



Household Claims Inflation Report 2008 to 2009

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EXECUTIVE SUMMARY

The purpose of this report is to provide a forecast of annual household property claims inflation for the remainder of 2008 and 2009.

A summary of our core findings are as follows:

BUILDINGS

The construction sector, in 2007, recorded negative growth of -2.5%, and represented a total investment of €36billion.

Housing completions fell in 2007 to 78,000 units and current estimates for 2008 have dramatically reduced to the region of 40,000 – 50,000 units. The ESRI are predicting a reduction in overall construction output of 21.6%, with housing being harder hit, with a reduction of 38.9%.

Material Costs

We estimate material costs will maintain a 5% increase in both 2008 and 2009.

Labour Costs

With the current impasse on the National Wage Agreement, there is uncertainty under this heading, however, with inflation running at 4-5%, it appears reasonable to predict pro-rata labour cost inflation, as outlined below:

- ✓ 2008 4%
- ✓ 2009 4%

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The current CPI statistics for July 2008, indicate an annual increase rate of 4.4%. This increase is mainly accounted for by Housing/Utilities 9.7%, Food 6.8%, Education 6.4%, Health 6.2%, and Transport 5.3%.

Consumer Goods -1.5% and Clothing & Footwear -5.8% have demonstrated negative growth during the year.

The 4.4% CPI increase is equally weighted between Services 4.5%, and Goods 4.2%.

There has been no significant price inflation in relation to consumer goods for 2008 and this will continue in 2009.

As outlined in previous years' reports, price inflation is not a factor in relation to content's claims. The main exposure under this heading continues to be the changing nature and profile of the contents risk and the increased proportion of high value and luxury goods contained in most modern houses.

We estimate annual contents inflation for 2008 & 2009 at 3% and 4%.

INFLATION FORECAST 2008-2009

Based upon the detailed research undertaken, and our knowledge of the market, we estimate claims cost inflation, on an annual basis, for 2008 and 2009 as follows:

	2008	2009
Materials	5.00%	5.00%
Labour	4.00%	4.00%
Buildings (Weighted: Materials 30:70 Labour)	1.30%	4.30%
Contents	3.00%	4.00%
Forecast Inflation (Weighted: Buildings 3:1 Contents)	3.98%	4.23%

CONSTRUCTION SECTOR OVERVIEW

After 13 years of consecutive growth, 2007 was the first year to record no growth with a marginal decline of –2.5% with investment at €36 billion. The economic outlook continues to worsen as we head into the first recession in 25 years.

Housing completions fell in 2007 to 78,000 units with predictions for 2008 looking like 40,000 to 50,000 at best with the first 6 months of this year only recording 27,736 completions. The ESRI are predicting a fall in construction output by 21.6% with housing falling even further by 38.9%.

A review of 2007 activity, has established the following key indicators:

- ✓ Total value of Construction output €36 billion, accounting for 25% of GNP

- ✓ Housing output fell to 78,000 units

- ✓ Tender levels showed an average decrease of 4.3% (but current figures show a 7.4% reduction between the first half of 2008 with the first half of 2007)

- ✓ Employment in Construction fell 5.8% in December '07 year on year (but latest 15.2% in June 2008 compared with June 2007)

- ✓ Material Costs rose by 3.2% over 2007

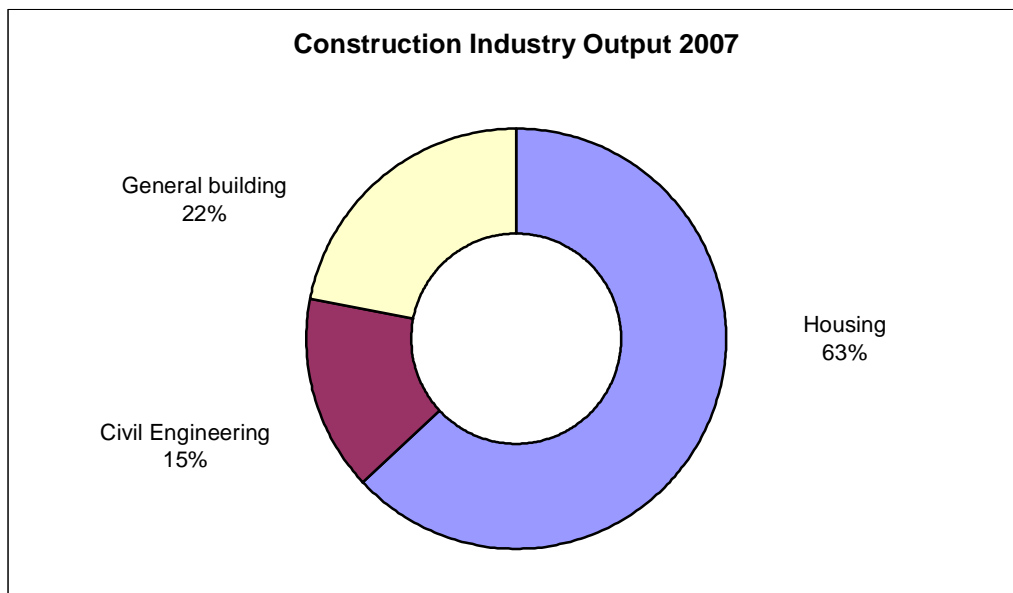
CONSTRUCTION SECTOR ANALYSIS

Construction output for 2007 stood at €36 billion, representing 25% of GNP. This sizeable output was driven by the Housing Sector, as is demonstrated in the table below.

Output categorised by sector for 2007 was as follows:

	2007		2006	
General Building	€7.9 billion	22%	€ 6.5 billion	18%
Civil Engineering	€5.4 billion	15%	€ 5.5 billion	15%
Housing	€22.7 billion	63%	€ 24.0 billion	67%
Total	€36.0 billion	100%	€ 36.0 billion	100%

There has been a change in the mix for 2007 with housing dropping back and general building showing an increase.



GENERAL BUILDING

In 2007, General Building was a star performer in the Irish Construction industry whilst housing slowed and civil engineering maintained a steady increase. The General Building sector totalled €8 billion and accounted for 22% of the total construction market. Investment in public buildings, particularly in health and education and OPW projects, showed a 30% increase in volume in 2007, with a total investment of over €2 billion. The private sector also performed well with commercial building, retail and industrial building growing by 25% with a total expenditure over €4 billion.

The office market remains strong especially in Dublin with almost 45,000 sqm of office lettings being signed in Dublin in the first quarter of 2008, more than 10% higher than the five year average for Q1 take-up. There are concerns however that occupier demand for office accommodation is likely to decline and that oversupply is looming. This is compounded by uncertainty in the financial markets and a general downturn in economic conditions which are likely to impede activity levels during the remainder of the year.

The last budget projected an overall increase of 2% in volume in public building, with education being the winner with an 8% increase. €600 million was earmarked for 30 new primary schools with most of the schools being in Dublin, eight of which will be in the Fingal region. In addition to post primary school projects progressing, construction is also expected to commence this year on the first bundle of PPP post-primary schools.

The OPW budget, however, was reduced by 14% in volume partly replaced by PPP projects.

An emerging area straddling all sectors is the Repair, Maintenance and Improvement sector (RMI). This sector will rise in value to over €9 billion by 2009. Of the €7 billion spent last year on RMI, €4.5 billion was spent on existing homes and apartments, reflecting a trend amongst home owners towards upgrading and extending their properties. There is also a growing move amongst home owners to improve the energy efficiency of their homes through insulation and other improvements.

Overall General Building is expected to continue to be the star performer in 2008, but at a slower rate. Whilst developers in the private sector have progressed projects on paper, start-up on sites are being delayed as a result of banks and other lenders refusing to advance capital in an uncertain market unless there is a high percentage of pre-sales/signed contracts with end customers.

Earlier in the year, there were predictions of 5% growth in this sector, however whilst there may indeed be growth, it may now be at a slower rate for the remainder of the year and will only partly compensate for the decline in the housing market.

CIVIL ENGINEERING

In 2007, Civil Engineering accounted for 15% of the output, coming in at €5.4 billion. This sector will become an increasingly important sector within the industry. The government's commitment to prioritise investment in the National Development Plan was underpinned by a major increase in the Budget.

Over €4 billion was invested in roads, transport and water and sanitary services in 2007. This was due to be increased by over 5% in volume in 2008.

Despite the boost from infrastructural work, the CSO in May 2008, noted that Civil Engineering output in the last quarter of 2007 had fallen by 14.9% in volume compared with the same period the previous year.

Whilst the budgets sets out targets, in the last number of years there has been a significant under spend and, with the exchequer's funds under increasing pressure, it remains to be seen whether major projects will get underway and if the NDP programme will be adhered to.

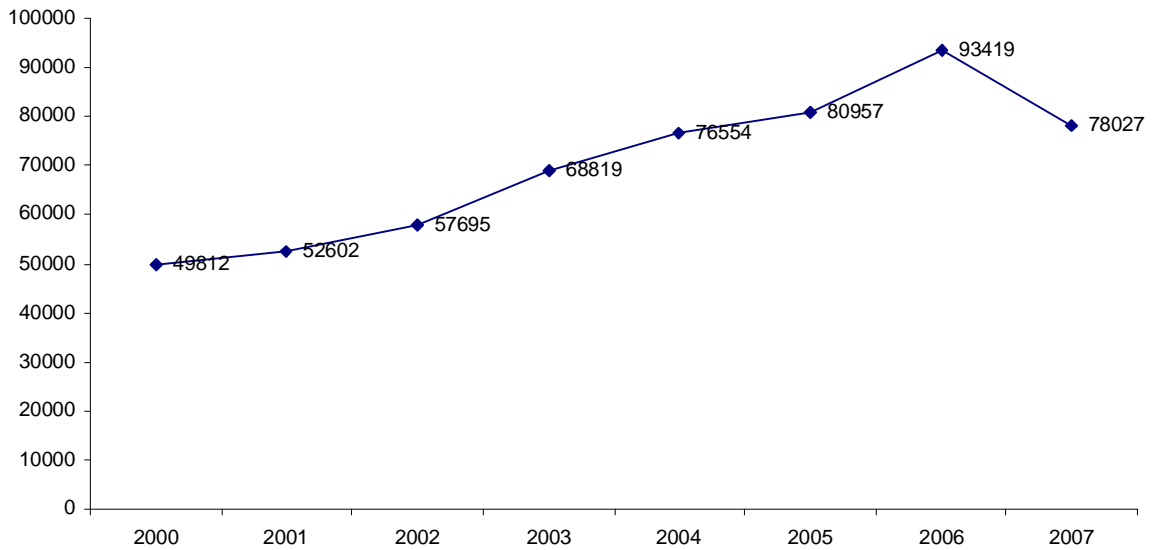
Again this was a sector with predictions of growth of 5% in 2008, however it is unlikely to reach this target.

HOUSING

Housing continues to be the key driver in the construction industry and in 2007, this accounted for 63% of output. Any change therefore in the housing market has a profound effect not just on the construction industry but also on the economy. Housing output peaked in 2006 with 93,000 units and 78,027 units for 2007. At the beginning of 2008, estimates for completions ranged from 45,000 units by the CIF to 65,000 units from the ESRI.

Q1 stats from the DoE show the number of house completions standing at 14,010 units (compared to Q1 for 2007 at 20,018 units a fall of 30%). The most recent data available to the end of June 2008 reveal that 27,736 housing units have been completed. Loan approvals are down 37.6% in volume and 31.5% in value compared to Q1 2007.

New House Completions



Apart from the noted slowdown, the government had committed to an increase of almost 10% in their investment in social housing. Whilst this is welcome, the problem is that Local Authorities have not been able to deliver on major social housing programmes.

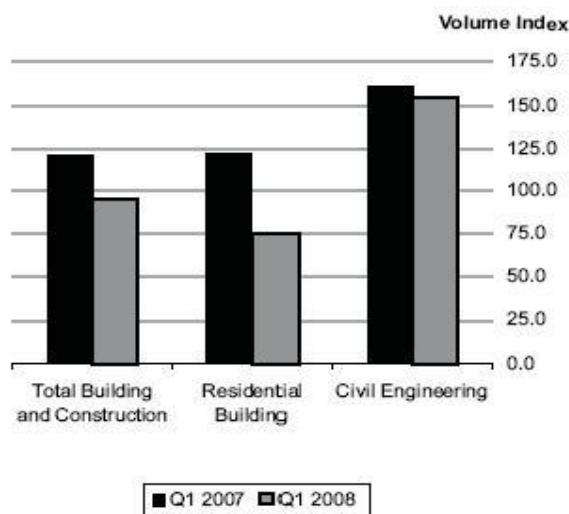
The slowdown is also a result of at least half of Irish construction companies halting construction in an attempt to offload existing properties. Some 30%, according to a survey by Merrion Capital, said oversupply of houses will take more than 12 months to clear. Of those companies currently not building, half don't expect to restart work for at least a year. The overall conclusion, according to the report, is that house builders expect the downturn in the Irish residential market to be deeper and more prolonged than they'd anticipated.

The demand for houses will remain high and one of the primary factors in the immediate future will be demographic trends. Ireland has a growing population with nearly a third of the population aged between 25 and 44 years. With the onset of inflation pressures, then this 'demand' may be tempered by the affordability and availability of mortgages.

SUMMARY

According to published data from the CSO at the end of July 2008, the volume of output in Irish building and construction has decreased by 21.6% in the first quarter of 2008 compared with the first quarter of 2007. The value of production decreased by 18.2% in the same period.

**Volume of Production for Building
Categories
Q1 2007 and Q1 2008
(Base: Year 2000=100)**



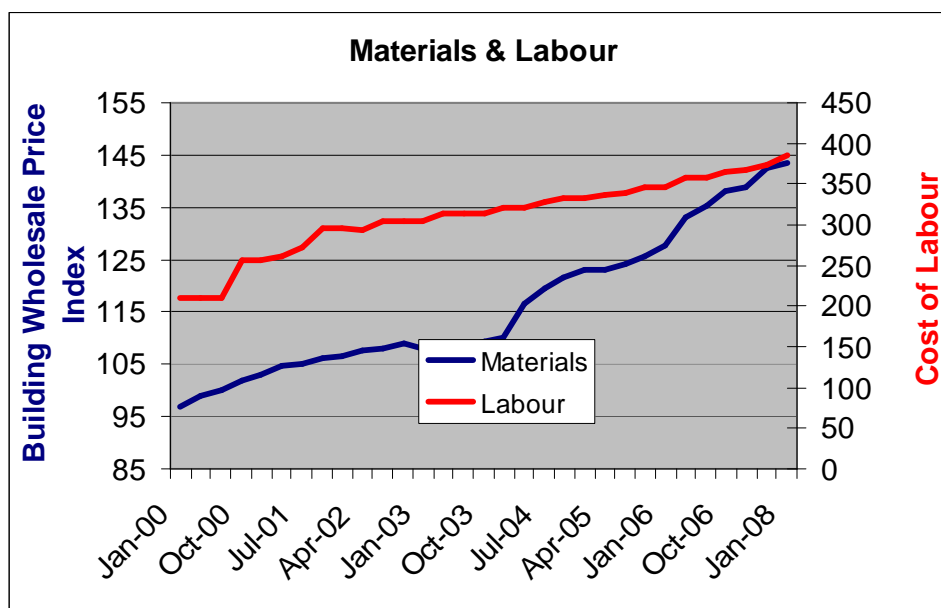
The fall in the volume of output largely reflects a decline of 38% in residential building work which was only partly offset by a rise of almost 9% in non-residential building work. The volume of output of civil engineering fell by 4% also contributing to the overall decrease.

Commentators DKM Economic Consultants Ltd., in May 2008 note that private non-residential construction activity should continue to expand in 2008. They also state that commercial construction alone is expected to reach a record level with reference to Lisneys noting that more office space was completed in Q1 2008 than in the whole of 2006. Combined with the €12 billion capital provision for social and productive infrastructure alone in the 2008 public capital programme, non residential construction activity can be expected to continue to support the construction sector throughout the year, while housing readjusts to more sustainable levels.

CONSTRUCTION COSTS AND PRICES

The annual rate of building and construction materials inflation has slowed sharply over recent months from a peak of 10% in October 2006 to 5.4% in June 2007. A moderation of input prices for oil based materials continued to decline by May 2007 but picked again in June. However, continuing high prices for timber, cement and steel are still a cause for concern.

The chart below shows inflation in the combined Cost of Labour and Wholesale Building Materials since 2000.



Having dropped to a two-year low of 3% in November of last year, the annual rate of building and construction materials inflation crept back up to 4.2% in February but declined again to 3.9% in March. The Capital Goods index (which covers materials and wages) also saw annual inflation jump from 2.9% (a four-year low) in November '07 to a peak of 4.6% in February '08, but eased back to 4.2% in March '08.

Inflation in the construction industry has eased considerably since the peak of the construction boom in 2006. However, global commodity prices have rocketed in recent months as economic uncertainty and the difficulties being experienced in financial markets have sent investors scrambling for the relative safety of commodities.

Annual inflation in March '08 was particularly strong for oil based products (bituminous emulsions (+24%), stone sand and gravel (+11%) with materials' prices for plaster reinforced metal and plumbing materials all increasing at in excess of 7%.

The latest figures Society of Chartered Surveyors figures show annual construction cost inflation accelerating to 4.9% in February '08 from 3.5% at the end of '07. The unexpected upward trend in construction cost inflation might be explained by a combination of stronger than expected wage growth within the industry and the global rise in commodity prices, as mentioned above.

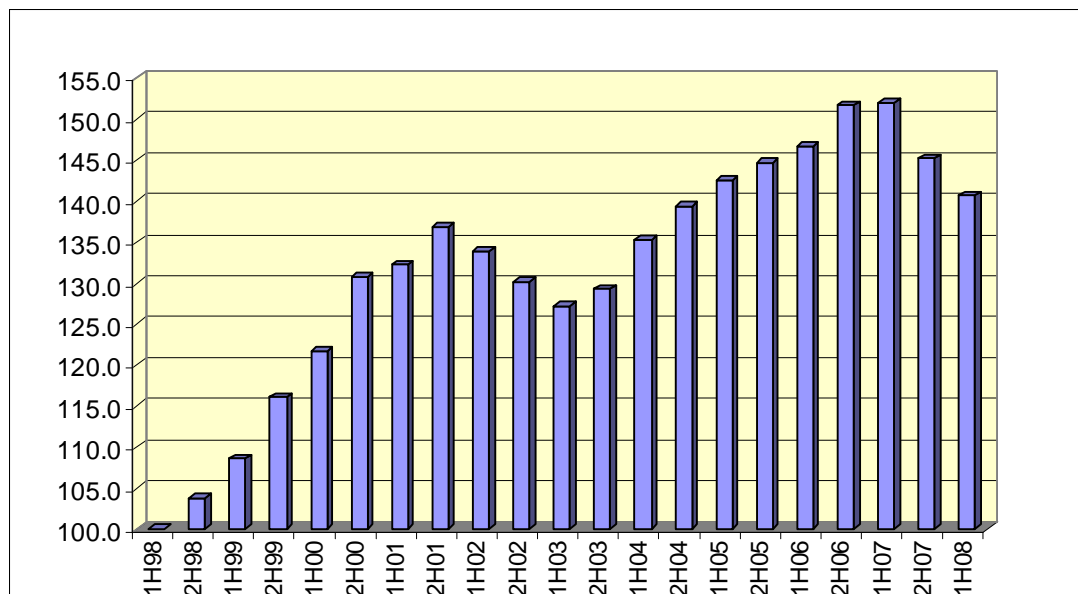
TENDER LEVELS

The latest Tender Price Index published by the Society of Chartered Surveyors shows that tender prices fell in 2007, mainly in the latter months of the year. The index for the first half of this year shows a decrease of 3.1% since the second half of last year and a decrease of 7.4% for the last twelve months.

The index numbers since 1998 are as follows:

First Half 1998	100.0	Second Half 2003	129.3
Second Half 1998	103.8	First Half 2004	135.3
First Half 1999	108.6	Second Half 2004	139.4
Second Half 1999	116.1	First Half 2005	142.6
First Half 2000	121.7	Second Half 2005	144.7
Second Half 2000	130.7	First Half 2006	146.7
First Half 2001	132.2	Second Half 2006	151.7
Second Half 2001	136.9	First Half 2007	152.0
First Half 2002	133.9	Second Half 2007	145.2
Second Half 2002	130.1	First Half 2008	140.7
First Half 2003	127.2		

Graphically, the entire period since the inception of the SCS index in 1998, is demonstrated below:



The graph illustrates how tender prices reduced further in the first half of 2008 and are now at similar levels to 2004. This reflects the well publicised slowdown in new residential construction and has now spread to all sectors of the industry including commercial projects and civil infrastructure works. The fall in tender prices comes despite recent increases in the cost of labour and material inputs and reflects the very competitive current market conditions where contractors are bidding at or below cost in order to secure a share of the ever diminishing number of new projects.

It remains to be seen if the expected growth in Civils and the impact of Government fixed price contracts will result in higher tender prices. On the flip side, the slowdown in the residential area may have a moderating effect on tender levels.

HOUSEHOLD BUILDING CLAIMS INFLATION

The construction industry is in re-adjustment phase balancing the decline in the housing market with a hoped for increase in output in the general and civil sectors.

Input costs are rising in a market where tender levels have fallen back. It is thought that this trend may continue in the immediate future. Whilst this fall in tender prices may be viewed favourably by the public and private clients who have seen tender prices increase year on year since 2003, it does highlight the ripple effect that a downturn in one sector has on the industry as a whole.

Other factors in the mix is the emergence of sustainability being driven by climate change and oil prices. This is manifest in the Building Regulations on Conservation of Fuel & Energy Part L 2006 and is being updated this year to even higher standards, along with Local Authority Requirements, Building Energy Rating etc. In addition to this, in the public sector the new Government Form of Contract is pushing the risk onto contractor's and this could result in a dual pricing market.

In the Insurance repair market one would hope to see more competitive pricing on claims where general contractors re-enter the market for insurance repair work particularly on some larger value claims. On the high volume small value claims the material costs increases cannot be expected to be carried by a small contracting company. Some of the large contracting companies are tendering below cost to keep cash flow coming in so as to retain key staff etc. These measures are not sustainable over the long term and should not be expected to be replicated by small building firms.

With the National Wage Agreement having expired and recent talks between the parties stalled, there is an element of uncertainty as regards Labour Costs over the coming period. Construction employers will seek to minimise any wage increase particularly in light of a DKM report on the topic which showed that Irish building workers wages are significantly out of line with other Western European countries (+26% higher than Germany and +19% higher than Spain). The report also showed that skilled construction workers earned more than those in the financial sector.

Materials

Over the 12 months of 2007, material costs rose by 3.2%, however, over the period May 2007 to May 2008 they rose 4%. In the first five months of 2008, prices have risen 2.5%.

Given the current global uncertainty, we can expect inflation on material costs to continue. We anticipate that material costs will rise over 2008 and 2009 as follows:

✓ **2008 ~ 5%**

✓ **2009 ~ 5%**

Labour

The National Wage Agreement has now expired with the last scheduled increase being 2.5% from January 2008 to June 2008. At this stage it is unclear whether the current round of talks will resume or whether there will be a free for all with wage demands being made by individual employees of contracting companies remains to be seen. Given that the first six months of 2008 is 'in the bag', we are looking at the remaining six months. If a further 3% was allowed for the balance of 2008 along with 4% for 2009 this would work out as follows:

Therefore, our summary forecast is as follows:

✓ **2008 ~ 2.5% (first 6 months) and 3 % (last 6 months) = 4% over 12 months**

✓ **2009 ~ 4%**

RETAIL SALES & CONSUMER PRICE INDICES

RETAIL SALES INDEX

The most current RSI figures available are for May 2008, and these show retail sales volume has decreased by -4.8% & value by -1.6% as follows;

	May 2008
Volume	-4.8%
Value	-1.6%

The volume of retail sales decreased by -4.8% in May 2008 compared to May 2007. This is the largest annual decrease since January 1987 and is an indicator of a significant change in customer spending patterns. In addition, the value of retail sales reduced by -1.6% in the same period.

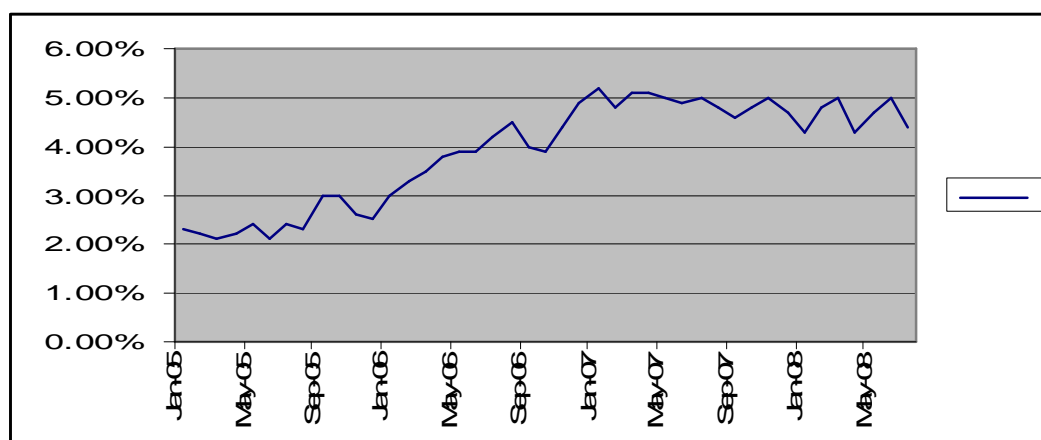
The largest decrease in volume was in relation to electrical goods, 18.6%. This demonstrates the area of volume being affected is in relation to discretionary spend.

CONSUMER PRICE INDEX

The annual CPI for the past 12 months has been reasonably stable, in the range 5% - 4%, with a July 2008 annual rate of 4.4%, which is a 0.6% reduction from the June 2008 figure. This reduction is driven by a CPI decrease of 0.3% for the month of July itself.

Monthly historic CPI figure in both tabular and graph format are detailed below:

	2008	2007	2006	2005
January	4.3%	5.2%	3.0%	2.3%
February	4.8%	4.8%	3.3%	2.2%
March	5.0%	5.1%	3.5%	2.1%
April	4.3%	5.1%	3.8%	2.2%
May	4.7%	5.0%	3.9%	2.4%
June	5.0%	4.9%	3.9%	2.1%
July	4.4%	5.0%	4.2%	2.4%
August	-	4.8%	4.5%	2.3%
September	-	4.6%	4.0%	3.0%
October	-	4.8%	3.9%	3.0%
November	-	5.0%	4.4%	2.6%
December	-	4.7%	4.9%	2.5%



The most notable sector changes in the year to July 2008, in descending order were;

Housing, Water & Utilities	9.7%
Food	6.8%
Education	6.4%
Health	6.2%
Transport	5.3%
Household Goods	-1.5%
Clothing & Footwear	-5.8%

Once again, as in both 2007 and 2006, consumer items, i.e. clothing & footwear and household goods, have negative price inflation.

The July 2008 CPI of 4.4% is reasonably equally split between Services (4.5%), and Goods (4.2%).

HOUSEHOLD CONTENTS CLAIMS INFLATION

The current annual CPI for July 2008 is 4.4%, but this is mainly driven by non-consumer items. In fact, consumer goods -1.5% and clothing & footwear -5.8%, show negative inflation.

The current CPI of 4.4% will not translate into a similar inflation increase in Household Contents Claims Inflation.

The main driver behind household contents claims inflation continues to be a mix issue, with a significant increase in luxury goods and high quality contents. This, to date, has been fuelled by high disposable income and the availability of low cost credit.

With the current dynamics of the economy (is the Tiger dead!!), this may change in the future.

We estimate Household Contents Claims Inflation, with an allowance for the mix issue, as follows:

- ✓ 2008 3%
- ✓ 2009 4%

FORECAST CLAIMS INFLATION 2008 – 2009

BUILDINGS

Our forecast for the main components of building claims inflation, on an annual basis, are as follows:

	2008	2009
Materials	5.00%	5.00%
Labour	4%	4%

Historical analysis has demonstrated an overall claims mix of 30% materials and 70% labour, which when applied, results in a weighted average overall annual inflation forecast as follows:

	2008	2009
Building Inflation Percentage (Weighted)	4.3%	4.3%

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During 2007/2008, there has been no price inflation in relation to consumer goods. The main driver of claims costs inflation, under this heading, for the remainder of 2008 and 2009, will continue to be the ongoing changing nature and profile of the contents risk, with all households now containing a high proportion of luxury goods and quality contents.

Our best estimate of claims cost inflation is as detailed below:

	2008	2009
Contents Claims Inflation	3%	4%

CONCLUSION

An analysis of our comprehensive database has demonstrated, as a general benchmark, expenditure in relation to household claims is proportioned on a Buildings 3:1 Contents basis.

Therefore, in order to estimate an overall composite household inflation figure, the building and contents figures, as outlined previously, require to be pro-rataed on this basis, resulting in a weighted forecast overall claims inflation as follows:

	2008	2009
Overall Household Inflation	3.98%	4.23%