



INDUSTRY UPDATE

QUARTER 4  
YEAR 2023

# Construction

The UK construction industry has witnessed a period of decline in recent years – negatively impacted by the cost-of-living crisis, post-Brexit reforms, pandemic affected supply chains and now a rising interest rate environment.

This has resulted in a rising number of insolvencies throughout 2023. This report provides an overview of the construction sector, including market structure, competitive landscape and future outlook.





## Industry Overview

The UK construction industry is broad, encompassing numerous services grouped across:

- Building of new specialised developments
- Civil engineering
- Remodelling, renovation, and repair of existing buildings

Industry revenues have contracted over the past five years at a compound annual growth rate (CAGR) of 2.3%, but are forecast to rebound, growing c.2.0% per year through 2029.

## Market Structure

There are two principal sectors within the construction industry – residential and commercial. With different sets of drivers of growth in each the market is fragmented in nature, with no single company controlling a dominant market share in both spaces.

### Residential sector

This sector has struggled with the tough financial climate of the past five years, particularly given the rise in cost of building materials and skilled labour. This has caused revenues to decline by a CAGR of 2.9% and profits by 21.7%, over the last five years. Brexit, the Covid-19 pandemic, and the current cost-of-living crisis have all contributed.

### Commercial sector

This sector relates primarily to specialised construction of non-residential buildings and civil engineering projects. Total revenue declined significantly during the pandemic (c.20.6% from 2020-2021). Although it has recovered to pre-pandemic levels, it too has been impacted by economic headwinds, resulting in a decline in profitability at a CAGR of 11.7% over the last five years.

## Market Segmentation

Below is a breakdown of the main activities within each sector, as well as the major markets in which they operate, for 2022/23.

### Residential

Total revenue for the residential sector for the 12 months to July 2023 was £84.3 billion. The main activities are as follows – construction of new single-unit housing; construction of new flats; and repair, renovation and remodelling. Market segmentation includes the private sector and public sector.

### UK Construction Industry Output (£bn)

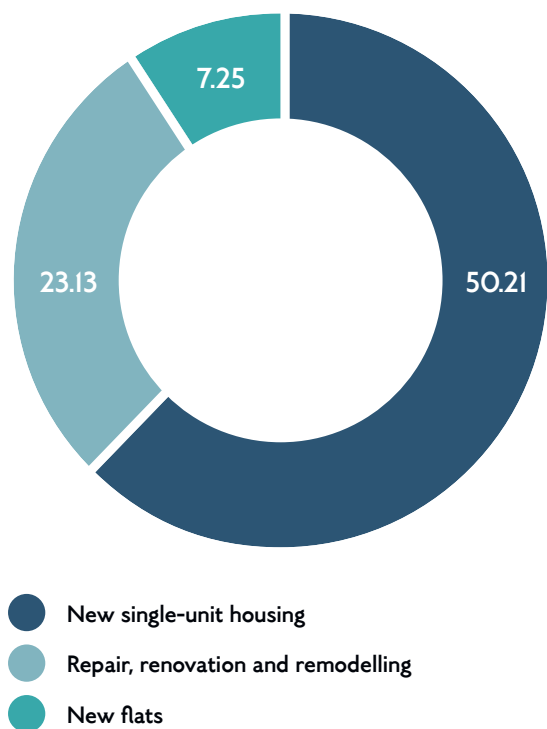


Figure 1a: Main Activities Segmentation (IBISWorld, 2023)

New single-unit housing dominates revenue within this sector, comprising 62.3%. Pre-pandemic growth was supported by the UK Government targeting 300,000 net additional dwellings each year and implementing the Help-to-Buy scheme. Recent demand for new single-unit housing has declined, with consumer confidence low amidst a backdrop of high inflation and rising interest rates.

Demand for repair, renovation and remodelling services (the second largest segment at 28.7%) has historically been directly correlated to house prices; this trend has persisted in recent years. In particular, during the pandemic, record-low interest rates and increased time at home promoted investment within renovation and increased house prices.

### Public/Private Revenue Split (£bn)

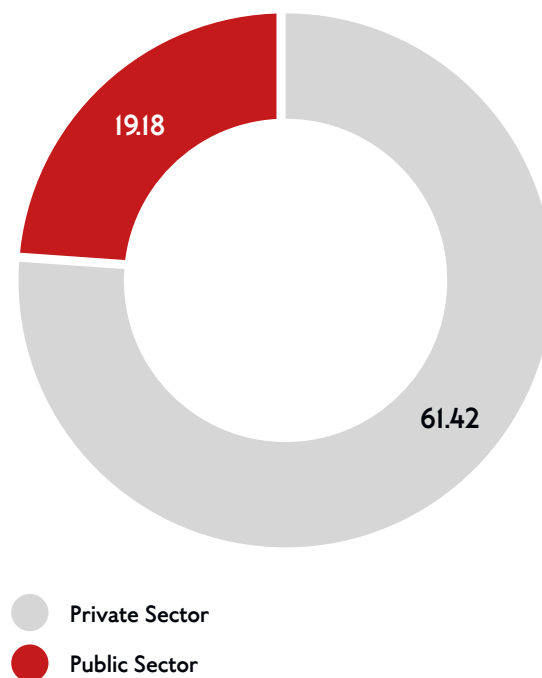


Figure 1b: Major Market Segmentation (IBISWorld, 2023)

New flats account for 9% of residential construction revenue. London is the most significant region for flat development, with 43% of Londoners living in flats – twice the national average (Office of National Statistics). However, high material prices and increased regulations on high-rise properties has suppressed new flat construction.

From Figure 1b, the private sector, comprised of property developers (£45.3 billion) and private homeowners (£16.1 billion) represents the greatest proportion of the market segmentation (c.76%) The public sector is comprised of housing associations (£17.5 billion) and local authorities (£1.7 billion).



## Commercial – Building

Total revenue for the commercial building sector for the 12 months to July 2023 was £20.2 billion. The main activities are as follows – construction of educational, recreational, healthcare, industrial and retail buildings; offices; and other. Market segmentation includes the private and public sector.

### UK Construction Industry Output (£bn)

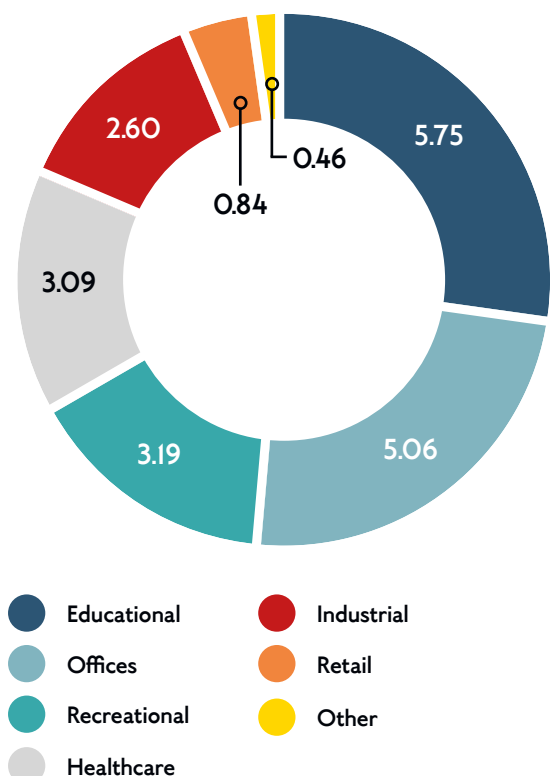


Figure 2a: Main Activities Segmentation (IBISWorld, 2023)

Construction of educational buildings (27.4%) comprise the largest segment of commercial building activity. Recent growth has been driven by UK government initiatives, most notably the School Rebuilding Programme (SRP) in June 2020 (a 10-year pipeline aimed to renovate and rebuild schools). Construction of offices (24.1%) also contribute a sizeable proportion; however, this is forecast to decrease with the movement towards hybrid and virtual work environments, triggered by the pandemic.

Retail is the smallest segment, representing 4.0% of total revenue. Retail demand has decreased in recent years, with no evidence to suggest this trend will not continue, due to the emergence of e-commerce, further boosted by the pandemic.

### Public/Private Revenue Split (£bn)

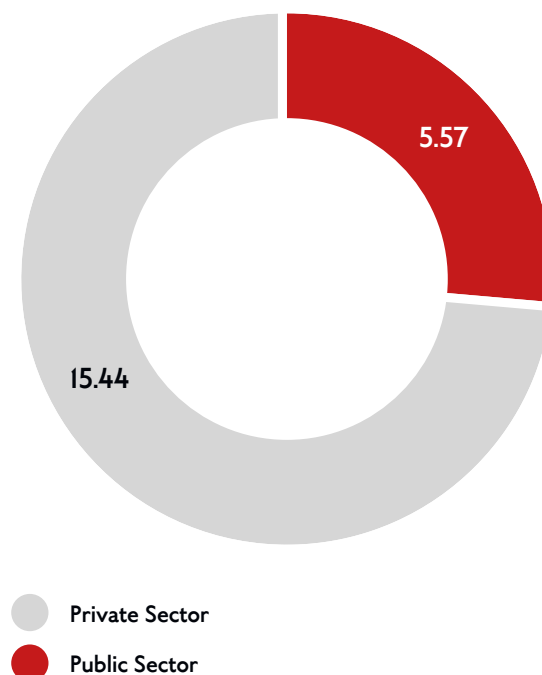


Figure 2b: Major Market Segmentation (IBISWorld, 2023)

As shown in Figure 2b, the private sector comprises 73% of commercial construction. The pandemic saw private investment fall by 9.9% in FY2021. Despite a resurgence in 2022, interest rate hikes into 2023 have reduced investor sentiment.

The public sector comprises 26.5% of total commercial revenue. Public sector investment occurs mostly within education and healthcare through UK government-led initiatives. In September 2020, the £3.7 billion Health Infrastructure Plan (HIP) was launched, aimed at building 40 hospitals by 2030.

In April 2023, the £9 billion Procure23 project was launched, aimed at the construction of NHS capital projects. In addition, the recent UK reinforced autoclaved aerated concrete (RAAC) crisis will result in significant public sector investment within schools, hospitals, airports, housing blocks and other public buildings – the total cost of which is still unknown.

We note that this is owing to the extensive use of the material across the UK from the 1950s to 1990s. RAAC is a lightweight building material at high risk of collapse owing to its short lifespan where not maintained correctly. Currently, 150 schools have been forced to close, either partially or fully.

### Commercial sector – civil engineering

UK Construction Industry Output (£bn)

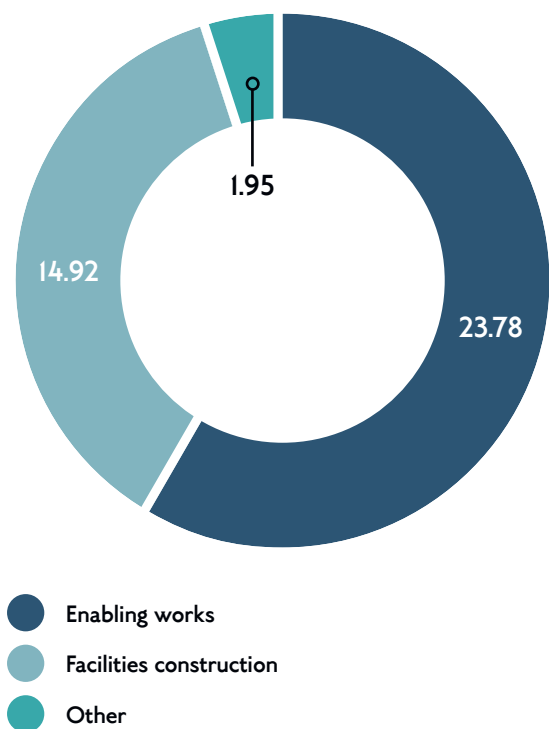


Figure 3a: Main Activities Segmentation (IBISWorld, 2023)

Enabling works constitute the largest proportion of civil engineering works (59%). This refers to groundwork, foundation engineering, and land improvement. Facilities construction constitutes 37% and relates primarily to the construction of industrial facilities, refineries and car parks. Demands for facilities construction is procyclical, moving in line with national output. In particular, facilities construction accelerated in line with post-pandemic recovery of industry output.

Public/Private Revenue Split (£bn)

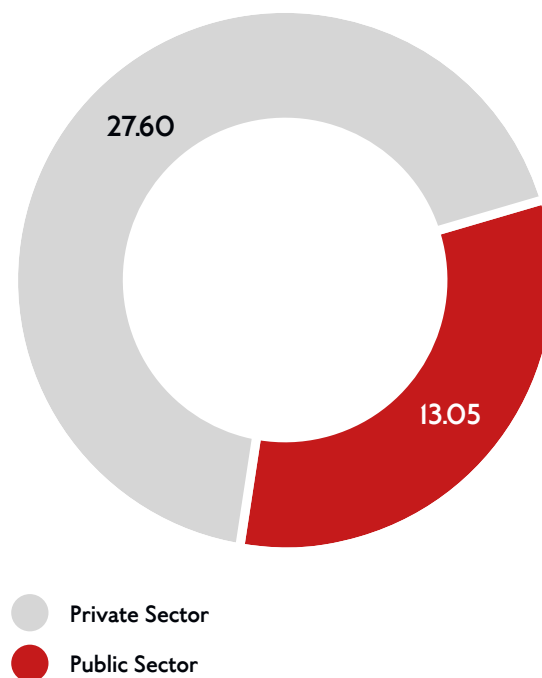


Figure 3b: Major Market Segmentation (IBISWorld, 2023)

Other activities (5%) relate to the provision of specialist civil engineering projects and consultancy services. The public sector investment represents 67.9% of all civil engineering projects. The Government has committed to developing the UK’s infrastructure networks, which has boosted demand from public sector entities. Recent private sector involvement has declined– largely due to the cessation of the private finance initiative (PFI) funding model in 2018.





## Key industry players

The UK construction industry is characterised by a competitive landscape, driven by economies of scale and vertical integration. Key industry members are presented below.

### 1. National Corporations

Large construction companies typically comprise vertically integrated property developers, securing most projects due to large land banks of brownfield land and the financial resources to take on projects. Table 1 below shows the major players within UK residential and commercial sectors.

Industry	Company	Market Share
Residential	Barrat Developments plc	7.5%
Residential	Taylor Wimpey UK Ltd	5.3%
Residential	Persimmon plc	4.6%
Commercial	Kier Construction Ltd	7.9%
Commercial	Morgan Sindall Group plc	3.9%
Commercial	Skanska Construction UK Ltd	3.9%

Table 1: Major UK players (IBISWorld, 2023)

The three largest residential contractors comprise 17.4% of market share, and commercial construction 15.7% – exemplifying the industry’s low concentration. Strong order books, predominantly with large-scale public projects, have underpinned FY2023 revenue growth.

This is exemplified by Kier Construction, who experienced revenue growth of 31.3% after their order book increased by 52.6% in 2022. Despite inflationary pressures, strong order books have fuelled optimistic growth prospects.

### 2. Small operators

UK construction companies are typically small and operate regionally. Despite accounting for 95% of residential construction enterprises, the share of homes developed by small contractors in 2020 was only 10%.

Large companies can utilise wide geographic scope and large workforces, whilst small companies have previously struggled to find skilled labour, particularly post-Brexit. Accordingly, Homes England implemented the 2021 Housing Accelerator Fund, providing £250 million to support small operators.

## Current Climate

The UK construction industry is influenced by numerous factors, including:

### Construction costs

Construction is raw material intensive. Recent high material costs has decreased profit margins and thus, disincentivised the undertaking of construction projects.

Ongoing supply chain constraints due to Covid-19 and Russia-Ukraine war has caused average material costs to surge (as illustrated in Figure 3), by 16.8% in FY2022 and 13.1% in FY2023.

## Construction Material Price Index (January 2018 to May 2023) (£)

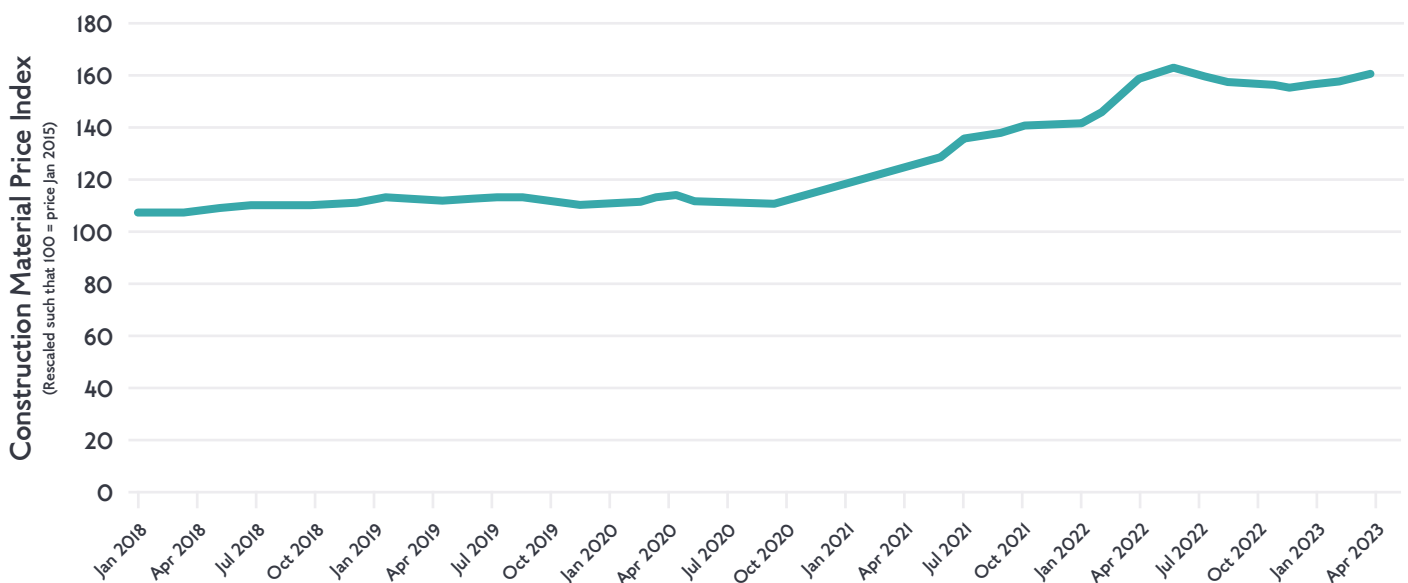


Figure 3: Construction Material Price Index (GOV.UK)

With high material costs and an overall inflationary climate, alongside having to repay Covid-era loans, 4,165 UK construction firms became insolvent in the 12 months ended 31 March 2023. Notably, Tolent Construction (historically generating c.£200 million-revenue) went into administration in February 2023.

### Government policy and regulation

To mitigate concerns of overpopulation and housing market pressures, the UK government has implemented several initiatives:

- **Housing Infrastructure Fund** – £5.5 billion fund to develop infrastructure in high demand areas.
- **Affordable Homes Programme** – Programme renewal for 2021-2026, including a multi-year settlement of £12.2 billion.

### Official bank rates

Central bank interest rates directly influence mortgage rates. Interest rate hikes make it harder for potential homeowners to find financing, resulting in lower demand for new homes. To counterbalance this, house prices are lowered, which reduces construction industry revenue.

Fifteen successive interest rate hikes from the Bank of England have seen two-year fixed mortgage rates reach c.6% in June 2023, whilst five-year rates reached 5.7% (highest since the 2008 market crash). Consequently, house prices have declined 2.7% since September 2022, displayed in Figure 4.

## Average House Price in UK and London (May 2013 to April 2023) (£)



Figure 4: A time series of average house prices (ONS, Apr 2023)

## M&A trends

Given the UK construction industry is mature and highly fragmented, there are numerous opportunities for consolidation through M&A with inorganic growth difficult to achieve due to the competitive landscape. The industry saw significant M&A activity across 2021 and 2022, as low interest rates following the peak of the pandemic fuelled opportunistic acquisitions. However, there has been a 22% decline in deal volumes in 2023, currently at 35 deals, compared to the equivalent period in 2022.

Corporate-backed deals currently represent 69% of deal volume, indicating greater interest within the corporate sphere. This suggests the importance of strategic acquisitions to increase geographic scope or services provided, thus providing a competitive edge.

We have presented recent corporate-backed/acquired deals, and recent equity-backed/acquired deals in Tables 2 and 3, respectively.

Date	Companies	Investors	Deal Synopsis	Company Description
May 23	WGC Scotland	Geg Capital	The Company was acquired for an undisclosed amount, expanding Geg Capital's portfolio.	UK based construction firm, delivering technically challenging construction projects.
Nov 22	Countryside Partnerships	Vistry Group	The company was acquired for £1.26bn to create a market leader in the partnerships housing sector.	UK based home builder, operating nationwide. It specialises in the activities of placemaking and urban regeneration.
Jul 22	O'Keeffe Construction	Byrne Group	The company was acquired for £10m to offer a one-stop-shop to the industry, from demolition to fit out.	Based in Kent, they are a provider of civil engineering and demolition services intended for the UK construction industry.
Jan 22	DCB (Kent)	MCG Global	The company, a subsidiary of Kinovo, was acquired for £5m.	Provider of renovation and maintenance services for residential and commercial buildings in the UK.

Table 2: Corporate-backed or acquired deals (PitchBook, 2023)



Date	Companies	Investors	Deal Synopsis	Company Description
Feb 23	Global E&C	SCF Partners	The company was acquired for an undisclosed amount through a leveraged buy-out.	Provider of construction and engineering services to the offshore and onshore energy sectors, based in Aberdeen.
Mar 22	Rula Developments	Foresight Group	The company, a subsidiary of Altalto, was acquired through a £975m leveraged buyout.	Developer of building and construction sites based in Oxford.
Feb 22	Bailey Street Group	Convent Capital	The company was acquired for an undisclosed amount through a leveraged buy-out.	Developer of outdoor spaces intended to serve in the construction sector.
Oct 21	RMD Kwikform	Altrad Group, Arkea Capital, Bpi France.	The company was acquired for an undisclosed amount through a leveraged buy-out.	Specialises in engineering of airports, commercial buildings and ground shoring.

Table 3: Equity-backed or acquired deals (PitchBook, 2023)

## Outlook

Whilst revenue growth appears promising, as the UK has returned to business-as-usual after Covid-19, thin profit margins is the main concern within the construction industry – currently c.6.1% and c.4.4% for residential and commercial construction, respectively. The ongoing concrete crisis will likely lead to a widespread replacement programme across the UK.

However, the impact of high material prices, inflation and supply chain disruptions has led to the construction industry making up nearly one in five of the insolvencies recorded during Q1 2023.

Significant movements in material and house prices are required to reduce this industry's exposure to further adverse developments. However, the highly fragmented market facilitates the possibility for consolidation in regional markets, for both big and small players.



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