. Although lenders began reducing mortgage interest rates at the end of 2023, they remain higher that at any point over the last decade and are likely to particularly impact first-time buyers and those with small deposits who are a key market for affordable home ownership properties. In comparison to 2022 and early 2023 when demand for affordable tenures increased, trading updates for Q3 showed sharp reductions in overall sales and completions. In the six months to the end of September 2023, completions by Peabody declined 37.2% year-on-year, completions by L&Q fell 37.2% and sales by Notting Hill Genesis were 83.1% lower.

The AHP 2021-2026 provides grant funding of £11.5 billion (£7.5 billion for outside London) and was initially expected to provide 180,000 homes (130,000 outside London and 50,000 in the capital) over the duration of the programme. However, the Department for Levelling Up, Housing and Communities (DLUHC) confirmed a £2.4 billion capital underspend for 2022/23, which was 25% below original plans, and includes £1.0 billion unspent on the Affordable Homes Programme due to economic volatility pausing plans. Of this, £0.9 billion has been reprofiled, with £0.6 billion moved into 2023/24 and £0.3 billion moved into 2024/25. The remaining £0.1 billion was returned to HM Treasury. DLUHC now expects the AHP to provide between 157,000 and 165,000 homes and in June, announced that funding would no longer be restricted to new build but could be used to replace existing homes in disrepair.

In 2021/22, the first year of the AHP, there had been 10,773 affordable starts, and 14,853 under the SOAHP. 21.2% of these starts in 2021/22 were for affordable rent, 14.0% for affordable home ownership and 5.7% for social rent. The tenure of the remaining 59.1% was not determined at the starts stage, which suggests that even immediately post-pandemic when housing demand was strong, there was still a considerable element of uncertainty over the future strength of the housing market and the extent to which grant funding can supplement housing associations' own resources as surpluses fall and remediation work on the existing stock becomes a priority. Highlighting the increased housing market uncertainty since then, for 2022/23 the tenure was undecided for 66.4% of the 26,410 affordable starts under the two

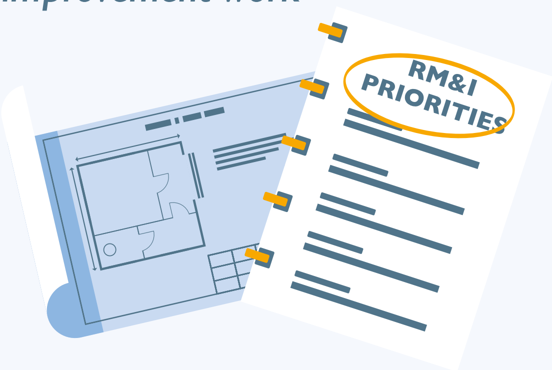
Public Housing Output



e = estimate, f = forecast, p = projection

Source: ONS, Construction Products Association

Plans and finance for new development *are competing against a growing list of* ***priorities for repair, maintenance and improvement work***



affordable homes programmes, whilst the number of starts for open market tenures was the lowest since 2013/14, and in the first half of 2023/24, the tenure of 70.2% of starts was undecided. In addition, the Regulator of Social Housing (RSH) surveys in recent quarters have shown that development spending has been markedly below forecasts, with providers citing reduced confidence to commit to new schemes in the current economic environment. Open market development has, unsurprisingly, been the most affected, with the pipeline reported at its lowest in eight years. Contractor insolvencies have also been identified as a factor slowing progress on building already started. Construction insolvencies reached a decade high in October (see Overview) and, therefore, remain a risk as financial constraints linger.

It is also assumed that internal planning processes for high-rise developments will be lengthened to account for the requirement for two staircases in residential towers above 30 metres in London and for buildings taller than 18 metres as the national policy for England. A local authority joint venture in Havering has been paused to reassess the scheme in the light of the new requirements, whilst housing association Clarion has paused 15 schemes. Cost consultant Arcadis assumes the policy will lead to a nine-month delay to high-rise schemes. A higher proportion of housing association completions are flats compared to private sector house builders (29% in 2022/23 compared to 15%), with flats accounting for the highest proportions of housing association completions in the higher-cost regions of London, the South East and East of England. This leaves housing associations exposed to wider housing market trends, and typically are not able to respond as quickly as the private sector.

The annual rent-setting agreement for housing associations in England allows an increase of the CPI inflation rate in September plus one percentage point. For the current 2023/24 financial year, the implied increase in social rents of 11.1% was reduced to 7.0%, whilst in Wales, social rents were allowed to increase by a maximum of 6.5%, and rose by an average of 5.1% in Scotland, aiming to balance the increase in revenue for providers with the ability to pay from social tenants given rising living costs. With CPI inflation at 6.7% in September 2023, the implied rent increase of 7.7% for England in 2024/25 was confirmed by government in January but the current year's real terms cut in rental revenue adds to the issues constraining housing associations' ability to invest in new developments. Ratings agencies have highlighted that the rising cost of borrowing means additional debt funding is unlikely to plug the shortfall, but this is particularly pertinent for financially-constrained local authorities. Since 2018, 12 Section 114 notices have been issued by local authorities, meaning that a council must pause its spending as forecast income is insufficient to meet its forecast expenditure in the current year's budget. Nottingham City Council and Birmingham City Council issued Section 114 notices in 2023 and for the latter, although its financial difficulties are related to legal compensation payouts, a 23.8% cut to its housing budget has been proposed.

In addition to a housing market slowdown and higher interest rates, another of the main challenges facing housing associations and local authorities over the next few years will be balancing debt-funded development of new homes with the need to invest in the existing stock given limited finance and resource. Credit ratings agency Standard & Poor's (S&P) anticipates that housing associations will need to borrow £16 billion for capital expenditure and refinancing over the next two years, leading to a total debt of over £116 billion by the end of 2024/25. S&P previously forecast a £21 billion borrowing requirement, with housing associations now assumed to redirect development spending instead. The Bank of England's increases in the base rate since 2022 have raised refinancing costs for housing associations, and with annual reports showing a widespread reduction in surpluses and building targets not being met since 2021/22, increased interest payments on existing debt not at fixed rates and the prospect of additional rises in interest rates on any new debt funding in 2023 and 2024 will clearly place further constraints on new build activity. In contrast to the sharp falls in new build completions in Q3, trading updates showed large increases in maintenance and improvement expenditure for existing homes.

The Greater London Authority (GLA) has £4.0 billion of the £11.5 billion funding for the Affordable Homes Programme 2021-2026. In contrast to the requirements for the rest of England, over half of units will be for social rent. The tenure has accounted for a rising proportion of GLA-funded affordable starts, from 22.4% in 2017/18 to 46.3% in 2020/21 and 60.8% in 2022/23. This has been slower to filter through to completions, however. GLA-funded social rent completions as a proportion of affordable home completions were 6.5% in 2017/18 before rising to 24.4% in 2020/21 and 37.3% in 2022/23 so it remains consistently lower than the social housing proportion of starts, which points to significant lags between social rent starts and completions plus units initially designated as social rent shifting towards other tenures as they are built out. As developing for social rent requires a higher grant than for other tenures, it may be impacted more by issues affecting overall affordable housing delivery. GLA-funded starts in the first half of 2023/24 were only 0.6% of the 2022/23 full-year level, whilst completions were 25.1% of the full-year level. Statistics are likely to be revised as late data is included but even so, the development pipeline in London appears to be significantly smaller.

In Scotland, the Scottish Budget allocated £556 million to the Affordable Housing Supply Programme for 2024/25. However, this is below the £752 million allocated for affordable housing in 2023/24 and the £831.6 million figure allocated in 2022/23. Two years of reduced funding is set against a backdrop of materials, products and labour cost increases and is likely to see a continued slowdown in house building activity. Starts by Scottish housing associations and local authorities in 2022 totalled 5,016, which was the lowest since 2016 and in the first three quarters of 2023, starts were 40.5% lower than a year earlier. Approvals under the Affordable Housing Supply Programme in Q2 were the lowest quarterly level since 2012 Q3 but nevertheless, for the first three quarters of 2023, starts were 7.9% higher than a year earlier.

In Wales, a five-year rent-setting policy similar to England, of CPI in September plus one percentage point, was implemented from April 2020, although below-inflation increases were implemented in 2023/24 and rents in 2024/25 will be capped at the September CPI inflation rate of 6.7%. The Welsh government is aiming to spend more than £1.0 billion on building new social housing over three years from 2022, including building 20,000 low-carbon social homes by the end of this parliament. It will spend £330 million on the Social Housing Grant in 2023/24 and £325 million in 2024/25, up from £310 million in 2022/23 and £250 million in 2021/22.

Overall, public housing is facing elevated build costs, higher interest rates and slower market-linked demand, including for shared ownership, reducing development appetite and activity on the ground. Macroeconomic factors also combine with competition for financial resources against a growing list of priorities for repairs, maintenance and improvements work. Throughout the forecast period, it is assumed that housing associations balance the increasing need to channel finance towards cladding remediation, fire safety measures, basic repairs and decarbonisation by reducing spending on new build. As a result, output is forecast to fall 10.0% in 2024 as these factors continue and significantly higher costs for new borrowing, combined with reduced surpluses and elevated construction costs constrain the recovery of new build activity. The deterioration from the 2.0% fall estimated for 2023 also reflects the lagged impact of delays to decision-making in 2022 and 2023 and for developments earlier in the planning pipeline that may need to be reassessed for design and viability due to new rules on a second staircase for buildings above 18 metres.

Joint ventures and partnerships between housing associations and private sector house builders increased from 2019 and such partnerships would be expected to increase in the near-term, as an insurance against the uncertain outlook for the private market. However, given the crossovers between private and public provision, in particular partnerships of this nature and the acquisition of affordable units by housing associations from private developers during the building process, ONS statistical classification of private and public sector activity may also change across starts, output and completions. From April 2020, the methodology for the Department for Levelling Up, Housing and Communities (DLUHC), formerly the Ministry of Housing, Communities and Local Government (MHCLG), house building data was changed to source completions from affordable housing supply data, rather than building control. In April 2020, the ONS also began classifying housing association house building as private sector output. This implies a structural break in the ONS split of housing output data, but given that this also coincides with the sharp declines in output due to the impacts of the social distancing restrictions imposed following the pandemic, the impact of this change is currently unclear. As with all sectors, the CPA is forecasting activity on the ground rather than matching the ONS data.

Upper Scenario:

- Demand for shared ownership and open market sales recovers as economy shows signs of strengthening
- Starts on the AHP increase

Earlier cuts in interest rates from Spring and a stronger recovery in economic growth see demand for affordable housing strengthen, given the lower deposits and mortgage loans required compared to the general housing market. This buoys housing association confidence to proceed with activity and underpins starts under the 2021-2026 AHP.

Lower Scenario:

- A significant weakening in the housing market undermines the focus on market-linked products
- Activity to complete at the end of the SOAHP is reduced
- An increase in local authorities declaring financial issues

By contrast, if interest rates are left on hold at their peak throughout 2024 and/or there is a prolonged period of house price falls, this would reduce demand for market-linked products already under construction on the current SOAHP, as well as further reduce appetite for development of these tenures on the 2021-2026 programme. An increasing number of local authorities signalling financial difficulties that may require significant cuts in capital spending is also a risk in the lower scenario.

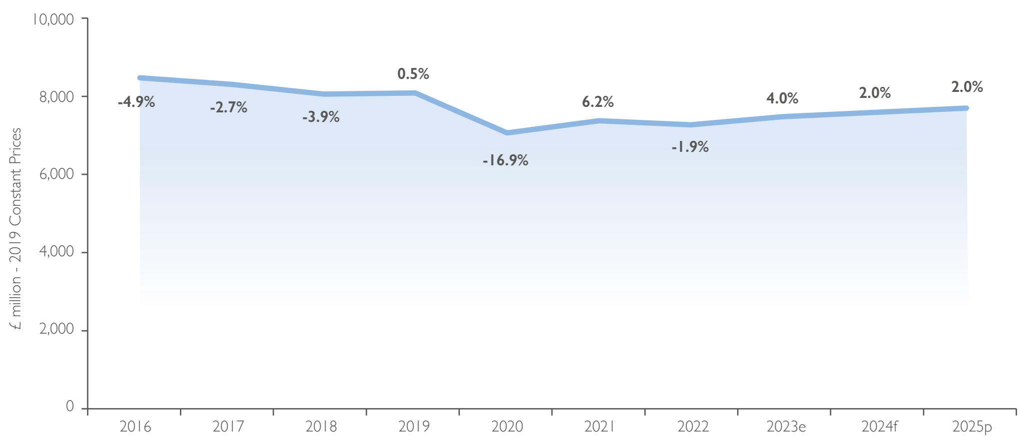
Public Housing RM&I

Investment in the existing stock is becoming the main focus for social housing providers but even with work now coming through on government-funded energy efficiency programmes, growth rates will be held back by limited finance that needs to cover a broadening scope of work across fire safety, decarbonisation and general condition improvements, even with funds diverted from new build programmes.

In the public housing rm&i sector, there is a growing pipeline of urgent cladding remediation, a drive for energy efficiency improvements to the existing social housing stock, and rising demand and awareness for general maintenance and improvements. In recent years, work to address legacy issues related to fire safety as well as energy-efficiency retrofit has, not surprisingly, become more of a priority among social housing providers and given the larger value and scale of these projects, would typically have been expected to drive growth rates in the sector. However, it has only been in recent quarters that the sector has begun to display an uptick in growth. In fact, output in 2022 was 22.7% lower than in 2015 as a combination of long gaps between announcements of government programmes and funding allocations to specific projects, capacity constraints for skilled labour, limited financial resource and two years of strong materials price inflation have led to delays and reprofiling of workstreams. As the rm&i focus expands, general repairs and maintenance, particularly mould and damp, is now also rising up the priority list and given limited scope to increase finance, social housing providers indicate that higher-priority and higher-value activity will continue to displace other non-urgent general works on existing properties that can be delayed. Sector activity is forecast to grow during 2024 and 2025 as work accelerates on government-funded programmes, but growth rates remain limited at 2.0% by the constraints on funding, capacity – for labour and materials – and rising costs for finance for work outside of these workstreams.

Over the past six years, the focus for social housing providers has understandably shifted to ensuring fire safety and, more recently, ensuring general standards of upkeep are maintained. Work to remediate buildings with ACM cladding is now almost complete, with work on all but

Public Housing RM&I Output



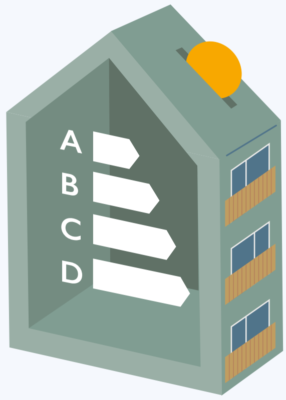
e = estimate, f = forecast, p = projection

Source: ONS, Construction Products Association

one of the 161 social housing buildings above 18 metres with this type of cladding complete, according to the Department for Levelling Up, Housing, Communities (DLUHC). Social housing providers were able to access the Building Safety Fund that provided £400 million for the remediation of ACM cladding. However, as the remit has shifted to remediation of other types of flammable cladding and the coverage widened to mid-rise buildings above 11 metres, funding has been prioritised for the private sector. Funding for the social sector is limited to covering costs that would have been passed on to leaseholders rather than the full cost of replacement, or for projects where remediation costs are deemed unaffordable or a threat to the financial viability of the housing provider. To date, £205 million has been allocated for non-ACM remediation of 163 social sector residential buildings in England, of which 66 are underway and 33 have completed. In contrast, £2.1 billion has been allocated for 1,095 buildings in the private sector. Applications for cladding remediation funding from May 2023 have been under in the £5.1 billion Cladding Safety Scheme. To date there are six social housing buildings over 11 metres that have been approved for funding.

Social Housing Decarbonisation Fund:

Wave 1:
£179 million *for delivery by March 2023*
Wave 2.1:
£778 million *for delivery by March 2025*
Wave 2.2:
£80 million *for delivery by March 2025*



Further £1.25 billion *allocated for delivery between 2025/26 and 2027/28*

With government funding for cladding remediation limited, results from the Regulator of Social Housing's (RSH) survey of the social housing stock above 11 metres, published in November, show the extent of work that will need to be self-funded by providers. Providers reported LCFS (life critical fire safety) defects relating to external walls and cladding on 1,608 buildings in England. This represents 10.4% of the 15,405 total reported buildings over 11 metres. Remediation has completed on 106 of these, is underway on 394 and is planned for 591. Plans were unclear for the remaining 510 buildings, whilst 7 will be demolished.

In Scotland, there are 105 residential blocks in the Cladding Remediation Programme, including 95 with high-pressure laminate cladding and combined with cladding that needs replacing on other public sector buildings, the Scottish government calculates a £900 million shortfall in funding from central government for the work and is now legislating to implement a Building Safety Levy on new development, similar to the one set for introduction in England. Nevertheless, of the £97.1 million allocated for Scottish cladding remediation, only £5.0 million had been spent at the end of September 2023. The majority of buildings in the programme are located in Glasgow and Lothian.

In Wales, £375 million is available for cladding remediation under the Building Safety Fund for both the private and social housing sectors between 2022/23 and 2024/25. To date, 26 social housing buildings have been remediated, with work on 46 underway and a further 38 allocated funding.

Increased scrutiny of the fire safety of residential buildings has also broadened to questions over the general quality of housing built and maintained by social landlords. High-profile cases, the 'naming and shaming' of 14 social landlords by Secretary of State, Michael Gove, the newly-implemented Social Housing (Regulation) Act and the proposals in Awaab's Law have led to greater awareness and demand from tenants, in turn increasing providers' focus on quality issues such as damp and mould, boiler faults and general disrepair. For example, in August 2023, Newcastle City Council reported that the number of repairs delivered through its repairs service increased from 85,000 in 2019/20 to 123,795 in 2022/23, driven by tenant demand. Given that this is becoming as high-profile an issue as fire safety, housing associations and local authorities are reporting that they are now diverting more spending to basic r&m. However, the overall funding pot remains limited and in December, Lewisham Council referred itself to the RSH to assess a potential breach of consumer standards relating to its repairs service and the condition of its homes. The council stated that as greater resource is allocated to fire safety improvements, this has reduced general repairs work, resulting in only 31% of emergency repairs completed on time between April and October 2023, compared to a target of 90%. On its own assessment, around 17% of the council's homes currently do not meet the minimum standard for social housing, but this is expected to rise to 31% by 2027 as finance continues to be diverted to fire safety work.

The RSH quarterly surveys, which are based on responses from private registered providers of social housing that own or manage more than 1,000 homes, reported that total repairs and maintenance expenditure in Q3 was £1.9 billion, split between £1.2 billion on revenue expenditure and £0.7 billion on capital expenditure, and was 5.6% higher than in Q2. Total r&m expenditure was £7.6 billion in the 12 months to September 2023, and is forecast to rise to a new high of £8.5 billion over the next 12 months. However, r&m spending has consistently been below forecast over the last 12 months, with work on planned programmes replaced by rectifying damp and mould issues and reactive repairs as they arise, as well as difficulties reported with contractor availability and price inflation. In Q3, 55% of providers surveyed reported either delays or changes to r&m programmes. In addition, although only one-fifth of social housing providers' loans are at variable interest rates, the rises in interest rates throughout 2022 and 2023 have added to financial pressures and interest rates for new lending will be significantly higher than the loans that financed previous activity. Illustrating the importance placed on improving building safety and living conditions, the RSH found that 30 providers had negotiated loan covenant waivers related to building safety works.

Similarly, 29 loan covenant waivers have been agreed for energy efficiency and decarbonisation work, with this also an increasing area of focus for the publicly-owned housing stock. In August, the housing association Stonewater agreed a £200 million loan for energy efficiency retrofit work on its stock of 36,000 properties to bring them up to an EPC rating of C before 2030. It will need to achieve three sustainability-based KPIs agreed with the lender for both its existing stock and new development over the loan period.

Following the failure of the Green Homes Grant (GHG) in providing energy-efficient retrofit in the private sector prior to its cancellation in its first year, the funding was shifted to the Local Authority Delivery (LAD) scheme and the Social Housing Decarbonisation Fund (SHDF). To date, £1.04 billion has been allocated in three waves under the SHDF, for delivery between March 2022 and March 2026 and will require match funding from social landlords. In December, an additional £1.25 billion was allocated by government for delivery between 2025/26 and 2027/28. The first wave of £179 million in SHDF funding was allocated in February 2022 on the optimistic basis of retrofitting 38,000 homes. However, responses to the tender indicated that the cost of retrofitting was almost two times higher than the initial expected cost that the government was expecting and, consequently, it will only see 20,000 homes retrofitted in the first wave. Between March 2022 and September 2023, which covers funding allocated in the first two waves, 18,102 measures had been installed in 10,047 properties under the SHDF. Under the LAD, in the £280 million third phase 24,591 measures have been installed in 20,542 properties since January 2022. Both programmes are dominated by insulation improvements, which account for 49% of measures installed under the LAD and 58% under the SHDF, followed by solar/PV measures (38% of measures for the LAD and 10% for the SHDF). One-fifth of measures installed under the SHDF relate to doors and windows, such as double/triple-glazing or energy-efficient doors.

Alongside these programmes, following an initial phase that allocated £150 million, a further £630 million was allocated for the Home Upgrade Grant scheme, which will be used by local authorities to support low-income households to carry out energy-efficiency upgrades on 30,000 properties up to March 2025. Between its start in January 2022 and September 2023, 6,282 measures had been installed at 4,051 properties. Similar to the other retrofit schemes, 43% of measures installed are for insulation and 28% are for solar/PV. In addition, £500 million was allocated to a new local authority retrofit scheme in December 2023 to fund insulation measures for 60,000 households on low incomes. Delivery is targeted between 2025/26 and 2027/28, although further details on timelines have not been released.

As with the original Green Homes Grant, all registered installers on government schemes must be registered with Trustmark and, where applicable, with the Microgeneration Certification Scheme (MCS), which may limit delivery. In addition, all projects must be compliant with PAS 2035:2019. As a consequence, the constraints on installers may mean that despite the finance available, the lack of eligible installers may hinder progress on projects, in addition to cost inflation.

Alongside these schemes, the next iteration of the Energy Company Obligation – ECO4 – will run concurrently, and for one year longer to 2025/26, and will provide funding of £1.0 billion per year for low-income and fuel-poor households. For social housing, eligibility will be limited to homes in EPC band E, F or G, which is around 117,000 properties according to the English Housing Survey. In addition, eligible measures are limited to insulation, first-time central heating, renewable heating systems and district heating. It has a target of 22,000 solid wall insulation retrofits per year. This is higher than under ECO3 (43,397 installations between October 2018 and March 2022), but lower than the 145,103 measures installed during the four years of ECO1 and 2. Between April 2022 and September 2023, there were 215,843 measures installed in total under ECO4, of which 14,087 were for solid wall insulation measures across privately and publicly-owned properties. The Great British Insulation Scheme, previously known as the ECO+ programme, allocates a further £1.0 billion to energy efficiency measures, distributed as £130 million in 2023/24 and £435 million each in 2024/25 and 2025/26. However, eligibility for social housing is even more constrained to avoid crossover with existing policies, and will cover insulation measures only, on properties with an EPC rating of E or below.

Cost inflation is likely to have a considerable impact on the sector in the medium-term given that many local authorities are already financially-constrained. Below-inflation social rent increases were implemented in April and providers are facing rising debt repayment costs as interest rates rise. As a result, despite funding being available for cladding remediation and decarbonisation on the local authority and housing association dwelling stock, this finance is not likely to go as far as initially expected, and will be a competing priority against general r&m so as CPA has highlighted in previous forecasts, we may see the value of activity coming through but not the volume. In addition, housing associations are still in the process of determining the scope of fire safety works outside of cladding remediation, particularly given that the more inspections are conducted on their stock, the more issues (such as fire stops and fire doors as well as other general issues) that they are likely to find and limited finance will need to be devoted to this area.

In the longer-term, a key issue for social housing providers is that it may not be financially viable to undertake energy-efficient retrofit, with Notting Hill Genesis highlighting that 15% of its 44,000 homes are currently Victorian terraces that are around 100 years old and have the lowest EPC rating. Getting such properties up to EPC C may be up to £100,000 per property. Instead, it may be that housing associations need to sell some older properties given the extensive retrofit cost. It may be even more difficult for financially-constrained local authorities. Projected housing r&m expenditure has exceeded budgets by £2 million for Oxford City Council and Selby District Council, for example, leading the latter to suspend all but basic repairs on empty properties, rather than spending on improvements to bring them up to a lettable condition.

Nevertheless, L&Q, one of the largest housing associations that manages 90,000 homes, awarded contracts for its 15-year major works homes upgrade programme, which aims to spend up to £300 million per year (£100 million per year in the earlier years of the programme) on bringing its properties up to an EPC rating of C by 2028, as well as a wider programme of estate and environmental improvements, mechanical and engineering works and internal decorations, including 48,000 new kitchens and 42,000 new bathrooms.

Across the other nations, the Welsh Government Budget will provide £580 million for the decarbonisation of social housing in Wales up to 2024/25, with 7,000 retrofitted to date since 2020. A total of £72 million in general capital will also be used to help accelerate the scale and pace of the decarbonisation of Welsh homes. Of this, £35 million will be used to test the use of new funding models. The Welsh government has set a target for rented housing achieving a minimum EPC rating of C by 2030. Plans to reach an EPC rating of A by 2033 have been dropped, however, with landlords now expected to provide an assessment of how they can improve properties to an A rating.

In Scotland, the Energy Efficiency Standard for Social Housing 2 (EESSH2) in Scotland targets a minimum EPC rating of D for social housing to be let from 2025. Only 7.0% of the 608,000 social sector dwellings in Scotland had an EPC rating below D according to the house condition survey for 2021 so with sufficient finance this may be achievable. It also sets a deadline of December 2032 for all social housing to reach an EPC rating of B, which looks more challenging given that 94% of Scotland's social housing stock is currently below this. Targets for energy efficiency in both Scotland and Wales are considerably higher than in England, where an EPC rating of C is required by 2035 to meet the net zero target. The Scottish Government's Budget for 2024/25 announced energy efficiency retrofit under its Home Energy Efficiency Programme (HEEPS) would have funding of £64.0 million, matching the amount allocated for the two previous years. The programme provides funding for local authorities to develop and deliver energy efficiency programmes (mainly solid wall insulation) with the aim of reducing fuel poverty. Overall, the government has allocated £358 million for energy efficiency upgrades and the installation of clean heating systems.

Activity increased in the first three quarters of 2023 but growth in public housing rm&i output is expected to remain restricted by capacity constraints for the key areas of demand across cladding remediation, energy-efficiency retrofit and general repairs, with the cost inflation and interest rate rises experienced in 2022 and early 2023, along with any associated delays or finance constraints, adding to the headwinds. The forecast assumes that this work proceeds as a priority, with further diversions of finance and resource away from new build projects and r&m work that can be postponed. As a result, public housing rm&i is forecast to rise by 2.0% in both 2024 and 2025.

Upper Scenario:

• Housing associations severely cut new build programmes to focus on the existing stock

Housing associations have already redirected spending away from new development towards investment in the existing stock and in the upper scenario, a deterioration in demand for tenures linked to the open housing market leads to further cuts in new build programmes and resources shifted further to address issues on the revenue-earning stock such as fire safety, cladding remediation, decarbonisation and general r&m.

Lower Scenario:

• Labour capacity constraints continue to hinder cladding remediation and decarbonisation

• Cost increases reduce volumes of work undertaken

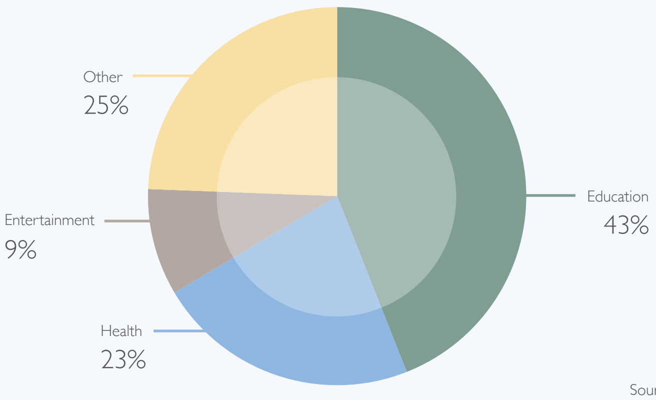
• More local authorities struggle with budgetary constraints

Skills shortages or contractor availability are likely to remain an issue, and given that government funding focuses demand on insulation and solar/PV installations, current areas of strong growth will be the most stretched for additional capacity. In addition, if funding cannot be increased to cover higher costs from two years of strong inflation then volumes of activity may fall, even as output values are maintained. An increasing number of local authorities signalling financial difficulties that may require significant cuts in capital spending is also a risk in the lower scenario.

Public Non-housing

Strong inflationary pressure in 2022 severely impacted progress in the government's flagship health and education capital investment programmes as fixed nominal budgets allowed little room for manoeuvre as construction costs soared. Easing cost pressures have started to loosen investment constraints and more health and education projects are reaching contract award. Delivery has been extremely weak against plans so far, however, and a significant catch-up in activity is unlikely.

Public Non-housing Output by Sub-sector 2022 (%)



Source: ONS

With net public sector borrowing in the financial year-to-November at £116.4 billion, a level only surpassed once since records began in 2020 at the height of the global pandemic, and net debt estimated at around 98% of GDP, government finances are highly constrained. Capital funding allocations by central government are the primary driver of public non-housing activity and the poor state of public finances limits scope for major new investment in social infrastructure. In real terms, the decline in public non-housing output has been marked. By the end of 2023, sector output had contracted by an estimated 17.5% since 2019. Modest growth is forecast as work slowly filters through the beleagured New Hospitals Programme (NHP) and School Rebuilding Programme (SRB) but it is anticipated that delivery will fall short of plans as the 2022 step-change in construction costs erodes the spending power of nominal budgets.

Growth is forecast from the 2023 low, but by the end of 2025 public non-housing output is still expected to be significantly down on pre-pandemic levels. Public non-housing output is forecast to rise by 1.7% in 2024 and 2.1% in 2025. With 2024 highly likely to be an election year, there is a potential risk that difficult or controversial spending decisions will be delayed.

The Autumn Statement confirmed plans for total capital investment across the UK at £99.2 billion in 2024/25, a modest 3.3% increase compared with anticipated spend in 2023/24. Block grant for devolved nations is anticipated to fall in 2024/25, by around 7% in Scotland and Wales.

In Scotland, Budget 2024/25 suggests overall capital spending will fall by a further 5.6% to £6.4 billion. This follows a similar reduction in 2023/24, meaning capital budgets have fallen by 11% since 2022/23. Fortunes vary across departments. The Department of Health and Social Care's capital budget has increased by more than £170 million (a 10% uplift) whereas the total available for social justice is down by nearly £350 million, 26% less than the previous financial year. Learning's capital budget is poised to reduce from £94.2 million in 2023/24 to £54.7 million in 2024/25.

The Welsh Government's draft budget suggests an overall reduction in nominal capital investment of 6.0% compared with 2023/24. There are winners and losers across expenditure groups. Health and Social Services sees a 6.0% uplift in available capital finance, whereas Education's capital budget reduced by 7.0%. Capital investment by the Social Justice department will fall by an estimated 3.0% in cash terms. After allowing for inflation, gains will be eroded and reductions will be increased.

Public non-housing output *outlook revised up -* ***increasing*** *by* **1.7%** *in 2024 and* **2.1%** *in 2025*

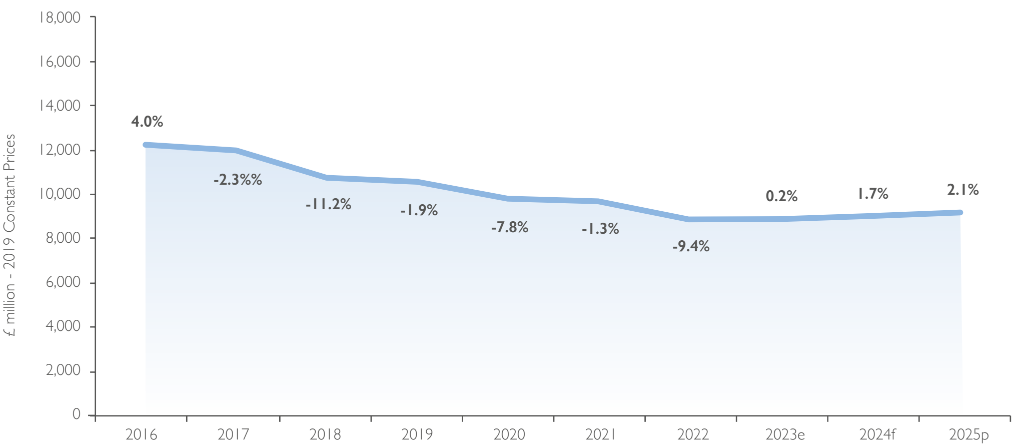
As the list of local authorities on the brink of bankruptcy in England continues to grow, central government announced additional funding in late 2023. A £64 billion support package equates to a 6.5% increase in funding for local councils in England but is less than the Local Government Association (LGA) estimates is needed. LGA analysis suggests cost and demand pressures have added £15 billion to the cost of delivering council services since 2021/22 – a 29% increase.

Since 2018, 12 local authorities have issued Section 114 notices. Section 114 notices are issued when local authorities cannot meet spending commitments in the current spending period. Against this funding backdrop, non-ringfenced funding streams will be diverted to the most urgent spending needs, such as maintaining adult and child social care provision. Less urgent capital and resource spending will be postponed or shelved.

In terms of sub-sector mix, education's share of total public sector non-housing work is forecast to reduce from 43% in 2022 to 41% in 2025, while health's share is expected to gain a percentage point, increasing from 23% in 2022 to 24% by 2025. Work on new prisons will drive an improvement in the other sector's relative performance and, by 2025, it is expected to take a 27% share of the total.

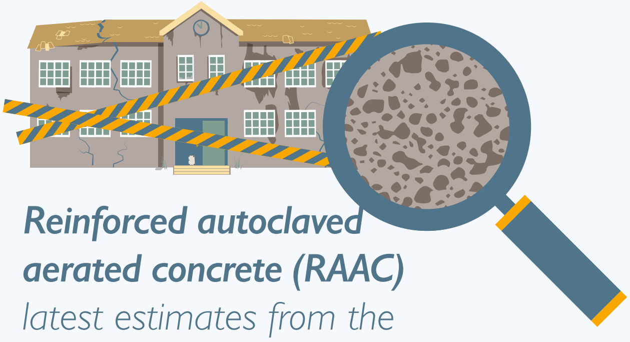
Publicly-funded **education** work is being sustained by the completion of construction work under the Priority School Building Programme (PSBP) and the Free Schools Programme (FSP), along with work slowly feeding through under the ten-year School Rebuilding Programme (SRP). Delivery, however, has been beset by problems due to fixed capital budgets and exceptional rates of cost inflation. Programmes are running significantly behind schedule and cost escalation

Public Non-housing Output



e = estimate, f = forecast, p = projection

Source: ONS, Construction Products Association



Reinforced autoclaved aerated concrete (RAAC)
latest estimates from the Department for Education states
235 schools are affected, up from 174 in summer

Source: Department for Education

has been a major factor. A moderation in inflationary pressure in 2023 has eased constraints but catch-up is unlikely. Output is forecast to increase by 1.0% in 2024 and 4.0% in 2025 as the SRP builds momentum but the overall volume of output will remain low relative to the long-term average.

To date the School Rebuilding Programme (SRP) has been slow to deliver. The last available progress update in May 2023 confirmed that four projects had been completed and works had started on 170 schools since the programme began in 2021. As of March 2023, only 24 SRP construction contracts had been awarded, compared to the 83 forecast due to inflation and contractor capacity issues. In response, the Department for Education (DfE) offered risk-sharing arrangements and developed a more standardised design but the DfE has conceded that it will be impossible to catch up on projects already running behind.

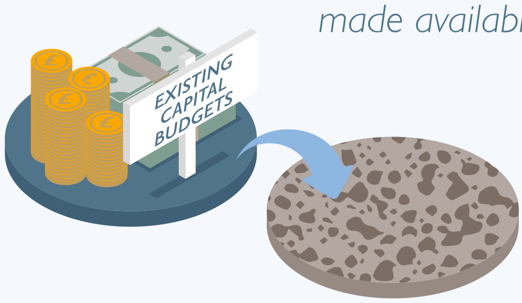
November figures from the DfE confirmed that the number of schools and colleges in England affected by RAAC issues has risen to 235, up from 174 in September, and the DfE is unable to confirm how many surveys to identify RAAC are still outstanding. HM Treasury has confirmed that no new funding is available and that additional capital expenditure on RAAC-related refurbishment and rebuilding works must be funded through existing allocations. The Public Accounts Committee recently raised concern that remaining funding through the SRP will be allocated to schools affected by RAAC issues. So far 400 out of 500 schools due to benefit from the SRP have been announced and there is an expectation that the remaining allocations will prioritise schools with serious RAAC issues over other serious issues such as asbestos.

Activity in the education sub-sector has been in long-term decline due to insufficient growth in capital funding, strong cost inflation and slow delivery. A recent National Audit Office (NAO) review of the condition of schools in England concluded that years of underinvestment in rebuilding, maintenance and repair has resulted in 700,000 pupils learning in schools believed to require major rebuilding or refurbishment with negative impacts on learning outcomes and teacher retention. Between 2016/17 and 2022/23, the DfE spent £2.3 billion a year, on average, on rebuilding and maintaining schools, significantly lower than the £5.3 billion the department estimated was needed annually in 2020 to maintain school condition and mitigate the most serious risks of building failure. Around 38% of school buildings in England are beyond their estimated initial design life.

School condition funding, to improve and maintain the school estate, reduced marginally in real terms in 2023/24. Totalling around £2.3 billion, it was around 4.0% lower in real terms than in 2022/23 according to the Commons Library.

The Autumn Statement confirmed the DfE's capital budget will fall by 12.9%, from an anticipated £7.0 billion in 2023/24 to £6.1 billion in 2024/25. In recent years, the DfE has struggled to spend allocated capital allowances as inflationary pressure impacted contract negotiations. The DfE's latest accounts tracked an overall fall in the value of contracted and approved capital commitments in the year to 31 March 2023 compared with the previous year, from £3.75 billion in the year to March 2022 to £3.52 billion in 2023. The department's capital budget rose by 32.0% in 2023/24 so it will be interesting to see if the planned spending will be delivered as inflationary pressures have eased. ONS new orders data recorded a 17.7% increase in the first nine months of 2023, suggesting a strong uplift in the number of schemes progressing.

RAAC work will be funded out of existing capital budgets – *no new capital funding will be made available*



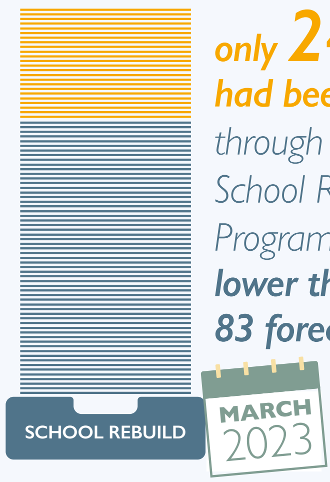
In November 2022, further education colleges were reclassified as public sector bodies, which means they are now subject to restrictions on commercial loans that were previously a key source of finance for capital spending. Colleges will now be reliant on either direct funding from government or public borrowing at a time when capital budgets are under strain and set to decrease in both nominal and real terms for education in 2023/24. A £150 million capital loans scheme will be made available from Summer until March 2025 but will be restricted to projects – planned or underway – that have been delayed due to financial issues related to the reclassification.

The £1.5 billion Further Education Capital Transformation Programme aims to upgrade and refurbish further education colleges across England between 2020/21 and 2025/26. In the final funding round, the DfE has allocated £286 million to 146 colleges. Recipients of this funding can opt to receive payments in two instalments but money should be spent in the year it is received. The largest allocations in the final funding round were £15 million for the NCG Group, £11.5 million for Havant and South Downs College and £10.4 million for the City of Bristol College. Overall, capital allocation payments are anticipated to total £101 million in 2023/24, rising to £185 million in 2024/25.

Contracts to deliver Stanmore College, a £50 million phased construction of five linked buildings in North West London, the £45 million redevelopment of Wigan and Leigh College, and two new buildings at Leeds City College with a construction cost of £27 million, were recently awarded with construction work due to start in 2024.

In Wales, schools capital investment is delivered under the Sustainable Communities for Learning programme – the Welsh Government's long-term schools and colleges investment programme. The Welsh Government's draft budget for 2024/25, indicated £10 million from the schools capital budget will be switched to revenue spend to overcome current budgetary challenges. Core projects within the Sustainable Communities for Learning programme will consequently be prioritised.

In Budget 2024/25, the Welsh Government announced £20 million towards the development of a Further and Higher Education Decarbonisation scheme to provide education establishments across Wales with funding for renewable energy and energy efficiency projects.



only 24 contracts had been awarded *through the School Rebuilding Programme,* **lower than the 83 forecast**

In Scotland, the £2.0 billion Learning Estate Investment Programme (LEIP), aiming to rebuild or refurbish schools from 2021 to 2026, is currently underway. The programme combines local authority and central government funding on a 50:50 basis, with local authorities funding the up-front construction cost and central government providing an outcomes-based annual payment over 25 years. Budget 2024/25 allows £10.5 million provision for LEIP for the first time as new schools complete and become operational.

Recipients of Phase 3 LEIP funding were recently announced after a lengthy delay. Ten local authorities will be awarded a share of the third phase of the programme, worth between £450 to £500 million. Phase 3 projects are expected to be completed by 2027. Successful bidders for funding through Phases 1 and 2 were announced in September 2019 and December 2020. However, a recent Freedom of Information request revealed that 20 schemes allocated funding in Phases 1 and 2 are being reassessed amid concerns about RAAC safety and wider market volatility.

Recent education project contract awards in Scotland include a new £85 million high school in South West Fife, the £68 million Liberton Community Campus in Edinburgh and the £35 million Faifley Education Campus in Strathclyde.

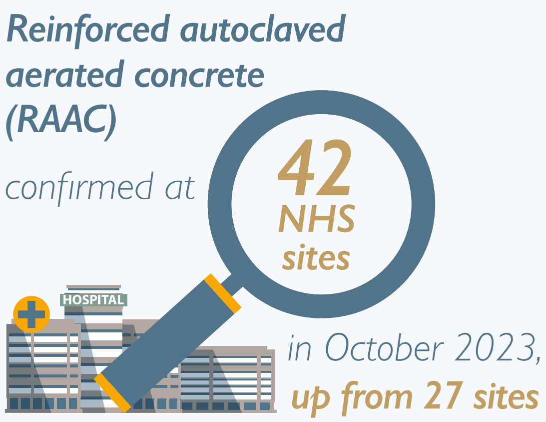
Upper Scenario:

• Activity accelerates under new school building programmes

As the pace of inflation slows, contractor appetite for fixed price contracts may increase plus the attractiveness of stable education projects may grow as work in other sectors slows. Negative publicity following the RAAC crisis and NAO criticism about the condition of schools in England may prompt the government to provide additional finance to help offset the increase in build costs.

Lower Scenario:

• Increased costs and a lack of contractor interest delays work under school building programmes



Source: Department of Health and Social Care

If contractor appetite for new school projects remains weak, start dates of planned projects under school building programmes across Great Britain may be pushed back and hinder progress further on delayed capital programmes.

Output in the **health** sub-sector, which covers publicly-funded work on hospitals, health centres and clinics, is forecast to increase by 2.0% in each year of the forecast period.

Health orders were strong in early 2023, boosted by the £300 million Oriel Moorfields Eye Hospital and £150 million new Shotley Bridge Hospital getting into contract. These schemes are part of the government's New Hospitals Programme (NHP) which planned to deliver 40 new hospitals by 2030 when it was originally announced in 2020. Since then, the NHP has been widely criticised for under-delivery and nearly one-third of the way through the NHP delivery programme, progress has been negligible.

Since the programme was first announced, NHP investment has been reprioritised to target existing hospitals seriously affected by RAAC issues. Ultimately this reshuffle means five hospitals with serious RAAC issues will now receive funding through the NHP, while eight schemes initially earmarked for NHP funding have been delayed and will now be completed after 2030. A few schemes are progressing – and these will boost output – but the NHP is currently unlikely to deliver anywhere close to the number of new facilities promised. Lack of funding is one significant problem. The maximum capital funding that is currently available to deliver 32 new hospitals by 2030, as well as completing eight pre-existing schemes, is £22.2 billion. This comprises of £3.7 billion through to 2024/25 plus an additional £18.5 billion from 2025/26. The government's own estimates suggest the cost of delivering the full scope of planned work will be closer to £35 billion – significantly more than currently expected to be made available. Plus, ramping up delivery relies on a new modular design concept called 'Hospital 2.0' which is due to be used for a number of schemes from 2025. Standardised 2.0 hospital designs still have not been completed and the efficacy of the approach and its ability to deliver the time and cost savings assumed has not yet been tested.

Seven NHS hospitals have extensive use of RAAC and will need to be entirely rebuilt. Two of these schemes were part of the original NHP line-up – West Suffolk Hospital in Bury St Edmunds and James Paget Hospital in Norfolk – and the remaining five schemes affected by RAAC are now due to receive NHP funding, with completion targeted by 2030. The five additional hospitals are Airedale in West Yorkshire, Queen Elizabeth King's Lynn in Norfolk, Hinchingbrooke in Cambridgeshire, Mid Cheshire Leighton in Cheshire and Frimley Park in Surrey. Completion is targeted by 2030, and consequently, the majority of the construction activity will occur beyond the forecast period.

Schemes securing early NHP funding are progressing and will provide output over the next few years and 2023 saw several NHP schemes gain planning approval. These include the £600 million redevelopment of West Suffolk Hospital, the £200 million Hillingdon Hospital scheme, a planned £110 million revamp of The Countess of Chester Hospital and the £150 million redevelopment of Shotley Bridge Hospital. Following planning approval, work on site got underway on two of these schemes – namely Shotley Bridge and The Countess of Chester Hospital – unusually swiftly. The central forecast assumes that other schemes will take longer to start on site but the speed at which these projects got on the ground presents a potential upside risk to the forecast.

Outside of the NHP and RAAC fund, mental health facilities are being developed in Surrey, Derbyshire and Liverpool through wider capital funding. Two 54-bed facilities are being developed in Derbyshire – one at Kingsway Hospital in Derby and the other at the Chesterfield Royal Hospital – for £80.0 million, with a further £70.0 million being spent to refurbish the Radbourne Unit at the Royal Derby Hospital. The facilities are due to complete in 2024 and 2025 respectively. In Liverpool, work is progressing on the creation of four, 20-bed wards to replace outdated facilities across the city. The consolidated centre is being developed on the site of the former Mossley Hill hospital at a cost of £53.0 million with completion expected in 2024.

*The **New Hospitals Programme** will now prioritise buildings with reinforced autoclaved aerated concrete (RAAC): **five schemes have been added to the programme** with construction work to **start in 2025***

The four-year Procure23 (P23) framework for NHS smaller works began in June 2022 and is worth £9.0 billion over four years. P23 supersedes Procure 22 which delivered projects with a total value of £5.0 billion.

Funding for capital investment in health in Scotland is set to rise by 12.0% in 2024/25 as work progresses on several large new hospital schemes. Two schemes for NHS Highland, will see £160 million invested at Lochaber and Caithness General Hospital.

Upper Scenario:

- Contracts for NHP hospital projects are all let in line with the base programme
- Funding allocations fully support current project design
- Hospital 2.0 standardisation supply chain is quickly mobilised and delivers planned programme savings

Funding detail for the remaining pathfinder projects in the government's New Hospital Programme, as well as final approval for the large-scale projects already in the pipeline and progress on planning approvals for other projects that allows activity to get off the ground quickly, would lead to stronger growth rates over the next two years.

Lower Scenario:

- Cost rises delay health projects
- Schemes under the New Hospital Programme are delayed by public funding cuts or limits

Supply constraints and cost increases for products and on-site labour may lead to delays, particularly if rising costs lead to projects being paused to renegotiate contracts. If government funding for the remaining projects in the NHP is lower than expected or if projects are paused for local trusts to review costs, in both instances, delays to publicly-funded schemes would lead to lower activity in the near-term.

Public non-housing **other** ccovers construction work on publicly-funded facilities such as prisons, defence projects and civil service offices and following an estimated increase of 10.0% in 2023, output growth of 3.0% is forecast for 2024, primarily due to an uplift in output from Ministry of Justice (MoJ) investment across the prison estate in England and Wales. Output is forecast to stabilise in 2025.

The £4.0 billion New Prisons Programme (NPP) aims to deliver 18,000 prison places by 2026 across England and Wales through the construction of new prisons and the extension and refurbishment of existing facilities. Six new prisons form part of this programme – two of which, HMP Five Wells and HMP Fosse Way, are now operational. HMP Millsike, a new £400 million facility in Yorkshire is now under construction and in late 2023 the government overruled a local decision to reject plans to build a 1,700-inmate prison near Market Harborough – HMP Gartree. This decision paves the way for construction on this £300 million project to start later this year.

New
1,700
inmate prison*, *HMP Gartree
in ***Market Harborough*,**
secured planning approval
in late 2023 as the Secretary of State overturned local council's decision to reject plans

Proposals for two additional new prisons in Chorley and Aylesbury are still subject to planning appeals. A date for the public inquiry into plans to build a 1,715-capacity prison on the border of Chorley and Leyland has yet to be set and a decision by the Secretary of State on HMP Aylesbury Vale is still outstanding.

Expansion and refurbishment of existing prisons is progressing. The Accelerated Houseblock Development Programme will increase capacity at six existing prisons – HMPs Bullingdon, Channings Wood, Elmley, Highpoint, Hindley and Wayland – by approximately 2,200 places. Additionally, work is progressing on increasing capacity at Stocken and Guys Marsh prisons at a total cost of circa £100 million.

In Scotland, the 2024/25 budget provides £175 million in capital funding for the redevelopment of HMP Inverness and HMP Barlinnie. Supporting figures suggest £167 million will be available for capital expenditure by the Scottish Prison Service in 2024/25, a 72% uplift compared with 2023/24.

The 2023 Autumn Statement confirmed the MOD's capital budget rose to £20.3 billion in 2022/23. In 2023/24, its capital budget reduced to £18.3 billion and is expected to increase marginally to £18.9 billion next financial year. Expenditure on property and other equipment accounts for around 17% of the Department's total capital budget, with infrastructure taking a 9% share.

In May, the MOD's £5.1 billion 10-year capital investment Defence Estate Optimisation framework came into play. Recent contracts to enhance the MOD estate include the Air and UK Strategic Command and Munster Barracks and Catterick lots, worth approximately £387 million, and a new 250-acre barracks at Caerwent Station training area in Monmouthshire.

The Government Property Agency now controls around 45% of the government's total office portfolio. In 2022/23, it invested £215 million in the estate, including around £76 million on improving the condition of the existing stock. £1.8 billion of capital investment is forecast through to 2028.

Capital work to support the Government Hubs Programme, aiming to reorganise public sector offices into 50 regional hubs by 2030, is progressing. So far, the Programme has delivered 96% of the ambition to relocate at least 15,000 London-based roles by 2025 and 65% of the overall ambition of 22,000 by 2030. Construction work is ongoing on new hubs in Croydon and Manchester, with refurbishments ongoing at three existing sites in Bristol, East Kilbride and York. So far, 17 office hubs have been announced, which are on the first phases of the programme that set out to provide 20 hubs by 2025.

Restoration of Parliament's Victoria Tower is currently underway, with tender submissions for the design and main construction works, worth an estimated £95 million. These works are expected to start in late 2024 and are scheduled to last five years. A vote had been expected in late 2023 on two options for more extensive works on the Palace of Westminster – with the full decant and refurbishment option expected to cost upward of £13 billion. However, concern over a commitment to spend such significant sums, at a time when public finances are highly constrained, suggests further progress on this project is now unlikely until after the General Election.

Funding through the Public Sector Decarbonisation Scheme (PSDS) will continue to support activity in this sector as phase three projects are delivered, although the nature of some of the energy efficiency works receiving funding may instead be captured in public non-housing r&m. Grants awarded through Phase 3 will total £1.4 billion for project delivery in 2023/24 and 2024/25. Phases 3a and 3b account for the majority of this funding and awards totalling just over £1.0 billion have been announced. Applications to receive a share of £230 million through Phase 3c of the programme, needed to be submitted by November 2023 and successful applications have yet to be announced. Beyond Phase 3, the government has indicted that £1.17 billion could be made available for Phase 4 of the PSDS in 2025/26 and 2027/28, subject to business case approval and value for money assessments.

Upper Scenario:

• New prisons overcome planning hurdles

The upper scenario assumes the Secretary of State grants planning approval for the two remaining new prisons that are part of the New Prisons Programme. With standardised design and framework contractors in place, these projects should be able to mobilise relatively quickly, potentially boosting output in the latter part of the forecast period as construction begins.

Lower Scenario:

• Prison and health projects delayed

Rising costs and a lack of availability of labour slows progress on current new build and/or redevelopment projects under prison building programmes and large health projects in England, whilst plans for future prison projects are delayed further in the planning system.

Public Non-housing R&M

Output in the public non-housing r&m sector, covering spend on basic repairs and maintenance carried out on schools, hospitals, prisons, as well as other government and local authority buildings, has grown in recent years. Decarbonisation and emergency repairs to address RAAC issues will provide a stream of work but fixed budgets are ultimately under pressure and basic r&m can be easily postponed.

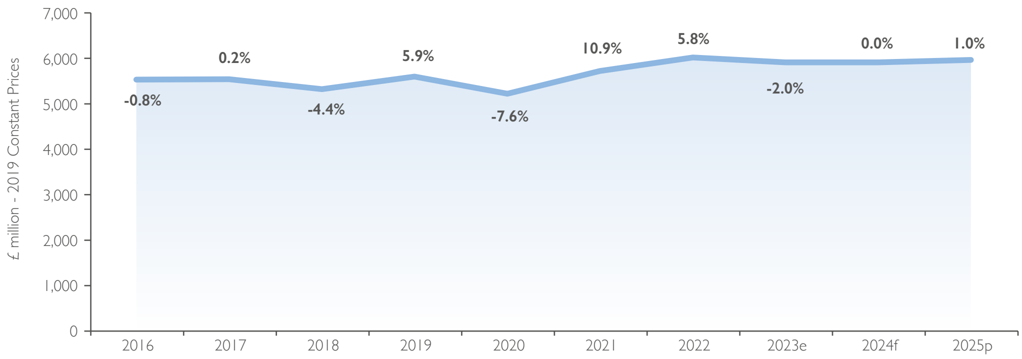
The public sector's tight financial position will limit scope for growth in public non-housing r&m activity over the forecast period and output is forecast to stabilise, at just under £6.0 billion, in 2024 before recording modest 1.0% growth in 2025.

Work is progressing on Phase 3 of Public Sector Decarbonisation Scheme (PSDS), worth £1.4 billion and building on £1.1 billion allocated in Phases 1 and 2. Phases 3a and 3b allocated £613 million and £604 million respectively to 462 schemes in total. Applications to secure a share of £230 million in 2024/25 through Phase 3c are still to be announced. The window to submit an application closed in November 2023. This phase will continue in 2025/26 and will target fossil fuel reduction as well as making public buildings more comfortable and efficient to warm. Beyond Phase 3, the government has indicted that £1.17 billion could be made available for Phase 4 of the PSDS in 2025/26 and 2027/28, subject to business case approval and value for money assessments.

Scotland's Public Sector Heat Decarbonisation Fund was announced in July. Grant funding of £20 million has been made available in 2023/24 to support the installation of heat pumps, the use of district heating networks, retrofitting buildings with insulation and the development of new low-carbon technologies. The application window closed in December and successful bidders have yet to be announced. Funding should be spent in 2023/24, which will make delivery challenging given the lack of time remaining.

In total, the Scottish Government intends to make £200 million available in the five years from 2024 to support the decarbonisation and increased energy efficiency of existing public sector buildings across the country.

Public Non-housing R&M Output



e = estimate, f = forecast, p = projection

Source: ONS, Construction Products Association

Overall, the condition of the schools estate in England remains poor. In June last year, the National Audit Office (NAO) reported that 700,000 pupils were being taught in buildings believed to be past their initial design life and highlighted the large gap between the Department for Education's (DfE) actual spend on maintenance and repairs, around £1.7 billion a year between 2016/17 and 2022/23, and the £5.3 billion that the DfE estimates is needed annually to maintain schools and mitigate the risk of building failure. The current Condition of School Buildings Survey, which ran between 2017 and 2019 and covered 22,031 schools across England, revealed that the total cost to repair or replace defective elements in the school estate was £11.4 billion, almost double the £6.7 billion previously estimated by the DfE in 2017. Schools in the South East and West Midlands have the highest condition need, with both regions requiring £1.7 billion, whilst schools in the North East have the lowest total condition need, estimated at below £600 million.

Public Sector Decarbonisation Fund

£1.1bn has so far been allocated through Phase 3 with the largest shares going to:

21% West Midlands

16% South-East

16% Greater London

Results of the next condition survey are due in 2026 and survey work is underway. However, in November 2023, the House of Commons Public Accounts Committee criticised the lack of DfE knowledge about the presence of asbestos across the schools estate and this is not within the scope of current survey work.

School condition funding, to improve and maintain the school estate, reduced marginally in real terms in 2023/24. Totalling around £2.3 billion, it was around 4% lower in real terms than in 2022/23 according to the Commons Library and the Autumn Statement confirmed the DfE's overall capital budget will fall by around 13%, from an anticipated £7.0 billion in 2023/24 to £6.1 billion in 2024/25 at a time when the need for investment has never been greater.

The full extent of the RAAC issue across England's schools estate is still not known. The latest estimates indicate 235 schools are impacted but the DfE is unable to confirm how many surveys to identify RAAC are still outstanding. HM Treasury has confirmed that no new funding is available and that additional capital expenditure on RAAC-related refurbishment and rebuilding works must be funded through existing allocations. It is assumed that the 100 remaining available slots on the Schools Rebuilding Programme will be allocated to schools with the most serious RAAC problems but there is still no funded approach to fully address the problem.

Without a clear direction on the remediation plan for schools affected by RAAC, there is a risk that near-term routine and cyclical maintenance could be postponed amid the uncertainty. A decision to press on with works such as replacement windows and roofs is unlikely to be taken in affected schools until it is known whether they will be rebuilt or simply refurbished to rectify RAAC issues.

In contrast to England, the proportion of schools in Scotland reported as being in good or satisfactory condition rose to 90.4% in 2021/22, from 90.2% in 2020/21 and 81.7% ten years earlier, according to the 2022 School Estate Statistics. The statistics also showed that 54 schools were built or refurbished in 2021/22, up from 42 in 2020/21. Overall, 1,053 schools have been built or substantially refurbished since 2007/08 and further upgrades are set to take place through the Scottish government's £2.0 billion Learning Estate Investment Programme (see Public Non-Housing).

The number of schools affected by RAAC issues in Scotland has reduced from 41 to 37 after a further assessment in one local authority. Out of 32 councils, only seven have still to complete assessments. RAAC has been confirmed at six higher education colleges and at ten universities. Seven college buildings are affected, with one fully closed and three partially closed, and two out of a total of 19 universities are still to confirm whether they are affected or not.

Results from NHS Digital's 2022/23 Estates Return Information Collection (ERIC) suggests that the cost of backlog repairs across the NHS estate has increased to £12 billion before taking account of associated RAAC costs, two and half times larger than in 2011/12. Backlog maintenance estimates the amount needed to restore a building to a decent state by estimating the routine maintenance that should have already taken place if the facility was appropriately maintained. The cost of 'high-risk' backlog – meaning urgent repair work is needed to prevent serious failure, significant injury or major disruption – rose by almost a third to a record £2.4 billion. Investment to reduce the backlog fell marginally from £1.41 billion in 2021/22 to £1.38 billion in 2022/23.

As of October 2023, the presence of RAAC was confirmed at 42 hospital sites in England, up from 27 at the last update, and full structural surveys are underway at affected sites. The Department for Health and Social Care (DHSC) has established a £685 million fund to 2024/25 to mitigate RAAC and has committed to remove RAAC from the NHS estate by 2035.

Currently 254 properties across Scotland's health estate are thought to have a high or medium likelihood of RAAC. Out of 43 intrusive surveys conducted at these sites to date, 20 have found RAAC but most simply require additional monitoring rather than urgent remediation. In Wales, survey work is ongoing.

Where RAAC remediation is classified will depend on the extent of work involved. If more than basic remediation is required, projects are likely to be classed as public non-housing new build rather than r&m. A proportion of RAAC remediation work is nevertheless likely to be classed as basic r&m.

The Ministry of Justice's capital budget increased from £1.5 billion in 2022/23 to £2.3 billion in 2023/24, and will fall to £1.8 billion in 2024/25 and is largely expected to focus on new build, expansion and refurbishment projects on the government's £4.0 billion New Prisons Programme that aims to deliver 18,000 new prison places in England and Wales by the mid-2020s. It is, therefore, unlikely to fully address the backlog of maintenance work within the prison estate, which is estimated to cost £916 million according to the HM Prison & Probation Service (HMPPS).

Turning to the Ministry of Defence, the focus will be on improving the quality of service accommodation over the forecast period amid a marked fall in satisfaction with accommodation by service personnel. In November, the government announced £400 million will be invested in improving military homes over the next two years, covering works from damp and mould remediation to full refurbishments.

Overall, the Ministry of Defence's capital budget fell from £20.3 billion in 2022/23 to £18.3 billion in the current financial year and is set to stabilise at this lower level in 2024/25. In real terms this equates to a sizeable reduction in capital funding which will limit funds available for general r&m activity.

The Government Property Agency's (GPA) transferred estate increased from 827,000 sq. m. at the end of 2021/22 to 957,000 sq. m. by the end of March 2023 – around 45% of the overall government office portfolio. During 2023/24, the GPA estate is forecast to grow by a further 10%, with plans to transfer approximately 80 buildings, with a combined area of around 200,000 sq. m., progressing. Estate transfers to the GPA will centralise maintenance requirements but the overall maintenance need will lessen as the estate rationalisation programme continues. The Government Hubs Programme aims to reduce the government estate from around 800 buildings to 200 by 2030 by creating shared regional hubs across government departments.

Audit Scotland has concluded that parts of the public estate need significant investment due to inadequate capital maintenance funding in the past and criticised the lack of an overall picture of estate condition across the public sector to inform funding prioritisation. Backlog maintenance in the NHS is at a record high of £1.1 billion in Scotland but its capital budget in 2023/24 is just £578 million. Between 2018 and 2022, capital funding for colleges' life cycle and backlog maintenance has fallen to £321 million, short of the £473 million needed. The Scottish Prison Service has underspent its allocated capital funding due to the impact of the pandemic, inflationary pressures and supply chain challenges. Delays in making repairs to HMP Greenock is an example of the impact of this underspend. Essential repairs have not been undertaken and the Chief Inspector of Prisons is now recommending the facility needs to be rebuilt rather than repaired.

Private Finance Initiative (PFI) contracts, delivering and operating social infrastructure through public private partnerships, have been widely used in the UK since the 1990s. PFI contracts appointed private-sector consortia to build, maintain and operate public sector assets for a period, typically, of 25 to 30 years. From early 2025, these contracts will expire and management responsibility will revert to public sector asset owners. Currently there are more than 700 operational PFI contracts in place across schools, hospitals, roads and other social infrastructure, worth an estimated £57 billion in 2020 prices. The National Audit Office estimates that 10 contracts expired annually in the five years to 2024/25 and this increases to an average of 31 contracts annually in the following five-year period. Responsibility for maintaining for these schemes will transfer from the private sector to the public sector.

Upper Scenario:

- Additional central government funding is allocated to maintaining schools, hospitals and other public sector buildings

With backlog maintenance across the public sector estate at record highs, and new build programmes struggling to meet delivery targets, additional funding could be allocated to the maintenance of existing buildings.

Lower Scenario:

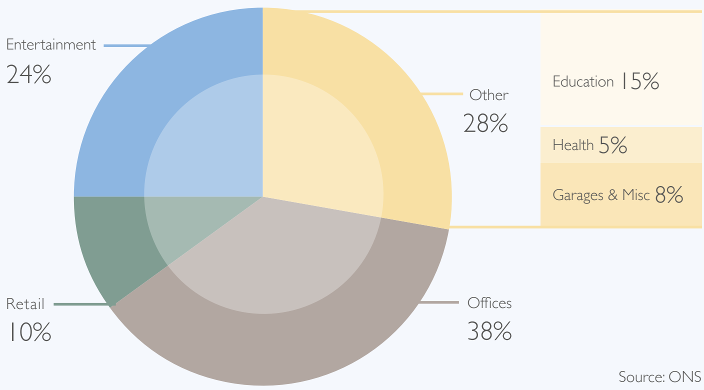
- Work to address RAAC issues is largely classified as new work
- Given financial constraints, new build projects are prioritised over routine r&m

The central forecast assumes a reasonable proportion of work to rectify RAAC safety issues will be low-level r&m. If more extensive remediation is required due to the nature of RAAC, public non-housing new work would benefit at the expense of r&m activity.

Commercial

A flatlining UK economy and interest rates at a decade-high are the key factors expected to hold back commercial sector activity in 2024 and continue to lengthen decision-making for large projects, particularly for new offices, university facilities and leisure and entertainment venues. The refurbishment and fit-out of existing commercial buildings continues to remain buoyant, however.

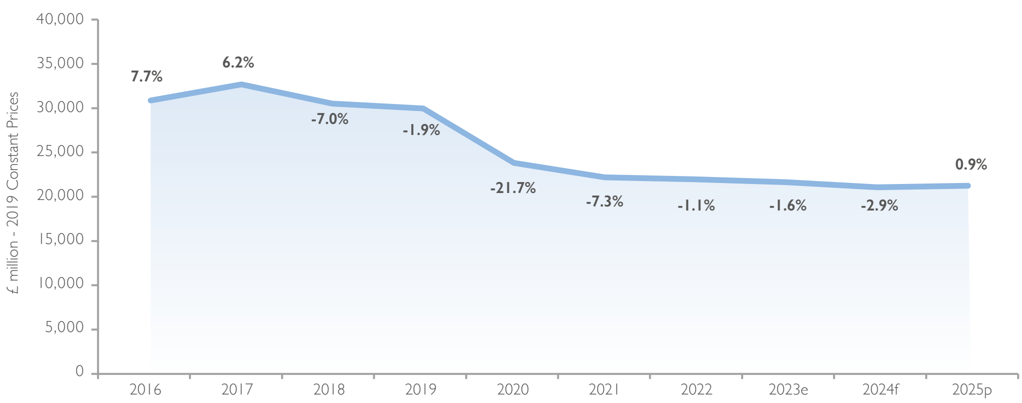
Commercial Output by Sub-sector 2022 (%)



Source: ONS

Growth in commercial construction output tends to be driven by large projects such as new offices towers, leisure and entertainment venues as well as retail premises and university buildings. As these projects require a large up-front investment, the sector's growth is strongly linked to macroeconomic performance and broader business and consumer confidence and spending. Across the commercial sector, large projects entering the early pipeline remain in 'wait and see' mode until clear signs emerge that the economy is strengthening, whilst given the long lags between approval, contract award and construction start, others have been paused indefinitely as conditions have changed markedly since they were first approved – across economic growth, build costs and financing costs and in some cases, changing requirements for space post-pandemic. A prominent question that has emerged over the last few years is what

Commercial Output



e = estimate, f = forecast, p = projection

Source: ONS, Construction Products Association

will happen to the growing stock of vacant or lower-quality commercial space. Across the whole sector, refurbishment work, whether it is to re-fit space for new occupiers, undertake energy efficiency improvements or repurpose vacant space, continues apace and is rising up the priority list for corporations, landlords, building owners and even entire localities such as the City of London. Nevertheless, at this point it will be insufficient to offset lower volumes of new build work, despite niche areas of growth in data centres, life sciences and student accommodation. The forecast for output in 2024 has been downgraded again, to a decline of 2.9% from a fall of 1.5% forecast in Autumn as there are more signs that large projects in the entertainment and leisure sub-sector are being paused to reassess financial viability.

Illustrating how the sector is held back by uncertainty, commercial output in October 2023 was still 24.8% below its pre-pandemic level from January 2020. Refurbishment and work to repurpose existing space has provided activity post-pandemic, either to appeal to new tenants taking over vacant units in offices and retail, to adapt workspaces given fewer workers on site simultaneously as hybrid home-office working continues, or to improve office amenities to encourage workers back to the office. Also driving refurbishment activity, commercial estate agents report that grade A office space is attracting a notable rental premium, whilst current Minimum Energy Efficiency Standards (MEES) regulations require commercial property to be rated EPC E but more pertinently, propose a minimum of EPC C by 2027 and EPC B by 2030. Despite a lack of clarity over whether MEES targets for non-domestic properties remain, after similar targets for residential properties were abandoned in September, corporate net zero priorities and a desire to capitalise on increased demand and rents for more energy-efficient properties are assumed to continue driving activity. As a consequence, demand for refurbishment is expected to remain high, although the higher cost of energy-efficient retrofit and 'back to frame' projects relative to a 'standard' refurbishment will be a limiting factor for some existing buildings, particularly in lower-rent areas.

Another key trend in the commercial sector, as highlighted in previous forecasts, is the conversion of previously retail-led developments, even in prime locations such as Oxford Street, into mixed-use led by residential, leisure and warehouses/logistics. However, in an environment of higher interest rates, increased development costs and greater risk aversion, CPA forecasts for these sub-sectors point to slower activity in these areas or, at least a lengthening in decision-making processes.

Retail activity has been particularly affected, both by prevailing economic conditions in recent years, and the long-term rise in online shopping. However, leisure and entertainment, the second largest commercial sub-sector, has benefited from the move to redevelop existing shopping centres or vacant store premises, in town and city centres into hotel or leisure-led facilities. Tourist volumes have steadily increased since 2020, although in the first nine months of 2023 they remained 7.9% lower than the same period of 2019, pre-pandemic, meaning that developers are still balancing this against longer-term expectations of a recovery, as well as the earlier impact of inflation and ongoing impact of higher interest rates on consumer demand and investment appetite.

Other niche areas of growth exist in commercial new build, but are subject to the same uncertainty and cost constraints. One of these is film and television studios, with main construction work underway on the £300 million expansion of Shepperton Studios, the £174 million Eastbrook studios in east London, the redevelopment and expansion of the Ealing Studios in west London and the formerly-derelict Littlewoods building in Liverpool, which is being redeveloped into a studio campus. A £260 million new build studio complex in Bedfordshire was approved in September and a £450 million film studio in Sunderland submitted for planning permission in November, although ultimately, the project is dependent on financial support from government, which has not yet been confirmed. However, two of the largest projects in the pipeline, the £600 million Hollywood Sunset Studios in Hertfordshire and the £700 million Sunset Waltham Cross Studios, were paused in the second half of 2023 to reassess viability in the light of higher construction costs and higher interest rates since they were approved.

Large arena and sports stadia projects are also in the pipeline, but there remain questions over when they will filter through to activity to replace work completing on Everton's £505 million stadium. For instance, a £100 million rise in the cost of the new Cardiff Arena scheme has delayed the project by one year, whilst the £350 million Gateshead Arena complex has been split into smaller phases to mitigate a rise in construction costs. Contracts were awarded for the £150 million first phase in September for a new build conference centre. Similarly, the £100 million expansion to Aston Villa's stadium was approved in October, after a new build events venue was removed from the plans to accelerate delivery of the stadium upgrade. Elsewhere, a new stand for Crystal Palace was approved in 2022, and although the club has warned that the current cost projection of £150 million is 50% higher than when the project was proposed in 2018, a start is expected at the end of the 2023/24 season in May. Manchester City's plans for its £300 million stadium expansion and hotel received full approval in October, whilst an expansion of Leicester City's football stadium received final approval in December. However, after a lengthy period of planning negotiations, the project will now be reassessed given the change in conditions since it was submitted in October 2021.

In terms of large leisure schemes, demolition and preparatory works for a £250 million spa resort in Manchester also began in 2022 Q4, with main works beginning this year and lasting two years, after revised design plans were approved in September. The £1.3 billion Olympia regeneration project in West London is also on site, for completion in 2025 and on the £200 million expansion of the Excel Centre, steelwork structures were completed in December.

Given that these larger new build projects only started entering the pipeline in 2022 and have a strong reliance on consumer confidence and spending, delays on projects yet to start cannot be ruled out as the economic backdrop remains weak in 2024.

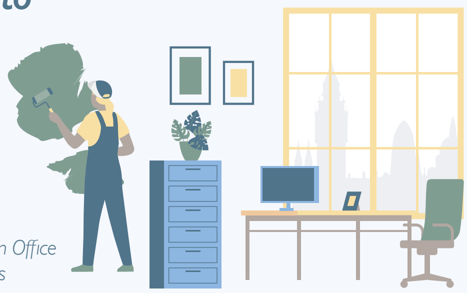
Set against the overall weak prospects for retail, grocery convenience stores, larger stores in retail parks and multi-use redevelopments of town centres will provide core activity and the £3.8 billion that has been allocated from the £4.8 billion Levelling Up Fund will also provide a stream of smaller regeneration projects. However, these will provide limited support to the sector, particularly as confidence and new major investment may still be hindered by the lingering effects of inflation for consumers, businesses and contractors. This is also likely to be the case for universities. Institutions across the country are in the midst of multi-year investments in new buildings for teaching and research, as well as university and privately-financed student accommodation projects, balancing favourable demographic trends with rising borrowing and financing costs.

The government has noted a significant and substantial demand for data centres – facilities that store IT infrastructure to run and store digital data. However, in November the Secretary of State refused planning permission for a 163,000 sq. m. data centre in Buckinghamshire over concerns about protecting green belt land. Nevertheless, in Q4, the contract was awarded for a £158 million data centre fit-out in London Docklands, with completion expected by mid-2024.

***Refurbishment** is a key area of activity:*

3.1 million sq. ft.
*refurbishments starts in London in the **six months to September 2023***

74%
of lease expiries** will be for spaces **occupied for more than ten years



Sources: Deloitte London Office Crane Survey and Savills

Across the commercial sector, financial viability and confidence to proceed with previously signed-off projects may be affected more than in other sectors given the already sizeable lags between project approval and the start of construction, particularly on large projects. Construction cost inflation has begun to recede, but costs remain elevated compared to pre-pandemic, whilst higher borrowing costs continue to be factored into investment decisions, even with expectations of interest rate cuts in the second half of 2024. Commercial new orders rose 2.0% in 2022 but fell 18.9% in the first three quarters of 2023. As above, for projects in the pipeline, delays relating to risk and issues around higher construction costs, expectations of a slower recovery in 2024 and the impact of higher interest rates on consumer and business demand, are assumed to lengthen the typical 12-18 month lag between contract award and construction start. As a result, after an estimated contraction of 1.6% in 2023, the forecast for 2024 has been downgraded to a decline of 2.9% in 2024, compared to a fall of 1.5% expected in Autumn. As confidence begins to return in 2025, growth of 0.9% is expected.

In the **offices** sub-sector, the projects that drive activity and growth are also those that require the largest up-front investments and are, therefore, the most affected by a subdued economic outlook and weak business confidence. Investment decisions will continue to be impacted by borrowing costs that are substantially above the low levels that were being factored into decision-making over the last decade, even as interest rates are expected to be lowered later this year. In addition, changing requirements for office space post-pandemic have complicated decision-making on large new build projects in particular, although demand now appears to be settling around hybrid models that mix home working with office attendance – assumed to be two to three days per week in the CPA forecasts. There is a pipeline of office towers projects at a pre-construction stage and as in previous forecasts, the key question remains when economic conditions will firm up for them to progress to construction and raise growth rates in the sub-sector. Given that the UK economy is expected to broadly flatline in 2024, this implies that decisions to progress schemes will continue to be delayed and lead to a third year of falling output.

Nevertheless, even with this weakness in the fundamental drivers of offices activity, demand and activity outside of new build towers has remained strong, and notably for refurbishments of existing office space. Energy efficiency, net zero and decarbonisation are rising up the corporate agenda and the increasing scope and value of improvements projects and the need for 'back to frame' energy efficient refurbishments mean that this type of work has now become a key driver of sub-sector activity. More widely implemented hybrid working patterns or full office attendance have also served as a driver to improve the quality of space and amenities to encourage workers back to the office or attract new tenants moving from lower-quality vacated space. Commercial property agents reported an increase in take-up in 2023 Q3 across most UK cities, with Knight Frank recording that take-up of grade A space in London and the South East accounted for the highest proportion on record, at 75%. Savills has also found that over the next five years, 74% of lease expiries in London and the South East will be for spaces occupied for more than ten years, leaving building owners and landlords to choose between refurbishment or the raised risk of 'stranded assets' – buildings that do not achieve a minimum EPC rating of B by 2030 in line with proposed Minimum Energy Efficiency Standards.

As a result, the need to improve both energy efficiency and the quality of facilities is expected to be a key driver of offices activity, both for new build projects and refurbishments across the forecast period. Currently, new commercial property leases, or renewals of existing ones, must be above an EPC rating of E and analysis by Savills estimated that only 1.3% of the existing offices stock in London and 4.9% of the stock in the rest of the UK can no longer be let due to its EPC rating. However, a further 67.5% of the existing London office stock and 71.8% in the rest of the UK has an EPC rating of C-E, which raises the issue of what will happen to space that is not upgraded in time for the new regulations. The prospect of 'stranded assets' rises in lower rent areas where the higher cost of a full energy efficient refurbishment makes projects unviable. Savills estimates that the cost of upgrading office space is around £40 per sq. ft. higher than typical refurbishment costs, whilst CoStar estimates that there is 102 million sq. ft. of vacant office space in the UK currently, the highest level since 2014 and 65% higher than the pre-pandemic level. Around one-third of the vacant space is in London. The City of London Corporation is considering a fast-track route for planning permissions for retrofit projects, fewer restrictions on changes of use for office buildings that cannot be upgraded, as well as consulting on a 'retrofit first' policy in its longer-term strategy to 2040. Scotland is yet to introduce an EPC target for non-domestic buildings, but based on a policy that mirrors that of England and Wales, Knight Frank found that 29% of Scotland's office stock has an EPC rating of E or below, with only 21% rated B or above.

The Deloitte London Office Crane Survey found that refurbishment schemes accounted for 79% of schemes started in the capital in the six months to September 2023, with refurbishment starts totalling 3.1 million sq. ft. of space across 34 schemes. All starts in Docklands and around three-quarters in the West End and South Bank were refurbishments. High-value refurbishment schemes have begun entering the pipeline, with work underway on schemes including Space House in Covent Garden, Citi Tower in Canary Wharf, the former Goldman Sachs HQ on Fleet Street and the £130 million Woolgate Exchange refurbishment that began in July. Large-scale projects that entered the pipeline at the end of 2023 and start of 2024 included the full retrofit of 10 Spring Gardens for the Crown Estate (contract awarded in November), the £200 million refurbishment of 5 Chancery Lane (contract awarded in December) and the redevelopment of Euston Tower (planning submitted in January).

Large new build projects have also entered the early pipeline, although lingering uncertainty over demand for office space and the combination of flatlining economic growth and higher financing costs is expected to lengthen decision-making and delay start dates. In central London, commercial estate agents have reported that offices transactions are taking longer to progress and remain significantly below the long-term average, with appetite worsening due to falling capital values. According to CBRE, capital values for UK offices and central London offices fell throughout 2023, after a 12.1% fall in 2022. The IPF consensus forecast from Autumn shows a 2.8% decline is expected in 2024. Lower capital values have benefited those with the means to make countercyclical purchases, however, with large landlords and developers reported to have been buying more actively over the last 12 months. Moreover, Great Portland Estates has stated a new focus on purchasing older buildings that need improving, with other large firms reporting a similar approach.

The CPA forecast assumes that commercial investors and developers continue to delay start dates on new build schemes until returns on investment become less uncertain, and for this to be the case particularly for large offices towers. Canary Wharf appears most affected by weakened confidence, illustrated by HSBC's announcement in June that it was moving to downsized premises in the City of London. In addition, construction remains on hold on the 214,000 sq. ft Frameworks development and the 119,000 sq. ft. Market Building pending a significant pre-let or a decision to proceed speculatively. Knight Frank estimated the offices vacancy rate in Canary Wharf at 15.6% in Q3, which is 6.1 percentage points above the long-term average and considerably higher than the 9.9% London average and 9.3% rate for the UK.

Although investors and developers appear to be in 'wait and see' mode to start large new build projects, there are schemes entering the pipeline, particularly in the City of London, with completion dates in 2025 and beyond. In Q4, the £500 million, 23-storey redevelopment of 55 Old Broad Street was approved, along with the redevelopment of a vacant hotel in Bloomsbury into a 19-storey offices-led tower. This adds to approvals earlier in 2023, including a development consisting of 63-storey and 22-storey towers at 55 Bishopsgate and a 45-storey tower at 18 Blackfriars Road, forming part of a scheme alongside two residential towers. Outside of London, large projects in the pipeline include a £500 million twin office block development at Botanic Place in Cambridge, One Medlock Street and Bridge Street in Manchester and a £200 million offices and hotel scheme at Haymarket Yards in Edinburgh. However, given there is still economic uncertainty and substantially higher financing costs, with these projects yet to begin construction, they remain susceptible to delays. Highlighting this, British Land has commenced demolition and basement works on 2 Finsbury Avenue, but is yet to commit to the full scheme.

In the first three quarters of 2023, new orders were 9.1% lower than a year earlier and the lowest since the corresponding period of 2020. New orders were, however, higher than in the same period of 2017, 2018 and 2019, when confidence was affected sharply post-Referendum. For the large refurbishment projects and the new build towers and large projects entering this pipeline the expected rate of return is over a longer and, consequently, riskier, period meaning that the lag between orders and output is longest. Large projects are now taking much longer than the 12-18 month lag that CPA analysis has previously found between new orders and output given the slow recovery expected in 2024, as well as higher build costs and financing costs that need to be taken into account in investment decisions. As a consequence, starts on large office towers projects that were approved or awarded contracts in 2023 and 2024 are expected to be pushed back for longer. Output is forecast to fall by 4.0% in 2024, which follows contractions in 2022 and 2023. The next recovery phase is anticipated to begin slowly, with growth of 1.0% forecast for 2025.

Upper Scenario:

• A widespread return to offices

• Broad increase in refurbishment projects

The CPA continues to assume in the forecast that office workers work from home two to three days a week, on average. However, if office workers end up in offices more frequently than this on a consistent basis, it would lead to a higher degree of business confidence in the near-term, with firms committing to refurbished existing space or moving to new premises with larger floor space or better amenities as leases expire in the coming months and years. In addition, increasing awareness of the minimum EPC B rating from 2030 drives an early pickup in refurbishment activity across offices of all sizes across the UK. The weak economic backdrop would limit the uplift, however.

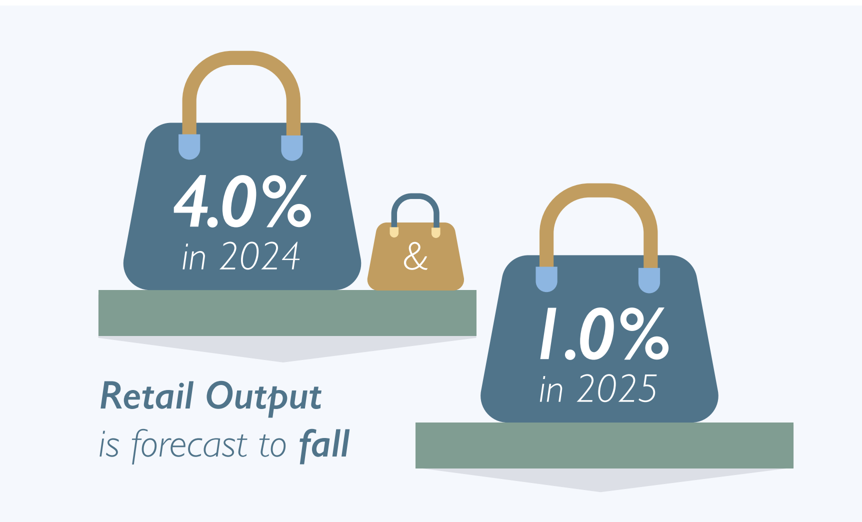
Lower Scenario:

• Slower recovery prolongs the period of uncertainty and constrained business investment

• Lack of developer interest

A longer period of weak economic growth, or interest rates remaining at their peak throughout 2024, stall decision-making for longer than in the main forecast. Along with potential occupiers holding off, increased borrowing costs and two more years of falling capital values could also cause developers to abandon projects, rather than delay them.

The prospects for the **retail** sub-sector remain downbeat given the headwinds highlighted in previous forecasts. Over the last couple of years, falling capital values, vacancy rates that remain high, particularly for high street and shopping centre settings, and a large increase in the cost of development finance as interest rates have been raised to a 14-year high have combined with the long-term structural shift in demand away from retail premises towards industrial space for operations linked to e-commerce. All of which illustrates the low appeal of new retail units, despite the recent improvements in consumer demand following slowing inflation, a return to real wage growth and gradually improving consumer confidence. However, there are areas where investment is more appealing, at retail parks and within the grocery or discount homewares segments, for example, and being able to acquire existing, vacant units from previous company administrations has facilitated expansion plans. Similar to offices, a 'flight to prime' and a rising awareness of energy efficiency and decarbonisation requirements also concentrates occupier and landlord demand on improving existing space. Work is, therefore, dominated by refits and refurbishment rather than new build. Larger-scale redevelopments



of lower-demand or vacant assets such as department stores and shopping centres is increasingly for mixed-use led by leisure, entertainment, offices or residential, thereby diverting output away from the retail sub-sector. Given these factors, output is forecast to decline in each year of the forecast period.

Output in the sub-sector has fallen 60.0% over the last ten years and the key driver of this long-term decline has been a structural shift in consumer spending habits. A gradual increase in retail spending online has redirected investment away from 'bricks and mortar' retail premises towards warehouse facilities for logistics and storage, and this appears to have been accelerated by the pandemic. The proportion of retail sales spent online peaked at 37.4% in February 2021, mid-pandemic and although this had steadily declined to 26.6% in November 2023, online sales still account for a much higher proportion of total retail than in 2019 (19.2% on average) and ten years earlier (10.4%), which will keep driving demand away from retail premises.

Shopping centres and department stores have been particularly affected by these changes and are displaying vacancy rates that are both higher than for other settings such as retail parks and high streets, as well as higher than a decade earlier. Consequent redevelopment as retailers have vacated stores and relocated to higher footfall locations has largely been geared towards repurposing and regeneration that move away from solely retail to mixed-use offices, leisure and residential. Similarly, formerly prime-sited department stores are now being redeveloped into mixed-use space. The Local Data Company found that 20% of former Debenhams stores and 10% of former BHS stores have so far been repurposed, including into leisure and entertainment venues such as those in Wandsworth, Coventry, Hastings and Colchester, and university buildings, as in Gloucester. However, 40% of former Debenhams stores remain vacant, as do half of ex-Arcadia stores.

In contrast to shopping centres and department stores, retail parks have fared well over the last few years due to the drive-to convenience and the presence of supermarkets and larger floorspaces that can mix in-person and online retail operations such as click-and-collect or click-and-deliver across a range of products. Vacancy rates, footfall and leasing activity have also outperformed other retail settings. Similarly, according to the Local Data Company, retail parks were the only location to record more store openings than closures in the first half of 2023, whilst British Land released an update highlighting that strong demand and limited supply are expected to strengthen rental revenue growth. Take-up has been led by grocery and discounters that have benefited from increased demand during a period of high inflation and falling real incomes. Savills found that supermarkets accounted for 31% of occupied floorspace in retail parks in 2022, up from 18% a decade ago, with the share for discount brands rising to 14% from 8%. In addition, one-third of new openings in 2023 so far have been by value brands.

Discount supermarket chains such as Aldi and Lidl have maintained a focus on physical stores with no, or very limited, online presence for groceries. In early 2023, however, Lidl, the sixth largest supermarket retailer, announced that it would be slowing its store opening programme from 50 per year to 25 per year in order to focus investment on expanding its warehouse capacity. Signalling that demand for out-of-town premises by supermarkets may have peaked, other grocery retailers have shifted focus to smaller convenience stores. Asda's expansion over

the next three years will focus on grocery convenience stores rather than its large out-of-town premises, with an aim of doubling its existing estate to 300 by the end of 2026, with new stores concentrated in the south of England. Sainsbury's and Waitrose have also announced a focus on convenience stores, whilst Co-op aims to more than treble its number of franchise stores within three years, from 43 to over 130, due to increases in demand in delivery services through Uber Eats, Deliveroo and Amazon. Amazon has paused its own plans to open 'cashierless' grocery stores, whilst openings of its Amazon Fresh grocery stores have remained significantly below the volumes initially announced.

Town and city centre regeneration schemes will also provide small volumes of retail work over the forecast period, with the £4.8 billion Levelling Up Fund and £830 million Future High Streets Fund supporting smaller council-led town centre projects that are part of wider regeneration schemes. However, such projects are following the trend for mixed-use, rather than solely retail developments. Allocations of funding under the Future High Streets Fund were announced in 2021, but given the lags between announcements, approvals and receipt, activity is still coming through, whilst under the Levelling Up Fund £3.8 billion was allocated in two rounds in October 2021 and January 2023. £460 million was allocated to town centre regeneration projects, including new market halls in Bury (£20 million), Barrow-in-Furness (£16 million) and Ellesmere Port (£13 million). Nevertheless, by the time funding is actually received, cost inflation may mean projects are financially unviable and so may not be able to even get started despite central government finance. At the end of 2023, preliminary works had only begun on one of these projects. Larger regeneration projects will be equally susceptible to delays or scaling back, particularly for those that are moving towards mixed-use led by residential and offices, that are two of the sectors forecast to be most affected by the weak economic outlook in 2024. Recent projects of this nature include the redevelopment of the Wigan Galleries centre into residential, a hotel and a market hall building. The latter was the first phase to be begin construction last year, for completion in 2024, as well as the 15-20 year plan to redevelop the St Enoch shopping centre in Glasgow. Nevertheless, plans were approved in June for a £500 million garden village in Broxbourne, Hertfordshire that will be led by 315,000 sq. ft. of retail space, whilst John Lewis partnership submitted planning applications for three of its Build to Rent residential schemes above stores in West Ealing and Bromley, also in June.

Given that the UK economic recovery is not expected to gain momentum until the end of 2024 and into 2025, the forecasts for retail construction output remain muted. After an 8.0% fall expected in 2023, output is forecast to fall 4.0% in 2024 and 1.0% in 2025 as consumer and business confidence remain constrained by a weak economy and interest rates settling at a level higher than consumers and investors have been accustomed to over the last decade.

Upper Scenario:

• Consumer confidence and spending improve quickly in early 2024

• Favourable business rates revaluation firms up confidence for retailer expansions

Measures of consumer confidence improved throughout 2023. If moderating inflation and the Bank of England begins loosening monetary policy earlier than expected in the main forecast, confidence is assumed to improve quickly in early 2024. Retailer and investor confidence for expansion would also be expected to improve. This is likely to be compounded if a reduction in business rates quickly filters through to decisions to expand.

Lower Scenario:

• Strains on disposable incomes restrict household spending throughout 2024

• Rising construction costs lead to delays or cancellations

A slow recovery and interest rates remaining at peak for longer, on top of higher household bills and payments for mortgages and rents, would keep household spending muted in 2024, in turn meaning that investor and developer confidence is likely to worsen, particularly if it affects rental revenues from existing outlets struggling to pay. Elevated construction and borrowing costs also pose a risk to viability and could delay projects or see them cancelled if existing contracts cannot be renegotiated or rising debt repayments won't be covered by lower rents or capital values.

In the **commercial education** sub-sector, 2023 ended with several large student accommodation towers projects and university construction schemes entering the early pipeline. Favourable long-term trends in domestic demographics and rising non-EU student numbers have underpinned past and current capital investment plans by UK universities and private accommodation providers, but institutions and developers will need to adapt to elevated build costs, slow economic growth and interest rates that are significantly higher than a few years ago. Although projects currently in the planning and preliminary works phases are scheduled to complete from 2025, when economic growth is expected to be stronger, investment and financing decisions will need to be taken in the coming months when the economic backdrop is more challenging.

There were 493,940 applicants accepted on to UK university courses for the 2023/24 academic year, according to UCAS, which was 1.7% lower than the previous year. The number of domestic students fell by 1.8%, although this marked a return to pre-pandemic levels. According to the ONS's 2020 population projections, the number of 18 year-olds in the UK will increase by 24.5% over the next decade, whilst UCAS forecasts applications to UK higher education institutions will be 30.0% higher in 2030 compared to 2022. For 2023/24, the number of international students from EU countries fell 2.7% from a year earlier and represented a new low level. Acceptances from EU students are now 58.3% lower than a decade ago. Acceptances from non-EU students also fell, by 0.8%, but this was the still the second-highest level on record. Non-EU student numbers have also risen 45.1% in the last ten years. In addition, since 2017/18 tuition fee income from non-EU students has risen by 70.4%, driving large capital spending programmes at UK universities to build and upgrade teaching and research facilities to attract higher fee-paying overseas students.

Following the first UCAS deadline of October, applications for entry in 2024 showed that total student numbers are likely to decline for a second consecutive year. Overall applications decreased 1.8%, although this remained 6.9% above 2019 levels. Applications from UK-based students fell 2.3%, they were 3.4% lower for EU students and 0.1% higher for non-EU applications.

One area of the sub-sector that has remained buoyant is the construction and refurbishment of student accommodation. Universities and private providers are investing heavily in purpose-built student accommodation, particularly given the increase in international (non-EU) students in recent years. Student accommodation developer Unite has four developments scheduled for completion between 2024 and 2026 in London, Edinburgh, Nottingham and Bristol and is still awaiting planning approval for a 1,000-bed scheme in Stratford, East London. Going forward, its strategy will focus on partnerships with high and mid-ranked universities, where demand is viewed to be strongest. In September it announced an 800-bed scheme in Glasgow to be delivered as a partnership, with planning approval expected in 2024 and completion for the 2026/27 year. It will be funded through capital disposals. Empiric has also announced a focus on higher-ranked universities where continued growth in international student numbers is expected, as well as a £44.0 million refurbishment programme and a £12.0 million in green initiatives. It has closed an accommodation block in Southampton for the current academic year to enable a full refurbishment of facilities, plus energy efficiency improvements. However, the developer has warned that rising costs are threatening viability on its projects and this may keep its Canterbury new build scheme, which was paused post-pandemic, on hold for longer.

Nevertheless, the longer-term pipeline for private sector student accommodation, and particularly large projects, remains strong. Schemes of 500+ beds continue to enter the pipeline, which already includes towers across UK cities. In Q4, work began on a seven-storey block in Liverpool and a three-tower scheme in Manchester, whilst a 555-bed scheme in Brighton received planning approval and planning applications were submitted for a 36-storey tower in Glasgow and a 35-storey tower in Leeds. In January, work began on a 26-storey tower in Salford that includes student accommodation above a new sixth form college and contracts were awarded for a 700-bed scheme in Bristol, among others.

Alongside accommodation work, universities have been driven to make major capital investment in education facilities to help compete at a global level and attract the higher fees paid by international students. In recent years, this has moved towards large-scale, phased redevelopments or new campuses, rather than new departmental buildings. The University of Oxford and the University of Birmingham have multi-year investment frameworks underway, whilst work continues on the University of Bristol's new £300 million campus and Sheffield Hallam University's satellite campus in Brent, north London, which will open for the 2025/26 academic year, with further expansion planned by 2030. In Q4, the University of Cambridge selected contractors for a £680 million four-year construction framework, whilst plans were submitted for a new science and engineering campus at the University of Warwick, a new library for Manchester Metropolitan University and the proposals by the University of Liverpool to convert the former Royal Liverpool Hospital building into a health sciences campus. The University of Portsmouth's £135 million 12-storey faculty building, which was approved in 2021 and was expected to see main construction work start on site in 2022, is still yet to start due to difficulties in sourcing contractors and highlights the risk for other projects moving from planning approval to contract award and start of works.

***Early applications** for entry to **higher education** in September 2024 **fell** 1.8%, marking a second year of decline*

Source: UCAS October application deadline

Outside of universities, the first projects to be funded through the Welsh mutual investment model of public-private partnership began in 2023. However, rising build costs have led to questions over the long-term value-for-money of resulting annual payments that will be required to be paid by the local authority. The mutual investment model framework is planned to provide up to £500 million of capital funding for education projects in Wales.

Construction output volumes this year and next will be dependent on how institutions, student accommodation developers and joint venture partners and contractors can deal with elevated build costs, an economic slowdown and costlier finance for projects in the near-term pipeline. Despite the increase in projects in the planning stages, new orders in the sub-sector – projects that have awarded contracts – were only 1.5% higher on a four-quarter total basis in 2023 Q3. Consequently, following an expected fall of 4.0% in 2023, output is forecast to rise by only 1.0% in 2024 and 2.0% in 2025.

Upper Scenario:

• Stability in student numbers and higher international fee income improves confidence

• Individual landlords exit the market

Higher fee income from international students that increase revenues and early signs that applications for 2024/25 entry show stability in UK and non-EU student numbers shore up confidence to progress student accommodation schemes and university capital expenditure programmes, despite the economic and financial backdrop. A longer-term consideration for student accommodation development is that rising interest rates and mortgage repayments raise costs for individual HMO (houses in multiple occupation) landlords and reduce returns to such an extent that it is not profitable to continue, thereby redirecting demand towards larger providers.

Lower Scenario:

• Deterioration in university finances and cost rises hinder the viability of university projects

In recent years, universities have had an increasing reliance on private sector borrowing such as private and public bond issuance to finance work. Appetite for bond issuance will be limited if economic recovery remains weak throughout 2024, which worsens investor risk aversion, with higher interest rates representing another cost for institutions to consider. Questions also remain over the impact of EU student numbers falling to a record-low post-Brexit. In the lower scenario, higher build costs also delay delivery timelines of projects in the pipeline.

Output in the **commercial health** sub-sector is less than half of the levels seen when PFI was used by government as a means of financing and building new hospitals. Since then, the construction of new facilities by private healthcare providers or privately-funded redevelopments of NHS hospitals has been the sole driver of activity. There has been a notable increase in NHS waiting lists and a lengthening in referral times, particularly post-pandemic, that have resulted in private healthcare providers reporting a rise in self-pay and privately-insured patients, whilst a small, but rising, proportion of NHS-funded treatments are being carried out by private providers to try to ease backlogs. However, this has not yet translated into expansion plans or new hospitals and continues to be balanced with ongoing pressure on household finances and pressure on operating costs. In August, the US health insurer Centene announced it was selling off its chain of private GP clinics and its Circle private hospitals and exiting the UK market as higher staffing costs eroded profitability. In the last few years, and again, particularly post-pandemic, life science, laboratory and medical research facilities have added a stream of activity, although projects are largely at the planning and tendering stages and will take some time to add to activity on the ground.

According to the Private Healthcare Information Network, the number of self-funding private patients peaked at 72,000 in 2021 Q2 and averaged 69,000 in the first half of 2023. This level is one-third higher than in 2019, pre-pandemic. In addition, the number of private in-patient and day admissions reached the highest since data collection began in 2016. According to the British Medical Association (BMA), a record 7.77 million people were waiting for treatment in September 2023, and 391,000 patients had been waiting over one year for treatment, compared to 1,699 people waiting over a year pre-pandemic in December 2019. So far, increases in investment by private healthcare providers have focused on staff and expanding services at existing facilities, particularly as the NHS backlog increases procedures being diverted to private providers. In 2022, 8.7% of NHS-funded treatments were carried out in private facilities and although only a small increase from 7.7% pre-pandemic, it signals the growing use of facilities due to NHS capacity constraints and the deteriorating condition of the NHS estate (see Public Non-housing R&M).

There are several large projects that are now in the pipeline, as work on the the £100 million acute care hospital in Harborne, Birmingham reaches completion in early 2024. This was the first large project on the £500 million Private Investment Construction Framework for healthcare began in April 2019, but only two other projects under £10 million each have been procured under the framework. The final business case for the £190 million phase 4 of Great Ormond Street's expansion – the redevelopment of the main entrance and a new cancer centre – was approved in October, with demolition of the existing building to begin in early 2024 and main construction to run between 2025 and 2027. Alongside this, a £376 million extension to the Evelina London Children's Hospital was approved in October 2021, although the construction contract was re-tendered during 2022 and there have been no further updates. Construction is set to run until 2027. It will be funded through a combination of public funding and private donations.

Medical research and life sciences facilities have emerged as an area of growth within the sub-sector. Work on a £150 million life sciences centre in Euston, London began in April 2023 and Moderna's Innovation and Technology Centre at the Harwell campus began in Q3. Other large projects are in the pre-construction or planning phases, including the award of contracts for a £300 million cancer research centre in Oxford in October, funded by the Los Angeles-based Ellison Institute for Transformative Medicine, a 22-storey life sciences wet lab in Canary Wharf, which was approved in July, and 600,000 sq. ft. of purpose-built laboratory space in Cambridge approved at the end of 2022. In July, plans were approved for a £900 million biotech campus is Stevenage, which will mix laboratory buildings, offices and manufacturing facilities across a phased development of 15 buildings and in November, three new laboratory buildings, which total 458,000 sq. ft. were approved in Oxford, forming the second phase of a £700 million R&D district. In addition, there are plans for a new £40 million Veterinary Vaccine Manufacturing and Innovation Centre at the existing Pirbright Institute campus in Surrey. The UK government is set to commit £18.5 million of funding to the project, whilst the Bill & Melinda Gates Foundation will provide £14.5 million. The consultancy contract was awarded in October 2022 and has construction running until 2025. However, work on the £120 million Vaccine Manufacturing and Innovation Centre in Harwell, Oxford has been suspended by the new investors to reduce capital expenditure.

Outside of the large projects that drive sub-sector growth, developer Assura currently has ten developments on site in the UK, totalling £114 million, including a £25 million training academy in Northumberland, an £11 million ambulance hub in Bury St Edmunds and a £31 million cancer diagnostic and treatment centre in Guildford, which will complete in early 2024. A further four schemes are expected to start on site within the next 12 months and there are 15 enhancement schemes with start dates beyond 12 months. However, it has noted that schemes are delayed by around three months due to managing build cost inflation, whilst appetite to expand has been dented by tighter financial market conditions. Similarly, Primary Health Properties will focus on its existing portfolio of properties and has paused new investments until it considers the economic and interest rate outlook has become clearer.

Annual new orders were above £700 million in both 2021 and 2022, marking the first time above this level since 2012. Nevertheless, the construction activity on large projects would be spread over two or three years and so would lead to smaller rises in output. In addition, on a four-quarter total basis, new orders in Q3 were 36.7% lower, which suggests only a temporary uplift in activity. As existing projects reach completion and activity is offset by new work entering the pipeline, growth over the forecast period is expected to be muted. Following the strong recovery in output in 2022, the start of the two major projects in London was expected to maintain output levels in 2023 and drive growth of 2.0% in 2024 and 1.0% in 2025, alongside the start of construction on research facilities.

Upper Scenario:

• Rising demand for private healthcare translates into new facilities

Hospital backlogs since 2020 have already increased demand for private healthcare and in the upper scenario, this leads to private healthcare providers planning new investments in facilities that open towards the end of the forecast period when it is assumed economic uncertainty has lifted. The removal of travel restrictions is also expected to increase demand from overseas health tourists. Work on the ground would take longer to filter through to activity from 2024, however.

Lower Scenario:

• Uncertainty leads to delays

As demonstrated by recent moves by private healthcare providers to pause new investment decisions or focus on improving existing facilities, uncertainty over the strength of the economic recovery and higher interest rates are likely to constrain new development. Similarly, high cost inflation since plans were approved and contracts awarded for larger new hospitals and research facilities adds a further risk of delay to these projects.

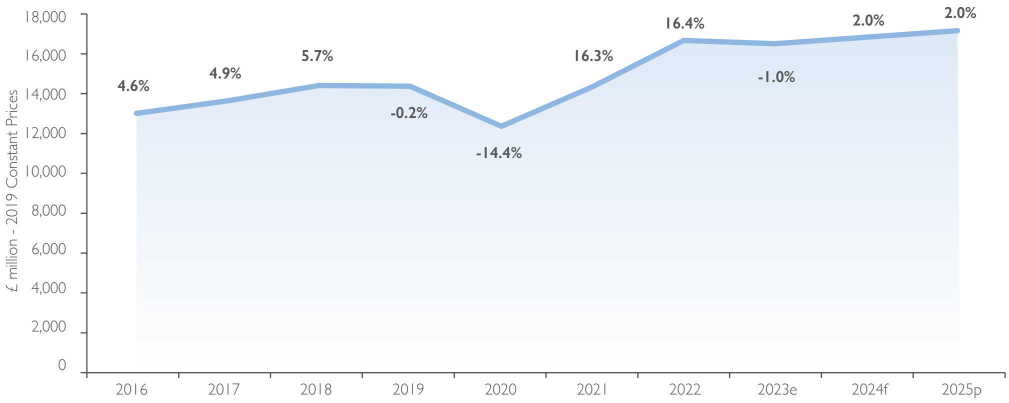
Private Non-housing R&M

Growth in private non-housing repair and maintenance (r&m) activity is expected to be restricted by higher costs and an increasing preference for larger-scale refurbishments and improvements on commercial properties.

Output in the private non-housing r&m sector includes basic repairs and maintenance of offices, retail premises, warehouses, factories and other privately-owned non-residential properties and is dominated by work on offices and retail units. Typically, sector output tends to be less volatile than new build, given the reliance on long-term facilities management contracts, but in recent years, the discretionary, non-essential element that is dependent on macroeconomic fundamentals related to business investment and consumer spending has been more affected by heightened macroeconomic uncertainty. This has been exacerbated by changes to working patterns and office space usage, as well as the increase in lower-quality vacant space, high inflation and the slower UK economy.

The recovery in offices and retail is not forecast to materialise until 2025 (see Commercial), whilst a fall in new investment in warehouses and factories that began in the second half of 2023 is expected to continue throughout 2024 (see Industrial). Although this means lower volumes of new build activity, conversely, building owners may shift their focus to r&m of existing buildings, particularly to appeal to new tenants. However, as illustrated by the offices sub-sector, refurbishment projects have grown in value and scale, which means activity is unlikely to translate into strong growth in r&m and be classified as new build commercial work and divert activity away from the r&m sector instead. This is particularly the case as businesses adapt to post-pandemic requirements for office space considering increased remote and hybrid working and lower, but variable, occupancy rates throughout the working week, as well as a focus on improving the growing stock of vacant office space that is unlikely to be grade A standard, and energy efficiency credentials to avoid stranded assets. Energy efficiency and decarbonisation improvements are increasingly being seen in retail, factories and warehouses too. Furthermore, the prolonged period of high construction cost inflation between mid-2021 and mid-2023, associated delays in contracts for new build, and lingering economic weakness throughout 2024 make it more likely that the sector will experience a deterioration in business confidence, a reduction in new investment and potential delays to some non-essential maintenance.

Private Non-housing R&M Output



e = estimate, f = forecast, p = projection

Source: ONS, Construction Products Association

Remediation of Aluminium Composite Material (ACM) cladding on private non-residential buildings above 18 metres is almost complete, with the Department for Levelling Up, Housing and Communities (DLUHC) monthly statistics from the end of November confirming that works have completed on 55 out of 58 student accommodation towers and 29 out of 31 high-rise hotels. Data on the extent of remediation required outside of ACM cladding is yet to be collected, but the student accommodation provider, Unite, owns 37 buildings with high-pressure laminate (HPL) cladding, with remediation completed on ten of these. It expects to continue remediating 10-15 buildings per year. Empiric's trading update in November highlighted that large refurbishment projects are also a consideration for private student accommodation providers, which, again, are likely to be classified as new build rather than r&m. Empiric has closed one of its Southampton properties for the 2023/24 academic year in order to undertake a full refurbishment across rooms and amenities, as well as energy efficiency, fire safety and decarbonisation.

As in the public sector (see Public Non-housing R&M), reinforced autoclaved aerated concrete (RAAC) is also likely to be an issue for some private sector buildings. Nine universities in Scotland, five in England and one in Wales, along with ten theatres, have closed buildings following the discovery of RAAC in structures but its wider presence in the private sector is so far undeclared. Whether this is due to lack of investigation into private buildings or whether it is because it is less prevalent in private buildings due to better maintenance is not known at this point. The scale of remediation required will determine whether it is classified as r&m, with large remediation projects emerging in the public sector suggesting that work is likely to be classed as new build.

Outside of routine or urgent r&m that cannot be delayed, discretionary r&m may benefit from any reticence or delays on new build projects that sees building owners focus on maintaining existing properties. However, this will be outweighed by lower volumes of work due to sharp rises in the cost of materials and labour, as well as larger-scale refurbishment and improvements that are classified as new build rather than r&m. Output volumes are expected to return to growth of 2.0% in both 2024 and 2025.

Upper Scenario:

• Stronger focus on r&m

Elevated inflation and continued economic weakness into 2024 are likely to lengthen the lag between new orders already confirmed and project starts for new build and lengthen the decision-making process for investment in projects slightly earlier in the pipeline. This would make maintenance of existing assets and facilities a greater focus for building owners and landlords. However, current and planned remediation works on larger-scale r&m projects may be delayed by high costs.

Lower Scenario:

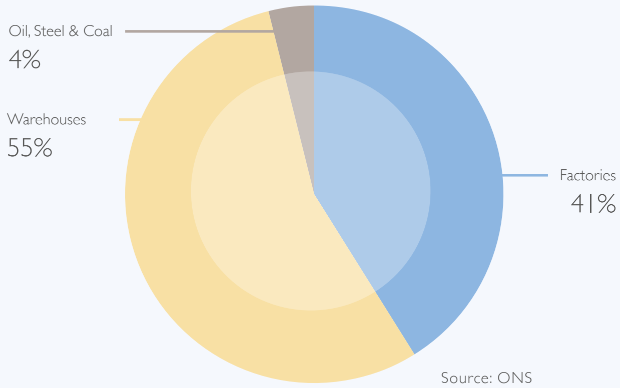
• Priority shifts to new build

If developers, contractors and investors continue to progress commercial and industrial projects through to starts on site given completion dates scheduled for later in the forecast period when economic growth is expected to be stronger, new build could be prioritised over r&m. Building owners choosing to refurbish rather than maintain the large stock of vacant office space also becomes commonplace in the lower scenario.

Industrial

Output growth in the industrial sector began to weaken in 2023 and falls in activity forecast in 2024 and 2025 highlight that an environment of higher interest rates and a slower outlook for economic growth, manufacturing and retail demand have reduced confidence to invest in new warehouses and factories in the near-term.

Industrial Output by Sub-sector 2022 (%)

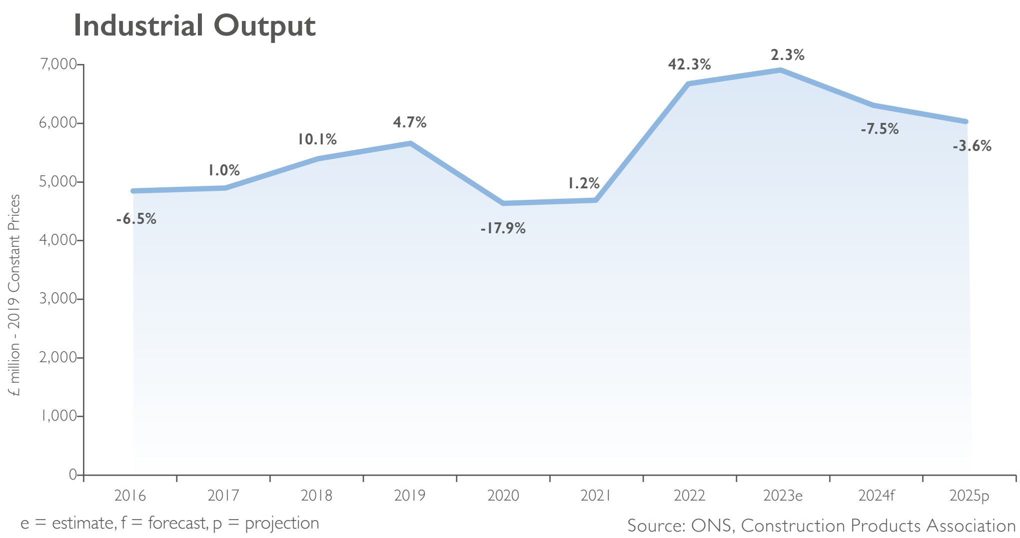


Source: ONS

Industrial output is dominated by the factories and warehouses sub-sectors and activity has now begun to fall from the peak levels reached post-pandemic and, particularly, in 2022 when double-digit rates of growth were recorded. The pipeline for new projects has been affected by muted economic growth, an increase in interest rates that means costlier finance for development and construction, as well as renewed uncertainty affecting business confidence for large new investments since the second half of 2022. Output in the factories sub-sector already fell in Q2 and Q3 last year and in warehouses, a noticeable slowdown in activity emerged in the second half of 2023, reflecting work completing on projects underway and a fall in new orders over the last 12 months. Demand for warehouses, and particularly the larger 'big sheds' projects, is expected to have passed its peak, with logistics and e-commerce demand from retailers slowing from the buoyant period of expansion immediately after the pandemic.

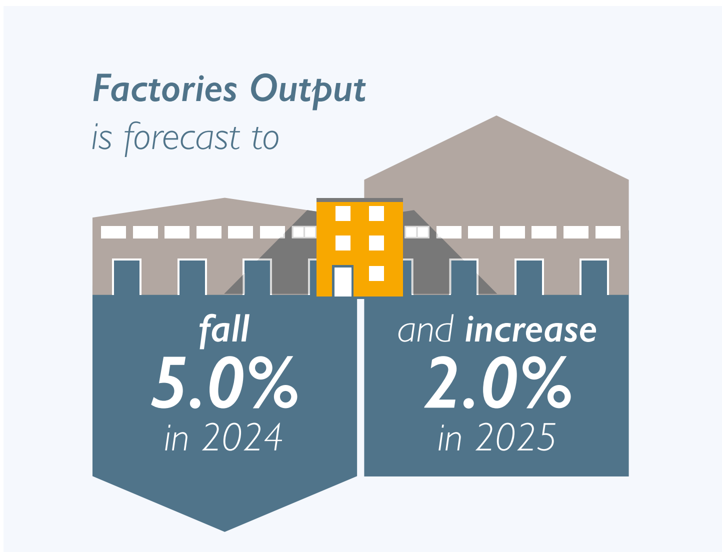
In oil, steel and coal, which historically has accounted for less than 3.0% of total sector output, the construction of a pipeline between the Fawley oil refinery in Southampton and London has kept output at a relatively high level for the sub-sector (over £350 million in the first three quarters of 2023). Once this project completes, output is expected to remain at this level after the government confirmed in September 2023 that it will be investing in Tata Steel's new electric arc furnace in Port Talbot. The proposed new £165 million coal mine in Cumbria, which was approved by the Secretary of State in December 2022, is not included in the forecasts as it is still subject to legal challenges that were continually delayed during 2023.

After two years of strong growth in 2021 and 2022, output in the **factories** sub-sector began falling from 2023 Q2 as the weakening in the economy from late-2022, along with a period of elevated costs and rising interest rates, has led firms to hold off on large capital spending commitments. The post-pandemic expansions that drove growth in recent years are now combining with weaker demand to leave excess capacity as the key issue for many manufacturing firms and means that the balance in activity has tipped away from work on projects signed off in 2020 and 2021 towards the narrowing pipeline from the ongoing pause in manufacturing investment decisions. This dynamic is expected to continue throughout the first half of 2024 until clearer signs of momentum in the economic recovery emerge towards the end of the year. The forecast profile for output has changed from Autumn, with a sharper decline expected to have occurred in 2023 and, therefore, the contraction in 2024 is now expected to be less acute.



Following a 5.0% decline in output now estimated for 2023, another 5.0% decline is forecast for 2024, which compares to -2.0% and -8.0% previously. As recovery begins in 2025, growth of 2.0% is projected for that year.

Activity in factories is primarily driven by manufacturing output, which began rising in mid-2023, although this follows annual falls throughout 2022 and the first half of 2023. In addition, survey data from the S&P Global PMI for December showed that manufacturing output has been contracting for ten consecutive months due to declines in demand domestically and from overseas. Given that the survey is, to a certain extent, reflecting sentiment, the extended run of weakness in the index does not come as a surprise given the weakness and uncertainty in macroeconomic conditions. Nevertheless, this is also reflected in forecasts for manufacturing output in 2024. In HM Treasury's monthly comparison of independent forecasts from December, the median forecast for manufacturing output growth in 2024 was 0.2%. The Make UK/BDO manufacturing survey for 2023 Q4 showed investment intentions for the next 12 months remained positive, although were more subdued than in Q3, despite the Autumn Statement confirming that 'full expensing' will be made permanent rather than ending in 2025/26. Since April 2023, 'full expensing' has allowed firms to reduce their taxable profits by 100% of the cost of their investments in plant and machinery in the first year. This has the potential to boost investment in factories, although the question remains over how and when it translates into investment decisions being made and construction work started. Concern over the economic outlook in the near-term suggests it will provide more of a support to activity from 2025.



The slowdown and then contraction in sub-sector growth apparent in official ONS output data from Q1 reflects the completion or final stages of larger projects in the pipeline, namely Aston Martin's £200 million Formula 1 factory in Northamptonshire, Forterra's £95 million

Desford brick factory, Ibstock's Atlas and Aldridge factories, the first phase of the Siemens Mobility £200 million rail factory in Goole and the Siemens Gamesa £186 million expansion to its offshore wind turbine blade factory in Hull.

There are still some projects further back in the pipeline, however, such as Aston Martin's wind tunnel and test facility at Silverstone, which was awarded contracts in December 2022 and will start upon completion of its other factory. Alongside this, Brompton's £100 million headquarters and bicycle factory on a 100-acre wetland site in Kent is still awaiting planning approval from December 2022, although the collapse of several bicycle manufacturers and distributors in the last 12 months may lead to a weakened investment case once planning is decided. Elsewhere, SeAH Wind's £300 million monopile manufacturing plant in Teesside began in July 2022. It consists of 1.13 million sq. ft. of space, with completion anticipated in 2024. The £600 million redevelopment of the Shotton Paper Mill in North Wales was approved in 2022 Q4, and excavation and piling works began in 2023. The £400 million, ten-year project to expand the Sheffield Forgemasters steelworks will see main works on the forging line throughout 2024 and 2025 and in July contracts were awarded for a £150 million sub-sea cable factory in Ayrshire, with construction between 2024 and 2026. In Stevenage, showing the extent of repurposing away from retail (see Commercial), the redevelopment of The Forum shopping centre was approved in February 2023 and will provide 400,000 sq. ft. of new advanced manufacturing space. Adding upside potential later in the forecast period, Rolls Royce is planning three off-site assembly factories for the manufacture of key components for small nuclear reactor (SMR) power stations. The shortlist for the site of its first has been narrowed down to three from six but all are likely to be dependent on the award of government contracts in Summer 2024.

The development of gigafactories to produce batteries to support the transition towards electric vehicles still has the potential to be a driver of sub-sector activity over the medium to long-term, despite the government pushing back its ban on the sale of new petrol and diesel vehicles to 2035 from 2030. The Faraday Institution estimates that ten gigafactories that would each produce 20GWh per annum will be needed in the UK by 2040, up from its estimate of seven factories in its 2020 report. Whilst the £2.6 billion gigafactory by Britishvolt in Northumberland now looks unlikely to progress, activity is coming through on Nissan and Envision AESC's £450 million gigafactory in Sunderland which started at the end of 2022 with a planned opening in 2025. After the government confirmed financial backing in July, Jaguar Land Rover has also approved its £4 billion gigafactory in Somerset. Plans to develop a gigafactory at Coventry Airport by 2025 have been given outline planning approval but they have not yet progressed as the joint venture between the airport and local authority is still seeking an investor.

Upper Scenario:

• Domestic and global demand recovers quickly

• Investments in gigafactories progress

The upper scenario assumes that domestic and foreign demand recovers quickly from 2024, ending the hiatus in UK investment decisions on new manufacturing capacity. Clear signs of definitive investment secured for the gigafactory in Coventry would also provide considerable uplift to growth prospects for the sub-sector over the forecast period, although a slowdown from the growth rates of 2021 and 2022 would be unavoidable.

Lower Scenario:

• Manufacturers delay or cancel investment plans again

A slower recovery in 2024 H2, combined with interest rates remaining at peak for longer, as well as any further policy uncertainty related to gigafactories would make new investments look less appealing, and in the lower scenario leads to a prolonged hiatus or cancellations of major long-term investment plans.

The forecast for the **warehouses** sub-sector remains unchanged from previous forecasts, with a 10.0% decline expected in 2024, followed by an 8.0% fall in 2025 as investment in warehousing space is expected to now be past its peak. Commercial estate agents have noted lower demand from retailers, who embarked on expansions of warehousing facilities linked to the rise in e-commerce during and immediately after the pandemic, which is unlikely to be fully offset by demand from other occupiers such as third-party logistics and manufacturers and more resilient demand for mid-size or small warehouse units. Furthermore, the rise in interest rates from historic lows throughout the last decade means that development finance is now considerably more costly and will have reduced investor appetite, particularly for speculative builds, which in recent years have accounted for the majority of new floorspace.

Commercial property agents have also noted lower industrial take-up and smaller development pipelines, along with rises in vacancy rates registered across most regions of the UK that began in the second half of 2022 as economic growth weakened and the Bank of England raised its base rate to a 15-year high of 5.25%. Between 2009 and 2022, interest rates did not move above 0.75%, so investors are now facing considerably higher financing costs than they have been accustomed to. Savills noted that in the first half of 2023, announcements of speculative developments fell by two-thirds compared to the same period of 2022 and were one-third lower than the post-pandemic average, whilst take-up of build-to-suit space fell 80% for the full year as focus shifts to ensuring occupancy of existing units as the development pipeline reduces.

Looking at the macroeconomic backdrop, data from the ONS shows that retail sales volumes fell 0.8% the three months to November 2023 compared to the previous three months, and were 1.2% lower than a year earlier. Online retail sales have also been on a downward trend since 2021 and the proportion of retail sales online was 26.6% in November compared to a peak of 37.4% in February 2021. The current proportion remains higher than the 19.2% average for 2019, however. The warehouses sub-sector is no longer benefiting from retailers expanding capacity as occurred during the pandemic when demand and online operations rose sharply, with Knight Frank noting that retailer take-up was particularly low in 2023. Some retailers are now having to reverse warehouse expansions as demand settles at a lower level. Moreover, this extends beyond retail to sectors such as manufacturing, which saw demand for storage facilities surge after capacity and production were rapidly increased in 2020. Plans for Ocado's two new automated distribution centres that would have opened in 2024 and 2025 have been paused as it now has surplus capacity, whilst Amazon will close three of its existing fulfilment warehouses. In addition, CBRE reported that falls in industrial capital values stabilised in the first half of 2023, with marginal increases recorded in Q3 and Q4, although this follows a 21.0% fall in values in 2022, with the largest falls for the largest floor spaces (greater than 300,000 sq. ft). Knight Frank has also reported take-up in London and the South East shifting towards smaller units (less than 250,000 sq. ft.). Given the past high levels of activity and strong growth in the sub-sector, there has also been a long-term decrease in industrial land space, with the Centre for London reporting a 24.0% reduction in London in the last 20 years, and a 20.0% reduction in Manchester, due to competition with residential developers.

Nevertheless, the rise in e-commerce remains a favourable long-term trend, which also creates demand for last-mile warehousing and logistics space. Knight Frank expects growth in this segment will be partly driven by the grocery sector, including 'dark stores' for rapid

delivery grocers, provided they remain profitable. In addition, the development of gigafactories across the UK that would produce lithium-ion batteries, primarily for electric vehicles (EVs), will generate an additional 50 million sq. ft. of demand for industrial and warehouses space by 2040, according to Savills, whilst JLL highlights rising demand from film and TV studios and producers (see Commercial).

There are still large projects in the pipeline, including a £100 million, 48-acre logistics complex in Leicestershire, 660,000 sq. ft. of logistics warehousing in West Yorkshire, a £100 million warehouse complex in County Durham, and 800,000 sq. ft. of warehousing space at Logicor Park in Daventry. In 2023, planning applications were submitted for a 1.3 million sq. ft. logistics park in Crewe and a 570,000 sq. ft. development near Nottingham for Rolls Royce. In addition, planning approvals were received for 1.4 million sq. ft. of speculative space at Magna Park, British Land's multi-level logistics hubs in Enfield and Southwark, an 800,000 sq. ft. logistics park outside Leeds and distribution warehouses at both Heathrow and Gatwick airports. The shorter lead times between project approval, contract award and construction start in the warehouses sub-sector means the majority of work on projects entering the pipeline will be completed during the forecast period.

New orders in 2022 fell 7.5% from a record high in 2021, and in the first three quarters of 2023 were 29.4% lower than a year earlier and 35.5% lower than the same period of 2021, which underscores that activity in the sub-sector is now falling from its peak. The worsening investor sentiment and business confidence that occurred in 2023, in addition to higher borrowing costs, result in activity falling this year, by 10.0% and a further fall of 8.0% in 2025. Given the strong growth in previous years, even after two years of contraction, output in 2025 is still expected to be higher than in 2018.

Upper Scenario:

- Consumer spending growth accelerates as inflation eases
- Warehousing and storage requirements related to Brexit and freeports

If consumer spending recovers quickly in 2024 as inflation eases and households gain confidence following reductions in interest rates, retail activity and online spending will post stronger growth rates, particularly if some households continue to work from home two or three days a week. Although post-Brexit import checks were delayed for a fifth time to the end of January 2024, this raises requirements for storage space close to all UK exit and entry points, whilst any progress on the freeports programme would also boost associated warehousing requirements.

Lower Scenario:

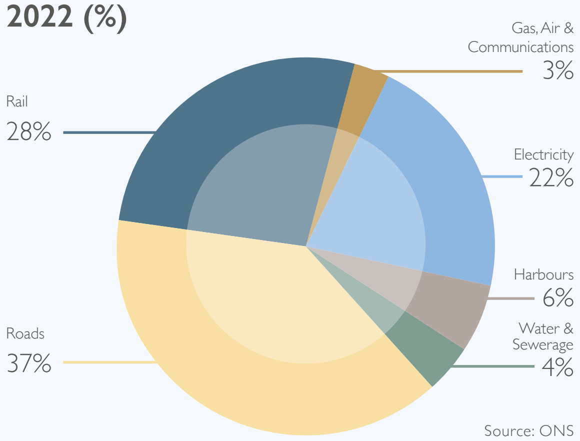
- Costlier development finance holds back new projects
- Speculative developments delayed or paused as supply chains are significantly impacted by inflation and economic weakness

A lengthy period of low interest rates that supported warehouses development ended in 2022 and if borrowing costs remain at peak for longer than assumed in the main forecast, margins, yields and viability will also deteriorate further and lead to lower investment in new projects, both speculative and build-to-suit. An economic recession and lingering inflation will also impact confidence more sharply on the speculative side.

Infrastructure

Delays to major transport infrastructure projects, government financial constraints and the step-change in construction costs that occurred over the past 18 months will weigh on infrastructure activity over the medium-term.

Infrastructure Output by Sub-sector 2022 (%)

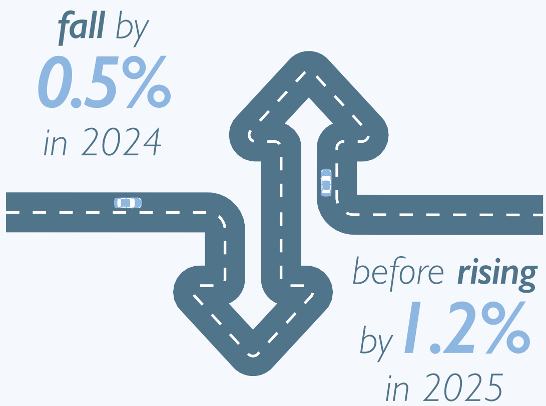


Source: ONS

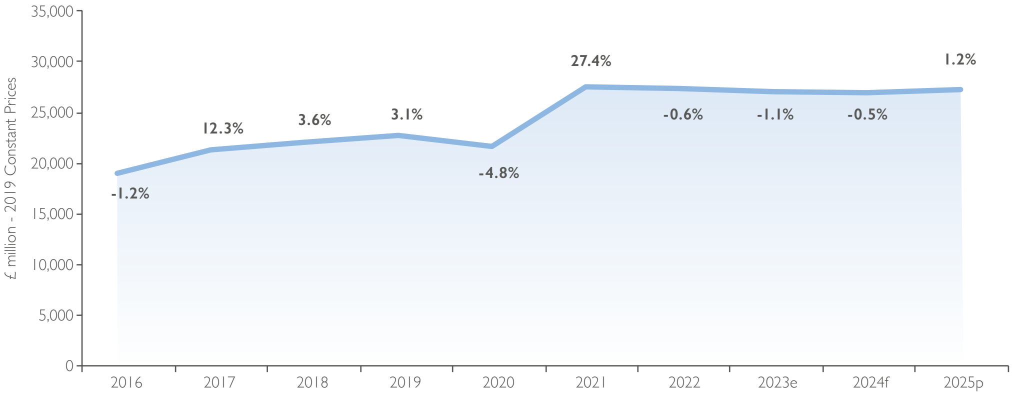
Please note that the Office for National Statistics (ONS) has issues with its measurement of the sub-sectors in infrastructure. Firstly, the ONS's methodology means that although total infrastructure overall may be fine, sub-sector output is determined by the average time between new orders and output in the medium-term, often determined by projects within five-year spending plans in regulated sectors. However, if a new order for a major project in the sub-sector is placed, this may underestimate the time taken for it to provide activity on the ground and overestimate the amount of activity earlier on. An example of this may potentially be the extent of recent growth in water & sewerage due to the Thames Tideway project. Secondly, the ONS only surveys firms that are officially classified as contractors so if the activity is done by an engineering firm then it will not be covered. This applies to all construction sectors and firms that do construction work but are not technically contractors. However, this issue impacts most upon infrastructure. Therefore, given concerns regarding the ONS's data on infrastructure output, especially at sub-sector level, the forecasts are not purely based on the ONS output data but take into account recent industry surveys and pipeline evidence.
This is particularly the case for the roads, rail and electricity sub-sectors. Please refer to the relevant sub-sectors for a more detailed explanation and specific examples.

Cost escalation continues to impact the delivery of major infrastructure projects, from Hinkley Point C and HS2 Phase One, along with major offshore wind and roads projects. Construction cost inflation has moderated recently but there has been a step-change in delivery costs that continues to impact appraisal viability. That said, the pipeline of projects progressing should be sufficient to maintain infrastructure output at a relatively high level. A modest 0.5% contraction forecast in 2024 would keep the volume of output above the £27 billion mark for the fourth consecutive year. A return to modest growth of 1.2% is anticipated in 2025.

***Infrastructure activity** to be maintained at a relatively high level but output due to*



Infrastructure Output



e = estimate, f = forecast, p = projection

Source: ONS, Construction Products Association

From £20.4 billion in 2022/23, the DfT's nominal capital budget largely flatlined at £20.8 billion in 2023/24 and is due to fall marginally to £20.1 billion in 2024/25. Within this, Network Rail received £5.9 billion in 2022/23 and its budget is anticipated at £5.8 billion in both 2023/24 and 2024/25.

*From **£20.4 billion** in 2022/23, the **DfT's nominal capital budget** largely flatlined at **£20.8 billion** in 2023/24 and is due to fall marginally to **£20.1 billion** in 2024/25*

A promise of significant additional funding for Network North was announced alongside the cancellation of HS2 phases 2a and 2b but has been widely criticised as reannouncements of existing or already-planned projects that are unlikely to deliver any new transport infrastructure in this decade.

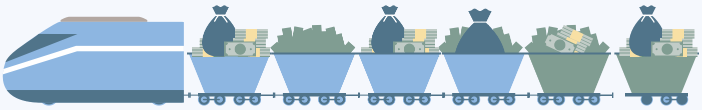
Transport for London (TfL) will receive a capital funding package worth £250 million in 2024/25 – just over half the amount thought to be required to deliver planned capital programmes. From 2018, when central government grant was first removed, TfL become self-financing but challenges presented by the global pandemic have made taxpayer support necessary. In 2022/23, TfL achieved capital spending of £1.7 billion, broadly in line with budget.

Sub-sector share of total activity is forecast to change over the forecast period. By 2025, electricity's share of sector output is forecast to increase from 22% in 2022 to 25%, whereas roads is predicted to fall to 34% of the sector total in 2025 from 37% in 2022.

Prospects for the **rail** sub-sector were substantially downgraded in 2023 following the government's decision to cancel subsequent phases of HS2 – including the Euston station extension and redevelopment which was originally part of the current phase. The Autumn forecast has been maintained and output is expected to contract by 3.0% in 2024 and a further 1.0% in 2025.

HS2 Phase One recently hit peak construction, with 350 active construction sites between the West Midlands and north London. Half the tunnel boring machines have been launched,

HS2 *now estimate the*
cost of Phase One *at between*
£49bn and £57bn
(November 2023), up from
£35bn to £45bn estimated *in March 2023*



completing around 14 miles of new tunnels to date, and it was recently confirmed that work on the Birmingham Curzon Street terminus will start in early 2024. Contracts due to be let in 2024 cover tracks, power, signalling, overhead lines and new network control and telecom systems. The new line is still expected to be operational between 2029 and 2033.

Cost escalation remains a big issue for HS2 Phase One. An update to Parliament in November 2023 shared HS2's revised cost estimate of between £49 billion and £57 billion, in 2019 prices. DfT officials disagree with this assessment, suggesting the price tag will actually fall to within the £45 billion to £54 billion range – still significantly higher than the £40.3 billion (in 2019 prices), with a confidence range set at between £35 and £45 billion, back in March 2023. The government has announced the scope of Phase One is under review to ensure only work necessary to support the scaled-down plan is delivered. In January 2024, the HS2 Executive Chairman Jon Thompson confirmed to the Transport Select Committee that the estimated cost for Phase One is between £49 billion and £56.6 billion at 2019 prices but adjusting the range for current prices involves "adding somewhere between £8.0 and £10.0 billion due to cost inflation. Given that infrastructure construction costs have increased by 24.6% since pre-pandemic, it suggests that even this upward revision to the cost estimate is insufficient and that in 2-3 years there will be further upward revisions to costs announced.

In October 2023, the government announced its decision to cancel the northern leg of HS2 between Birmingham and Manchester, following on from its decision to axe the eastern section of the new network a year ago and the postponement of the Birmingham to Crewe leg and the Euston station extension in March of last year. October's announcement confirmed that HS2 will now only run between Birmingham and Old Oak Common initially. HS2 is still expected to eventually run to Euston but this is dependent on attracting private sector investment. A new development company, separate from HS2 Ltd, will be appointed to manage the delivery of Euston station. The Euston extension involves digging a 4.5-mile tunnel from Old Oak Common and building a new station at Euston next to the existing West Coast Main Line terminus. Prior to the postponement, work at Euston was estimated at £4.8 billion, £2.2 billion over the established budget. Under the government's new proposal, the Euston development will be scaled back significantly. If private sector appetite is sufficient to bring the Euston extension back into play, work on the ground is highly unlikely to start within the current forecast period.

Network Rail's current five-year Control Period 6 (CP6) ends in March 2024. CP7, covering April 2024 to March 2029, will focus on building network resilience, climate change and increasing rail freight with investment totalling an anticipated £40 billion (2023/24). £18.8 billion is due to be invested in operations, maintenance and support, with £18.2 billion secured for core asset renewals and other capital expenditure.

Out of the overall renewals budget, £15.8 billion has been earmarked for core asset renewal, marginally less than £15.9 billion, on a consistent price basis, during CP6. The Eastern region is due to receive 30% of CP7's core asset renewal budget, whilst the North West & Central region is expected to get 29%, the Southern region will get 24% and the Wales & Western region is set to receive 17%. CP7 includes essential replacement work on the West Coast Main Line North to ensure smooth connections with HS2 when it becomes operational.

Network Rail's annual report confirmed that nominal capital spending rose from £6.1 billion in 2021/22 to £6.5 billion in 2022/23, suggesting a slight decline in the volume of activity after taking inflation into account. Enhancements to increase the capacity of the network amounted to £2.4 billion, compared with £2.2 billion in 2021/22. This included £1.8 billion of DfT-funded schemes, £0.2 billion funded by Transport Scotland and £0.5 billion of other grant-funded projects.

***Network Rail's Control Period 7** kicks off in April 2024 – **core asset renewals budget** is*

***£15.8bn**, split by:*

29% North West & Central

30% Eastern region

17% Wales & Western

24% Southern

East West Rail's (EWR) first connection stage between Bicester and Bletchley is 99% complete. The project is being delivered in three sections: connection stage 1 from Oxford to Bletchley and Milton Keynes; connection stage 2 from Bletchley to Bedford and connection stage 3 from Bedford to Cambridge. Connection stage 1 is due to be operational in 2025. DfT estimates suggest delivering EWR will cost between £5.7 billion and £6.6 billion, with £1.12 billion spent by March 2023.

A further £3.9 billion of funding has been allocated to the Transpennine Route Upgrade, taking total government funding to £6.9 billion. Work to electrify lines and enhance station accessibility is already underway and is due to complete in the 2030s. Network Rail intends to submit a full business case for MetroWest Phase 1 to the DfT in February 2024 and, as the scheme already has initial permission, construction work could start in late 2024.

In the South West, plans to develop a new train line linking Portishead and Bristol, as part of the MetroWest expansion, are progressing. Plans include track refurbishment, new stations at Pill and Portishead and approximately 5km of newly constructed track. This £152 million scheme is part of the DfT's £500 million Restoring Your Railways Fund and work on this scheme is due to start in Summer 2024.

Major work is also progressing at several stations including a new £200 million station at Cambridge South, the £140 million Darlington redevelopment and the £161 million revamp of Oxford Station.

The Scottish Government's 2024/25 Budget allocates £1.14 billion of capital funding to the rail sector, a 5% decline compared with 2023/24. £147 million is allocated to enhancement projects, with network infrastructure attracting £488 million in 2024/25.

Network Rail and Scotland Railway are procuring delivery partners for a £1.3 billion civils framework and a £150 million signalling, power and communications framework for CP7, running from April 2024 to March 2029. Overall, around £1.9 billion is due to be invested in asset renewal during Control Period 7, an 11% reduction in nominal terms compared with CP6. Investment in track renewals will reduce by over a third while the budget for drainage and lineside safety will increase by two-thirds.

In Scotland, electrification works worth £450 million are due to be delivered between August 2024 and 2029, with the development of electrical safety on the Aberdeen Route Upgrade should account for £50 million to £60 million of the overall funding pot. The £55 million Fife electrification project will see work from Haymarket to Dalmeny complete in late 2024, with the partial electrification of Fife Circle due to complete 12 months later.

Please note that the ONS historic output figures for rail should be treated with caution given the ONS's mismeasurement of infrastructure sub-sector level data that have been further exacerbated by methodological improvements made in 2018. For example, output in the rail sub-sector increased sharply in 2017 and 2018, even though main works on Europe's largest infrastructure project, HS2, was yet to begin. The main civil engineering contracts for the first phase of the project, worth £6.6 billion were awarded in July 2017 and, as a result, new orders rose to a record high of £9.0 billion in 2017. Rail output rose 58.9% in that year and 39.3% in 2018. The divergence between new orders and output has meant that the levels of output appear inflated in 2017 and 2018, despite CP5 ending. More recently, large falls in output were recorded in 2019 and 2020 even though enabling works on HS2 continued during the pandemic and the formal start of main construction works was announced in September. Given these inconsistencies, the CPA is forecasting growth rates for actual activity on the ground.

Upper Scenario:

• Euston extension to HS2 swiftly receives private sector-backing and progresses without significant delay

If private sector development of Euston station progresses more quickly than anticipated, activity resuming on the project could provide a boost late in the forecast period.

Lower Scenario:

• Further cost escalation on HS2 impacts spend on other new and enhancement rail projects

HS2 has already been subject to strong cost escalation and the latest update from HS2 suggests a further significant uplift needs to be funded. The DfT is currently review the estimate and Phase One scope. If HS2's latest estimate is maintained, significant additional funding for the project will need to be found.

Electricity is a buoyant sub-sector driven by work to shore up energy security and progress the country's grid decarbonisation agenda. The project pipeline is sizeable but sector capacity is struggling to meet burgeoning demand and appraisal viability continues to be impacted by cost inflation and unrealistic maximum price agreements set by government. Due to these constraints, electricity output is forecast to sustain a moderate annual growth rate over the forecast period – increasing by 5.0% in 2024 and 6.0% in 2025.

Construction of Hinkley Point C reached a major milestone in December as the 245-tonne steel domed roof was craned into place, paving the way for the first reactor to be installed next year. However, EDF recently confirmed another rise in construction costs and a further delay to scheduled completion. In January, EDF reported that construction costs could now hit £35 billion, up from a targeted completion cost of £32.7 billion in mid-2023 (2015 prices). The date the first reactor is due to begin generating electricity has slipped from mid-2025 to 2027, or as late as 2031 in more adverse conditions. Further cost overruns increase concern about project finance. CGN, EDF's delivery partner holding a 33.5% share in the new facility, has reportedly stopped making payments after meeting its contractual financial requirements – based on the original 2016 cost estimate of £18 billion. EDF is currently investigating alternative financing solutions.

Sizewell C, a proposed nuclear facility in southeast England, took a step forward in late 2023 with the Court of Appeal's dismissal of a legal challenge over the environmental impact of the project. As it currently stands, the project will receive £700 million of public funding and the UK government will take a 50% stake during the development phase. Should the project go ahead, EDF anticipated both reactors will be operational by mid-2034 and main construction work would occur beyond the forecast period. Design work is progressing and the Department for Transport recently committed £54 million to improving the A12 in Suffolk ahead of construction.

The UK is experiencing a connectivity logjam which is restricting renewable energy projects from connecting to the grid. National Grid data suggests that 176GW of new renewable generation and interconnector schemes, across more than 600 projects, are currently in the queue looking for a connection to the electricity transmission system in England and Wales. For context, 64GW of renewable energy generation is currently connected to the grid. From late 2023, Ofgem approved a plan to enable the connectivity queue to be managed to ensure projects progressing in line with agreed milestones are prioritised. Failure to meet agreed progress milestones will now result in connection applications being terminated.

National Grid invested £7.7 billion in delivering smart energy infrastructure and maintaining its networks in 2022/23. Total investment in the five years to 2025/26 in electricity transmission maintenance and expansion is expected to be close to £9.0 billion, with a further £6.0 billion in asset replacement, reinforcement and connections, facilitating the infrastructure for electric vehicles, heat pumps and directly connected generation, to support the distribution network.

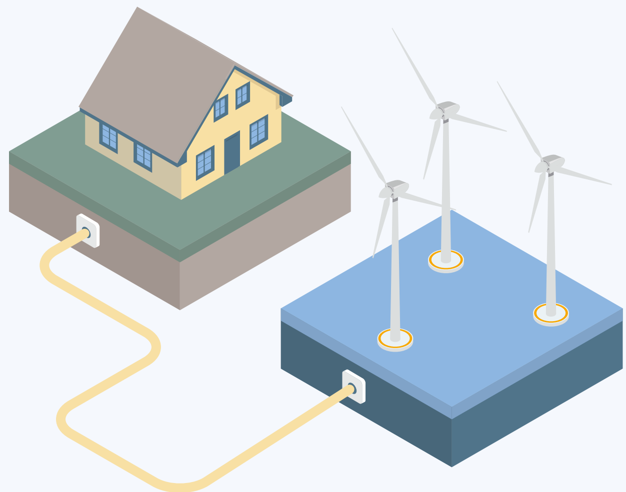
Scottish Power is tendering for £5.4 billion substation and overhead powerline frameworks as part of its Pathway to 2030, with work spanning up to ten years. The substation works framework is worth £2.4 billion.

Whether work to enhance the grid will be captured in the construction output statistics will depend on the main function of firms awarded the contracts. If they are officially classified as a construction firm work will be included in the construction output figures but, if their primary workstream is electrical engineering, these works will be classified elsewhere.

Following Ofgem approval, construction is expected to start this year on the £2.5 billion Eastern Green Link 1 subsea transmission cable project from Scotland to Durham. This National Grid and Scottish Power Energy Networks project is targeted to be operational in 2029. Contracts have been awarded for two converter stations for Eastern Green Link 2, a planned 436km electrical superhighway linking Peterhead in Scotland to Drax in England, with construction work also expected to start in late 2024. A preferred bidder has been selected for both cabling contracts.

In December 2023, Ørsted confirmed Hornsea 3 will proceed. With an anticipated development cost of close to £11 billion, the 2.9GW project will become the world's largest offshore wind farm. Delivery cost pressures delayed the investment decision but Ørsted has permission to submit up to 700MW of the project's capacity in future bidding rounds. Strong cost pressures continue to affect offshore wind projects under development, however. December also brought news that Norfolk Vanguard East and West and Norfolk Boreas

Hornsea 3** was confirmed in December – the **£8bn** **offshore wind project** off the Norfolk coast will become **the world's largest offshore windfarm**, generating enough energy to meet the average daily electricity needs of **3.3 million homes



schemes had been purchased from Vattenfall by RWE. These schemes faced an uncertain future due to significant cost escalation but the RWE has vowed to proceed and all three projects are expected to be commissioned this decade.

In 2024, the government has confirmed the maximum price available for state contracts to build offshore windfarms will be 66% higher than in the failed 2023 bidding round, at £73 per MWh. The subsidies are set in 2012 prices and index-linked. For floating offshore wind farms, the price will be £176 per MWh, up from £116 per MWh in 2023. For solar, the maximum price in the 2024 round will be £61 per MWH, up from £47 per MWh in 2023. Results from the next auction are expected to be announced in September.

RWE is pressing ahead with a £6.9 billion investment programme across the UK. Construction is about to start on the energy firm's third onshore wind farm in Scotland. The 63MW Strathy Wood project in Caithness joins Enoch Hill in East Ayrshire and Camster II, also in Caithness. The Scottish government has set an ambition to deploy 20GW of onshore wind in Scotland by 2030.

Changes to planning policy in England failed to revive demand for onshore wind development. Onshore wind development has been effectively banned in England since 2015 when planning policy was changed, allowing onshore wind projects to be blocked by a single objection. Since the policy changed in 2023, no applications for onshore wind projects have been submitted and industry bodies are calling for government to restore onshore wind to the Nationally Significant Infrastructure Projects process.

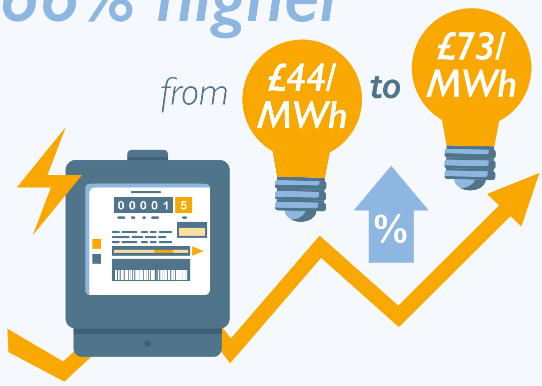
In the Electric Vehicle Infrastructure Strategy published in March 2022, the government pledged to create 300,000 public electric vehicle (EV) charge points by 2030, backed by a promise of £1.6 billion of funding through the Local EV Infrastructure (LEVI) Fund and the Rapid Charging Fund (RCF). At COP28, the Transport Secretary announced a £70 million pilot scheme to support ultra-rapid electric vehicle charge points at motorway service stations in England. Government funding will cover a portion of the costs of upgrading the electricity grid at successful motorway service areas. This is the first funding to become available through the Rapid Charging Fund, first announced in March 2020 when the government promised £500 million to support the rollout of a fast-charging network for electric vehicles through to 2025.

Recent analysis by the RAC showed that the government target of having six or more rapid or ultra-rapid electric vehicle chargers at every motorway service area in England by the end of 2023 was missed by a wide margin. As of November 2023, charging statistics from Zapmap show the UK has 53,029 charging devices, one-fifth of which are rapid or ultra chargers.

It is worth noting that, according to the ONS, EV charging points in the historic construction output data are classified in infrastructure electricity for existing buildings and structures but when they are a part of new buildings and structures then the EV charging points activity will be a part of whichever sub-sector the building or structure is in. For instance, if the EV charging points are a part of a new housing development then they will classified in housing.

*After **no bids were received** during the 2023 auction for state contracts **to build offshore windfarms**, the government has announced the **maximum price for electricity** in the 2024 round will be*

66% higher



Large projects with long delivery programmes distort official electricity orders and output data. Output in the electricity sub-sector declined 5.7% in 2019 even though main civil engineering works above ground on Hinkley Point C started in September 2019. That fall was followed by growth of 21.1% in 2020 despite the impact of the first national lockdown on workforce numbers and activity on site at Hinkley Point C during the first half of the year and according to the ONS output fell by 20.2% in 2021 despite it comparing with a pandemic-impacted year before. This suggests that the ONS construction output data is not accurately reflecting activity on the ground, and as a result, the CPA is forecasting actual activity growth in the sub-sector rather than distortions in the ONS data.

Upper Scenario:

• Investor confidence improves allowing new energy projects to get off the ground

If investor confidence improves amid a reduction in economic uncertainty and increased cost certainty, it could help large-scale projects to get off the ground, particularly offshore wind farms.

Lower Scenario:

• More offshore wind projects stall in England due to the step-change in cost and restrictive policy environment

If more developers who successfully bid for schemes during the 2022 auction round take the decision to pause schemes as cost pressures erode profitability, activity in this sector could reduce.

Investment by water companies through the five-year Asset Management Programme (AMP) is the primary driver of activity in the **water & sewerage** sub-sector. Three years in, AMP7 is consistently failing to deliver promised investment and significant catch-up is increasingly unlikely as attention turns to the next – significantly larger – investment. High profile sewage spillages in 2023 will increase pressure on water companies to complete promised storm overflow works in line with planned programmes and Ofwat's decision in mid-2023 to fast-track infrastructure projects outside AMP7 will also provide a small boost. Output is forecast to increase by 2.0% in 2024 before contracting by 2.0% in 2025 as work completes on AMP7 and before activity on AMP8 ramps up.

Water companies plan to invest
£96 billion
*in **AMP8** (2025 to 2030), nearly **double the amount** in 2020 to 2025*

AMP7 – the current investment period running through to 2025 – provides an overall spending allocation of £51 billion in 2017/18 prices, inclusive of £13 billion of infrastructure investment. So far, AMP7 has failed to deliver the expected level of capital investment.

Ofwat's recent assessment of performance in AMP7 to date found that the majority of water companies have failed to deliver their spending commitments on enhancements. Under its outcome delivery incentivisation mechanism, the regulator recently announced that, overall, water companies must return £70 million to customers during 2024/25 to offset underinvestment in 2022/23. Out of the 17 regulated firms, only five exceeded investment expectations. Severn Trent Water topped the performance league table whilst Thames Water, which appears to have severe financial difficulties currently, posted the worst performance by a sizeable margin.

Water companies have submitted detailed business plans detailing plans to invest £96 billion (in 2022/23 prices) between 2025 and 2030. Plans include building ten new reservoirs, reducing leakage by a quarter from 2020 levels and installing technology at sewage works to remove more than a million tonnes of phosphorus from rivers. Final determinations will be published at the end of next year and several water companies have commenced contractor procurement ahead of AMP8 starting in 2025/26.

With planned capital investment in AMP8 nearly double AMP7, water companies are seeking delivery partners ahead of regulator approval. In recent months, South West Water has announced successful bidders on its £3 billion major projects framework and procurement is underway on United Utilities' major projects ten year framework, spanning AMP8 and AMP9, which could be worth £14 billion.

Wessex Water has received full planning permission for its planned £100 million upgrade of the water recycling centre at Avonmouth. The expansion is expected to come into operation in 2028. Pipelaying has commenced on Northumbrian Water's £155 million water resilience scheme and work is progressing on the Bury St Edmunds to Colchester stretch of Anglian Water's new £400 million pipeline, stretching from North Lincolnshire, through Cambridgeshire, to Suffolk and Essex, following planning approval in September. Work has begun on a £26 million flood storage reservoir in Lowdham in Nottinghamshire.

Work on the 25km Thames Tideway Tunnel is over 90% complete and testing is due to starting 2024, paving the way for handover in 2025 as planned. Costs increased marginally in the six months to September, rising by £25 million, but the estimate at completion remained at £4.5 billion.

Outside of planned AMP investment, Ofwat approved funding of £2.2 billion in June 2023 to deliver an additional 33 infrastructure projects between 2023 and 2030. Included within this is £1.7 billion to tackle storm overflows across ten schemes. Work on some of these schemes is anticipated to start in the next 18 months.

A National Audit Office (NAO) report from November 2023 confirmed that 500 flood defence projects have been removed from the Environment Agency's (EA) £5.2 billion flood-safety programme, originally announced in 2020, due to skills shortages and inflationary pressures. This equates to a 40% reduction in planned delivery in the six years to 2027. In the first two years of the programme, the Agency has delivered less than one-fifth of its initial target, despite using one-third of the time and more than one-quarter of the funding. The EA now expects to protect 200,000 homes by 2027, far less than the 336,000 homes originally targeted.

Scottish Water is in the third year of its 2021 to 2027 regulatory period. Planned capital investment reached £694 million in 2022/23, one-third higher than in 2021/22 and helping to offset an underspend in the first year of the programme.

In Wales, construction work has started on a £69 million tranche of work under the Central Rhyl Coastal Defence Scheme for Denbighshire County Council.

Please note that the ONS historic construction output figures for water & sewerage should be treated with caution given the ONS's mismeasurement of sub-sector level data. For example, in 2018, output in the water & sewerage sub-sector fell by 8.7%, despite main construction works occurring on the Thames Tideway Tunnel. Contracts for the project were awarded in February 2015 and, as a result new orders increased fivefold in that year. Output rose 58.8% in 2016 (albeit from a low base), followed by a further 57.7% to a five-year high of £2.4 billion in 2017, even though main tunnelling works on the project were yet to begin. This suggests that the ONS's construction output data is not accurately reflecting activity on the ground and is likely to have been incorporated too early in the data. As a result, the CPA's forecasts for the sub-sector focus on growth rates that are more illustrative of activity on the ground.

Upper Scenario:

• Water companies significantly increase expenditure in 2023/24 and 2024/25

Following public criticism, should water companies achieve a catch-up in activity, helping to get AMP7 back on track , growth in 2024 and 2025 could be stronger.

Lower Scenario:

• Focus switches to AMP8 and attempts to increase spend on AMP7 priorities are not made

AMP8 stands to be the biggest ever investment round and there is a risk resource will be diverted to getting activity underway quickly on AMP8 at the expense of increasing investment under AMP7.

The forecast for **roads** construction output has been maintained, with a 3.0% contraction expected in 2024, before output stabilises in 2025 due to delays to major roads contracts.

Activity through to 2025 will continue to be driven by National Highways' (NH) Road Investment Strategy 2 (RIS2) but substantial cost overruns and unforeseen planning complexity creates a challenging backdrop. The NH spend on renewals and enhancements in 2022/23 was £3.2 billion, including £1.7 billion on enhancements and £0.9 billion on renewals. Work started on four schemes during 2022/23, including a £317 million project at junction 10 on the M25 and the £460 million improvement scheme on the A417 at Birdlip. Work at M25 junction 10 is due to complete in 2025, with the new stretch of the A417 due to be open by 2027.

More recently, construction work started on the Black Cat to Caxton Gibbet stretch of the A428. The £1.0 billion scheme will deliver a new 16km stretch of dual carriageway, along with improvements to existing junctions and roundabouts and work is poised to start on North Somerset Council's Banwell Bypass scheme despite costs increasing by around one-third since 2019. Now anticipated to cost £89.2 million, work should start in early 2024 and take around two years to complete.

In March 2023 it was confirmed two enhancement schemes planned for RIS2 would be pushed back. The £320 million A27 Arundel Bypass and the A5036 Port of Liverpool access road are now likely to be included in Road Investment Strategy 3 (RIS3) for delivery in the 2025 to 2030 period. 30 schemes initially intended to be included in RIS3 were also pushed back and may be delivered beyond 2030.

In addition, fourteen smart motorways were scrapped and the £9 billion Lower Thames Crossing also slipped back into RIS3 when the Secretary of State for Transport announced a two-year delay in March amid concern about value for money as costs escalate. Work on the six-year programme will now start in 2026 at the earliest.

Beyond 2025, investment in the UK's strategic roads network will focus on renewals and maintenance, rather than enhancements, in response to the challenges of aging roads infrastructure. It is estimated that over 70% of the National Highways network of roads and bridges will be over 45 years old by 2025. During RIS3 the focus will shift to making the most of the existing network, including greater use of digital technologies and preparing the network for connected and autonomous vehicles. Investment in smaller schemes, valued between £2 million and £25 million, is also likely to increase.

Major roads projects continue to be delayed due to cost inflation. A £23 million increase in the cost of Norfolk City Council's £250 million Norwich Western Link project has delayed DfT sign-off. Subject to additional funding being agreed, initial works could start in late 2025. Plans to submit a development consent order for the £500 million A358 dualling have been scrapped by National Highways, but no detail on the decision was provided.

To address safety concerns, £900 million will be spent to upgrade existing smart motorways and new smart motorways currently under construction. As part of this, NH has committed to build more than 150 additional emergency refuge areas across the country by 2025 in response to lack of driver confidence in the approach.

Work is progressing on TFL's Silvertown Tunnel, linking Silvertown in Newham with the Greenwich Peninsula. The project, costing an estimated £179 million, is due to complete in the second quarter of 2025/26. A proposed pedestrian bridge and portal buildings above the tunnel entrances are still in design phases.

In the local roads pipeline, a planning application for the new £200 million North Hykeham Relief Road in Lincolnshire was submitted in October, with construction expected to start in 2025. Work is also due to start on the recently approved £86.9 million A164 upgrade in East Yorkshire in Spring and complete in 2026.

*Focus of **National Highways**' next investment strategy, **RIS3**, will shift to **renewals and maintenance** – schemes are likely to be smaller worth between*

£2m and £25m

In Scotland, Budget 2024/25 suggests investment in maintaining and improving the country's trunk road network will increase by 39% in 2024/25, from a total of £356 million in 2023/24 to £496 million in 2024/25. However, the lion's share of funding will be spent on critical safety and maintenance and will likely be classified as Infrastructure R&M, with the improvement budget worth just £134 million.

Transport Scotland is progressing with the delayed Tomatin to Moy A9 dualling project. Procurement is underway on the £150 million scheme which was initially scheduled for 2021.

The construction contract is expected to be awarded in Summer with work commencing in 2025.

Procurement of a £100 million civils framework for the trunk road and county areas in North and mid-Wales is underway. Contracts will operate from 2024 Q2 and will cover capital projects with values ranging from £50,000 to £5.0 million.

Please note that in a similar vein to the water & sewerage and rail sub-sectors, the ONS's mismeasurement of sub-sector level data has meant that historical figures for roads output appear inflated, contradicting other pipeline evidence and industry surveys. Data from the Mineral Products Association (MPA) showed that sales volumes of asphalt sales declined 8.6% in 2020, before rising by 12.5% in 2021. The pace of recovery in 2021 is in stark contrast to the growth reported in the official data of 81.3% that took output to a record high of £10.6 billion even though the delivery of major road projects has been impacted by planning delays. Overall, this suggests that the ONS's construction output data is not accurately reflecting activity on the ground, and as a result, the CPA is forecasting actual activity growth in the sub-sector rather than distortions in the ONS data.

Upper Scenario:

- Road schemes receive go-ahead
- National Highways brings forward road schemes

Activity in the pipeline would increase if National Highways revisited the decision to push schemes back from RIS2 to RIS3, and large schemes progress more quickly in the planning and pre-contract stages.

Lower Scenario:

- Existing road schemes delayed due to further cost escalation and funding issues
- Delivery of road schemes impacted by planning delays and environmental concerns

Cost inflation remains a problem in this sector – inflation has slowed markedly but there has been a step-change in delivery costs that may still impact decision-making on schemes yet to start, along with considerable delays at the planning stage.

Output in the **gas, air and communications** sub-sector is forecast to rise by 8.0% this year and by a further 6.0% in 2025 as work progresses on expanding digital communication infrastructure continues and airport investment recovers after the pandemic-induced hiatus in activity.

As passenger numbers edge closer to pre-pandemic levels, investment at major UK airports is picking up from a low baseline. Between April and September 2023, the Manchester Airport Group reported that passenger numbers were 96% of pre-pandemic levels overall. At London Heathrow, passenger number were down by just 2.0% compared with 2019 in the year to November, a marked improvement compared to 2022, which trailed 2019 by one-quarter.

Work is progressing on the final phase of Manchester Airport's £1.3 billion transformation programme. The final phase, worth £440 million, includes construction of a new pier and second security hall, extending the departure lounge to include 27 new shops and restaurants and airfield reconfiguration. Work is due to complete in 2025.

Plans to increase capacity at London Stansted Airport have recently secured planning approval after a lengthy appeal. The approved scheme will increase the terminal building by 16,500 sq. m. to create a bigger departure lounge, a larger security hall and a three-bay extension. London Stansted became the first major airport to exceed 2019 passenger volumes in July 2023 and October was the busiest on record with 2.6 million passengers travelling through the airport. The extension will allow the airport to reach its agreed passenger cap of 43 million. A start date for works has yet to be announced.

Plans to increase capacity at London Luton Airport from 18 million passenger per year to 32 million moved forward in October with a Planning Inspectorate recommendation that full planning permission be granted. Approved works include increasing the capacity of the existing terminal by expanding existing facilities and building new aircraft stands. Work could commence towards the end of the forecast period.

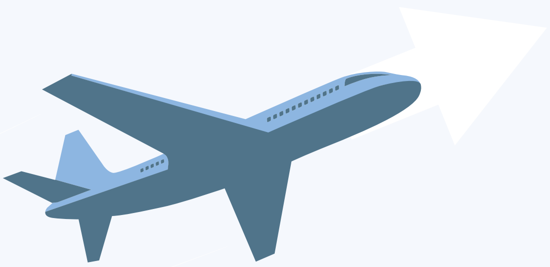
At London Heathrow, £3.6 billion of capital investment is planned over the next five years. Last year, a construction delivery partner was appointed to progress a range of schemes, including next-generation security scanners and a new baggage system with a collective expected cost of around £1.3 billion.

Construction work has begun on Bristol Airport's £60 million capital investment programme that will deliver a transport interchange hub and multi-storey car park to improve accessibility. The project will take 18 months to complete. Two extensions to the terminal building, a new walkway and pier to support an increase in passenger numbers from 10 million to 12 million, are also planned.

Plans to increase capacity at London Gatwick are also being considered by planning officials. The proposals would bring the airport's existing northern runway into routine use, providing capacity for passenger traffic to double to 75 million. Currently the northern runway is only used when the main runway is closed. Construction would begin in late 2025, with the runway coming into use at the end of the decade. A decision on the application is expected in 2024.

In addition to expanding capacity, aviation asset owners are progressing large maintenance programmes. Large runway resurfacing projects, together worth £95 million, recently commenced at London Stansted and London Heathrow and similar work is planned at Newcastle Airport. Manchester Airport Group has begun the procurement process for rehabilitation and enhancement works on airfields at Manchester, East Midlands and Stansted airports, worth £548 million in total. Procurement should be complete by 2024 Q3.

*As **passenger numbers return** closer to pre-pandemic levels, **investment at major UK airports is picking up** from a low baseline.*

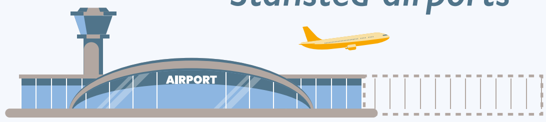


Project Gigabit, the government's £5 billion programme to deliver reliable broadband to hard-to-reach locations across the country, launched in March 2021 to replace existing programmes such as Superfast, Local Full Fibre Networks and Rural Gigabit. Procurement is ongoing and since the last update, contracts with a combined value of around £76 million have been agreed for North East Staffordshire, South Oxfordshire, North Oxfordshire and

Derbyshire. Contracts signed in 2022 and 2023 will deliver output in 2024 but overall work volumes are set to reduce as legacy projects wind down. By 2025, Project Gigabit activity on the ground is anticipated to exceed the volume of work delivered under legacy projects.

Alongside Project Gigabit, the government's Shared Rural Network programme – a £1.0 billion joint investment with industry which aims to deliver 4G coverage to 95% of the UK by December 2025 – is progressing. The first phase of the scheme will see the UK's four mobile network operators invest over £500 million in a network of new and existing phone masts.

Planning approval now secured *for* ***expansion of Luton*** *and* ***Stansted airports*** *–*



work could commence in 2025 H2

General rollout of 5G and full-fibre broadband capability is continuing. BT Openreach recently announced it has connected 12.5 million households to its network – half the 25 million households targeted by 2026. In 2024, a further 3.5 million premises will be targeted, increasing to 4.0 million in 2025.

Upper Scenario:

- UK airports bring forward planned capital expenditure amid an improvement in passenger demand
- Planning challenges are unsuccessful

Holiday travel is back at pre-pandemic levels but business travel remains relatively low. An improvement in business travel could further boost confidence and support further investment at UK airports, alongside projects receiving planning approval.

Lower Scenario:

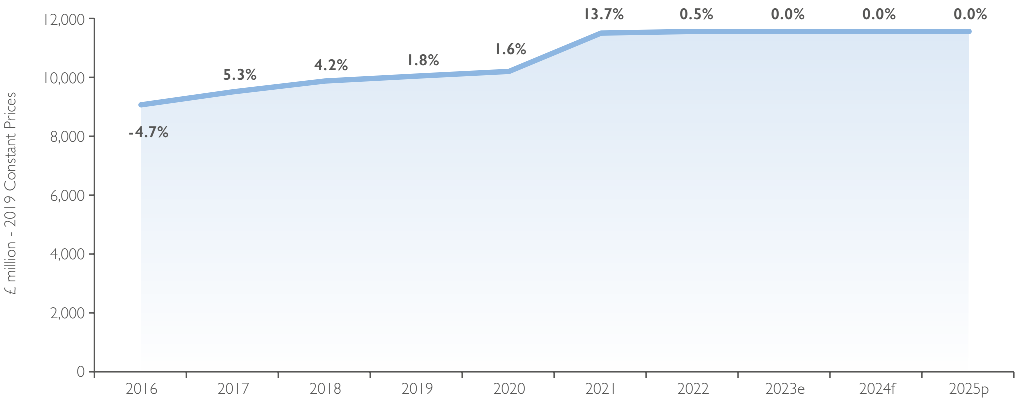
- UK airports focus on enhancements to existing facilities throughout the forecast period rather than long-term expansions or major refurbishments

Several large schemes at major UK airports are working through the planning system but there is a risk airport owners may still scale back plans even if planning is successfully secured due to cost pressures.

Infrastructure R&M

As the focus turns to the next investment period across regulated sectors, there is a stronger emphasis on existing asset maintenance which will help sustain infrastructure r&m activity at a high level. Overall, budget constraints will, however, limit scope for growth and the outlook suggests stabilisation at a relatively high level.

Infrastructure R&M Output



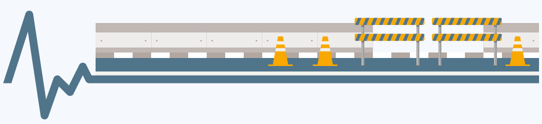
e = estimate, f = forecast, p = projection

Source: ONS, Construction Products Association

Infrastructure repair and maintenance (r&m) includes work on assets owned by utility companies, airports and energy-generating facilities, and publicly-owned assets such as roads and rail, which will help sustain a high level of activity over the next three years.

As local authorities struggle to fund day-to-day services, roads maintenance and repairs risk slipping down the agenda. The government estimates that local authority spending power reduced by nearly one-third between 2009/10 and 2021/22 and unless additional ring-fenced funding is made available for repairs to local authority roads networks, it is likely that only the most essential work will take place. An additional £64 billion support package, equating to a 6.5% increase in funding for local councils in England, was announced in December, but is far less than the Local Government Association (LGA) estimates is needed. LGA analysis suggests cost and demand pressures have added £15 billion to the cost of delivering council services since 2021/22 – a 29% increase.

Infrastructure r&m *expected to flatline as* ***funding is focused on basic repairs and maintenance*** *rather than new projects*



Data from the Department for Transport (DfT) suggests that the amount spent by local authorities to maintain local 'A' and 'B' roads has been broadly flat for the past three years, at around £4.4 billion per year, in current prices. Nominal spending in 2023 was at its highest level since 2011 but it remained 10% lower than in 2010. After allowing for inflation, maintenance expenditure on local authority roads has reduced sharply over the past decade. Spending to maintain trunk motorways and trunk 'A' roads totalled £1.2 billion in 2023, in current prices, and has similarly suffered a sizeable contraction in real terms in recent years.

Funding for ***flood defence maintenance*** *to* ***reduce*** *from* ***£201m*** *in 2022/23 to* ***£196m*** *in 2023/24 and* ***£190m*** *in 2024/25*

Research by the Asphalt Industry Alliance found that resurfacing now takes place less than once every 100 years and estimates the cost of the backlog of repairs to bring the network up to standard, at just over £14 billion. The Alliance's 2023 survey found that average highway maintenance budgets across England and Wales increased by 4.5% to £25.8 million per authority in 2022/23. Concern about persistent underinvestment in the country's roads network, and government understanding of the extent of the problem, has prompted a National Audit Office investigation which is due to complete in Spring.

Local highways authorities will receive £150 million in both the current financial year and in 2024/25 to tackle potholes as part of the redirection of funding earmarked for scrapped HS2 works. Allocations are part of the £8.3 billion promised to support local road repairs through to 2034. Greater visibility of medium-term funding will help local authorities develop more proactive management strategies but overall it equates to a near-term reduction in central government funding for pothole repairs and is significantly less than is needed. Through to 2034, the North East, North West and Yorkshire and the Humber will receive £3.3 billion, with £2.2 billion allocated to the East and West Midlands. The remaining £2.8 billion will support pothole works in the East of England, South East, South West and London.

A shift in focus in the 2025 to 2030 investment period, as National Highways seeks to 'make the most' of the current network, could lead to a greater proportion of their capital investment programme being classified as r&m but any benefit will largely fall outside the current forecast period.

In the rail sub-sector, Network Rail's five-year Control Period 6 (CP6) ends in March 2024 and Control Period 7 (CP7) begins, covering April 2024 to March 2029. Network Rail's Strategic Business Case for CP7 estimates £9.8 billion will be invested in maintaining the rail network across England and Wales (2023/24 prices) – a modest 4% increase compared with CP6. The Eastern region is expected to attract the largest share of funding (£3.4 billion), with the North West & Central securing £2.3 billion, £2.5 billion for the Southern region and £1.5 billion for Wales & Western. Due to Network Rail's industry classification, maintenance works completed by its in-house teams will not be recorded in the official construction output statistics.

Within water & sewerage, activity will be supported by the current five-year Asset Management Plan (AMP7) which runs through to 2024/25. AMP8, starting in 2025/26, will see record investment, with water companies seeking approval to invest more than double the amount of AMP7. Large new infrastructure is included within AMP8 plans, including ten new reservoirs, but water companies intend to invest considerable amounts in replacing old and failing water mains. United Utilities plans to replace 900km of pipes, Yorkshire Water plans to replace 746km of pipes and Anglian Water plans to replace 695km of pipes. Classification between new work and r&m is also an issue in this sector given that anything more than just basic repairs and maintenance should be classified as new work (see Infrastructure – Water & Sewerage).

Scottish Water spent £192 million on responsive repair and refurbishment costs in 2022/23, higher than £152 million in 2021/22 but £161 million lower than allowed for in the final determination. Responsive repair and refurbishment costs are expected to total £215 million in 2023/24 but general inflationary pressure is impacting delivery.

Maintenance finance available to the Environment Agency (EA) is set to fall throughout the forecast period. In 2022/23 Defra made a nominal £201 million allowance available for flood defence maintenance to the EA, reducing to £196 million in 2023/24 and an anticipated £190 million in 2024/25. National Audit Office recommendations, following a recent review of progress towards improving the UK's resilience to flooding, include considering reprofiling capital programmes to help overcome short-term maintenance funding constraints to provide the EA with the certainty it needs to plan its maintenance programme effectively.

Upper Scenario:

- Central government increases infrastructure r&m spending

If government is looking for a quick fiscal stimulus to boost economic and industry activity then a large increase in ring-fenced funding to local authorities for transport projects that allows work to get off the ground would provide a boost to infrastructure r&m output in the near-term.

Lower Scenario:

- Financial constraints for local authorities restrict non-essential repairs and maintenance
- Planned r&m work impacted by rising costs
- Infrastructure r&m is likely to be overshadowed by new build activity rather than basic maintenance

Local authorities are likely to prioritise the essential repair and maintenance of critical infrastructure over routine r&m if their finances deteriorate due to rising spending on local health and social care needs. Faced with renewed cost pressures and supply chain disruption, local authorities are also likely to scale back or cancel planned r&m works in the near-term. In this scenario, government's focus on infrastructure spending and delivering large new build projects to stimulate economic recovery would also shift the focus further away from r&m activity, hindering growth prospects for the sector.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The Construction Products Association is the leading organisation that represents and champions construction product manufacturers and suppliers. This vital UK industry defines our built environment, providing the products and materials needed for homes, offices, shops, road, railways, schools and hospitals. Our industry directly provides jobs for 382,500 people across 24,000 companies and has an annual turnover of £62.5 billion.

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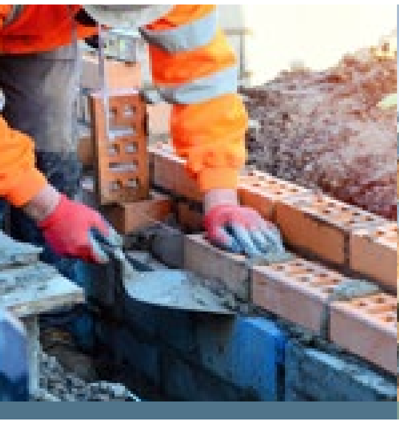


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