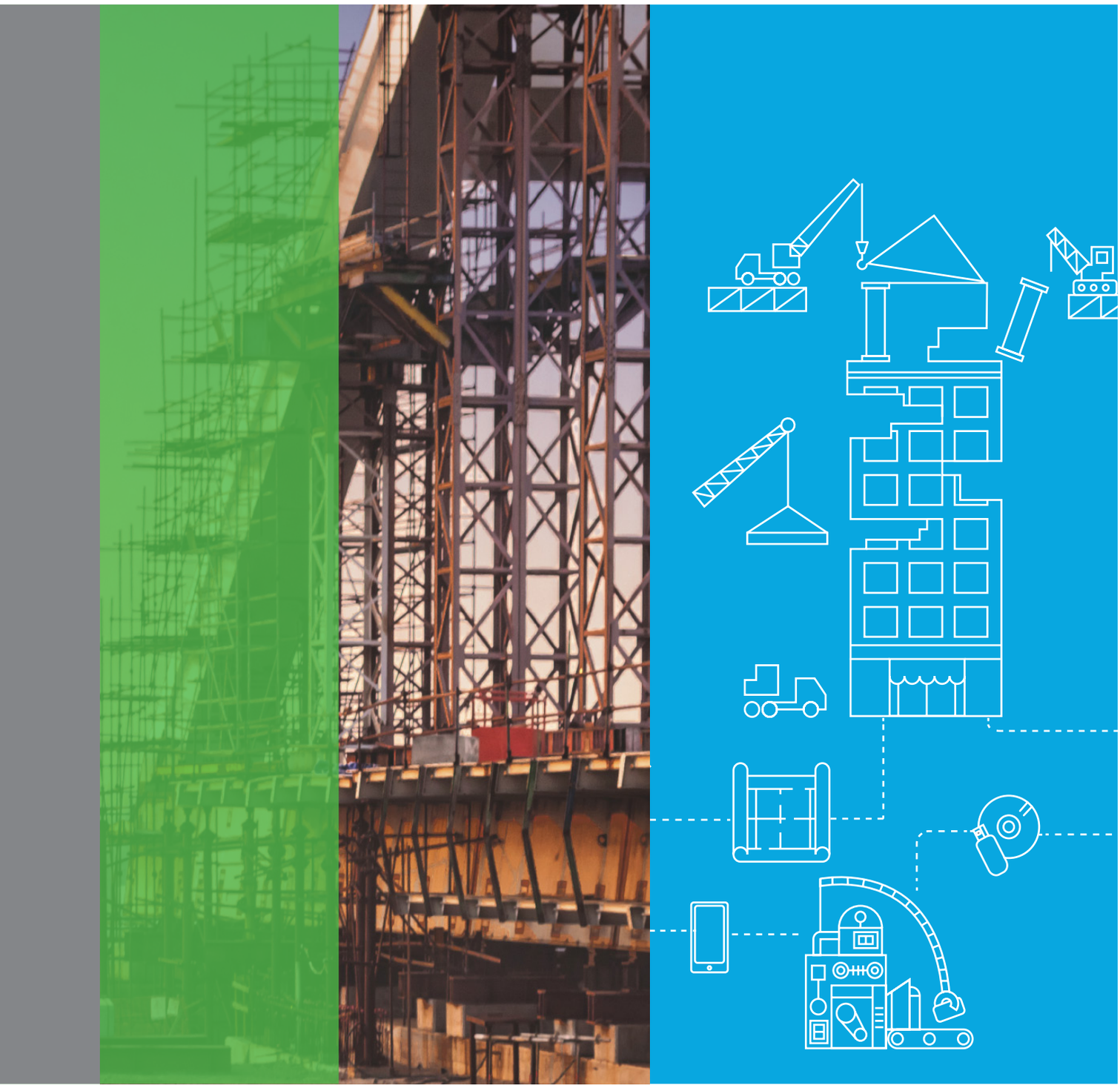


CONSTRUCTION SECTOR ACCESS TO FINANCE

THE POWER OF BEING UNDERSTOOD
AUDIT | TAX | CONSULTING

RSM

FOREWORD FROM THE CIF

The construction industry is the key enabler of the Irish economy and society. All sectors depend on construction to deliver the infrastructure that underpins competitiveness, housing for employees and specialist buildings and manufacturing facilities. Every community in Ireland depends on construction with over 35,000 construction-related enterprises operating in every town and village around the country, employing over 147,000 and sustaining 45,000 self-employed. So, it's essential that construction companies can access finance to deliver essential housing and infrastructure and to continue to contribute to the social and economic fabric of Irish life.

This report should sound alarm bells for those concerned with regional development, spatial strategy and in resolving the housing crisis.

It shows that construction companies are experiencing difficulty in securing finance. This is especially acute in the regions and amongst SMEs. This report confirms that lending outside the urban centres is particularly challenged. Many companies reported that they are unable to access finance from external sources and are dependent on dwindling cash reserves. These are the companies the Government is dependent on to resolve the housing crisis and deliver Ireland's infrastructure. They cannot do so without access to finance. To address this, the CIF's budget submission has called for the establishment of a small builder's fund. This fund would provide finance, at market rates, for viable projects where traditional sources are unwilling to lend.

This is not a call for a return to the speculative lending of the past. This report highlights many cases where companies are unable to secure finance to develop viable and essential residential projects particularly outside the greater Dublin area. It also highlights the paucity of funding available for construction companies to invest in plant, staff, technology, innovation and other core functions. At a macro-level, this threatens to undermine productivity in the industry and limit its growth over the coming decade.

Essentially, this report identifies the funding gap between companies and traditional sources of finance. Increasingly, companies are forced to rely solely on cash reserves to survive. A significant cohort has disengaged from traditional banking institutions and find private equity terms and conditions uninterested. Many respondents had ambitious growth strategies in place that they are now considering downgrading due to the lack of available finance. The resultant loss of turnover, exports, innovation and jobs will be a huge lost opportunity for them but for Ireland, the impact of this frustrated ambition is ongoing housing shortages, dilapidating infrastructure, less jobs and damaged competitiveness. On a positive note, the construction industry has always been resilient and these companies, supported by a small builder's fund and other recommendations in this report, can deliver the world-class infrastructure and housing Irish society deserves.

Tom Parlon
Director General, CIF

CONSTRUCTION INDUSTRY FEDERATION

FOREWORD FROM RSM

Access to finance remains a critical issue for the construction industry to deliver sustainable growth in the medium to long term. A strong and dynamic construction sector plays a vital role in the Irish economy through the delivery of employment, assistance to secondary business growth and delivery of vital public infrastructure.

It is imperative therefore that Irish construction companies can readily access funding at competitive rates, in a timely manner to facilitate their management of current projects, the undertaking of new projects and their ability to invest in their businesses for the future.

The following report comprises the views of the construction industry with regard to their experiences in seeking to access finance, the barriers they face and the impact it is having on the strategic objectives of their companies.

A strong and vibrant construction industry remains a critical component in the recovery of the Irish economy. At present, the construction sector accounts for approximately 6% of GDP which is somewhat below the 10-12% share that it holds in most European countries. A 10-12% share of the economy is recognised as a sustainable level of activity for the construction industry in the medium to long term.

A dynamic construction sector contributes to the economy firstly through direct employment and taxation but also indirectly through the growth of ancillary businesses. Furthermore, an active construction industry is vital to the delivery of the necessary housing and infrastructure to improve Ireland's competitiveness as a location for foreign direct investment and to better serve society's needs.

Central to a robust construction sector is the availability of finance that enables Irish construction companies both large and small to access the required credit facilities. Access to finance is critical in facilitating companies to manage cash flow, undertake new projects, recruit staff, expand and develop.

RSM engaged Accuracy to conduct the quantitative research and CIF member interviews on their behalf.

Paddy O'Connell
Construction Lead, RSM

RSM

CRITICAL ISSUES TO EMERGE FROM THE RESEARCH

- There is a market failure in delivering finance to construction companies, particularly SME's, that could constrain the sector's ability to deliver essential construction activity.
- The construction sector is experiencing ongoing challenges when seeking access to finance. 63% of construction companies who sought to borrow from financial institutions in the last year reported a difficulty in securing finance.
- Many of the companies reported that the limited access to finance had a negative impact on their company's ability to expand, develop, recruit staff, undertake new projects and plan for the future.
- Negative past experience with financial institutions remains a critical factor as to why construction companies have not sought funding. In many instances companies were either refused a loan previously or were left waiting several months on a decision for a loan application.
- There is a high reliance on cash reserves evident. Only 34% of construction companies report borrowing from the financial institutions to fund investment in their company in the last 3 years and only 7% report using private equity finance.
- Many respondents based outside of Dublin reported that both the financial institutions and private equity firms prioritise Dublin as the prime area for providing development finance with negligible interest in regional projects.
- Only 8% of companies were of the view that the government/state play an active role in enabling companies in the construction industry to access finance.
- A large number of companies are not seeking professional advice when looking to secure finance.

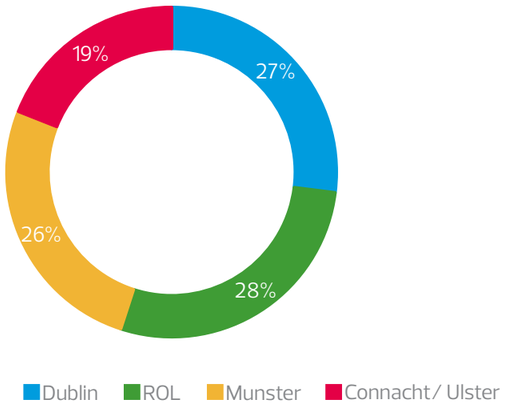
APPROACH AND METHODOLOGY

Given the importance of the construction industry to the economy and to Irish society in general, this report sought to better understand the experiences of construction companies when seeking to access finance. In particular, the report aimed to understand what impact if any access/limited access to finance is having on construction companies.

A detailed questionnaire was developed and telephone surveys were independently conducted with 303 construction companies. The sample was drawn from the 2017 Construction Industry Federation's database which delivers a margin of error of approximately + or – 5% at the 95% confidence level. The sample is proportionate by turnover to the total population of CIF members.

12 qualitative one to one interviews were also conducted with senior personnel within Irish construction companies to provide a deeper understanding of companies' experiences in seeking to access finance.

FIGURE 1. Sample breakdown by company region



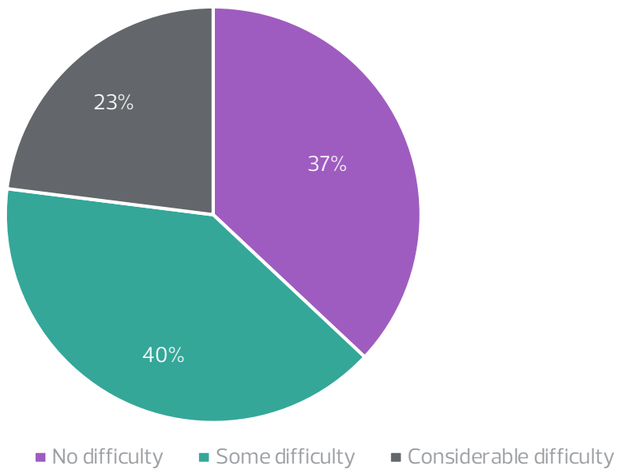
KEY FINDINGS

1. Access to finance remains a challenge

A consistent theme to emerge from the research was the ongoing challenges encountered by many in the construction sector when seeking access to finance. 63% of construction companies who sought to borrow from financial institutions in the last year reported experiencing a difficulty in securing finance. In the past 12 months only 33% of those involved in house building have obtained bank finance.

The challenges appear greater for the small to medium sized companies with a turnover of under €9 million as opposed to those companies with an annual turnover in excess of this figure. Almost two thirds of all companies who tried to borrow money in the last year experienced a difficulty in doing so.

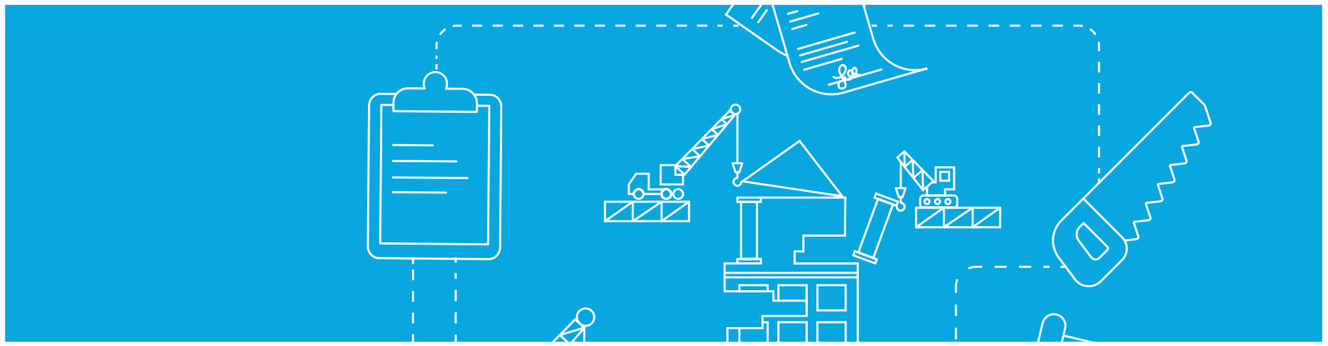
FIGURE 2. Level of difficulty experienced when borrowing



" We have found it extremely difficult to get access to finance as the process has been very time consuming and it is very difficult to get an answer quickly on a loan application which makes it impossible to move forward on a project."

Medium sized construction company, Midlands

KEY FINDINGS

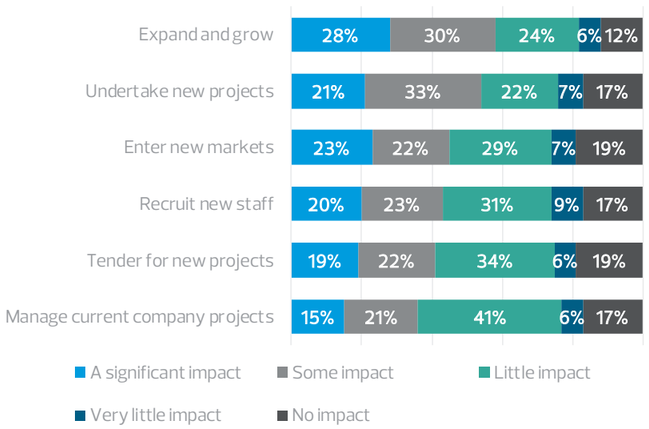


2. Notable impact of limited access to finance

Several of the companies reported that the limited access to finance had a negative impact on many areas of their businesses. These areas included the company's ability to expand and grow, undertake new projects, enter new markets, recruit new staff, tender for and manage current projects.

Some of the companies who experienced difficulty accessing finance reported how limited access to funds had notably impacted their company's future development, in particular their ability to expand and grow. This issue was most prevalent amongst companies with a turnover under €9 million.

FIGURE 3. Impact of limited access to finance on business



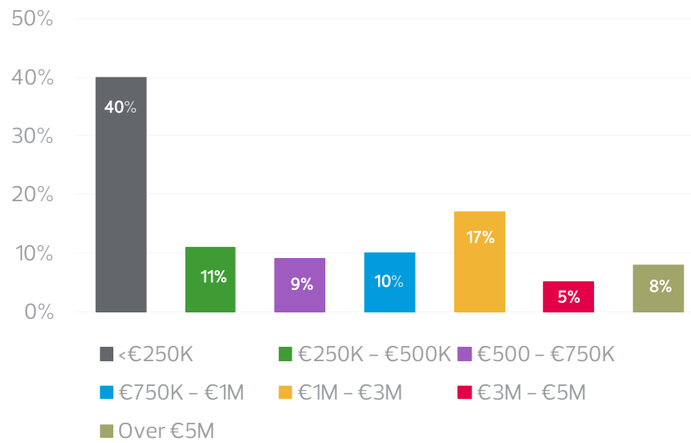
"Having access to finance is critical to our business as without adequate funding it limits the number of projects we can take on as managing cash flow becomes much tighter. If we can take on more projects we can gear up by taking on more staff and very quickly we can grow and expand."

Construction company, Galway

Limited access to finance also notably impacted companies' ability to take on new projects with the issue particularly evident amongst medium and larger sized companies. Lack of finance also restricted many companies' entry into new markets with smaller and medium sized companies experiencing the greatest difficulty.

Staff recruitment and the ability to tender for new projects were also impacted by limited access to finance. The difficulty in recruiting new staff was more prevalent amongst smaller and medium sized companies. Similarly, over half of small and medium sized businesses also experienced a greater difficulty in tendering for new projects.

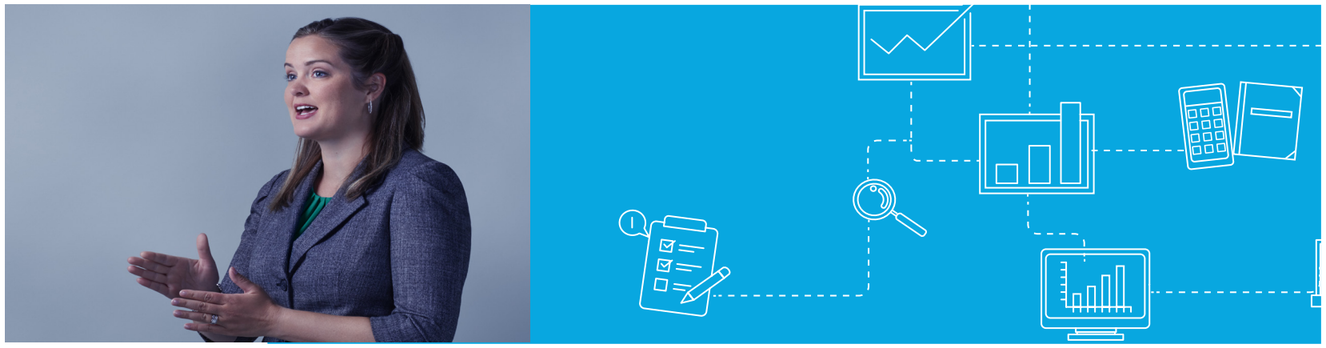
FIGURE4. Projects to be undertaken if finance was available



"If we had the finance available that we need then there are 3 sites we would be in a position to develop and we could be up to developing a 100 houses a year within 18 months. This would be a sustainable number of houses for us to build for the next number of years. The market clearly needs this housing stock as inadequate supply is inflating house prices. But the truth is we cannot get access to funding for land development."

Medium sized construction company, Cork

KEY FINDINGS

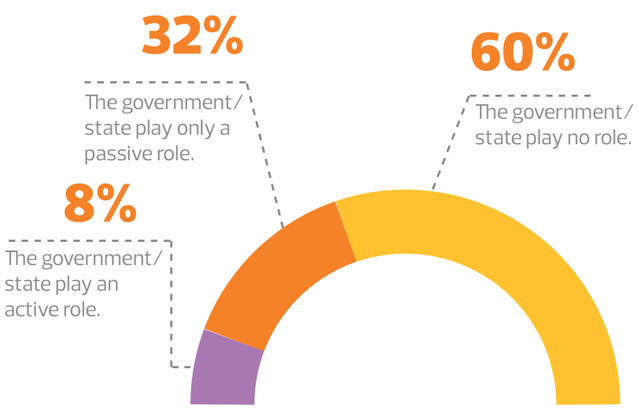


3. Absence of government/state support

The majority of companies were of the view that the government/state played no formal role in enabling companies in the construction industry to access finance.

Furthermore, only 8% held the view that the government/state plays an active role in facilitating construction companies to secure funding. Yet many reported the need for the State to play a more active part by engaging with the financial industry directly to deliver appropriate funding for development opportunities.

FIGURE 5. Familiarity with government support initiatives



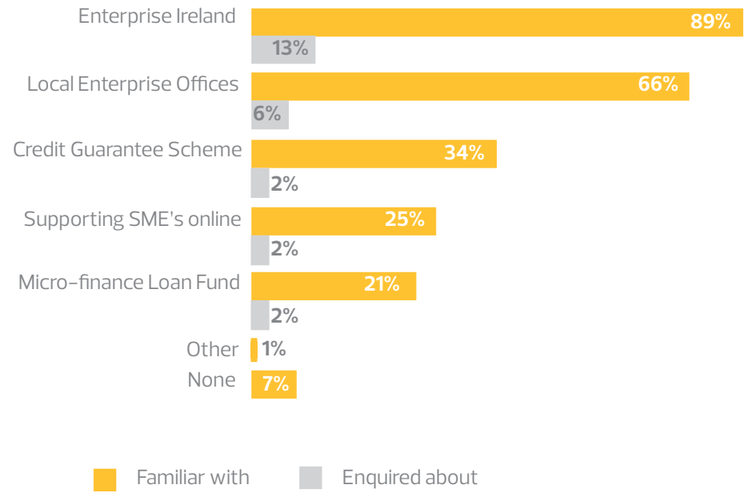
“ The government or state plays no role in helping the construction industry access finance and any such commentary is no more than lip service. If the government really wants to help the sector then it needs to hold the financial institutions to account and to ask them to produce regional figures on lending so that we can really see what money is being made available and in what areas of the country.”

Medium sized construction company, Cork.

A large number of respondents were familiar with a number of government support initiatives, the main ones being Enterprise Ireland and the Local Enterprise Offices. Even though large numbers were familiar with these, only a small portion of respondents had actually enquired about these initiatives.

There was limited awareness about the Credit Guarantee scheme, supporting SME's online and the Micro-Finance Loan fund scheme.

FIGURE 6. Familiarity with government support initiatives



KEY FINDINGS

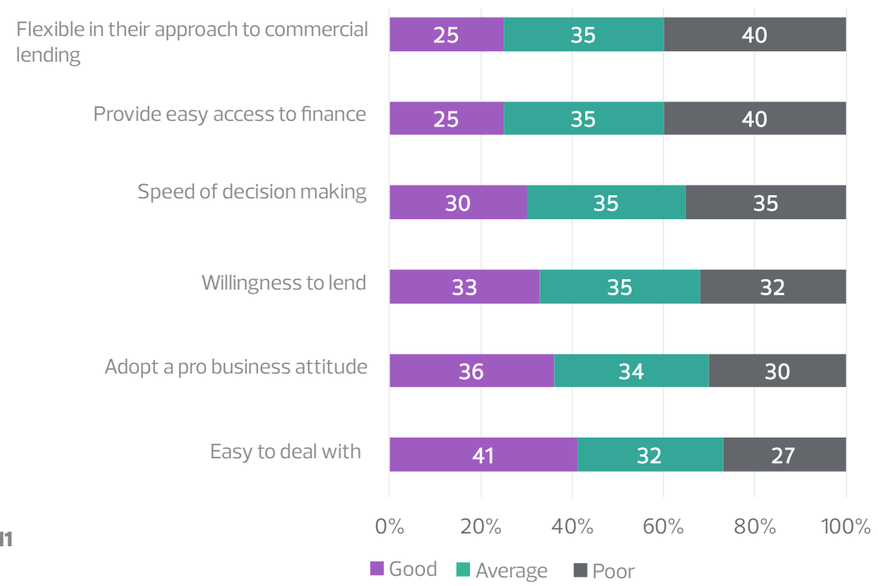
4. Negative past experiences with financial institutions a critical factor

For those companies who have not sought to borrow in the last 12 months, the primary spontaneous reason given was that they prefer not to borrow. However, deeper probing in the one to one interviews suggests that although some companies may prefer to fund construction projects from current funds, very often the reasons why many businesses have not approached the financial institutions are due to negative past experiences including loan refusal in previous years, slow decision making and lack of response.

Financial institutions were generally viewed to be very slow to provide lending for development opportunities and in several cases it was reported that financial institutions openly stated that it was no longer providing finance for such projects. Hence many companies reported that they had disengaged from financial institutions as they were of the view that finance would not be forthcoming.

The negative interactions shared by companies who have disengaged from financial institutions in recent years are also mirrored in the experiences of those companies who have recently sought to secure finance in the last 12 months with only 41% finding institutions easy to deal with.

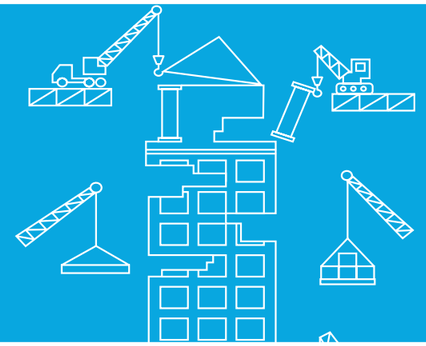
FIGURE 7. Experience of dealing with financial institutions in last 12 months



" I found dealing with the financial institutions to be incredibly bureaucratic and tedious, one of the big issues is the lack of developed personal relationships as people are being constantly moved making it impossible to form a relationship of trust with anyone. I found it almost impossible to get someone to make a decision as things tended to get passed around within the organisation. Also, the paperwork is exhaustive, after about 4 months we still did not have an answer so we left it and no one ever came back to us. "

Small construction company, Galway

KEY FINDINGS



5. Heavy reliance on cash reserves constraining expansion plans

Only 34% of construction companies report successfully borrowing from financial institutions to fund investment in their company in the last 3 years. Furthermore, only 7% report using private equity finance with 5% using bonds and 2% using "other" methods (i.e. partner, client, Nama etc.). Government support initiatives account for 4% of all borrowings by companies in the sector.

Interestingly, the majority of companies have had to fund investment via cash reserves indicating that the financial institutions do not appear to be the driving force behind growth in the construction industry in the last 3 years. In the one to one interviews, it was reported that many of the companies have no other option but to rely on cash reserves. This has the potential to significantly limit the ability of construction SME's in particular investing in their capacity over the coming three years.

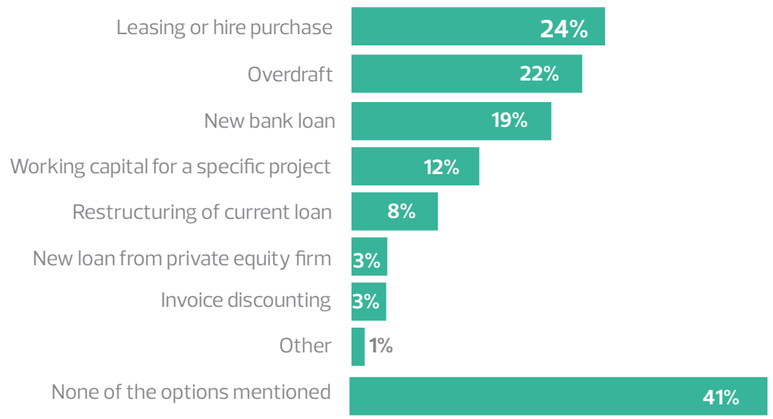
Furthermore, the role of the financial institutions in the future growth of the construction industry remains in question as again only 34% of companies expect to borrow from them in the next 12 months.

FIGURE 8. Sources of finance used or will use

	Last 3 years	Last 12 months	Next 12 months
Cash Reserves	72%	72%	65%
Trade Credit	48%	47%	47%
Bank borrowing	34%	32%	34%
Private equity finance	7%	6%	7%
Bonds	5%	4%	5%
Government support initiatives	4%	4%	3%
Other	2%	2%	3%
None	6%	7%	8%

A low level of engagement with financial institutions is evident when we examine the types of finance requested by construction companies in the last 12 months. Only 19% of respondents requested a new loan from a bank in the last year with a total of 14% successfully securing finance. Furthermore, only 12% requested working capital for a specific project, while 8% requested restructuring of a current loan. 41% of respondents did not request any finance from financial institutions in the last year.

FIGURE 9. Sources of finance requested in the last 12 months



"When we approached the bank's a couple of years ago for funding for a development site, we were told that they no longer provided finance for such projects. We have stayed away from them since as it seemed they were not interested in financing small builders".

Small construction company, Leinster

KEY FINDINGS

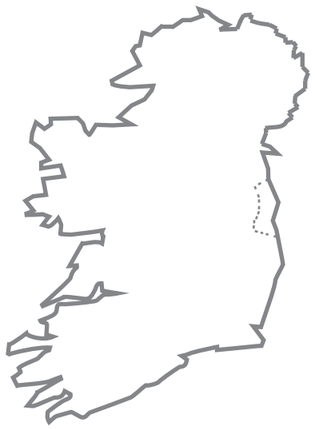
6. Regional and economic disparity

A consistent theme that emerged was the regional and economic disparity evident. In the one to one interviews, a number of respondents based outside of Dublin held the view that financial institutions prioritise Dublin as the prime area for development as prices have recovered more favourably.

Such companies report that financial institutions attach a lower risk profile to Dublin and have therefore prioritised lending to companies conducting projects that are Dublin based.

Conversely those seeking to develop outside of Dublin or even seeking access to finance for refurbishment projects often reported a disinterest from providers of finance. Such companies report that financial institutions have very limited interest in lending for any development or refurbishment projects etc. other than commercial businesses.

Again this is viewed to be the policy of financial institutions that they do not want to lend outside of Dublin as it does not match their risk profile.



"As far as I can see neither the Banks nor the private equity firms have any interest in lending for any development outside of Dublin. It seems to be a policy across the board that property prices outside of the capital have not recovered sufficiently to justify from their perspective and until such time as they do, no further lending is likely to happen."

Medium sized construction company, Galway

"From my experience of trying to access finance, as soon as you mention that the project is outside of Dublin, the institutions just do not engage. Any buildings or land outside of the capital, unless it is a trading asset, the senior debt holder's have no interest."

Medium sized construction company, Midlands

CONCLUSION

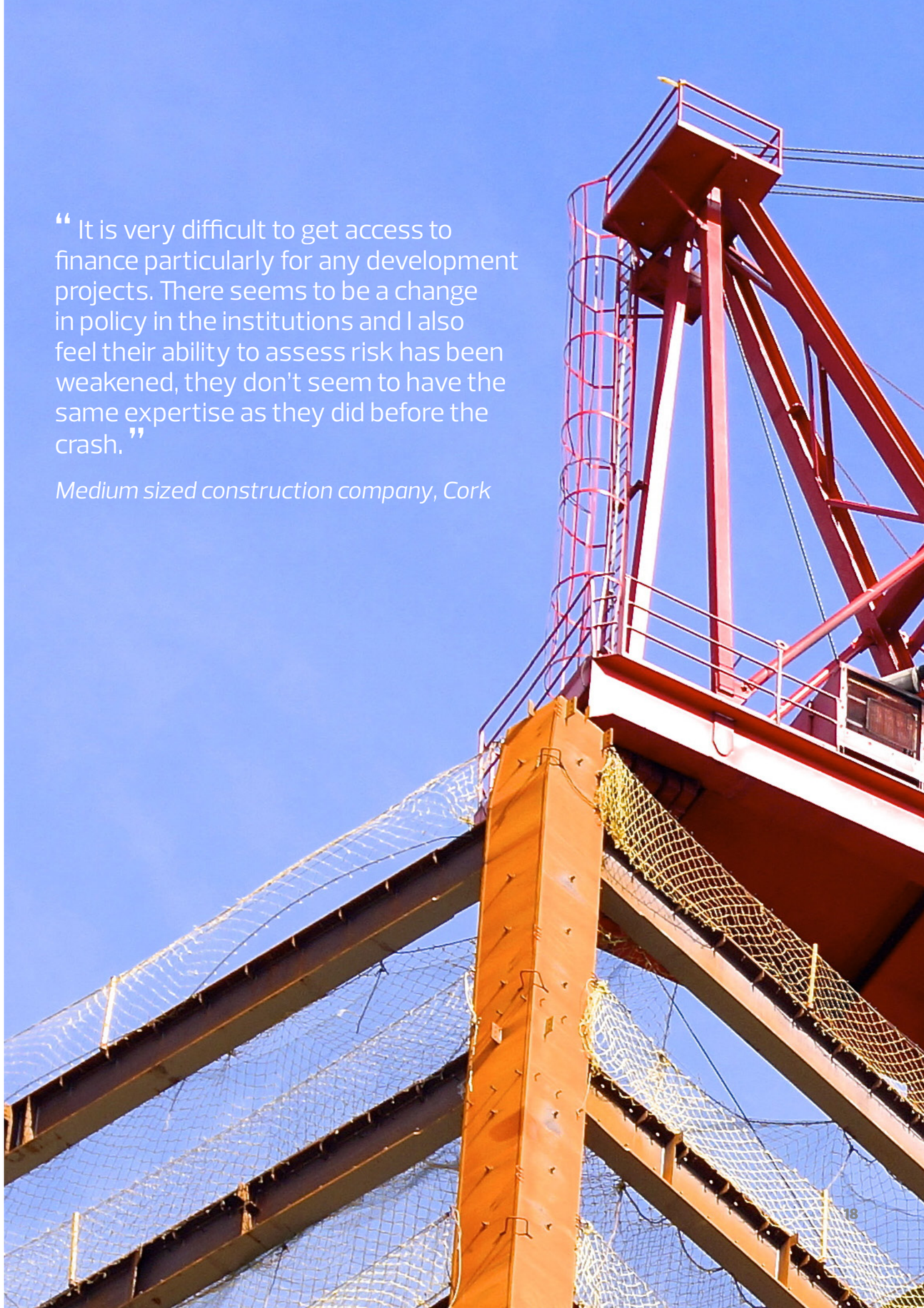
- The CIF members surveyed are encountering difficulty in accessing finance with many disengaging from traditional sources. The CIF members have emphasised the need for a more flexible funding environment in order to encourage and empower companies to undertake projects and to think strategically about long term growth. The development of a sector specific fund for the construction industry would inject much needed finance into the construction sector and enable companies to grow and deliver housing and infrastructural projects. A builders fund similar to the UK Home Building Fund, could support sustainable regional and local construction activity. This funding would enable companies to invest in technology and modern building practices such as Lean and BIM and to expand capacity where demand is viable.

- A number of companies have expressed their dissatisfaction with the difficulties they are encountering when seeking to raise finance. Even those companies who secured finance experienced difficulties in doing so. The survey highlights a reliance on retained funds to undertake projects. This reliance is a limiting factor for any business with growth ambitions. Additional funding is required for working capital which in turn will create capacity within the Sector to undertake additional projects and address supply issues, particularly in housing. One company interviewed stressed the lack of adequate funding available to companies which means they cannot move forward on projects. Another company communicated the need for urgent funding options for house builders which is preventing them from developing much needed housing.

- A large number of the companies' surveyed expressed their loss of confidence in the financial sector with only 34% of companies planning to use bank borrowing to invest in their companies in the next 12 months. A number of companies did not have a positive experience when engaging with banks over the last 12 months citing high interest rates and unwillingness to lend as the main issues. A large number of companies agreed that there needs a be a greater willingness to lend and more flexible payment terms available to companies within the construction industry. There is a perceived need for a change in lending practices and attitudes towards the construction industry.

- Many of the members interviewed felt that they encountered more challenges when trying to access finance as a result of being outside of the Dublin area. One company revealed that financial institutions are not engaging once it is mentioned that the project is outside of Dublin unless it is a trading asset. The companies argue that unless more funding opportunities are made available to regional areas, there will be no scope for developments outside of the greater Dublin area and the housing and infrastructure crisis cannot be addressed.

- Overall a more responsive funding environment is being sought by respondents to help them realise ambitious growth plans and to meet increasing demand for construction products and services.



" It is very difficult to get access to finance particularly for any development projects. There seems to be a change in policy in the institutions and I also feel their ability to assess risk has been weakened, they don't seem to have the same expertise as they did before the crash. "

Medium sized construction company, Cork

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