

Market Intelligence

Q1 2011

BTY Group's Market Intelligence newsletters analyze industry trends to provide our clients with insights about current and future building markets in British Columbia, Alberta, Saskatchewan, Ontario and Quebec.

Infrastructure investments sustain construction levels, stabilize costs

2011 will be a good year to kick off construction with cost increases expected to be moderate for most provinces before returning to normal levels in 2012.

Construction costs declined sharply in 2009 after the global economic storm hit. The industry began to turn around in 2010 and costs have evened off at mid-2006 levels, about 35% higher than they were in 2001.

The cooling residential sector in the second half of 2010 will continue to moderate cost increases through 2011. Residential construction was a prime driver of record cost escalation rates in 2007 and 2008. But with residential construction stabilizing over the next two years, expect annual industry increases to return to historical norms of 2% to 3% by 2012.

A wave of major new infrastructure projects will continue to sustain construction levels and stabilize costs. The deadline extension of projects under the federal government's \$40 billion federal stimulus fund to October 31, 2011 will give the wave an extra lift.

Quebec leads the way with health care and transportation mega-projects. Ontario is getting housing and sports venue projects underway for the Pan American Games in 2015. In BC, it's highways, transit, health care and social housing. In Alberta, it's renewed investment in oil sands projects, and in Saskatchewan, it's investment in the energy and resource sectors, potash in particular.

CMHC is projecting housing starts nationwide to decline from 186,200 in 2010 to 174,800 in 2011. Only BC and Alberta are expected to see increases, with the remaining provinces expecting slight declines.

Cost escalation will be flat to moderate across the country. Quebec and Saskatchewan may well see the highest escalation rates – between 6% and 10% in 2011 and 2012. These two provinces are now like BC during the run-up to the Olympics, when multiple, simultaneous major projects stretched the industry's capacity, reducing competition and fueling cost increases.

Ontario, which experienced substantial cost declines during the recession, will see an increase of 2% to 5% in 2011 and 2012. BC and Alberta will see rates of between 1% and 2% in 2011.

Offsetting factors balance out cost increases

Each region has its own unique set of factors determining construction costs. Overall, however, some factors are contributing to cost escalation while others are acting as a brake on increases.

Upward pressure on pricing is coming from:

- Steadily rising oil prices;
- Higher commodity prices that could cause an increase in materials costs;
- Increased spending on infrastructure; and
- Continuing strong immigration.

Downward pressure is coming from:

- Slower economic growth forecast for 2011;
- Expected fall-off in housing starts;
- Strong competition among contractors and suppliers for available projects;
- A stronger Canadian dollar lowering the cost of imported goods; and
- Tighter restrictions on mortgage lending.

National Escalation Update – Selected Provinces



2011: 1-2%
2012: 1-2%
2013: 2-3%
2014: 2-3%

Transportation infrastructure sustains construction activity

With its residential sector expected to stabilize in 2011 and capital costs of major projects under construction valued at \$62.8 billion, BC has been relatively well cushioned from 2009 and 2010 declines in industrial and commercial building. While the advent of the HST in BC caused a sharp spike in new home sales in 2010 prior to the tax's July 1 implementation date, in the long term it is expected to have a slightly negative impact due to the high proportion of BC's relatively pricey homes above the tax-free threshold of \$525,000. On the other hand, the HST is expected to bring construction firms substantial savings since they can now recover more cost inputs. The BC Business Council estimates that the cost of producing goods and services in the province will drop by about \$2 billion annually as a result of the HST, leading to increased private sector investment that will particularly benefit commercial and industrial construction. As of Q3 2010, such cost savings had yet to be reflected in Statistics Canada's indices.

Another cost stabilizer in 2011 will be the moderate level of construction wage increases anticipated in BC. A survey by the Independent Contractors and Businesses Association of BC on wage and benefits expectations for 2011 and 2012 showed forecast increases of 2.15% in 2011 and 3.47% in 2012.

Major infrastructure projects helping to sustain construction levels include:

- The proposed \$6 billion Site C dam and Mackenzie Gas Project.
- \$3.1 billion Gateway Program: this involves widening Highway 1, twinning the Port Mann Bridge (2014 completion), South Fraser Perimeter Road (2013 completion).
- \$1.4 billion Evergreen Rapid Transit Line (2015 completion).
- \$565 million renovation of BC Place stadium.
- Continuing and new major social and public safety infrastructure projects; these include the redevelopment of Children's and Women's Health Centre; Surrey Memorial Hospital Expansion, Royal Columbian Hospital Expansion, Mid-Vancouver Island Hospital Project, and supportive housing sites and Single Room Occupancy Hotel renovations in Vancouver.

Major private sector projects include:

- \$2 billion Naikun Wind Project in Haida Gwaii.
- \$500 million Telus Office and Residential Towers. Three other developers (Oxford, Bentall and Aquilini) are also planning new office projects.
- \$450 million entertainment complex at BC Place (2011 start, 2013 completion).
- \$250 million Guildford Town Centre Expansion.

Rising oil prices and renewed oils sands investment re-energize economy

Steadily rising oil prices and lower construction costs have renewed interest in Alberta's oil sands. In 2010, Asian investments alone exceeded \$8 billion. Growth in the oil sands is expected to continue at a sustainable rate but not return to the pace of recent years. (In 2008, oil sands investments reached \$19.2 billion.) With drilling activity in 2010 more than doubling from the slow pace in 2009, energy sector strength will drive Alberta's economy. TD Economics predicts that Alberta will lead Canada in 2011 with 3.5% GDP growth.

Although the residential sector rebounded in 2010, growth will remain modest through 2011. The Construction Sector Council projects slight increases in commercial and industrial building in 2011 and 2012.

Major infrastructure projects in Alberta include:

- \$776 million West Light Rail Transit Expansion in Calgary (completion 2013).
- \$1.42 billion Northwest Ring Road in Edmonton (completion 2011).
- Ongoing projects include the \$1.1 billion expansion at the Edmonton Airport and \$1.3 billion concourse at Calgary Airport.
- \$8.1 billion upgrade to the energy transmission grid to be in service by 2012.



2011: 1-2%
2012: 2-3%
2013: 3-4%
2014: 3-4%

National Escalation Update – Selected Provinces



2011: 6-8%
2012: 8-10%
2013: 6-8%
2014: 4-6%

Resource surge eclipses dip in new housing starts, cut to government spending

Buoyed by a resurgent potash industry, investment in the resource sector and continuing expansion of the service sector, Saskatchewan is expected to be one of the country's strongest performers in 2011, with real GDP growth of 3.3%. The province had a record level of net migration in 2009, and this elevated level is expected to continue into 2011. The in-migration helped sustain the 2010 rebound in housing starts, which is forecast to decline slightly from 5,175 in 2010 to 4,900 in 2011. Unlike other provincial governments, Saskatchewan is cutting infrastructure spending, allocating \$302 million for road and highway projects and \$177 million for municipal infrastructure in 2010 – 2011. Major projects include:

- Twinning of Highway 11, the Lewvan Drive interchange, the Yorkton Truck Bypass, 470 kilometres of rural highway and bridge replacements in Saskatoon.
- Canadian Pacific Intermodal facility in Regina (construction start in early 2011).
- Health care projects including the \$200 million Children's Hospital in Saskatoon and several residential care facilities.
- Proposed new Mosaic Stadium in Regina at more than \$200 million.
- Private-sector investment in residential development in Regina and Saskatoon.



2011: 2-4%
2012: 4-5%
2013: 3-4%
2014: 3-4%

Transportation, energy and social infrastructure keep up momentum

Ontario is half way through the province's largest two-year investment ever in infrastructure that helped it lead Canada with a projected 3.5% GDP growth in 2010. But the majority of non-residential stimulus investments will end in 2010 and early 2011. Just as that surge winds down, Ontario will be gearing up for new facilities for the 2015 Pan American Games in Toronto. That expansion, with ongoing infrastructure projects and a solid commercial and industrial construction recovery from 2009 levels, will help offset a decline in residential building in 2011 that most analysts have predicted. However, a sharp surge in Toronto multi-unit starts in November 2010 pushed Ontario housing starts for the year 14% higher than in 2009. This could stoke a stronger residential sector in 2011.

The impact of the HST is expected to have only a minor, longer-term impact on new home construction since the majority of new homes in Ontario (75%) are currently priced under the tax-free threshold of \$400,000. Overall, The Ontario Construction Secretariat predicts the HST will bring the provincial construction industry \$2.3 billion in savings. As of Q3 2010, such cost savings had yet to show up in Statistics Canada's indices.

New housing starts are projected to rise to 59,900 units in 2010, up from 50,370 units in 2009, but decline to 55,000 for 2011. Commercial and industrial construction will have modest growth through 2011 and 2012, according to the Construction Sector Council.

Major new and ongoing infrastructure projects include:

- More than \$2 billion for the Pan Am Games Athletes Village, just east of Downtown Toronto.
- \$700 million for 2015 Pan American Games sport venues.
- \$2.6 billion Toronto-York Spadina Subway Extension (completion 2015) and \$1.5 billion Windsor-Essex Parkway (completion 2014).
- \$7 billion investment in wind and solar power generation from a consortium led by Samsung C&T Corporation and the Korea Electric Power Corporation, (completion 2015), and Hydro 1's ongoing \$2.3 billion investment in new transmission and distribution lines.
- Major ongoing and new infrastructure includes the Centre for Mental Health Project, Women's College Hospital Redevelopment, Bridgepoint Hospital, the Ontario Provincial Police Modernization Project, St. Joseph's Healthcare Hamilton West 5th Campus Project, and renovations at London Health Sciences Centre (LHSC).
- \$26 billion nuclear replacement / refurbishment program over the next decade.
- \$640 million Union Station renovation (completion 2015).

National Escalation Update – Selected Provinces



2011: 7-8%
2012: 6-7%
2013: 5-6%
2014: 3-4%

Mega-projects to stretch construction industry capacity

Quebec is about to experience what BC did in the run-up to the 2010 Winter Olympic Games: multiple, simultaneous large-scale horizontal and vertical infrastructure projects that stretched construction industry capacity. In 2009, Quebec launched its \$42 billion infrastructure plan to upgrade, renew and maintain public infrastructure over the next five years. Such public investment will help sustain activity against a decline in the residential sector and modest commercial and industrial activity.

Residential construction is forecast to decrease in 2011 after a strong 2010. New housing starts are expected to decline from 50,310 in 2010 to 45,000 for 2011. Commercial and industrial construction are forecast to see steady, albeit modest, growth. With these sectors relatively stable, intensified demand from new infrastructure will exert upward pressure on labour costs as well as key materials, including concrete.

Major projects include:

- \$30 billion in ongoing commitments to hydro and wind power projects, including the \$6.5 billion Romaine project (first commissioning 2014, completion 2020).
- \$3 billion Turcotte Interchange in Montréal (completion 2016), \$1.5 billion Autoroute 30 (West Side) and \$777 million Autoroute 175 (completion 2012).
- More than \$3 billion for major healthcare projects: Centre hospitalier de l'Université de Montréal and McGill University Health Centre (completion 2014), and Centre de recherche de hospitalier de l'Université de Montréal (completion 2013).
- \$575 million Pratt & Whitney Mirabel Aerospace Centre.
- \$100 million Shriners Hospital for Children.

Independent Certifier Role Crucial to Public Private Partnerships Projects

and transportation infrastructure projects now procured using the P3 model. Despite this model's widespread use, misperceptions remain about the roles and responsibilities that it entails, in particular those of the Independent Certifier (IC). The IC ensures compliance with the drawings and specifications, and ultimately issues the Certificate of Service Commencement / Substantial Completion that triggers the start of the term of the agreement.

As the pivotal link between the public authority and the consortium undertaking a P3 project, an IC has a duty of care to both parties and can make a critical contribution to mitigating risk for both sides. An experienced IC can educate participants, facilitate process and resolve issues without invoking the formal Dispute Resolution Process.

Canada is emerging as a global leader in Public Private Partnerships (P3) projects with up to 20% of social

An experienced IC is especially critical when public authorities and/or construction consortia lack extensive experience at the project team level or a thorough understanding of the process from inception to completion. BTY Group's experience providing the IC role (and/or Lenders Technical Advisor (LTA)) on more than 30 P3 projects across Canada has shown that no two projects are ever alike, even if they follow project agreements that are, in many respects, similar.

An experienced IC with local knowledge can be especially valuable to foreign-led consortia undertaking P3s with public authorities in Canada. Lack of knowledge of local building codes, statutory obligations and regulations, the builders lien act and sub-trade competence, and the inability to get to the construction site at a moment's notice can add significant risk to an otherwise well planned project.

Having advised on more than CDN\$15 billion in P3 capital investment in Canada since 2000, BTY Group is a leader in the evolving use of the P3 model.

We would like to acknowledge and thank the ICBA (Independent Contractors and Businesses Association) for their contribution to this newsletter. www.icba.bc.ca

The opinions expressed in this newsletter are those of BTY Group and are provided as information only. Readers are cautioned on the use of the data provided. BTY Group strongly recommends that readers retain the services of a Professional Quantity Surveyor prior to establishing budgets for their projects. Media inquiries should be directed to Saira Muzaffar at 416-596-9339 or sairamuzaffar@bty.com.

