Construction costs in Ireland – bumpy times ahead?

DENTONS

June 10, 2021

In our **Real Estate Market Predictions Report** issued in February this year, we noted that the increase in construction costs expected as a result of COVID-19 had not yet been observed in the market. Given the lack of projects starting, it was difficult to predict how this would play out and our prediction was that this was definitely an area to watch. Fast-forward four months to the full re-opening of construction sites and it is clear that labour and materials shortages are driving construction costs higher. The question is whether these issues will resolve themselves in the short term or are there bumpy times ahead?

Concern about the cost of materials and labour shortages is not new. Prior to COVID-19, there was much talk in the industry about the lack of skilled labour and a shortage of those entering apprenticeships. The rising costs of materials, utilities and financing were also seen as pressure points. COVID-19 has exacerbated the issue on both the demand and supply side (i.e. a slowdown in production of materials and, now, a spike in pent-up demand). In terms of labour, the extended period of site closures has seen skilled workers (already in short supply) leaving the market to take up lucrative work in the UK and beyond. Current travel restrictions are unlikely to facilitate a rush to return.

Brexit has provided a further complicating factor to supply chain issues, the impact of which may not be seen for many months, particularly if the Northern Ireland protocol comes under threat. Further from home, the Suez Canal blockage has grabbed headlines, but a bigger concern is a building boom in the US impacting supplies. Ireland is not alone in experiencing these difficulties, with warnings being issued by the Construction Leadership Council in the UK of shortages of many items, with timber, steel and plastics being the worst hit.

Politically, construction costs have become entangled in the housing supply issue, which has become an incredibly hot topic since the full re-opening of construction a few weeks ago. In a recent interview, housing minister Darragh O'Brien discussed the myriad of obstacles faced by a government seeking to achieve 33,000 housing units per annum – unsurprisingly, labour and materials featured heavily.

Notwithstanding all this doom and gloom, industry analysts have not yet predicted these issues leading to a major increase in tender prices, although it may be too early to tell. In its Report published on 31 March 2021, Linesight predicts tender inflation rising 1.75-2.25% this year, which lands somewhere between earlier estimates from AECOM (2% predicted increase in tender prices) and Mitchell McDermott (2.5-3% tender price increase) predicted in January.

More recently, Deloitte (Q1 Industry Review, published May 2021) has analysed construction costs and predicts an increase in construction cost inflation towards the end of the year and beyond, as rising costs become fully realised and new projects become available – but doesn't venture a figure. Elsewhere, there is a sense in the market that the current materials shortages are temporary and unlikely to last into Q2 2022. Hibernia REIT is one developer which recognised concerns when publishing its annual results in the last fortnight, but is predicting that issues will normalise within six to nine months.

Even if the current issues are short term, the underlying problems remain and there have been many calls for the government and other industry stakeholders to focus on increasing capacity and driving efficiencies to strengthen the market against future shocks. There are a number of opinions on how this might best be done, but it is likely that a successful strategy will require a multi-pronged approach, including embracing construction technologies and off-site construction while increasing the labour force.

As per Minister O'Brien, the government is exploring ways that precast, prefabrication and off-site construction can drive down costs. While scale is a factor, this is also something that can be further embraced in the private sector. BIM and other newer forms of construction technologies such as virtual reality, wearables, drones, artificial intelligence and robotics are utilised from time to time on and for construction projects, but the industry has yet to see sufficient proliferation of these technologies such that the industry as a whole can really begin to reap the benefits.

A co-ordinated strategy will also likely be required for increasing the availability of skilled labour, including attracting Irish workers home and placing a renewed focus on both apprenticeship schemes and academic qualifications. More long-term solutions, such as introducing digital design and construction into the school curriculum, have been called for. This is to increase the attractiveness of a career in the Irish construction industry for school leavers, although this will have to be backed up by the use of technologies on the ground. In short, our prediction remains unchanged since February – this area is definitely one to watch.

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