Ontario Construction Secretariat

EYE ON ICI NEWSLETTER

MARCH 2015

INSIDE THIS ISSUE

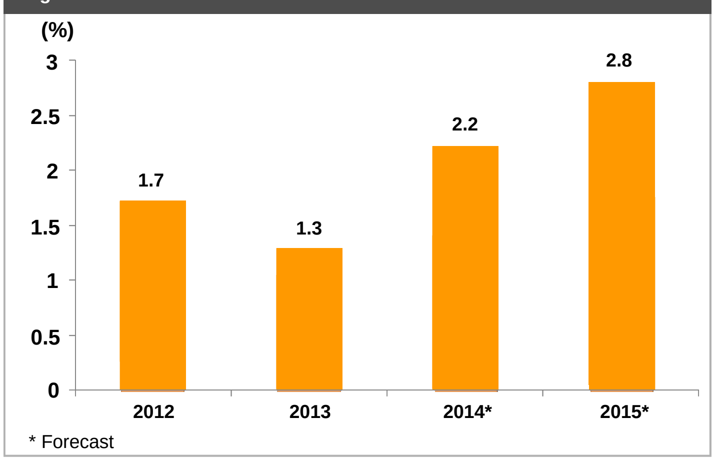
THE ECONOMY AND CONSTRUCTION: A REVIEW AND OUTLOOK

The Economy and Inflation

When the final numbers trickle in, they are likely to show that Ontario's economic growth (as measured by real GDP) perked up to 2.2% in 2014 from 1.3% the year prior. Last year, Ontario's economy was supported by strong export growth, thanks to solid U.S. demand and a low-flying loonie. Firm consumer spending provided an additional lift to the economy. On the negative side, residential construction was a drag on the growth as housing starts dipped 7% last year. Turning to inflation, it trended higher in 2014 despite sharply lower gasoline prices, lifted by broad economic strength and gains in other energy prices.

The outlook for 2015 is for accelerating economic growth, as a firming U.S. economy and a low loonie continue to buoy exports. Meanwhile, significantly lower oil prices should help stimulate consumer spending as Ontarian's benefit from a break at the pumps. **Dropping oil prices are likely to be a net benefit for Ontario's economy**, owing to the boost it provides to consumer spending and the manufacturing sector through lower input costs. Consumer price inflation is expected to be significantly lower thanks to oil's precipitous plummet, coming in at around 1% in 2015 compared to 2.4% last year.

Figure 1: Ontario's Real GDP Growth is Poised to Accelerate in 2015



Source: TD, BMO, RBC, CIBC, Scotia Economics, Statistics Canada

ICI Construction Markets

Total ICI Investment

In 2014, there was a constant-dollar, seasonally adjusted $16.1 billion invested in the ICI market, a shade lower than 2013 and marking the third straight annual decline. As expected, investment was boosted by the industrial and commercial markets but weighed on by the institutional sector. The ICI market has been generally characterized by this trend since the beginning of 2012.

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Industrial Market

Current Analysis

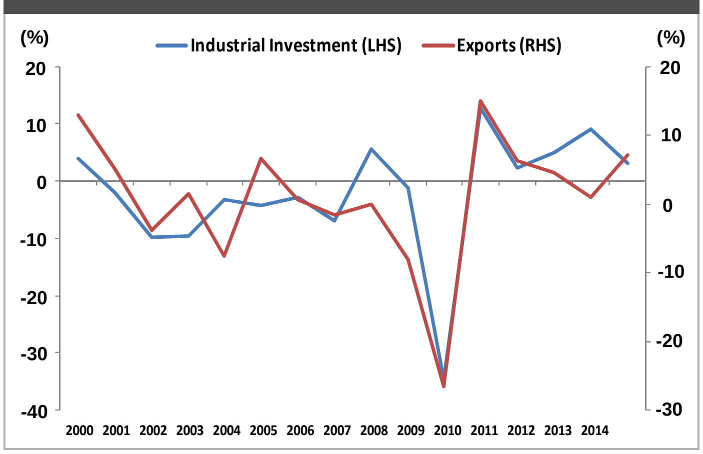
Industrial investment grew by 3.1% in 2014 and came in at $2.1 billion, thereby inching closer to its 2008 near-term peak. The first half of the year was marked with declines, perhaps partly due to adverse weather conditions. In the 2nd half of 2014 investment growth was robust, averaging a 9% quarterly increase.

Regionally 7 of 15 Census Metropolitan Areas (CMA) had higher industrial investment in 2014 with the biggest growth coming in Peterborough. The largest contribution came from Toronto, where investment jumped 21%, spurred by construction at Union Station and investment in industrial warehouses in the western part of the CMA. There was a solid level of investment in Brantford thanks to construction of a new manufacturing plant and alterations to an existing one. Construction spending was also relatively high in Kingston. On the opposite end of the spectrum, big decliners included Ottawa, Kitchener, St. Catharines-Niagara and Oshawa.

Outlook

Given the close correlation between exports and industrial investment (see *Figure 2*), we would expect to see an increase in industrial investment in 2015 as exports are likely to increase given a weak dollar and robust U.S. demand. Other factors which would argue for an increase in industrial investment include a low interest rate environment, upward creeping industrial capacity utilization, increased building permit issuance in 2014 and lower availability rates for industrial buildings in key markets, like Toronto.

Figure 2: Constant-dollar Industrial Investment and Exports, Year-Over-Year % Change



Source: Statistics Canada, OCS Calculations

Industrial investment and exports are linked through the manufacturing sector as factories and plants still represent the majority of industrial building investment in the province. Within the manufacturing sector, Chrysler is in the midst of a $2 billion expansion at its assembly plant in Windsor. Meanwhile, Honda has invested $857 million to expand capacity at its assembly plant in Alliston. GM will invest $560 million in its Ingersoll plant while auto-parts maker Linamar will spend $500 million to expand its Ontario operations. Other major projects which will stimulate industrial investment include the Spadina subway extension job, the Union Station revitalization project and the $1.2 billion natural gas power plant in Napanee.

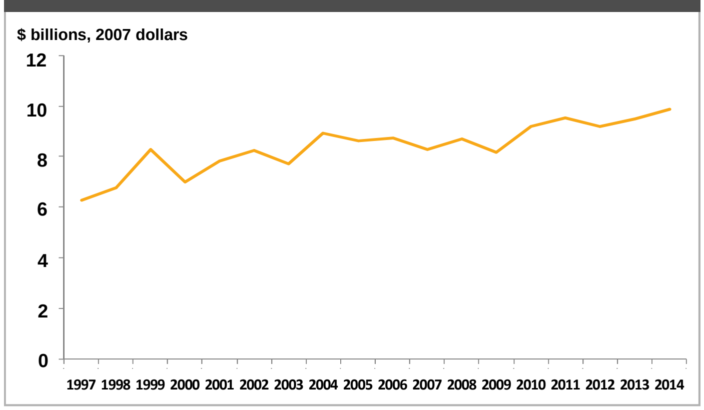
Commercial Market

Current Analysis

In 2014, commercial investment advanced a solid 4% to $9.8 billion – a new record level. There was positive growth in all but one quarter last year. Going back further, commercial investment has only dropped in 3 out of the past 12 quarters.

Looking across CMAs, 8 of 15 saw greater commercial investment in 2014. The largest positive contributions belonged to Toronto, Ottawa and Barrie. However, there were also above-average levels of construction spending in Oshawa, St. Catharines, Sudbury and Thunder Bay. Conversely, investment fell to below average levels in Brantford, Hamilton, Kingston, Kitchener, London, Peterborough and Windsor.

Figure 3: Constant-dollar Commercial Investment



Source: Statistics Canada, OCS Calculations

Outlook

Forecasters are projecting a modest increase in commercial investment in 2015. Higher investment would be consistent with accelerating economic growth, continued population growth and increased consumer spending. Additionally, interest rates remain low, operating profits are healthy and company surveys indicate that businesses are confident about their prospects. Additionally, there is over 6 million sq. ft. of office space currently under construction in the GTA.

There are three major factors which suggest that growth in commercial investment could be subdued. Firstly, office vacancy rates are trending higher in major commercial markets, creating a disincentive to build. Secondly, the current level of investment is extremely high, making large increases in spending a difficult proposition. Finally, the value of building permits issued last year dipped 7%.

The exit of Target from Canada means a significant amount of retail and office space will be made available (over 15 million square feet across the country). The company plans to pull out this year and the newly available space may potentially be subject to demolition, expansion, retrofitting, renovation or repair as other companies get their hands on it. This would be positive for construction, though it's difficult to gauge exactly when these benefits would accrue. This optimism is tempered by the fact that Target's lack of success in Canada is a negative for commercial Real Estate Investment Trusts, though thankfully the damage doesn't look too significant. For instance, RioCan, which is Target's biggest Canadian landlord, maintained that their properties represented only 1.9 per cent of their annual rental revenue, and noted that the leases are backstopped by Target Canada's U.S. parent corporation.

Institutional Market

Current Analysis

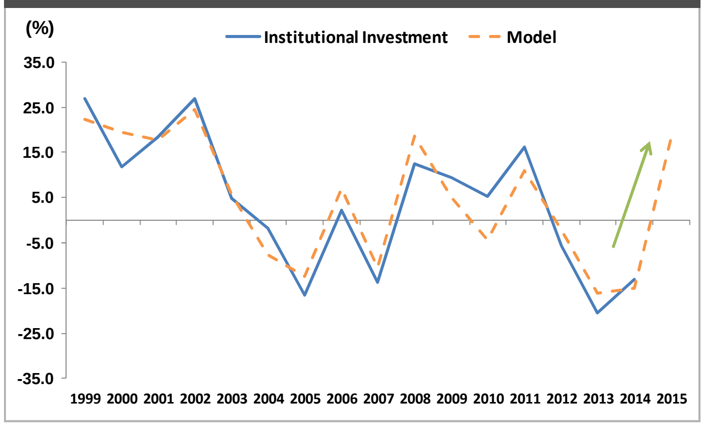
Last year, institutional investment dropped 12% to its lowest level since 2007. This was the 3rd straight yearly decline as investment continued to unwind from its 2011, stimulus-assisted peak. Regionally, investment in 10 out of 15 CMAs fell, with the steepest declines belonging to London, Ottawa, Brantford, Peterborough and Windsor. On the flip side, investment was at its highest level since at least 1997 (first period of data) in Kingston, thanks to the Providence Care Hospital project. Other, less substantial increases were also seen in Guelph, Kitchener, St. Catharines-Niagara and Thunder Bay.

Though investment dropped in 2014, examining each quarter of the year paints a brighter picture. After 10 straight quarters of decline, investment inched higher in the third quarter (q/q) and even managed a respectable 3% fourth quarter gain.

Outlook

Forecasters are expecting institutional investment to edge higher in 2015. As mentioned above, spending posted back-to-back quarterly gains to end 2014, suggesting that it has some momentum for this year. Coupled with this, building permits – which are a good predictor of upcoming investment trends – advanced 27% last year. The OCS's proprietary model of institutional investment – which considers lagged building permits and population growth – is pointing to a significant increase in institutional spending this year. Though we would be hesitant to project strong growth in institutional investment in 2015, a milder increase doesn't seem to be an unreasonable expectation. However, even with a gain, the level of investment would likely remain relatively subdued.

Figure 4: Constant-dollar Institutional Investment, Predicted versus Actual, Year-over-year % Change



Source: Statistics Canada, OCS Calculations

Concluding Remarks

Ontario's economic growth is likely to accelerate in 2015, driven by a strong U.S. economy, a lower loonie, and continued consumer spending. Industrial investment is expected to increase this year, lifted by major industrial projects and in-line with growing exports. Spending on commercial construction will also drift higher, though a significant increase may be difficult to achieve. Finally, we anticipate that institutional investment will grind higher for the first time in four years.

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Construction Information Coordinator
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ONTARIO REGIONAL PERMITS UPDATE

NORTHERN ONTARIO

Last year a solid $125 million worth of **industrial** building intentions were issued, higher than in 2013 and above the long-term average. The Northeastern region drove the increase with particularly strong issuance in the final quarter of the year which may portend higher industrial investment in the early part of 2015. The value of permits dropped in Northwestern Ontario, the 2nd straight yearly decline.

A soft fourth quarter led **commercial** permit issuance lower last year. The value of permits dropped in both Northeastern and Northwestern Ontario, despite significant alteration and repair work permitted for in the latter region. Despite the decline, commercial building intentions have been solidly upward trending for the last decade.

Permit Values - Year End Totals - 2014

Sector	Value (in 000s)	% Change
Industrial	$125,475	▲ 62.0%
Commercial	$221,226	▼ -20.4%
Institutional	$186,498	▼ -15.0
Total ICI	$533,199	▼ -7.2%

Source: StatsCan

Institutional building intentions dropped 15% in 2014 as the Thunder Bay Consolidated Courthouse fell out of the permit data. At $186 million, the level of permitting was at its lowest level since 2005 which suggests that institutional construction could be subdued in coming quarters. Issuance was significantly lower in Northwestern Ontario while being higher in Northeastern Ontario.

EASTERN ONTARIO

Last year a mere $129 million worth of **industrial** permits were issued in Eastern Ontario, well below both the short and long-term averages. Permits fell in both Ottawa and Kingston-Pembroke. Though building intentions paint a subdued picture, the natural gas power plant in Napanee is slated to begin construction this year. This project will keep the industry very busy.

In 2014, **commercial** permit values dropped for the 2nd straight year to their lowest level since 2010. The Ottawa region drove the decline as permit issuance was higher in Kingston-Pembroke. Falling permits in Ottawa squares with upward trending office vacancy rates. These two factors raise the risk that investment could be subdued in Ottawa over the next few quarters.

Permit Values - Year End Totals - 2014

Sector	Value (in 000s)	% Change
Industrial	$129,770	▼ -37.1%
Commercial	$849,607	▼ -13.2%
Institutional	$680,707	▲ 193.7%
Total ICI	$1,660,084	▲ 17.2%

Source: StatsCan

A record $681 million worth of **institutional** permits were issued last year. The gain was driven by Kingston-Pembroke thanks to the Providence Care Hospital project. Meanwhile, permits were at their highest level in almost a decade in Ottawa in the midst of ongoing construction at the University of Ottawa Heart Institute and at Hawkesbury Hospital. Such strength in building intentions suggests that the institutional market may be healthy this year.

GTA ONTARIO

Though the value of **industrial** permits dropped last year, its level was above-average, thanks to substantial fourth quarter issuance. This points to relatively solid investment going forward. Meanwhile, a low industrial availability rate, increasing exports and higher capacity utilization also form a supportive backdrop for further investment growth. Industrial warehouse space left behind with Target's exit from Canada may need renovation or reconstruction, which could also lift the market.

Commercial permit issuance eased slightly from its record 2013 level last year though was still a rock-solid $3.9 billion. Therefore, permits are signalling continued strength in the GTA's commercial market. This is consistent with solid retail sales trends. The market is being fuelled by office construction.

Permit Values - Year End Totals - 2014

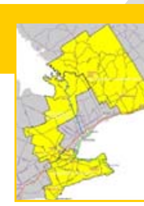
Sector	Value (in 000s)	% Change
Industrial	$970,595	▼ -4.2%
Commercial	$3,944,976	▼ -2.2%
Institutional	$1,271,961	▲ 11.1%
Total ICI	$6,187,532	▼ -0.1%

Source: StatsCan

Institutional permit issuance increased in 2014 which forecasts increasing institutional construction this year. This squares with the litany of institutional projects planned or underway in the region, most notably the new Mackenzie Vaughan Hospital. Still, the value of building intentions was relatively low which points to a subdued increase in investment this year.

ONTARIO REGIONAL PERMITS UPDATE

CENTRAL ONTARIO



Permit Values - Year End Totals - 2014

Sector	Value (in 000s)	% Change
Industrial	$651,444	▲ 30.6%
Commercial	$1,003,659	▼ -19.0%
Institutional	$770,183	▲ 20.8%
Total ICI	$2,425,286	▲ 2.1%

Source: StatsCan

The value of **industrial** building intentions finished the year at a record $651 million, pointing to an uptick in industrial construction going forward. There were major increases in Muskoka-Kawarthas and Kitchener-Waterloo-Barrie. In fact the level of issuance was at its highest level since 2007 in the latter. Permit issuance was down in Hamilton-Niagara, easing from back-to-back massive years.

Commercial permit issuance was low last year, despite increasing employment in the region. Though receiving a boost from continued permitting for Tim Horton's field, building intentions fell in Hamilton-Niagara. Permits also dropped in Kitchener-Waterloo-Barrie, consistent with upward trending office vacancy rates. Permits drifted higher in Muskoka-Kawarthas.

Institutional building intentions trended higher in 2014 thanks to permitting for the Cambridge Memorial Hospital as well as for a new retirement home in Hamilton. However, the value of permits issued was below-average, weighed on by a weak fourth quarter. Nevertheless, the gain in permits points to increased institutional construction which would be a welcome change after dropping for three straight years.

SOUTHWESTERN ONTARIO

Permit Values - Year End Totals - 2014

Sector	Value (in 000s)	% Change
Industrial	$489,101	▼ -2.0%
Commercial	$388,921	▲ 6.9%
Institutional	$240,175	▼ -1.1%
Total ICI	$1,118,197	▲ 1.1%

Source: StatsCan

Last year, a weak fourth quarter sent **industrial** permit issuance lower than its 2013 value. However, the level of building intentions was very healthy, being the 2nd highest since 2007. The drop was driven by London and Windsor-Sarnia as permits were higher in Stratford-Bruce. Honing in on Windsor-Sarnia, permits were higher in Windsor (not to mention they have an ongoing $2 billion retool at their Chrysler plant), implying that the decline was concentrated in Sarnia.

Commercial building permits were higher last year than in 2013, though were at a relatively low level. The gain was driven by London (consistent with a lower office vacancy rate and increased employment) and Stratford-Bruce while being weighed on by Windsor-Sarnia. Spending on Southwestern Ontario's commercial market has been volatile for the past decade as upward trends in London and Stratford-Bruce have clashed with downward trending expenditures in Windsor-Sarnia.

Institutional building intentions dipped slightly lower in 2014, the third straight yearly decline. With the drop, building intentions were at their lowest level since 2000 – suggesting that 2015 will be a down-year for institutional spending. Permits were weighed on by Windsor-Sarnia and Stratford Bruce. Even though they were higher in London, their level was fairly low.

TOP CONSTRUCTION PROJECTS STARTED IN 2014

PROJECT	CITY	VALUE
Waterloo Region LRT	Waterloo	$818M
Providence Care Hospital	Kingston	$810M
Armow Wind Farm Project	Bruce County	$185M
The Beverly Hills Mixed-Use Building	Richmond Hill	$181M
Ernst & Young Office Tower	Toronto	$180M
Cambridge Memorial Hospital	Cambridge	$175M
Canadian Tire Warehouse and Distribution Centre	Caledon	$150M
Ruskview Road etc Watermains	Kitchener	$102M
Centennial College Residence and Culinary Arts Centre	Scarborough	$85M
BMO Field, Phase One	Toronto	$85M

Source: CMD Group, Industrial Info Resources

PUBLIC AFFAIRS UPDATE: SPRING 2015

Ontario's Legislature resumed sittings on February 17th. The Liberal government of Premier Kathleen Wynne has been buoyed by their recent by-election win in Sudbury. That seat was held by long-time Liberal MPP Rick Bartolucci, and was recently won by the NDP in the June 2014 general election. The by-election was held after the riding's new NDP MPP resigned for personal reasons.

The government's focus for the first half of 2015 will be on their 2015 Budget, their first Budget of their renewed mandate. Recent governments have tried to deliver bad news – cancelled projects or tax increases, for example – early in their mandate, hoping that economic fortunes may improve, allowing the opportunity to deliver spending promises in future budgets, closer to the election date.

In 2004, the McGuinty Liberals introduced a $300 to $900 tax increase -- labelled a health premium -- to counter a fiscal deficit that was almost $5 billion greater than acknowledged by the previous Conservative government, and to allow increases in program and capital spending.

The Conservatives unveiled a number of cost-cutting steps almost immediately after assuming office. In a July 1995 Economic Update – there was no 1995 Budget passed by the departing Rae government – the government announced the cancellation of a number of capital projects, like the Eglinton subway, non-profit housing, childcare, and social assistance.

In both cases, stronger economic conditions, plus the impact of the changes over time, put the government in a position to announce balanced budgets in time for an election almost four years later.

It's speculated that the “bad news” that the government will unveil will include its plans for establishing a price on carbon emissions – either through a cap and trade system, or a carbon tax.

The Budget, given the province's requests for increased federal funding for infrastructure or social services, will probably follow the Federal Budget, expected in April.

Key Elements of the Ontario Governement’s Agenda for 2015

Ontario’s deficit

Most of the government's decisions will be made within the context of a large deficit (expected to reach $12.5 billion for the year ending March 31, 2015), which the government has pledged to eliminate by 2017-18. Funding for new programs will be scarce in this Budget – expect continued emphasis on efforts to limit pay and benefits increases to the government's own employees, and employees in the broader public sector.

The Budget is expected to announce decisions by the government, based on advice it will have received from a committee led by former TD economist Don Drummond, tasked with “unlocking value from government assets.”

Infrastructure

Much of the government's fiscal flexibility has been taken up by an ambitious infrastructure agenda, which includes $29 billion in planned investments in transit projects across the province. Many communities are hoping that the province will announce which projects will receive funding – and how much funding – from these dedicated funding sources.

Part of that agenda includes Bill 6, Infrastructure for Jobs and Prosperity Act, 2014, presented by Economic Development and Trade, Infrastructure and Employment Minister Brad Duguid. The Bill is of importance to the ICI industry for several reasons. If passed, it will require the government to publish 10-year infrastructure plans. It will also give the Minister the power to set apprenticeship targets on public infrastructure projects, and ensure that identified professionals, like architects, are involved in the design of provincially-funded public infrastructure.

Construction Issues in 2015

Two important government reviews will conduct their work in 2015. Former Head of the Ontario Public Service Tony Dean will conduct a review of the College of Trades, examining issues related to scope of practice -- its processes for establishing compulsory trades or identifying the work performed within trades. Mr. Dean is expected to submit his report to the College of Trades and the Ministry of Training, Colleges and Universities in October 2015.

In response to Prompt Payment Legislation that was considered by the Legislature in 2014, the government will establish a committee to review of the Construction Lien Act throughout 2015. Attorney-General Madeleine Meilleur has appointed Toronto construction law expert Bruce Reynolds to conduct the review. The government expects the review to be completed by December, and will reach out to industry stakeholders in writing to provide an overview of next steps and preliminary plans for the review and industry consultation.

Pensions

As part of its concerns for income inequality or poverty in the province, the government is establishing a provincial pension plan, projected to require that workers and employers who are not currently enrolled in a pension plan contribute 1.9% each for each employee. Firms without a pension plan -- even those with matching-RSP plans -- will be required to pay into the provincial pension plan. Since most ICI unions already have a pension plan, this may actually eat into advantage non-union employers may have in wages and benefits over the unionized sector.

Opposition Parties

Ontario PC party members will select a new party and Official Opposition Leader on May 9th. Candidates for the role are Whitby-Oshawa MPP Christine Elliott, Barrie MP Patrick Brown, and Lambton-Kent-Middlesex MPP Monte MacNaughton. Even after a new Leader is chosen, the PC party will not be in a position for some time to commit to any changes in party policy.

NDP Leader Andrea Horwath won a strong mandate from her party's membership, with 77% of party delegates supporting her leadership at its Fall 2014 convention. The NDP will be looking to support policies that allow it to regain support in Toronto it lost, while solidifying its gains in Southwestern Ontario.

Federal News

The federal government has announced that it will wait until April to deliver its 2015 Budget, hoping that oil prices – with a significant impact on tax revenues – will have stabilized by that point. Despite the decline in tax revenue, the $3 billion contingency fund the government uses in its annual Budget should allow the Conservative federal government to post a small surplus or balanced budget for the year ending March 31st (2014-2015).

At the federal level, private member's bill C-377, *An Act to amend the Income Tax Act (requirements for labour organizations)* remains before the Senate. That bill will require labour organizations – meant to capture unions, but possibly also capturing contractor associations and other organizations involved in labour relations – to publicly post financial contributions above $5,000, including salary information. Conservatives, “open shop” contractors and other supporters of the bill say that it will increase transparency in the expenditure of funds which are exempt from taxation. Unions (including CLAC) and opponents of the bill see it as an intrusive piece of legislation that is meant to harm unions that are ideologically opposed to the Conservative Party.

In the previous session of Parliament, Senator Hugh Segal was able to secure amendments to the legislation that would mirror disclosure rules for senior civil servants (requiring disclosure only for salaries above $454,000), but Senator Segal subsequently left the Senate, and the government prorogued Parliament, returning the bill to the Senate in its unamended form. The Senate may not have enough time before the current Senate session ends in June to consider and pass the bill, given a number of government bills that are given higher priority than private member's bills. A federal election – either this spring, or in October, as mandated by legislation – would kill C-377. Supporters of the bill will have to find another MP to reintroduce the bill after the election, since MP Russ Hiebert, whose BC riding is a Conservative stronghold, will not be seeking another term in Parliament.

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UPCOMING EVENTS

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

MARK THESE IMPORTANT DATES IN YOUR CALENDAR FOR 2015

2015 OCS EVENT CALENDAR

APR 14-16 FUTURE BUILDING 2015
Queen Elizabeth Building
Toronto, Ontario
www.futurebuilding.ca

SEPT 28-29 OCS ANNUAL GENERAL MEETING
Location TBA

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

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