Turner & Townsend

Republic of Ireland market intelligence survey

Spring 2019

making the **difference**

Introduction

Contractor perceptions indicate that the cost of labour has increased marginally when looking back over the past six months

Over the past six months average contractor sentiment indicates that material costs have increased marginally

Average sentiment indicates that overheads have increased marginally when looking back over the last six months

In the past six months, surveyed contractors state that average profits have marginally increased

Preliminaries have increased marginally according to contractors over the last six months

The construction sector in the Republic of Ireland continues to experience increased levels of activity and the short and medium term outlook appears positive. Results from our latest Republic of Ireland market intelligence survey echo this sentiment with a majority (77.8 percent) of contractors surveyed expecting the Irish market to warm in the short to medium future.

According to surveyed contractors the market in the Republic of Ireland is still very competitive, but with a good steady supply of tender opportunities coming through contractors are keeping their order books filled for the early part of 2019 and beyond. Current order books are on average 83 percent full, indicating a very healthy short term outlook. The sectors performing notably well are residential/housing, commercial/office and the public sector. Infrastructure generally continues to show very low levels of activity, with many of the projects expected to begin only now at the early planning stage; activity in this sector is expected to increase in the short to medium term.

Margins, however, remain tight although they have shown a slight improvement to 4.1 percent in the current report. Rising labour and material costs continue to be a significant challenge with mechanical, electrical and façade contractors experiencing upward pressures on labour and material costs.

Tendering conditions remain competitive but in a market with continued rising costs. Contractors expect average tender price inflation to reach 7.0 percent in 2019 following on from a 7.6 percent rise during 2018. These rises are very similar to the tender index increases as published by the Society of Chartered Surveyors in Ireland (SCSI).[1]

Brexit continues to be a major concern with Irish contractors, with the ongoing uncertainty putting upward pressure on materials in particular. Depending on the outcome this will be a key challenge in 2019 and beyond.

Turner & Townsend tender price inflation

7.0%
Republic of Ireland
2019

→

5.5%
Republic of Ireland
2020

→

4.5%
Republic of Ireland
2021

Background to this report

Turner & Townsend regularly interacts with the supply chain in order to better understand the market dynamics that are fundamentally affecting construction price and cost movements in the Republic of Ireland. Every six months we collate survey responses from Irish contractors, allowing us to glean a snapshot of the local market place. This enables us to provide our clients with the most relevant and up to date market intelligence.

[1] https://www.scsi.ie/documents/get_lob?id=1474&field=file

Tender and market conditions

Construction and tender costs continue to warm

When we compare against relative responses six months ago we can see that the market is continuing to warm. Over three quarters of respondents consider that to be the case with 'moderate' tender price levels; more interestingly 22 percent believe the market to be beginning to overheat, with reduced levels of competition and high tender prices.

While the Irish construction industry is influenced by continued rising costs the tendering market does appear to remain competitive. Contractors expect average tender price inflation to reach 6.9 percent in 2019 following on from a 7.6 percent rise during 2018. Further increases of 5.1 percent are currently expected during 2020, indicating continued pressure on labour and material resources. During the 5 year period 2018 to 2022 cumulative tender price inflation in Ireland is expected to be c. 31 percent; this is substantially more than the UK where average similar tender price increases are expected to be in the range of 13 to 17 percent.

The increasing preference for projects to reach site as quickly as possible is reflected in the 47 percent of projects that are procured either through a 2 stage process or by negotiation. In addition a further 18 percent of projects are procured through frameworks, pointing towards a more collaborative approach. Not surprisingly a negotiated tendering process is still seen as the preferred route, reducing risk exposure within the current markets.

Figure 1: What proportion (%) of your current contract/tender negotiation

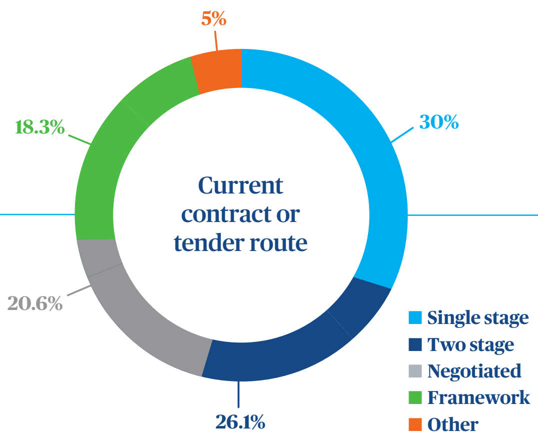
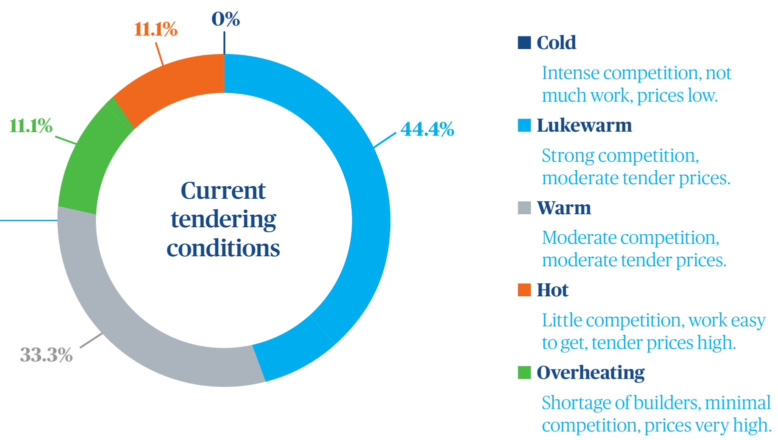


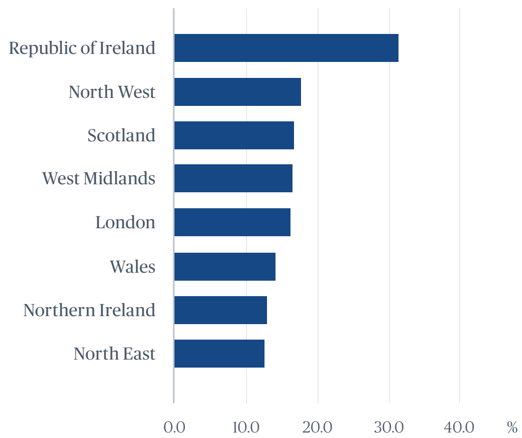
Figure 2: How would you describe current market tendering conditions within your region?



Tender price inflation (TPI) overview

Source: SCSI + Assorted consultants, available data reported as of 2019 Q1.

Cumulative UK and Ireland regional TPI - 2018 to 2022



Residential sector coming to the fore

It is no real surprise that 37.5 percent of contractors surveyed perceived the residential sector to be the top performing sector across the Republic of Ireland. This is an increase of eight percent on the prior six months. Based on the current activity in this sector, including Private Rental Schemes/Build to Rent (PRS/BTR), we expect this sector to grow further during the next six to 12 month period.

As of the fourth quarter of 2018 surveyed contractors have recorded significant order books for 2018/19, which are on average 83 percent full. Likewise, for the 2019/20 financial year, order books are strong at 43.3 percent full. These figures are an increase to those recorded six months ago, indicating continued optimism in short term outlook although with capacity remaining at 83.3 percent, there is still room for additional work. Despite the recent upsurge in activity margins are starting to rise compared to the previous 6 month period but still remain low at 4.1 percent.

Figure 1: Is the construction market getting warmer, cooler or staying the same?

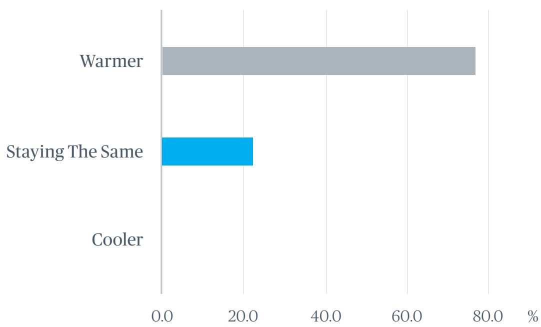


Figure 2: What is the top performing sector within your region of work?

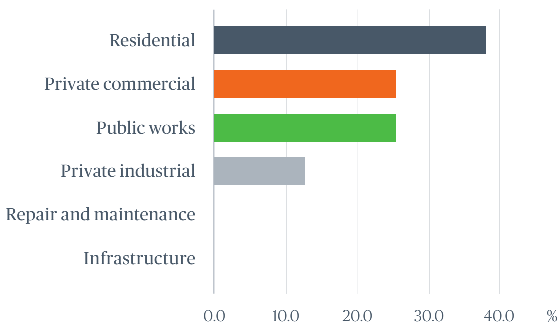


Figure 3: On a typical medium commercial job (5000m2 GFA), what are your margins, preliminaries and overheads & profit?

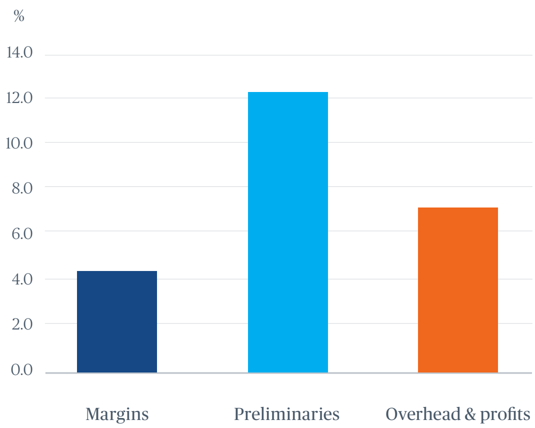


Figure 4: Approximately (%) how full is your order book for the following

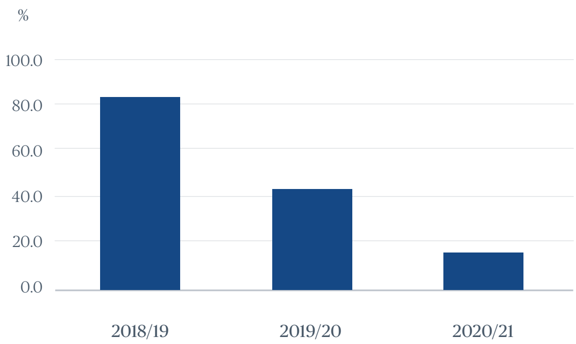


Figure 5: What capacity (%) is your company currently operating at? (100% = full capacity)

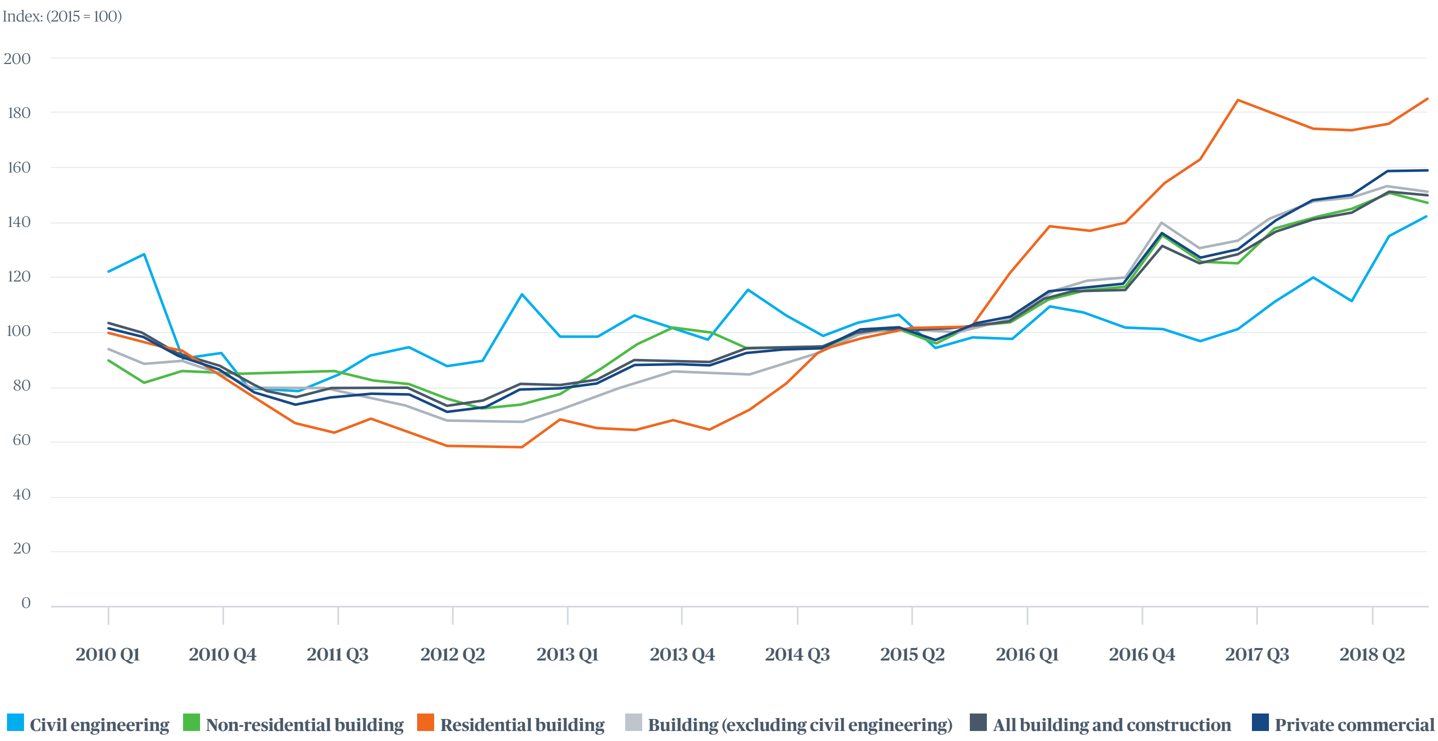
83.3%

> *The Republic of Ireland market is on the rise with a lot of work available to tender. Tenders remain very competitive especially outside of Dublin and Cork, however problems remain with the sourcing labour and sub-contractors.”*

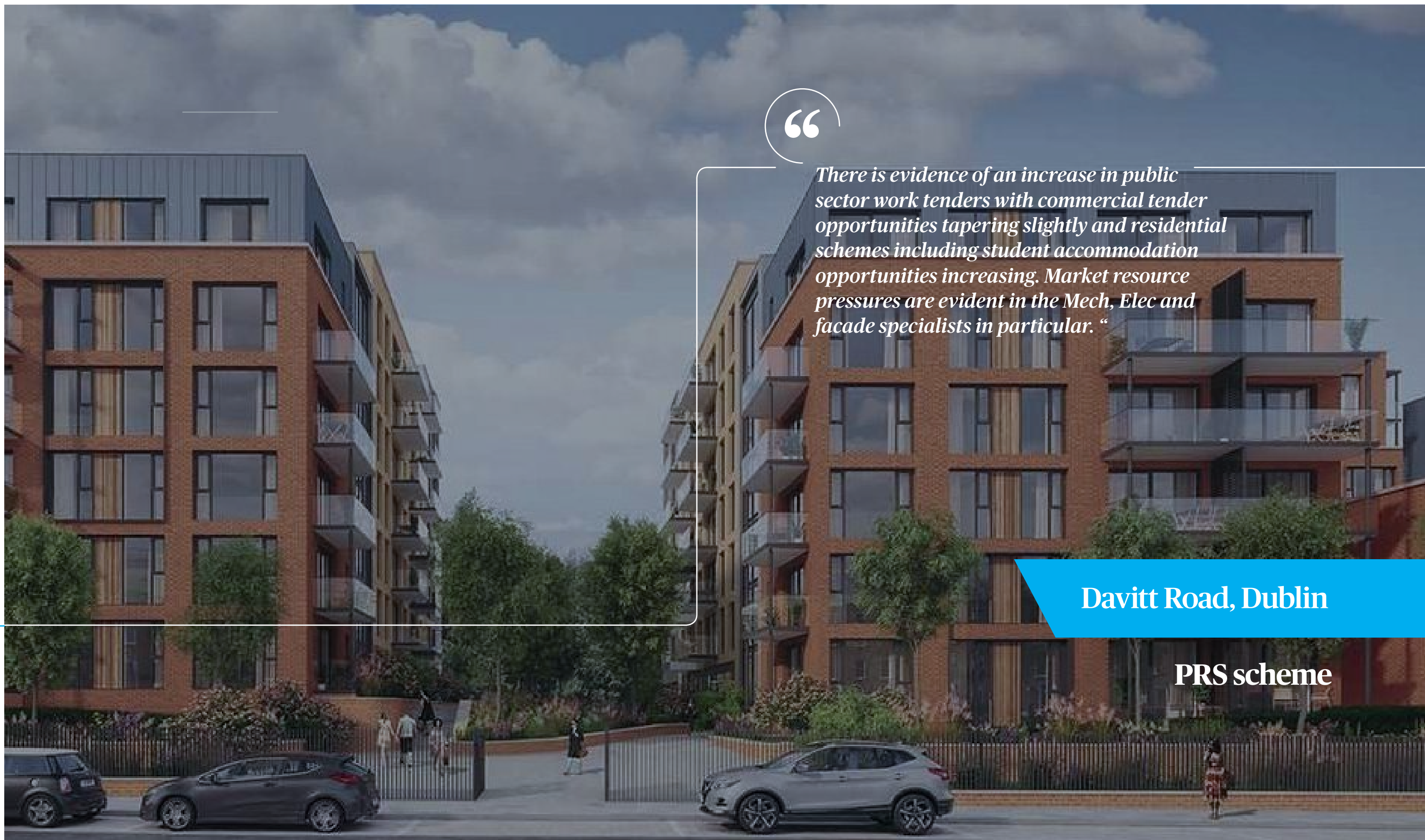
Regional output summary

Total construction output in the Republic of Ireland in the final quarter of 2018 increased by 1.7 percent when compared with Q3 and was 12 percent higher compared to the same quarter in 2017.

Volume of production index in building and construction (seasonally adjusted) - 2010 Q1:2018 Q4

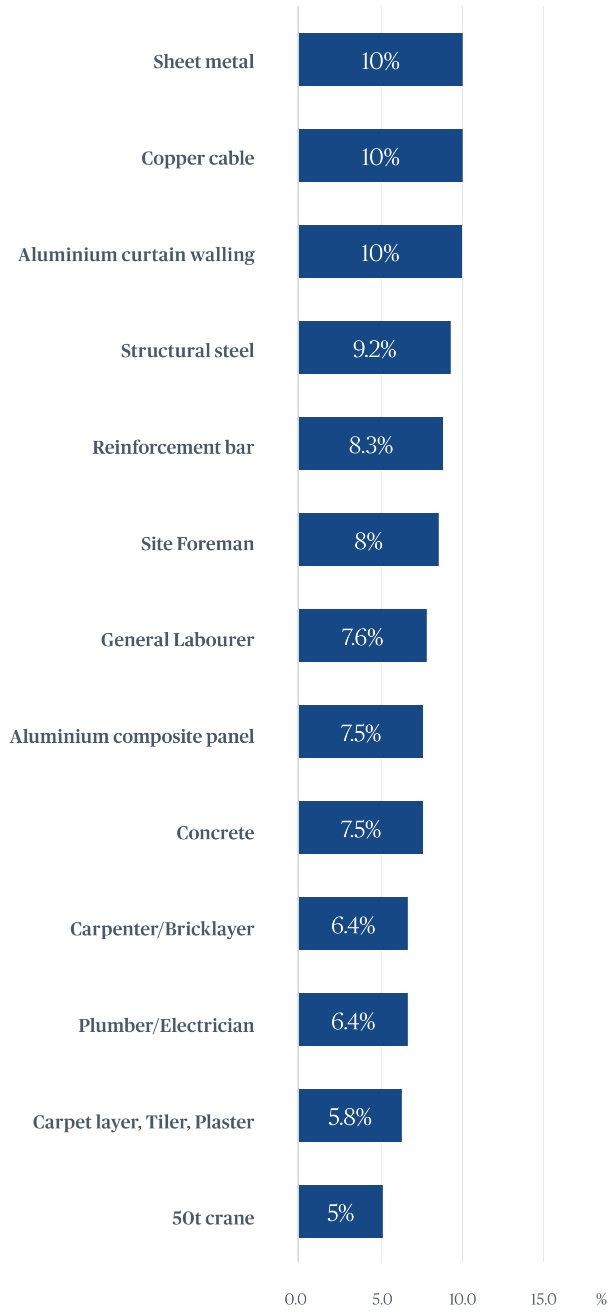


Source: Central Statistics Office (ROI) - Data as of 2018 Q4

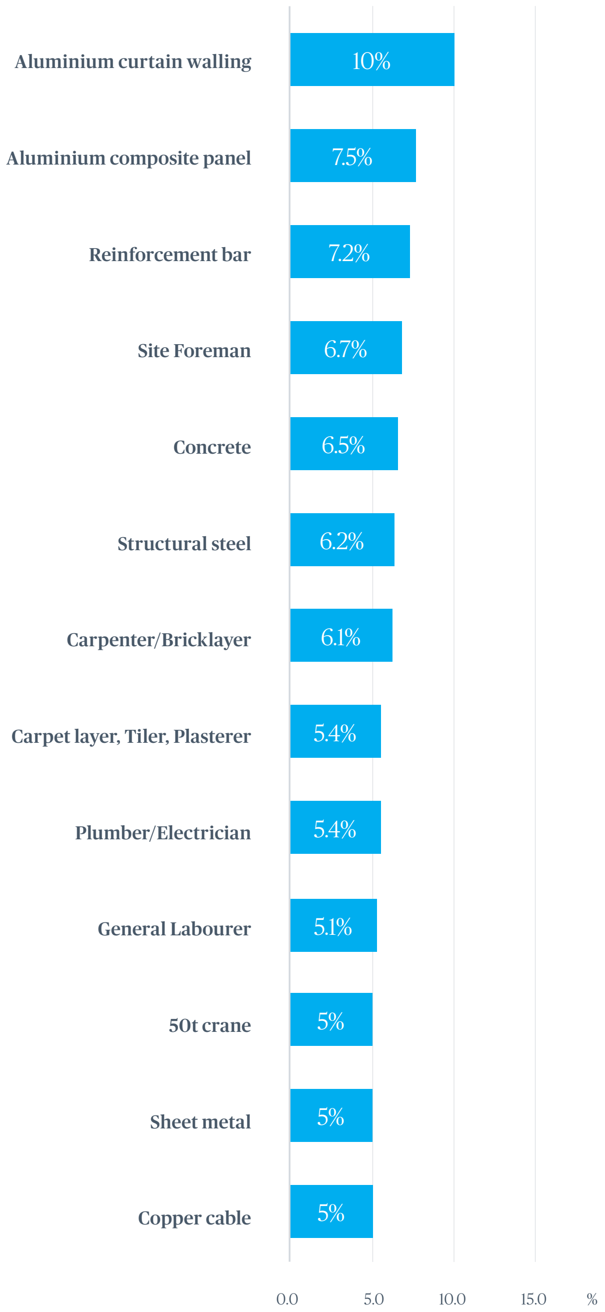


Labour and material inflation

Percentage increase (in nominal terms) of construction costs in the last 12 months



Expected percentage increase (in nominal terms) of construction costs in the next 12 months



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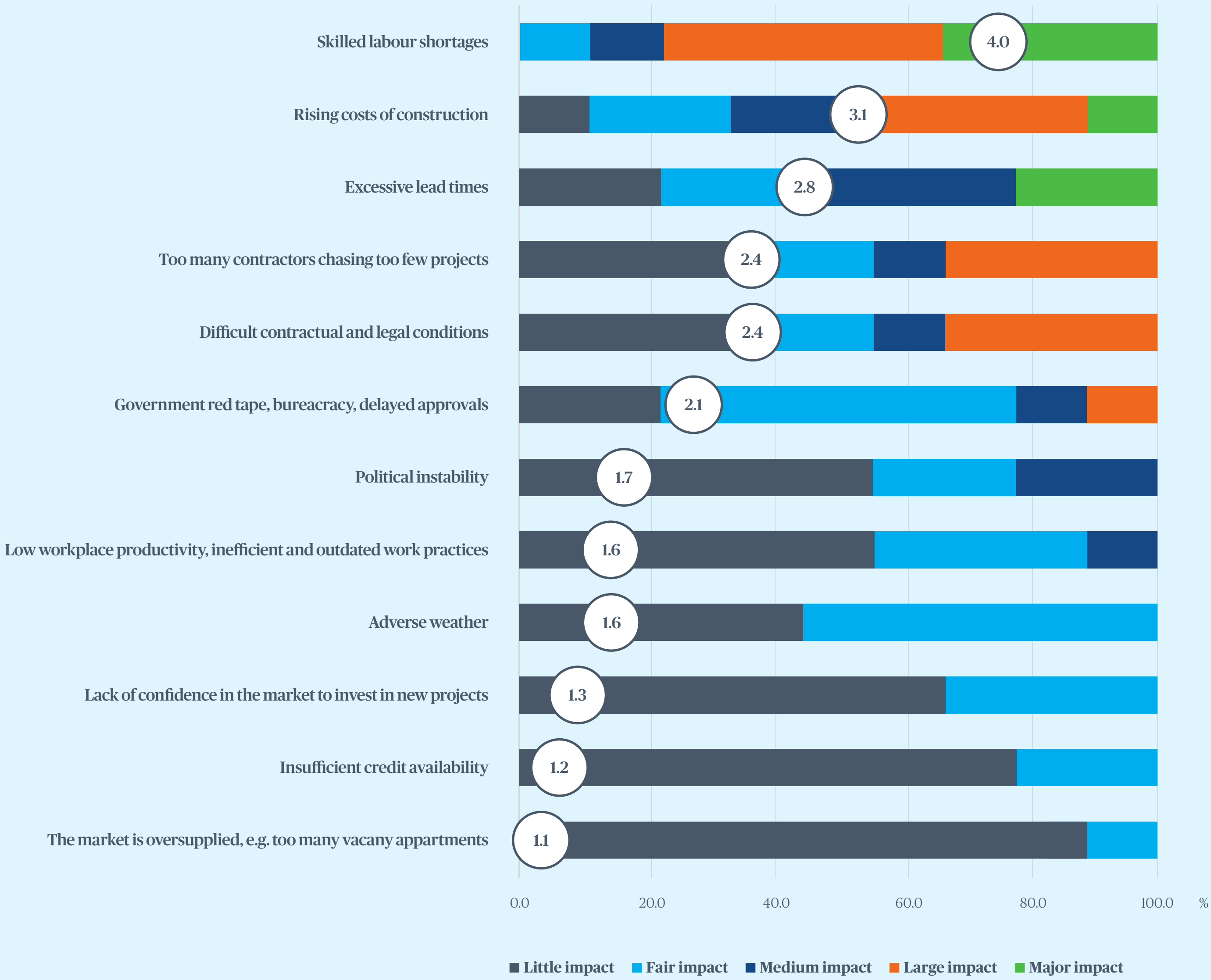
Brexit is the current main challenge, along with the supply chain issues which may arise from that in 2019. Additionally, volatile world trade and economic conditions present medium-term risks."

Key challenges

Compared with six months ago 'skilled labour shortages' remains the surveyed contractor's key challenge, but 'rising construction costs' and 'excessive lead times' are also deemed to be making a large to major additional impact. In another sign of a buoyant market, 'lack of confidence', 'credit availability and 'market oversupply' are all playing little to no impact on contractors operations.

The highest ranking key challenges - skilled labour shortages, rising costs and excessive lead times - are not unexpected and reflect a major challenge facing the industry. In addition Brexit continues to be a major concern, with the ongoing uncertainty putting upward pressure on material costs and adding risk to the procurement process.

The coloured bars in the chart below represent the proportion of respondents indicating whether a particular challenge is having a: little impact; fair impact; medium impact; large impact; or major impact on delivering construction works. The challenges are then ranked, on a scale of 1 - 5, according to their response.



Insight

Build to rent: hitting the sweet spot

Apartments now comprise 12 percent of all occupied households in Ireland and 35 percent of occupied households in Dublin City (Census 2016). However, Ireland is a long way behind European averages in the numbers of households living in apartments, especially in our cities and larger towns. In many European countries it is normal to see 40-60 percent of households living in apartments.

The demand for housing continues to outstrip supply and 'Generation Rent' is on the rise. To capitalise on this rise more and more developers and investors are entering the private rented sector, to the extent that Build to Rent schemes (or private rented communities) will make up a significant proportion of the development pipeline within many of our regional cities in the near future.

What are the opportunities and challenges facing the sector?

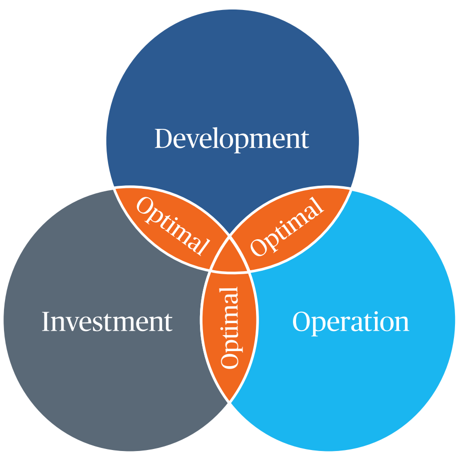
In the short term to 2020, the Housing Agency in Ireland has identified a need for at least 45,000 new homes in Ireland's five cities, more than 30,000 of which are required in Dublin City and suburbs. The National Planning Framework (NPF) also projects a need for a minimum of 550,000 new homes to 2040, at least half of which are targeted for provision in Ireland's five cities. The NPF also signals a shift in Government policy towards securing more compact and sustainable urban development, to enable people to live nearer to where jobs and services are located; this will require at least half of new homes within Ireland's cities to be provided within the current built-up areas.

The Irish Government's aim is to ensure that apartment living is an increasingly attractive and desirable housing option for a range of household types and tenures, building on and learning from experience to date, both in Ireland and across Europe and beyond. To help promote this the Government introduced revised and updated Planning Guidelines for Design Standards for New Apartments in 2018, allowing for a relaxation of many of the restrictions which previously had made the development of apartment schemes uneconomical.

As a result numerous developers and investors have now entered the sector, with a multitude of investment models. Operators are looking for inventive ways to attract customers, develop their brands and minimise operational costs. But has anyone truly found the optimum combination of success factors to overcome these challenges and hit the sweet spot?

Ultimately only time will tell when future incomes and running costs become a reality, but a significant factor in delivering these schemes will be how the public and private sector work together to provide consistency of approach during planning and viability. This will allow operators to attract and retain their customers on a level playing field, to deliver high quality rental communities that meet the needs of the customer. This can only be a good thing for 'Generation Rent' and the local community.

Delivering a viable and sustainable rental community is about finding the right balance between development, investment and operational aspects of the viability equation. This paper considers some of the key issues under each aspect in turn:



Development

- Planning approach
- Land value
- Construction costs
- Professional fees
- Finance
- Profit and risk
- Programme

Investment

- Government funding
- Equity and debt Funding
- Gross to nett income
- Yield
- Expected returns

Operation

- Customer service
- Rental income and security
- Void periods
- Amenities and services revenue
- Running costs
- Letting costs
- Sink fund
- Sustainability

Development

Delivering 'build to sell' schemes, whilst managing development risk and maximising value, should be bread and butter to most developers. They understand the rules of the game and whilst these are still fundamental ingredients to successful delivery, more consideration has to be given to the investor's and customer's requirements on a Build to Rent scheme and how this impacts on the design, operation and management of the building. The emerging Build to Rent pioneers are having to work out what will work for today, and for the future, and what quality, services and management structures they need to compete for their customers and still make a return on their investment.

Design

Successful schemes need to emphasise how the resident will live and interact with the building, its facilities and develop strong community identity as priorities. This needs to be achieved without limiting the potential for evolving the design as customer requirements develop and new trends emerge. Such flexibility could include the provision of amenity space that has direct access to non-residents, or is mirrored in size and grid pattern to standardised apartment layouts, allowing flexibility of apartment mix depending on take up. Early input from the operational and management team will be essential to getting the brief right. Similarly, customer surveys of the target tenants would be recommended to keep up to date with the trends of the target tenants. Within the updated planning guidelines issued in March 2018, build-to-rent apartments were recognised as their own classification and design requirements are differentiated which can help improve the viability of build-to-rent developments compared with build-to-sell.

These measures include relaxation on 10 percent addition to minimum sizes, numbers of units per core and removal of specific requirements on unit mix. These three changes combined can greatly increase the density of development and enhance viability, whilst also being able to provide a mix that suits the likely demographic in the area of the development.

Construction costs and benchmarking

Early stage cost and schedule planning will always be needed to inform the emerging brief, design and test viability and desired financial return. Our approach seeks to interrogate cost and programme drivers that bring about assurance.

Some of the key cost drivers to be considered in a Build to Rent scheme are:

- Site constraints and required scheme density
- Apartment mix and apartment types
- Building height
- Parking provision
- Nett to gross ratio – including back of house, front of house and amenity area
- Wall to floor ratios
- Specification of fit out / furniture packs / white goods / sanitary ware / amenity areas
- Energy strategy and level of renewable on site provision
- Life cycle cost analysis – optimal capital cost to cost of building in operation
- Tenancy periods and frequency of refresh to communal areas and apartments.

Operation

Brand and customer service

The 'Millennials' or 'Generation Y' will be a primary target customer for the large scale, inner city private rented communities. Studies show they are sociable, tech savvy and brand loyal. On the flip side they can also be very discerning and if the brand isn't 'cool' or the customer service is poor they will move elsewhere without hesitation and probably share their opinion on social media. This is new territory for most developers and investors which is reflected in the numerous company mergers and joint ventures being announced, with new brands being created, specifically aimed at the Build to Rent market.

The basic customer requirements from a development still apply, such as location, quality of finish, space and services. However, the long term viability of a Build to Rent scheme, and indeed a Build to Rent business, will depend on customer service and sense of community that is generated by the development and its management activities, which will have a direct impact on rental income, rental security and void periods for instance.

Operating costs and sustainability

By considering the need to maximise net rental income the minimising of operating costs will be essential to achieve the required return on investment. The operating costs will be difficult to fully predict before the scheme is up and running, but will need to take into account running costs (typically 8 to 12 percent), lettings costs (typically 7 to 13 percent) and long term sink fund (6 to 9 percent), giving a gross to net rental discount range of 20 percent to 35 percent.

Building in sustainability was historically seen as a capital cost burden to Build to Sell developments, with marginal tangible appreciation in sales value to offset the additional up front cost. Most initiatives to date have seen a 'carrot and stick' approach by Government. However, with Build to Rent there is a direct benefit of investing in sustainability and considering life cycle costing and operational costing at the outset. When considering that the most common appraisal approach is based on future cashflow, finding the right balance between capital expenditure, operational expenditure and life cycle costing is paramount. Building Information Modelling (BIM) will play its part in this analysis too, as well as adding value to the investment by providing a 'full service history' of the scheme and efficiency in maintenance if used as an asset management tool.

Investment

Investors will normally base their valuations on future income and this is affected by a host of factors, such as local market rent levels, inflation, occupancy levels, void periods and operating costs. Coupled with the uncertainty around planning policy, stamp duty and letting fees this is a difficult equation to balance.

What does the future hold?

Build to Rent is here to stay, and who knows it may become a mature asset class of its own. Once more established we are likely to see true innovation and market differentiation between the current and future players in the market. Some possible trends are outlined below:

- Brand identity and customer service the main factors in tenant attraction and retention
- Increasing use of technology and faster broadband speeds
- Increase in amenity provision and decrease in unit sizes
- More trade-off between capex and opex/whole life costs
- BIM increasingly used to provide 'full service history'
- Increasing use of planning policy and guidance, particularly in relation to PRS design and quality standards.

The emergence of high quality private rented communities, particularly in core regional city centre locations has the potential to support long term housing demand and is an important fillip to regeneration. Successful schemes will put the customer at the heart of the design to maximise their communal living experience and increase tenant interaction and retention. However this must be considered with a keen focus on capital costs, operational costs and the selection of sustainable solutions.

In truth, while the dynamics of Build to Rent can provide many investors and developers with viable outcomes, those who can bring forward schemes quickly, provide good customer service and demonstrate reliable net returns are likely to establish strong market leading brands. Finding the viability sweet spot, working with the Local Authorities and developing customer loyalty through branding and service provision, will be the key factors in the successful long term aspirations of this exciting sector.

Bryn Griffiths
Director, cost management

Case studies - PRS/BTR and mixed use

About Turner & Townsend

Turner & Townsend is an independent professional services company specialising in programme management, project management, cost and commercial management and advisory across the real estate, infrastructure and natural resources sectors.

With 108 offices in 45 countries, we draw on our extensive global and industry experience to manage risk while maximising value and performance during the construction and operation of our clients' assets.

We been working in Ireland for over 60 years. From our Dublin office our project, cost and advisory specialists work across the island applying our global expertise on local projects.

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