

COST UPDATE

The downturn's effects become evident as inflation escalates for consumer, input, output and materials prices, says **Peter Fordham** of **Davis Langdon**

01 / KEY CHANGES

- ▲ Consumer price inflation is double its target and still rising
- ▲ Industry input and output price inflation at record levels
- ▲ Oil prices and fuel costs are driving inflation but may have peaked
- ▲ Materials price inflation accelerates again

The chart (right) shows how costs have moved in different sectors over the past seven years and the consumer price index.

Percentage change year on year (2Q07-2Q08)

	trend	direction
Building cost index	4.7	▲
Mechanical cost index	3.5	▼
Electrical cost index	4.7	▲
Consumer prices index	3.3	▲

(2Q08 figures provisional)

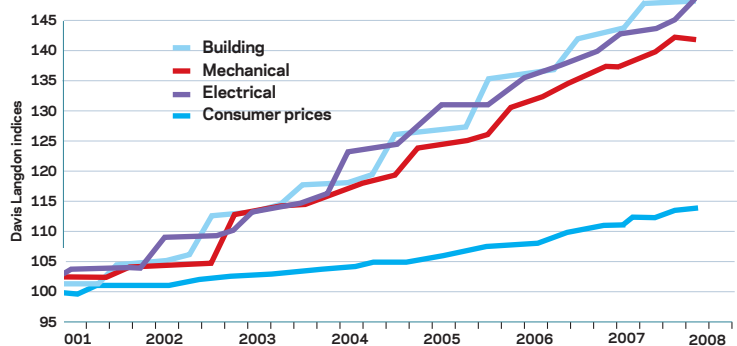
Building cost index The inflation rate rose one point in the second quarter as materials price inflation accelerated in the three months to June. A wage award at the end of June will prompt a further rise.

Mechanical cost index The annual rate of inflation has declined to 3.5%, its lowest since the end of 2003, but the rate of materials price inflation is picking up, rising by 2.6 points in the quarter to June.

Electrical cost index Electrical cost inflation rose 3.1 percentage points in the three months to June and 5 points in the past six months.

Consumer prices index Consumer price inflation rose from 1.8% last September to 4.4% in July, driven by food and transport costs.

Davis Langdon indices



Guide to data

Davis Langdon's cost indices track movements in the input costs of construction work, incorporating national wage agreements and changes in materials prices as measured by government statistics. They provide an underlying indication of price changes and differential movements in work sectors but do not reflect changes in market conditions affecting profit and overheads, site wage rates, bonuses or any discounts or premiums in materials prices. Market conditions are recorded in Davis Langdon's quarterly Market Forecast (last published in Building on 25 July).

02 / PRICE ADJUSTMENT FORMULAE FOR CONSTRUCTION

In the 12 months between July 2007 and July 2008, the 60 building work categories have recorded an average rise of 7.6%: considerably higher than the 5.3% recorded this time last year. This was owing, in part, to a wage rise of 6% for building operatives in June, compared with the 4.3% rise last year.

Those showing the greatest increase have been:

	% change
Concrete: reinforcement	24.3
Piling: steel	21.7
Waterproofing: asphalt	17.4
Waterproofing: liquid-applied coatings	16.5
Waterproofing: built-up felt	16.4

Fencing	15.4
Pavings: coated macadam and asphalt	15.0
Windows and doors: aluminium	13.6
Excavation and disposal	13.2
Cladding and covering: lead	12.9
Piling: concrete	12.5
Imported filling: hardcore and granular	12.3
Metal: miscellaneous	12.1
Demolitions	12.0

Costs have been driven over the past year by the rising cost of steel and oil. The cost of plant also rose almost 20%, largely as a result of increasing fuel prices. At the same time, there has been minimal inflation and even

falls in some work categories, for example:

Cladding and covering: zinc	-11.3
Pipes and accessories: copper	-2.9
Cladding and covering: copper	-1.3
Windows and doors: softwood	1.0
Softwood carcassing and structural members	1.5

Copper prices have been steadier over the past few months but there has been a clear downward trend over the past month. Zinc prices are close to 50% of their level a year ago, hence a reduction in cladding prices. Timber prices have actually fallen after their sharp rises in 2007.



Materials Output price inflation is at its highest rate for a quarter of a century

03 / EXECUTIVE SUMMARY

▲ Industry input cost inflation exceeds 30%. This level was last recorded in 1974

▲ Construction materials prices rise by 5.4% during the second

quarter compared with a year ago

▲ Industry output price inflation passes 10%. That is the highest rate since 1982

04 / KEY INDICATORS

	% change Past 12 months (July 2007-July 2008)
Consumer prices	
Consumer prices index (CPI)	+4.4

Consumer price inflation (CPI) jumped to 4.4% in July, its highest level since April 1992. The principal reasons have been rises in food prices and transport. The Bank of England expects CPI inflation to rise to 5% later this year before falling to 2% or below by the beginning of 2010.

Industry input costs	
Materials and fuels purchased by manufacturing industry	+30.1
Materials and fuels purchased by manufacturing industry excluding food, beverages, tobacco and petroleum industries (FBT&P)	+16.6

Headline input cost inflation has topped 30% for the past two months, compared with 0.6% last July. Inflation of more than 30% has not been seen since 1974. More than half the rise is owing to increases in crude oil prices, which have gone up 144% since January 2007. However, with oil prices down 20% from their July peak, the input cost index may also have peaked. After crude oil, the biggest rising commodity has been gas, 74% higher over the year to July.

Industry output prices	
Output prices of manufactured products	+10.2
Output prices of manufactured products excluding FBT&P	+6.7

Output prices inflation surpassed 10% over the past year, its highest since 1982. A 35% rise in the price of petroleum products has led the surge. Twelve months ago, output price inflation was at a steady 2.5%. However, the output prices of manufactured products have still risen 6.7% over the past year, its highest figure since 1981. This includes:

Wood and wood products	+2.4
Rubber and plastic products	+4.0
Fabricated metal products	+7.1
Electrical machinery and apparatus	+3.9
Recovered secondary raw materials	+78.7

The price of recovered secondary raw materials (that is, scrap metals) has soared in the first half of this year, up 97% between December 2007 and June 2008, its fastest ever recorded rise. A small drop between June and July suggests prices may be beginning to fall.

	June 2007-June 2008
Construction materials	
New housing	+4.4
Non-housing new work	+8.6
Repair and maintenance	+5.2

Construction materials rose to 6.7% over the year between June 2007 and June 2008, but the figures above show a different trend between materials for housing and non-housing work; for the latter, prices rose 8.6% in the first six months of this year. This largely reflects the higher input of steel in non-housing work (see table above).

Mechanical services materials	
Housing only	+5.5
Non-housing	+4.0
Electrical services materials	+5.3

Most of the increases in M&E materials have occurred since spring, largely reflecting higher copper prices. World copper prices have been falling since July so the annual percentage rises may have peaked. Significant changes over the past year include:

Gas oil	78.5
Diesel engine road vehicle fuel	36.0
Steel sheet piling	34.3
Concrete reinforcing bars	39.8
Fabricated structural steel	31.1
Crushed rock	15.9
Coated roadstone	14.1
Cement	12.5
Paint (non-aqueous)	9.6
Sand and gravel	9.0
Insulating materials	0.1*
Clay bricks and tiles	-3.9
Imported softwood	-8.3*

* June 2007-June 2008

June/July 2008 figures are provisional (Data sources: ONS and BERR)

Fuel prices head the table with gas oil up almost 80%, mirroring the rise in crude oil prices. The increase in diesel prices over the same period is much lower because of the impact of duty. Steel prices have been resurgent in the first half of 2008. Prices have increased worldwide as producers have been faced with rises in raw material costs. Imported timber prices have fallen this year despite the slide in the pound as some correction took place the 30% rise during 2006/07.

Labour New wage awards have kicked in for building and demolition operatives and asphalt workers

05 / EXECUTIVE SUMMARY

- Figures from the Office for National Statistics show that average earnings in Great Britain in June were 3.4% higher than the year before, the lowest annual figure for almost five years.
- Average earnings in construction in June were just 0.7% higher than a year before after peaking at 3.3% in May 2007.
- In the past three months there have been new wage awards for building operatives, asphalt workers and demolition operatives.

Building operatives

The new basic hourly rates (based on a 39-hour week) and applying between Monday, 9 June 2008 and Sunday, 14 June 2009 are:

S/NVQ3 qualified operative	£10.41 (previously £10.06)
S/NVQ2 qualified operative	£8.95 (previously £8.65)
Adult general operative	£7.73 (previously £7.40)

The new rates mean an increase of 3.5% for qualified operatives and 4.5% for general operatives and compares unfavourably with the June 2008 rise of 6% for operatives under the third part of an agreement promulgated in May 2006 when industry conditions looked much stronger.

Wages for building and civil engineering operatives in Northern Ireland increased 6% from 4 August.

Heating and ventilating operatives

Heating, ventilating, air-conditioning, piping and domestic engineering operatives are expected to see their wage rates rise by 4% from 6 October. This will be the third and final part of a three-year wage agreement promulgated in October 2006. The new rates will be:

	£/hr
Foreman	14.71
Senior craftsman	12.16
Craftsman	11.16
Installer	10.11
Adult trainee	8.52
Mate (18 and over)	8.52

The same rise will be applied to responsibility allowances, premium rates and daily travelling allowances. However, the agreement recognises that Amicus may wish to approach the Heating and Ventilating Contractors Association if inflation in the CPI for October 2008 exceeds the level set out in the wage agreement.

Wage agreement summary

The following table summarises the wage agreements currently in force for the principal wage-fixing bodies in the construction industry

Operatives	Agreement body	Current basic hourly rate	Effective since	Details in	Date of next review
Builders and civil engineering operatives	Construction Industry Joint Council	Craft Rate: £10.30 an hour	30 June 2008	Cost Update 8 June 2007; Spon's Architects and Builders' Price Book 2008	29 June 2009 (rates to be agreed)
	Building and Allied Trades Joint Industrial Council	S/NVQ3 qualified operative: £10.41 an hour	9 June 2008	See below; Spon's Architects' and Builders' Price Book 2009	8 June 2009 (rates to be agreed)
Plumbers	The Joint Industry Board for Plumbing Mechanical Engineering Services in England and Wales	Advanced plumber: £12.12/hour	7 January 2008	Cost Update 20 March 2008 / Spon's Mechanical and Electrical Services Price Book 2009	5 January 2009 (basic rates will rise by 4.5%)
	Scottish and Northern Ireland Joint Industry Board for the Plumbing Industry	Advanced plumber: £12.08 an hour	2 June 2008	Cost Update 30 May 2008 / Spon's Architects' and Builders' Price Book 2009	1 June 2009 (basic rates will rise by 4.6%)
H&V operatives	Joint Conciliation Committee of the Heating, Ventilating and Domestic Engineering Industry	Craftsman: £10.73 an hour	3 September 2007	Cost Update 7 September 2007; Spon's Mechanical and Electrical Services Price Book 2008	6 October 2008 (basic rates will increase by 4%; see below)
Electricians	The Joint Industry Board for the Electrical Contracting Industry	Approved electrician: £13.08 an hour	7 January 2008	Cost Update 20 March 2008; Spon's Mechanical and Electrical Services Price Book 2009	5 January 2009 (basic rates will increase by 4.5%)
	Scottish Joint Industry Board for the Electrical Contracting Industry	Approved electrician: £13.08 an hour	7 January 2008		5 January 2009 (basic rates will rise by 4.5%)