McLarens

Value at Risk: The Rise in Construction Costs

Since the significant rise of construction costs from March 2020, McLarens and Brawdia have been researching costs with the aid of industry experts and data analysis from a variety of sources. This article provides an overview of why UK and EU construction costs have reached their current levels and an indication of where construction costs are moving to, along with the detrimental effect rising costs can have if the insurance industry is not prepared.

Statistics from a UK national building supplier show that household material costs from January 2022 to January 2023 increased between 8 and 20%. Plasterboard, bricks and roofing materials all increased between 15 and 20%.[1] Forecasts point to an increase across the board of anywhere between 2 and 12% for individual building materials by the end of this year.[2]

	UK (2015–2022)	EU (2015–2022)
Materials	60% Increase	35% Increase
Labour	30% Increase	14% Increase

Contributory Factors

EU states have experienced similar cost pressures for cement, timber, steel and labour but nowhere near the increased levels seen in the UK. Experts sway towards Brexit and the energy crisis being about 40% each contributory causes of the UK rise, and the pandemic only 20%. Additional increases for the UK in supply chain issues, delivery and tariff challenges are attributed to leaving EU.

The UK has reduced domestic manufacturing, relying on imported goods and materials, leaving the UK in far less control of our energy supply costs. 40% of UK electricity is generated from gas power stations and 80-90% of our households use gas boilers to heat our homes.[3]
This is far higher than most of Europe and explains why we have been hit hardest by the energy crisis but with new regulations set to be introduced in 2025 banning gas boilers in all new build homes, we will start to become more in control of our supply.

Risks for Policyholders, Brokers and Insurers

1. For policyholders, periods of high inflation create a risk of under insurance, where sums insured are eroded by price increases. If the sum insured at set up or renewal is not correct, there is a risk of the full claim value not being settled, and the average clause being applied.

2. Where brokers manage a portfolio of insured properties, they may have a duty of care to ensure their customers portfolio is adequately insured and that VARs (Value at Risk assessments) are undertaken to provide an accurate sum insured and avoid under insured portfolios.

3. For insurers, inflation poses a significant risk of under-pricing, as claims inflation can outpace the ability to adjust terms and rating, especially where VARs are not updated regularly. In addition, inflation, material and labour cost increases can squeeze contractors' profit margins, threatening the quality of construction work, liquidation, direct and third-party claims.

Undertaking Value at Risk Assessments

The most important aspect is to carry out a physical survey and inspection of the building, its nearby environment, location, external features within the title plan, and any special features or high specification products and design within the building. We also need to consider items that are not accounted for within the rebuild rates such as the external areas of the building that fall within the title plan. Build items such as car park surfacing, external flood lighting, security lighting, boundary fences, hardstanding, landscaping, car park spacing.

The Royal Institute of Chartered Surveyors (RICS) provide detailed recommendations on how to undertake assessments, collate and process the site information. The Building Cost Information Service (BCIS) provide an online portal of quarterly updates on tender submissions for all building types, setting out recent data on historic project costs. It also allows for location indexing and uplifts due to regional variations in labour and land value. This is the only source of independent data in the UK.

The Future of Construction Costs

High inflation and low economic growth, as we are currently experiencing, is known as stagflation. Some, industries have done well historically out of such an event, for example oil, pharmaceuticals, and beverages, but this is not good for the construction industry. Some financial and economic experts are warning that the mix of prolonged weaker growth and rising inflation could continue for some time.

With no clear indication of a levelling off for energy prices and the indications that inflation is not easing up, it is reasonable to assume the rise in construction costs will continue.

Because of a lack of supply and a high demand, construction labour rates also continue to rise. According to the BCIS, labour rates on building sites broke records in January 2023 as average weekly earnings for self-employed tradespeople hit £1,027.[4]

In our own experience, we have seen a varying degree of increase in Sums Insured that are only three years from their previous valuation, between 15% and 30%, depending on building type, location, and intensity of labour involved in re construction.

Stakeholders can put themselves in the best possible position to ride the wave of uncertainty by ensuring they are adequately insured, avoiding under reserving building claims at Day One, and being aware of where construction costs and construction labour rates are leading to in the next couple of years.

> Mitigation of underinsurance
> is key via up-to-date VAR.

Tony J Rellis BSc (Hons) Dip Surv MRICS
Director, Brawdia

+44 (0)7442 686 028

tony.rellis@brawdia.com

This article is a joint piece by McLarens and Brawdia, who offer a range of expert surveying services for commercial and residential property stakeholders and property insurance professionals.

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