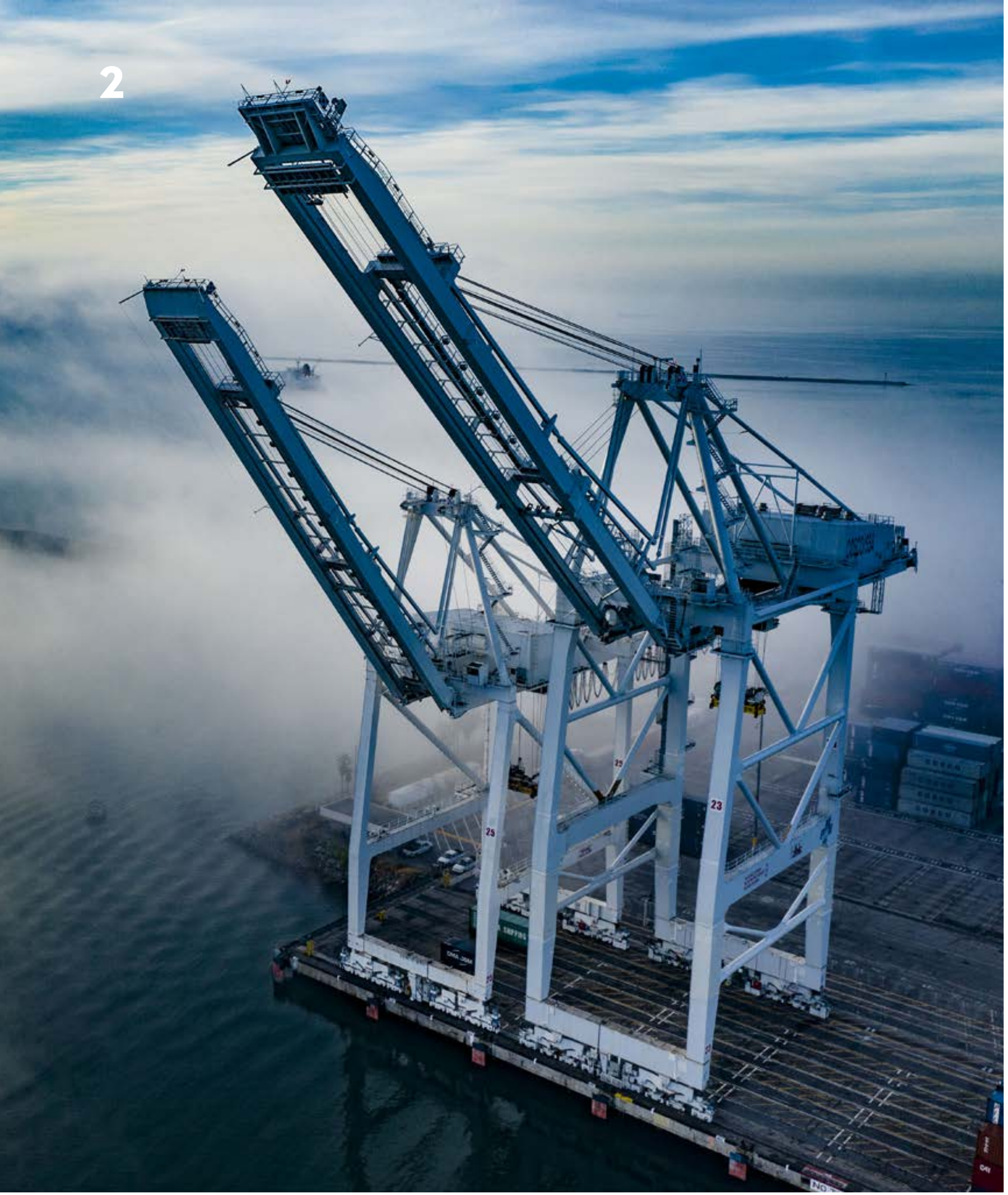
Marsh

# Brexit one year on: What has been the effect on UK construction?

How has Brexit affected contractors since the UK left the EU's single market and customs union?



# Brexit one year on

Construction bosses will have breathed a sigh of relief at the eleventh hour signing of the Trade Cooperation Agreement (TCA) between the UK and the EU. The Agreement, announced just days before the UK's 31 December 2020 departure from the EU, guaranteed tariff- and quota-free trade between the two parties.

Despite the avoidance of a much-feared "hard Brexit", difficulties for UK contractors were predicted, especially as the country was in the grip of the global COVID-19 outbreak. The pandemic caused site shutdowns in its early days, in spring 2020, and contributed to other challenges such as worker and materials shortages throughout 2020 and 2021.

## Issues for construction companies in the UK

Marsh commissioned research to discover the extent of the effect that Brexit has had on UK construction in the run up to the withdrawal from the EU, and during the subsequent months. This has led to the conclusion that, while there is no doubt Brexit has presented a multi-faceted challenge to construction firms and been the key driver in some instances, it has proved harder to quantify the extent it has played in other issues, due to the disruption caused by COVID-19.

## Materials price increases and availability

The UK is a net importer of materials, with roughly 60% of imported materials used in construction projects coming from the EU. The surge in demand, triggered by the COVID-19 recovery stimulus plans, exerted continuous pressure on supply chains to deliver products.

Although there are no tariffs on the movement of goods between the UK and EU under the TCA, suppliers have to meet relevant rules of origin for their products. Additional border checks and "red tape" have increased lead times and administrative costs.

Further layers of complexity have arisen through the imposition of VAT on imports and exports, and the need for importers and exporters to have an Economic Operators Registration and Identification (EORI) number for both customers and VAT documentation (and sometimes more than one, depending on where they import and export to). The Construction Services Domestic Reverse Charge (CSDRC) rules for VAT, which came into force on 1 March 2021, have also increased the administrative burden.

Congestion at UK ports, caused by the national shortage of haulage drivers (exacerbated by a Brexit-related exodus of workers), has caused serious delays, increasing prices as construction firms compete for dwindling resources.

In October 2021, Construction News reported that materials costs had surged by 23% in a year, with product prices going up exponentially. Imported sawn or planed wood cost 74% more than in August 2020, and fabricated stainless steel prices jumped by 74.8% during the same period.

In November 2021, the increases in construction materials cost were at their highest levels in 40 years, reported RICS. The Institution forecasts an increase of 10% in material prices going into 2022, along with an increase in tender prices in the range of 5% to 6%.

## IN THE LAST YEAR

**23%**

Materials costs have surged by 23% in a year.

**74%**

Imported sawn or planed wood cost 74% more than in August 2020.

**74.8%**

Fabricated stainless steel prices jumped by 74.8% in the same period.

*Source: Construction News*


## Workforce constraints

There is no doubt that Brexit has contributed to the UK's ongoing skills shortage. In 2018, approximately 7% of workers in the UK construction industry were non-UK citizens from EU countries.

The number of EU-born workers in the UK construction industry had dropped by more than a quarter in the 12 months from Q3 2019, down to 127,000, from 176,000 in Q3 2020.

Under the UK's new points-based immigration system, contractors have been able to sponsor European nationals classed as skilled workers in order to allow them to stay in the country, whereas unskilled workers do not qualify. Our research found that, by October 2021, just 654 construction companies were licensed to sponsor overseas workers. While contractors have been able to continue to draw from the talent pool of European skilled labour, they have found the sponsoring process time-consuming and cumbersome, with the defining of skilled labour presenting a hurdle. Contractors have found that sourcing unskilled labour has also become more expensive since the withdrawal from the EU.

Brexit has also exacerbated the UK's continuing issues arising from an aging workforce. It is anticipated that roughly 500,000 UK-born construction workers could retire in the next 10 to 15 years. Coupled with the exit of EU-based workers from the country, this could put a significant strain on the number of general workers and specialist tradespeople available to the economy.

To illustrate, a 2021 migration and construction report, published by the Construction Industry Training Board (CITB) warned that recruitment agencies believe the UK's new, points-based immigration system will lead to a 40% decline in the number of skilled construction workers coming to the UK. The report also forecast a drop of 58% in the number of low skilled construction workers working in the UK.

**500,000**

Approximately 500,000 UK-born construction workers could retire in the next 10 to 15 years.

## Subcontractor default

In 2019, before the COVID-19 pandemic, construction had the highest insolvency rates of any sector within the UK. This trend was arrested in 2020 with the Government support measures announced during the pandemic. The furlough scheme was in effect from March 2020 to September 2021, helping to keep businesses afloat when COVID-19 restrictions closed sites and reduced productivity levels.

However, in January 2022, the FT reported that hundreds of UK construction firms were going bust every month due to the rise in materials prices, and the Brexit-related reduction in the number of skilled workers available, which had helped contribute to wage inflation of about 6%. It reported Insolvency Service data showing more than 260 businesses a month collapsed in the three months to October 2021 — the largest number since before the pandemic, and a 29% rise on the previous period. Labour shortages had delayed construction projects, it added, giving clients the opportunity to demand compensation from builders, potentially threatening their solvency.

> **“Hundreds of UK construction firms were going bust every month due to the rise in materials prices.**

## HOW TO PROTECT AGAINST SUBCONTRACTOR DEFAULT

In the UK, contractors generally request surety bonds (performance, advance payment, retention, and so on) from their subcontractors. A surety bond is an agreement between three parties: the contractor, subcontractor and surety provider, with the performance of the subcontractor guaranteed by the surety.

Subcontractor default insurance (SDI) had been another option, but is not now generally available in the UK. SDI is an agreement between a contractor and insurer that offers coverage for economic losses incurred by a general contractor or construction manager, caused by a default in the performance of their subcontractor. This includes both direct and indirect costs. Coverage is on a project enrolment basis and is non-admitted. Companies concerned about the issue of subcontractor default should discuss the most appropriate response with their construction insurance broker.

## Construction project delays

Since March 2020, the COVID-19 pandemic has been a major cause of delays and disruptions on construction projects in the UK. The UK Government allowed construction projects to continue during the lockdown periods, but many active sites shut down either partially or completely due to COVID-19 measures. This presented significant challenges to employers, contractors and the supply chain in fulfilling obligations while ensuring compliance. Some 85.5% of the large pre- and mid-pandemic construction projects have suffered delays. Nearly 60% of projects were delayed by at least two months; nearly 23% by more than 250 days, and 13% for more than a year.

While COVID-19 has been a key point of focus, Brexit has also played a significant part in site delays. As already highlighted, the construction industry has been experiencing an outflow of EU-born skilled workers since the announcement of Brexit in 2016. With the uptick in demand, post-pandemic, larger contractors have taken workers from the shrinking labour pool. This has made it difficult for small and medium-sized firms to obtain skilled employees, leading to capacity erosion.

Additional paperwork required under the terms of the TCA has also slowed deliveries to UK sites, as European suppliers choose to service companies in mainland Europe before taking on the additional administration involved in exporting to the UK.

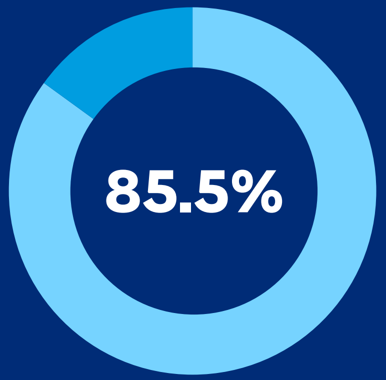
Delays could also arise in the near future through the post-Brexit certification system, which requires the testing of construction products for a switch to the new UK Conformity Assessed (UKCA) mark on 1 January 2023. Under the new system, testing must be conducted in the UK, which has a limited or non-existent testing capacity for several products, including glass, radiators, and sealants. This means the Government will have to set up centres to recruit and train staff to conduct the tests, ready for 2023.

The Construction Leadership Council (CLC) has warned that construction of more than 150,000 homes may be delayed due to the slow process of certification of materials. It has also said that the current 12-month time period allowed for making a switch to the new marking system is insufficient for the UK's testing capacity expansion. Anecdotally, contractors have reported to Marsh that materials shortages were more likely than staff shortfalls to cause site delays.

**150,000**

More than 150,000 homes may be delayed due to the slow process of certification of materials.

## PROJECT DELAYS




Some 85.5% of the large pre- and mid-pandemic construction projects have suffered delays.

> **Smaller or very centrally-organised companies tend to be more impacted by Brexit.**

## Issues specific to overseas contractors operating in the UK

Unsurprisingly, restrictions on people movement and labour have been felt by all contractors, whether UK firms working on UK projects or European contractors wanting to maximise opportunities in the UK and needing to find staff. Supply chain chokepoints and subsequent materials shortages have also been an issue globally.

Establishing UK entities has been of relevance here. Many European contractors bidding on projects will be in joint ventures with UK contractors, and they will have had to set up local entities. The restriction on free movement of people has also been a driver to set up companies in the UK where UK staff need to be recruited.

However, large companies with significant activity already had an established operation in the UK. What Marsh has seen is that the smaller or very centrally organised companies tend to be more impacted by Brexit, and have had to think hard about their post-Brexit company structure.

The insurance headquarters for major European contractors is usually within their European headquartered country. Increasingly, annual programmes and insurer relationships have been complicated, given that EEA insurance requirements now exist. Often, authority for insurance needs to move to the UK for some of the European contractors working on UK projects.

Despite increased Brexit-related pressures, Marsh's experience is that European contractors continue to remain very active in the UK, largely due to project opportunities, such as HS2.

## Construction insurance challenges for companies operating in the UK

One of the difficulties for construction companies is that seamless programmes for the EEA have been broken down and separate structures put in place for EEA and UK risks.

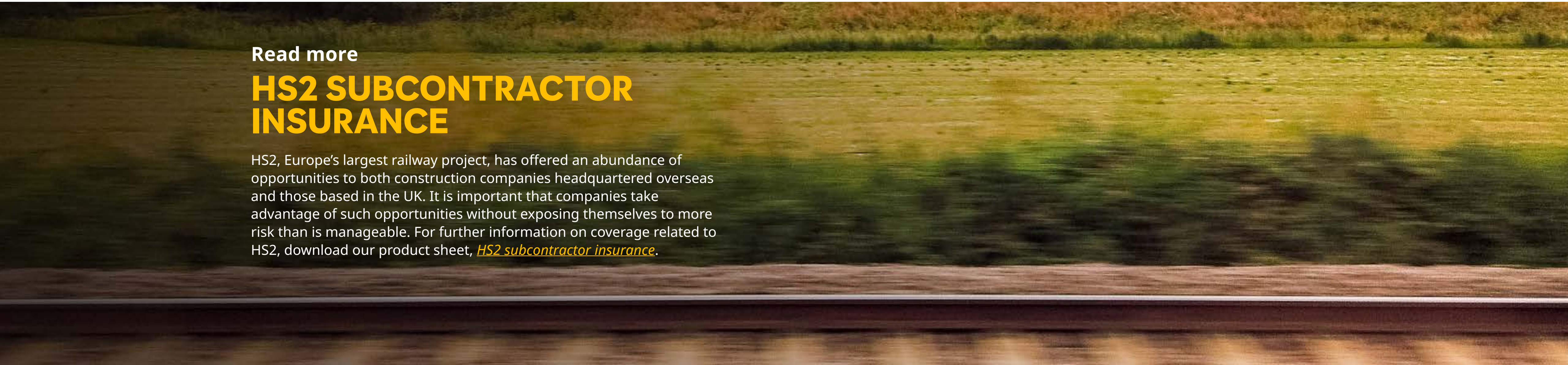
Companies now have to arrange separate programmes or ensure their insurers can write both UK and European risks, which has made the process more cumbersome and expensive. The added complexity compounds the already-challenging construction insurance market.

It also affects the pool of available insurers, as they must be able to underwrite risks in the UK and the EEA.

As there are now two different types of forms to review, construction companies have to ensure that both sets of forms cover all the risks, which increases exposure and creates additional cost.

The regulatory environment in which contractors are buying insurance is also being affected. Indeed, the Lloyd’s insurance market changed its structure and platform due to new regulations. Rules are expected to continue evolving, and it is expected that the regulatory environment will become more challenging.

> **“Lloyd’s insurance market changed its structure and platform due to new regulations.**



**Read more**

## HS2 SUBCONTRACTOR INSURANCE

HS2, Europe’s largest railway project, has offered an abundance of opportunities to both construction companies headquartered overseas and those based in the UK. It is important that companies take advantage of such opportunities without exposing themselves to more risk than is manageable. For further information on coverage related to HS2, download our product sheet, *HS2 subcontractor insurance*.

**“It has been predicted that shortages of timber, steel, and electrical components could continue throughout 2022.**

## How Brexit is going to affect construction in 2022

Professor Noble Francis, economics director of the Construction Products Association, has reported that while large firms experienced initial disruption with importing goods and materials during 2021, they had largely developed processes to deal with choke points, and log jams. It is important to note, however, it has been predicted that shortages of timber, steel, and electrical components could continue throughout 2022.

Professor Francis added that smaller firms were continuing to report some difficulties and initial costs importing into the UK. Additionally, he reported that the larger trade issues being experienced by firms appeared to be in respect of exporting construction products to the EU. He commented that exports fell by half during Q1 of 2021, and exports in Q2 were 38.7% lower than during the same quarter two years earlier. The greater impact on UK exports to the EU, compared with UK imports from the EU, is partly due to the increased administration and cost associated with exporting to the EU, which has implemented full checks on goods.

Speaking in The Guardian, Jan Crosby, the head of infrastructure, building, and construction at accountancy firm KPMG, said that along with disruptive weather, any tightening of restrictions due to COVID-19 and its variants, will probably result in project delays and site closures in 2022.

He added that the impact of the Omicron variant, along with supply chain issues and skills shortages, will continue to create uncertainty in the months ahead. He said the sector has shown resilience during the past two years, and will need to keep doing so throughout 2022.

## Liaise with a construction insurance broker

While it is easy to attribute most of the difficulties suffered by construction firms to Brexit, combined with the COVID-19 pandemic, many other circumstances have come into play. During late 2020 and throughout 2021, UK Government stimulus spending added to the challenges suffered by contractors as pent up demand exacerbated materials shortages, and price increases caused by global macroeconomic factors.

In order to keep up with often fast-moving events, it is important to work collaboratively with a construction insurance broker. They will have the experience to help construction companies make appropriate mitigation for risks related to Brexit, COVID-19, and other events in the future.

Marsh

## About Marsh

Marsh is one of the world's leading insurance broker and risk advisor. With around 40,000 colleagues operating in more than 130 countries, Marsh serves commercial and individual clients with data-driven risk solutions and advisory services.

Marsh Specialty is our specialist division, committed to delivering consulting, placement, account management and claims solutions to clients who require specialist advice and support. Our local specialists work seamlessly with global experts, considering problems from every angle and challenging the status quo with entrepreneurial ideas and solutions. The service offering is enhanced with insight-driven advice supported by tailored data, analytic and consultancy capabilities to support clients in making important decisions about complex risks.

Marsh is a business of Marsh McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people.