CONSTRUCTION EMPLOYERS FEDERATION

Submission to the Department of Finance on the draft 2021/22 Northern Ireland Executive Budget, February 2021

Introduction

The Construction Employers Federation (CEF) is the certified representative body for the construction industry which employs c30,000 staff in Northern Ireland. The organisation has over 800 member companies ranging from micro businesses employing a handful of people to the largest construction companies in Northern Ireland.

In total, CEF member companies account for over 70% of construction output in Northern Ireland.

This paper supplements the comments made in a meeting with Department of Finance officials on 2nd February.

Comments on draft 2021/22 Northern Ireland Executive Budget

The construction market in 2021

- In January, the Federation published its State of Trade Survey covering the second half of 2020. Summary headlines of this included:

- ***A game of two halves with two-thirds of turnover completed in H2 - that is twice the activity in H2 than H1 and was due to the lifting of restrictions on construction work.***
- ***On average, turnover was still down 20-25% on 2019.***
- ***The number of firms reporting a deterioration in profit margins outnumbered those reporting an improvement by more than eleven to one.***
- ***Over half of firms are operating at full or almost full capacity (53%) while the remainder (46/47%) are operating at ¾ capacity or less.***
- ***Encouragingly the vast majority - 82% - of firms expect furloughed staff to be retained.***
- ***Cost inflation has led to rapid input costs rises with 64% of responders seeing increases in labour costs, 95% in material costs and 67% in plant costs.***
- ***79% have experienced delays in supply chains as a result of Covid-19 and Brexit.***
- ***35% have seen the delays in supply chains severely disrupt their business while 35% haven't but expect it to in due course.***
- ***Prospects for the year ahead - Almost 3 x as many firms (43%) see reduced opportunities in the public sector than those who expect increased opportunities. Even more stark for NI commercial opportunities with two-thirds expecting these to fall in the next year while 4% foresee increases. On commercial opportunities in GB market, 17% see these reducing with 17% expecting increases.***

Tendering in the current market

- Within this context, a conventional capital budget of £1.75bn (a substantial uplift from 20/21) is to be welcomed.
- It is however worth noting that this is the first time that the Northern Ireland Executive's capital budget has been above £1.7bn since 2007/08 and, in the context of construction inflation alone in the intervening 14 years, means that the Executive's 'bang for its buck' is significantly reduced in comparative terms.
- With a challenging commercial market into this year, and likely next, there will undoubtedly be more competition for public works.

- While this, in many ways, should be seen as a good thing – it must be acknowledged that this is occurring at a time when a significant number of public sector works are being procured as 'price only'.
- The absence of 'quality' with respect to tender scoring has the capacity to drive the market down to unsustainably low pricing and, when you add this to the downturn in the commercial market, creates something of a perfect storm.
- That storm is exacerbated by the early year impacts on materials supply and pricing.
- While well publicised issues on matters like steel imports will, likely, begin to resolve themselves on the supply side – where the price will settle is, at this stage, harder to gauge.
- That, alone, puts massive pressure on contractors now to price appropriately for both one off projects and, more alarmingly, longer term arrangements such as measured term contracts.
- In the wake of the UK's EU membership Referendum in 2016, a number of Government Clients faced months of pressure in getting projects awarded and on the ground due to the understandable inability of contractors to stand over prices that had been submitted pre-Referendum.
- Our concern is that a similar situation is now coming to pass and this, without flexibility on the part of Clients, may lead to challenges with respect to getting contracts awarded in a timely manner – and in a manner that aligns with detailed draft Budget plans once available.

<u>Detailed spending breakdowns</u>

- With the exception of the high-level spending allocations to each Department, and some sporadic detail on specific projects, there is little information at present on how capital budgets will be spent by each Department.
- While we fully appreciate that the draft Budget was only published on 18th January, we have been surprised by some Clients suggesting that even indicative figures won't be published until April or perhaps May.
- This process needs to be expedited or else we risk, for yet another financial year, real challenges in getting our capital budget spent in the most productive way while, for our members, it creates uncertainty over the next two months with respect to what projects they price as they come to tender.
- We do, of course, acknowledge that a significant element of the 21/22 capital spend is already contractually, or otherwise, committed.

<u>RRI borrowing</u>

- Our sector strongly welcomes the use of this funding mechanism – particularly as it is one stream of funding where construction has to be its premier output (historically, our estimate is that, in any one financial year, the actual quantum of the capital budget that gets spent on construction is around 60%).
- It is also significant that the Executive has earmarked this funding for two areas which are in drastic need – Northern Ireland Water and new build social housing.
- With respect to social housing, moving to 1,900 new starts in 21/22 is a major statement of intent and one that our industry will look to actively support. We would however caution that one (new build social housing) is increasingly dependent on the other (wastewater treatment works capacity issues) so we hope this figure has been settled on in a strategic manner.

- On the matter of Northern Ireland Water, our members are already part of a suite of contractors which will deliver a large element of the PC21 programme.
- Given, however, the scale of the works required in PC21, it is important that there is early understanding of how much money will be allocated to Northern Ireland Water in 21/22.
- £70m of RRI borrowing is a good start but, by our estimate, this would need to be at least trebled (and likely quadrupled in the years thereafter) to ensure PC21 is delivered.
- Even with these growing allocations, we remain of the view that Northern Ireland Water's governance and funding challenges must be urgently reassessed. There is little sense in, given the context of one-year Budget's, having a surge in capital next year and follow this with a downturn in 22/23.
- With the discussion having begun with respect to the long-term governance and funding requirements of the Northern Ireland Housing Executive, we believe it foolish not to at least begin the discussion with respect to Northern Ireland Water.
- On the matter of NIHE reform, however, it is of concern that no funding has been allocated against taking this forward in 21/22 with a bid of over £3m for transformation not being funded to date. It is important that the Department for Communities now addresses what, if anything, it will take forward with the proposed transformation programme ahead of next year's Assembly election.

<u>Executive Flagships</u>

- We welcome the further allocations to the Flagship projects.
- These will ensure their forward progression and, in the case of a large bulk of the A6 works, their completion during 21/22.
- We do however reassert that, looking to the formation of a new Executive after next year's election, caution needs to be exercised with regard to the conditions for naming a project a 'Flagship'.
- The ring-fencing that has been applied to these projects over the last five years has worked in scenarios where the projects are actually at, or close to, their construction stage.
- While projects like Phase 1a of the A5 and the redevelopment of Casement Park are important and must be speedily delivered, we have seen monies returned against each in the January Monitoring Round because neither has entered construction in this financial year.
- These hold-ups are, in large part, not the fault of Ministers – but we should exercise a degree of caution with respect to naming 'Flagships', and the financial considerations that come with these.
- Indeed, in the 21/22 financial year, we do believe there remains a level of question around the £20m that has been set aside for Casement Park.
- While it would be fair to assume that construction will commence in the coming year, there are caveats to this: the planning process is yet to be fully completed and a new business case is yet to be agreed and submitted for approval.
- It is also crucial to say that, just as was the case with the Strule Shared Education Campus or Belfast Streets Ahead Phase 3, if contractors believe there is any level of budget uncertainty with respect to a project, then this will raise questions.
- We do not have a view on who/how the totality of the project should be funded – but we do have a very strong view, given what has gone before, on the need for this question to be urgently cleared up.

Strule Shared Education Campus

- After three years of financial uncertainty with respect to the project, it is very welcome to see its funding now ring-fenced (in the truest sense of the phrase) as a key deliverable of the £500m over ten years shared education element of the Fresh Start Agreement.
- With £28m of this set aside for 21/22, we look forward to the project returning to the procurement market in the short-term.
- We do however retain our long-held view that, in concert with strategic approaches contained in The Construction Playbook, that this is the type of project (a campus with five separate schools) which must be considered for being let in lots.
- We retain the view that, had a version of this model been taken forward in 2017/18 when the project was last in procurement, it would now be nearing its completion.
- On this basis, we look forward to engaging with the Department of Education, Strategic Investment Board and Construction & Procurement Delivery on the pre-market engagement that is forthcoming.

Financial Transactions Capital

- This has proved a hugely challenging pot of funding to allocate and deliver throughout its decade-long existence.
- While the creation of the Northern Ireland Investment Fund gave a vehicle to deliver some of the spend, that figure has not exceeded a totality of £100m during the Fund's operation to date.
- It is therefore welcome that, before the commencement of the new financial year, the 21/22 allocation has been assigned and we can see a path towards it being spent.
- Within this, it is vital to recognise the crucial importance of Co-Ownership Housing.
- This has been, in a substantive sense, the only truly effective way that FTC monies have been spent over the last 10 years.
- Building on their many years of growth prior to the funding becoming available, they have significantly grown their offering in the last decade and it is, in the context of many local councils focusing on affordable housing as part of their Local Development Plans, absolutely critical that this funding continues at 21/22 levels, at least, for many years ahead.

City Deals

- We welcome the allocations that have been made in the draft Budget towards some of the capital projects that have been outlined in the various City Deals.
- Is though important that additional allocations are signed off the Secretary of State in short order so to ensure these projects proceed with the budget certainty that is needed throughout their medium-term delivery timescales.

Beyond 2021/22

- The Federation concurs with the Finance Minister's position with respect to getting additional fiscal flexibility with respect to our capital budget – specifically end-year carryover.
- We also acknowledge that the Executive wasn't able, as had been the plan, to set a multi-year Budget due to the one-year Comprehensive Spending Review.

- Multi-year budgets must remain the medium-term goal given their undoubted benefits with respect to areas like planning out new build social housing projects and the efficiency of the road maintenance budget.
- At this stage, and given that the next Westminster election is still three years away, we would anticipate a further CSR by the UK Government this year.
- While this may give the Executive financial certainty (or a least a financial 'floor') for 22/23 onwards, it would be good to know what the Executive's intentions would be with respect to such figures as they enter an election period.
- The CEF is also supportive of proposals relating to the establishment of an independent Fiscal Council and an independent Infrastructure Commission.