BRIEFING

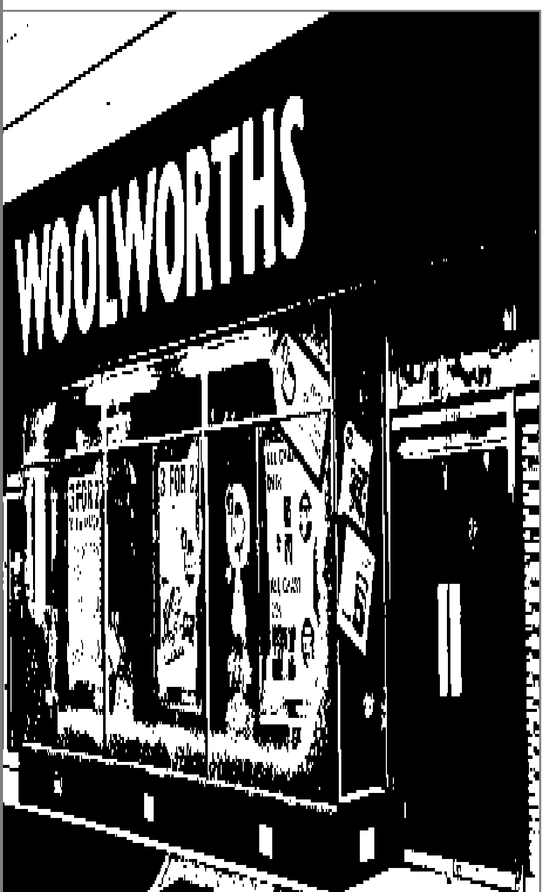
CONSTRUCTION, ECONOMIC AND PROCUREMENT UPDATE – AUTUMN 2011
CREDIT CRUNCH - 4 YEARS and COUNTING

FEATURES

MIKE JEWELL

mjewell@mdaconsulting.co.uk

FOUR YEARS INTO RECESSION AND STAGNATION; WHERE ARE WE GOING?



Following my comments about world population in May, I was pleased to see on the BBC News that the United Nations marked the birth of the 7 billionth child on the 31st October and predicted a peak of 10 billion by about 2085. The last billion only took 12 years, so let's hope they are not being complacent.

The theme of this issue is the continuing economic paralysis being suffered by the "Old World" and how this is affecting worldwide economic activity. This is a big subject going back to July 2007 that has affected worldwide trade, Europe's economic health, UK prosperity (or lack of it), and the construction industry in general. We also have information and news on construction costs and updates on some of our more noteworthy activities and projects.

The term Credit Crunch was initiated in the autumn of 2007 and this phenomenon became clear to us in September when the UK Government took over Northern Rock. Since then, we have been either in recession or fearing the worst and at home we have not really started to improve the outlook in any meaningful way.

In the UK from late 2007 until May 2010 we tippy-toed around, whilst the main political parties were in denial about how hard they would have to cut spending to start rectifying our domestic problems. In the event we did very little, but we printed some more money to put the problem on hold and drifted aimlessly. Now that the cuts have hit home, the UK seems to be in no man's land and going nowhere, yet we appear to be marginally better off than most other countries- 'Stagnant'.

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KEVIN HEATON

kheaton@mdaconsulting.co.uk

TENDER PRICE FORECAST

Earlier hopes for signs of improvement within the construction industry have been firmly set back by the continuing market volatility, disappointing data on output and growth and concerns over the potential European debt default. This uncertainty combined with figures from the Office for National Statistics (ONS) recording significant falls in the volume of new orders in the first and second quarters of 2011 provides a strong indication of a further, protracted slowdown in the recovery.

The Government spending cuts are now beginning to be felt and there is no indication that the private sector increases will be sufficient to compensate for the shortfall. The public sector cuts have impacted most on the regions where workloads continue to fall whilst workloads in London and the South East continue to recover.

Forecasters Experian and the Construction Products Association are now predicting no recovery in overall workload until 2013.

Material and input costs continue to rise placing additional pressures on contractors although the surge in commodity prices during 2010 has slowed and the markets have witnessed a certain amount of 'correction' in the price of commodities taking place. However, commodity prices remain highly sensitive to the on-going political and economic uncertainty.

As a consequence of the slowdown in recovery and the disappointing data on new orders and expected workloads, most analysts and commentators have cut back forecasts of tender price inflation over the next two to three years. We share this view and have reduced our predictions for tender price inflation in London and the South East to between 1% and 2% in 2012 and between 2% and 3% in 2013. The picture in the regions is likely to remain depressed with little sign of any tender price inflation returning until 2013 and even then we consider it unlikely to rise much above between 1% and 2%.

Indeed, there is a risk that prices may fall even further during 2012.

KEITH WARBURTON

kwarburton@mdaconsulting.co.uk

LOOKING BACK TO LOOK FORWARD

You may be forgiven for thinking that this current recession being the worst in 90 years can't be right, what about the Great Depression of 1929 and the recession years of 1979-1983? Well, when looking at the shrinkage in the value of all goods and services (GDP) and the recovery of that shrinkage, it would appear this recession is the worst.

The 1929 recession saw the economy shrink by 8% over an 18 month period, the 1979 recession shrinkage of 6.2% over the same period and the current 2008 recession shrinkage of 6.5% over the same period. However, in both the 1929 and the 1979 recessions, the economy had recovered the shrinkage within 4 years from the start of those recession periods.

Back to the current recession, well we are 3½ years in since the economy shrank and of the 6.5% shrinkage we have so far only recovered 3.1%. It is the weak recovery that is making this recession the worst. So, whilst the general economy is 3.4% smaller than the beginning of 2008, it is interesting to note statistical data on the construction sector shows it to be 10.7% smaller than the beginning of 2008.

What is also interesting to note when analysing the recession periods of 1929-33 and 1979-83, is that both these recessions were double dip recessions.

The 1929 recession saw a 2.3% growth before shrinking again by 2.3% whilst the 1979 recession saw 2.5% growth before shrinking again by 1.4%. In fact other recessions shows this double dip prior to full recoveries the only exception being the 1990-1993 recession. The likely reason for this double dip probably being the efforts of the then Governments to stimulate the economy having only a short term affect.

Historical data suggests a double dip recession is inevitable, especially now with the added problem of the Euro crisis affecting consumer confidence and demand and Banks tightening credit in readiness for loan defaults. If not for the Euro crisis the UK economy may avoid a double dip as it did in the 1990-93 recession period, and with any luck may still do.

On the basis of the historic precedence and the complication of the Euro crisis, the target for full recovery of the general economy is likely to be 2015? It has been said for the construction sector this will be some time thereafter!

However, don't lets get too disheartened though as this is only 3 years away and we're halfway through!!

STEVE JONES

sjones@mdaconsulting.co.uk

REBUILDING LIBYA

The Libyan bubble burst for many UK construction consultancies in February of this year as the Arab Spring spread into the country.

The seeds sown in Benghazi in the East quickly spread culminating with Tripoli being liberated around 22 August 2011. Approximately 7 months. Sirte, Gaddafi's home town, continued to resist but has also now just fallen.

However, this "re-birth" of a nation is unlikely despite optimistic reports in the UK press to lead to increased activity for the beleaguered UK construction industry.

The National Transitional Council or NTC is now effectively in control though there are power politics at play and a number of different groups seeking to influence the transition.

Frozen assets have not been released in a substantial volume and the country is therefore still suffering from a cash squeeze. The population has yet to re-deposit their hoarded cash back in to the banking system and so liquidity is negligible and severe restrictions continue on cash withdrawals from the banks. This is squeezing the private sector who find it hard to pay basic operating costs and, crucially, wages. Efforts are being made to restore liquidity but the challenges remain.

Regarding the resumption of business, construction is far down the list. The priorities are clearly the oil and gas sectors which will generate the substantial cash reserves needed to run the country. As a result, urgent maintenance and repair contracts are being let on a direct basis. It is unlikely that new exploration contracts will be awarded but the drilling work that was on-going in February will at some point re-commence.

New contracts are generally not being awarded in any sectors. The authorities recognise that they do not necessarily have the legitimacy to commit the country to projects and that this should be the responsibility of an elected government. In other sectors there is little on-going work and certainly few, if any, contracts being awarded.

The current view pertaining to existing government contracts, including those in construction, is that a commission will be established to investigate corruption and a policy formulated. It is envisaged, but by no means certain, that those over 75% complete will be allowed to continue, those between 40-75% will be investigated and those below 40% completely re-tendered. The timescales regarding this process are unknown and hence the uncertainty continues.

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REBUILDING LIBYA Cont'd

It is unlikely that many of the signature schemes promoted by the Gaddafi regime will ever be built.

Existing private sector contracts in construction may never re-commence and if they do, it could be many years down the line due to the liquidity and confidence issues outlined above

Confidence, as it is everywhere, is the key.

The next steps for Libya are:

- Announcement of Country Liberation (expected November 2011)
- An Interim Government ("IG") will then be formed and the NTC Executive Office dissolved
- Within 30 days of the formation of the IG, a Constitutional Authority ("CA") is appointed to draft a new constitution
- A new constitution shall be referred to the Libyan people for a referendum vote, 3 months after formation of the CA. The people have 1 month to vote Yes or No
- Within 8 months of the formation of the IG, a National Congress ("NC") shall be formed and approximately 200 members voted in. The NTC will dissolve. The NC will be the legislative arm of the (State/Republic of) Libya and will appoint a Prime Minister and a new Cabinet to run the country until elections
- 10 months after the NC is formed, democratic elections will take place to elect a new government. These elections will be overseen by the UN

The above process could take up to 2 years but it is only when a new democratically elected government is in place that the wounds, memories and scars will begin to heal and reconstruction can re-commence in earnest.

To conclude, Libya will not be the light at the end of the tunnel for the UK construction industry just yet and my quiet strolls around the cafés of Green (now Martyrs) Square in Tripoli will continue to be a distant memory.

Acknowledgement: Grateful thanks to Tuareg Capital for their assistance with this article.

(4 Years into Recession and Stagnation; Where are we going? . . . Continued from Front Page)

By common consent, Brown and Darling contributed strongly to the early work on baling out of world finances and the banking industry late in 2008. However, according to the pundits, the Government's deficit in boom times 6 or 7 years ago whilst still talking about prudence should never have happened and that damaged us. Mr Brown often said that he had put an end to "boom and bust". All he did for certain was help to put an end to the "boom" bit for the time being.

We all think that it's bad enough here, but we only have to cast our eyes across the channel to see that we were lucky (or smart) not to get into the Euro. There has clearly been too much welfare spending in most countries on the continent, but the first countries to break the rules on deficits were France and Germany, so the rest followed behind them. There is poetic justice in the Germans baling out Greece et al this year, because their exports boom has been caused in part by the PIIGS, etc., pulling down the value of the Euro. Sadly, they have to take the rough with the smooth.

Recently, after another patch repair in Europe, the begging bowl has gone off to China, India, Russia and Brazil. These countries are still (per capita) poor, but they have cash reserves to invest. Trade is so globalised these days that even these countries will suffer if there is continuing stagnation or a recession across Europe and the USA, because there will be no market for their goods. None of these countries has yet generated the internal demand for their own manufactured goods, as many of their citizens still live at the yardstick poverty level of less than a dollar a day.

Unfortunately, we can't even spare ourselves a smile about the European conundrum, because Europe is our biggest trading partner, so we are all in it up to our necks, even though we avoided the main Euro pickle. To quote somebody we all know …. . "We are all in this together!"

Uncle Sam has posted some good retail figures very recently, but it is difficult to say whether it is enough to save Mr Obama's skin next year, after he lost out at the mid-term elections. There were arguments and a political hiatus in the USA recently over their budget deficit crashing through $14 trillion and this sum is very difficult for a simple QS to comprehend. One of our Associate Director's, Trevor Harrison, worked out that it equates to a pile of $100 bills reaching to the moon – or something like that, anyway. Goodness knows where they keep them all.

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(4 Years into Recession and Stagnation; Where are we going? . . . Continued from Front Page)

The UK Construction Industry amongst other things is suffering from a lack of investment and this is caused by the squeeze on everything financial. One thing is that the Government wants the banks to keep more collateral to cover for potential losses on loans.

They also say that citizens should be saving more for our later years and to keep us comfortably solvent. In the current economic conditions, these actions are good for longer term stability, but they don't really want these things to happen NOW. We really need more borrowing and more spending to help the economy along and generate growth.

We are fortunate in the UK, insofar as many wealthy foreigners come to London and buy properties and this has kept values at a relatively high level. Property prices generally have not fallen as far as earlier predictions and this means that house building is still economically viable.

There is massive demand for social housing, so they could use the old trick of selling them at a discount to people who no longer need the subsidy, but don't really want to move. The radical approach this time would be to use the money to seed fund more social housing.

Unrest in the Middle East has also contributed to the stability of property prices, with people investing in the UK as a safe haven for cash that might otherwise be snatched back after political change. This has had the effect of generating potential workload for the industry, either through the banks or directly with our developer clients.

The general economic gloom is giving rise to widespread re-structuring in UK companies, with some of our larger competition, being subsumed into huge international conglomerates, which will change their roles and is bringing their objectivity into question.

One thing it will do is make life a little more comfortable, but it is interesting to note that people have left these combines to return to their traditional roles elsewhere.

MDA has suffered with all of the others in the last year and we have lost some life-long friends. We do hope, however, that the exceptional talents of the people we still have will pull us through the continuing difficult trading conditions.

THEY ALL GOT IT WRONG

ECONOMISTS as well as politicians got it spectacularly wrong. Out of 35 experts polled by Reuters, not one had predicted a drop in GDP over the quarter. The average expectation had been for a 0.2per cent rise.

Their optimism had led broadcasters to predict confidently that the country would be emerging from recession.

The revival in the stock market and stronger than expected retail sales had all misled economists into thinking that consumers and investors were spending.

It was also thought that manufacturing output was picking up and the weak value of the pound was helping our exporters. None of this seems really to have happened.

Part of the problem is the experts' apparent over-reliance on surveys – which reflects attitudes rather than trends in the real economy – and a tendency to think that the stock market behaves in a rational way.

CLIVE WITTER

cwitter@mdaconsulting.co.uk

AN INTRODUCTION TO 'ERIC'

In August MDA were asked by Carillion Construction to come to the Southmead Hospital Re-development site (value circa £430m) and meet **ERIC** **(Estates Return Information Collection)**.

We had previously provided quantities to assist them in their package procurement and so were familiar with the complex building layout.

The redevelopment involves the rationalising of services currently on the Southmead site and those in other locations across north Bristol. The hospital, which is due to open in 2014, will provide state of the art clinical facilities and 800 beds, the vast majority of which are in single rooms with en-suite bathrooms.

When we got there, they explained that the building had to meet a certain level of energy efficiency and that in order to calculate how efficient the building was, they first had to establish the heated volume of the building.

This was the task that **ERIC** and MDA had to complete. For those of you who are familiar with the workings of the NHS, you are likely to be already acquainted with **ERIC**.

For those of you who do not know, **ERIC** is not a person but a methodology and **ERIC** is just one of many acronyms to be found within the health service and the construction industry.

The NHS estate is one of the largest and most complex estates in Europe, with buildings that range from the latest healthcare facilities, designed especially to meet the demands of modern and future healthcare, to hospitals that were established before Florence Nightingale. It currently comprises 25 million m^2 of occupied floor area and has a value of £36 billion for buildings and equipment.

To maximise efficiency in data collection, the EFM information system (Estates and Facilities Management) was developed.

The EFM information system contains data on many different returns, that each Trust has to complete and ranges from Estates Information Returns, Fires, Defects and PFI units to Cleanliness in Hospitals, Food and Privacy & Dignity Issues.

The system is made up of a number of modules, **ERIC** being just one of them.

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AN INTRODUCTION TO 'ERIC' Cont'd

So, what exactly is **ERIC?** This is the main central data collection for the NHS and this information is used for supporting policy development and strategic investment planning in the Department of Health for the NHS estate. **ERIC** data is also used by other organisations such as the Healthcare Commission and National Audit Office.

Enough of the background, what did we actually have to do?

The ERIC definition of the Heated Volume is:
Total Occupied Internal Floor Area
(where the internal floor area is the overall internal floor area within the perimeter of the external walls)
X
the height between the floor surface and the room ceiling
-
floor area covered by internal walls and partitions (taken as 6%)

Heated volume should also exclude unheated spaces such as plant rooms, boiler houses, ceiling voids, pipe ducts, covered ways etc. The void above false ceilings should only be taken into account if the space is heated i.e. if it is not insulated.

The volumes we calculated for what is essentially a single building spread over seven levels were as follows:-

Gross Overall Volume **591,308m^3**

Heated Volume **496,220m^3**

The overall volume clearly indicates that the building is of a significant size, but the following less obvious values may also be of interest:

Volume within window reveals included within the Heated Volume = **5668m^3**

Volume of the Atrium included within the Heated Volume = **81,162m^3**

Based on the calculated Heated Volume, the allowance for total energy consumption is likely to be in the order of 55,000,000 kWh/annum.

Apparently another guy called **PEAT** is also used, but he is part of the **Patient Environment Assessment Team.**

MARTIN TAYLOR

mtaylor@mdaconsulting.co.uk

PROJECT UPDATE – G-LIVE ENTERTAINMENT VENUE: "OFFICIALLY OPEN"

MDA is proud to be associated with Guildford Borough Council's new state of the art theatre and entertainment venue. MDA provided Project Management, Cost Management and Quality Audit services on this flagship project, which was delivered to the Council below budget and on time. The building, (renamed G-Live), now forms an iconic landmark in Guildford and has capacity to accommodate 1,000 people seated or 1,700 if customers are offered a combination of seated and standing tickets.

MDA's Project Director Martin Taylor told **Briefing:**

"This is a fantastic building. The success of the project was due to the whole project team and the Council positively engaging in a collaborative manner."

MDA was responsible for administering and controlling the Council's development budget, which included fee approvals, the main construction contract, furniture provision, I.T. infrastructure and computer provision, Section 106 and signage works.

Martin Taylor commented that, *"Challenges included working on a restricted town centre site adjacent to another building site. Communication with project stakeholders was key to the projects' success, so local businesses and residents were invited to open days and Saturday morning visits. This ensured regular first hand communication to these stakeholders in addition to the theatre operator, so that all parties were kept fully informed of the projects' progress during the project".*

MDA's overarching role was to ensure that the works were coordinated, controlled and to the highest quality standards. Any change order requests were reviewed and their implications established before they were considered for incorporation and a "live" risk register was used to mitigate project risks on a progressive basis.

The main construction works were completed on time, on 1st July 2011 following which, the furniture, fixtures and equipment were installed and staff training commenced.

MDA was proud to attend the grand opening, which was a 'Gala Evening' hosted by the London Symphony Orchestra on 24th September 2011.

ANY OTHER BUSINESS

MATTHEW FLETCHER
BIM MANAGER

mfletcher@mdaconsulting.co.uk

INTRODUCING OUR BIM MAN

Matthew is leading the integration of "Building Information Modeling" (BIM), and its processes and procedures into MDA for all our clients' benefits.

What is BIM?

BIM is the process of generating and managing data derived from the building, during its life cycle. Typically BIM uses three-dimensional, real-time, dynamic building modeling software to increase productivity in the design and construction stages.

Introduction

BIM covers geometry, spatial relationships, light analysis, geographic information, quantities and properties of building components. BIM data can be used to illustrate the entire building life cycle, from feasibility to the end of the buildings' life; quantities and properties of materials can be extracted and the scope of works can be easily defined. Furthermore systems, assemblies and sequences can be shown in a relative scale to each other and relative to the entire project.

How does BIM work?

A BIM system can, of course, produce drawings but these are no longer based on lines, shapes and text boxes but on data sets that describe objects virtually, in the same way that they will be handled physically. However, the real difference is in the true interoperability and the capability for proper integration, allowing the inputs of the various professionals and specialist to come together in the Building Information Model.

Please do not hesitate to contact Matthew for further details or to find out more.

BRIEFING PRODUCTION TEAM

Steve Banks
Maria Billings
Robert Kennedy
Helen Richards-Carpenter

Thank you from **Briefing** to all our article authors and contributors

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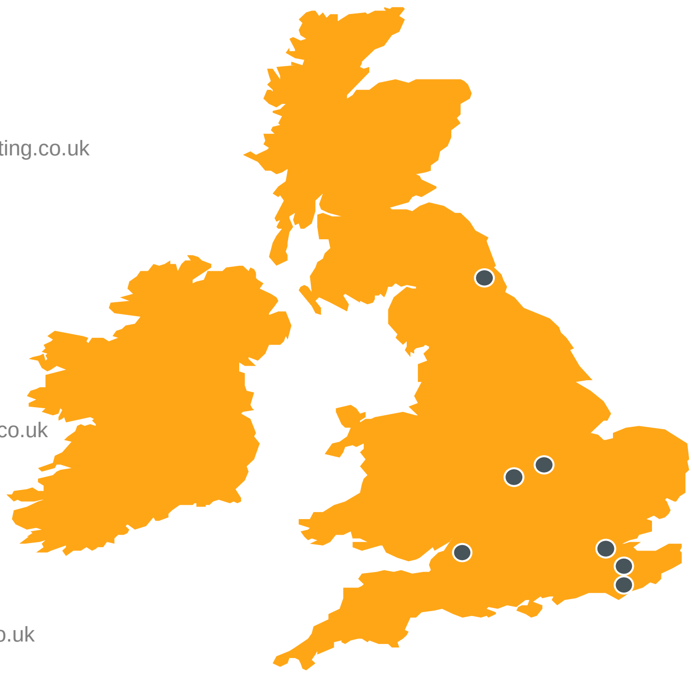
OFFICE LOCATIONS – UNITED KINGDOM

BIRMINGHAM
12 St Paul's Square
Birmingham B3 1RB
T: 0121 233 3839
F: 0121 233 3841
E: birmingham@mdaconsulting.co.uk
Contact: Rob Kennedy

BRIGHTON
7 Hove Manor Parade
Hove Street
Hove
East Sussex
BN3 2DF
M: 07921 058 196
F: 020 8681 8275
E: mtaylor@mdaconsulting.co.uk
Contact: Martin Taylor

BRISTOL
11-12 Queen Square
Bristol BS1 4NT
T: 0117 929 2641
F: 0117 929 2125
E: bristol@mdaconsulting.co.uk
Contact: Kevin Heaton

CROYDON
Philip House
6 Lansdowne Road
Croydon CR0 2BX
T: 020 8686 5566
F: 020 8688 2879
E: croydon@mdaconsulting.co.uk
Contact: Keith Bowler



LEICESTER
No 1 Museum Square
Leicester LE1 6UF
T: 0116 254 8951
F: 0116 254 7676
E: leicester@mdaconsulting.co.uk
Contact: Rob McGuinn

LONDON
17 Grosvenor Hill
Mayfair,
London
W1K 3QB
T: 020 7399 0888
F: 020 7399 0889
E: london@mdaconsulting.co.uk
Contact: Steve Jones

NEWCASTLE-UPON-TYNE
5-13 The Side
The Quayside
Newcastle upon Tyne NE1 3JE
T: 0191 232 0888
F: 0191 232 0919
E: newcastle@mdaconsulting.co.uk
Contact: Maurice Low

OFFICE LOCATIONS - INTERNATIONAL

MDA OMAN
MONK DUNSTONE ASSOCIATES
(Muscat) LLC
Building 6829
Way 1595
Medinat al Ilam
Muscat
Sultanate of Oman
GSM: +0968 9737 6915
M: +44 7803 288 054
E: mjewell@mdaconsulting.co.uk
Contact: Mike Jewell

MDA CZECH REPUBLIC
MDA PRAHA s.r.o
Vinohradská 22
120 00 Praha 2
Czech Republic
T: +420 2 4248 6780
E: jhrubes@mdapraha.cz
Contact: Jan Hrubes

MDA TURKS AND CAICOS
MDA CONSULTING (TCI) LTD
Richmond House
Leeward Highway
PO Box 127
Providenciales
Turks & Caicos Islands
British West Indies
M: +44 (0)7803 288 055
E: jcollinge@mdaconsulting.co.uk
Contact: John Collinge