Global Matters Weekly

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Inflationary pressures

by Jackson Franks

Having a Swedish partner meant that this weekend was spent eating a whole load of pickled herring and drinking unsweetened flavoured schnapps. For those who are unaware, this means it was Midsommar, an annual celebration in Sweden which celebrates the middle of summer. The festivity consists of a never-ending lunch party which involves flowers in your hair, dancing around a maypole, singing songs and enjoying the acquired tastes of the above-mentioned food and drink. This year we spent it in Hyde Park and were lucky enough to be close to The Rolling Stones Hyde Park concert. So, whilst Gimme Shelter was playing live in the background, we were dancing around the maypole singing Små Grodorna, which translates to The Little Frogs. You can make your own mind up, but I know where I would have rather been...

Surprisingly this year's maypole, which is traditionally made from birch, pine or ash and bound with leaves, flowers and ribbons, had its main structure built from steel. The organisers must have been thinking about longevity over price, as over the last 12-months structural steel prices have increased by 38.5%[1]. Steel is not the only commodity that has seen its price soar. Over the 12-months to June 2022, aluminium, timber and concrete were all up 41%, 30% and 28%, respectively[1]. With these being key materials used in developing an asset (which typically accounts for 25% to 30% of the total build cost) margins within the sector are being squeezed, and we are starting to see the impact.

Here in the UK, the construction industry is booming. What should translate to healthy profitability for building companies has in fact seen more than 3,400 smaller UK construction businesses enter administration in the year up to April 2022, the highest number since the global financial crisis. Soaring material and labour costs have caused construction prices in the UK to increase by 25% over the last 12-months[2]. The inflationary pressures are hitting the smaller construction companies harder than the larger companies. Where larger construction companies have access to cash to buy supplies in advance, visibility on demand, room to store materials, and the ability to pass the costs on to customers, smaller builders do not. However, larger developers may begin to feel a tighter squeeze in the months to come. Adding to the already soaring material prices, energy costs continue to rise, meaning plant equipment on building sites are becoming increasingly more expensive to use, and therefore margins will continue to tighten.

Nevertheless, with the construction industry under significant pressure, current asset owners may be the beneficiaries. Due to the ever-rising costs in developing a new asset, the new supply coming to the market is minimal. Berkley Group, one of the UK's largest home builders, recently announced that the number of new homes being built in London could halve in the coming years because of these rising costs. With a lack of new supply entering the market, competition for existing space may intensify, enabling landlords to take advantage as supply and demand dynamics shift across sub-sectors.

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Sources:
1 Energy & Petroleum Regulatory Authority (EPRA), Main Suppliers of Construction Material in Kenya, KNBS & MACE YMR
2 Department for Business, Energy and Industrial Strategy

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Belvest 研富

For more information, please contact your adviser or alternatively contact:

Belvest Investment Services Limited
研富投資服務有限公司
9th Floor, Centre Mark II
305-313 Queen's Road Central
Sheung Wan, Hong Kong

Tel +852 2827 1199
Fax +852 2827 0270
belvest@bis.hk
www.bis.hk

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