

Position Paper

January 2018

The impact of Brexit on the infrastructure industry

Introduction

- The construction and infrastructure industry is of key strategic importance to the UK economy. It is not only a major employer and driver of economic growth in itself: it also sits at the heart of the Government's plans to future-proof and strengthen the economy by implementing the ambitious infrastructure plans set out in the National Infrastructure Pipeline.
 - Construction generates almost £90bn annually – c. 7% of GDP.
 - It employs around 3.1m people, c.10% of UK employment¹.
 - However, it has a skills shortage which is set to worsen. Government figures predict that by 2020², construction will need 250,000 new workers, excluding any Brexit impact.
 - With c.8³-10% of the sector's workforce today comprising EU emigrants, any loss of access to this skills pool will exacerbate the current shortage, compromising delivery of key infrastructure and housing, and driving up wage costs.
- The key areas in which Brexit is impacting the industry are:
 - Skills, due to the large number of EU migrant workers in the sector.
 - Procurement costs linked to the weak pound and the possibility of future tariffs, given a substantial amount of building components and materials are imported.
 - Infrastructure investment to replace funding which currently comes from the European Investment Bank (EIB).
 - Generally, the uncertainty associated with Brexit, its implications for business and the general risk associated with the broader economic effects are likely to impact procurement decisions and UK infrastructure investment.
- With continued coordinated action with Government and across the industry, steps taken to mitigate the impact of Brexit have the potential to strengthen the industry over the long-term. However, reduced government spending, economic uncertainty, and a failure to address short-term skills shortages also have the potential to see the

¹ BEIS

² <http://www.constructionleadershipcouncil.co.uk/news/our-opportunity-the-construction-industry-sector-deal/>

³ RICS, March 2017

construction sector move back into contraction, putting at risk the delivery of large infrastructure projects. This could exacerbate the future skills shortage as a contraction in the industry may result in the sector have less money to invest in training.

- This paper sets out Balfour Beatty's views on steps which could be taken to mitigate any negative impacts on the construction and infrastructure industry, and to enable it to take full advantage of opportunities as they arise.

Skills and productivity

- Research carried out by McKinsey has found that productivity in the construction sector is far lower than the UK average and costing the sector more than £15bn a year⁴. The construction and infrastructure sector is also facing skills shortages across the industry, which are causing wage inflation as companies compete for the best skilled workers.
- Faced with low productivity and a growing skills shortage, the way the industry does business must change. While we must focus on recruiting and retaining more workers into the sector, we must also become more strategic and invest more in new technologies and ways of working.
- Balfour Beatty believes that a strong and resilient construction industry needs a robust domestic skills base. As a British company with a hundred year legacy in the UK, Balfour Beatty is committed to addressing the skills shortages in the UK and investing in home grown talent. However, developing the skills we need to build tomorrow's infrastructure takes time. It can take a decade from starting an apprenticeship or training for someone to gain all the skills they need in specialist areas such as nuclear new build, for example. With various large infrastructure projects in the pipeline, including mega projects such as HS2 and Hinkley Point C, our progress in addressing the skills gap needs to accelerate.
- The Government should also continue to engage with industry regarding the Apprenticeship Levy, which will need to evolve to ensure it is delivering the maximum number of apprentices. Critically, the process by which new standards are developed and approved will need to speed up and be made more responsive to employers' needs, particularly for the construction sector, which urgently needs the apprenticeship standards which have been delayed.
- Furthermore, while it is essential to invest in home grown skills, the increased volumes of workers the industry needs, together with the ageing workforce, mean that it will be challenging to recruit the skilled workers the industry requires to build tomorrow's infrastructure, even if we guarantee the right to stay of existing EU migrants in the industry. The projected need is for over 250,000 construction and over 150,000 engineering construction workers by 2020⁵. If the EU workers in the industry were to leave in the short-to-medium term, this figure would be undeliverably high.

⁴ <http://www.constructionleadershipcouncil.co.uk/news/our-opportunity-the-construction-industry-sector-deal/>

⁵ National Infrastructure Plan for Skills, HMT, September 2015

- For the infrastructure industry, free movement of labour in the EU has allowed us to find the skilled staff we cannot currently find in the UK. Indeed, Royal Institution of Chartered Surveyors (RICS) data shows that 8% of the UK's overall construction workforce is made up of EU nationals and in November 2017:
 - C.10% of the Balfour Beatty workforce hold non-British EU passports. However, only around 2% of our total number of employees come from outside the EU due to the complexity, cost, administrative burden and time delays required in managing the current points based sponsor licence system.
 - Of those recruited in 2017, 91% are British and c.5% hold non-British EU passports.
 - In our supply chain, the proportion of non-British EU workers is even higher.
- Uncertainty around the free movement of labour in the EU is already causing the industry recruitment and staffing difficulties, increasing costs where demand for labour outstrips supply. As the costs of Government-funded construction projects increase taxpayers will carry the burden. We therefore welcome the agreements in principle reached already during the Brexit negotiations regarding the status of Europeans living in the UK⁶. It is important to note however, that in the short-term, while we are still heavily reliant on workers from elsewhere in the EU, the weakness of sterling and slower economic growth are likely to deter new migrants and may result in some currently working here, returning home.
- However, recruiting more workers is, in Balfour Beatty's view, not the only solution. Over the medium-to-long-term, we see digital technology, modular design and offsite construction as powerful ways to mitigate the skills bottleneck and drive up productivity.
- The offsite construction sector currently accounts for around 10%⁷ of total construction output in the UK, a figure which is increasing. These technologies have potential beyond addressing the skills shortage: they can help improve safety, increase efficiency, which will deliver the much-needed new housing and the low carbon agenda. It is extremely welcome, therefore that the Government has announced it will use its purchasing power to drive modern methods of construction by favouring offsite manufacturing on all publicly funded construction projects from 2019⁸, and that £170m of government investment will be provided through the Industrial Strategy Challenge Fund to support innovation and productivity improvement in the sector.
- Balfour Beatty has a purpose built off-site facility manufacturing products including packaged plant rooms, service modules, riser modules and modular electrical systems. Working in this way is safer (e.g. significantly fewer 'at height' hours), more productive, high quality with less waste, and provides customers with substantial savings in terms of time and money.
- We also welcome the announcement of a Sector Deal, for the construction industry, announced as part of the Industrial Strategy⁹.

⁶ Joint report on progress during phase 1 of negotiations under Article 50 TEU on the UK's orderly withdrawal from the EU, HMG, December 2017

⁷ CITB, 2017

⁸ HMG, Budget, November 2017

⁹ HMG, Industrial Strategy White paper, November 2017

Procurement

- EU membership allowed for the free movement of goods within the EU without duties and other restrictions. Cross-EU supply chains have developed during the currency of the UK's EU membership and UK companies have the advantage of a deep market for specialist products, raw materials and construction technology.
- Depending on the outcome of negotiations on the UK's exit from the EU, there could be implications for the infrastructure industry in terms of procurement of materials, machinery and equipment from the EU. Core raw materials, such as cement and bitumen, could be subject to tariffs or taxes.
- Recent government data shows that 61% of imported building components and materials come from the EU, equating to a net total of £5.7bn, up from £4.9bn in 2015¹⁰.
- Costs have already increased since the vote to leave the EU, due to the weakening pound, and are likely to continue to rise. The Construction Products Association's State of Trade Survey covering Q4 2016 found the strongest growth in raw material prices in five years.
- Much of the specialist machinery used in large infrastructure projects is also imported and purchased from the EU intermittently, for example boring machines for use on major tunnelling projects such as Crossrail and HS2 and specialist rail plant deployed across the UK's rail network. Ultimately, higher prices will have an impact on infrastructure owners (including the Government), end customers and ultimately taxpayers. Indeed, some of this impact is already being felt, as European companies are beginning to price in risk to allow for day to day currency fluctuations, which impact import costs on a business as usual basis. Moreover, UK supply chains are increasingly focused on indexation and inflation implications of long-dated contracts and commitments.
- If a possible outcome of Brexit results in a public procurement approach which supports the use of UK-based companies and materials, over the long-term this will strengthen the UK economy given the criticality of construction and infrastructure to UK GDP and domestic productivity. However, in the short-term, long lead times for infrastructure project lifecycles and procurement requirements mean that it is unlikely that there is currently capacity in the UK market to provide all the materials required, or to deploy those materials in-country for existing and planned projects.

Investment

- The UK's access to the EIB has, via a system of long-term loans at attractive interest rates, enabled the building of new transport, water and energy schemes, schools, university buildings, hospitals and other infrastructure across the UK. Loans have been made to high-profile schemes including Crossrail and Thames Tideway's 'super sewer'. The EIB financed £6.9bn of public infrastructure projects in the UK in 2016¹¹.

¹⁰ Monthly Statistics of Building Materials and Components, Department for Business, Energy and Industrial Strategy, February 2017

¹¹ EIB

- While Brexit does not necessarily mean the end of the UK's ability to access funding from the EIB, what happens post-March 2019 is unclear and this is already impacting infrastructure investment, with the EIB having put most UK applications for long-term loans on hold until a Brexit deal has been agreed.
- Balfour Beatty's view is that losing access to this funding stream could impact project delivery across the UK. Seeking continued involvement in the EIB should be the priority; if this is not possible, the funding would need to be replaced in some capacity.

About Balfour Beatty

Balfour Beatty is a leading international infrastructure group. With 15,000 employees across the UK, Balfour Beatty finances, develops, delivers and maintains the increasingly complex infrastructure that underpins the UK's daily life. Delivering projects across transportation, power and utility systems, social and commercial buildings: from Crossrail and the Channel Tunnel Rail link, Heathrow T2b to the M25, M60, M3 and M4/M5; Sellafield and soon Hinkley C nuclear facilities; to the Olympics Aquatic Centre and Olympic Stadium Transformation. We also have significant experience and understanding of the links between infrastructure investment and regeneration and economic growth.

Balfour Beatty employs over 150 apprentices each year in the UK in addition to the 320 currently under training in a diverse range of roles across the business. We employ around 700 more on graduate and part-time higher education / degree schemes. Balfour Beatty is also a long standing member of The 5% Club, an employer led organization set up by our Chief Executive, Leo Quinn, four years ago, aiming to address the skills gap by getting more young people into earn to learn opportunities, encourage businesses to take the lead on training and promote apprenticeships as a positive career decision.

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