Household Claims Deflation Report 2012 to 2013

Prepared by John McGee, Tom Cleary, Jamie Middleton
Group Technical Services Team
June 2012

Contact:
john.mcgee@osg.ie or
tom.cleary@osg.ie
00 353 (0)1 661 5344

CONTENTS

OSG (Outsource Services Group Ltd) is an independent outsource service provider to the insurance and financial services market. Originally established in Dublin in 1984 as a professional partnership under the name Farrell & Associates, we have progressed through indigenous growth, strategic recruitment and business acquisition to our current position as the premier provider of outsourced service solutions to the insurance and related financial services market. We now directly employ over 280 people.

EXECUTIVE SUMMARY

The purpose of this report is to provide a forecast of annual household property claims deflation for the remainder of 2012 and 2013.

A summary of our core findings are as follows:

BUILDINGS

Overview

- Total value of Construction output fell in 2011 to €8.7 billion, a 26% fall on the previous year
- Housing output fell to 10,480 units in 2011, a 28% reduction on 2010 with the number of new dwelling units for 2012 only expected to reach 5,000, an all-time low.
- Tender levels on large projects are now back to 1998 levels
- Direct employment in construction was down to 107,600 in Q4 2011, down 23% on Q4 2010.
- Future growth opportunities are in the Green sector and Foreign Direct Investment
- NAMA to invest €2 billion by 2016 with the potential to create 35,000 jobs

Material Costs

We estimate material costs will rise in the remainder of 2012 and 2013 as follows;

- 2012: 2.00%
- 2013: 2.25%

Labour Costs

Competitive dynamics within the economy, with a greater supply of labour, will maintain labour cost reductions in the medium term. We estimate deflation as follows;

- 2012: -5.0%
- 2013: -4.0%

CONTENTS

We expect the cost of household content claims to marginally reduce in the next 18 months as follows:

- 2012: -2.25%
- 2013: -2.00%

DEFLATION FORECAST 2012 - 2013

Based upon the detailed research undertaken, the current subdued economic environment and our knowledge of the market, we estimate household claims cost deflation, on an annual basis, for 2012 and 2013 as follows:

	2012	2013
Materials	2.00%	2.25%
Labour	-5.00%	-4.00%
Buildings (Weighted: Materials 30:70 Labour)	**-2.90%**	**-2.13%**
Contents	**-2.25%**	**-2.00%**
Forecast Deflation (Weighted: Buildings 3:1 Contents)	**-2.74%**	**-2.10%**

1. CONSTRUCTION SECTOR OVERVIEW

From hero to zero, well almost! From a peak of €39 billion in 2007, output fell to between €8.5 - €8.7 billion in 2011, a massive drop of almost 78%. In terms of construction output as a percentage of GNP, this equates to 7% of GNP, a reduction of 25% on the prior year. For 2012, the prediction is that output will decline to €7.5 billion. This will be the fifth year in a row to experience reductions, reaching just 6% of GNP.

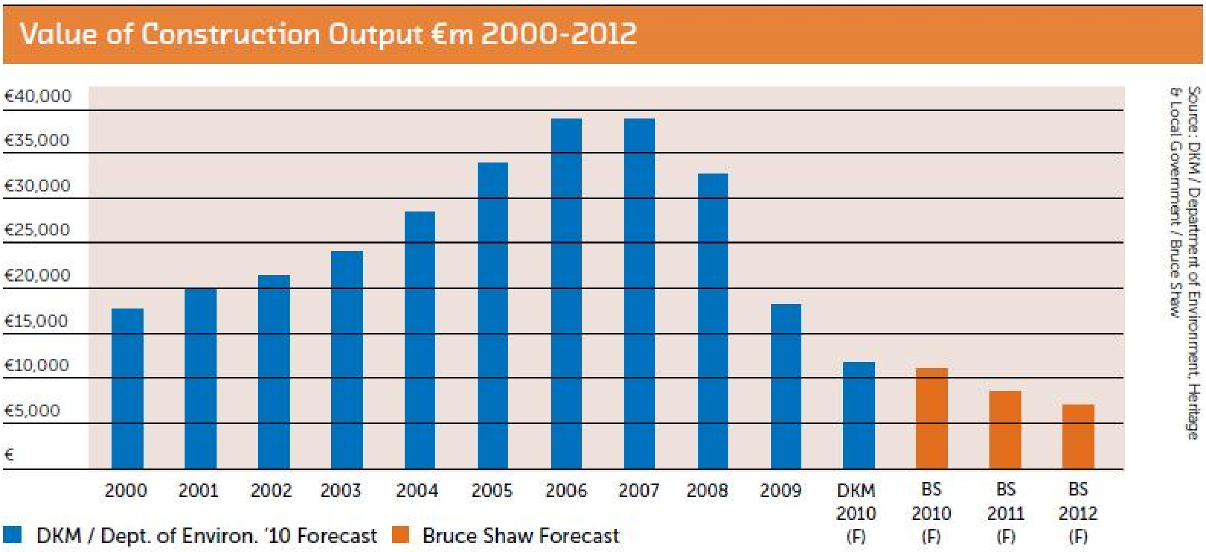
A recent report issued by the Society of Chartered Surveyors Ireland produced by DKM Economic Consultants entitled 'The Irish Construction Industry 2012' identified the following:

- Total value of Construction output fell in 2011 to €8.7 billion, a 26% fall on the previous year
- Housing output fell to 10,480 units in 2011, a 28% reduction on 2010 with the number of new dwelling units for 2012 only expected to reach 5,000, an all-time low.
- Tender levels on large projects are now back to 1998 levels
- Direct employment in construction was down to 107,600 in Q4 2011, down 23% on Q4 2010.
- Future growth opportunities are in the Green sector and Foreign Direct Investment.
- NAMA to invest €2 billion by 2016 with the potential to create 35,000 jobs

CONSTRUCTION SECTOR REVIEW

Construction output for 2011 was down 78% from 2007 with the year-on-year variance being -16% in 2008, -45% in 2009 - 35% in 2010 and -28% in 2011. It is predicted that output in 2012 will fall to a mere €7 to €7.5 billion, representing a massive fall of 82% from the peak.

The table below graphically shows this decline:



Construction Output 2007-2011

	2007	2008	2009	2010 (f)	2011 (f)
Value of Output at Current Prices (€m)	38,601	32,593	18,048	11,733	8,500
Change in Value of Output (%)	0%	-16%	-45%	-35%	-28%
Construction Output as % of GNP	23.7	21.1	13.7	9.2	6.8

Source: DKM / Department of the Environment / Bruce Shaw

Gross National Product (GNP) 2007-2011

	2007	2008	2009	2010	2011(f)
GNP at Current Prices (€m)	163,413	154,673	132,233	128,207	125,500
% Change in GNP	5.4%	-5.3%	-14.5%	-3.0%	-2.1%

Source: CSO / ESRI

The SCSI/DKM table below in summary, illustrates the rise and subsequent sharp fall experienced by construction output over the past decade. It gives the value of output in 2000 and 2011 and also shows the average annual growth rate until the volume of industry output peaked in 2007:

Current prices and volume % changes

	2000	2007	2011	2012E	2000-'07	2007-11	2012E
	Current Prices (€m.)				*Average annual % change in volume of output*		
Residential Building	9,496	23,392	3,763	2,917	7.6%	-26.9%	-22.5%
Private non-Residential Building	3,820	7,116	575	694	6.9%	-41.1%	20.7%
Public Social Infrastructure	1,207	2,327	1,166	930	6.7%	-6.7%	-20.2%
Total Building	14,523	32,835	5,503	4,540	9.1%	-27.1%	-17.8%
Productive Infrastructure - Civils	3,063	5,765	3,181	2,908	4.7%	-8.8%	-8.6%
Total Construction Output	**17,586**	**38,601**	**8,684**	**7,448**	**6.9%**	**-22.7%**	**-14.5%**

Source: Annual Construction Industry Review and Outlook publication to 2010.
DKM 2011-2012E

There are three different measures of construction output (shown in the table on the following page) and each show the substantial contraction in overall output and in the contribution of the construction industry to the economy since 2006. Depending on the measure used, construction accounted for between 6 - 7% of GNP in 2011 although in strict value added terms, the proportion has declined to an estimated 2.6%.

The official measure of construction output was published by the Department of the Environment, Community and Local Government until 2010 in the annual Construction Industry Review and Outlook (CIRO) publication. This publication contains the official estimates for the value and volume of construction output associated with all new and repair and maintenance projects, across the private and public sectors, each year.

Taking the CIRO measure which is based on expenditure, construction peaked at around 25% of GNP in 2006, falling back to an estimated 7% in 2011. Based on the 2012 estimates presented in the SCSI/DKM report, construction is expected to fall back to 6% of GNP (4.7% of GDP).

Using the investment measure, building and construction output accounted for 6.9% of GNP in 2011 compared with 22% in 2006. The projected share of GNP in 2012 is lowered again at 5.9%.

The value added measure is the most accurate measure of the real contribution of the construction sector to economic activity. It shows construction peaked at 10.7% of GNP in 2006 but had fallen to just 2.6% by 2011. This figure compares with a contribution from agriculture, for example, which is estimated at around 2.4% of GNP in 2011.

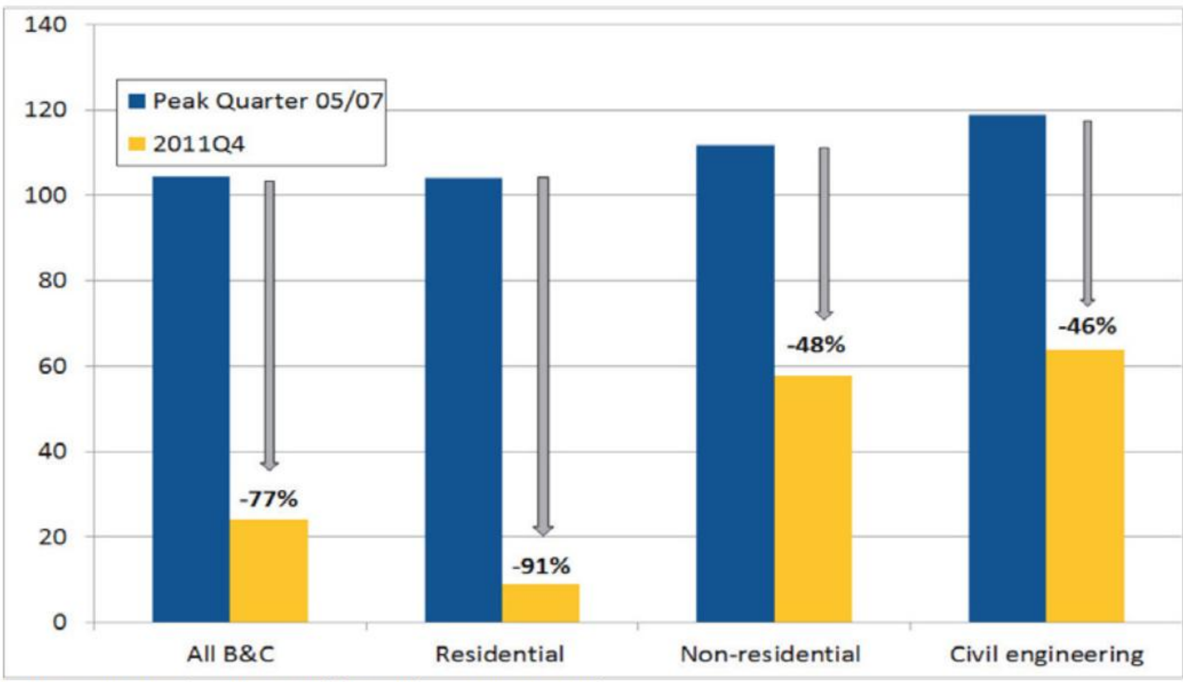
Measures of Building and Construction Output (Current Prices)

	CIRO* Measure €m	% of GNP	Investment Measure €m	% of GNP	Value-added Measure €m	% of GNP	GNP Current €bn.
2006	38,631	24.9%	33,490	21.6%	15,809	10.2%	155.0
2007	38,601	23.6%	32,999	20.2%	15,215	9.3%	163.4
2008	32,593	21.1%	27,053	17.5%	11,083	7.2%	154.7
2009	18,048	13.6%	16,065	12.1%	5,826	4.4%	132.2
2010	11,700	9.1%	10,236	8.0%	4,014	3.1%	128.2
2011E	8,684	7.0%	8,528	6.9%	3,211	2.6%	123.9
2012E	7,448	6.0%	7,400	5.9%	N/A	N/A	125.1
Contraction in value terms:							
2006-2011	77.5%		74.5%		79.7%		

Sources: DECLG, CSO, DKM.
* CIRO = Construction Industry Review and Outlook to 2010, DKM estimates for 2011 and 2012.

There is a fourth measure, the new quarterly Production in Building and Construction Index produced by the CSO, which monitors trends in the value and volume of production, based on a sample survey of private firms operating in the building, construction and civil engineering sector. Although this index does not generate values, it shows the scale of the overall contraction since the peak at 77% based on data up to 2011. The index suggests that contraction was most severe for the residential construction sector.

Volume of Production Index for Building and Construction
(Base Year Index 2005 = 100, seasonally adjusted)



Source: CSO Production in Building and Construction Index.

Based on the above index, which peaked in Q4 2006, the total value of construction output in Q4 2011 would be in line with the 2011 estimate of €8.7 billion above, having also contracted by 77%.

Bruce Shaw, in their Handbook 2012, state that in November 2011 the government published it's Infrastructure and Capital Investment Framework for 2012 to 2016. This shows a much reduced expenditure on the public side of €3.94 billion in 2012, reducing to €3.37 billion in 2013 and further reducing to €3.25 billion for the following three years. There is very little activity on the private side of the industry either. Commercial projects have been hampered by oversupply, lack of funding and delays and uncertainty related to NAMA projects.

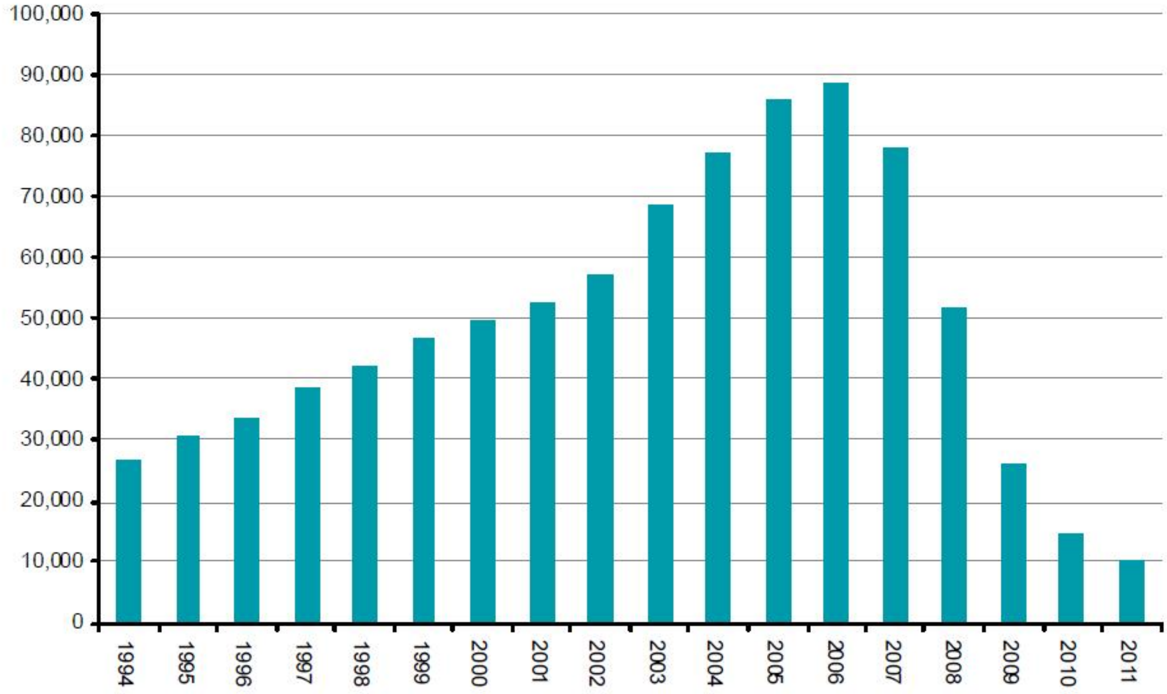
HOUSING

The SCSI/DKM report advises that the housing market remains in an exceptionally weak position, having been through a sharp adjustment for the past five years. That adjustment is continuing back towards a more "normal" market. What constitutes a "normal" level will require some equilibrium to be reached between demand and supply. Housing activity, whether measured in regard to planning permissions, starts/commencements, completions, mortgage transactions or house prices, has reached an exceptionally low level.

The number of planning permissions has plummeted since the peak with just 9,489 units granted planning permission in the first nine months of 2011 down 38.9% on the same period in 2010 and compared with 101,653 planning permissions in 2004 (peak). There has been a substantial reduction in the number of apartments granted planning permission (68.9% below the same period in 2010). When residential planning permissions in the first nine months of 2011 are broken down by floor area, one off/individual houses accounted for 52%, multi development/estate houses 35%, and apartments accounted for 13%.

The total number of units completed (measured in terms of dwellings connected for electricity) across the state was 10,480 in 2011, 28.2% below the corresponding level in 2010. Of the total of 10,480, 62% represented one off/individual houses, 25% estate houses and 13% apartments.

House Completions



DoE

Irish Housing Supply

	Housing Completions	New Home Registrations
1996	33700	23769
1997	38842	27080
1998	42349	29067
1999	46512	33852
2000	49812	34613
2001	52602	28845
2002	57695	51157
2003	68819	56859
2004	76954	60782
2005	86000	62284
2006	88400	66650
2007	78000	38352
2008	51700	12,676
2009	26400	3,740
2010	14602	1,680
2011	10480	834

DoE

Commencement (housing starts) totalled 4,365 units in 2011, 31.7% below the corresponding level in 2010. 79% were single units with the following counties accounting for the highest proportions of single units: Cork County (12% of total), Mayo and Galway County (8% each), Kerry (6%) and Dublin, Limerick County and Clare (4% each).

Based on data from the Irish Banking Federation the total value of mortgages advanced for the purchase of dwellings was €2.1 billion for 11,050 loans in 2011. Of the total funds advanced, first-time buyers accounted for 53%, existing owners moving houses represented 44% while investors represented just 4%. The average loan in 2011, based on the loans advanced for the purchase of a dwelling was €189,502. The corresponding average loan for first-time buyers was €174,600.

The latest official data available on residential property prices from the Central Statistics Office shows that property prices, on average were down by 16.4% in April 2012 on the same month in 2011 and by almost 50% since the peak. Based on the peak house price value from the Permanent – TSB index (now discontinued), this would suggest an average house price currently of around €155,000, which is equivalent to 4.3 times average earnings.

There are a number of factors likely to influence the return to a more "normal" market including the following:

Consistently weak consumer sentiment

The lack of access to credit

The build-up of new unsold stock estimated at 18,638 or close to 1% of the total housing stock. There will also be the vacant units which are expected to be released by NAMA plus the potential number of properties held by over indebted buy-to-let borrowers, which the banks are coming under pressure to repossess. The most recent results from the 2011 census estimated the total vacancy rate (new and second-hand) across housing stock at 14.7%

Housing Stock and Vacant Dwellings 2011 (CSO, 2011 Census Population)

	2011
Housing stock 2011 (Number)	2,004,175
Vacant dwellings 2011 (Number)	294,202
Vacancy rate 2011 (%)	14.7
Actual change in vacant dwellings 2006-2011 (Number)	27,880

Negative equity and mortgage arrears with an estimated 13.1% of mortgaged households (approximately 151,000) in negative equity at the end of 2010, based on Central Bank Research. The increase in unemployment for some households combined with falling disposable incomes for others, has resulted in an increase in mortgage arrears, with 71,000 or 9.2% of private residential mortgage accounts in arrears for more than 90 days at the end of December 2011. The corresponding value of mortgages in arrears was almost €14 billion of which €1.2 billion represented the value of arrears. The latest Central Bank data reports that 1 in 10 mortgages are now in arrears with a rise from 6.3% in Q1 2011 to 9.2% in Q4. Currently the Central Bank advise that there ware now over 75,000 homeowners, or 10.5% of the total unable to pay their mortgages after 90 days.

In 2011, just over 11,000 new mortgages for house purchases were drawn down, which is substantially below the 2010 figure (i.e. in excess of 18,000) and extraordinarily low relative to the number recorded at the peak of the cycle in 2006 when over 110,000 mortgages were reported by the IBF data. However, according to the Bank of Ireland Property Review (March 2012) the quarterly breakdown implies that the market may have bottomed in the first quarter of 2011; that total of 2,325 was exceeded in each of the three successive quarters, culminating with over 3,200 in Q4.

Mortgage Lending for House Purchase

	No. of Mortgages	Average Mortgage (€000)	Total Market (€bn)
2005	110,500	220	24.4
2006	110,800	251	27.8
2007	84,200	266	22.5
2008	53,600	271	14.5
2009	25,100	232	5.8
2010	18,300	207	3.8
2011	11,100	189	2.1

IBF/PWC and ERU

The picture is similar in terms of the sums advanced, with Q4 seeing €571 Million against €548 Million in Q3, €509 million in the second quarter and €466 million in Q1. The annual figure at €2.1 billion, is still very weak, of course, compared to the €3.8 billion in 2010, but again the quarterly pattern implies that we may be at a turning point.

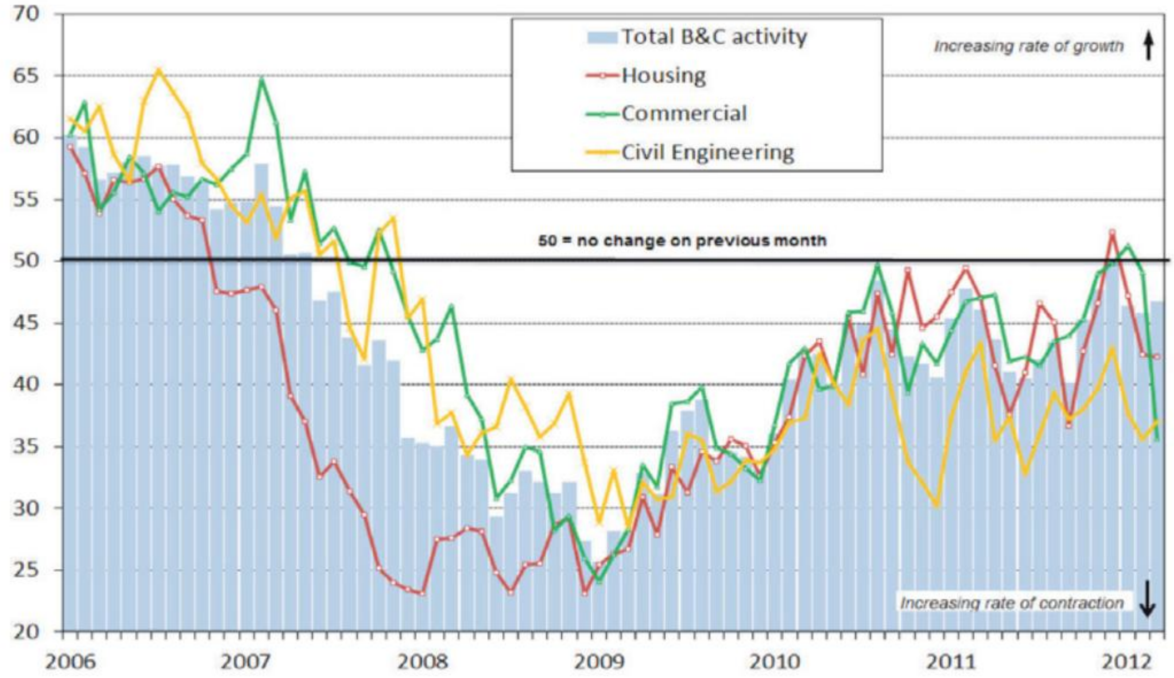
The figure for total mortgage lending (which includes top-ups and remortgaging) tell a broadly similar story as well, with the Q4 figure at €639 million up from the €576 million in the first quarter, and an annual total of €2.5 billion.

First-time buyers now dominate the market, accounting for 49% of total loans in Q4 with movers accounting for most of the remainder (31%). Buy-to-let lending has collapsed, accounting for only 3% in the final quarter, with remortgaging at 11% and top ups just 5%.

Medium-Term Prospects for Construction

A recent Construction Purchasing Managers Index from The Ulster Bank remained in contraction at the end of the first quarter of 2012. The index reported that jobs continue to be shed in the sector although at a slower pace than in the previous month. The new orders index was broadly unchanged in March, having declined solidly in the preceding months. Sentiment regarding future activity levels improved as respondents expected activity to be higher in 12 months time from its current low level, nonetheless a number of respondents reported that a reluctance amongst clients to commit to projects was preventing arise in new orders.

Index of Construction Confidence to March 2012



Source: Ulster Bank Construction Purchasing Manager's Index.

There are a number of challenges in the social housing sector, not least of which is the escalating number of households on the social housing list. The most recent national assessment shows that at 31 March 2011, just over 98,000 households (circa 6% of the total) were in need, compared with over 56,000 in 2008, an increase of over 75%. All of the investments under the public housing program are expected to deliver between 3,500 and 4,000 additional social housing units this year. In the context of a growing social housing list, these figures are well short of what is required.

One area supporting the private housing RM&I (Repair, Maintenance and Improvement) sector has been investment in energy efficiency. Funding for improving the energy efficiency of the residential building stock has taken the form of direct grant payments to households. It is estimated that to date over €300 million in public and private funding has been spent on 270,000 energy efficient measures in 110,000 homes. The total capital allocation this year in grant support is €76.1 million for energy efficiency measures in private residential housing, low-income homes and the public and commercial sectors. Ernst & Young Ireland are of the opinion that retrofitting buildings owned by the state to make them more energy efficient could provide the catalyst for the creation of over 6,500 new jobs.

The total housing RM&I market was worth an estimated €2.83 billion in 2010. This figure covers investment by households in major housing improvements and minor housing repair works as well as public sector investment in the refurbishment of the public housing stock. Notwithstanding the boost from energy efficiency measures and a focus on renovation and improvement works by the local authority sector, overall investment in housing RM&I is forecast to decline by almost 8.5% in volume terms in 2012 as private household incomes and local authority funding continue to be affected by austerity and fiscal consolidation measures.

The private non-residential building sector has also suffered with the total value of new industrial, office, retail and other private sector buildings falling from unprecedented levels reached during the boom years. Nonetheless a QS Survey reported strong activity in the private non-residential building sector, with much of it from commercial and industrial contracts. Projects in the commercial building sector related predominantly to office and administration buildings whilst the industrial market is being fuelled by new projects from companies which are expanding activity or in growth sectors including new FDI announcements.

Much of this work was reported to relate to data processing centres and factories, including FDI announcements for companies like Intel, Amgen and Eli Lilly all of which are expected to boost the volume of industrial construction work in the medium term. On foot of the QS Survey, the total market value of new industrial and commercial work was revised upwards in 2011 and 2012. The value of industrial building output is projected at €339 million in 2012, the volume increase of 71%; the corresponding value of commercial building output is projected at €216 million, a volume increase of 10.8%. The sector also includes agricultural and tourism areas however the prospects for construction in each of these are expected to remain weak in 2012.

With regard to Public Sector Construction, the Public Capital Programme shows the five-year capital investment having a budget of €17.1 billion. Whilst most categories of investment are projected to decline this year ,two areas recorded an increase namely Energy (+15%) and Housing (+60%) although the total housing provision of €1 billion declined by 19% when local authority housing loans (€568 million) are excluded. The Government's priorities with regard to the Capital Investment Programme essentially revolve around three key areas comprising education and the provision of new schools, health and enterprise.

For 2012 taking the estimates for the value of construction output in each sector, the total value (new and RM&I) of construction output is estimated at €7.4 billion. This is 14.2% below the corresponding value in 2011.

Value, Volume and % Change in Construction Output 2010-2012E

	2010	2011	2012E	2010	2011	2012E	2010	2011	2012E
	Current prices €m.			Constant 2010 Prices €m.			Annual % change in volume		
Residential Construction									
Private Housing	3,828	2,963	2,467	3,828	3,292	2,741	-31.4%	-14.0%	-16.8%
Public Housing	1,062	800	500	1,062	889	500	-7.3%	-16.3%	-43.8%
Sub Total	**4,890**	**3,763**	**2,967**	**4,890**	**4,181**	**3,241**	**-27.3%**	**-14.5%**	**-22.5%**
Private Non-residential Construction									
Industry	169	198	339	169	204	339	-70.9%	21.0%	71.1%
Commercial	250	195	216	250	201	216	-76.6%	-19.6%	10.8%
Agricultural	150	120	87	150	124	87	-44.6%	-17.5%	-27.5%
Tourism	66	35	31	66	36	32	-75.3%	-45.5%	-11.4%
Worship	35	27	21	35	28	22	11.1%	-19.7%	-22.2%
Sub Total	**670**	**575**	**694**	**670**	**593**	**715**	**-69.8%**	**-11.5%**	**20.7%**
Productive Infrastructure									
Roads	1,345	932	809	1,345	961	834	-38.5%	-28.5%	-13.2%
Water Services	983	788	661	983	812	681	-4.1%	-17.4%	-16.1%
Airports/Seaports	117	80	65	117	82	67	-74.3%	-29.7%	-18.2%
Energy	1,300	907	1,000	1,300	935	1,031	20.1%	-28.1%	10.3%
Transport	485	325	250	485	335	258	-7.4%	-31.1%	-22.9%
Communications	240	150	123	240	155	126	-6.0%	-35.6%	-18.3%
Sub Total	**4,470**	**3,181**	**2,908**	**4,470**	**3,279**	**3,016**	**-19.2%**	**-26.6%**	**-8.6%**
Social Infrastructure									
Education	825	623	507	825	642	522	23.6%	-22.2%	-18.7%
Health	348	328	277	348	338	286	-15.2%	-2.8%	-15.5%
Public Buildings	261	97	80	261	100	83	-20.1%	-61.7%	-17.2%
Other Social	237	118	66	237	121	68	-32.0%	-48.8%	-43.8%
Sub Total	**1,671**	**1,166**	**930**	**1,671**	**1,202**	**959**	**-4.7%**	**-28.1%**	**-20.2%**
Total All Construction	**11,700**	**8,684**	**7,448**	**11,700**	**9,254**	**7,912**	**-27.9%**	**-20.9%**	**-14.5%**
of which									
New Construction	7,330	5,214	**4,467**	7,330	5,488	4,652	-33.5%	-25.1%	**-15.2%**
RM&I Construction	4,370	3,471	**3,049**	4,370	3,766	3,260	-15.9%	-13.8%	**-13.4%**

The above figures include repair and maintenance expenditure.

The SCSI/DTM report comments that with regard to 2013, the volume of output will again decline. Apart from some very modest improvement in the output related to private non-residential construction, albeit from a very low base, all other sectors are expected to be weaker in 2013. The total number of dwellings built next year is expected to continue on a downward trend as any recovery in private house building is likely to require a sustained improvement in demand and a significant run down of the vacant stock. The preliminary prospects indicate a further contraction in overall construction output by 6.6% in volume terms in 2013. The corresponding value of construction is forecast at €7.1 billion, after allowing for a recovery in tender price inflation of 2%.

Current prices and volume % changes

	2011 (€m)	2009	2010	2011	2012E	2013F
		% change in volume of construction output				
Residential Building	3,763	-45.9%	-27.3%	-14.5%	-22.5%	-5.2%
Private non-Residential Building	575	-52.2%	-69.8%	-11.5%	20.7%	0.7%
Public non-Residential Building	1,166	-6.9%	-4.7%	-28.1%	-20.2%	-4.0%
Total Building	5,503	-43.5%	-32.4%	-17.4%	-17.8%	-4.1%
Productive Infrastructure - Civils	3,181	-3.5%	-19.2%	-26.6%	-8.6%	-10.6%
Total Construction Output	**8,684**	**-34.2%**	**-27.9%**	**-20.9%**	**-14.5%**	**-6.6%**

Source: Annual Construction Industry Review and Outlook publication to 2010.
DKM 2011-2013F

The hope is that in 2014 there will be some evidence of stabilisation and possibly a resumption of output growth, after six years of decline.

Since the publication of the SCSI/DKM report, NAMA have announced it is to invest circa €2 billion by 2016, creating 35,000 jobs. The chairman, Frank Daly, states that NAMA's loan portfolio has more potential than was originally expected and they propose to invest, particularly over the next three years, with a view to ensuring that this property is available to meet commercial and residential demand over the rest of the decade. He added that in some market segments, large offices, for instance, supply shortages are already emerging and they plan to address that now. This investment, he says, could potentially generate 25,000 jobs in construction and a further 10,000 jobs in the wider economy.

CONSTRUCTION COSTS AND PRICES

As mentioned in previous reports It is important to distinguish between tender prices and construction input costs. The former are subject to market pressures while the latter reflect the actual cost of labour and materials.

The most recent annual data for the wholesale prices of building and construction materials show prices increased by 2.6% on average in 2011. The composite measure known as the capital goods price index, which captures the cost of materials and wages, shows prices were down by 2.5% on average in 2011. This was the highest rate of decline in five years. Overall construction costs fell by 1.3% on average in 2011, according to the SCSI Construction Cost Index.

The most negative trends arise for average earnings per week which declined for the third year in a row in 2011 and an accelerated rate (-6%). Based on the CSO's average annual figures for 2011, average earnings in construction fell by 9.5% since 2008. The corresponding fall in general consumer prices was 3% over the same period.

Trends in building and construction cost inflation 2007 – 2012

Annual average % changes

	2007	2008	2009	2010	2011	2012E
Wholesale Price Inflation - B&C Materials	5.3%	3.3%	-3.1%	2.7%	2.6%	2.4%
B&C Capital Goods Price Inflation - Materials and Wages	4.9%	3.4%	-1.5%	1.1%	-2.5%	1.0%
SCSI Construction Cost Inflation	4.5%	4.2%	-1.4%	1.6%	-1.3%	0.0%
Average Earnings per week in B&C	5.8%	1.2%	-0.7%	-3.0%	-6.0%	-3.0%
Consumer Price Inflation	4.9%	4.1%	-4.5%	-1.0%	2.6%	1.5%

Source: CSO, SCSI.

The CSO Wholesale Price Index (March 2012) notes that with regard to building and construction, all material prices increased by 2.4% in the year since March 2011. The most notable yearly changes were:

- Ready mixed mortar and concrete +5.9%
- Concrete blocks and bricks +9.1%
- Structural steel and reinforcing metal +2%
- PVC pipes and fittings -10.7%
- Copper pipes and fittings +3.8%
- Paints, oils and varnishes +9.5%
- Glass +6.6%

Average hourly earnings in construction have been declining in year on year terms since Q1 2010. By Q4 2011, earnings per hour had declined by 11.8% to €18 .65. The average hours worked has been more volatile but had fallen to 35.1 hours per week in Q4 2011, 3.8% below the figure in Q4 2010.

Trends In Construction Earnings 2008 – 2011E

	2008	2009	2010	2011
Total Direct Employment (000s, average annual)	235.5	155.9	119.8	107.1
Average Hourly earnings (Euro)	20.1	20.9	20.4	19.1
Average Weekly Paid Hours (Hours)	37.5	35.7	35.4	35.7
Average Earnings per Week (Euro)	752.3	747.2	724.6	681.0
Average Annual Earnings (Euro)	39,118	38,855	37,678	35,412

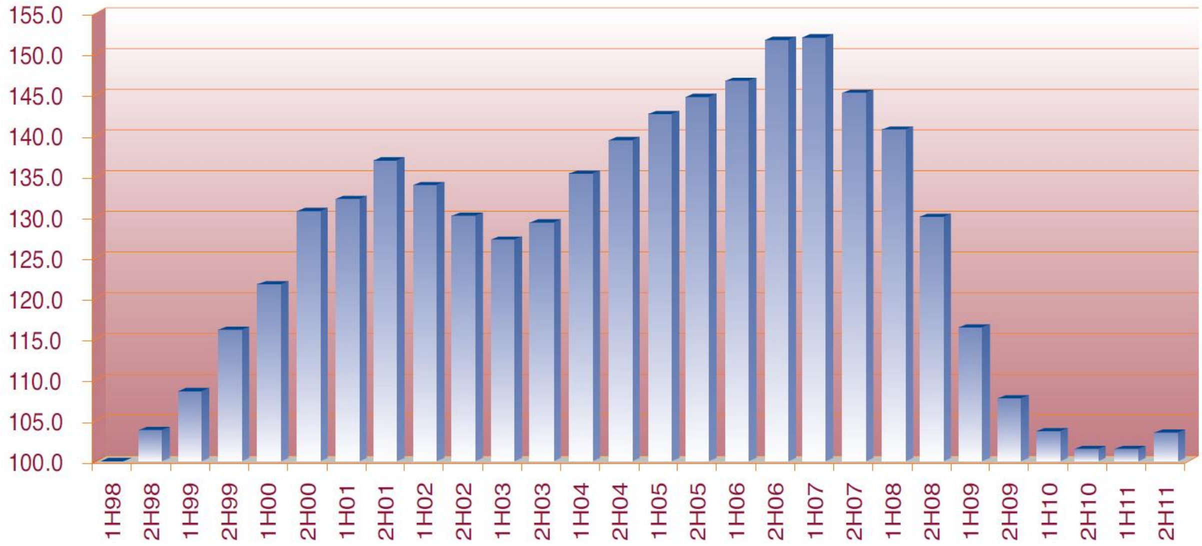
Source: Employment QNHS, CSO Earnings, Hours and Employment Costs Survey[8]

TENDER LEVELS

The tender price index prepared by the Society of Chartered Surveyors is based on actual tender returns for non-residential projects during the period in question. It is based predominantly on newbuild projects with values in excess of €0.5 million and covers all regions of Ireland. The index is therefore a measure of average price increases across differing project types and locations.

The latest figures from the Society of Chartered Surveyors Ireland show that building cost have bottomed out and even increased slightly in the second half of 2011 by 2%. The Society note that construction tender prices have fallen by approximately one third since

their peak in the first half of 2007 and are now still only at a level last seen 13 years ago in 1998. They add that the stabilisation and slight increase in tender prices in 2011 reflects this severe shortage of new construction projects and reduction in the available pool of contractors. This is due to both company failures and some contractors and subcontractors concentrating their efforts on overseas markets. They also observed that the levelling off and slight increase in tender prices is also due to the growing realisation that pricing work at below cost and not pricing risk items in tenders is unsustainable.



First Half 1998	100.0	First Half 2005	142.6
Second Half 1998	103.8	Second Half 2005	144.7
First Half 1999	108.6	First Half 2006	146.7
Second Half 1999	116.1	Second Half 2006	151.7
First Half 2000	121.7	First Half 2007	152.0
Second Half 2000	130.7	Second Half 2007	145.2
First Half 2001	132.2	First Half 2008	140.7
Second Half 2001	136.9	Second Half 2008	130.0
First Half 2002	133.9	First Half 2009	116.4
Second Half 2002	130.1	Second Half 2009	107.7
First Half 2003	127.2	First Half 2010	103.7
Second Half 2003	129.3	Second Half 2010	101.5
First Half 2004	135.3	First Half 2011	101.5
Second Half 2004	139.4	Second Half 2011	103.5

The chairman of the Quantity Surveying Professional Group of the SCSI remarked that "whilst there is more realism about pricing levels for construction projects recently, there is still a severe shortage of work within all construction sectors and tenders are likely to remain very competitive for the foreseeable future".

Bruce Shaw tender price index shows that prices rose in the full year by 2%. They predict that prices will remain very competitive but they will rise by a further 3% during 2012. In later

years they predict that prices are then likely to increase generally in line with inflation from 2013/14 onwards. With respect to Labour rates, Bruce Shaw note that these were reduced by 7.5% in February 2011 following prolonged negotiations with the construction trade unions. They also observed that the prices of some materials are reducing but by less than might be expected since local manufacturers are experiencing smaller production volumes and imported commodities such as steel and copper reflect global demand. Overall the Bruce Shaw Construction Input Cost Index declined by 2% in 2011 and they predict that it will fall by a further 1% in 2012 and will then bottom out at that level. They further observe that the small increase in tender prices coupled with small the decrease in construction input costs is shown as a narrowing of the gap between both and is to be welcomed as a sign of reality starting to come back into the marketplace. On larger projects Bruce Shaw advise that clients should look carefully at the financial strength of contractors and their ability to obtain performance guarantee bonds before entering into construction contracts.

Tender %	6	-2	-4	4	4	3	0	-12	-17	-6	2	3
Cost %	9	3	3	2	3	3	3	3	-2	-3	-2	-1

:

2. BUILDING CLAIMS DEFLATION

A lot of the information provided in the Construction Sector Overview is taken from sources that are primarily focused on larger scale projects. Nonetheless this does have an impact on the domestic insurance claims arena given the oversupply of resources and competition for work.

Materials

There was a 2.4% increase in material costs year-on-year March 2011 to March 2012. The table below shows a breakdown extracting the materials most commonly encountered in domestic claims along with the monthly changes for Q1 2012:

Wholesale Price Index (ex. VAT) for Building & Construction Materials				
	March 2012 % Annual Change	Monthly % Change		
Materials		Jan	Feb	March
Paints Oil Varnishes	9.5%	0.0%	0.0%	4.4%
Concrete Blockwork	9.1%	-1.7%	0.4%	3.0%
Glass	6.6%	0.0%	3.4%	0.0%
Ready Mixed Mortar & Concrete	5.9%	1.3%	-0.2%	0.3%
Other Timber	4.6%	0.0%	0.0%	0.0%
Copper Pipes & Fittings	3.8%	1.9%	0.0%	0.6%
Structural Steel & Reinforcing Metal	2.0%	0.5%	0.6%	0.4%
Insulating Materials	1.6%	0.0%	-0.7%	0.0%
Electrical Fittings	0.8%	0.0%	1.0%	0.0%
Rough Timber	0.7%	1.2%	0.0%	0.0%
Plaster	-1.9%	0.0%	-0.3%	0.0%
PVC Pipes & Fittings	-10.7%	0.0%	0.0%	0.0%

Factors to be borne in mind in reviewing material cost changes include the economic uncertainty, manufacturers reducing production runs due to the falling demand together with the fact that on insurance repair work contractors are unlikely to be in a position to avail of bulk discounts. Nonetheless, there is still upward pressure on material costs and therefore with respect to the remainder of 2012 and 2013 we would predict that there could be increases as follows:

- 2012: +2.00%
- 2013: +2.25%

Labour

A 7.5% wage cut was ratified by the Labour Court in January 2011 and was applicable from 4th February 2011. This would have accounted for some of the official wage reduction in 2011; however market forces have also seen contractors reduce labour costs below this.

With regard to domestic claims we predict that there will be continued pressure on contractors to reduce labour costs for the remainder of 2012 and into 2013 as shown below:

- 2012: -5.00%
- 2013: -4.00%

The utilisation by Insurers of Managed Contractor Schemes should ensure that the projected reduction in labour costs are crystallised.

3. RETAIL SALES & CONSUMER PRICE INDICES

RETAIL SALES INDEX

The most up to date RSI Statistics are for April 2012, which illustrate annual percentage reductions of 2.7% in volume and 1.8% in value. The month itself shows a drop by 1.5% in volume and 1.1% in value.

It is important to note that the above figures are inclusive of the Motor Trade sector. If this sector is excused from the equation, the resulting figures would be an annual reduction of 3.8% in volume and 2.3% in value (1.8% and 1.6% respectively for April 2012).

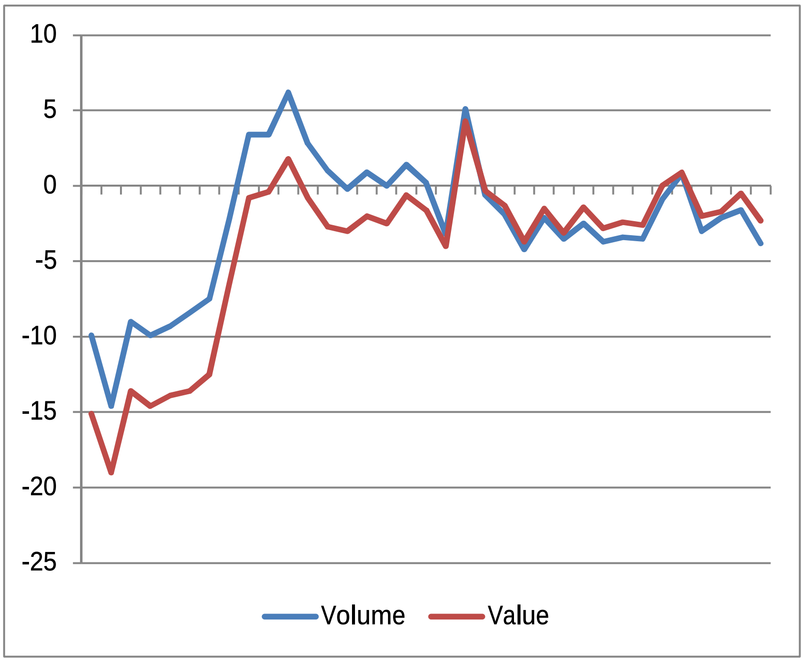
The key annual, to April 2012, percentage movements in both volume and price by business category are:

	Volume	Value
Motor Trade	3.7%	2.9%
Department Stores	-10.0%	-10.1%
Food, Beverage & Tobacco	-3.1%	-1.8%
Fuel	-3.0%	6.7%
Pharmaceutical	-0.9%	-1.7%
Clothing, Footwear & Household	-9.6%	-9.9%
Furniture & Lighting	-0.7%	-4.8%
Hardware, Paint & Glass	-17.8%	-17.3%
Electrical Goods	1.9%	-4.3%
Books & Newspapers	-7.7%	-7.7%

The above table, coupled with the data and graphs on the following page, illustrate that almost all categories have experienced a depressed year in both volume and value, with the exception of the Motor Trade in both volume and value, Electrical Goods in volume, and the obvious increase in the price of Fuel.

HISTORIC RETAIL SALES INDICES

	Month	Volume	Value
2009	June	-9.9%	-15.1%
	July	-14.6%	-19.0%
	August	-9.0%	-13.6%
	September	-9.9%	-14.6%
	October	-9.3%	-13.9%
	November	-8.4%	-13.6%
	December	-7.5%	-12.5%
2010	January	-2.2%	-6.5%
	February	3.4%	-0.8%
	March	3.4%	-0.4%
	April	6.2%	1.8%
	May	2.8%	-0.8%
	June	1.0%	-2.7%
	July	-0.2%	-3.0%
	August	0.9%	-2.0%
	September	0.0%	-2.5%
	October	1.4%	-0.6%
	November	0.2%	-1.6%
	December	-3.2%	-4.0%
2011	January	5.1%	4.3%
	February	-0.6%	-0.3%
	March	-1.9%	-1.3%
	April	-4.2%	-3.7%
	May	-2.1%	-1.5%
	June	-3.5%	-3.1%
	July	-2.5%	-1.4%
	August	-3.7%	-2.8%
	September	-3.4%	-2.4%
	October	-3.5%	-2.6%
	November	-0.9%	0.0%
	December	0.8%	0.9%
2012	January	-3.0%	-2.0%
	February	-2.1%	-1.7%
	March	-1.6%	-0.5%
	April	-3.8%	-2.3%



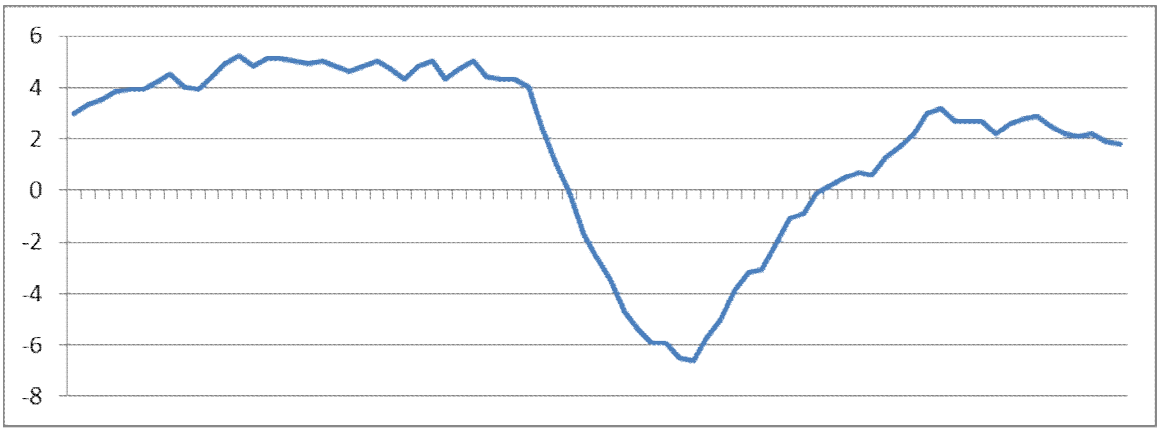
June 2009 – April 2012

May 2011 – April 2012

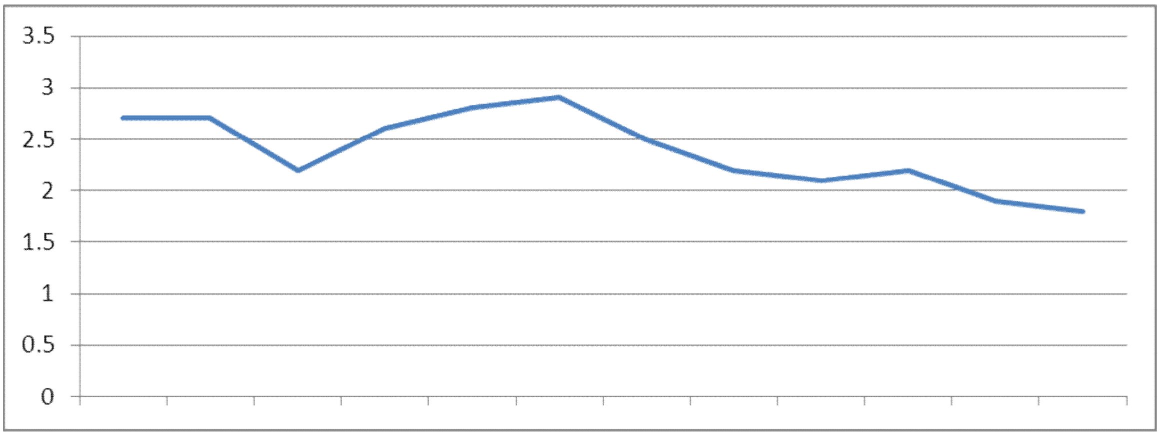
CONSUMER PRICE INDEX

Historic CPI percentage annual change statistics to May 2012, in both tabular and graphical format, are as follows:

	2012	2011	2010	2009	2008	2007	2006
January	2.2%	1.7%	-3.9%	-0.1%	4.3%	5.2%	3.0%
February	2.1%	2.2%	-3.2%	-1.7%	4.8%	4.8%	3.3%
March	2.2%	3.0%	-3.1%	-2.6%	5.0%	5.1%	3.5%
April	1.9%	3.2%	-2.1%	-3.5%	4.3%	5.1%	3.8%
May	1.8%	2.7%	-1.1%	-4.7%	4.7%	5.0%	3.9%
June	-	2.7%	-0.9%	-5.4%	5.0%	4.9%	3.9%
July	-	2.7%	-0.1%	-5.9%	4.4%	5.0%	4.2%
August	-	2.2%	0.2%	-5.9%	4.3%	4.8%	4.5%
September	-	2.6%	0.5%	-6.5%	4.3%	4.6%	4.0%
October	-	2.8%	0.7%	-6.6%	4.0%	4.8%	3.9%
November	-	2.9%	0.6%	-5.7%	2.5%	5.0%	4.4%
December	-	2.5%	1.3%	-5.0%	1.1%	4.7%	4.9%



January 2006 – May 2012



June 2011 – May 2012

The annual CPI percentage change to May 2012 was 1.8%, however there was no change for the month of May itself.

The annual rate of inflation for services was 2.2%, and for goods 1.3%.

The most notable sector changes during the year were:

Education	9.4%
Transport	5.0%
Alcoholic Beverages and Tobacco	4.2%
Miscellaneous Goods & Services	4.1%
Housing, Water & Utilities	2.3%
Household Goods	-2.7%

Since January 2010, there has been monthly CPI inflation ranging between a low of 1.7% in January 2011 to a peak of 3.2% in April 2011.

For the first five months cumulative to May 2012, monthly CPI inflation has averaged at circa 2%.

4. CONTENTS CLAIMS DEFLATION

As detailed under Section 3, Retail Sales and Consumer Price Indices, CPI, inflation for the first five months of 2012 cumulative to May, has been stable on a monthly basis at circa 2%.

The main drivers of this inflation are components that do not directly affect the insurance spend on household contents as follows:

Education	9.4%
Transport	5.0%
Alcoholic Beverages and Tobacco	4.2%
Miscellaneous Goods & Services	4.1%
Housing, Water & Utilities	2.3%

A more detailed analysis of these statistics, demonstrates actual deflation in the core areas of the household contents insurance spend as follows:

Household Goods	-2.7%
Clothing & Footwear	-0.7%
Furniture & Household Equipment	-2.7%

Based on the above trends, we would estimate Household Content Claims deflation as follows:

- 2012: -2.25%
- 2013: -2.00%

OSG by the utilisation of our Evaluate Price Validation Initiative will be in a position to guarantee Household Contents Claims settlement at best available market price, and therefore be in a position to deliver savings to Insurers in excess of projected deflation rates as outlined above.

5. FORECAST CLAIMS DEFLATION 2012 – 2013

BUILDINGS

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

		2012	2013
Materials	(30%)	2.0%	2.25%
Labour	(70%)	-5.0%	-4.00%

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

	2012	2013
Building Deflation Percentage (Weighted)	-2.9%	-2.13%

CONTENTS

We expect the cost of household content claims to marginally reduce in the next 18 months as follows:

	2012	2013
Contents Claims Deflation	-2.25%	-2.00%

CONCLUSION

Our historic claims experience has established, 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 deflation figure, the building and contents figures, as outlined previously, require to be pro-rataed on this basis, resulting in a weighted forecast overall claims deflation as follows:

	2012	2013
Overall Household Deflation	-2.74%	-2.10%

6. BIBLIOGRAPHY

The following list represents the resource material used in the production of this report.

- Bank of Ireland. (2012, March). The Irish Property Review.
- Bruce Shaw. (2012). Bruce Shaw Handbook.
- Central Statistics Office. (2012, June 07th). Consumer Price Index.
- Central Statistics Office. (2012, May 28th). Retail Sales Index.
- Central Statistics Office. (2012). Wholesale Price Index for Building & Construction Materials.
- Irish Construction Industry Magazine. (2012, April/May). Irish Construction Industry Magazine.
- The Society of Chartered Surveyors in Ireland & DKM Economic Consultants. (2012). The Irish Construction Industry in 2012.
- The Society of Chartered Surveyors in Ireland. (2012). Tender & Construction Cost Indices.
- Ulster Bank. (2012, May 14th). Ulster Bank Construction PMI Report (RoI).