SCSI/PwC Construction Market Monitor 2020

October 2020

pwc

Society of Chartered Surveyors Ireland

Contents

At a glance - key highlights

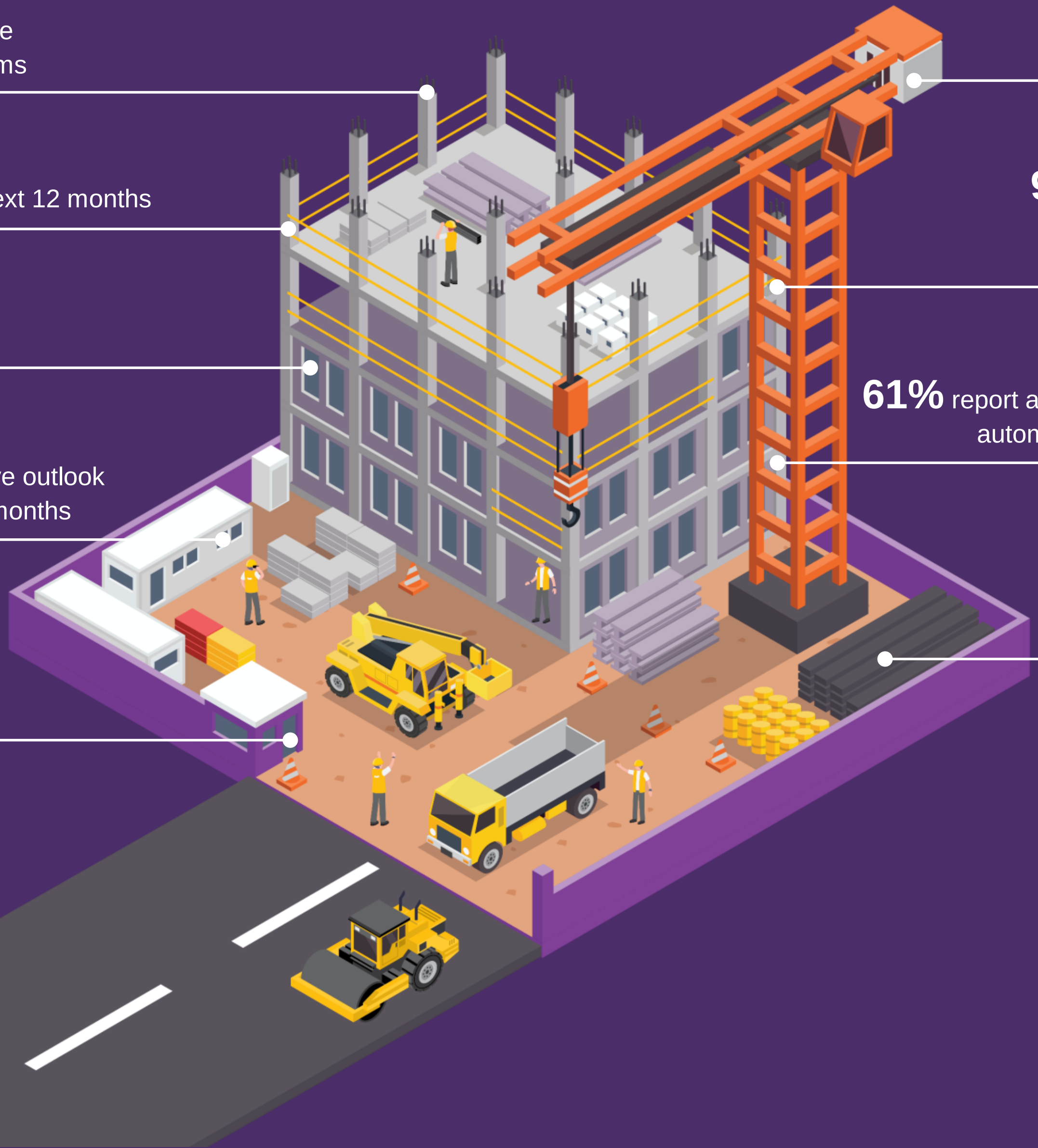
COVID-19 has resulted in a **20%** decrease in activity levels of construction surveying firms

51% expect a decrease in workloads in next 12 months

68% reported a decrease in profit

71% report a neutral or somewhat negative outlook for the construction sector over the next 12 months

Surveying firms' proportion of turnover relating to public procurement increases by **8%** in 12 months



Sanitation facilities and the provision of PPE are the two most significant expenditure items associated with returning to construction activity post lockdown

99% expect the raising of development finance to be more difficult as a result of the COVID-19 crisis

61% report an increase in investment in digitalisation / automation in response to the COVID-19 crisis

60% have undertaken some level of preparation for Brexit in advance of the end of transition period

Executive summary

The SCSI/PwC Construction Market Monitor 2020 is our 4th annual report assessing current activity levels across the Irish construction sector. Our joint report provides insights into current trends as well as challenges facing construction consultants and the sector at large. Moreover, the report examines surveying professionals' expectations over the next 12 months, which is a useful gauge of expected activity levels to come in 2021.

The results presented in this report incorporate the views of almost 300 chartered surveyors canvassed in February 2020. Due to the unprecedented impact of COVID-19 on the Irish construction sector, a supplemental survey was released to SCSI members in June 2020 in order to gauge the impact of the pandemic on the sector at that time and to accurately reflect members' expectations for the industry over the next 12 months, taking account of the huge level of disruption experienced by the sector as a result of the COVID-19 pandemic.

Private sector activity – the COVID-19 impact

A comparison of surveyor responses between February and June 2020 provides a very clear picture of the severity of the impact of COVID-19 on the Irish construction sector. When asked about headcount, margins and workloads, a significant proportion (up to 68%) of surveyors reported a downward trend across the three areas. This is a stark contrast to February 2020 when only up to 12% of surveyors expected headcount, margins and workloads to decrease

Since the reopening of the sector on 18 May 2020, activity has begun to gear up following weeks of lockdown. Sectoral protocols introduced provide for new working arrangements to manage COVID-19 risk. Extended construction timelines under these new arrangements and dealing with issues that still persist in relation to supply chain delays for certain materials, has impacted output levels.

The study reveals that the overall national impact of COVID-19 on surveying firms resulted in a 20% decrease in activity levels

The cost of COVID-19

The return to construction activity in May 2020 was very welcome and efforts to ensure activity could progress with health and safety being of paramount importance was clear with the publication of specific sectoral COVID-19 protocols. However, the return to sites comes with a financial cost. Surveyors reported that the top three return to construction costs with COVID-19 (aside from extended construction timelines due to lockdown) were associated with COVID-19 were additional sanitisation costs, investment in PPE and thirdly, additional costs associated with providing infrastructure on sites such as extended walkways and hygiene facilities.

More competition for publicly funded projects

The public capital expenditure programme is a significant proportion of annual output in the construction industry. Further capital investment of €500m was made available in the July stimulus package which is welcomed. Capital expenditure thus far in 2020 has largely been for healthcare, and business, enterprise, and innovation[1]. The Government has indicated that investment under the Public Capital Programme will increase to just over €9Bn in 2021.

[1] BUILD 2020

In the wake of the current global economic crisis resulting from COVID-19, competition for foreign direct investment will be even further intensified. It is therefore critically important that government remains committed to the strategic objectives outlined in Project Ireland 2040 such as ensuring enhanced regional accessibility, a strong economy supported by enterprise, innovation and skills, and strengthened rural economies and communities in order to bolster our competitiveness and our ability to attract and retain crucial foreign direct investment.

The latest SCSI Tender Price Index (September 2020) reveals that annual tender inflation is at 3.8%, down from 6.2% in 2019. Commitment by government to continue with important state projects coupled with more competitive tender rates from the Irish construction sector is likely to provide an environment for increased value for money for the taxpayer.

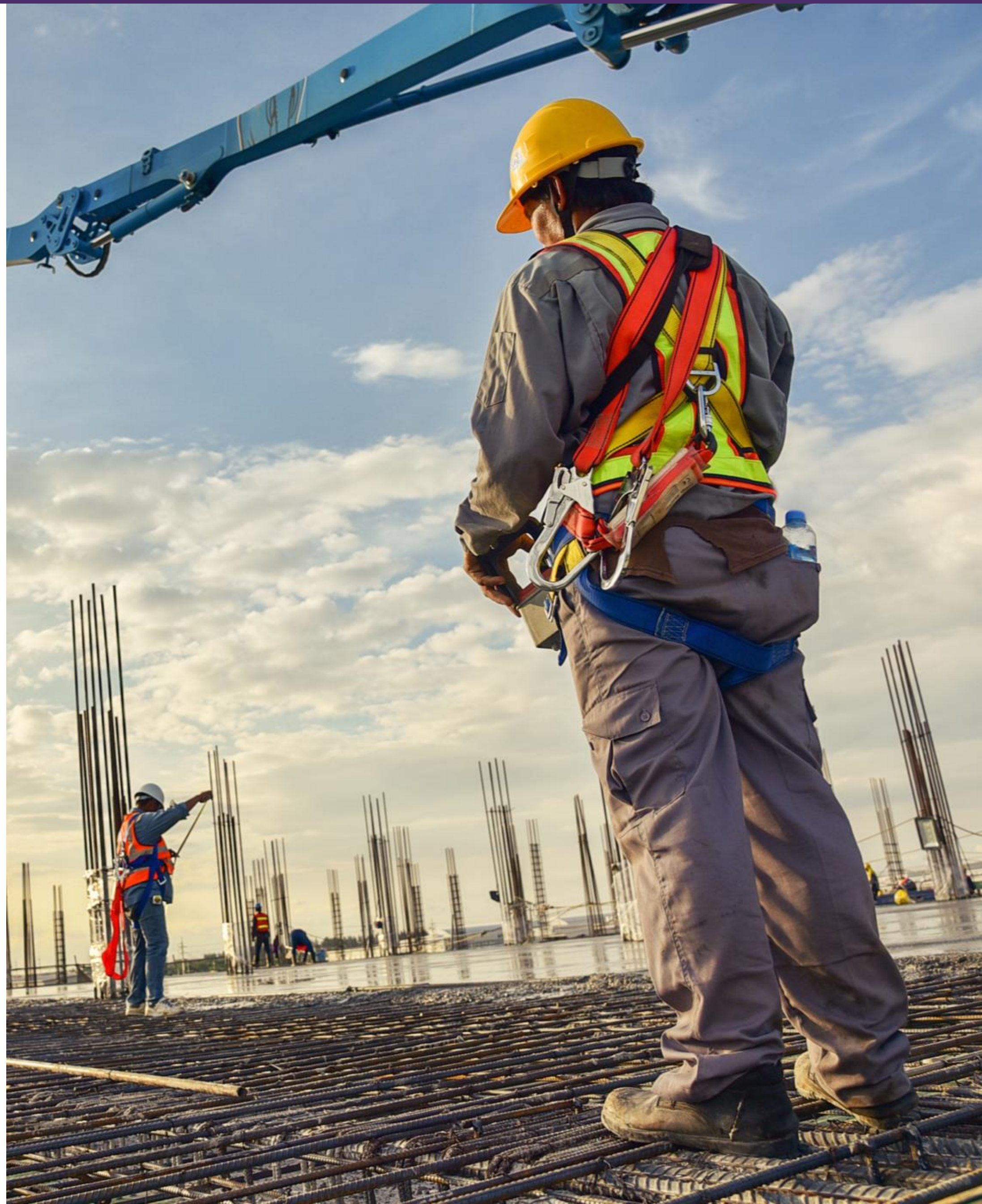
Outlook remains cautious as noted in SCSI's latest Tender Price Index report *'COVID-19 has had a sharp and immediate impact on the level of tendering activity, and in turn tendering rates as many construction firms focus attention on securing projects for 2021. Large scale projects in the data centre and pharmaceutical sector continue to be very active at present however since the reopening of construction sites in May, there has been an increased level of caution regarding funding new developments generally. It remains to be seen what proportion of projects that were paused get restarted and the level and timing of capital investment included in the upcoming Budget, however given this uncertainty we are forecasting a similar level of below 1% inflation for the second half of 2020."*

Outlook

The outlook for construction in terms of activity levels remains positive, but growth and output are coming under gradual pressure. The volume of new mortgage lending in July 2020 increased by 50% month-on-month but declined by 34% year-on-year. The residential market is reporting steady trade with activity levels (bidding, viewings and offers) remaining positive according to the SCSI Residential Markets Report. The latest CSO data reports very slight increase in values (0.1%) in the year to June.

The outlook for the construction sector generally, has changed in the past 6 months. When surveyors were polled in June 2020, as the construction sector began to return to work in line with Government guidelines and following two months of virtually no building activity, this outlook changed. 47% of surveyors reported a 'somewhat negative' outlook, up from only 7% in February. Only 23% of surveyors had a 'somewhat positive' outlook and 2% had a very positive outlook for construction over the next 12 months.

The Irish construction sector is still one of the single biggest employers in the state and contributes a combined output of over €25Bn annually. It is the backbone of our economic growth and attracts significant foreign direct investment across Ireland. Two significant challenges remain for our economy and for this sector, EU/UK trade negotiations and COVID-19. Investment, commitment and confidence is required to ensure this sector remains healthy and strong so that it is poised to continue with the delivery of quality buildings and infrastructure for our built environment.



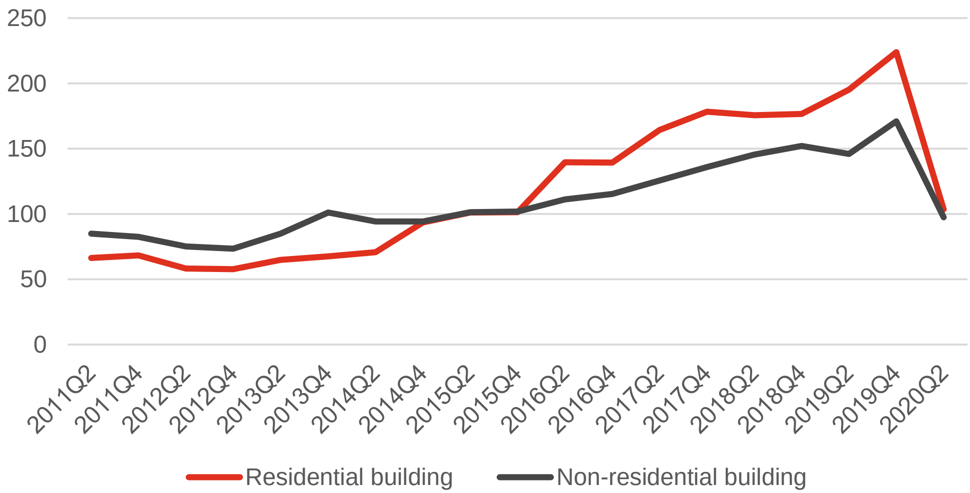
1 Activity levels and COVID-19 impact

1. Activity levels and COVID-19 impact

Construction activity

Activity in the Irish construction sector has remained in positive territory since 2013 according to the Central Statistics Office. Residential and non-residential construction activity has steadily increased in value and volume output over the previous 8 years, with residential construction now registering higher volume output when compared with non-residential construction. However, provisional CSO data for Q2 2020 indicates that the volume of activity for both residential and non-residential construction both declined significantly in Q1 and Q2 2020, reflecting the impact of COVID-19 related restrictions during the first half of the year on the sector.

Chart 1: **Volume of construction activity 2011-2020***



Source: CSO

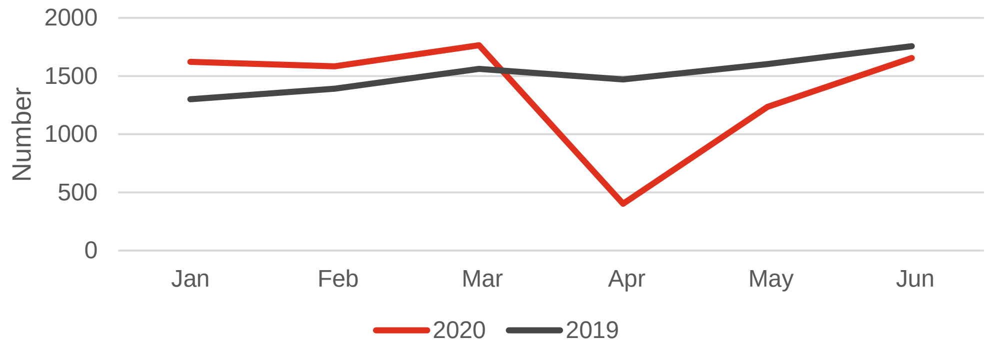
*figures for Q2 2020 are provisional figures

Residential

New housing completions for 2020 is expected to be approximately 16,500[2] for 2020, down from 21,000 in 2019. The main reason for this decrease in activity is due to COVID-19. The impact of COVID-19 on housing output can be seen in chart 2.

[2] Goodbody Stockbroker - Estimate

Chart 2: **New dwelling output 2020**

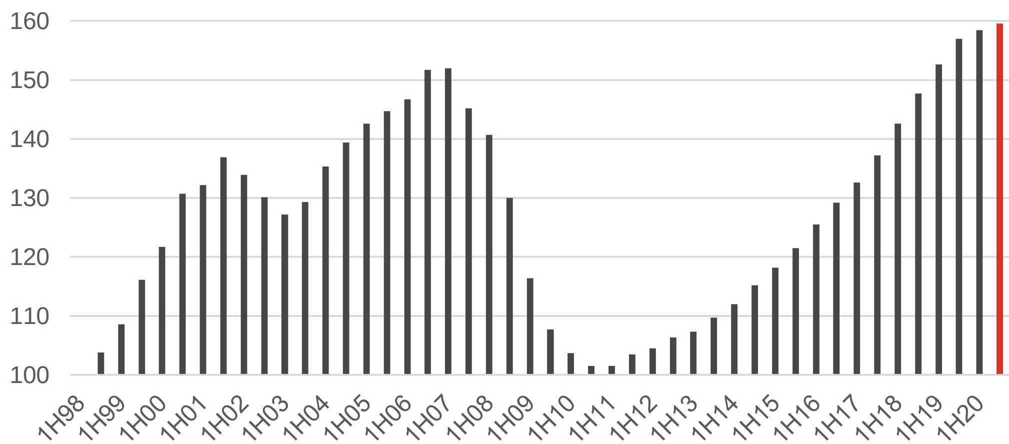


Source: CSO

Non-residential construction

Non-residential construction has faced an equally challenging few months, mainly due to the COVID-19 lockdown where most building sites were closed. On a positive note, many state projects still proceeded, and data gathered from the SCSI Tender Price Index (1H 2020). shows that Tender rates have become more competitive with annual inflation down to 3.8% down from 6.2% annually.

Chart 3: **SCSI Tender Price Index**



1.1 Sentiment regarding construction related activity

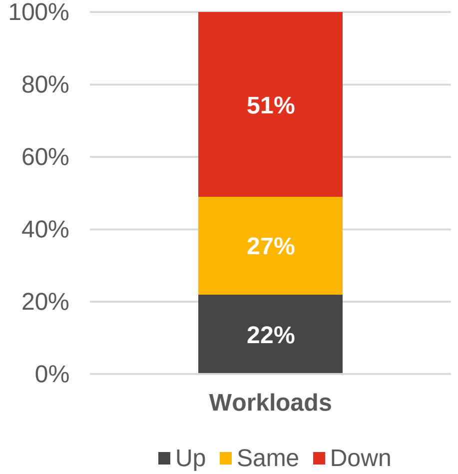
Our latest survey results reflect the ongoing challenges facing the Irish construction sector and the economy more generally. The impact of COVID-19 related restrictions and the lockdown of society and business in spring and early summer is now being revealed in our latest results. Respondents to our survey, mainly Quantity and Building Surveyors, point towards an unsurprisingly more entrenched negative sentiment.

Expected decrease in workloads

The results in chart 4 highlight that over half (51%) of surveyors expect a decrease in workloads over the next 12 months while only 22% anticipate an increase in workloads. This is a significant change to the outlook of surveyors prior to lockdown. When surveyed in February 2020, 67% of surveyors expected to see an increase in workloads over the coming 12 months and only 8% expected a decrease in workloads.

During the period of the lockdown, most building sites were temporarily closed. This resulted in many construction-related consultancy firms performing limited amounts of work due to this suppressed activity. Quantity Surveyors, who are chiefly involved in tendering and procurement, are well placed to capture the expected construction pipeline activity over the next 6-12 months. This is another indicator that 2021 is likely to be a challenging year in respect of residential and non-residential building activity.

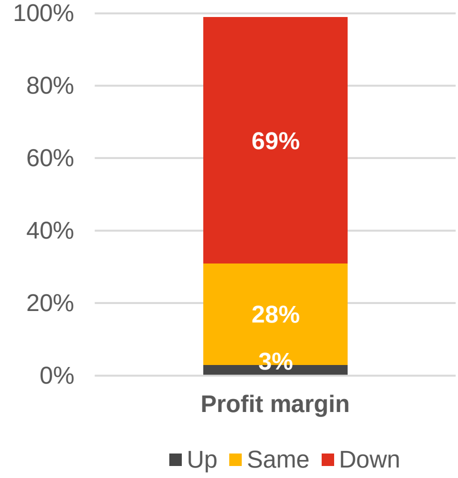
Chart 4: **Workloads – Surveyor expectations over next 12 months**



Profit margins looking increasingly negative

The SCSI/PwC Construction Market Monitor reported in 2019 that 45% of chartered surveyors expected profit margins to increase in 2020. 12 months on, only 3% of chartered surveyors expect a similar trend, which can be attributed solely to the onset of the COVID-19 virus.

Chart 5: **Profit margins – Surveyor expectations over next 12 months**

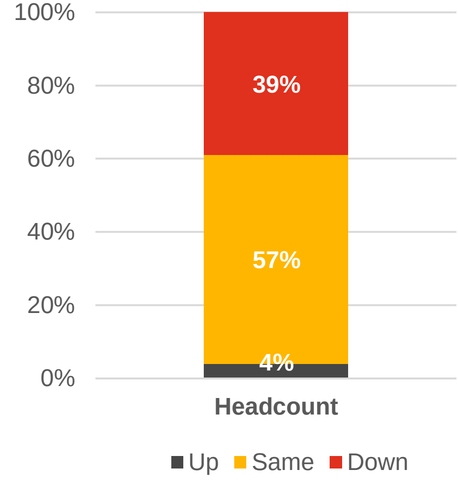


Findings from our survey issued in February 2020 illustrate that only 12% of surveyors anticipated a decline in profit margins. These figures were in line with the outlook of our 2019 report, which indicated a positive outlook for industry and indeed capacity constraints for the sector heading into 2020. However, post lockdown in June 2020, 69% believed a decrease in profit margin would occur in the next 12 months. By the same token, 88% of surveyors anticipated a positive outlook of maintaining or increasing profit margin in February. This figure reduced to 31% three months later.

*Figures have been rounded to the nearest percent

Downward trend for headcount

Chart 6: **Headcount – Surveyor expectations over next 12 months**



While 62% of surveyors in 2017 and 71% in 2018 anticipated an increase in headcount, 2019 and early 2020 saw a slight dampening of this optimism. However, in both years, over 96% of surveyors anticipated an overall positive/neutral outlook of headcount either increasing or remaining the same.

In contrast, when surveyed in June of this year, only 4% of surveyors anticipated that headcount would increase over the coming year. 39% anticipate that headcount will decrease and 57% anticipate that numbers will remain the same.

Given the uncertainty in the sector following the lockdown period and further impacts of COVID-19 such as ensuring compliance to social distancing measures on-site, it is perhaps unsurprising to see surveyors having a more cautious outlook to headcount expectations over the coming year.

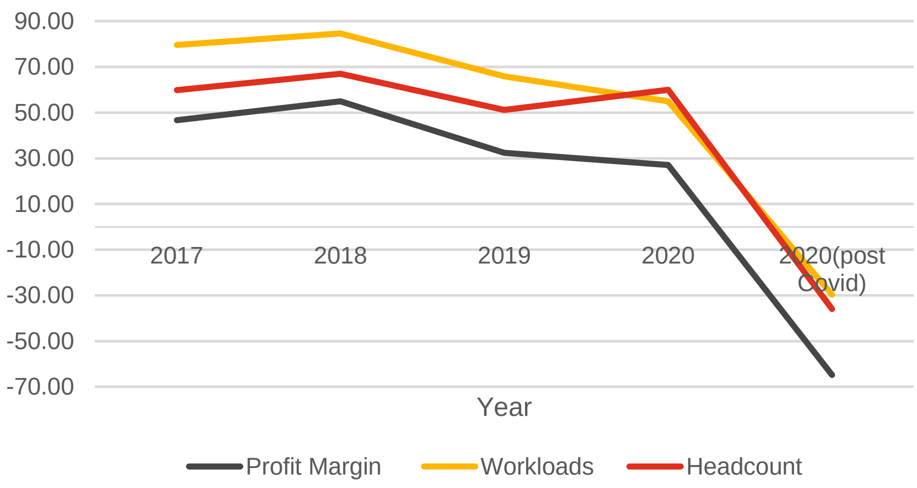
Post lockdown – impact on sentiment

As would be expected, the outlook in the sector was largely more negative for the months post-lockdown than it was pre-lockdown when the true extent of the impact that COVID-19 would have in Ireland was as of yet unknown. While activity has picked up recently, compliance with Government health and safety guidelines and the need to implement certain safety measures accordingly will continue for some time into the future to varying degrees.

Surveyors anticipate that demand for certain builds may decline in response to the economic impact of COVID-19 on consumers or due adherence to Government guidelines on social distancing. However, others note that since the reopening of the sector (May 2020), the need to deliver on key residential and capital projects has led to an increase in workloads for some firms.

Past surveys had already begun to highlight a worsening trend across areas such as profit margin, headcount and workload expectations. The onset of COVID-19 has exacerbated this negative trend in 2020, the extent of which is visible in chart 7, the SCSI/PwC Construction Activity Monitor sentiment index.

Chart 7: **SCSI/PwC Construction Activity Monitor, Sentiment Index - (Expectations)** (Net balance %)

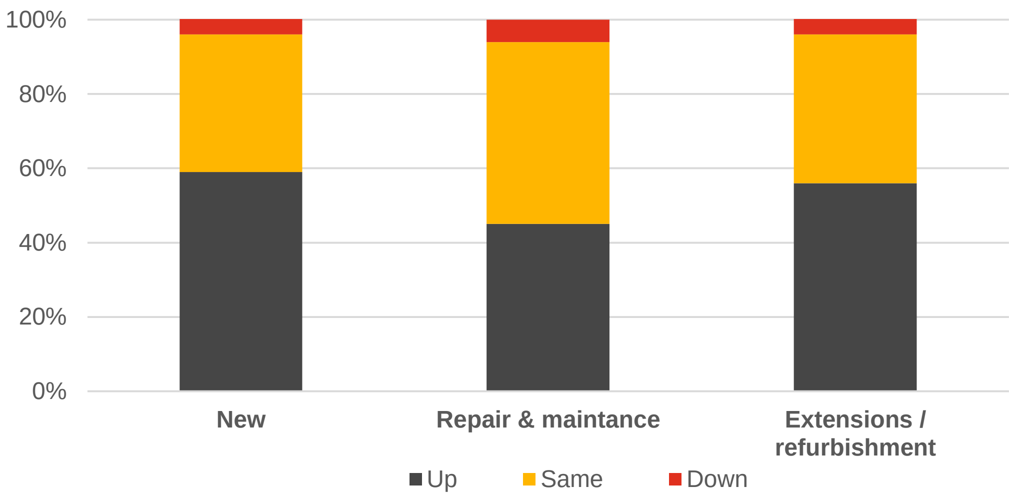


* Net balance = Proportion of respondents reporting a rise in activity minus those reporting a fall (if 30% reported a rise and 5% reported a fall, the net balance will be 25%)

Extensions and repair / maintenance improving

To better understand activity within the construction sector, we asked surveyors to indicate their activity levels in the new, repair and maintenance areas. Interestingly, a growing number of surveyors indicated that repair and maintenance is beginning to be a greater feature of their overall business activity. Whilst business activity with the construction of new buildings is the main driver of surveyor's business activity, extensions and repair are becoming increasingly prominent features.

Chart 8: **New, Repair & Maintenance and Extension/ Refurbishment activity over the past 12 months**

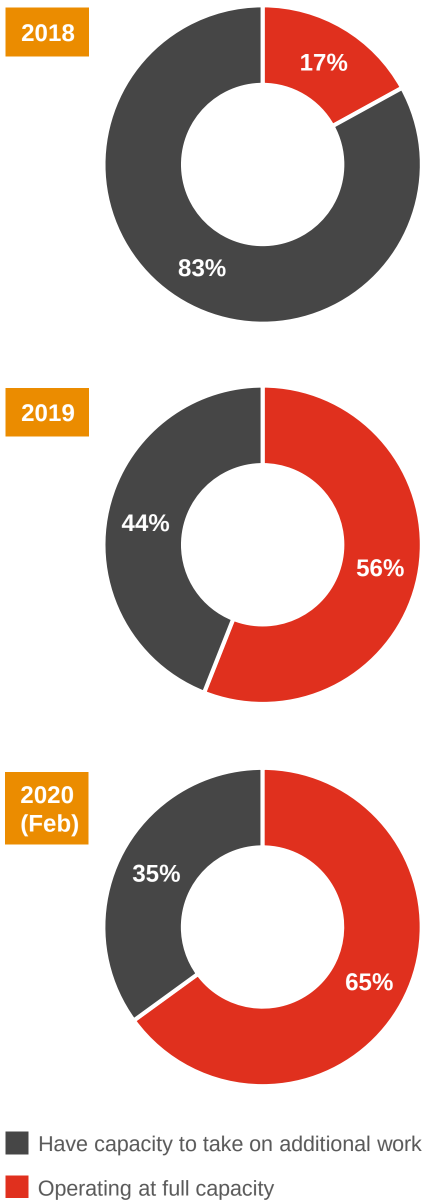


Firms have less capacity to take on work

Over the last number of years, firms increasingly indicated that they were operating at full capacity. While in 2017 only 17% indicated that they did not have the capacity to take on additional work, this increased to 56% in 2019. This demonstrates that the sector continued its strong growth period over the past number of years into the beginning of 2020.

In 2020, of those who responded that they could take on additional work (35%), on average, surveyors indicated that their firms had the capacity to take on an additional 31% of work. This is a slight increase from 30% in 2019 and 21% in 2018.

Chart 9: **Operating Capacity**



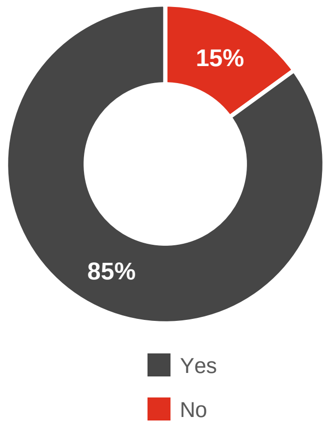
Post COVID-19 lockdown

Following the COVID-19 lockdown, 85% of chartered surveyors indicated that activity levels have been impacted as a result. Overall, the average impact amounts to a 20% reduction in activity levels.

This response largely mirrors the fact that construction sites were mostly closed from March-May and projects were delayed or shelved.

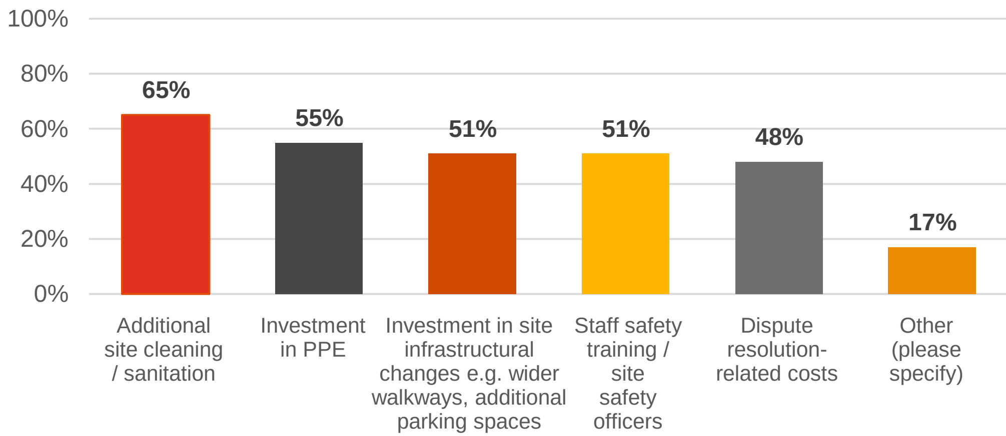
COVID-19 impact on activity	**-20%** national average

Chart 10: **Percentage of respondents indicating a negative COVID-19 impact on activity**



COVID-19 costs occurred

Chart 11: **COVID-19 cost drivers**



The construction sector, like other sectors, has had to absorb additional costs associated with COVID-19 safety and compliance measures. As illustrated in chart 11, the most common expenditure items incurred (excluding additional costs resulting from extended construction timelines) include additional site cleaning/sanitation, investment in PPE and investment in infrastructural changes to sites to accommodate the implementation of social distancing measures.

Other costs noted by surveyors was the increase in production times due to adherence with social distancing measures and knock-on consequences of construction delays during lockdown.

2 Industry trends

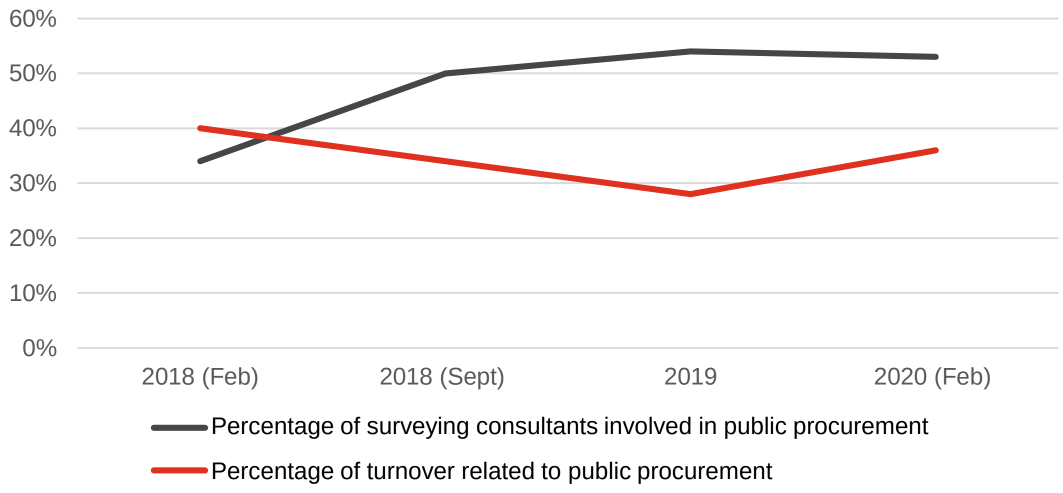
2.1 Public procurement and tendering

The public capital expenditure programme is a significant proportion of annual output in the construction industry. Further capital investment of €500m was made available in the July stimulus package. Capital expenditure thus far in 2020 has largely been for healthcare, and business, enterprise, and innovation[3]. The Government has indicated that it is envisaged that investment under the Public Capital Programme will increase to just over €9Bn in 2021.

[3] BUILD 2020

Due to the impact of COVID-19, a fall is anticipated in private sector investment in Irish construction sector in 2021. It is important that the Government continues investment in the strategic objectives as outlined in **Project Ireland 2040** such as ensuring enhanced regional accessibility, a strong economy supported by enterprise, innovation, and skills, and strengthened rural economies and communities.

Chart 12: **Public procurement**



A recent SCSI survey of quantity surveyors (QS) (pre-COVID) revealed that there was a 30% decrease in the number of small QS firms (less than 5 employees) providing consultancy services to the public sector. This is a concerning trend and one that will hopefully be reversed following the review and implementation of improved changes to the tendering process. Whilst many may argue that this is simply a symptom of increased activity in the private construction market, the top ranked reason why QS members are withdrawing their interest in tendering for public work was that the tendering and decision making process, and the onerous paperwork involved in tendering was a deterrent for them. Many QS members also cited that disproportionally high Professional Indemnity Insurance, requirements for small projects were also a significant deterrent.

2.2 Skills

Despite the strong economic recovery and the significant growth experienced by the Irish construction sector in recent years, an acute skills shortage has persisted in the industry since the financial crisis. Results from the February 2020 survey evidence that access to and the availability of critical construction related skills continues to be one of the biggest challenges facing the sector, with over 80% of Surveyors reporting an undersupply of skills across most construction related trades and professions.

As reported in 2018 and 2019, an acute skills shortage is a trend that has continued in the Irish construction sector over the last number of years and is a significant obstacle holding back construction output. COVID-19 is likely to have further exacerbated the issue with the widescale shutdown of construction sites resulting in up to 52,118 construction workers seeking financial support through the Pandemic Unemployment Payment and large numbers of overseas workers, who have been a critical support to the sector in recent years, leaving Ireland to return home during the crisis.

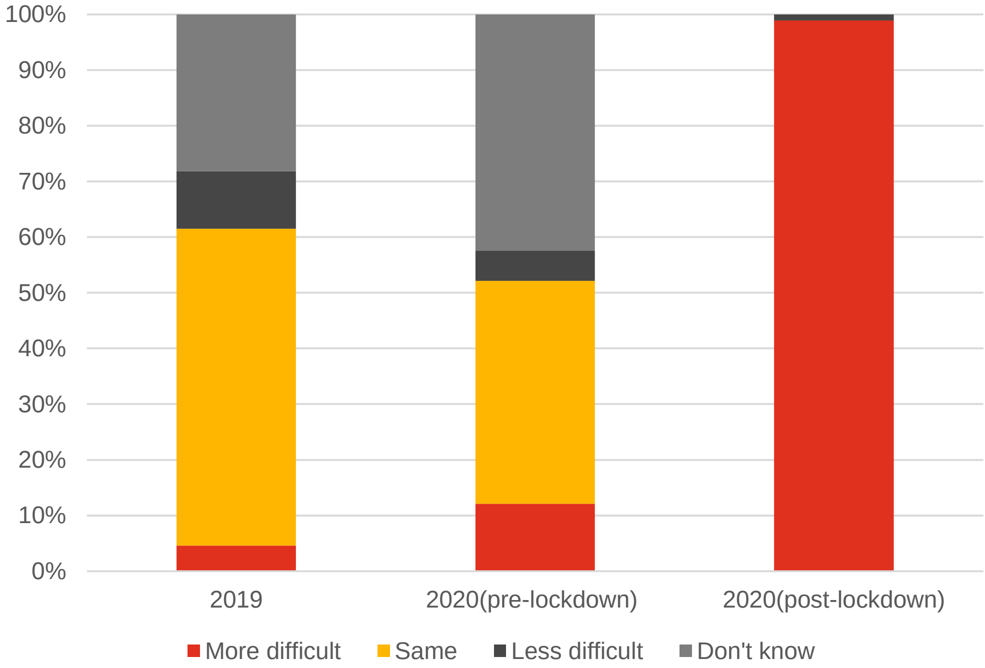
Industry stakeholders have worked hard in recent years to attract and retain talent in the sector. The commitment to long-term investment programmes (such as Project 2040) has provided some certainty and confidence that the industry can provide viable and sustainable career opportunities. It is therefore critically important that Government remains committed to its public capital expenditure programmes. As part of the July stimulus, further significant investment in education and training was also announced, including a renewed focus on Apprenticeships which is very welcome.

2.3 Development finance

Despite the positive signals and continued growth in the Irish construction sector in recent years, difficulties raising development finance have persisted. Results from the 2020 SCSI / PwC Construction Market Monitor show that the issue had become even more acute with an increase in the number of surveyors indicating that raising development finance was more difficult compared to the previous 12 months. The impact of COVID-19 on the Irish construction sector is likely to have further exacerbated this issue, with 99% of surveyors expecting the raising of development finance to be more difficult as a result of the crisis.

The negative sentiment reported in terms of access to finance is perhaps somewhat surprising as there have been a number of State-backed entities established in recent years to offer an alternative source of funding to traditional bank finance and to try to alleviate some of the challenges accessing finance being experienced by companies in the sector. Entities such as the Strategic Banking Corporation of Ireland (SBCI) have been established to offer low-cost credit to Irish SMEs. In 2019, the SBCI sanctioned loans totalling €247m, with 11% of this lending related to “construction services”. Other initiatives have been introduced such as Homes Building Finance Ireland (HBFI) which provides funding at market rates for commercially viable residential developments in the State. By the end of July 2020, HBFI reports that it had approved funding of €340m, which equates to 1,477 new homes across 29 developments.

Chart 13: **Raising of development finance compared to 12 months previously and impact of COVID-19**



Surveyors have identified **1. Viability of projects, 2. Access to bank credit** and **3. Cash flow, liquidity constraints** as the top three issues contributing to difficulties in raising development finance in the current environment. Furthermore, financial constraints on consumers / clients has also been identified as potentially having the biggest impact on building activity in the coming months.

3 Technology

3. Technology

Compared to most other industries, the construction sector has been slow to adopt new ways of working and to take advantage of advances in technology. While the use of some new technologies such as Building Information Modelling (BIM) has become more prevalent across certain subsectors in recent years, appetite among stakeholders to embrace new technologies has traditionally been quite low and most construction practices currently remain extremely labour intensive and site based.

A recent report published by the Department of Expenditure and Public Reform 'Economic analysis of productivity in the Irish Construction Sector' identifies this lack of integration of digitalisation and technology uptake by Irish construction firms as one of the **"key themes underpinning low productivity in the Irish construction sector"**.

The COVID-19 crisis has forced the Irish construction sector to find new ways of working. The wide-scale shutdown of the vast majority of construction sites for 6 weeks together with the health and safety protocols required to ensure a safe reopening and the continued operation of sites post lockdown (i.e. adherence to social distancing requirements), has acted as a major catalyst for stakeholders with regard to technology adoption with **61%** of surveyors indicating that the crisis has led to increased investment in digitalisation / automation in their firm. This is a very positive development but in order for there to be long-lasting change, increased use of technology needs to occur right across the construction supply chain. Appropriate training and financial incentives need to be made available so that smaller companies in particular, can be supported and encouraged to innovate and digitalise. Otherwise, there is a risk of a digital divide emerging across the already fragmented Irish construction sector. Another critical issue is that the increased investment and technology adoption rates which are being seen in the private sector, need to be matched by the public sector stakeholders otherwise the opportunity for real productivity gains and innovation across the sector will be lost.

61% of surveyors

'The crisis has led to increased investment in digitalisation / automation of the firm.'

4 Brexit

4. Brexit

In in addition to the disruption caused by COVID-19, Brexit remains a real and present concern for businesses in Ireland. It has the potential to have significant impacts on business operations and trade already reeling from the effects of the pandemic.

With the transition period ending on 31 December and negotiations on the shape of the future economic partnership between the EU and the United Kingdom ongoing, there is a risk of a hard Brexit. In that case, the UK will trade with the EU in the future on WTO terms. Even where agreement is reached by 31 December and a trade deal comes into force from 1 January 2021, Brexit will impact businesses. Therefore, steps need to be taken now to prepare for operating in a post-Brexit era, whatever form Brexit ultimately takes.

In the construction sector we have seen a widespread 'wait and see' approach to Brexit. It is positive to see that 50% of surveyors to the SCSI/PwC Construction Market Monitor reporting that they are at least "somewhat prepared" for Brexit, and a further 9% reporting that they are "well prepared". By undertaking some form of preparation and analysis of what the potential impact of Brexit may be on their businesses, these companies should be better placed to respond and recover.

There are a set of no risk actions that construction businesses can take now to ensure that they are Brexit-ready, particularly those engaged in cross-border trade.

There are a set of no risk actions that construction businesses can take now to ensure that they are Brexit-ready, particularly those engaged in cross-border trade.

Registrations and authorisations	Prepare the necessary customs and trade registrations and authorisations now in order to be in a position to facilitate customs clearance and duty payments day one. In addition, ensure a customs broker is engaged to lodge customs declarations on your behalf. Furthermore, checking as to whether key materials and supplies will continue to have the necessary regulatory approvals will be key.
Invest in customs expertise	Irish companies will need to think strategically about customs and trade. On import and export, there will be a need to file customs declarations for all goods imported and exported to or from the UK. Expert customs and trade knowledge will be essential for day to day operational activities. This should lead to a robust customs function to support products crossing international borders.
Have enough cash flow and inventory	Cash flow problems will increase for companies that need to hold extra inventory as insurance against potential border delays. This may present significant challenges for businesses who are already experiencing cash flow constraints due to the impact of COVID-19. Furthermore, foreign exchange volatility will impact on cash flow.
Develop a contingency plan	There is no guarantee that border procedures will operate smoothly immediately after Brexit. Companies need a contingency plan to mitigate against any risk of delay when goods enter or leave the country. Customs reliefs available to reduce customs duty payable should be explored as part of any Brexit planning. Developing a contingency plan will enable businesses to prepare, respond and recover sooner!
Check your workforce	Immigration is the one area where a clear picture is emerging. The UK has outlined details of its settlement scheme and temporary residence scheme. Registration for UK citizens will be a big change for employers. Systems and immigration policies will need to be updated. Firms should already have completed an impact assessment on what this could mean for their business.

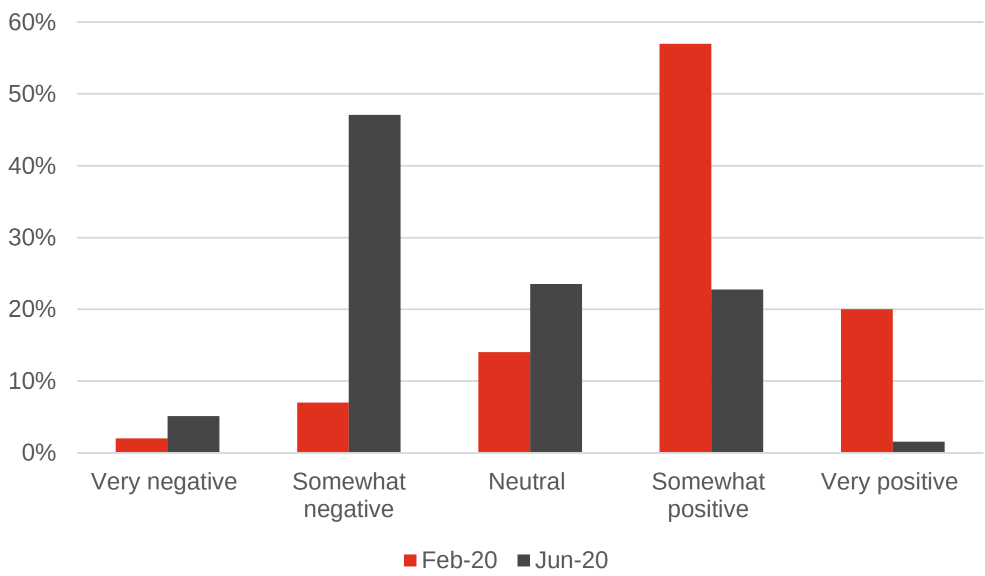
5 Surveyors’ outlook for industry and concluding remarks

5.1 Market activity outlook

Initially, our survey was issued to members in February 2020, however, in order to gauge the immediate impact of COVID-19 on the construction sector, a second survey was issued in June 2020. Surveyors in both surveys were asked to share their sentiments on the outlook of industry over the coming 12-months.

The following chart compares survey surveyors' outlook on industry in February 2020 and June 2020.

Chart 14: **Construction Market Activity Outlook for next 12 months**



As illustrated in chart 14, overall surveyors' outlook was more positive in February than it was in June 2020. This reflects the that at the beginning of the year, the true extent of how COVID-19 would impact on society was largely unknown. While some uncertainty was starting to creep in surveyors' outlook, over half of surveyors (57%) reported a 'somewhat positive' outlook for market activity and 20% of surveyors had a 'very positive' outlook. 7% of surveyors reported a 'somewhat negative' outlook and 2% held a 'very negative' position.

When surveyed in June 2020, as the construction sector began to return to work in line with Government guidelines and following two months of virtually no building activity, this outlook changed. Outlook for 'very negative' remained relatively low, increasing from 2% to 5%, but 47% of surveyors reported a 'somewhat negative' outlook, up from 7% in February. Only 23% of surveyors had a 'somewhat positive' outlook and 2% had a very positive outlook.

COVID-19 and its effect on markets and commercial activity has presented a range of challenges to the Irish construction sector. Some projects are delayed or have been cancelled as a result of the impacts of COVID-19 on the companies that commissioned them. Supply chain bottlenecks affecting equipment, materials and people are likely to cause delays in currently funded projects, or reduced spending on future ones. As a result of the COVID-19 crisis, Irish companies in the construction industry have been hit on numerous fronts.

The construction sector is resilient and remains an important sector for the success of our overall economy. It is likely that the immediate impact of COVID-19 will change the way that we use buildings, particularly commercial buildings but one thing for certain is that demand for renovated properties to meet our climate change targets and the demand for additional residential units over the next decade at least will ensure that a pipeline of work is there to maintain a level of activity for our important construction workforce.

5.2 Survey methodology

This report has been informed and guided by views, perceptions and options of 286 chartered surveyors, as well as input from other industry participants. In addition to interviews, the research included online surveys conducted in February and June 2020.

These professionals work in the property and construction markets in large corporate firms, construction agencies, government bodies and financial institutions.
The surveyors are a mix of quantity, planning and development, building and project management-chartered surveyors.

SCSI and PwC would like to thank all those who contributed to the research.

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