Ontario Construction Secretariat

EYE ON ICI NEWSLETTER

OCTOBER 2013

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The 2013 OCS Tripartite Conference - Deerhurst Resort, Huntsville, Ontario

EVENT RECAP

The 5th Biennial OCS Tripartite Conference

The Ontario Construction Secretariat's multi-trade Tripartite initiative was created with the goal of strengthening labour, contractor and owner relationships and identifying best practices to enhance the position and value of Ontario's unionized construction industry.

On August 11^{th}-14^{th}, the OCS hosted its 5^{th} biennial OCS Tripartite Conference in Deerhurst. The focus of the conference was on change management and leadership to help drive safety, workforce sustainability and implement Tripartite Best Practices. The popularity of the event continues to grow as there was another increase in delegate attendance this year. Owner attendance increased by 25% and a significant milestone was achieved as all three ICI sectors were represented for the first time.

On the opening night, conference delegates were treated to an inspirational talk on improving teamwork by keynote speaker and former NBA All-Star Mark Eaton. On day two, attendees were briefed on key OCS research projects and were given a progress report on the regional Tripartite process. As a reminder, the regional process involves working with regional to partners implement best practices developed to enhance stakeholder relations add value and reduce risk. Delegates then engaged in some lively discussion in caucus sessions about OCS research and the path forward for the Tripartite initiative.

Leadership Panel (L to R): George Pappas - Union Gas, Ian Turnbull - Aecon Industrial, John Telford - U.A.

On day three, an Owner-Contractor-Labour panel comprised of George Pappas of Union Gas, Ian Turnbull of Aecon and John Telford of the U.A. International Office discussed change management, highlighting different ways that they had dealt with change in their respective workplaces. Delegates had an opportunity to interact with the panelists and appreciated the candor of the panel.

Overall, the OCS is pleased with the increase in owner attendance at the event and with the valuable insight provided by attendees on how to drive the industry forward.

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5TH BIENNIAL OCS
TRIPARTITE
CONFERENCE
2013

2013 TRIPARTITE LEADERSHIP AWARD
Presented to Larry Brokenshire of Aecon Industrial


(L to R): Stew Stevenson - OCS Tripartite Coordinator, Joe Keyes - OCS President, Larry Brokenshire - Aecon Industrial, Sean Strickland - OCS Chief Executive Officer.


Conference delegates & families enjoying an outdoor afternoon reception


Minister of Infrastructure, Glen Murray


Tripartite delegates networking


Comedian Glen Foster


Deerhurst Resort in Huntsville, Ontario - A beautiful location for the 2013 Tripartite Conference


Mark Eaton and Minister Glen Murray together with OCS CEO Sean Strickland and OCS Board members


Keynote speaker, Mark Eaton delivers a powerful message

CURRENT ANALYSIS AND NEAR TERM OUTLOOK:
TRENDS IN INVESTMENT AND BUILDING PERMITS

Total ICI Investment

Seasonally adjusted, constant dollar ICI investment in Ontario dipped 0.5% (q/q) in the 2nd quarter to $4.2 billion. Over the first half the year, ICI investment totalled roughly $8.3 billion, down slightly from January-June 2012.

The dominant storyline that has taken shape is the diverging performance between the public and private sectors. Recall that the government provided emergency stimulus during the recession in an attempt to buffer the economy from its effects. This move was on top of already-committed public infrastructure dollars. The result was a 31% increase in institutional (i.e. public) investment from the end of 2008 to 2011. With the stimulus program ending in 2011 and large-scale institutional projects winding down, institutional investment has unwound, falling 4% in 2012 and followed by another steep decline in 2013.

As most construction stakeholders had anticipated this development, their concerns centered on whether the private sector could be the source that would power investment growth. To that end, industrial and commercial (i.e. mostly private) investment has taken the baton from the public sector, marching forward to the tune of five-straight quarters of positive growth, including 2013Q2. However, since industrial and commercial investment began their upward trek in the 2nd quarter of 2012, there have been larger drops in institutional investment, resulting in a 2% decline in the overall ICI market (see Figure 1). It's worth noting that some investment classed as "private" is financed by public dollars (such as transportation terminals) meaning that the decline in public investment isn't quite as severe as what is implied by the institutional investment data, nor are the private investment figures as high as what is seen when commercial and industrial investment are summed. However, the larger story of contrasting public vs. private investment is unchanged.

The silver-lining for unionized construction comes out of the fact that industrial investment has rebounded aggressively since the end of the recession, as the unionized sector tends to be a large player in the industrial market.

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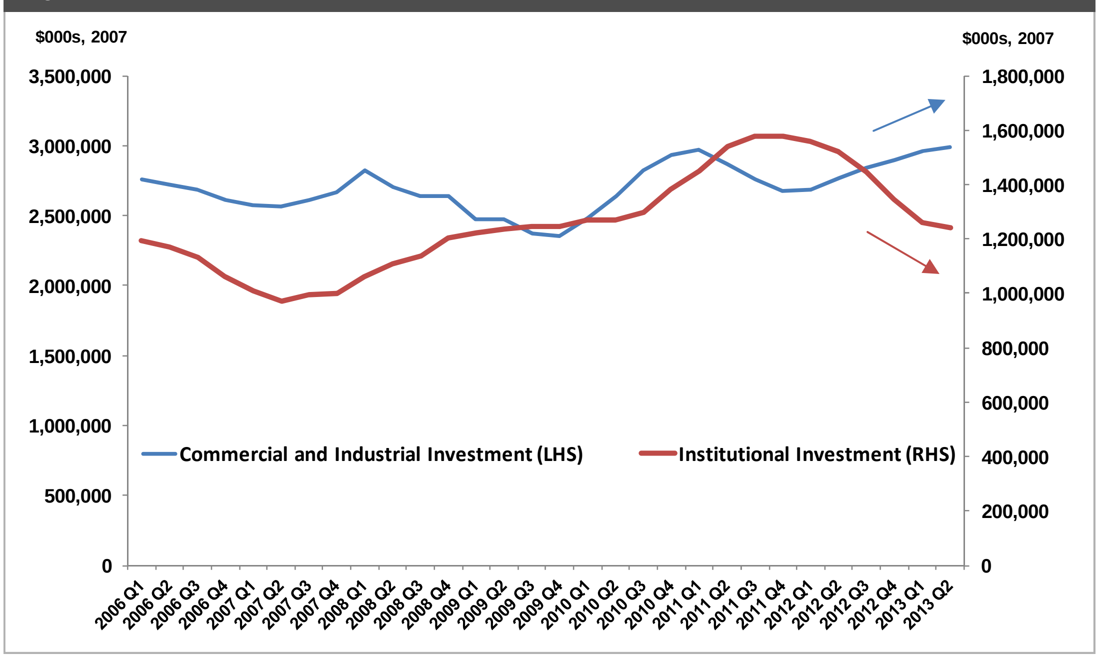
Figure 1: *Commercial and Industrial versus Institutional Investment*



Source: Statistics Canada, OCS calculations

> ***"The silver-lining for unionized construction comes out of the fact that industrial investment has rebounded aggressively since the end of the recession"***

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The analysis below details trends in each of the three ICI markets

Industrial Market

Current Trends

$517 million was invested in industrial buildings in the 2nd quarter, up 0.9% from the 1st quarter and 14% higher than a year ago. Over the first half of the year, there was over $1 billion worth of industrial investment, the highest such level since 2008.

Once again, Hamilton led the way in terms of investment growth, advancing 25% (q/q) in the 2nd quarter on the back of the Maple Leaf Foods processing plant project. Solid growth was also observed in the St. Catharines-Niagara CMA (Census Metropolitan Area), thanks to the Cytech chemical plant expansion in Niagara. Industrial investment was moderately higher in Toronto, lifted by projects in the western part of the CMA, according to real estate specialist CBRE. Over Jan-June, substantial gains were made in Brantford, Guelph, Hamilton, Kingston and Oshawa versus the same period in 2012. Declines were observed in Windsor, Peterborough, Thunder Bay, Kitchener-Waterloo-Cambridge and London.

Outlook

Building permit data – which is a leading indicator of investment – is pointing to slightly softer investment over the next few quarters. Industrial building intentions fell 3% over the first half of the year, compared to the same period in 2012. Permit values were lower for factories and plants and mining and agricultural buildings while being higher for transportation (i.e. transit terminals) and utilities buildings (i.e. sewage treatment plants).

Commercial Market

Current Trends

In the second quarter, commercial investment edged up 0.3% (q/q) to $2.4 billion and was 5% higher than its year-ago level. Over the first half the year, commercial investment totalled nearly $5 billion – only slightly lower than 2011's record level. Simply put, the province's commercial market has been very strong so far in 2013.

The Toronto CMA has been by far the largest contributor to the strength in commercial investment, thanks to robust office building construction in the downtown core. Hamilton has also been a strong source of commercial investment this year, thanks to construction of a major office building, arena and hotel as well as a slew of smaller retail and office projects. In Windsor, commercial investment has quietly surged nearly 200% higher so far this year compared to the first half of 2012 thanks in part to a new aquatics centre, but also because the level of investment was so low last year. There were also notable gains made in Ottawa and London.

On the flip side, first half declines were registered in 7 out of 15 CMAs, with the largest declines belonging to Barrie, Brantford, Guelph and Kitchener-Waterloo-Cambridge.

Outlook

Declining building permits raises the risk that commercial investment could be lower in coming quarters. Over January-June, commercial building intentions fell 14%, compared to the same period in 2012. At $2.6 billion, the value of first-half permits was the 2nd lowest in the past 6 years. Lower permits for retail buildings were the primary driver of the decline, consistent with a modest trend in retail sales growth. The value of permits issued for office buildings was also lower, despite solid office building construction in the GTA. The main reason for this dichotomy is that the office buildings currently under construction in Toronto were already permitted for in prior years and were therefore captured in earlier permit data.

Positive growth in building intentions was registered for hotels and restaurants, service stations (i.e. gas stations), and laboratories.

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Institutional Market

Current Trends

Institutional investment dropped 2% over April-June versus the first quarter, marking the seventh straight quarterly decline. At $1.2 billion, the level of investment was 20% lower than its year-ago level. Over Jan-June, institutional investment was valued at $2.5 billion – or about the same level managed by the province before the stimulus funding kicked in.

The drop in institutional investment was fairly narrow across CMAs with 5 out of 15 posting quarterly declines, "led" by London, Guelph and Thunder Bay.

Only 6 out of 15 CMAs managed to increase in the first half of the year versus the same period in 2012 highlighted by Peterborough, Oshawa and Ottawa, though only Ottawa's level of investment was significantly above its recent trend.

Outlook

Building permit trends are indicating that there will be further declines in institutional construction going forward. The value of institutional building intentions dropped 18% in the first half of 2013 compared to a year-ago – a larger decline than either the industrial and commercial markets. The moderation brought the value of first half intentions to $1.4 billion, the lowest amount since 2006. Looking on the bright side, permit issuance was up fairly strongly in the 2nd quarter, though further growth will be needed before we can confidently say that the fortunes of the institutional market have turned for the better. Looking across building types, declines were concentrated in permits for government buildings, long-term care facilities and religious buildings. Meanwhile increases were recorded in building intentions for hospitals and schools.

"The private sector is doing its share to boost construction, but is being outweighed by sharply declining public investment"

Bottom Line

The private sector is doing its share to boost construction, but is being outweighed by sharply declining public investment, leading to no growth in the ICI market. With first-half building permit values lower, the risk is that investment remains subdued in coming quarters.

ONTARIO REGIONAL PERMITS UPDATE

NORTHERN ONTARIO

Soggy permit issuance in April helped send **industrial** permit values lower in the first half of the year. The Jan-June decline (compared to the same period a year-ago) was entirely accounted for by Northwestern Ontario. Conversely, there was a sharp pick-up in building intentions in Northeastern Ontario, thanks in part to permitting for work at the Sudbury Wastewater Treatment Plant.

Commercial building intentions were higher in the first half of the year (compared to Jan-June 2012) with gains occurring in both the first and second quarters. Permit values were higher in both Northwestern and Northeastern Ontario with the former strengthened by permitting for a new medical office building and the latter lifted by retail alteration work.

Permit Values - April to June - 2013

Sector	Value (in 000s)	% Change
Industrial	$41,322	-33.8%
Commercial	$100,659	41.7%
Institutional	$125,365	-21.2%
Total ICI	$267,346	-8.6%

Source: StatsCan

Despite a massive permit issued for a new long-term care facility in Thunder Bay, **institutional** permit values dropped in the first half of the year (versus the same period in 2012). Despite the decline, the first half level of intentions was healthy. This year marked the 2nd straight where there was a major institutional permit issued in Thunder Bay.

EASTERN ONTARIO

There was lower **industrial** permit issuance in both Ottawa and Kingston-Pembroke in the first half of the year (compared to the same period in 2012). These two economic regions comprise Eastern Ontario. At $92 million, the level of permits issued was only "so-so" for the region. The major industrial project is the Ottawa LRT, where site-preparation work began in July.

Over Jan-June, **commercial** building intentions dropped to their lowest first -half level since 2008, continuing their unwind from a huge 2012. Like the industrial sector, declines were observed in both Ottawa (consistent with upward trending office vacancy rates) and Kingston-Pembroke (despite solid support from a new aquatics centre being built).

Permit Values - April to June - 2013

Sector	Value (in 000s)	% Change
Industrial	$92,080	-15.1%
Commercial	$329,019	-29.9%
Institutional	$159,931	-9.1%
Total ICI	$581,030	-22.9%

Source: StatsCan

Institutional permit values declined over the first half of the year (compared to Jan-June 2012), extending the trend of subdued permit issuance in place since 2010. The future does hold some promise for the institutional sector, with Infrastructure Ontario noting that major hospital projects are in the pipeline in Hawkesbury, Kingston, Brockville and Ottawa.

GTA ONTARIO

A strong first quarter propelled **industrial** building intentions higher in the first half of the year. So far in 2013, there has been a below average level of permits issued, pointing to more moderate industrial construction going forward. CBRE (a commercial real estate services firm), indicates that current construction in the GTA is skewed towards the west part of the region in places like Mississauga and Milton.

The decline in **commercial** permit values in the first half of 2013 represents an unwind from a very strong 2012 level and does not indicate weakness in the market. However, it does point to some slowing in commercial construction in the near-future. The market is being fuelled by office building in Metropolitan Toronto with 7 new buildings either under construction or starting soon.

Permit Values - April to June - 2013

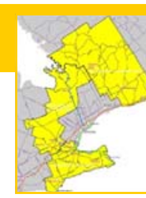
Sector	Value (in 000s)	% Change
Industrial	$367,880	4.0%
Commercial	$1,367,900	-17.8%
Institutional	$592,379	-28.4%
Total ICI	$2,328,159	-18.2%

Source: StatsCan

Institutional building intentions were lower in the first half of 2013, with declines in both the 1st and 2nd quarters of the year. $592 million worth of permits issued represents the lowest level since 2009, as the region continues to cool off on the heels of three huge years.

ONTARIO REGIONAL PERMITS UPDATE

CENTRAL ONTARIO



Permit Values - April to June - 2013

Sector	Value (in 000s)	% Change
Industrial	$253,661	-3.8%
Commercial	$592,136	8.6%
Institutional	$369,290	27.0%
Total ICI	$1,215,087	10.5 %

Source: StatsCan

Declining **industrial** building intentions in Hamilton-Niagara drove a drop in permit values in the first half of the year (compared to Jan-June 2012), despite a large permit issued for an industrial warehouse in Hamilton. Permits were also lower for the Muskoka-Kawarthas region. Conversely, values were higher for Kitchener-Waterloo-Barrie (KWB), thanks to upcoming major alteration work in Barrie.

Strength in Hamilton-Niagara propelled **commercial** building permit values higher in the first half of the year. The largest commercial permit issued was for an office building in Hamilton, with additional support coming from permitting for the new Tim Hortons Field. Permits in KWB were modestly lower over Jan-June, consistent with still-high vacancy rates. They were also lower in Muskoka-Kawarthas.

Hamilton-Niagara accounted for over 90% of the gain in **institutional** building intentions in the first half of the year, versus Jan-June of last year. The major permit issued in Hamilton-Niagara was for new construction at McMaster University. There was a nice pop in the value of permits issued in Muskoka-Kawarthas while institutional permit values were slightly lower in KWB.

SOUTHWESTERN ONTARIO

Permit Values - April to June - 2013

Sector	Value (in 000s)	% Change
Industrial	$223,227	1.0%
Commercial	$212,222	-26.8%
Institutional	$110,448	-43.2%
Total ICI	$545,897	-22.6%

Source: StatsCan

Industrial permit values were up modestly in the first six months of 2013 (versus the same period in 2012) as the region further distanced itself from its recession doldrums. The increase was entirely accounted for by the London region, where there was a significant value of permits issued in the first quarter. In Windsor-Sarnia, permit issuance fell to a disappointingly low $59 million over Jan-June while also dropping in Stratford-Bruce.

Commercial building intentions fell to a below-average level in the first half of the year, pointing to slower commercial construction going forward. The big story was Windsor-Sarnia, where commercial permit values dropped 63% as they are unwinding from a strong 2012. The other two sub-regions were essentially flat in terms of permit growth.

Institutional permit values retrenched significantly over Jan-June, falling to their lowest level since 2005. Declining building intentions in London and Windsor-Sarnia more than offset a gain in Stratford-Bruce. In Windsor-Sarnia, permit values are unwinding from their sizzling 290% gain in 2012. The value of permits issued was so low in London that any further declines are unlikely.

TOP CONSTRUCTION PROJECTS STARTED - APRIL TO JUNE 2013

PROJECT	CITY	VALUE
Cami Assembly Plant Expansion	Ingersoll	$250M
Pan Soccer Stadium, Velodrome, Athletics Stadium	Hamilton, Milton, Toronto	$206M
One York Street Office Building	Toronto	$156M
Ashbridges Bay Water Treatment Plant Alterations	Toronto	$146M
Leslie Street Connection Track	Toronto	$104M
BioAmber Sarnia Succinic Acid Plant	Sarnia	$80M
Niagara-on-the-Lake Outlet Centre, Phase One	Niagara-on-the-Lake	$61M
Apartment and Commercial Building	London	$52M
Lambton-to-Longwood Transmission Upgrade	London	$40M
St. Catharines Performing Arts Centre, Main Building	St. Catharines	$36M

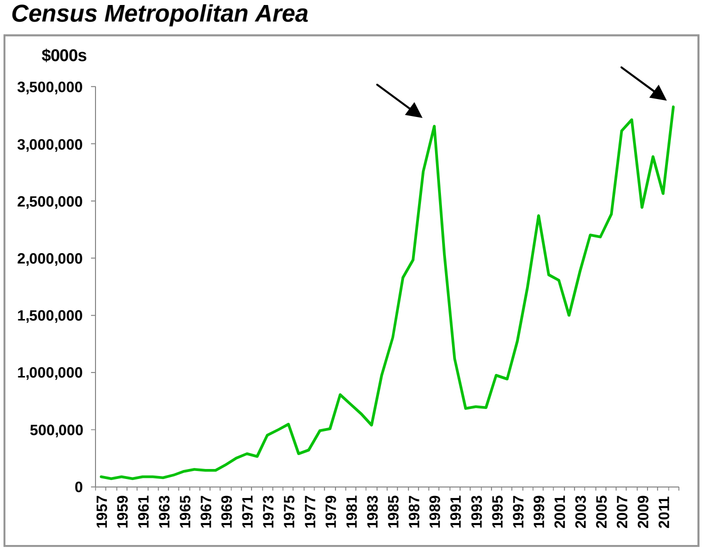
Source: Reed Construction Data, Industrial Info Resources

TORONTO'S COMMERCIAL MARKET:
IS IT HEADING FOR A MELTDOWN?

Analysts have noted that Toronto's commercial market is booming and that the last time construction was this robust was in the late 1980s – early 1990s (see Figure 1). CBRE (a commercial real estate services firm) notes that there are no less than 7 major office buildings currently under construction, including the MaRS Discovery District Phase 2, the Bremner Tower, RBC Waterpark Place, the Queen Richmond Centre West, the Bay and Adelaide Centre East, and office towers at 1 York Street and 100 Adelaide Street West.

When we noticed this fact, suffice it to say that we were a little troubled. Why the concern? As you'll recall, the late 80s – early 90s period was home to a huge speculative overbuild in the city's commercial market, followed by a spectacular crash. As a result, the value of commercial construction (as measured by building permits) dropped from over $3 billion in 1989 to a mere $680 million in 1992 and remained stagnant for a few more years. Looked at another way, the market was basically in a recession for 5 years. Given this, we wanted to assess whether the current development cycle would end in the same ugly manner, or if it will be different this time.

Figure 1: ***Commercial building permit values, Toronto Census Metropolitan Area***



Source: Statistics Canada

What is driving the construction boom?

It's helpful to trace out some of the possible reasons why Toronto's commercial market is running so hot. There are a multitude of factors one can point to, including:

1) Low downtown office vacancy rates: CBRE indicates that the vacancy rate for the downtown office market is currently at an ultra-low 4.7%, compared to a long-term average of around 8%. Similarly, the vacancy rate in the financial core is a modest 5.6%, much lower than its 7.1% historical norm. Low vacancy rates are indicative of tight supply conditions and an incentive to build, given demand.

2) Capitalization rates are attractive: Capitalization rates measure the annual return from owning a commercial building. Current capitalization rates offer a good return, helping make commercial real estate an attractive investment. For example capitalization rates in the downtown core ranged from 5% to 6.25% in the second quarter according to Colliers International, a nice premium over the roughly 2.1% average return on the 10-year benchmark Government of Canada bond.

3) Toronto is a great place to have a presence: The city boasts a highly educated workforce, a stable and large financial sector and an important transportation hub in Union Station.

4) Robust population growth: Population growth into Toronto has been strong, with annual growth running 60% higher than the province as a whole. Young workers are increasingly choosing to live in the city, attracted to the big-city lifestyle and short commute.

"Analysts have noted that Toronto's commercial market is booming and that the last time construction was this robust was in the late 1980s – early 1990s"

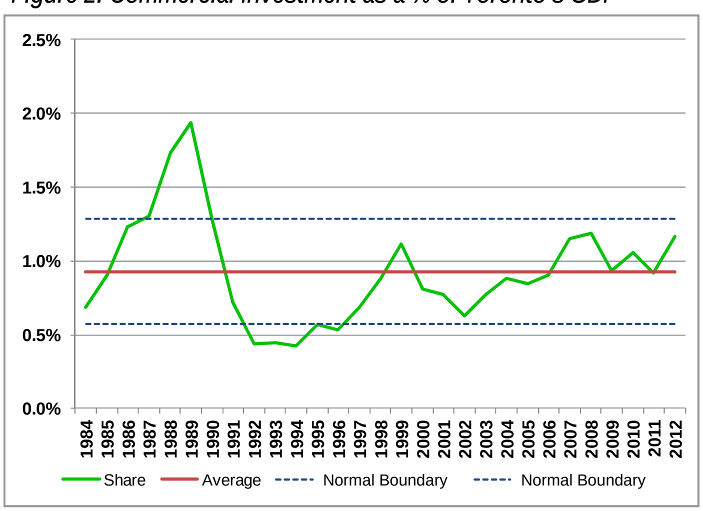
Is the market overbuilt?

Returning to our original question, we judge that the market is probably not overbuilt for a few reasons. Firstly, although the value of construction (again, as measured by permits) topped its 1980s level last year, that value does not account for inflation. When we attempt to account for inflation by using the Non-residential Construction Price Index (which, while not entirely appropriate, does give a rough measure of "real" commercial construction), we find that the inflation-adjusted value in 2012 was 78% below its 1989 peak.

Secondly, the rate of increase in construction has been more gradual in this recent cycle, as compared to the late 80s. For example, building permit values were 240% higher at the end of 2012 than they were when they began their upward climb in 1995 - meaning an increase of 13% per year. This rate of increase looks much more sustainable when compared to the 80s, where building permits jumped 482% from 1983 to 1989 - average growth of 80% per year.

Thirdly, we when we account for growth in the overall economy, the commercial market doesn't look overdone by any means (see Figure 2).

Figure 2: Commercial Investment as a % of Toronto's GDP



Source: Conference Board, OCS calculations

As the figure shows, at the end of 2012 the commercial market's share of the overall economy was within its normal bound. Really, the only time where commercial investment was punch-

"Really, the only time where commercial investment was punching dangerously above its weight - in terms of its share in the overall economy - was in the late 80s"

Finally and perhaps most importantly, more than 50% of office space currently under construction has been pre-leased, which implies that construction is occurring to meet fundamental demand (i.e. the complete opposite of speculative building).

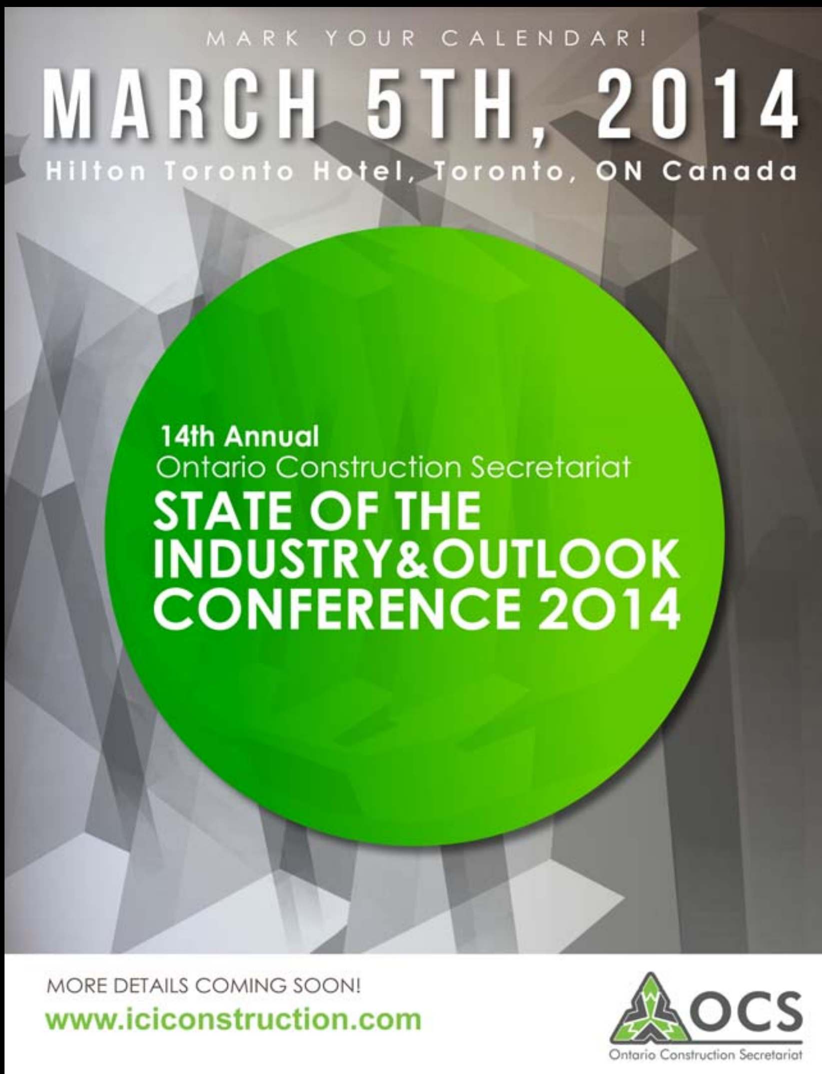
Bottom Line

Toronto's commercial market is on fire, leading some to wonder whether the market is getting overbuilt and therefore heading for an early 90s style crash. Thankfully, there are compelling reasons to believe that this won't be the case, including the fact that 50% of office space currently under construction has been pre-leased.

UPCOMING EVENTS

FOR MORE INFORMATION AND OTHER UPCOMING CONFERENCES & INDUSTY EVENTS: **www.iciconstruction.com**

MARK THESE IMPORTANT DATES IN YOUR CALENDAR FOR 2013 - 2014



FOR INFORMATION ON THIS EVENT OR OTHERS:
Email: info@iciconstruction.com
www.iciconstruction.com

2013/2014 OCS EVENT CALENDAR

DEC 4-6 CONSTRUCT CANADA 2013
Metro Toronto Convention Centre
Toronto, Ontario
VISIT OCS BOOTH #3012

MAR 5 2014 STATE OF THE INDUSTRY & OUTLOOK CONFERENCE

COLLECTIVE BARGAINING WORKSHOP
Hilton Toronto Hotel
Toronto, Ontario

FOR MORE INFO ON THESE EVENTS EMAIL US AT: INFO@ICICONSTRUCTION.COM

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