

UK MARKET VIEW

**Devolution promises
opportunities as construction
challenges mount**

Introduction

The UK construction market is entering a period in which opportunity and delivery risk are moving in parallel.

Devolution, planning reform and changes to infrastructure appraisal could unlock a stronger pipeline across housing, transport and public services, giving local leaders greater influence over investment. But policy ambition alone will not put projects on site.

Output declined 1% in the three months to August, while new orders fell 11.8% in Q2, its third consecutive quarterly decline. At the same time, high borrowing costs, fragile confidence and construction material price inflation of 6.4% are intensifying pressure on viability and delivery.

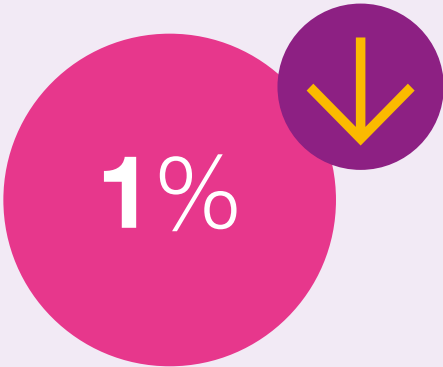
Against this backdrop, clients and local authorities will need clear funding, realistic programmes, robust supply-chain due diligence and early commercial engagement. Those that combine local ambition with disciplined decision-making will be best placed to improve certainty, manage inflation and convert the emerging policy opportunity into successful outcomes.



Ceri Evans

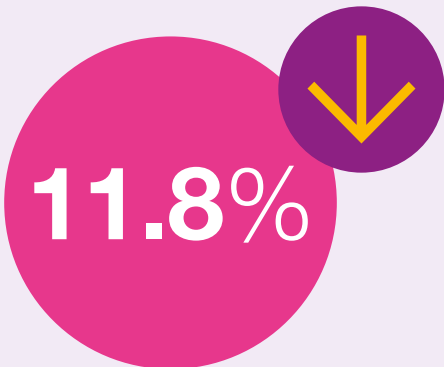
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Construction output declined...



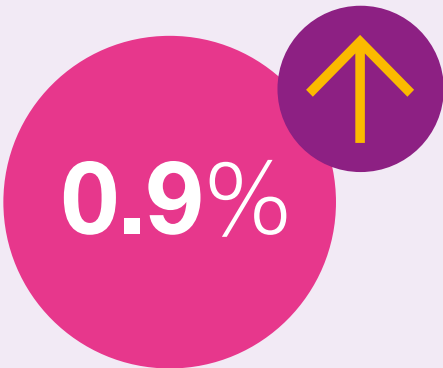
in the three months to August and is 1.6% smaller than 12 months ago.

Ongoing uncertainty contributed to new orders shrinking...



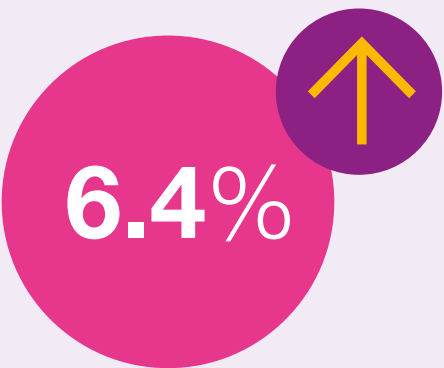
the third quarter in a row in which they have declined.

While regular construction earnings rose...



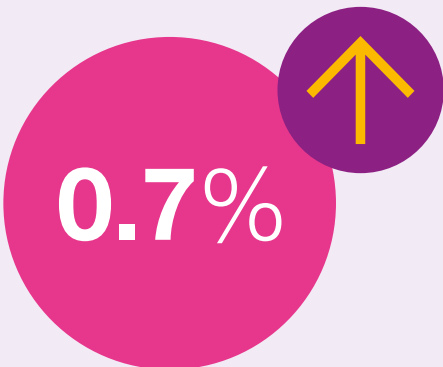
in the three months to July, they have risen just 0.3% over the past year.

Construction material price inflation hit ...



in August, the highest it has been in over three years.

The economy is proving more resilient than expected, growing...



in the three months to August.

Tender prices

	2026	2027	2028	2029	2030
National Real Estate	3.5%	3.5%	4.0%	3.5%	3.5%
National Infrastructure	4.5%	4.5%	4.5%	4.0%	4.0%
London	3.5%	3.5%	4.0%	3.5%	3.5%

This table gives our current tender price inflation forecast. The figures should be treated as averages and there will be variations due to procurement methods, project type and local factors.

Setting the scene

Over the past quarter, two of the dominant global economic themes from the first half of the year continued to dominate headlines, with little indication that either is approaching a smooth resolution. At the end of August, the conflict in the Middle East flared up again, pushing the price of Brent crude oil back above US\$100 a barrel. With natural gas prices also rising, albeit nowhere near the levels seen in 2022, and storage levels very low, a cold winter could trigger much higher inflation.

Higher energy prices, and the impact these will have on inflation, are also behind another key concern, government borrowing. Yields have been steadily rising this year, with 10-year gilts hitting their highest level since 2008 and 30-year gilts climbing to their highest level since 1998. UK borrowing costs are noticeably higher than their G7 counterparts, and as we discussed in our Q2 Market View, this is a particular worry for the Chancellor, John Healey. The Office for Budget Responsibility is currently in the process of preparing its forecasts for October's Autumn Budget and, unfortunately, the higher borrowing costs become, the less fiscal headroom there will be. As such, the new government will find it much tougher than it would like to fund its priorities.

A prominent advocate of devolution, Andy Burnham has been particularly vocal about transferring powers away from central government. A policy focused more on reallocating funding rather than increasing overall spending will give local leaders more control over housing, transport, skills and public services. As part of this, Mayoral Strategic Authorities will get to keep a share of business rates from next year and, more drastically, a share of income tax from 2028. However, moving power away from central government will not be straightforward, and while local leaders may be better placed to understand what their communities need, delivery will remain a significant challenge. Notably, last year's Spending Review laid out plans, and in many cases provided increases, for the capital budgets of government departments. However, new orders data suggest this money is yet to flow through to the construction sector. Devolution has the potential to add further complexity if local priorities do not align with those of Whitehall departments and resolving this friction will be key to the policy's success.

Boosting housing delivery is not a new government ambition and devolution does little to overcome market

headwinds. While the Bank of England has left interest rates on hold at 3.75%, it is looking likely they will raise rates in November. For the Monetary Policy, higher borrowing costs are helping hold back inflation somewhat. So far, they have avoided tightening, in part due to corporates and households facing higher borrowing costs but higher energy costs look set to result in a rate increase. Nonetheless, the increase in mortgage rates is bad news for house building and helps explain some of the weakness in the sector, with the commercial sector experiencing similar difficulties.

GDP grew 0.7% in the three months to August, however, this resilience is primarily down to two sectors, professional services and information and communication. Whereas the wider economy is enjoying a boost from AI, with growth projects revised up, the construction sector is struggling. In the three months to August, total output was down 1.0%, with all new work shrinking 5.0% over the past 12 months. With new orders sinking 11.8% in Q2 – the third quarter in a row in which they have declined – the outlook for future output growth has also dimmed. Fragile confidence and ongoing viability issues have made it a challenge to get approval to take projects to site, and every sector saw a drop in new orders in Q2.

Given the weakness in the industry, there is a strong argument that we should cut our tender price forecasts. This tension between weaker demand and renewed cost pressures is likely to remain a defining feature of the market over the coming quarters. Contractors will need to be more competitive to win work. This will require tight cost control and continued pressure throughout the supply chain. However, the escalation of the conflict in the Middle East, with Houthi attacks on Saudi Arabia adding to the existing problems in the Strait of Hormuz, has caused energy prices to once again surge. In the UK, petrol and gas prices have hit their highest level since 2022, and with the construction sector highly exposed to such movements, there will be a limit to how much contractors can avoid passing on material price rises. The most competitive tender may not be the best one and could come about from firms with a lack of work trying to buy jobs. We are therefore leaving our forecasts unchanged, with risks to the downside if the market weakens further and renewed upside risks from spiking energy prices.

Housing weakness weighs on construction output

Construction output is having a difficult time. It has fallen in four successive months, and in the three months to August, output was 1.0% smaller than in the three months to May. Output is 1.6% smaller than a year ago, with all new work shrinking 5.0% since the three months to August 2025. While repair and maintenance has grown 3.0% over this time, it too has weakened recently, declining 0.3% on a quarterly basis.

The main driver of all new work’s decline over the past year is the housing sector. Private housing has shrunk 6.1%, with public housing dropping 27.9%. Combined, these two sectors account for two-thirds of the 5.0% reduction in all new work. More recently, it looks like the sector’s prospects have worsened with total housing output dropping 4.5% in the three months to August. The government’s announcement of how it will allocate almost £10bn of funding in its Social and Affordable Homes Programme as well as the forthcoming Your First Home scheme will offer some support the sector.

However, projects will take time to start, and viability issues will limit the number of new homes these proposals can deliver.

Infrastructure is the industry’s second largest sector and, relative to Q2 2025, output has fallen 0.1%. However, output has been steadily improving since January, and in the three months to August, it had risen 3.7%. Supported by 2025’s strong new orders figure, these new projects should continue to boost output over the next 12 months.

Private commercial, which grew 0.6% in the three months to August, is the only part of all new work to have expanded over the past year. Output is 1.6% higher than in the three months to August 2025, which is a step in the right direction after a prolonged slump. Nonetheless, such modest growth isn’t enough to offset weakness in the other sectors, and within private commercial, developers still have many reasons to be cautious.

CONSTRUCTION OUTPUT CONTINUES TO FALL

Source: ONS



New orders

New orders fell 11.8% in Q2 as fragile confidence hit every sector. The weakest release in a year-and-a-half, this is the third successive quarter in which new orders have declined and highlights the challenges of getting projects to contract. While a strong second half of 2025 means that on a rolling four-quarter basis new orders are still in a better position than a year ago, the downward trend will mean that contractors’ pipelines are becoming slimmer. The uncertainty caused by the conflict in the Middle East, as well as the impact this has had on borrowing costs, helps explain some of the weakness. However, given the broad-based nature of the latest fall, other factors are also likely to be holding back investment, including ongoing viability and delivery challenges.

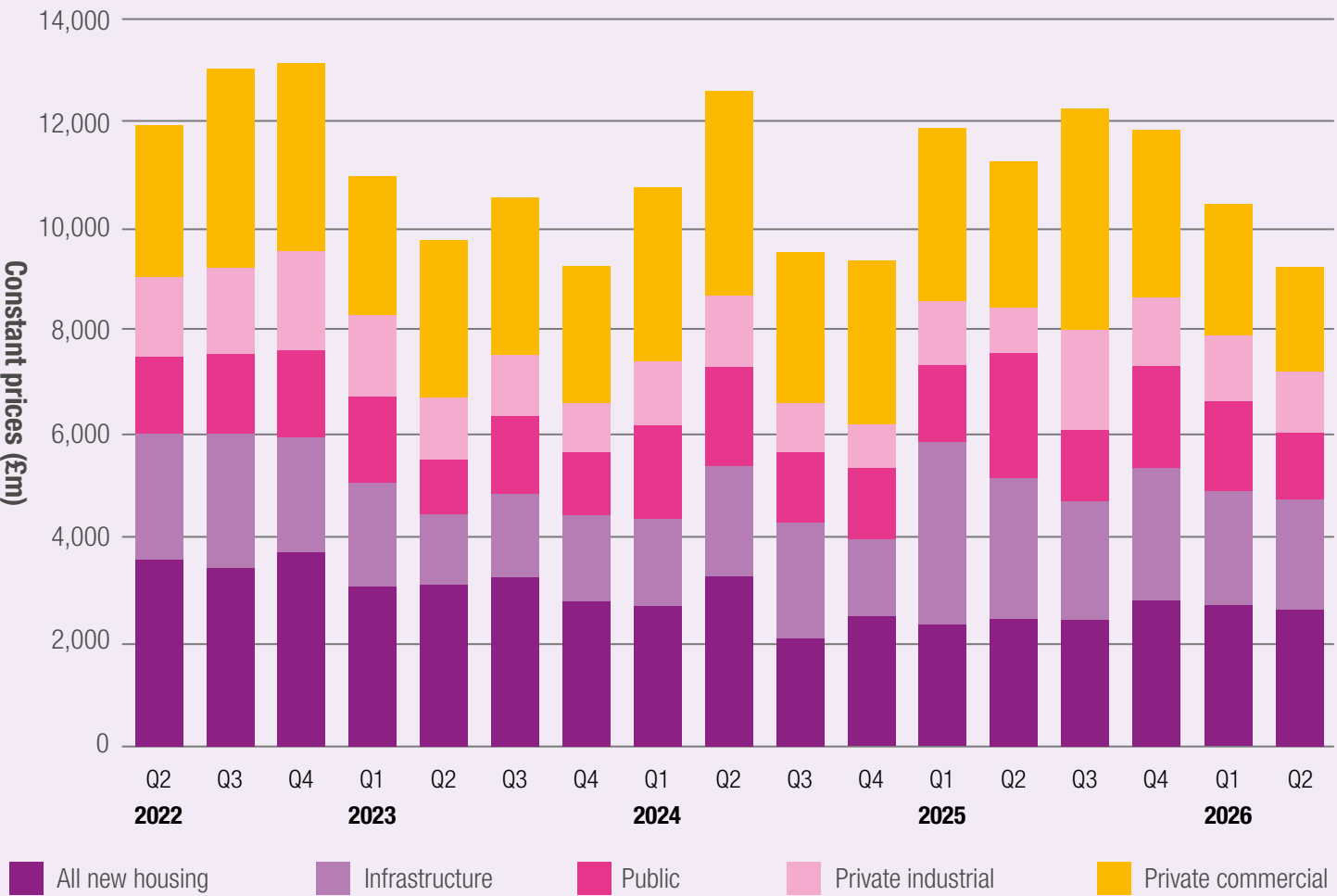
Notably, the worst performing sector in Q2 was public non-housing. Down 22.0%, this is a sector where interest rate concerns and short-term economic volatility should be less of a factor. Furthermore, on a rolling four-quarter basis, new orders are 5.5% lower than in Q2 2025. Given last June’s Spending

Review was intended to provide greater confidence to government departments as well as additional funding to a number of key areas, this weakness suggests it is more than just a timing issue that is preventing funding from flowing through to the construction sector. Within this sector, the two largest components, schools & colleges and health, have seen their fortunes diverge. While schools have seen a jump in new orders, activity in the health sector has weakened. The Spending Review did promise more money for the DfE in the coming years, with no change in real spending for Health and Social Care between 2025/26 and 2029/30. Nonetheless, this wouldn’t seem to warrant a reduction in construction expenditure in health, and it is likely this downturn will prove temporary.

Infrastructure, another focus area for government spending, also saw a fall in new orders. Declining 5.1%, the nature of large projects explains why this sector can be particularly volatile. Despite this being its fourth fall in five quarters – suggesting projects aren’t coming to the market as quickly as contractors would like – on a rolling four-quarter basis, infrastructure is still in a much better position than in 2023 and 2024.

WEAK CONFIDENCE DRIVES A THIRD SUCCESSIVE FALL IN NEW ORDERS

Source: ONS



There were double-digit falls for private industrial and private commercial. Private commercial, which fell by more than 20% for the third quarter in a row, recorded its worst quarter since the pandemic. Having struggled for a number of years, the end of 2025 had been very encouraging, but these fortunes have quickly reversed. A reduction in offices was the reason for the latest fall, with higher borrowing and build costs, in addition to renewed uncertainty, causing new schemes to face extra scrutiny.

Input costs

Construction pay is slowly moving in the right direction. Yet, despite having risen 0.9% over the past three months, regular earnings are only 0.3% higher than a year ago. This is better than three months ago, when the annual rate of regular earnings growth was -0.6%, but it remains incredibly weak. The spread between these figures from the ONS and those provided by HMRC from PAYE has also persisted. Median construction pay in August 2026 was 5.2% higher than in August 2025, marking the fastest rate recorded by this indicator in three years. However, with the same dataset reporting there were almost 10,000 fewer employees than in July 2025, it is hard to explain such a rapid pace of growth.

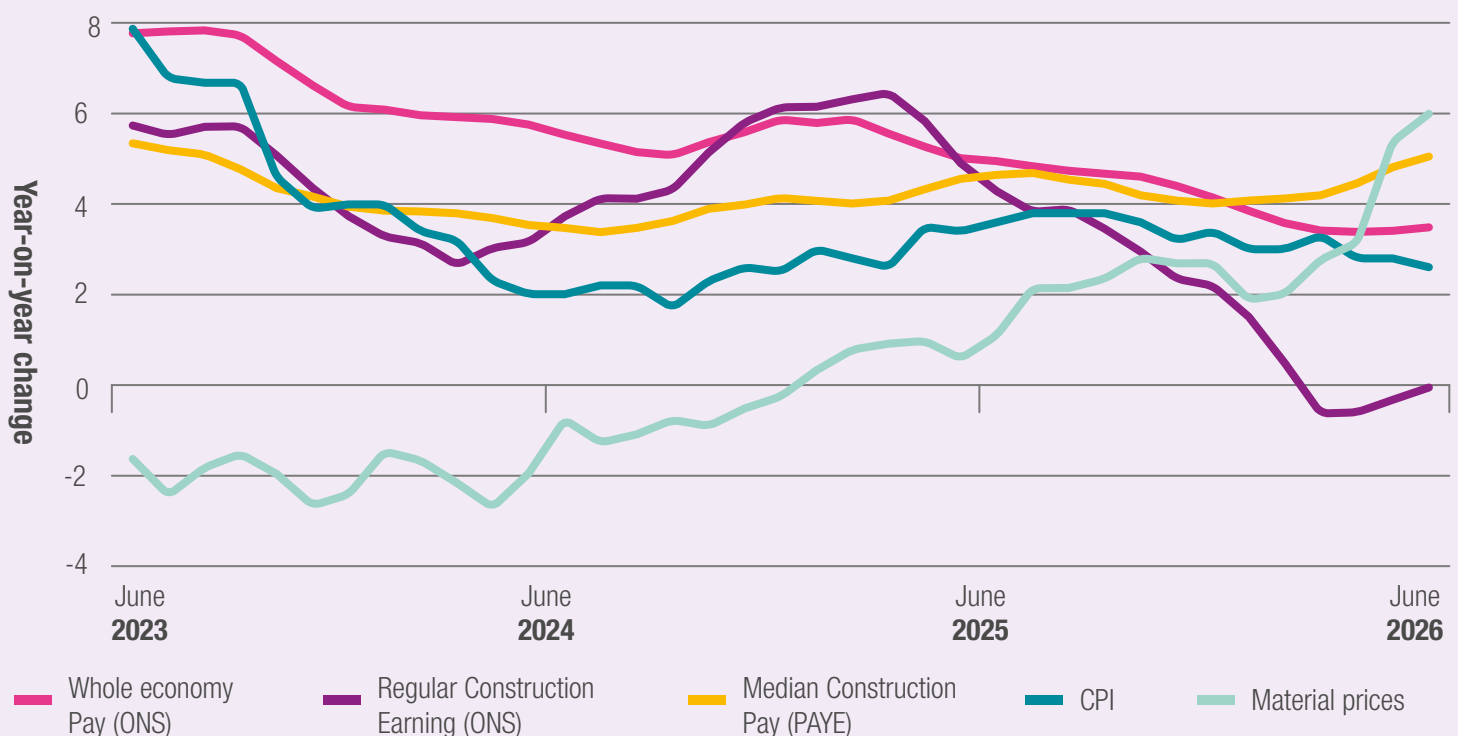
Across the whole economy, regular pay is 3.5% up on a year ago. In large part due to the public sector, pay growth in the private sector is only 2.9% and has continued to steadily ease since the start of the conflict

in the Middle East. Providing support to the Bank of England's position of leaving interest rates on hold, there is little evidence of the second-round inflation effects it needs to change its position. Yet, despite unemployment at 4.9% and CPI inflation rising to 3.1% in August, the recent jump in energy prices and anticipated move in January's Ofgem's energy price cap, the Monetary Policy Committee are now likely to vote for a rate rise this year.

In August, construction material prices rose 0.4% month-on-month, an easing on the monthly increases seen earlier in the year but another acceleration is probable as we move into Q4. Since the escalation of the conflict in the Middle East, the annual inflation rate of the 'all work construction material price index' has surged, reaching 6.4% in August. The highest it has been since March 2023, it is considerably more than the rate of consumer price inflation. This difference shouldn't come as a surprise and, during large oil price moves, both up and down, material prices usually shift by substantially more than consumer prices. Construction products are more exposed to energy prices than consumer prices, and previous large oil price increases, including in 2011, 2018 and 2022, all saw material price inflation rise much faster than CPI inflation. Having dipped in during the summer, petrol and gas prices have been on the rise again, and with both hitting their highest levels since 2022, this will feed into further material price rises.

MATERIAL PRICE INFLATION SURGES AS CONSTRUCTION PAY REMAINS WEAK

Source: ONS, DBT, HMRC



Turning local powers into construction activity will take time

Andy Burnham has made devolution and transfer of powers away from central government a central pillar of his leadership. A recent [OECD report](#) found that locally raised revenues from council tax and business rates were under 20% compared to an OECD average of 34%. Additionally, in the UK, over 60% of subnational revenues come from grants and subsidies, whereas the OECD average is 40%. The Cabinet Office's [Rewiring the State statement](#) recognises that local leaders are often better placed to understand local priorities and challenges facing their communities. In setting out a new model for government and making the case for greater devolution of powers and resources to local areas, the hope is that this will help drive economic and productivity growth across the UK.

To support devolution, the government has announced changes that will allow mayors to keep a share of locally raised income tax and business rates. Starting next April with business rates, income tax will follow in 2028. The intention is that greater local revenue-raising powers will gradually replace the current reliance on grant funding as the main source of income for local authorities. Details on what exactly this means and how it will work are currently limited, but the government intends to publish a white paper with a roadmap alongside the Autumn Budget.

As well as overhauling funding, local authorities are also due to gain 'greater powers' over areas including housing, transport, skills and public services. For housing, there will be more devolved funding and stronger planning and regeneration powers for local leaders. Meanwhile, local leaders will get more control over large local transport projects. In both cases, if these reforms prove successful and play out as hoped, they should boost construction output. However, the key challenge will be delivery. Accelerating planning, securing funding, developing local capability and managing increasingly complex programmes will ultimately determine whether devolved powers translate into additional construction activity. In addition, authorities with the strongest pipelines, funding certainty and delivery capability are likely to be best placed to realise the benefits first.

A stated aim of all recent governments has been to build more homes. As with the latest policy, previous ones have included a combination of funding and planning changes often involving a target of 300,000 new homes a year. The UK has not delivered more than 300,000 new homes in a year since 1977. In 2025, there were only 171,520 completions. Completions have dropped in each of the past three years, and the significant viability challenges that currently exist will continue to be a bigger determining factor in what gets built than changes to the planning system. The recent publication of the 33 councils, housing associations and other providers who will benefit from the first £10bn of the £39bn Social and Affordable Homes Programme further highlights the scale of the problem. While clearly a positive step, it will take many years for the funding to deliver the proposed 70,000 homes.

Transport is where the public is most likely to see the day-to-day impact of these reforms. The intention is that greater local control will enable integrated ticketing, as seen in London and Greater Manchester, and improve service reliability. For construction, the bigger change comes from increasing the threshold where central government approval is needed. Rising from £200m to £500m, this should theoretically speed up the time it takes such projects to get to the delivery phase, while also giving stakeholders greater certainty that they will happen. Greater certainty over project progression is likely to improve confidence across the investment and delivery community. For clients, investors and supply chains alike, clarity around funding



Devolution has the potential to boost construction output, but delivery capability will ultimately determine its success.

and approvals often plays a critical role in determining whether projects move forward.

Public capital spending on transport is one of the most uneven areas of government spending. In 2024/25, the Institute for Fiscal Studies reports that whereas average spending across the UK was £415 per person, in London it was over £800 per person. Yet this also shows how shifting money from the capital to elsewhere is not straightforward. All of the difference in spending is due to rail. In addition to having the only underground system in England, of the 1.5bn national rail passenger journeys that took place between March 2024 and April 2025, over 1bn of those started, ended or took place entirely in London. Increasing rail usage outside London is desirable, but this shouldn't come at the expense of cutting funding to the existing system.

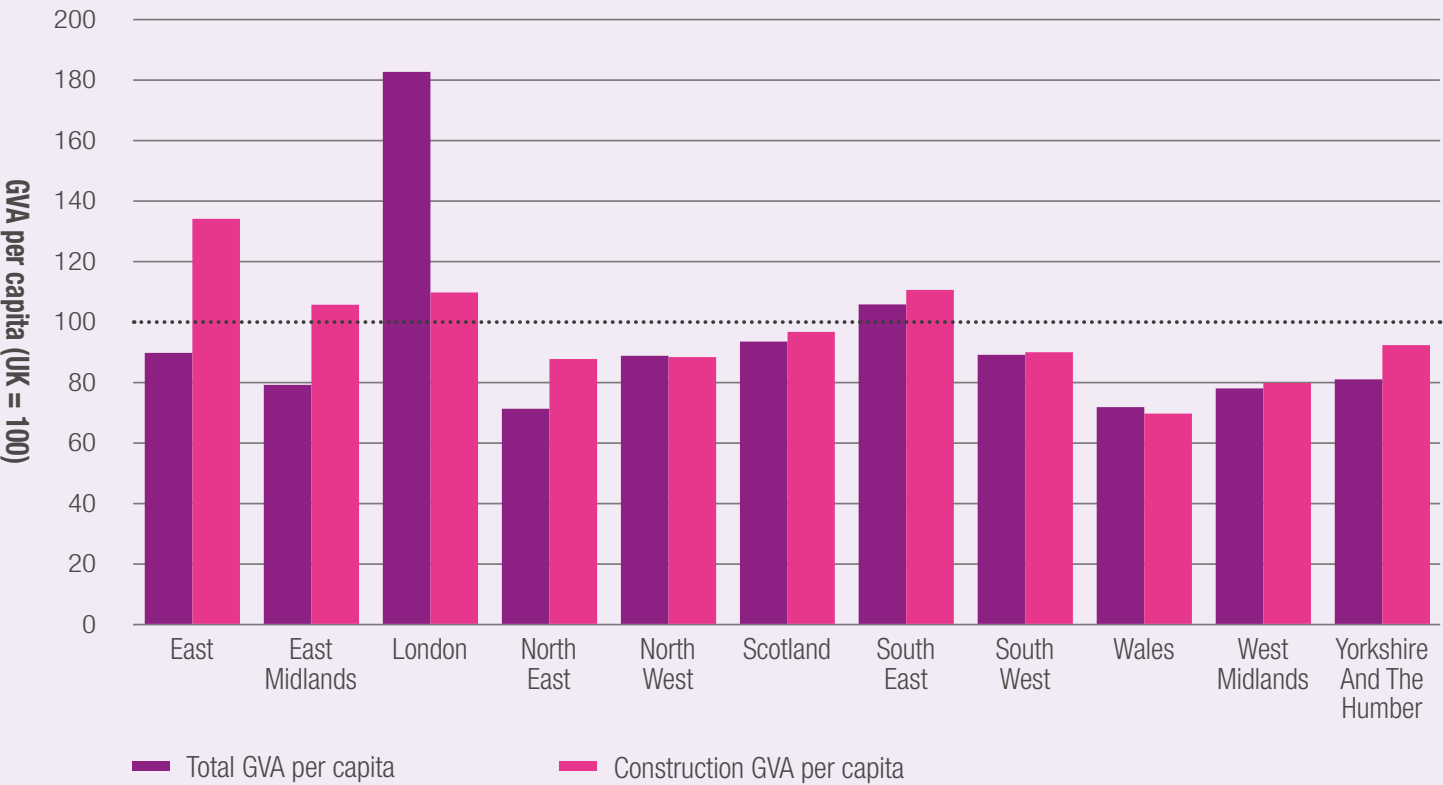
More generally, ensuring fairness across the regions is the biggest and most obvious challenge with devolution as a policy. If, for example, the new system uses a flat rate to determine the share of income tax that areas get to keep, it would leave London substantially better placed than regions with less money. In this scenario, an equalisation processes would be needed, and adjusted over time, assuming some regions are better able to capitalise on the opportunities and enjoy faster growth than others. If a mayor's priorities differ widely from the government's this may also create

problems. Already, one mayor has said they plan to provide rebates to local taxpayers. The proposal was quickly rebuffed by central government, highlighting one reason previous governments have been reluctant to reduce their control on spending and potential limitations on decision making that will need to be imposed.

The timeframe for introducing the new policies, as well as the lag before construction projects get to site, means it might not be until the 2030s before there is a noticeable impact. In the meantime, there are several datasets which cover the spread of construction across the country. These show that, although a significant proportion of projects are London-based, the economic benefits are more evenly distributed. The first observation when looking at gross value added (GVA), a similar measure to GDP that is used to calculate the size of industries and regions, is just how much larger London's economy is than any other region in the UK. Creating one of the main arguments for devolution, the variation in construction GVA is less pronounced. However, importantly, GVA reflects where the businesses delivering the work are based. The East's strong performance is likely because many firms are based there but operating in London. This suggests that skills and experience are more evenly distributed across the country, which should support devolution. However, it also likely understates where construction spending is actually taking place.

WHILE LONDON IS THE RICHEST REGION, CONSTRUCTION IS MORE EVENLY SPREAD

Source: ONS, Oxford Economics





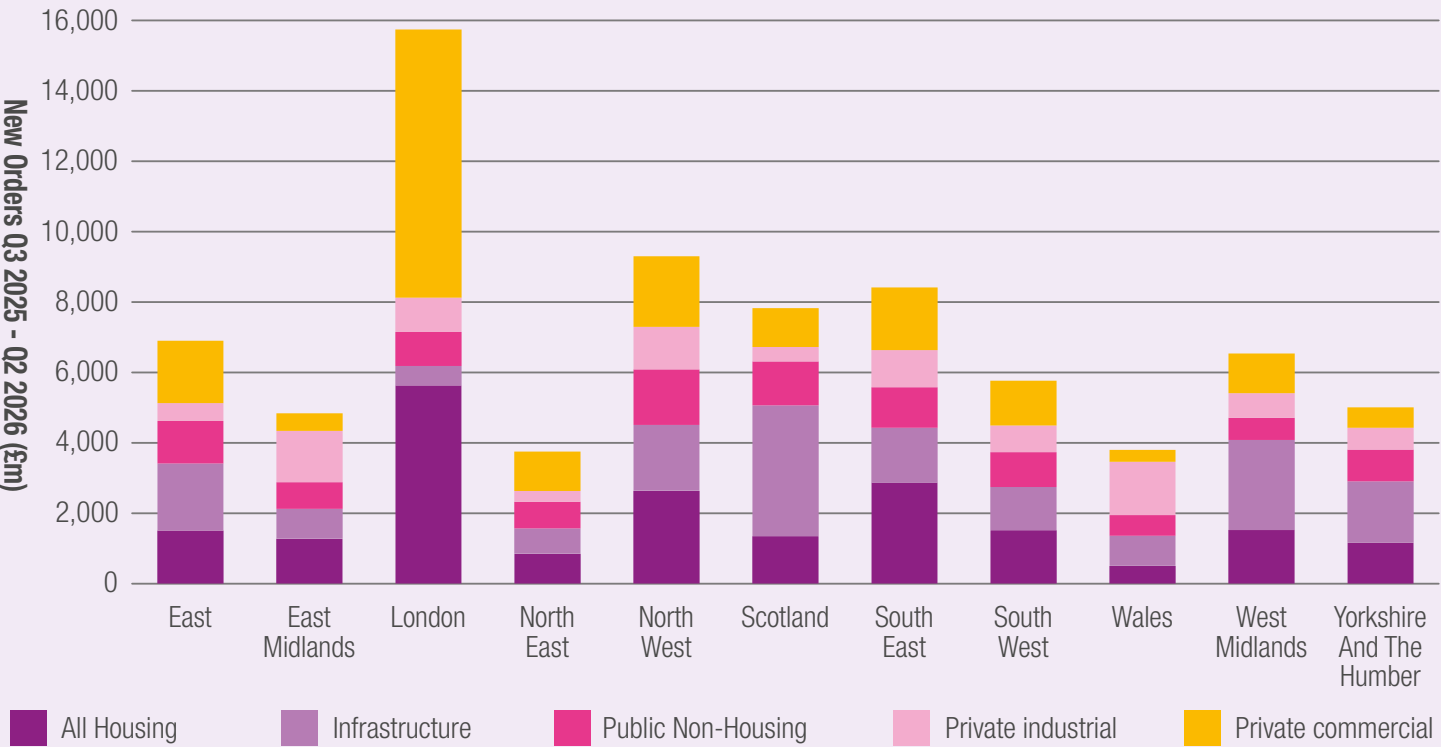
The real impact of devolution may not be visible until the 2030s, when policy begins translating into projects on the ground.

An alternative to GVA is new orders. This data shows the sectoral split of awarded construction work and the location of the projects and, unsurprisingly, in most quarters, London has the largest value of new orders. Typically accounting for over 20%, the capital has an oversized share of the housing and private commercial sectors. Were it not for private commercial, which itself has had a number of difficult years, new orders in London wouldn't stand out anywhere near as much. Additionally, if devolution works, then there will be faster economic growth across the UK. In turn, this will lead to greater demand for houses and offices in these regions, narrowing the gap in construction work that currently exists.

Meanwhile, London's share of infrastructure new orders since the pandemic has averaged just 7.4%. Whereas during the 2010s it had large schemes such as the Tideway Tunnel, Crossrail, and several considerable HS2 packages, it has not received the same level of investment more recently. Instead, electricity has driven infrastructure sector growth. Scotland has done particularly well, supported by onshore and offshore wind projects, alongside the associated transmission and grid infrastructure. While continued investment in electricity generation and transmission will be essential for the UK to meet its climate targets, the government will hope its devolution policies will also boost transport expenditure.

THE COMMERCIAL SECTOR
EXPLAINS MUCH OF LONDON'S
CONSTRUCTION STRENGTH

Source: ONS



Planning and appraisal reforms could unlock more projects

Devolution is not the only recent policy news that has significant implications for construction. In August, the government published an updated National Planning Policy Framework (NPPF), the eighth iteration since 2012. Reflecting the continued shortfall against the long-standing target of 300,000 new homes a year, according to the [Ministry of Housing, Communities and Local Government](#), it involves “common-sense changes that will fast-track quality homes in well-connected areas”. In particular, the Framework introduces plans under which suitable housing developments near well-connected train, Tube and tram stations should be approved, unless their benefits are substantially outweighed by adverse effects. Sites within around 800 metres or a ten-minute walk of qualifying stations will benefit from stronger support for residential development, including sites within the Green Belt. Alongside this, it supports higher densities in well-connected locations, greater flexibility over Green Belt development and increased housing delivery through stronger requirements to meet housing need, allocate sufficient land and bring sites forward.

Yet, while the government has talked at length about giving greater power to local authorities, the NPPF arguably takes away some of its ability to reject projects. Planning committees will still be able to push back on projects for reasons such as serious townscape harm or unacceptable effects on residents. The Framework is, therefore, much more nuanced than a “default yes” for developments near stations, but the changes should result in more schemes getting approved. However, providing developers with greater certainty and confidence about their schemes will only help to a certain extent, and as we discuss elsewhere in this report, viability challenges are increasingly problematic and holding back investment. The Framework also provides some support by allowing developers to justify a viability assessment at the application stage in certain circumstances such as a recession. Strategic sites, typically those providing at least 1,500 homes, may also benefit from greater flexibility over affordable housing provision and the timing and funding of infrastructure.

In July, the National Infrastructure & Service Transformation Authority published its 2025/26 Annual Report. Covering 189 projects in the Government Major Projects Portfolio (GMPP), this includes 68 infrastructure and construction projects. With whole-life costs of £450bn out of the total £924.2bn, and monetised benefits of £372.4bn out of £603.6bn, infrastructure and construction is comfortably the largest component. Frustratingly, a change in methodology means that the costs and monetised benefits are not comparable with last year’s figures. However, the average project duration within the category has increased from 10.9 years to 14.8 years. This represents a substantial increase, particularly as both government transformation and service and military capability projects only increased by 0.3 years. Some of the largest changes, such as those affecting East West Rail and Northern Powerhouse Rail, are due to maturing schedules and updated scope. More concerning for the industry are recent delivery setbacks. The additional prison places programme was delayed after a contractor entered administration, while Project Gigabit was extended by two years due to supplier financing and delivery challenges. This highlights the importance of due diligence across the supply chain and demonstrates how the government’s plans to improve infrastructure planning and remove barriers to delivery could help.

Over the past year, eight construction projects left the GMPP, while there were seven new projects added to it. One factor influencing whether projects secure approval and enter the pipeline is the discount rate. A figure used to convert future cashflows, benefits and costs into today’s value, it also makes it possible to compare schemes of different size or duration. Higher discount rates place greater weight on money today than in the future, reducing the present value of schemes where benefits take a long time to emerge. Therefore, the government’s announcement that the appropriate discount rate should fall from 3.5% to 3.0% should make it easier to approve projects with long-term potential. The government expects this change to boost major infrastructure projects, which have large upfront costs and economic and social benefits that are not realised until years in the future.

However, the reduction in the discount rate is not solely the result of a political desire to make long-term projects more attractive. In part, and without delving too far into the technical and mathematical reasons, it is also because forecasts of future growth are lower than they were previously. When the 3.5% discount rate was first introduced in 2003, long-term real growth per capita rates were higher than they are now. Lower discount rates leading to more projects getting the green light may be a desirable outcome. However, the weaker growth forecasts denote a variety of long-term problems and given the UK's recent economic performance, further downgrades to the discount rate may be necessary in future reviews.

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