ARCADIS

Market View
Winter 2023

Waiting for Growth

Introduction

Since the last Market View, the political party conference season has come and gone, bringing with it the cancellation of later phases of the HS2 high-speed rail line by Prime Minister Rishi Sunak, and a pledge from Sir Keir Starmer to build 1.5 million homes within the first five years of a Labour government. Meanwhile, the housebuilding sector has its 16th Housing Minister since 2010. Conference promises cannot immediately be converted into construction sector growth and, despite a few potential positives, election year 2024 is unlikely to offer much solace. Construction, like the wider economy, is waiting for recovery – and growth.

Flat economic outlook

In our Autumn Market View, we described how a precarious balance between growth, inflation and monetary policy influenced industry prospects. Little has changed in terms of the overall picture, although sentiment is improving.

The Bank of England's (BoE) latest Monetary Policy Report forecasts zero GDP growth from now until the end of 2024 and growth of just 0.25% in 2025. While this is only a slight downgrade from the BoE's August forecast, the 'lower for longer' outlook is now more closely aligned with the Office for Budget Responsibility's viewpoint too, with the OBR's November 2023 Economic and Fiscal Outlook forecasting growth at a far more subdued pace in 2024 than anticipated in March, with weaker average annual growth forecast through to 2027 as well.

More positively, the Monetary Policy Committee (MPC) held interest rates at 5.25% for the second meeting in a row. While base rates remain at a 15-year high, talk is now switching to when rates will be cut. BoE Governor Andrew Bailey is firmly holding the line that this will not happen before Q3 2024, playing down expectations – even from within the Bank itself – of an earlier cut.

Animal spirits are also encouraged by latest CPI readings from October, reporting a fall to an annual rate of 4.6%, down from 6.7% a month earlier and ahead of BoE's own forecast of 4.75% for Q4 2023. Encouragingly, both core inflation and services inflation fell, suggesting that tightening is working. Nevertheless, with inflation expected to remain at

3.75% in 2Q 2024, the BoE's 2% target for CPI won't be reached anytime soon. Indeed, the OBR now suggests that CPI will not reach the 2% target until the first half of 2025, more than a year later than it was forecasting in March.

Unfortunately, there is a lot of tightening to come. The BoE believe that less than 50% of interest rate rises announced so far have actually impacted the economy. However, with five-year mortgage deals now available at under 4.5%, the expected impact might not be as great as anticipated.

	OBR Nov 2023 Forecast (Mar 2023)	BoE Nov 2023 Forecast (Aug 2023)
GDP	• 2023: +0.6% (-0.2%) • 2024: +0.7% (+1.8%)	• 2023: +0.5% (+0.5%) • 2024: 0% (+0.5%) • 2025: +0.25% (+0.25%)
CPI	• Q4 2023: +4.8% (+2.9%) • Year to Dec 2024: +3.6%	• Year to Dec 2023: +4.6% (+4.9%) • Year to Dec 2024: +3.1% (+2.5%)
Base Interest Rate	• Peak of 5.4% (4.3%) in 4Q 2023	• 4Q 2023: +5.3% (+5.8%) • 4Q 2024: +5.1% (+5.9%)
Unemployment	• Peak of +4.6% (+4.4%) in Q2 2025 (Q2 2024)	• 4Q 2023: +4.3% (+4.1%) • 4Q 2024: +4.7% (+4.5%)
Business Investment	• Total (real) from Q1 2024 to Q1 2028: £994bn (£969bn)	• 2023: +6.75% (+1.75%) • 2024: -1.0% (-2.0%)

Table 1: UK Economy forecasts

Sources: Office for Budget Responsibility, Economic and Fiscal Outlook (March 2023 and November 2023), Bank of England, Monetary Policy Report (August 2023 and November 2023)

Note: Figures in brackets refer to previous forecast – Mar 2023 for the OBR and Aug 2023 for BoE.

Pipeline running dry?

Construction can't escape these trends, although it is a very resilient sector. It remains the case that despite all the turmoil from Covid, Brexit and Ukraine, construction output has continued to grow in real terms. Admittedly, this was by just 0.1% in Q3 2023, yet this was the eighth consecutive quarter of growth. However, growth recorded by ONS in 2023 has come solely from repair and maintenance work. By contrast, new build work has contracted for three consecutive quarters.

Latest orders data from Q3 brought the welcome relief of a 4% increase, after three consecutive quarterly falls. However, the £18.4bn total order value recorded in Q3 2023 is 13% below the long-term average since 2015. Low levels of replacement workload suggest that next year will be tough. This is illustrated by recent analysis from construction data firm Glenigan. They predict that UK construction starts (as opposed to either orders or output) will fall by 20% during 2023. Despite growth in project starts of 8% in 2024 and 7% in 2025, workload is not forecast to recover to 2022 levels before 2026. Glenigan's prediction of a dramatic fall in the value of starts aligns with the Construction Products Association's output forecast which currently predicts a near 7% contraction in output in 2023, followed by a contraction of 0.3% in 2024.

Higher-than-average levels of insolvency contribute to the gloomy outlook. Since the start of 2022, more than 350 construction firms per month have become insolvent – a 30% rise on both the 2019 pre-Covid average of 270 and the long-term average since 2010. We review insolvency risk in a 'Zoom into' feature later in this report. Paradoxically, reduced capacity following insolvency may over time contribute to higher levels of construction inflation.

Contrasting fortunes

Behind the headline data, construction sub-sectors are seeing very different growth and contraction trends. The latest UK Construction Monitor report from the Royal Institution of Chartered Surveyors (RICS), records a steep fall in workload, with a net balance score of -10%; the most downbeat result since the start of the Covid outbreak. Private housebuilding is inevitably seeing contraction but only the Infrastructure and Public Works sectors are reporting a positive net balance of activity in Q3 2023. The figures are backed up by our latest internal survey, where around 60% of respondents have experienced delay on projects. The situation is most acute in the commercial and residential sectors as well as on transport projects, where viability and affordability issues are major concerns. By contrast, in the energy sector, projects are proceeding at pace and in utilities, the supply chain is preparing for greater investment from 2025 onwards.

There is plenty of evidence to corroborate these trends. A survey by the Railway Industry Association (RIA) reports that confidence is at a five-year low, with 54% of rail suppliers expecting contraction in 2024. By contrast, activity in water and wastewater is set to ramp up, with planned Totex expenditure for AMP8 increasing by nearly 90% compared to the previous control period. Tenders are already out for some work but whether all plans will be approved by Ofwat remains to be seen.

In the commercial sector, data is difficult to interpret. The November 2023 Deloitte London Office Crane survey points to a rapid growth in refurbishment work during 2023, but from other perspectives, prospects are more challenging. London's office vacancy rate hit 9% in Q3 2023 and CoStar reports that the £2bn of investment in London office properties recorded in Q3 2023 is far below pre-pandemic levels and 20% lower than this time last year.

Most significantly, housebuilding continues to contract. RICS's latest housebuilding workload index fell to -26 in Q3 2023. Save for Covid lockdowns, this is its lowest level since 2009. Latest National House Building Council (NHBC) data records the registration of 20,680 new homes in Q3 2023, down 53% on the same quarter in 2022. Private sector registrations were hit hardest, down 57% by comparison to a 43% decline in the rental and affordable sector. National housebuilders (including Vistry for example) are focusing on partnership working with Housing Associations, local authorities and Build-to-Rent providers to bring forward development. We examine opportunities to improve viability using the JV model in our Spotlight on collaborative procurement further on in this report.

Early signs of a turning point?

Despite all the gloom, there are a few signs that maybe, just maybe, there are reasons to be a bit more optimistic. Take housing. Both Halifax and Nationwide are reporting house price rises of about 1% between September and October – the first monthly increase since March 2023. Prices are still down 3.3% nationally since last October, with those in South East England down 8%, but the decline is not as severe as had been expected. Although the increase was more down to lower supply than buyer demand, that could be about to change too, with a recent trading update from leading housebuilder, Taylor Wimpey, suggesting that although the order book was down 23%, recent private sales rates have returned to levels seen at this time in 2022. This led to broker Peel Hunt proclaiming that “it increasingly looks like we are past the darkest days for the (housebuilding) sector”, as well as Savills suggesting that the UK housing market could be “past peak pain”.

Other signs of an uptick include evidence from construction data specialist Glenigan, reporting that detailed planning approvals in Q3 2023 were up 12% on the previous quarter and 32% ahead of where they were in the same period in 2022. Furthermore, in the commercial sector, Deloitte reports the highest volume of new schemes for almost 20 years, with 5.1m sq. ft of new construction started in the capital between April and September 2023, across 43 schemes. This finding does not align with recent ONS orders data.

It is still way too early to suggest that the worst is over for the sector. Nevertheless, there are enough positive data points to provide a chink of light for a hard-pressed sector.

Forecast

Even though the UK's growth outlook continues to look weak, early signs of a turning point in the economic cycle are a positive for the construction sector. However, contractors need to work through a weak order book and prospects for an immediate improvement in outlook are slim.

Weak order books dampen prospects in 2024.

We published our Autumn 2023 Market View forecast shortly after the BoE declared that interest rates would stay higher for longer. As highlighted in our introduction, there are welcome early signs of a turn in the cycle. In the meantime, contractors will continue to face significant headwinds with respect to new workload, including political uncertainty, even as longer-term prospects improve.

UK construction markets face a paradox. Two years into a deep cycle of monetary tightening, output remains robust, even as forward indicators of opportunity continue on a downward path. Such a resilient performance is partly a result of project delays and means that contractors have stayed busier for longer than expected. However, recent orders were down by 20% on the comparable period and, as highlighted in our introduction, Arcadis's own internal survey data confirms this trend. Improved sentiment may point to restarts in the future, but at present, the near-term procurement pipeline is weaker than it should be.

Although incentivising investment and reforming planning were both big themes in November's Autumn Statement, the construction sector is unlikely to see much immediate benefit. OBR forecast a 4.7% reduction in capital investment next year. Chancellor Hunt also confirmed previous plans to freeze public sector investment in cash terms from 2024/2025 onwards, meaning that public sector investment will shrink under Conservative plans. Even measures to unblock house building delayed by nutrient neutrality rules will require long-term investment in water treatment rather than a short-term fix to planning rules.

Although the pipeline is looking weak, we see growing evidence that contractors will not accept work on any terms. Following the failure of MJ Lonsdale and other trade contractors, some tier one contractors are adopting a more risk averse approach to contract terms and price fixity. Whilst this trend won't necessarily affect the level of tender prices, exit costs may increase as a result of risks that cannot be fixed through the contract. This is a developing trend which will be determined on a contract-by-contract basis.

Sectors to look out for in 2024.

A better-than-expected performance this year means that 2024 rather than 2023 will likely see the deepest reduction in workload. However, the picture is far from straightforward, and some sectors can be expected to show signs of recovery, even as overall construction activity slows further. High density residential development, particularly schemes focused on affordable housing and build to rent sectors, are a likely candidate, particularly as schemes delayed by second staircase design are brought back to market.

Affordable housing delivered using the JV procurement model outlined in our Spotlight on unlocking projects with collaborative procurement is looking increasingly promising because clients on these schemes have multiple levers to improve viability. However, these high-density schemes face a further hurdle now that Gateway 2 reviews for Building Safety are operational.

Retrofit works also appear to be generating a significant and counter-cyclical source of workload. In residential, public-sector clients including many registered providers are focusing available resources on fire safety and energy efficiency retrofits of existing housing. Commercial refurbishments are also becoming a much more important source of workload. Deloitte report that over six million square feet of office refurbishment projects have started on site in Central London during 2023, three times the reported scale of new build development. The Central London major project market continues to be capacity constrained, so there is less of the downward price pressure seen in other sectors like housing.

One segment that is not meeting expectation is the public sector non-residential development, despite generous government funding through various levelling-up funds. Order volumes have fallen further since Q2 2023. A recent National Audit Office (NAO) report highlights that barely £0.9bn of the £10.6bn of government-managed levelling-up funds had been spent by March 2023. More than £800m of allocations to Town Deals, Future High Streets Fund and Levelling-up funds have not been used. Even though the final tranche of levelling-up funds were confirmed in November, there is little sign of these projects moving forward due to problems with affordability as well as approvals.

	Workload	Pipeline
North East	**+7%** (++)	**+18%** (--)
North West	**+2%** (-)	**-6%** (--)
Yorkshire and the Humber	**+12%** (++)	**-1%** (--)
East Midlands	**-1%** (++)	**-7%** (--)
West Midlands	**+6%** (-)	**-8%** (--)
Eastern	**+4%** (--)	**-2%** (-)
London	**+9%** (-)	**-1%** (--)
South East	**-6%** (+)	**-2%** (--)
South West	**-1%** (+)	**+14%** (--)
Wales	**+7%** (++)	**-8%** (-)
Scotland	**-14%** (-)	**-6%** (--)

Source: ONS, Arcadis

Explanation of the table:

Data in bold is represents the trend rate for workload in comparing the average level between 3Q 2022 and 3Q 2023 with the long-term average for the period 2015 to 2023.

Data in brackets is short-term movement of workload based on full year-on-year change between 3Q2022 and 3Q 2023. (=) is no movement. (+) and (-) is movement less than +/-10%. (++) and (--) is movement greater than +/-10%.

Data is sourced from ONS: Construction New Orders Table 6. Sub-national Construction Output Table 1. New Orders and Output data are deflated to constant prices.

Regional variation – pain on the horizon

The latest update to the Arcadis Hot Spot analysis confirms that the differential between robust current workload and weak forward pipeline can be seen across Great Britain. The Hot Spot analysis compares two-year workload and pipeline against a long-term (eight-year) trend. The analysis also tracks growth or contraction in the past 12 months. For workload, seven out of 11 regions currently experience above trend workload and six have seen growth in the past 12 months. The most buoyant market by far is Yorkshire and the Humber, which has seen double-digit workload growth in 2023, meaning that recent workload has been 12% above the long-term trend.

However, for future pipeline, the picture is much less comfortable. The short-term pipeline of nine out of 11 regions is below the value of the long-term trend. Furthermore, all regions have seen a decline in orders over the past 12 months.

In aggregate, the regions with the strongest combination of current workload and pipeline are the North East, boosted by a backlog of industrial work, and the South West, with a large infrastructure pipeline.

Materials – nothing to see here.

We featured a deep dive into material price deflation in our Autumn Market View and, in the intervening three-months, the situation has continued to stabilise. Prices for a basket of materials for new build construction tracked by the Department of Business and Trade (DBT) fell by 4% in the 12 months to September 2023. Encouragingly for contractors, there has been very little price movement across any of the categories in the three preceding months.

Looking forward there are growing signs of surplus inventory. Brick stocks, for example, are at their highest level since 2016, up by 100% in 12 months.

Manufacturers are already rationalising production to rebalance supply and demand, but in the short-term, there are likely to be some opportunities for discounting, particularly for components exposed to a slowdown in housebuilding.

Labour market – increasing certainty.

The construction labour market is subject to a lot of uncertainty related to labour availability, long-term wage deals and the going rate for self-employed labour. In Q3 2023, all factors appear to be going in the right direction for clients.

- Vacancy levels. Vacancy levels remain at their lowest level since Covid, with 2.3 vacancies for every 100 employed, well below the economy-wide average of 3.0.
- Wage deals. Working rule agreements have been concluded for most trades including plumbing, electrical and heating and ventilating engineers who have agreed separate two-year deals. Looking forward to 2024 and 2025, these recent MEP deals indicate that settlements from 2024 onwards are likely to be around 5%.
- Day rates for the self-employed. Site rate inflation is below the rate of the directly employed. Data from Hays for Q3 2023 shows site rates up by 2% year-on-year, whilst data from labour agency Hudson's Contracts records an average increase in weekly earnings of 4% since August 2022.

Average weekly earnings, as recorded by the ONS increased by 5.7% in the year to September 2023, lagging the economy-wide average of 6.7%. Most wage deals have now been closed for 2023, giving greater certainty to contractors and their clients.

Forecast

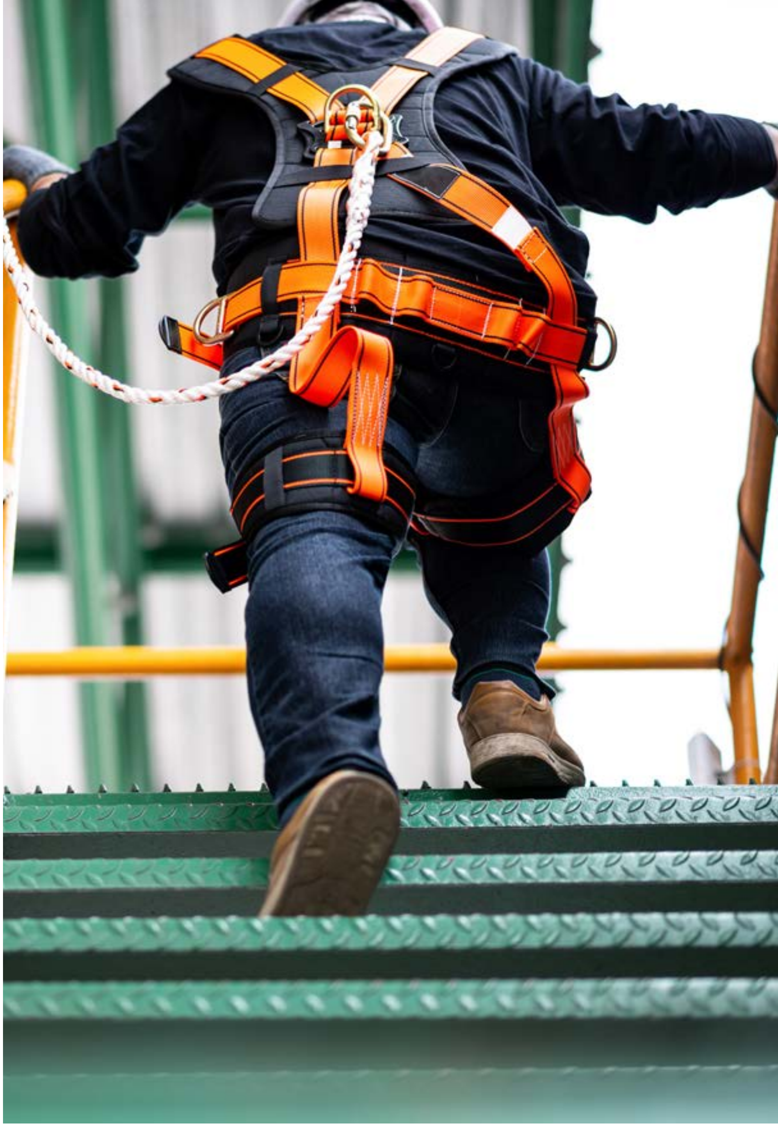
There has been no material change in market conditions in the past three months. There are early signs of an improvement in investment sentiment that can be directly attributed to falling gilt rates and speculation about the date of the first base interest rate cut. However, the key challenge for the construction sector remains the mid-term impact of a weak pipeline of new work. Until there is clear evidence of a recovery in future workload, the outlook will remain downbeat.

We retain our view on forecast price inflation across building and infrastructure in advance of seeing firm market-backed evidence of a recovery in future workload. However, we note an improvement in sentiment in the housebuilding sector that should result in some recovery in workload in 2024. Our central case for the period 2023 to 2025 remains low inflation, not deflation.

The forecast has two major components, in line with our Autumn 2023 projection:

- Input cost inflation affecting labour only will continue to result in higher construction costs, even as workload falls.
- Infrastructure will continue to be affected by materially higher inflation than for buildings, enabled by cost-reimbursable contract models as well as competition in the resilience and energy transition sectors.

Our unchanged Winter 2023 forecast is set out in the table below:



	Regional Building Construction TPI	London Building Construction TPI	National Infrastructure Construction TPI
2022	10% (10%)	10% (10%)	12% (12%)
2023	2% (2%)	2% (2%)	5-7% (5-7%)
2024	1-2% (1-2%)	1-2% (1-2%)	3-4% (3-4%)
2025	3-4% (3-4%)	3-4% (3-4%)	3-4% (3-4%)
2026	4% (4%)	4% (4%)	5% (5%)
2027	4% (4%)	4% (4%)	5% (5%)
Total	**24-26%**	**24-26%**	**33-37%**

Source: Arcadis

Inflationary drivers	Deflationary drivers
• Continuing above-trend levels of workload in sectors other than housing	• Structural deflation from 3Q2023 onwards
• Supply chain consolidation	• General economic slowdown
• Attitude to risk transfer	• Order book replacement across most sectors
	• Attitude to work winning

Zoom into: the implications of increased insolvency risk

One of the key issues affecting the construction market is a significant increase in construction insolvencies, with business failures at levels last seen in 2010 and 2011. It is an appropriate moment to look at the recent trends in more detail and, with the assistance of Arcadis expert Mark Williams, to outline some measures to protect projects from the worst impacts of a contractor failure.

The evidence

The latest data from the Insolvency Service shows that total corporate insolvencies in England and Wales in the six months to the end of September reached their highest level since the 2009 financial crisis, with 6,208 registered company insolvencies between July and September alone. This was 10% up on Q3 2022 and just 2% below the Q2 2023 peak.

In the construction sector, failures per quarter in England and Wales have averaged 2,100 since Q1 2022. In Q3 2023, the trend continued at a slightly lower level. There were 991 company insolvencies, and 790 voluntary liquidations, adding up to a total of 1,982 construction business failures for the quarter. Recent levels of business failures are 33% higher than the long-term quarterly average and even 6% above the peaks recorded after the financial crisis.

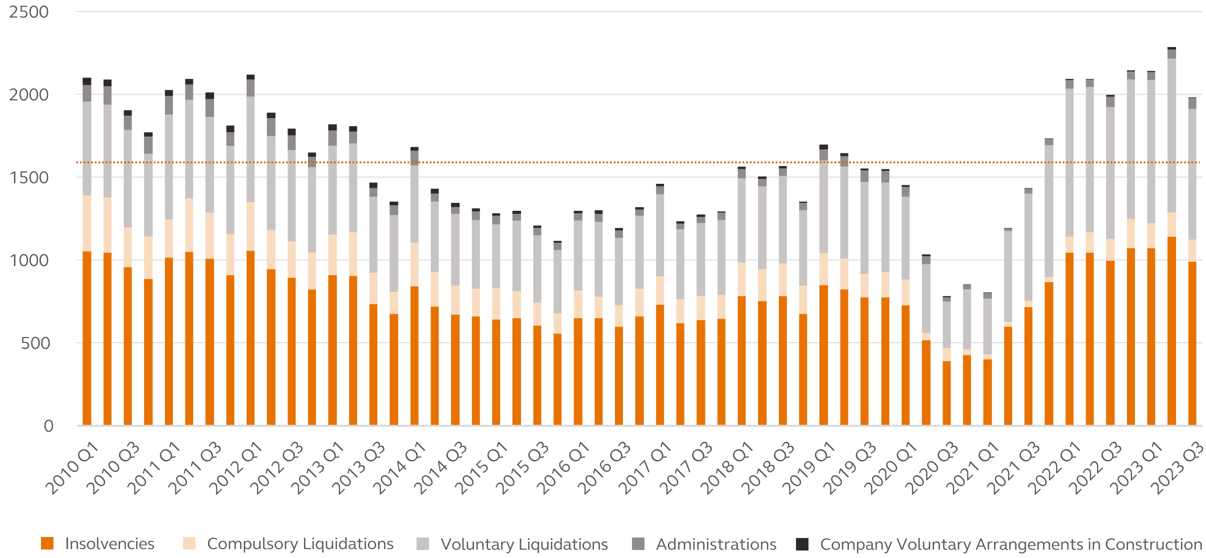


Figure 1: Business Failures in Construction in England & Wales

Source: Insolvency service, November 2023

And the situation could be about to get worse. The latest 'Red Flag Alert' report from insolvency specialist Begbies Traynor reports that nearly 6,000 construction companies are in 'critical' financial distress. These are firms defined as having a county court judgment exceeding £5,000 against them. Critical distress is often a precursor to formal insolvency.

The number represented a 46% quarterly rise in construction businesses on the verge of failure, and the top ranking of the various sectors. Further, there was an 18% quarter on quarter rise in the number of construction firms that were now in 'significant' financial distress.

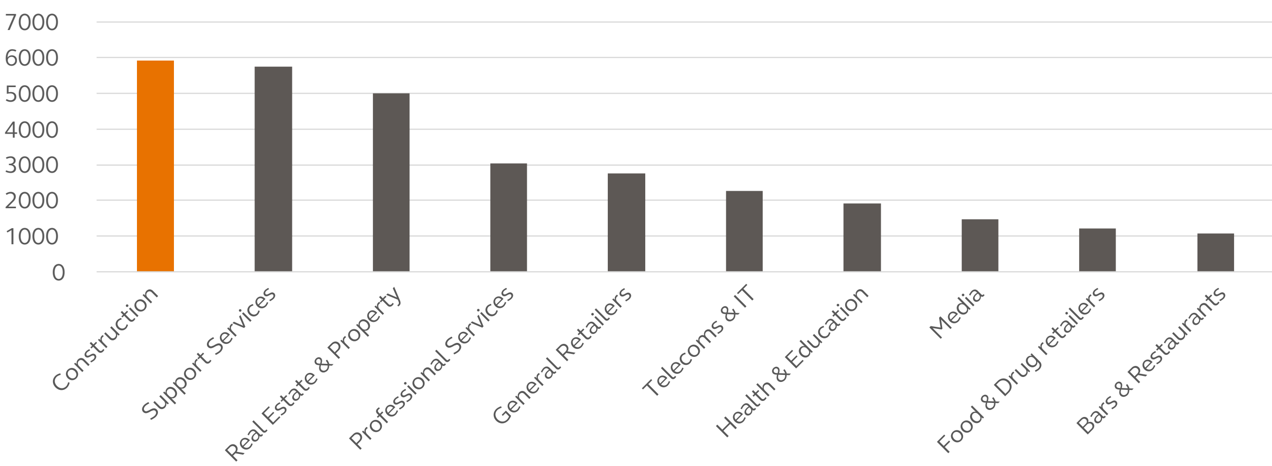


Figure 2: Number of companies in critical financial distress, Q3 2023

Source: Red Flag Alert, Q3 2023, Begbies Traynor

Inevitably most of the companies identified in the Red Flag report will be micro-SMEs, but the data is emblematic of an industry that is exposed to low margins and unpredictable cashflow and is at a greater risk of failure in volatile markets. Even though this is the case, identifying businesses at risk is difficult, particularly during project procurement.

Signs of impending insolvency

Once a project is on site, there are common signs that a contractor or sub-contractor is in difficulty, including:

- Work on site lacks progress or slows without any particular reason.
- Unexpected claims for additional payment are made.
- Materials, plant and equipment are removed from site.

However, ahead of a contractor or sub-contractor appointment, any signs are likely to be less conclusive. Great care for example is needed when investigating rumours or industry gossip. Credit reference agency products like Dunn and Bradstreet also rely on historical published accounts as well as more current transaction data and cannot be expected to provide a fully accurate or up to date assessment. Similarly, payment data for larger contractors published by Build UK is only updated on six-monthly intervals. Other potential indicators of financial difficulties include delayed accounts or the non-availability of bonds or ultimate parent guarantees, but these have to be identified on a case-by-case basis.

The challenge with many of these indicators is there may be perfectly legitimate explanations for a negative reading that are not related to solvency. Ultimately, there is no substitute for careful due diligence by the client's financial advisors and an open dialogue during pre-qualification and tendering.

Steps available to a client and their advisory team to identify and potentially mitigate risk include:

- Review of Companies House and credit reference reports, together with a more detailed review of accounts undertaken by a financial advisor.
- Securing of parent company guarantees, bonds, warranties, and insurances before appointment. The reasons for non-availability of securities should be reviewed.
- Checking for signs of financial difficulty on other projects with the same contractor or supplier.
- Keeping up to date with the construction press.
- Mitigation of supplier failure risk by considering reviewing payment terms, by considering project bank accounts and other measures such as bond-protected advance payments.

Unfortunately, such warning signs are becoming more commonplace, with the Construction Leadership Council recently highlighting, for instance, that sub-contractor access to trade credit insurance is becoming a growing concern for the supply chain.

Collaborative solutions to a collective problem

In such troubled times, it is easy for companies to take an insular approach rather than to support their project partners. Hardening commercial behaviours in the supply chain, for instance, will only add to market pressures, especially for smaller firms. Instead, a collective response is surely the right approach to take, with all parts of the industry working together to address the problem.

From a client perspective, this might mean taking time to become better aware of the challenges affecting the supply chain, valuing more highly contractors that are making the effort to strategically invest with their project partners. Meanwhile, treating the supply chain fairly, for example by paying regularly and promptly and by viewing them as important assets in the success of a project or programme, is likely to lead to better outcomes for clients and contractors alike.

Measures taken to rebalance the contract will increase the client's risk exposure to varying degrees. Such measures should only be considered after the completion of effective due diligence, the creation of appropriate safeguards and with the agreement of all contracting parties.

Navigating the industry challenge of increasing insolvency rates requires everyone in the industry, from clients through contractors and the materials supply chain, to play their part in addressing a collective problem.

Spotlight on: unlocking projects through collaborative procurement

In both our introduction and forecast for the Winter 2023 Market View, we highlight that housebuilding is the construction sector that is facing the most severe headwinds with respect to regulation change and viability, including the withdrawal of purchaser support via Help to Buy. This slowdown has major implications for the wider economy, as a shortage of affordable housing across all tenures will hold back further a stuttering recovery. Whilst rising share prices suggest that UK housebuilders are past the worse of the cycle, production volumes of for-sale housing are unlikely to increase in the foreseeable future.

Other housing providers including Registered Providers (RP) and Local Authorities (LA) face the same development headwinds as well as wider legacy issues associated with the energy efficiency, sustainability, safety and quality of the existing portfolio. Many housing providers are questioning whether they should develop at all – even though the need for affordable housing in particular is overwhelming.

How flexibility improves viability

Despite often having to follow public procurement procedures, RPs and LAs paradoxically have more flexibility in the current market to achieve viability. This is because of the increasing adoption of the Joint Venture (JV) development model where a public sector body like an RP joins forces with a developer or investor on a 50:50 joint venture basis. Partnership development models and JVs have been used in the UK for many years, enabling RPs and LAs to leverage the value of land assets to expand their capacity to build homes. In the current market however, the JV model is giving the partners more options to address viability and quality issues by eliminating some aspects of development on-cost and by properly aligning the interests of the land owner and the development partner.

The concept of a residential JV is to bring together all the capabilities needed to take forward development. The private sector partner is likely to bring development management, construction management and sales capabilities, whilst the RP is likely to have strengths in long-term tenant and estate management and stakeholder engagement. The JV parties will also bring equity in the form of land, working capital and contributions in kind.

In the current market, the JV model has also opened up a wider range of levers to address issues of cost, value and viability.

- **Input costs.** In the current market, private sector partners are securing volume savings from their supply chain. The JV model ensures that these savings contribute to project viability.
- **Land values.** Public sector partners have greater flexibility than listed housebuilders to adjust their land values in line with market conditions. By reducing value of the land equity, total development costs are reduced – again improving viability.
- **Grant funding.** Funding bodies including Homes England, Greater London Authority and others are increasing grant funding allocations. This is in response to viability gaps as well as the opportunity to change the tenure mix of schemes. Whilst for-sale housebuilders can secure support for infrastructure development, the grant element can only be accessed by RPs and LAs. Again, the ability to flex the level of support unlocks schemes.
- **Multi-tenure development** unlocks forward funding, which in turn supports development cashflow. Developments that feature a mix of affordable rent and institutional buy-to-let alongside for-sale and shared-equity are the most robust in the current market. Multi-tenure schemes typically have a lower overall rate of return than sales-led schemes but are more deliverable in the current market. By resetting development return benchmarks, for example to Return On Capital Employed (ROCE), more projects can be brought forward.
- **Procurement.** The Investment Partnership model (IP) enables public bodies to form JVs outside of a formal public procurement process. This gives the client greater flexibility as well as reducing the cost and time needed for the procurement process.

The diagram illustrates how the five viability levers combine to raise the margin curve so that a mixed tenure JV development can meet a reset margin target.

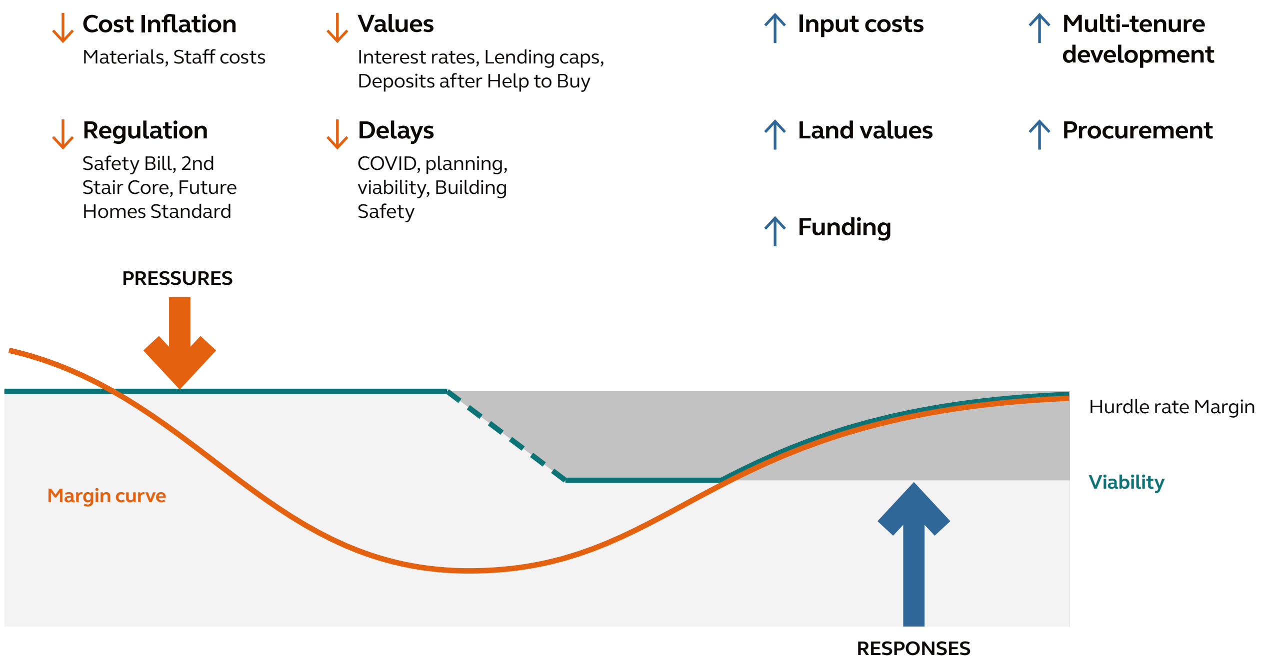


Figure 3: How the JV model can help to improve viability

Trust and transparency

If the cornerstone of a JV is the 50:50 commercial model, the mortar that holds everything in place is trust facilitated by transparency. The vital element that underpins trust is the clarity that neither party can manipulate the JV to their advantage (for example through the valuation of their contribution) and also that both parties are obliged to perform to the best of their abilities. Paradoxically, greater exposure to development risk is a further incentive for good governance within the JV as both parties hold each other to account.

The JV model is no panacea. All housing developments need to wash their face, and in many locations, with grant funding levels so low, the land element of a JV has little if any value. Similarly, developers only have so many levers to improve viability and can't always buck the market trend. However, where opportunities to revisit the viability equation can be found, and where the deals stack up, the JV model increasingly looks like the best way for the public and private sector to come together to deliver much needed housing.

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