Ontario Construction Secretariat

EYE ON ICI NEWSLETTER

YEAR END REVIEW ISSUE MARCH 2013

INSIDE THIS ISSUE

ICI INVESTMENT: REFLECTING AND PROJECTING

With 2012 firmly in the rear-view, now is a good time to do some reflecting upon the year that was and projecting of the year that will be for Ontario's ICI markets. To do this, we utilize Statistics Canada's "constant dollar" non-residential investment data, which measures investment trends while stripping away the inflationary impact of materials and labour. We also use building permit data to give a sense as to what the near-term investment picture looks like.

Industrial

Current Trends

A solid fourth quarter propelled industrial investment higher last year, as it advanced 5% to its highest level since 2008. The gains were concentrated in Toronto and Oshawa in particular, where industrial investment exploded to a 460% gain driven by the Go Transit east rail maintenance facility. Industrial investment was higher in Toronto for the first time in four years.

Outlook

Fortunately, the outlook for industrial investment is positive for 2013, as foreshadowed by the 19% year-over-year increase in industrial building permits in 2012. Investment in the industrial sector will be driven by continued growth in the U.S. economy which will lead to increased exports and higher manufacturing revenues. As such, manufacturers will have increased funds with which to invest. Additionally, the capacity utilization rate – which measures the intensity with which resources in the manufacturing sector are being utilized – is currently above-average, meaning that there is an incentive to expand capital through investment.

Industrial activity will also be helped by the mining sector, thanks to work at the Red Lake and Musselwhite mines. Additionally, industrial investment will receive a lift from Vale's $1 billion Atmospheric Emission Reductions (AER) plant in Sudbury.

Finally, large-scale transportation projects will also help stimulate construction in the industrial sector, specifically the Light Rail Transit projects in Ottawa and Waterloo Region and the Metrolinx projects in the GTA.

Commercial

Current Trends

In 2012, the level of commercial investment declined 5% to $8.8 billion. This is consistent with softening retail sales and employment growth as well as above-average office vacancy rates. The decline was concentrated primarily in Kitchener-Waterloo-Cambridge (KWC), where investment unwound from a record 2011. The KWC market now faces an oversupply of office buildings, as reflected in a sky-high vacancy rate.

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Despite declining last year, there are some positives to take away. Firstly, the level of investment remained above its 5-year average, indicating that the market didn't collapse. Secondly, investment gathered momentum as the year progressed, growing at a 9% annualized pace in the fourth quarter, the largest such gain in nearly 2 years.

Outlook

Commercial investment is expected to grow at a decent pace over the next three years, consistent with a steadily improving economy and labour market, continued population growth and increasing building permits (up 17% in 2012). Strength will be concentrated in the Greater Toronto Area (GTA), which is important as the GTA represents more than half of Ontario's commercial market. The migration of the echo-boomer generation to the downtown core has played a role in stimulating office building demand, which when combined with tight supply conditions has spurred a new office construction cycle. Commercial investment in other regions of the province will also likely grow, though perhaps not as fast as the GTA. Office vacancy rates remain high or are increasing in major commercial centres outside of the GTA, corroborating this view.

As Statistics Canada classifies government owned projects related to the Pan Am Games as "recreational centres", they are considered commercial projects. As such, Pan Am Games projects will also help boost commercial investment. The capital budget for the Pan Am Games is $674 million and includes a bevy of projects in the GTA and Hamilton. Several of these projects have already been tendered by Infrastructure Ontario.

Institutional

Current Trends

Institutional investment dropped 6% versus 2011 with the declines intensifying as the year progressed. This is in-line with the cessation of the stimulus programs and, more generally, the tightening of government purse strings. Still the amount of investment was very strong, totalling $5.6 billion dollars, 7% higher than its 5-year average.

Outlook

Institutional investment will weaken in 2013 as government spending retrenches and the sector continues to unwind from the stimulus-related gains seen in 2010 and 2011 when institutional investment grew by a meaty 8%, on average. Softening institutional activity is already evident as institutional permits declined 22% in 2012 versus 2011.

Notably, although institutional investment is expected to decline, it will remain at a relatively healthy level in 2013 and beyond. Major institutional projects which are currently underway – like the $2 billion hospital in Oakville and the new $1.75 billion Humber River Regional Hospital – promise to keep construction activity high in the sector. Additionally, Infrastructure Ontario has indicated that there are roughly 29 major institutional projects that are currently in the planning stage.

Engineering

Current Trends

Data from Statistics Canada indicates that capital expenditures in the engineering sector surged 19% in 2010 (the last period of available data), juiced by the Infrastructure Stimulus Fund. It's safe to assume that engineering investment was also strong in 2011 reflecting the ongoing commitment of infrastructure funding through 2011.

Outlook

Growth in engineering investment is projected to be fairly solid in 2013 before slowing in later years in response to fiscal austerity. Almost every region of the province has one or more major engineering projects planned or underway. The GTA is home to the Metrolinx transportation projects and construction on highway 407. Looking longer-term there is also the anticipated nuclear rebuild project slated for 2016. Light Rail Transit projects in both Ottawa and Waterloo Region will lift engineering investment over the next three years. Engineering investment will also be strengthened by the mining sector in Northern Ontario and the Rt. Hon. Herb Gray Parkway and Detroit River International Crossing in Southwestern Ontario.

Bottom Line

CI investment in Ontario will increase in 2013, driven by the commercial and industrial sectors. Meanwhile, investment in the institutional sector is projected to decline. Finally, engineering investment growth will likely be relatively strong in 2013 before dropping off in later years.

ICI constant dollar investment, by CMA	2012	
CMA	**Value (000s)**	**% change versus a year ago**
Barrie	$217,633	-26.1
Brantford	$109,336	-20.9
Greater Sudbury	$162,507	-33.1
Guelph	$209,451	-12.4
Hamilton	$788,512	-1.7
Kingston	$173,742	-12.2
Kitchener-Cambridge-Waterloo	$796,082	-29.1
London	$842,220	10.7
Oshawa	$341,482	12.4
Ottawa	$1,308,905	4.6
Peterborough	$76,123	-2.3
St. Catharines	$453,261	-41.7
Thunder Bay	$149,959	-3.2
Toronto	$7,959,124	5.3
Windsor	$306,341	-18.7

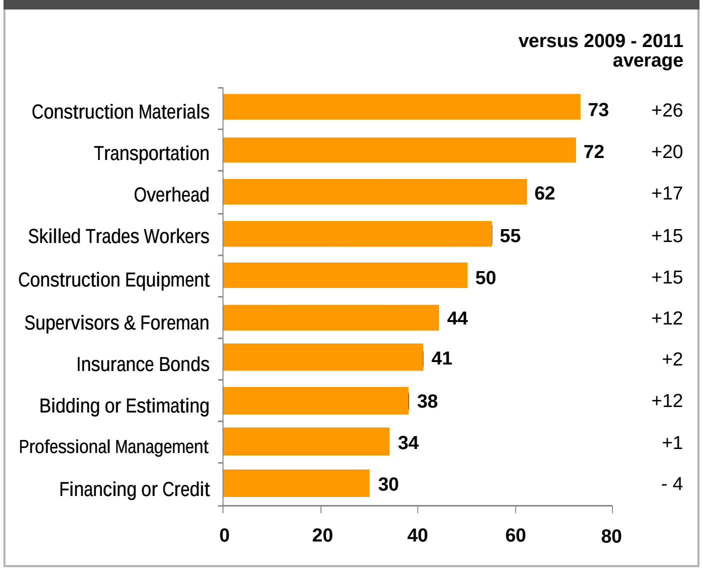
Building permit values, by building type	2012	
Building Type	**Value (000s)**	**% change versus a year ago**
Industrial - Factories	$884,134	17.2
Industrial - Transportation & Utilities / Power	$785,368	20.5
Industrial - Mining and Agriculture	$379,097	32.9
Commercial - Retail & Services	$2,115,353	73.8
Commercial - Offices	$1,615,745	-2.1
Commercial - Recreation	$524,430	14.3
Commercial - Warehouses	$608,537	50.5
Commercial - Hotels & Restaurants	$522,964	-18.8
Institutional - Government Buildings	$661,065	-27.1
Institutional - Schools and Education	$1,284,481	-32.1
Institutional - Welfare Homes	$501,678	27.9
Institutional - Hospitals and Medical	$850,172	-29.8

Source: Statistics Canada, Ontario Construction Secretariat

CONTRACTORS CONCERNED ABOUT COSTS

In our analysis of the OCS annual *Survey of Ontario's ICI Construction Industry* - where 550 contractors across the province are surveyed to assess their expectations for the year - a very interesting and perhaps surprising result caught our attention. According to the survey, a large share of contractors are expecting to experience input cost inflation this year, much more so than in any previous years. This result is captured in the following chart.

Percentage of Contractors Expecting an Increase in the Following Costs

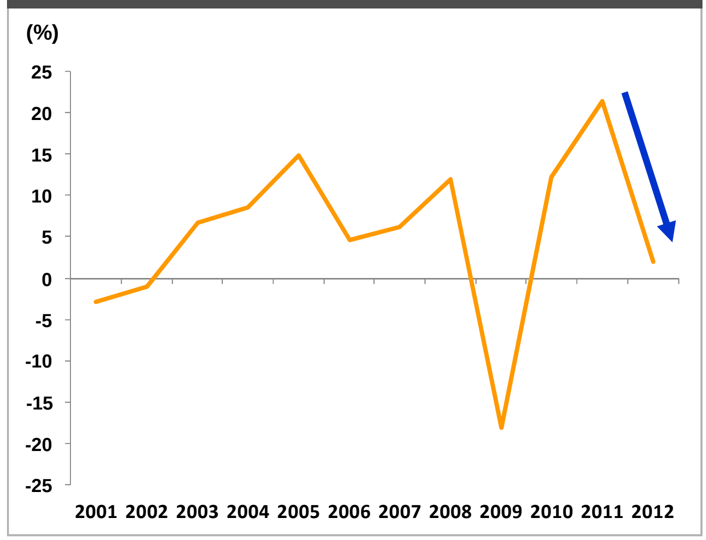


Source: 2013 Survey of Ontario's ICI Construction Industry (OCS)

As can be seen, an overwhelming amount of contractors are anticipating cost inflation, particularly for construction materials, transportation, overhead costs and skilled trades workers. Leaving aside overhead costs and the cost of skilled workers, this note focuses on the cost of transportation and construction materials.

Seventy-two percent of contractors in our survey anticipate higher transportation costs for 2013, which is somewhat at odds with recent trends in gasoline and diesel fuel prices. According to Statistics Canada, the price of regular unleaded gasoline increased by a modest 2.0%, on average, last year in Toronto, Ottawa and Thunder Bay – the three major cities for which data is collected. This is a far cry from the 21% gain seen in 2011. In the case of diesel fuel, this trend is even starker, as diesel prices inched up a mere 0.2% in 2012 after jumping 25% higher in 2011.

Price Growth of Regular, Unleaded Gasoline - Simple Average of Toronto, Ottawa and Thunder Bay



Source: Statistics Canada, OCS Calculations

While the recent behaviour of fuel prices is not consistent with a highly inflationary environment, an examination of the outlook is more instructive, given that we are dealing with contractors' expectations. The U.S. Energy Information Administration (EIA) provides forecasts for crude oil prices – the primary factor which influences gasoline prices. Refiners in Western Canada face

> **"A large share of contractors are expecting to experience input cost inflation this year"**

prices similar to West Texas Intermediate (WTI) oil, which is a North American oil price benchmark, while those in Eastern and Central Canada encounter prices similar to Brent crude oil – which is a global oil price benchmark.

For 2013, the EIA expects prices for both WTI and Brent crude oil to drop, thanks to rising production and limited ability to get the product to market. The agency correspondingly anticipates that gasoline and diesel fuel prices will move lower in 2013. Other forecasters (i.e. Toronto Dominion Bank, the World Bank), are in agreement with this view. Therefore, though the vast majority of contractors are expecting higher transportation costs, there are reasons to believe that oil prices - which are an important driver of these costs – will decline.

Turning our attention to the cost of construction materials, we find that the expectations of contractors square with those of key forecasters. Materials costs are a function of raw materials prices which are largely expected to be higher in 2013. For instance, the World Bank expects the price of aluminum to rise 9% this year. Similarly, increases are expected for zinc, iron ore, tin, nickel and lead. This is a stark contrast from 2012, where prices in these commodities declined by 11%, on average.

TD Economics points to companies needing to restock their inventories and increasing global demand as the main drivers pushing base metals prices higher this year. They also note that zinc prices should grow strongly supported by limited supply. Meantime, while the price of copper will likely be higher in 2013, marginal supply increases could limit the gain.

Commodity	2012	2013 (forecast)
Aluminum (USD / metric tonne)	2,023	2,200
Copper (U.S. cents / pound)	360.54	365.5
Iron Ore (U.S. cents / dry metric tonne unit)	128	130
Lead (U.S. cents / kilogram)	206	210
Nickel (USD / metric tonne)	17,548	18,000
Tin (U.S. cents / kilogram)	2,113	2,200
Zinc (U.S. cents / kilogram)	195	210

Lumber prices are set to record their 2nd straight double-digit increase and be a top commodity performer in 2013. Last year, U.S. housing starts surged by over 20%, lifting lumber prices. Continued improvement in the U.S. housing market combined with rising offshore demand (from China in particular) will support lumber prices in 2013.

The Bottom Line:

According to our *Survey of Ontario's ICI Construction Industry*, the vast majority of contractors are expecting to deal with higher costs this year. This looks to be true for construction materials, given a healing U.S. housing market and continued global economic growth. Fortunately for contractors, the story is not as cut-and-dry for transportation costs, as rising production coupled with issues bringing the product to market suggest that oil prices will be lower, not higher this year.

> HIGHLIGHTS

- The vast majority of contractors anticipate having to deal with cost inflation, particularly for construction materials and transportation costs
- Key forecasters anticipate that oil prices, an important driver of transportation costs, will be lower this year. This view runs counter to what contractors expect.
- Forecasters see raw materials prices, which heavily influence construction materials prices, heading higher this year, driven by increased global demand. This is consistent with contractors expectations.

ONTARIO REGIONAL PERMITS UPDATE

NORTHERN ONTARIO

Industrial permit issuance jumped 74% in 2012, matching its 2011 increase and climbing to the highest level in the history of the data. Gains were paced by Northeastern Ontario, where permit values advanced 120%. Conversions of a pulp mill and a coal plant, combined with mining sector work will boost activity in the North.

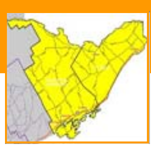
Institutional building intentions posted only a modest gain in 2012 as an increase in Northwestern Ontario was nearly offset by a drop in Northeastern Ontario. A large courthouse in Thunder Bay accounted for roughly 80% of the value of permits issued in the Northwest.

Permit Values - Year End Totals - 2012

Sector	Value (in 000s)	% Change
Industrial	$204,204	73.9%
Commercial	$190,287	-25.8%
Institutional	$208,908	6.4%
Total ICI	$603,399	5.8%

Source: StatsCan

Commercial permit issuance dropped to its lowest level since 2007, driven by a decline in Northeastern Ontario.



EASTERN ONTARIO

Industrial permit values reached their highest level in 5 years in 2012, driven by the Ottawa region and buttressed by Kingston-Pembroke. The pickup in permit issuance is particularly heartening for Ottawa as it implies increased investment - sorely needed after 2 straight yearly declines.

Commercial permit issuance was higher in both Ottawa and Kingston-Pembroke in 2012. In Ottawa, the big commercial projects are the federal government's Long-Term Accommodation Project and the Landsdowne Park renovation project. Meanwhile, a new office building for Kingston Hydro and movie theatre accounted for much of the gain in Kingston.

Permit Values - Year End Totals - 2012

Sector	Value (in 000s)	% Change
Industrial	$222,654	116.4%
Commercial	$1,015,793	19.2%
Institutional	$377,444	-8.0%
Total ICI	$1,615,891	18.3%

Source: StatsCan

The decline in **institutional** permit issuance was concentrated in Kingston-Pembroke in 2012. Meanwhile, Institutional intentions increased slightly in Ottawa though the level remained low.

GTA ONTARIO

Industrial permit issuance increased modestly in 2012, suggesting that the level of investment will be relatively unchanged from the low level that prevailed last year. The GTA's industrial sector has been in decline for more than a decade. Back in 1997, the industrial sector accounted for 20% of the ICI market. Today only 6% of ICI projects are industrial.

Last year, the value of **commercial** building intentions increased to their highest level in at least 15 years. With below average vacancy rates as well as continued employment and population growth, Toronto's commercial market may be poised to break out in the near-term future after making only modest gains since the recession.

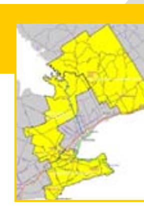
Permit Values - Year End Totals - 2012

Sector	Value (in 000s)	% Change
Industrial	$912,066	7.6%
Commercial	$3,408,126	26.8%
Institutional	$1,670,884	-31.7%
Total ICI	$5,991,076	0.2%

Source: StatsCan

Though declining, **institutional** permit issuance remained at a healthy level in 2012, suggesting a lower but still decent level of investment for this year. Infrastructure Ontario has roughly 15 major projects planned for Toronto, highlighted by the St. Michael's Hospital project.

CENTRAL ONTARIO



Permit Values - Year End Totals - 2012

Sector	Value (in 000s)	% Change
Industrial	$641,327	27.2%
Commercial	$1,063,279	6.9%
Institutional	$942,779	20.1%
Total ICI	$2,647,385	15.9%

Source: StatsCan

The increase in **industrial** construction intentions in 2012 was driven entirely by the Hamilton-Niagara region, thanks to the new Maple Leaf Foods plant project. Industrial building permit values declined in both Kitchener-Waterloo-Barrie (KWB) and the Muskoka-Kawarthas region.

Commercial permit issuance increased only modestly in 2012, weighed on by KWB. There was a robust gain in Hamilton-Niagara and a smaller increase in Muskoka-Kawarthas. In Hamilton-Niagara the main permit issued was for a new office building for Union Gas.

Mirroring developments in the industrial and commercial markets, Hamilton-Niagara led the way in terms of growth in **institutional** permit issuance in 2012. The increase in Hamilton-Niagara was primarily accounted for by a permit for the St. Joseph's Healthcare project. There was a solid gain in Muskoka-Kawarthas. Meanwhile, institutional permit values sank to their lowest level since 2006 in KWB.

SOUTHWESTERN ONTARIO

Permit Values - Year End Totals - 2012

Sector	Value (in 000s)	% Change
Industrial	$396,801	-5.7%
Commercial	$538,348	7.9%
Institutional	$397,934	-49.2%
Total ICI	$1,333,083	-21.7%

Source: StatsCan

Industrial building permits dropped only modestly for the second straight year in 2012. Thus the permit data is suggesting that industrial investment could match 2012's relatively decent level this year. Permit values were lower in both London and Windsor-Sarnia, despite a new Bio-Amber warehouse facility in the latter.

The increase in **commercial** building permits in 2012 was driven by the Windsor-Sarnia region, thanks to permitting for a new aquatics centre building in Windsor. Permit values were also higher in Stratford-Bruce, coming in at $95 million. Although down in London, commercial permits remained strong.

Last year, **institutional** permit issuance dropped to its lowest level in 5 years, weighed on by London where values fell significantly after a record 2011. Permits dropped to their lowest-level in 10 years in Stratford-Bruce. Conversely, permit values exploded 290% higher in Windsor-Sarnia, thanks to the Southwest Detention Centre project.

TOP CONSTRUCTION PROJECTS STARTED IN 2012

PROJECT	CITY	VALUE
Humber River Regional Hospital	Toronto	$1,750M
Detour Lake Gold Mine Restart and Mill Addition	Cochrane	$1,450M
Highway 407 East	Durham Region	$1,000M
Pan Am Games Athletes' Village	Toronto	$514M
Red Lake Cochenour / Bruce Channel Gold Mine Restart / Expansion	Red Lake	$420M
Maple Leaf Foods Processing Plant	Hamilton	$395M
Eglinton Scarborough Crosstown Tunnel	Toronto	$320M
Erieau Windfarm	Blenheim	$305M
Corunna Refinery Ethylene Feedstock Converstion and Debottleneck	Corunna	$300M
Durham York Waste-to-Energy Centre	Clarington	$250M

Source: Reed Construction Data, Industrial Info Resources

UPCOMING EVENTS

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

MARK THESE IMPORTANT DATES IN YOUR CALENDAR FOR 2013 - 2014

2013 OCS EVENT CALENDAR

MAR 6 — STATE OF THE INDUSTRY & OUTLOOK CONFERENCE
Hilton Toronto Hotel
Toronto, Ontario

AUG 11-13 — TRIPARTITE CONFERENCE
Deerhurst Resort
Huntsville, Ontario

SEPT 23-24 — OCS ANNUAL GENERAL MEETING
Queen's Landing
Niagara-on-the-Lake, Ontario

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

For any enquiries related to the **EYE ON ICI NEWSLETTER** or
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