



Insight

Summer 2015

making the difference

UK market intelligence Is two-stage working?

Revisions to national statistics, particularly in construction data, have seen GDP improve. In the second quarter of 2015 GDP appreciated by 2.6 percent compared to its respective quarter in 2014. Confidence has resumed following the election, but the political environment in Europe is still cause for concern, with the sustainability of Greece's renegotiated bailout a particular worry. Further afield, a dampened Chinese growth rate has brought focus onto weakened global demand. Nonetheless, internal demand in the UK remains relatively robust.

New methodology adjusting construction output data has seen the suspected construction recession ousted from national statistics over the last two quarters, with construction output unchanged over the quarter as of Q2 2015. Further revisions will surely be made in the future as an improved output deflator is adopted, but for now, economists have painted a more upbeat picture. This runs in line with confidence and sentiment indicators in the industry, with increasing new instructions boosting growth, albeit restricted by supply constraints.

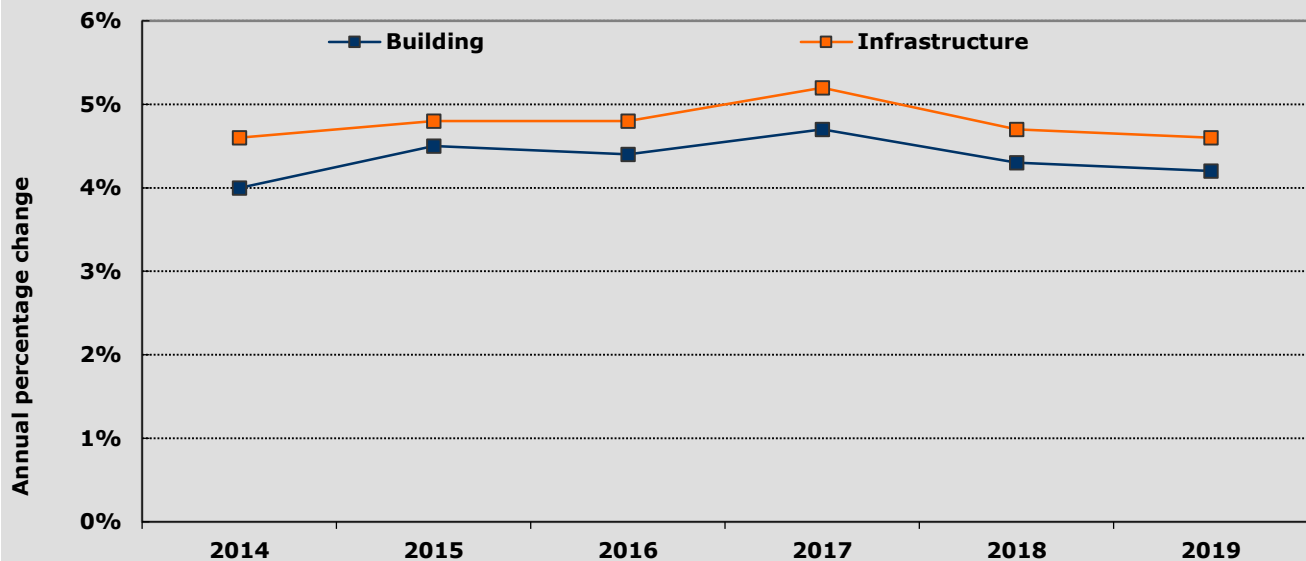
These supply constraints are increasingly causing significant stress within the contracting supply chain - adversely affecting inflation allowances. Recent consolidation and administrations further add to inflationary pressures and two-stage tendering has become more widespread in this rising market.

**Turner & Townsend tender price index
annual percentage change**

	Building	Infrastructure
2014	4.0%	4.6%
2015	4.5%	4.8%
2016	4.4%	4.8%
2017	4.7%	5.2%
2018	4.3%	4.7%
2019	4.2%	4.6%

The data shown above is representative for the UK as a whole and costs may vary substantially between regions. For further assistance on cost assurance and inflation analysis in your area, please contact Turner & Townsend.

Turner & Townsend tender price index



Key indicators



Materials: A shortage of key materials is driving costs up further. Bricks, plasterboard and fabricated steel are all now on long lead-in times and acute supply shortages are affecting cost and productivity.



Preliminaries: Further wage pressures and reduced tender competition is reflected in an increase of preliminaries. Although variations are present across the regions.



Overheads and profits: Strong identified forward work streams of Tier 1 contractors are allowing for increases in OH and P's despite increase in cost of Tier 2 trades.



Labour: Shortages of skilled labour persist in various geographic locations and key trades such as brickwork and cladding are in particular deficiency.

Construction by numbers

- After two consecutive quarters of growth, construction employment fell slightly by 0.1 percent in Q1 2015 when compared to Q4 2014. On a yearly basis improvements were still seen at 1.5 percent.
- Vacancy statistics increased in Q1 2015 by 21.7 percent when compared to the previous quarter and 47.4 percent compared to the previous year.
- Total construction new orders increased by 0.4 and 8 percent on the quarter and year respectively as of Q1 2015. A large increase in infrastructure and modest improvements in private industrial works led the gains.
- Construction administrations increased by 11.9 percent on the quarter as of Q1 2015 with a few high profile administrations evident during the current quarter.

UK economic data



GDP (at market prices) index
Q2 2015: 107.8
Q1 2015: 107.1
Increase: +0.7%



Bank of England base rate
August 15: 0.5%
May 15: 0.5%
No change



Consumer price inflation
June 15: 0.0%
March 15: 0.0%
No change



Unemployment level (thousand)
Q1 2015: 1,827
Q4 2014: 1,862
Decrease: -1.9%



Construction output index
Q2 2015: 104.3
Q1 2015: 104.3
No change

Hot rates



Brick price index
Q2 2015: 122.6
Q1 2015: 122.3
Increase: +0.2%



Fuel (Diesel) price index
Q2 2015: 120.4
Q1 2015: 116.2
Increase: 3.6%



Sawn wood price index
Q2 2015: 110.9
Q1 2015: 114.0
Decrease: -2.8%



Structural steel price index
Q2 2015: 90.6
Q1 2015: 92.5
Decrease: -2.1%



Copper price index
Q2 2015: 98.1
Q1 2015: 97.4
Increase: 0.7%

Hot topic

Is two-stage working?

Two-stage tendering has fast become the accepted method of procurement in the construction industry. But a red-hot market in some parts of the country and process administration challenges has attracted bad press. So how can the industry avoid the pitfalls and what are the best ways to effectively manage the process? Let's examine some of the issues.

With primary indicators demonstrating material lead times increasing, specialist subcontractors being more selective about what they bid competitively for, and the lengthening time it is taking to finalise and agree contract terms, it is no surprise that the market is driving towards using the two-stage route.

There has been a shift in negotiating influence in favour of the supplier. Construction procurers need to recognise that suppliers now wield greater commercial power than during the recession years. Given supplier capacity will continue to outstrip demand for some time to come, it is clear the conventional two-stage formula needs to be revisited if two-stage is to deliver best value in an overheating market.

Two-stage tendering can work well for both employers and contractors if it is set up and controlled in a way that respects both parties' risk appetite. Main contractors like it because, in conventional two-stage, if they are successful at the first stage they are in a stronger position to develop their overall offer, often on a negotiated basis. The benefit to employers of conventional two stage is the main contractor positively contributes to the schedule, design, buildability and logistics during the second stage, in collaboration with the employer's team. The result, in theory, is a better overall result as owing to improved evaluation of risk.

However, a combination of an overheating Tier 2 supplier market and industry-wide management stretch is giving two-stage tendering a bad name and resulting in negative publicity. This management stretch is often manifested in less rigorous process administration which has, in certain situations, led to escalating costs towards the end of the second stage.



What are the 'must dos' in two-stage?

- **Rigorous pre-qualification of suppliers.** This may seem self-evident but in an overheating market, there is a greater stress on financial resources, management, leadership and commercial controls. A successful prequalification process needs to get to the bottom of the supplier's real time capability and capacity
- **Hands-on control against the Pre-Construction Services Agreement (PCSA).** The PCSA needs to be robust. It should document all commercial protocols e.g. competitive procurement of packages, target cost certainty dates, progressive removal and allocation of design risk, dates of deliverables, details of the Contractor's proposed resources and team etc. The PCSA should enable the employer's team and contractor to jointly demonstrate progress against design, schedule, the approved cost plan and risks during the second stage.

- **Agree effective management procedures and easy-to-use common templates for the project.** It is important to track information release status, sub-contractor procurement and provide early warning on reconciling commercial and programme risk against the approved cost plan. Make sure integrated reporting and communications is in place - avoid multiple reports circulating between suppliers, the main contractor and employer's team.
- **Secure a sub-contractor procurement programme as part of the main contractor's first stage tender.** This allows the employer to fully scrutinise and obtain visibility of sub-contractor selection and helps prevent sub-contracts from being awarded to non-pre-qualified suppliers.
- **Development of the main contractor's own cost plan in collaboration with its supply chain at stage one.** Share the approved cost plan (at the right time) and use pooled information to develop a common cost plan at the start of the second stage prior to the appointment of the main contractor at the end of the first stage.

What else can construction procurers do?

As well as more effectively managing the second stage, here are our top three tips:

1. Incentivise main contractors to perform

To drive the right contractor behaviours in an overheating market, incentivisation can be a strong motivational lever. The most basic form of incentivisation is allocation of future work through repeat requirements and a visible pipeline of work. More complex arrangements are available depending on an employers' and contractor's risk/reward profile - e.g. pain/gain share on contractor or supplier profit based on performance against a target objective, defined bonus payment for achieving critical activity by a desired milestone in the programme etc.

More sophisticated incentive arrangements may require a wider project based incentive strategy involving the professional services team and key Tier 2 suppliers locked into a common incentive system.

2. Consider 'hybrid' procurement arrangements

In some circumstances, the design programme may allow early release of key packages with sufficient information to enable a main contractor to price in competition as part of the first stage bid. Main contractors are showing an appetite to take on packages such as basement and structural framing. An alternative arrangement can be the novation of separately procured enabling works to the main contractor as part of the first stage to remove risk from the overall construction programme

3. Challenge the duration of second stage period

While the pressure to carry out design development and achieve a robust second stage procurement process are key challenges, there may be opportunities to shorten the second stage period particularly if the project team is well established and a robust design programme is in place. A shorter period can focus minds and can reduce the opportunity for abortive working or unnecessary scope of risk creep.

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