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RESEARCH NOTE 17

HIDDEN COSTS OF 2012:

CONSTRUCTION INFLATION TO COST £4 BILLION

This research note shows how the 2012 Olympics will add almost **£4 billion** to construction inflation in **London** and the **South East** between now and the start of the Games in five years time.

The official budget for the Olympic Games has increased from £2.4 billion in July 2005, when London won the bid to host the Games, to £9.35 billion currently.[1] With five years to go until the start of the Games, the **TaxPayers' Alliance 2012 Watchdog** has expressed concerns that the official budget may increase still further, and will be closely monitoring developments to ensure that taxpayers are getting value for money.

Preparations for the 2012 Olympics will, however, lead to a range of additional costs that have so far escaped scrutiny. In the first of a series of research notes, the 2012 Watchdog is investigating the hidden costs of the Olympics. The first area of scrutiny is the **impact of the Games on construction inflation in London and the South East:**

- The official bill for the Olympic venues, infrastructure and regeneration is currently almost £5 billion.[2] The huge demand for construction that this represents will have knock-on effects in the wider construction industry, pushing up construction inflation each year until the Games have been held. EC Harris, a leading construction consultancy, estimates that the Olympics will **increase annual construction tender price inflation in London and the South East by 1 to 1.5 per cent.**
- For new construction orders in London and the South East, which are expected to reach well in excess of £10 billion by 2012, this will mean substantially higher prices for buyers. The 2012 Watchdog calculates that if the Olympics adds 1.25 per cent to construction inflation (the midpoint of the EC Harris range) each year between now and 2012, **the increased cost of construction orders attributable to the London Olympics will reach £3.9 billion in total.**

[1] National Audit Office "Preparations for the London 2012 Olympic and Paralympic Games – Risk Assessment and Management", February 2007, pp.14-15; Jowell, T. "Oral statement by Tessa Jowell on costs and funding for the 2012 Olympic & Paralympic Games", March 2007

[2] Jowell, T., op. cit.

- The £3.9 billion total is not an annual figure, but is the sum of the increased construction costs each year between 2007 and 2012. Table 1 compares the value of construction orders in London and the South East with and without the projected effect of the Olympics on construction inflation.

Table 1: The effect of the Olympics on construction inflation

Year	Value of construction orders without Olympics inflation, £ billion	Value of construction orders with Olympics inflation, £ billion	Effect of the Olympics on construction prices, £ billion
2006	12.2	-	-
2007	12.7	12.9	0.2
2008	13.3	13.6	0.3
2009	13.8	14.4	0.5
2010	14.4	15.1	0.7
2011	14.9	15.9	1.0
2012	15.5	16.7	1.2
Total			**£3.9 billion**

NB: Figures have been rounded to the nearest £100 million

- The increase in construction costs between now and 2012 attributable to the London Olympics will be felt in a number of areas. The 2012 Watchdog calculates that the Olympics will have the following effects for the different categories of construction order:
  - **£1.5 billion** increase in the cost of private commercial buildings, new office and retail space.
  - **£921 million** increase in the cost of building private housing, potentially adding to house price inflation in the Capital.
  - **£640 million** increase in the cost of public buildings, potentially affecting plans for new schools, NHS units and GP surgeries.
  - **£444 million** increase in the cost of infrastructure work, without factoring in large potential projects such as Crossrail.
  - **£237 million** increase in the cost of building public housing during a critical period when projects for new social housing in London will be agreed.
  - **£161 million** increase in the cost of private industrial buildings.

Comment from the TaxPayers' Alliance 2012 Watchdog

Alex Story, Former Olympian and Spokesman for the TaxPayers' Alliance 2012 Watchdog, said:

> *"Most people are excited by the prospect of the London Olympics, but the constant stream of negative news almost every month about bad management and rising costs will soon start to weigh heavy on peoples' enthusiasm. The picture that was painted to win the bid was far too rosy and the lack of honesty and transparency about hidden costs like these runs the risk of killing the buzz for what should really be an awesome party."*

Matthew Sinclair, Policy Analyst at the TaxPayers' Alliance, said:

> *"Increasing the cost of construction in London and the South East is not only hazardous to the health of the British economy but also imperils the objective of getting enough new homes built to make things easier for first-time buyers. The bigger the bill for the Olympics becomes, the more damaging this knock-on hidden cost will be."*

Sources and methodology

- The following sources were used for the calculation in this research note:
  - The effect of the Olympics on annual construction price inflation in London and the South East was taken from *The 2012 Olympics – time to pick up the pace? EC Harris, July 2006*. The report states:
    > *"Our view now is that the London Games will lift tender price inflation in London and the South-East by some 1 to 1.5 per cent, to show increases of approximately 5.5 - 6 per cent over the next five years, with little chance of a slowdown thereafter until after 2012."*
    > http://www.echarris.com/uploadeddocuments/6212_Olympics_Report.pdf.
  - The value of new construction orders in London and the South East over the last decade was taken from *Table 1.5, Construction Statistics Annual Report 2006, Department of Trade and Industry, September 2006*. The time-series was also broken down by type of order.
    > http://www.berr.gov.uk/files/file34487.pdf
- The value of future construction without the Olympics has been estimated by running a time series regression for each of the different types of construction, using data from 1995 to 2005 to establish trend rates of growth. Those trends are then used to extrapolate each category of construction forward to 2012.

- The value of future construction including the effect of the Olympics on construction inflation has been calculated by taking the mid-point of EC Harris' estimate of the added tender price inflation created by the Olympics of 1.25 per cent per annum, which is then compounded by the number of years the inflation has been ongoing. This calculation is made for each category of construction, and the total effect on the construction industry is simply the sum of the various categories.

- The cost estimates in this report are based on a projection of construction demand absent the Olympics. Of course, as the Olympics increases the cost of construction a very rational response for many companies and public sector organisations would be to undertake less construction. This may well mean that the financial costs of Olympics related construction inflation are less than the amount quoted above. If construction is cancelled, however, there will be other costs to the economy. For example:
  - Offices and shops not being built could mean that commercial rents rise and the cost of doing business in London, already one of the most expensive cities in the world, rises further.
  - Housing developments being cancelled at the same time as the London population continues to grow rapidly would lead to more difficulties for young people looking to get onto the property ladder and council tenants looking to find suitable accommodation. The Olympics project will provide additional housing after 2012 when the Olympic Village is converted for private use, but as this is being produced with Olympics priorities in mind it may not have the location or the qualities that the housing market is looking for

- The appendix to this report contains the full tables, showing the effect of the Olympics on construction price inflation in London and the South East for the different categories of construction order.

- An excel spreadsheet with full details is available on request.

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APPENDIX

FULL TABLES

- Notes to the tables in this appendix (NB figures may not sum exactly due to rounding):
  - All numbers are in £ million and show the effect of the 2012 Olympics on construction inflation in London and the South East.
  - *Without Olympics Value* represents the value of construction orders, taken from Department of Trade and Industry data up to, and including, 2005. After 2005 it is a projection based upon a linear regression of the 1995-2005 values. The equation of the regression is shown at the bottom of each table.
  - *With Olympics Value* is the 'Without Olympics Value' multiplied by the 'Inflation Adjustment'.
  - The *Inflation Adjustment* is the mid-point of EC Harris' estimate of the added tender price inflation created by the Olympics compounded by the number of years the inflation has been ongoing.
  - *Change* is the amount of extra cost created by Olympics inflation in that sector, in that year.

Table A1: Private Commercial

Year	t	Without Olympics Value	With Olympics Value	Inflation Adjustment	Change
1995	1	2,324	-	-	-
1996	2	2,404	-	-	-
1997	3	2,954	-	-	-
1998	4	3,647	-	-	-
1999	5	3,796	-	-	-
2000	6	3,997	-	-	-
2001	7	4,634	-	-	-
2002	8	4,078	-	-	-
2003	9	3,233	-	-	-
2004	10	4,086	-	-	-
2005	11	4,689	-	-	-
2006	12	4,772	-	-	-
2007	13	4,964	5,026	1.0125	62
2008	14	5,156	5,286	$(1.0125)^2$	130
2009	15	5,348	5,551	$(1.0125)^3$	203
2010	16	5,539	5,821	$(1.0125)^4$	282
2011	17	5,731	6,098	$(1.0125)^5$	367
2012	18	5,923	6,381	$(1.0125)^6$	458
Total					**1,503**

*Regression equation: Without Olympics inflation = 2471.6 + (t * 191.73)*

Table A2: Private Housing

Year	t	Without Olympics Value	With Olympics Value	Inflation Adjustment	Change
1995	1	909	-	-	-
1996	2	1241	-	-	-
1997	3	1483	-	-	-
1998	4	1284	-	-	-
1999	5	1406	-	-	-
2000	6	1484	-	-	-
2001	7	1663	-	-	-
2002	8	2036	-	-	-
2003	9	2061	-	-	-
2004	10	2638	-	-	-
2005	11	2740	-	-	-
2006	12	2717	-	-	-
2007	13	2883	2919	1.0125	36
2008	14	3049	3125	$(1.0125)^2$	77
2009	15	3214	3337	$(1.0125)^3$	122
2010	16	3380	3552	$(1.0125)^4$	172
2011	17	3546	3773	$(1.0125)^5$	227
2012	18	3712	3999	$(1.0125)^6$	287
Total					**921**

*Regression equation: Without Olympics inflation = 727.5 + (t * 165.8)*

Table A3: Other Public

Year	t	Without Olympics Value	With Olympics Value	Inflation Adjustment	Change
1995	1	939	-	-	-
1996	2	864	-	-	-
1997	3	779	-	-	-
1998	4	1225	-	-	-
1999	5	1040	-	-	-
2000	6	1506	-	-	-
2001	7	1188	-	-	-
2002	8	1928	-	-	-
2003	9	1559	-	-	-
2004	10	1656	-	-	-
2005	11	1804	-	-	-
2006	12	1938	-	-	-
2007	13	2042	2067	1.0125	26
2008	14	2145	2199	$(1.0125)^2$	54
2009	15	2249	2334	$(1.0125)^3$	85
2010	16	2352	2472	$(1.0125)^4$	120
2011	17	2456	2613	$(1.0125)^5$	157
2012	18	2559	2757	$(1.0125)^6$	198
Total					**640**

*Regression equation: Without Olympics inflation = 696 + (t * 103.5)*

Table A4: Infrastructure

Year	t	Without Olympics Value	With Olympics Value	Inflation Adjustment	Change
1995	1	1267	-	-	-
1996	2	1502	-	-	-
1997	3	1098	-	-	-
1998	4	1155	-	-	-
1999	5	1288	-	-	-
2000	6	1131	-	-	-
2001	7	1881	-	-	-
2002	8	1301	-	-	-
2003	9	1578	-	-	-
2004	10	1098	-	-	-
2005	11	1738	-	-	-
2006	12	1534	-	-	-
2007	13	1562	1582	1.0125	20
2008	14	1590	1630	$(1.0125)^2$	40
2009	15	1618	1679	$(1.0125)^3$	61
2010	16	1646	1729	$(1.0125)^4$	84
2011	17	1673	1781	$(1.0125)^5$	107
2012	18	1701	1833	$(1.0125)^6$	132
Total					**444**

*Regression equation: Without Olympics inflation = 1199.9 + (t * 27.9)*

Table A5: Public Housing

Year	t	Without Olympics Value	With Olympics Value	Inflation Adjustment	Change
1995	1	325	-	-	-
1996	2	367	-	-	-
1997	3	312	-	-	-
1998	4	331	-	-	-
1999	5	334	-	-	-
2000	6	196	-	-	-
2001	7	406	-	-	-
2002	8	433	-	-	-
2003	9	502	-	-	-
2004	10	726	-	-	-
2005	11	830	-	-	-
2006	12	695	-	-	-
2007	13	739	748	1.0125	9
2008	14	783	802	$(1.0125)^2$	20
2009	15	826	858	$(1.0125)^3$	31
2010	16	870	914	$(1.0125)^4$	44
2011	17	914	972	$(1.0125)^5$	59
2012	18	957	1031	$(1.0125)^6$	74
Total					**237**

*Regression equation: Without Olympics inflation = 170.7 + (t * 43.7)*

Table A6: Private Industrial

Year	t	Without Olympics Value	With Olympics Value	Inflation Adjustment	Change
1995	1	362	-	-	-
1996	2	297	-	-	-
1997	3	421	-	-	-
1998	4	689	-	-	-
1999	5	373	-	-	-
2000	6	396	-	-	-
2001	7	548	-	-	-
2002	8	492	-	-	-
2003	9	516	-	-	-
2004	10	426	-	-	-
2005	11	543	-	-	-
2006	12	541	-	-	-
2007	13	555	562	1.0125	7
2008	14	568	583	$(1.0125)^2$	14
2009	15	582	604	$(1.0125)^3$	22
2010	16	595	626	$(1.0125)^4$	30
2011	17	609	648	$(1.0125)^5$	39
2012	18	622	671	$(1.0125)^6$	48
Total					**161**

*Regression equation: Without Olympics inflation = 379.2 + (t * 13.5)*

Table A7: All construction orders (sum of Tables A1-A6)

Year	t	Without Olympics Value	With Olympics Value	Change
1995	1	6,126	-	-
1996	2	6,675	-	-
1997	3	7,047	-	-
1998	4	8,331	-	-
1999	5	8,237	-	-
2000	6	8,710	-	-
2001	7	10,320	-	-
2002	8	10,268	-	-
2003	9	9,449	-	-
2004	10	10,630	-	-
2005	11	12,344	-	-
2006	12	12,198	-	-
2007	13	12,744	12,904	159
2008	14	13,290	13,625	334
2009	15	13,837	14,362	525
2010	16	14,383	15,115	733
2011	17	14,929	15,886	957
2012	18	15,475	16,672	1,198
Total				**3,906**