Rider Levett Bucknall

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Property & Construction Roundtable Series

Funding, Planning and Contracting

Property & Construction

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Introduction

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The construction sector has, historically, been an early indicator in the barometer of economic recovery. However, will this indicator's acceleration be limited due to longer than expected development times? What are the constraints that are holding back the industry and what can it do to escape them?

Funding remains an issue, particularly early in the development cycle. Traditional lenders are still risk averse and alternative lenders have yet to get a handle on the complexities of construction finance – if they ever will. Developers need to look beyond loan finance to other sources of funding, and get to grips with the ever changing landscape of tax incentives and grants.

Planning remains the final obstacle – a reduction in planning resources has been accompanied by a multiplicity of stakeholder interests to satisfy. The industry needs to support and engage with local authority initiatives which bring together parties in a collaborative way to create consistency and confidence.

Developers and contractors need to work on their relationship – too often they sit on opposite sides of the fence, divided by disputes over price. A shared approach to risk and a much deeper collaboration from the start of projects is the route to profitability. As the skills shortage bites, the firms with the strongest supply chain relationships will gain the competitive edge.

These three areas were the discussion points at a recent roundtable event, attended by industry leaders. These areas have been expanded upon in this paper, from the attendees viewpoint. This event was attended by representatives from the following companies: AFL Architects, Built Environment Skills in Schools, Clugston, Colmore Tang, D-Drill, Deeley Group, DWF, Gensler, Jessup Brothers, Mace Group, Success Train, WSP, Shaylor Group, Marketing Birmingham and Turley Associates.

Funding

Despite the longevity of the recovery, traditional funding for construction can be hard to come by. It is particularly difficult to find funding for speculative projects, or land purchase. However, it can become much easier to attract debt later in the lifecycle of a development when some of the risk has been removed, and particularly when income can be identified and guaranteed.

Alternative sources of funding, such as peer-to-peer lending and crowd funding have recently gained a lot of publicity, but they have been slow to show much interest in construction or grasp the complexities of subcontractor payments.

Developers may therefore need to look beyond debt finance to other sources of funding such as grants and tax reliefs which offer numerous possibilities for construction.

Grant funding is available for projects at the regional, national and European level but these funds are not widely known and need to be sought out. Grants continually appear and disappear and it is difficult to keep abreast of this changing landscape. For example, Innovate UK (formerly the Technology Strategy Board) recently made available £2 million to encourage the creation of more integrated, collaborative supply chains in the construction industry.

Current areas being grant funded include intelligent buildings and new materials such as fibre reinforced polymers. Sources of grant funding include the Regional Growth Fund, European Structural Investment Funds, and projects such as Horizon 2020 or the Eureka Project.

Initially the paperwork and effort to attract even small amounts of grant funding seems daunting. But although grants initially take a lot of time and effort, there seems to be a lot of communication between grant providers. Once one grant has been given, other providers may proactively approach you and much of the paperwork can be reused.

Another form of alternative funding is to look at incentives in the tax system. The business premises renovation allowance offers generous tax rebates, and can be the key to unlocking bank finance (albeit often at steep interest rates).

One area that is almost completely overlooked by the construction industry is research and development (R&D) tax credits, yet contractors and developers do many innovative and novel things as a matter of course over the life of a project which typically

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qualifies for R&D tax relief. If a business employs engineers or designers working on risky or complex projects, then it is likely there will be some R&D and could consequently benefit from the relief.

Areas highlighted that could benefit from R&D included:

- projects that use renewable or new materials;
- lower carbon emissions, greener, sustainability;
- complex designs;
- working in hazardous environments or confined spaces;
- projects that require minimal disruption to surrounding services such as hospitals, schools, airports or train stations.

The benefit of claiming R&D tax credits is that it gives over a quarter cash benefit back from qualifying spend, for example, for £100,00 qualifying R&D spend for an SME company, a claimant can potentially recover £26,000 of tax savings/cash back from HMRC.

From left to right – Paul Fenner (Moore Stephens LLP), Nigel Mason (RLB) and Mike Best (Turley Associates)

Paul Fenner, Moore Stephens LLP

Andy Robinson, Colmore Tang

Julie White, D-Drill

Planning issues

There is a widespread perception that, even with funding in place and sites acquired, planning is the major obstacle to development. Local authorities are seen as a bottleneck or even as actively trying to block development.

Certainly there are contradictions in the system: a high level focus on economic development and growth sits uneasily with a real push for local decision making and consultation with local people. The shift back to 'localism' needs embracing, and there needs to be more consistency in the system. There are increasing numbers of stakeholders to satisfy and interpretations of apparently simple concepts such as 'viability' can vary considerably.

There are signs of progress however: in one area planners have brought together local authority planning departments, investors and developers to create a roadmap which will create consistency and confidence in the planning process.

But not all authorities sign up to such initiatives. There is not only inconsistency between local authorities, but worse still, this can even occur within individual applications. Strain on resources means that having a dedicated planning officer throughout all stages of a development is rare. Handovers between officers, even for holidays or sickness, bring different viewpoints and different subjective judgments at every stage of the journey. With multimillion pound projects at stake it is unacceptable to continually have to redo designs and plans which have already been approved.

A lack of consistency and clearly stated ground rules, coupled with a perception that some planners have a very negative view of developers' motives, combine to undermine confidence and therefore investment.

The only way to counter the subjectivity in the process is communication, engagement and lobbying as many people as possible. The difference positive engagement can make can be seen by comparing different areas. Oxford and Cambridge, for example, would seem to have similar assets, particularly in the knowledge economy. Yet Cambridge seems to have grasped the benefits of joining up public and private enterprise – not putting politics aside but allowing the greater good to override it.

Similarly, the contrast between Birmingham and Manchester has been striking, particularly in the buzz around the 'Northern

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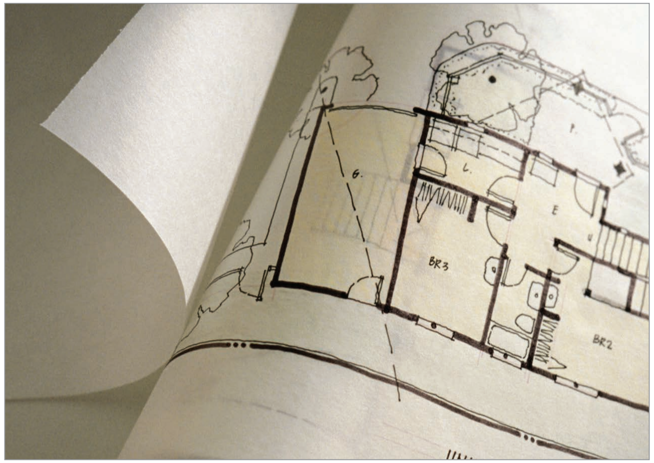

“The difficulty developers face is engaging the ‘silent majority’ who are in favour or indifferent to development against the vocal minorities who attend planning meetings to voice their objections.”

Powerhouse’ compared to Birmingham’s West Midlands Combined Authority. But this is not so much about branding as sorting out the politics, which opens the door to new powers and funding. These issues have been made worse by under-resourced planning departments which have often lost key personnel: the hope is that the Combined Authority will help develop consistency in planning decisions and improve outcomes across the wider region.

These initiatives often boil down to the leadership of one or two individuals at the top, but developers can work from the ground up, building relationships with local communities and anticipating both the stakeholders and the technical assessments that will have to be satisfied later on. Seeking approval from CABE (the Commission for Architecture and the Built Environment) can often give local authorities the confidence to approve schemes.

The difficulty developers face is engaging the ‘silent majority’ who are in favour or indifferent to development against the vocal minorities who attend planning meetings to voice their objections.

On the other hand, even a project which may not have great prospects in planning can radically improve its chances by getting the community behind it. Emphasising the benefits to the community and the new facilities on offer can really make a difference. Even promising to sort out a local highways issue can turn an otherwise unpromising application into a successful development.

Contractors and developers

Disagreements over price can delay projects even when a precontract agreement is in place, which sometimes means the project has to go back to open tender again. Sometimes it is impossible to reach an agreement over price, and this is often about risk: the developer's view of risk may vary significantly from that of the external contractor.

But a shared understanding of risk – and the issues that really affect the bottom line – can begin to take price out of the equation. Rather than seek to transfer risk to each other, both parties should negotiate to share it in pursuit of mutual profitability.

Some developers value their close relationship with their supply chain and nurture it by paying not only well but regularly; it's important to remember that payment terms are almost as important as price in the building industry supply chain. This gives them an edge over the competition when skills are in short supply.

This ability to call on trusted contractors will become even more valuable as the skills gap becomes more acute; the ups and downs of the last 10 years have severely eroded the UK's skills base.

The tendering process is inimical to building trust, and this perhaps reflects the reputational issues which still plague the industry. Open, transparent negotiation is a good way to proceed.

But the skills base is also affecting contractors: the cost assumptions which applied at the beginning of projects 12 months ago are now way out of line, and with margins yet to return to pre-slump levels, it is very hard for contracting firms to absorb the cost. The cost of bidding for tenders – often running into the millions – is rapidly becoming unsustainable.

Yet at the same time contractors are up against the 'man-with-a-van': who puts in a 'suicidal' bid that companies with permanent staff and high overheads simply cannot match.

Sometimes the choice of contractors who can do the work is very limited: choosing the one you have the best relationship with may be a better choice than selecting purely on price. One developer found it necessary to develop its own contracting management business, which is now a leading player in its own right with a five-year pipeline.

If the goal is quality then transparency and an open book relationship with the contractor is essential: this applies not just to costs but the contractors own supply chain. To become a 'Tier One' supplier, quality and delivery are essential, which means being able to guarantee the supply chain. Ultimately a developer is only as good as their supplier and contractor loyalty.

However, trust is very hard to build during a tender process: you can only really trust people you have previously done business with. But this raises another problem: how then do you meet anyone new?

The challenge, particularly in the public sector, is to get clients to focus on quality rather than the 'most economically advantageous tender' which inevitably means the cheapest. Weighted scorecards still favour price, because while quality can never score 100%, the lowest price always will.

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Things are slowly changing: more and more local authorities are going towards a ‘competitive dialogue’ process, where financial bids only come in after it is clear what the client wants. Negotiation becomes more about educating the client about where the value lies.

Clients need to understand that if bids are wildly at variance it is not an opportunity to achieve extreme value for money, but an indication that something has gone badly wrong in the bidding process. That should prompt a clear and honest re-examination of the whole supply chain to ensure that the low price is not associated with unacceptable risks.

The whole industry needs to learn that profit is not a dirty word: tenders and public sector frameworks need to ensure that the supply chain is delivering not only value for money, but a reasonable margin for the supplier. Many subcontractors have grown up with post-recession pricing. It seems unlikely that margins will ever return to pre-2009 levels of 9% or more but remain in the 4-5% range, although with a greater focus on quality and negotiation this could get back to 5-7%.

Early engagement is a clear source of value, although the hurdles of public sector procurement can work against this. Bringing engineers and architects together with subcontractors early on helps them to share knowledge and anticipate problems: this kind of communication can both reduce the cost to the client and boost suppliers’ profits. Currently, the developer and contractor communities are poles apart: yet in the past, greats such as Brunel, openly acknowledged that their success rested on working in close collaboration with contractors from the outset.

Conclusion

The issues that act as a drag on project development are clearly closely interrelated; aversion to risk causes problems with early stage funding, which in turn leads contractors and developers to focus on price rather than outcomes. Inconsistencies and delay in planning impacts on margins and increase risk, which in turn feeds back into difficulties with funding.

There are ways around these problems, but these solutions cannot be found by continuing to act in the same manner. The industry needs to be more open and engaging: seeking alternative sources of funding means not only talking to different people, but viewing one's own activities in a different light. Early engagement, whether with contractors or planners, can prevent problems later on and lead to more successful and profitable projects.

What can the industry do?

- Look beyond traditional funding models and exploit opportunities in the tax and grant system.
- Engage with the supply chain outside the traditional tender process and negotiate for shared risk and joint success.
- Build relationships and loyalty by treating suppliers and customers well.
- Understand that quality and delivery are more important than price.
- Work with initiatives to create greater consistency and better communication in the planning process.
- Reach out to all stakeholders in the planning process and look for opportunities to build alliances and gain local support.

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