



Department
for Business
Innovation & Skills

**METHODOLOGICAL CHANGES TO
CONSTRUCTION PRICE AND COST
INDICES**

User Consultation

JULY 2014

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Methodological changes to construction price and cost indices

The Department for Business, Innovation and Skills (BIS) currently releases Construction Price and Cost Indices¹ for each quarter. Following several reviews of these statistics, which identified issues with the methodology, and the awarding of a new contract for compilation of the indices, Aecom² in partnership with BIS embarked on a programme of work to develop the methodology used to measure construction price statistics.

The Office for National Statistics (ONS) uses construction tender price indices to remove the effects of price movements from new orders in the construction industry. ONS convert these tender price indices to output price indices which are used to deflate: (a) output in the construction industry and (b) gross fixed capital formation data.

These indices are also used outside of ONS by the construction industry to adjust construction contracts, by utilities regulators and by analysts.

The purpose of the consultation is to gather users' views on the proposed methodologies for input cost indices and their conversion to output price indices, the choice of a market indicator, the length of the published back series and how far back it is incorporated into ONS statistics on construction and gross capital formation.

Issued: 07/07/2014

Respond by: 28/07/2014

Enquiries to: Frances Pottier, 0207 215 1953, materialstats@bis.gsi.gov.uk

This consultation is relevant to: users of the construction price and cost indices and of the ONS statistics on construction and gross capital formation.

¹ <https://www.gov.uk/government/collections/price-and-cost-indices>

² <http://www.aecom.com/>

1. Executive Summary

1. The Department for Business, Innovation and Skills (BIS) currently releases Construction Price and Cost Indices for each quarter. Following several reviews of these statistics which identified issues with price statistics compiled by BCIS, on winning the contract for the compilation of these indices, Aecom in partnership with BIS embarked on a programme of work to develop the methodology used to measure construction price statistics.
2. The proposed methodology for deriving input cost and output price indices can be found in the article *Improvement to the Construction Price Indices* (<https://www.gov.uk/government/publications/construction-price-indices-improvements>).
3. The purpose of the consultation, is to gather users views on the proposed methodology for:
 - Input cost indices
 - Conversion of input cost indices to output price indices
 - The choice of market indicator
 - The length of the published time series
 - Its incorporation into ONS statistics
4. The article *How construction price indices are used in construction statistics and gross fixed capital formation* (<http://www.ons.gov.uk/ons/guide-method/method-quality/specific/business-and-energy/output-in-the-construction-industry/how-construction-price-indices-are-used.pdf>) explains the use of these statistics by ONS.

Input costs

5. In summary the proposed methodology for input cost indices is to use a basket of goods approach, where costs for selected inputs are collected on a type of work basis for:
 - Typical materials and products
 - Types of labour
 - Construction equipment
6. Transport and energy costs will not be included in the basket, which is a departure from the OECD guidance on sources and methods for construction price indices. (<http://www.oecd.org/industry/business-stats/2372435.pdf>)

7. For each type of work published in Output in the Construction Industry (<http://www.ons.gov.uk/ons/rel/construction/output-in-the-construction-industry/april-2014/stb-construction-april-2014.html>) an appropriate resource mix of the above will be used. These will be combined using expenditure weights based on current price construction output to create an all construction input cost series.

Output prices

8. The proposed method for compiling output price indices is to convert input costs using a multiplier in the form of a market indicator that best reflects market conditions and estimates of other costs such as preliminaries, overheads, profit and taxes.

Market indicator (Multiplier)

9. The proposed market indicator is to take new work orders at current prices by sector (<http://www.ons.gov.uk/ons/rel/construction/output-in-the-construction-industry/april-2014/stb-construction-april-2014.html>) and divide by an employment index, (a ratio of the number of construction employees and the number of people employed in the whole economy).

About the consultation

10. The consultation will be open from 7 July 2014 to 28 July 2014.
11. Responses will be used to inform how Aecom, BIS and ONS proceed with this change in methods. The results of the consultation will be published within approximately three weeks of the consultation closing.

2. How to respond

12. When responding please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents by selecting the appropriate interest group on the consultation form and, where applicable, how the views of members were assembled.
13. The consultation response form is available electronically on the consultation page: <https://www.gov.uk/government/collections/price-and-cost-indices> (until the consultation closes). The form can be submitted by post or email to:

Frances Pottier
Statistical Analysis
Department for Business, Innovation and Skills
5th Floor Spur 1, 1 Victoria Street, London, SW1H 0ET
Tel: 020 7215 1953
Email: materialstats@bis.gsi.gov.uk

14. A list of those organisations and individuals consulted is in Annex B. We would welcome suggestions of others who may wish to be involved in this consultation process.
15. You may make printed copies of this document without seeking permission.
16. Other versions of the document in Braille, other languages or audio-cassette are available on request.

3. Confidentiality & Data Protection

17. Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.
18. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

5. Help with queries

19. Questions about the policy issues raised in the document can be addressed to:

Frances Pottier
Statistical Analysis
Department of Business, Innovation and Skills
5th Floor Spur 1, 1 Victoria Street, London, SW1H 0ET
Tel: 020 7215 1953
Email: materialstats@bis.gsi.gov.uk

The consultation principles are in Annex A.

6. The proposals

20. The proposed methodology for deriving input cost and output price indices can be found in the article Improvement to the Construction Price Indices (<https://www.gov.uk/government/publications/construction-price-indices-improvements>).

21. The purpose of the consultation, is to gather users views on the proposed methodology for:

- Input cost indices
- Conversion of input cost indices to output price indices
- The choice of market indicator
- The length of the published time series
- Its incorporation into ONS statistics

Input costs

22. In summary, the proposed methodology for input cost indices is to follow a basket of goods approach, where costs for selected inputs are collected on a type of work basis for:

- Typical materials and products
- Types of labour
- Construction equipment

23. Transport and energy costs will not be included in the basket, which is a departure from the OECD guidance on sources and methods for construction price indices.

24. For each type of work published in Output in the Construction Industry (<http://www.ons.gov.uk/ons/rel/construction/output-in-the-construction-industry/april-2014/stb-construction-april-2014.html>) an appropriate resource mix of the above will be used. These will be combined using expenditure weights based on current price construction output to create an all construction price series.

Output prices

25. The proposed method for compiling output price indices is to convert input costs using a multiplier in the form of a market indicator that best reflects market conditions and estimates of other costs such as preliminaries, overheads, profit and taxes.

Market Indicator

26. The proposed market indicator is to take new work orders at current prices by sector (<http://www.ons.gov.uk/ons/rel/construction/output-in-the-construction-industry/april-2014/stb-construction-april-2014.html>) and divide by an employment index, (a ratio of

the number of construction employees and the number of people employed in the whole economy). Cost such as preliminaries, overheads, profits and taxes are included in the value of new work orders, but cannot be distinguished from other costs.

7. Consultation questions

27. The following are the questions on which we would welcome your input. A separate form is available at <https://www.gov.uk/government/collections/price-and-cost-indices>

Input Cost and Output Price Indices

- 1) What are your views on the proposed method for compiling input cost indices?
- 2) The current proposal suggests that the basket of materials for input cost materials will be updated quarterly. Is this the correct frequency? If no, how often should the basket of goods be reviewed and updated?
- 3) How should input cost indices be converted to output price indices?
- 4) OECD guidance <http://www.oecd.org/industry/business-stats/2372435.pdf> suggests that the difference between input cost indices and output price indices is the addition of contractors' profit margins, productivity and overheads. How should these be defined?
- 5) If a market indicator is used, what should that market indicator consider? A list of indicators already considered is available in Annex B.

Length of time series

- 6) It is possible to create a series that dates back to 2005, does this meet your needs?
- 7) When incorporating into estimates of construction output and gross fixed capital formation, should the ONS take on data back to 2005?

8. What happens next?

28. We will publish a summary of the comments made approximately three weeks after the consultation closes.

Annex A: Consultation principles

The principles that Government departments and other public bodies should adopt for engaging stakeholders when developing policy and legislation are set out in the consultation principles.

<http://www.cabinetoffice.gov.uk/sites/default/files/resources/Consultation-Principles.pdf>

Comments or complaints on the conduct of this consultation

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

John Conway,
BIS Consultation Co-ordinator,
1 Victoria Street,
London
SW1H 0ET

Telephone John on 020 7215 6402
or e-mail to: john.conway@bis.gsi.gov.uk

However if you wish to comment on the specific policy proposals you should contact the policy lead (see section 5).

Annex B: List of market indicators already considered

To derive a robust market indicator a number of possible influencers have been examined.

- Average % Preliminaries per quarter
- Average % overheads and profits (OHPs) per quarter
- Employment level changes (quarter on quarter) in the construction industry
- Unemployment rates (per region, per sector)
- New Construction Order series (current and constant prices)
- Liquidation rates in the whole economy (Insolvency Service) (differences from average, quarter on quarter)
- Liquidation rates construction industry (Bankruptcies, Compulsory Liquidation, Individual Insolvencies, Creditors Voluntary Liquidation)
- Measures of House Prices (Halifax House Prices, ratio average house price to average mortgages, ratio average house prices to average earnings)
- Aecom Spon's Output Prices
- Global Unit Prices per square foot
- Investment Property Databank (IPD) indices average yields Real Estate Investment Trusts (REITs) (Commercial property)
- IHS Global Insight Construction
- Construction Price Indices, Tender Price Indices (AECOM and BIS) and Resource Price Indices
- Construction Producer Price Indices
- Experian Leading activity indicator
- Barbour ABI construction sentiment indicators
- Markit Qualitative indicators, industry sentiment surveys
- Industry commentaries
- Return on Investments / profitability of major contractors (FAME database)
- OJEU (Official Journal of the European Union) notices of public work

- Job advertisements (egg Architects Journal)
- Productivity measures (e.g. productive hours in Construction)
- Yields Bank of England
- Proxy Indices from official statistics (e.g. deconstructed CPI, Pieper, BEA approach)
- Academic publications covering theoretical pricing systems and deflator creation
- Commodity prices

Annex C: List of Individuals/Organisations consulted

On 19 June ONS hosted a seminar on the construction price indices at which they and Aecom gave a presentation about the proposals. Attendees included representatives from the following organisations:

Barbour ABI

Building Cost Information Service

Confederation of British Industry

Construction Products Association

Department for Communities and Local Government

Experian PLC

HM Treasury

Mineral Products Association

Mott MacDonald

Nuclear Defence Association

Office of Budget Responsibility

Phoenix Management Consultants Ltd

Scottish Government

On 25 June, BIS hosted a meeting of the regular Consultative Committee on Construction Industry Statistics, at which AECOM and ONS repeated the presentations from the seminar. Attendees included representatives from the following organisations:

Barbour ABI

Building Cost Information Service

Construction Products Association

ConstructionSkills

Department of Communities and Local Government

Experian PLC

Glenigan

National Federation of Builders

University College London

University of Salford

University of Westminster

If you are aware of any other individuals or organisations who should also receive the consultation, please let us know using the contact details in section 5.

Annex D: Methodological Changes to Construction Price and Cost Indices response form

This form is available at <https://www.gov.uk/government/collections/price-and-cost-indices>

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.

The closing date for this consultation is 28/07/2014

Name:

Organisation (if applicable):

Address:

Please return completed forms to:

Frances Pottier, 5th Floor Spur 1, 1 Victoria Street, London, SW1H 0ET

Telephone: 020 7215 1953

Email: materialstats@bis.gsi.gov.uk

Please tick the type of respondent you are:

- Business representative organisation or trade body
- Central government
- Charity or social enterprise
- Individual
- Large business (over 250 staff)
- Legal representative
- Local Government
- Medium business (50 to 250 staff)
- Micro business (up to 9 staff)
- Small business (10 to 49 staff)
- Trade union or staff association
- Other (please describe)

.....

Input Cost and Output Price Indices

- 1) The current proposal suggests that the basket of materials will be updated quarterly. Is this the correct frequency? How often should the basket of goods be reviewed and updated?

- 2) How should input cost indices be converted to output price indices?

- 3) OECD guidance suggests that the difference between input cost indices and output price indices is the addition of contractors' profit margins and productivity overheads. How should these be defined?

- 4) If a market indicator is used, what should that market indicator consider?

Length of time series

- 5) It is possible to create a series that dates back to 2005, does this meet your needs?

- 6) When incorporating into estimates of construction output and gross fixed capital formation, should the ONS take on data back to 2005?

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