



SCSI/PwC Construction Market Monitor 2018



May 2018

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Executive summary

Confidence amidst challenges

We are delighted to present our 2018 SCSI/PwC Construction Market Monitor, incorporating the views of over 300 chartered surveyors canvassed in March 2018 and September 2017.

The research reveals increasing confidence in the Irish construction sector, regionally and nationally. For example, over half (56%) of chartered surveyors experienced increased activity in the six months to March 2018, largely driven by private housing and commercial activity. Infrastructure also showed robust performance. 71% of respondents stated that activity in private housing increased. 53% of respondents stated that activity in public housing increased and 44% reporting an increase in infrastructure. The increase in stamp duty for commercial property from 2% to 6% introduced in the last Budget appears to have been absorbed by the Dublin commercial property market. However, we understand that this increased cost to purchasers has made sales more challenging outside of Dublin.

The increase in activity levels is expected to continue given the Government's commitment to invest more capital in areas such as roads, hospitals and communication networks. Among the principal aims of the recently published Project Ireland 2040 Plan is the provision of balanced regional city development and a significant improvement in the State's infrastructure, which is welcomed.

However, the sector does have a number of constraints dampening activity. Quantity surveyors/commercial managers are in very short supply and the availability of skilled trades such as plasterers, carpenters, electricians, bricklayers and plumbers is an acute challenge. Planning and regulatory delays and/or complexities as well as raising finance are also proving challenging.

The survey reports the average operating capacity of surveyors in the industry is now at 79% compared to 85% in 2017. This reflects a variety of factors such as seasonality of projects, weather, price competition, delays in projects commencing, planning delays etc.

Survey respondents are positive about the outlook for the industry with nine out of ten surveyors expecting activity to increase in the year ahead. The majority expect employee numbers in this sector to increase. There are clear skill shortages and, therefore, it remains to be seen where the additional labour will come from. Indeed, the recent Central Bank report reveals that the number of people at work in the Irish construction sector is around half (46%) of 2007 levels and some overseas hiring may be required. High accommodation costs are a significant deterrent to overseas hires.

The sector has come through a period of restructuring and rebalancing over the last ten years and the majority of respondents also expect profits to increase in the year ahead. Competition for contracts in the sector remains fierce and the risks associated with below cost tendering are still a concern.

In the PwC Pulse Survey, Irish CEOs have been calling out the housing and infrastructure challenges on growth prospects for their businesses over the last number of years. It is encouraging, therefore, to see a construction industry that is

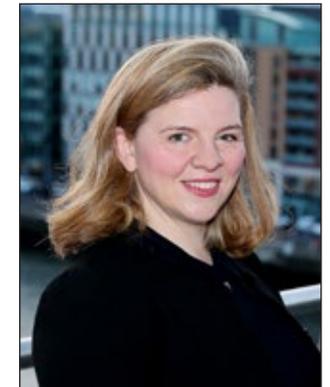
positive about the future. For an open economy that relies heavily on foreign direct investment and exports, it is critical that we have the housing and infrastructure to support it. And while Brexit will likely bring many challenges, it will also likely bring opportunities. For Ireland to realise a Brexit dividend, it will be important that our economy can support any relocation of operations from the UK to Ireland. However, Ireland will need to have the skills in place to deliver this growth. The report highlights that skills shortages persist which may stall economic progress in the construction sector. If not urgently addressed, the Irish construction industry may have a challenge in delivering the ambitious development goals of the public and private sectors.

We hope that you find this report informative



Áine Myler

Director General of the Society of Chartered Surveyors Ireland.



Joanne Kelly

Partner, PwC Ireland Real Estate Leader

Survey key findings - National

Construction activity expectations remain high, but skills shortages remain top concern for surveyors

Over half (56%) experienced increases in construction activity in the six months to March 2018

Around **three out of four** surveyors saw an increase in both private commercial and private residential construction

Nearly half (44%) saw increased activity in the infrastructure sector

70% expect growth in headcount; and 63% expect growth in profits in the year ahead

Future growth expectations for the industry are overwhelmingly positive: 90% expect activity to increase in the year ahead, but lags actual growth being achieved in the last six months

Acute challenges exist. Over 80% experienced skills shortages, particularly for professions and trades such as quantity surveyors/commercial managers, plasterers, carpenters, electricians and bricklayers

77% experienced planning and regulatory challenges

52% said that finance was a challenge, though the level of difficulty has eased off since 2017

Surveyors report an average operating capacity of 79%

1. Activity levels & operating capacity



Positive signals

“The cost of construction versus the sales price for domestic housing is still hindering the supply of housing in the Munster area.”

Cork-based surveyor

The research reveals that general business activity among chartered surveyors has notably increased in the six months ended March 2018 compared to the six months ended September 2017. Over half (56%) reported that business activity had increased during this period, up from 46% in 2017.

Private housing (71%) and private commercial (68%) are two of the construction sub-sectors which are seeing the greatest growth in activity, representing a 13% and a 10% increase of surveyors experiencing an upturn in activity in the six months ended March 2018 compared to September 2017.

Activity in infrastructure recorded a growth in 2018, with 14% additional surveyors reporting that activity increased.

“A lot of skilled trades are not moving back to the residential market from the commercial market and this is leaving a shortfall on residential buildings/refurbishments. There is a larger lead-time on organising trades, with much more advanced notice needed to get people on site.”

Dublin-based surveyor

Chart 1: Construction activity by region

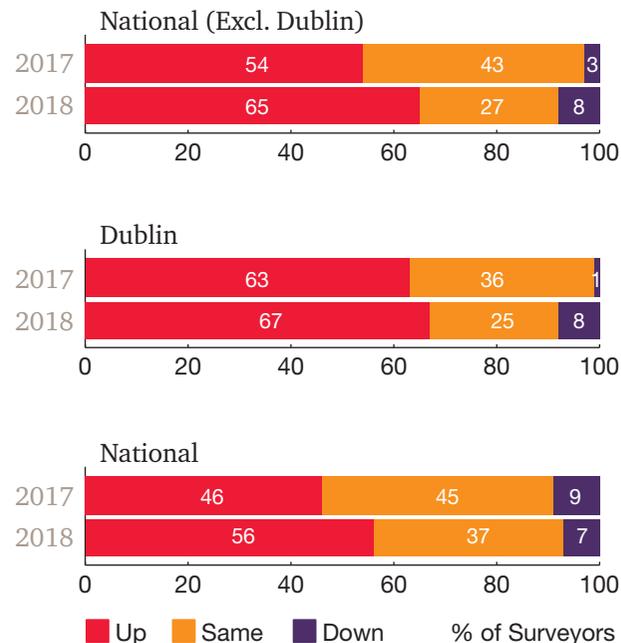
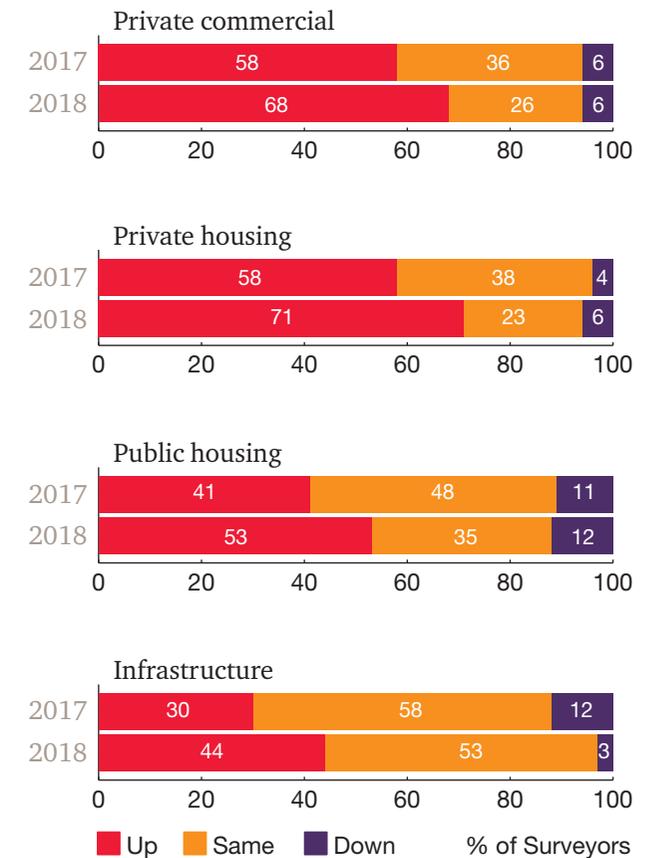


Chart 2: Construction activity by sector



Operating capacity scope for even more activity

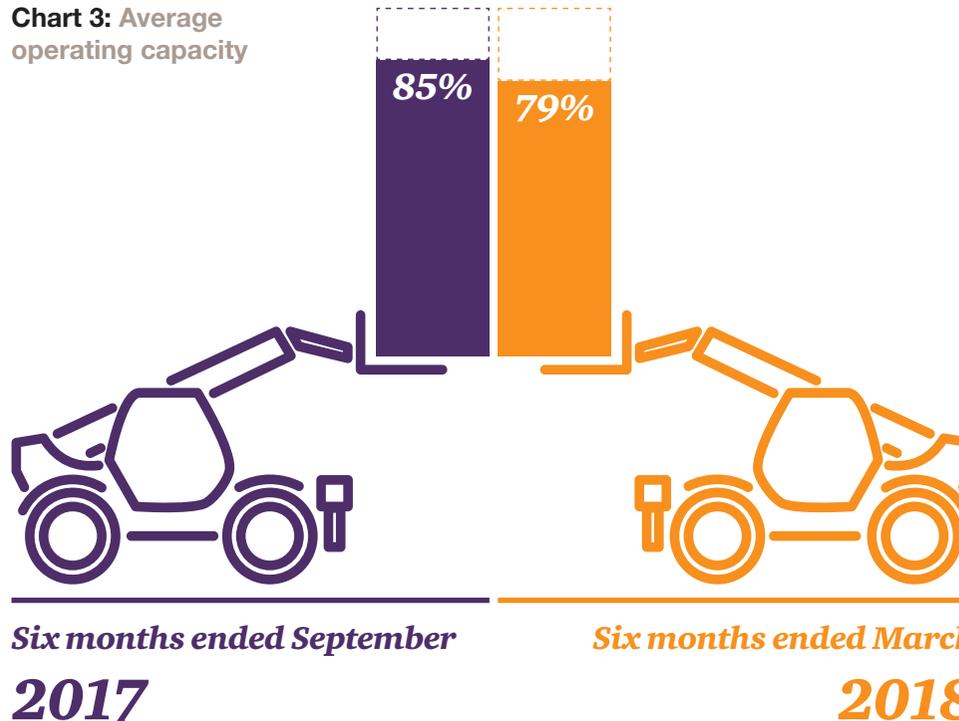
The average operating capacity of surveyors in the industry is now at 79% compared to 85% in 2017. There may be a number of reasons for this movement, such as seasonality of some projects, delays in getting projects started due to accessing finance, delays in planning, bad weather, etc.

According to PwC's latest CEO Pulse Survey, over three-quarters of Irish business leaders have indicated that affordable housing and better infrastructure are key challenges for business growth. With a severe housing crisis and infrastructure deficit in our economy, the SCSi/PwC research suggests that those offering professional services to the Irish construction industry, such as surveyors, have the capacity to take on additional business activity. Furthermore, the advancements of technology such as Building Information Modelling, has and will continue to be an important factor in the delivery of more capacity in the marketplace.



21%
spare capacity
in March 2018

Chart 3: Average operating capacity



2. Infrastructure



Communications and water/utilities

key drivers of infrastructure upsurge

Surveyors reported increased activity levels in Communications, Water / Utilities and Energy (+9%, +6% and +2% respectively). Whilst some of these increases remain relatively modest, the trend is positive and is a possible early indicator of the impact of Project 2040.

The projected significant investment in physical infrastructure, including the construction of 500,000 new homes, as laid out in Project 2040, is particularly welcome. It will be particularly important, considering our country's skills challenges, that there is available talent to facilitate these construction plans and also that rising construction costs are kept in check. Project 2040 also envisages:

- Expansion of attractive and sustainable public transport to meet significant increases in travel demands
- Enhancement in road networks across the regions, with emphasis on accessibility to the Northeast
- Continued investment in our ports and airports, particularly in the post-Brexit environment.

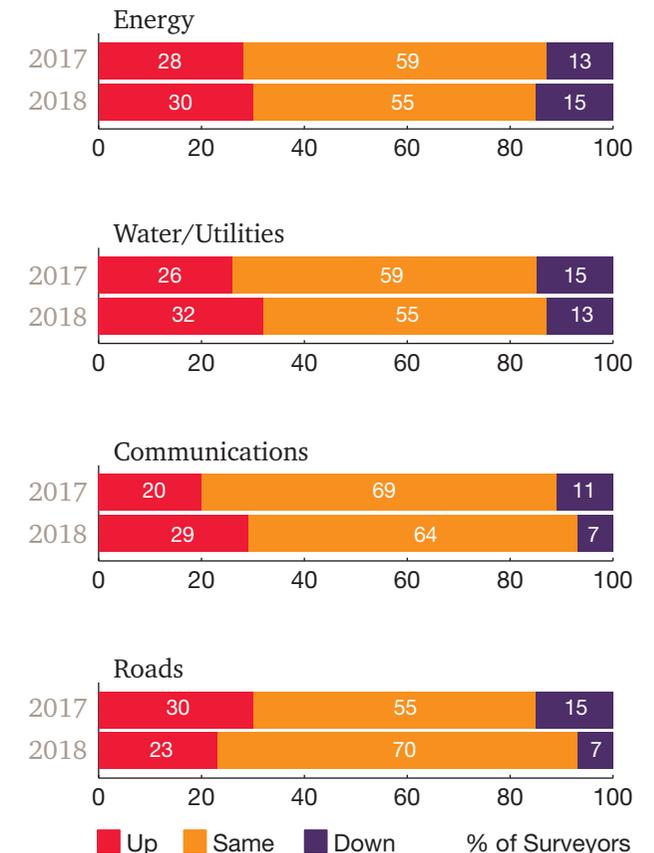
Speaking about the National Development Plan, Minister for Finance and Public Expenditure and Reform, Paschal Donohoe TD, said: "This National Development Plan will change how we invest in public infrastructure in Ireland. It moves beyond the approach of the past, which saw public investment spread too thinly and investment decisions which didn't align with a spatial strategy.In order to meet the needs of our citizens, a number of major innovations are being introduced. Among them are a longer-term (10 year) strategic approach to public capital investment; a sustained increase in that investment to meet the infrastructural needs of all communities; four new Funds to target urban and rural renewal, climate action and 'disruptive technologies'; and the establishment of a new National Regeneration and Development Agency to help to drive growth and renewal in towns and cities across the

country – all of which will enable us to work towards making a more equal and a fairer Ireland a reality".

Achieving Project 2040 will take time and resources. The Government's 2040 plan should, however, pave the way towards Irish construction firms achieving full capacity in the infrastructure area. Key to achieving this though, will be ensuring that adequate labour resources are in place in the construction industry.

The upgrading of Ireland's water and broadband network must remain a key priority for Government. Although progress is being made by Government in terms of increasing capital investment in our infrastructure, the delays with procurement, planning and commencements are having the combined effect of stifling goals and targets as set out in Government's strategy. Competing demands for contractors to deliver on these important projects is another immediate concern and potential challenge for Government. The latest SCSi Tender Price Index highlighted increases in Tender prices by 7% nationally. These increases are being driven by a strong pipeline of work combined with an acute skills shortage, leading directly to increased costs. Development and construction companies are finding it more and more difficult to recruit skilled and unskilled labour. While specialist sub-contractor prices have been increasingly steadily for some time now, we are also seeing significant rate increases for traditional trades such as concrete installations, reinforcement and formwork. One other emerging challenge is the shortage of sites for the licensed disposal of construction waste. This is a particularly acute problem in Dublin and its immediate surroundings.

Chart 4: Levels of activity in infrastructure construction



3. Challenges



Challenges amidst positivity

Whilst the survey contains some very optimistic findings, it is important that we do not underestimate the challenges facing the industry.

Financial viability and the cost of construction have been significant areas of discussion in recent years. In response to the housing crisis, the Government recently published its Review of Delivery Costs and Viability for Affordable Residential Developments report. These reports look at land costs, construction costs, professional fees, levies, finance and VAT. A number of recommendations are highlighted, such as monitoring the effectiveness of the vacant site levy, reviewing skill shortages with the Department of Education and Solas, and clarifications on the Part V agreement process. Of note is that the Government does not recommend any changes to the 13.5% VAT rate applying to construction. We welcome the report as a way to continue ongoing dialogue between Government and the construction industry recording key factors driving construction costs.

The recent analysis by the Central Bank of Ireland has shown that the construction sector has regained 46% of the jobs lost during the crisis. It is a concern that a large proportion of construction workers who lost their jobs during the crash are likely to have emigrated or taken up alternative work in an improved economy. With an increase in the average age of employed construction workers, the expectation of the Central Bank is that the sector is likely to require a significant inflow of labour from abroad in the short to medium term to fill vacancies created by this renewed demand. In this report, we have looked to specifically identify the trades with the most significant under supply.

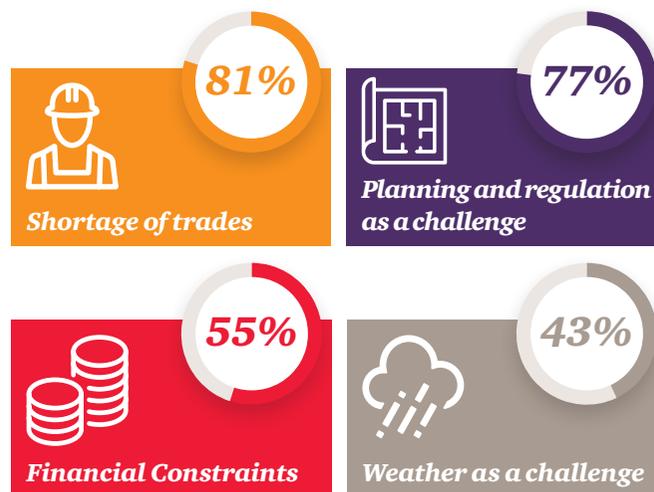
Brexit negotiations are continuing, with some progress made but some significant obstacles still to be overcome. PwC's view remains that it would be prudent for Irish businesses to plan for

a hard Brexit. Brexit remains one of the single largest unknowns for the Irish economy. It is generally accepted by the Irish construction industry that the UK exiting the European Union will impact their businesses negatively. However, there may also be advantages as a result of Brexit from an Irish construction industry perspective. For example, additional accommodation will be required as Ireland secures its share of relocations by UK firms seeking EU passporting benefits. Additionally, Brexit could also result in lower materials costs on goods imported from the UK if the sterling weakens against the euro.

The impact of Storm Ophelia and "The Beast from the East" have had a negative impact on construction projects, with many respondents in March 2018 saying the weather was a challenge. While weather conditions are beyond our control, there are other key challenges including labour, planning and regulation, and finance which need to be addressed over time.

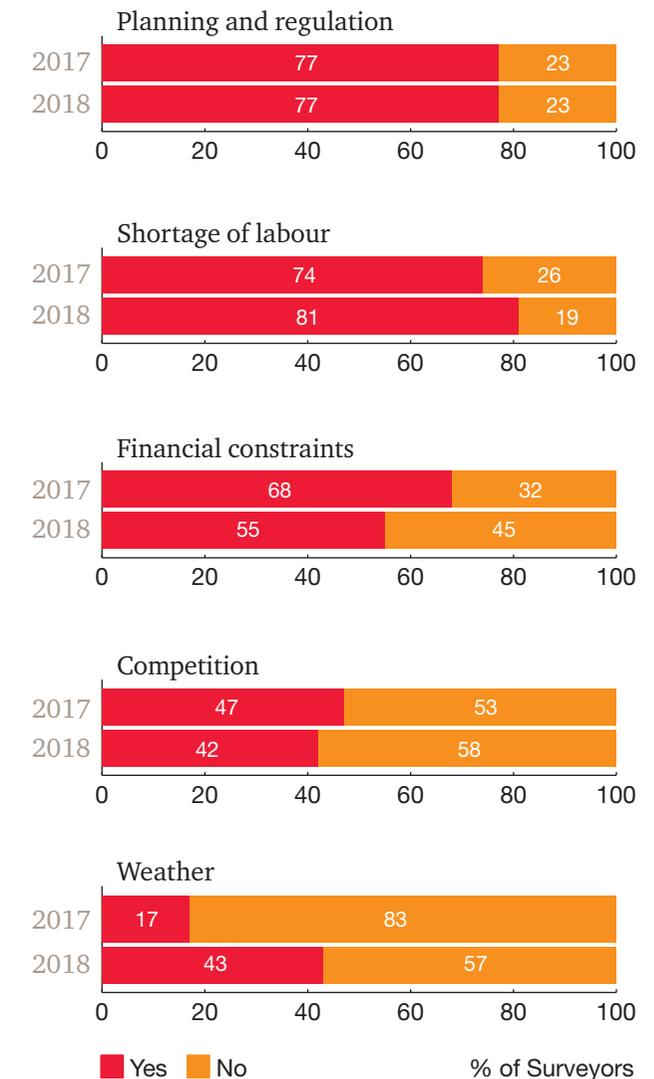
Respondents indicated that there are significant challenges curtailing the industry, as follows:

Challenges facing the construction sector



% of surveyors

Chart 5: Challenges facing the construction sector



■ Yes ■ No % of Surveyors

Skills



81% reported skills challenges, up from **74%** in 2017

The skills shortage is the single biggest obstacle holding back construction output with eight out of ten respondents reporting constraints.

The research indicates a skills shortage across most construction related trades and professions. The most acute skills shortages were for quantity surveyors/commercial managers (respondents indicating an acute shortage, 84% in 2018, up from 81% in 2017). Although the shortage has eased somewhat compared to Q4 2017, the significant majority report skills shortages for plasterers, carpenters, electricians, bricklayers and plumbers.

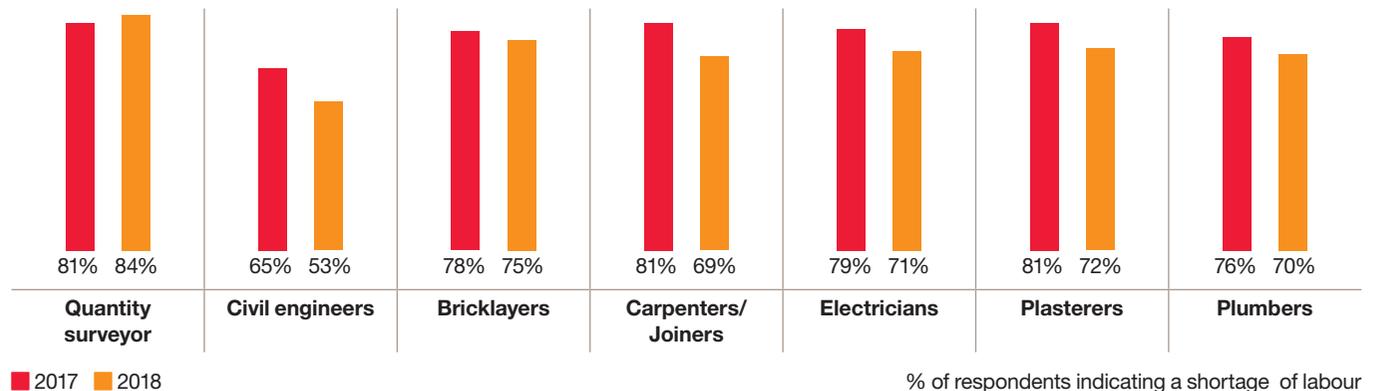
Measures have been taken in the past to address skills shortages on a short term basis, such as sourcing labour from abroad. However, as discussed, this presents its own challenge and a clear plan is needed to ensure the provision of a skilled workforce while embracing technology, to help sustain our economic wellbeing for the long term. It is also timely that the recent Central Bank Report ‘Where are Ireland’s construction workers?’ noted the number of people at work in the Irish construction sector was 110,000 at the end of 2017 – 46% lower than in 2007. It noted that a large number of construction workers who lost their jobs in the period 2008–2012 have not regained employment in the sector. The report further noted that the Irish construction industry may need to recruit from abroad to fill jobs.

“From a main contractor’s point of view, the lack of skilled labour and rising cost of staff is a major issue. i.e. block laying costs have increased by 25% in past 6 months.”

Connaught-based surveyor

Based on current estimates provided in recently published reports such as the CIF/DKM employment Report, projected supply of labour will not be sufficient to meet projected demand. A shortage in qualified surveying professionals has also been identified in the ‘Employment Opportunities and Skills Requirements for Construction and Property Surveying 2014-18’ report across construction, property and land surveying. The shortfall is substantial based on the official projected economic growth but remains significant even in a more limited economic growth scenario.

Chart 6: Specific skills shortages in the construction industry



Planning and regulation

Planning and regulation issues have been the subject of much scrutiny and criticism in recent years. It is clear from respondents that issues still remain with over three-quarters reporting planning and regulation to be a challenge.

In an attempt to address difficulties such as planning delays and the cost of construction, changes have been introduced such as the fast track planning process for large-scale developments and the release of new regulations in respect of apartment design and planning. While respondents reported some easing of planning and regulation challenges in our survey in March 2018 compared to September 2017, it is too early to determine whether the above Government initiatives are having a positive impact on the industry. The three reports published by Government on the 12th April 2018, *Review of Delivery Costs and Viability for Affordable Residential Developments*; *Cost analysis of the updated Sustainable Urban Housing: Design Standards for New Apartments, Guidelines for Planning Authorities*; and *Comparison of Residential Construction Costs in Ireland to other European Countries* suggest that Ireland's construction costs are relatively comparable to other EU countries such as the UK, France, Germany and the Netherlands.

The publication of these Government's Reports suggests that apartment construction savings of up to 15% are envisaged following the recent review of the Planning and Design guidelines. It will be interesting to see the initial impact of these changes in the next survey but it's still a real concern that the expected cost savings are not enough to encourage more affordable supply to the market. According to the *SCSI Real Cost of New Apartment Delivery Report 2017*, construction costs account for 43% of the total apartment delivery cost and the projected 3% to 15% savings range on construction costs alone are unlikely to fully address viability and the acute shortage of affordable new apartment delivery in areas of demand.

Another worrying trend in the market is construction price inflation. The SCSI monitors inflation in the market through the Tender Price Index which is the only independent assessment of construction tender prices in Ireland. The most recent results (February 2018) show that construction tender prices are continuing to rise steadily. The SCSI members' forecast for the first half of 2018 is for a further increase of 3.3%, which equates to an annual increase of almost 7% from the first half of 2017. This will bring construction prices back to the level they were at in 2008, a year after the 2007 peak.



77% reported
planning and regulation
is still a significant
challenge

The indices represent a national average; however, the rate of increase is not uniform across the country. For the second half of 2017, Dublin showed the highest percentage increase at 3.91%. This was followed by Connaught/Ulster at 3.43%. The increase in the rest of Leinster was 3.13% and in Munster 3.02%.

A major factor for the increase in construction tender prices is due to increasing demand as construction output rises. The skills' shortages that exist for both main contractors and specialist sub-contractors are also a significant factor driving increased costs.

Finance



As noted earlier in the report over half of respondents still find it a challenge to raise finance. On a positive note, the difficulty of raising finance has eased from 58% in 2017.

Initiatives announced in recent months, such as the Home Building Finance Ireland (HBFI) fund, which is aimed at increasing access to finance for residential construction have helped, however respondents also indicated that cash flow, liquidity and delays in payments are also issues.

Between bank finance and mezzanine finance, the SCSi has indicated an average cost of finance of 7% for residential development within its Report “The Real Costs of New Apartment Delivery”. This is a blended figure and finance costs can vary hugely from development to development.

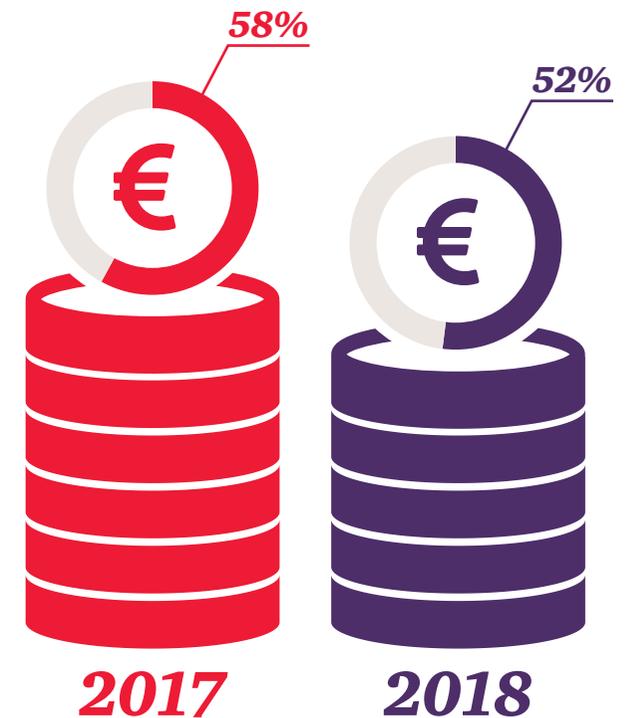
The survey results show an overall healthier position in terms of accessing finance. In our experience, the availability of finance for large and mid-size projects, and Dublin/urban projects is very positive. International sources of finance is readily available for prime real estate projects which are underpinned by strong financial fundamentals. The rising market of rents and property prices has made the development of residential sites more economically viable, which should over time, ease the housing crisis. However, on the other hand, this does increase vendor expectations of site values, so there are competing priorities in the market.

Certain companies, particularly SMEs, are still facing difficulty in accessing reasonably priced finance. There remains a legacy from the downturn where construction companies had negative experiences or a poor track record with lending institutions. However, this seems to be more of an issue for regional and secondary projects.

Clearly, where there is difficulty in accessing finance for projects, this curtails the opportunities to take on new projects and people. One of the findings from our prior year construction survey was an increased appetite for companies to seek alternative, non-bank finance to support their projects, with private equity, joint venture arrangements and crowd funding becoming viable options. We have seen alternative finance providers become more established in the market, which is positive for the industry. The Irish banks have also increased their real estate teams, which is a good indication of their confidence in a growing market.

As noted earlier in the report, in Finance Act 2017, the Government increased the rate of stamp duty on non-residential property from 2% to 6%. The rate had previously been reduced down to 2% in an effort to stimulate the property market. In the context of the increase in rate noted above, and in recognition of the housing supply challenges that currently exist in the market, the Minister for Finance announced that a stamp duty refund scheme will be introduced for land purchased for the development of housing. There will be a number of conditions which will need to be satisfied in order to qualify for a refund, including a requirement that development

Chart 7: Level of difficulty raising finance



% of respondents indicating a challenge in raising finance.

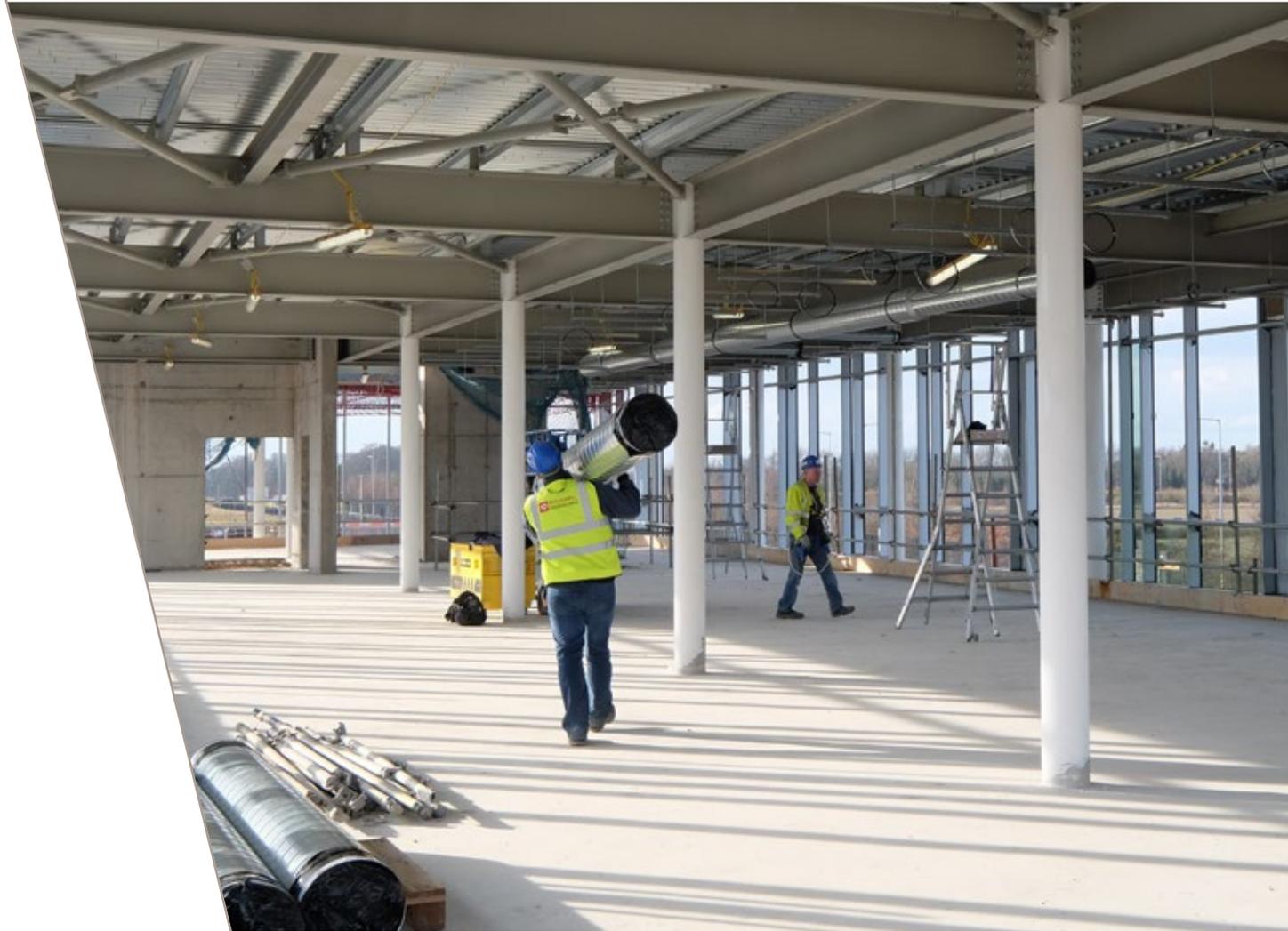
of the land will need to commence within 30 months of the land purchase.

The Finance Act 2018 also brought about changes to the Vacant Site Levy, which is due to be introduced in 2019. The annual levy will increase from 3% to 7% in the second and subsequent years. It will be interesting to see the practical implications of this levy when it is implemented.

The Minister also announced a reduction in the holding period for investors who availed of the capital gains tax exemption introduced in 2012, from seven years to four years. There was also an extension of mortgage interest relief and the relief will now not be fully phased out until 2021.

The Government had previously implemented significant changes to the taxation of Irish investment funds. The new regime applies to regulated funds that invest, or may invest, in Irish real estate and related assets. It introduces a potential 20% withholding tax on certain events, including the sale of units, distributions and redemptions from such funds, and additional reporting and compliance requirements. Funds carrying on a business of renting, developing or trading in Irish real estate are the primary focus of the legislation.

Amendments were also made to Section 110 of the Taxes Consolidation Act 1997 to restrict the deductibility of profit-participating loans where they are used to finance the business of s110 companies related to Irish property transactions.



4. *Future outlook*



Overwhelming positivity for the year ahead



According to PwC's latest *Global Economic Outlook*, Ireland should remain the fastest growing Eurozone economy through to 2024.

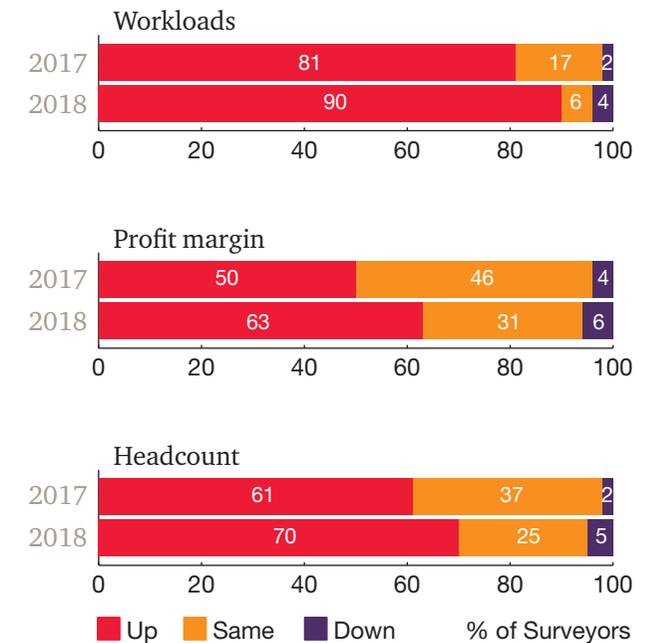
The latest Central Bank report forecast's our economy to grow by 4.8% this year and 4.2% in 2019. The SCSi/PwC Construction Market Monitor also reveals an industry that is upbeat about the future. Nine out of ten (90%) respondents expect activity to increase in the year ahead, slightly more upbeat than in 2017.

Housing and under invested infrastructure are widely considered to be barriers to growth prospects. It is encouraging, therefore, to see a construction industry that is positive about the future. For an open economy that relies heavily on foreign direct investment and exports, it is critical that we have the housing and infrastructure to support it. And while Brexit will likely bring challenges, it will also likely bring opportunities. In order for Ireland to realise any Brexit dividend, it will be important that our economy can support any relocation of operations from the UK to Ireland. It is also encouraging that plans have been outlined in Government's

Project 2040 Plan for significant infrastructure and housing investment. However, Ireland will need to have the skills in place to secure this growth. Our report highlights acute skills challenges and the recent Central Bank report reveals that the number of people at work in the Irish construction sector is around half (46%) of 2007 levels. The Irish construction industry will face many challenges in delivering its planned activity increases, unless these skills challenges are addressed.



Chart 8: Predicted workloads, profits and headcount in the year ahead



5. Survey methodology and key contacts

This report has been informed and guided by views, perceptions and opinions of over 300 chartered surveyors, as well as input from SCSi, PwC and other industry participants. In addition to interviews, the research also included online surveys for the six months ended March 2018 and the six months ended September 2017.

These professionals work in the property and construction markets in large corporate firms, construction agencies, government bodies and financial institutions. The respondents are a mix of quantity, building and project management chartered surveyors. SCSi and PwC would like to thank all those who contributed to the research.

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