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EUROPEAN CONSTRUCTION INDUSTRY FEDERATION

# Impact of conflict in Ukraine on construction

## Belgium

1. Increase in energy and construction material prices

Russia's invasion of Ukraine has exacerbated the volatility of energy prices in Belgium (and other EU countries), which had already risen sharply in recent months. In concrete terms, soaring energy prices are having a worrying impact on the production costs of construction companies, which must cope with high volatility in the price of building materials and high fuel prices, used not only for construction equipment but also for transport. These cost increases may jeopardize the continued operation of businesses that would otherwise have been profitable.

[The support measures adopted by the Belgian government at the beginning of March mainly affect households and the self-employed. Many construction companies fear that they will not be able to continue their activities without federal support measures to help them cope with rising energy prices.

In addition to soaring energy prices, the prices of a whole range of inputs for the manufacture of various building materials are also increasing sharply, with the result that producers are (temporarily) stopping production. Producers consider it impossible to continue production at this price level, given the difficulties of passing on these increases in their sales prices on the one hand and the demands of profitability on the other.]

2. Supply difficulties and difficulties in respecting delays

The war in Ukraine is also causing a whole series of supply problems in Belgium. These problems directly concern certain construction materials for which Ukraine,Russia or Belarus were important suppliers to the European and even the world market. For example, the supply of steel is made very difficult by the fact that several European steelworks, on the one hand, can no longer obtain supplies of sub-materials, and Ukrainian steelworks, on the other, have been forced to stop production becauseof the war. In addition, the European Commission has also banned steel imports from Russia in a market already under pressure.

The supply problems related to Russia's invasion of Ukraine also indirectly affect a range of other construction materials for which the European or even global marketfor the raw materials necessary for their manufacture was largely supplied by these two countries, such as, for example, wood-based materials, non-ferrous metals, polypropylene, PVC and certain components necessary for the manufacture of insulation materials.

These supply difficulties, as well as rising energy prices, have an impact on the execution of contracts, as well as on the deadlines.

3. Problems of passing on price increases and their adverse effects

Large increases in input prices can never be borne "without damage" by contractors, as they cause cost increases that exceed their margin on the work they perform.

Nevertheless, in Belgium price revision formulas can in principle be used to pass on price changes that occur between the submission of the tender or the conclusion ofthe contract and the execution of the work. Nevertheless, for a whole series of reasons (price formulas not including certain materials, etc.), these price revision formulas only very partially reflect the cost increases that companies must face. Indeed, the parameters applied often do not take sufficient account of certain materials, which weigh significantly in the market.

While the price revision formula is widely applied in public contracts, this is much less the case in private contracts. Indeed, principals who generally only have a limited budget are led to conclude fixed price contracts.

It is clear that in cases where a price revision formula is applied, it does not fully compensate for the extra costs that actually occur.

Moreover, invoking unforeseeable circumstances (in the case of public contracts, but also in private contracts if this is provided for in the contract) or the exceptional nature of the current situation in order to pass on price increases means that it is necessaryto revise the contract and therefore to negotiate. In this context, both contractors and principals may find themselves in a situation where it is more appropriate to suspend the work or even terminate the contract.

There is also a risk that clients (public or private) may be frightened by the current price level, chilled by the effects of applying a revision formula or simply lack the budget to cope with this price level and refrain from placing an order.

4. Problems of bidding and its effects on the contracts to be concluded

The increase in prices for building materials following the Ukrainian crisis has left contractors with no visibility. In Belgium, suppliers are currently giving prices that are only valid for 24 hours, and there is no guarantee that they will be able to meet delivery deadlines.

This visibility is necessary to be able to:

a. Draw up a correct offer while taking into account the commitment period that applies to prices enabling the client to evaluate the offer and make a decision;

b. Compare the different offers received while respecting the equality of the contractors who have submitted prices, especially in public procurement.

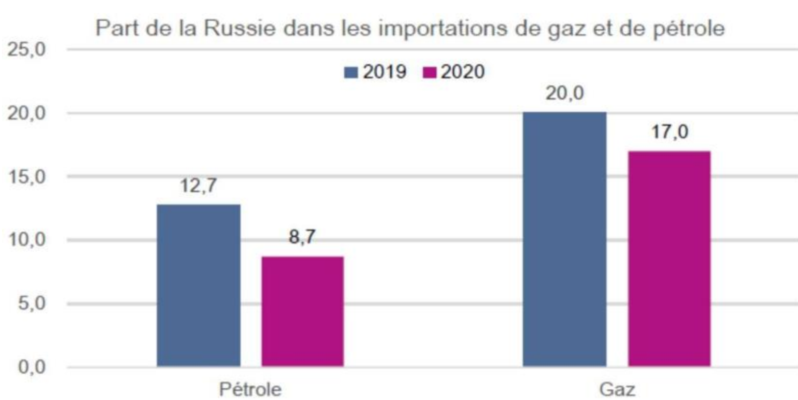
There is therefore a real risk that clients (public or private) will be frightened by the current price level - not to mention the application of the price revision formula - which would lead to a fear of not taking adequate decisions while respecting the equality of contractors and of not having the necessary budget and could lead them to refrain from placing orders.

5. Risks on continuity of construction companies' operations

The direct and indirect consequences of the war in Ukraine on the construction sector are putting business continuity at risk in Belgium. Indeed, the situation of companies is affected every time their production is hampered by a lack of raw materials and even worse when they cannot pass on the extra supply costs to their customers for current contracts. As a result, they may find themselves temporarily unable to repay their contractual, fiscal or social obligations. Companies may also find themselves temporarily unable to repay their loans or lose the confidence of credit insurers, pushing them towards bankruptcy.

### France

The first impacts of Russia's war with Ukraine are beginning to show for our sector. First of all, energy prices are soaring, as Russia is a major supplier of oil and gas (see graph 1).




Sources : SDES, INSEE, Natixis

In fact, the price of oil passed the $100 mark the day after the offensive was launched and it has continued to rise since, exceeding $115. It has therefore risen by almost 40% in two months. There has also been an exponential increase in the price of diesel.

As for the wholesale price of gas, which was already very high at the end of 2021, it has risen by a further 72%, while the price of electricity (basic tariff) has risen by 66% over the same period.

However, the energy load weighs heavily on many materials used in the building industry. We have been receiving warnings for several months about aluminium products, tiles and bricks or tiling. For these materials, it has been announced that production lines or even factories will be closed due to variable costs that have become unbearable (producing is more expensive than not producing). Stocks have acted as a temporary buffer, but the year is coming to an end.

Moreover, steelmakers are beginning to send out warning signals, beyond the energy impact. In fact, Russia, Belarus and Ukraine are proving to be :

- large exporters of steel slabs (large parallelepipedic blocks), particularly to Italy, where rolling mills transform these semi-finished products into plates consumed locally or exported in turn. These plates are used for public works (marginally for construction, to cover "holes"), but also for the production of construction equipment, cranes, etc. It is therefore to be feared that supply difficulties in this area will increase significantly.
- large producers of wire rod and billets (primary processing of scrap metal)which, in Italy in particular, are processed into welded wire mesh. The producers of welded wire mesh went out of business (no more orders) in the days immediately following the war, before reopening but without price and without delay. It is likely that suppliers of bars and coils will follow suit, as their stocks appear to be limited.

As regards concrete reinforcement, it should be noted that alternative supply routes are still being sought. For example, the European Commission has transferred the remaining EU steel import quotas for Russia, Belarus and Ukraine to the Turkish quota. However, the latter is largely supplied with scrap metal from Ukraine (which is much cheaper than European products). As for Germany, it imported massively from the first three countries (Arcelor has a very large mine and smelter in Kryvyi Rih, in Ukraine, which supplied Germany) and is seeking to compensate for its shortfall on the French market.

As regards toother materials, warnings are more limited. Saint-Gobain mentioned difficulties with paper, which is necessary for the manufacture of plasterboard, while indicating that the problem would be limited to the German market. The prices and supply of materials such as lime or plastic are also being affected.

While the industry is unanimous in anticipating a substantial increase in prices, there is still debate on whether there will be a real and lasting shortage. Some within the industry claim than if the conflict persists, this will indeed lead to a shortage in raw materials which, in turn, would halt construction works and prevent companies from bidding for tenders without any visibility of prices.

More generally, the closure of access to European ports for Russian and Belarusian cargoes complicates the situation.

In light of the increase in the price of raw materials, supplies and energy and concerns about price variation clauses, some within the sector have been calling for measures such as freezing the *domestic consumption tax on energy products* (TICPE) as well energy and fuel prices by decree of the Council of State as provided for in the Commercial Code, the use of the "unforeseen circumstances" provisions of the public procurement code[1], etc.

On March 16th, the French government, announced its [economic and social resilience plan] incorporating a number of objectives, some of which are relevant to the public works sector. These include:

- Supporting companies with high gas and electricity costs. More specifically, aid will be granted to companies, of all sizes and in all sectors, whose gas and electricity costs represent at least 3% of turnover, and which, due to the increase in their energy costs, would become loss-making in 2022. This aid, in effect until the end of 2022, will cover half of the excess energy cost, enabling companies to reduce their losses by up to 80%, and will be capped at €25 million.
- Targeted support to the sectors most exposed to rising input costs. In the construction sector, many projects have been concluded without a price revision clause adapted to the situation. Moreover, it is becoming difficult for professionals to commit to their clients on prices and deadlines when theirsuppliers can no longer commit to the same terms. The Government will ask public players to apply, where possible, the theory of *unforeseeability* for public contracts that do not contain a price revision clause and not to apply penaltiesfor delays when the latter are justified by the extension of a delivery deadlineby a supplier due to the crisis". A "public procurement" circular is currently beingdrafted.

[1] These provide for the possible modification of contracts, and in particular their amounts, in the event of circumstances that a diligent buyer could not foresee.

- Measures aimed at avoiding the failure of companies affected by the shock. These include the State Guaranteed Loan[2], the industrial growth loan[3], subsidised state loans[4], a new state-guaranteed liquidity facility[5], etc.

## Germany

A significant problem for Germany relates to energy supply, which is largely based on gas supplies from the three countries Ukraine, Russia and Belarus. Germany is expecting a noticeable shortage from the summer of 2022 onwards, with market prices rising astronomically.

At present, various materials necessary for construction works are in fact still available in the market. However, the material manufacturers are already artificially causing a shortage. These manufacturers do not place the material on the market, and count on an increase in prices in order to be able to take the corresponding profits on the global market. In fact, price increases up 100% have been observed, leading to huge prices increases for infrastructure projects. Also, daily steel prices are forcing a standstill of construction sites.

Depending on the length of the ongoing conflict in Ukraine,  there could be a shortage of material supplies from autumn at the latest. However, it is not possible to foreseethe level of price increases.

In Germany, the percentage of materials coming  from  Russia, Ukraine and Belarus can be broken down as follows:

- 26 % of natural gas
- 40 % iron ore
- 45 % steel products
- 25 % nickel
- 75 % titanium

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[2] This will remain available, under its current terms and conditions, until 30 June 2022 for all eligible businesses and for any reason whatsoever. In addition, for companies particularly affected by the economic consequences of the by the economic consequences of the Ukrainian conflict, the government has decided to increase the amount of the PGE to 35% of turnover, compared to 25% in the general scheme.

[3] Introduced last December, it will be open to construction and public works companies, and the stimulus growth loan will be replenished. This  scheme is adapted to companies experiencing temporary  cash  flow difficulties  due to supply difficulties, and only have the capacity to amortise their debt in the long term.

[4] These loans are adapted to companies that have not been able to benefit, or to a very limited extent, from market banking solutions and that have real prospects for economic recovery. This public aid is granted on a case-by-case basis by the CODEFI.

[5] From the second half of 2022, a new state-guaranteed liquidity facility will be set up for companies affected by the war in Ukraine and its economic consequences. The precise terms and conditions of this facility will be facility will be discussed rapidly with the European Commission, French companies and banks.

- 40 % bitumen

A further problem is that the purchase prices for materials cannot be passed on 1:1 to the clients. Material price revision clauses, which are practiced in Germany in public procurement procedures, have no effect in these cases. The manner in which prices increases can be absorbed is always dependent on individual agreements between contractors and clients, or on the resilience of a company.

**Hungary**

At the start of the conflict, around 15.000 Ukrainians worked permanently in Hungary. It is estimated that around 10% of them were in Ukraine on holiday when the war has broken out and most couldn't return to Hungary due to travel restrictions introduced in the meantime.

Significant quantities of building materials, mainly iron, steel and timber, arrived in Hungary from Russia and Ukraine. There is no shortage of these building materialsyet. Nevertheless, if the duration of the war is long and these materials are not replaced by other sources of supply, serious shortages and price increases will be expected.

**Netherlands**

Arcelor Mittal, a steel production company, announced in a letter addressed to several construction companies that they are withdrawing immediately all their offers of supply. They nevertheless confirmed that all the signed orders will be respected. Further announcements are expected in the coming weeks, particularly concerning price increases of their products.

**Slovakia**

It is estimated that around 10.000 workers from Ukraine are working in the construction sector in Slovakia, representing around 6% of the workforce. The situation is similar in the Czech Republic. Many of these workers are returning to Ukraine due to the conflict, sometimes leaving their wives and children behind without income. Some Slovak and Czech employers have volunteered to pay these families roughly one-third to half of their wages to cover living expenses. Some in Slovakia are calling for targeted support from the European Commission for such cases.

The Slovak construction industry expects the departure of most Ukrainian employees, which will increase the shortage of workforce in the construction market and reduce the volume of construction production. It also expects an increase in prices for steel (iron ore/raw iron is imported from Ukraine and Russia) and energy.

The construction industry suggests that the increase in construction costs could be considered as *force majeure* by the European Commission and, as such, factored into the increase in the price of public construction works.

**Slovenia**

As seen in other countries, there has been a marked increase in the prices of certain building materials and raw materials, such as reinforcing iron, cement and brick products, bituminous and polymer products, water and sewage pipes and, of course, energy products, such as natural gas and petroleum products. The problem is linked to global markets, not just the local environment, because of the current politicalsituation.

During this period, the construction industry has also been perceiving a marked increase in the scarcity of these raw materials, both on the Slovenian market and on the European Union market. The causes of the above-mentioned negative effects on trade in building materials and products on the Slovenian market are linked to the risein the prices of basic natural raw materials, such as iron and petroleum products, whichis due to several factors, such as reduced production due to the Covid-19 epidemic and OPEC's planned cut in oil production.

The war in Ukraine has aggravated these problems. In the last three weeks, there has some of the price parameters for building materials and energy have increased bymore than 150%. The industry estimates that the dollar price of individual energy products has risen by more than 100% compared to last year (industrial gas alone by 1000% or more), and that of non-energy raw materials by 60%, with metals and other natural minerals rising by more than 100%. In the period March 2021-March 2022 alone, reinforcing iron rose by 245% on average, bituminous products by between 120% and 140%, brick and ceramic products by 70% and polymer products by between 50% and 75%. This is already data that requires consideration on the part of building contractors as to how to approach this issue. Ultimately, the current contractual pricing ratios are becoming unsustainable for building contractors.

Another point of concern for the construction industry is that, even in light of the situation described above, some public sector contracting authorities continue to include price-fixing clauses in their tenders. This could ultimately lead to a situation where contractors start to renege on their contractual commitments, the sector warns. As such, those in the construction industry are calling for the competent Directorate for Public Procurement to provide the State contracting authorities with a starting point for the preparation of public procurement in the field of State infrastructure construction investments, which would include solutions that would take full account of the current economic situation on the market for construction materials and energy products and that would include in the tendering contracts the valorisation of contractual value from the date of the tender award.

## Spain

The conflict in Ukraine has intensified the serious problem of the exorbitant increasein the price of energy and materials for construction, problem that the sector has been increasingly suffering since 2021.

Russia and, to a lesser extent Ukraine, are among the main producers of some raw materials and the EU presents a high dependency on imports. Regarding oil and gas, Spain is less dependent on Russian imports than other EU countries; regarding raw materials to produce tiles, Ukraine was an important provider for Spanish producers.

It is clear that the conflict in Ukraine has further strained the inflationary spiral, and construction companies are finding it difficult to receive supplies of some raw materials such as wood, ceramics, copper, bituminous products or steel. Some construction sites have had to paralyse some activities and there are also cases of postponement of work starts; moreover the rise in energy and materials prices is driving up the costsof the works.

## Sweden

Sweden has limited trade with both Russia and Ukraine. Nevertheless, the sector will be affected indirectly by surges in energy prices, increased prices of building materials and inflation. The sector is also keeping an eye on imports of petroleum products.

The Swedish construction sector expects prices to remain high, not falling below pre-pandemic levels. Among the consequences is that, in 2021, fewer condominiums were built than in previous years. A similar outcome is expected with the latestdevelopments in Ukraine. Furthermore, the sector also anticipates cost calculations for planned infrastructure projects to increase.

The conflict might have an important impact in terms of workforce. Sweden has many construction workers from Poland, which in turn relies on workers from the Ukraine. As such, a chain reaction of an expected shortage might be observed.

However, the sector's continued concern is on strategic dependencies on raw materials, in particular, limestone supply. The geopolitical situation highlights vulnerabilities in importing prefabricated elements from the Baltic region or filling the supply gap with limestone from non-EU markets such as China. The sector has beenin contact with the Commission, stressing the importance of a swift in-depth analysis of the construction ecosystem's reliance on raw material coupled to realising the EU's climate objectives (mainly by supporting fossil free energy systems) and a holistic perspective. For example, cement is needed to build both wind turbines and for hydrogen storage.