2017 FORECAST

"AVALANCHE" OF INFRASTRUCTURE TO COME

Public spending to carry the load for growth

BY JIM BARNES

The crystal ball for Canadian construction next year was already cloudy before Donald Trump was elected the 45th president of the United States. That one event has thrown a lot of forecasts into the trash bin.

It's difficult to assess the impact. Themes of his campaign included reworked international relations, a focus on U.S. infrastructure and abandoning climate-change initiatives – and most importantly for Canada – renegotiating trade deals.

How much of this platform was mere rhetoric and how much can win support in Congress and the Senate? It looks like 2017 will be an eventful year.

MURKY

Only one thing seems certain, the government's reliance on infrastructure spending to keep the Canadian economy moving. "By the spring of 2017, you would expect to see a real avalanche of public infrastructure work coming," says Michael Atkinson, president of the Canadian Construction Association in Ottawa.

Even before the U.S. election, predictions uniformly called for weak economic growth in Canada. In mid-October, the Bank of Canada (BoC) projected Canada's real GDP to grow by 1.1 per cent in 2016 and about two per cent in both 2017 and 2018. The economy won't return to full capacity before mid-2018, BoC said. In a fiscal update delivered in October, Federal Finance Minister Bill Morneau forecast higher deficits and no return to balance through 2021-22.

TRADE OFF

Growing protectionism can be expected from the new regime in the U.S. While few Canadian construction contractors do much offshore business directly, their clients do.

Trump has vowed to rip up NAFTA. The North American Free Trade Agreement is the cornerstone of trade among Canada, the U.S. and Mexico. Can it be discarded so quickly? Apart from the legalities (and legal challenges inevitably would follow), Republicans have historically been pro-trade and any such legislation may run into friction in Congress and the Senate.

However, whether NAFTA survives or is somehow renegotiated, "Buy American" policies can be expected to proliferate.

Even before the potential trade disruptions with the U.S., exports were expected to weaken. "Growth in exports over 2017 and 2018 are projected to be slower than previously forecast, due to lower estimates of global demand, a composition of U.S. growth that appears less favourable to Canadian exports, and ongoing competitiveness challenges for Canadian firms," according to the BoC. "Modest prospects in the global economy will hamper Canadian growth in 2017."

VERTICAL THINKING

Non-residential building – what Atkinson calls the vertical sector – is hurting. "The horizontal industry, in terms of sewer and water, roads and bridges, seems to be doing okay... That tends to be provincial and municipal. It's less clear what is going to happen in the vertical, building area."

Investment in non-residential building construction totalled $12.5 billion in Q3 2016, the sixth decrease in seven quarters dating back to the first quarter of 2015, according to Statistics Canada (Stats Can). The decline especially reflected lower spending on commercial and industrial building construction.

"Corporations are sitting on all this cash that they are not investing, primarily due to the mood of uncertainty and low confidence," says Atkinson. That lack of confidence is unlikely to improve with the changes in the U.S.

Executives surveyed in the Conference Board of Canada (CBoC)'s pre-Trump *Autumn 2016 Survey of Business Confidence* revealed increasing concern about Canada's investment climate. The index of business confidence fell three points to 94.8 in the third quarter of 2016 (2002=100).

Stats Can capital expenditure data, which includes both non-residential capital construction and machinery and equipment, also points to weakness. For 2016 the agency was projecting about $242 billion, down 4.4 per cent from 2015 and down more than 11.2 per cent from 2014. "That translates to somewhere between 23 and

The Highway 407 East Phase 2 projet will extend Highway 407 about 22 kilmetres from Harmony Rd. in Oshawa to Highway 35/115 in Clarington.

$30 billion of actual construction investment," says Atkinson.

A primary indicator of demand in industrial construction is capacity utilization rates. Canadian industries operated at 80 per cent of production capacity in Q2 of 2016, down from 81.4 per cent in Q1. The decline was widespread, with 19 of the 21 major groups in the manufacturing sector recording a lower rate. A decrease was also observed in every other non-manufacturing industry surveyed, except electric power generation, transmission and distribution, said Stats Canada.

BIG PRIVATE PROJECTS

According to Stats Can, total capital spending by private-sector organizations is expected to decline 9.3 per cent to $157.4 billion in 2016, mainly due to declines in spending on capital construction. Oil and gas extraction capital expenditures totalled $8.8 billion in the second quarter, down 28.8 per cent from the second quarter of 2015.

Oil was trading at about the $45 per barrel mark at the time of the U.S. election, and is anticipated to decline further. That's bad news for oil sands operators, who need a price of about $57 per barrel to turn a profit. "With commodity prices expected to remain low, a recovery in 2016 is not in the cards," noted CBoC.

One bright note in the U.S. election comes for pipeline companies. President-elect Trump supports pipeline construction, a sentiment shared by most Republicans in government. A number of pipelines are under consideration, including the pivotal Keystone XL pipeline that President Obama ruled against. It won't be a slam dunk for pipelines, though. Energy Board and environmental requirements have to be met and in some cases negotiations concluded with First

Nations peoples whose land the pipelines may cross.

Even before the U.S. election, the outlook was weak. “It’s a double whammy,” says Atkinson, referring to the declines both in the resource sector and manufacturing. “In the overall Canadian economic numbers, that has been reflected in how badly exports have been doing. They are nowhere near what was anticipated.”

RAMPING UP INFRASTRUCTURE

The Liberal government made infrastructure investment a major plank of its election platform, predicting economic stimulus and improved Canadian competitiveness.

As reported in *On-Site*’s August, 2016 issue, they doubled down on the previous government’s already large commitment to infrastructure in two phases of spending totalling $120 billion over 10 years.

Phase 1 of the funding committed $5 billion to green infrastructure, $3.4 billion to social infrastructure and $3.4 billion to public transit and transportation infrastructure, among enhancements to the basic program.

Phase 2 will be in place by the end of the year, the government has announced. The specifics are not yet available.

More money followed. In the Fall Economic Statement, Morneau announced a further $22.6-billion in infrastructure spending for two years following the 2025-26 fiscal year. He also announced a $10.1-billion commitment to trade and transportation infrastructure over 11 years, starting in 2017-18 and $2-billion over 10 years for rural and northern communities, starting in 2018-19.

As well, private-sector access to programs is to be simplified and a Canadian Infrastructure Bank established (*see sidebar on page 24*). Further details will follow in the 2017 budget.

Canada’s infrastructure gap may be as high as $500 billion, Morneau said. The infrastructure situation is indeed serious. According to the *2016 Canadian Infrastructure Report Card* published by CCA, FCM, the Canadian Public Works Association and the Canadian Society for Civil Engineering, 35 per cent of municipal infrastructure assets are in need of attention, especially roads, municipal buildings, sport and recreation facilities and public transit.

According to Infrastructure Canada’s dataset, more than 300 public projects are slated to start in 2017, of all sizes

Soft housing

Concerns about the housing market overheating are now being shared by government and the Canadian Housing and Mortgage Corp. (CMHC).

Historically high household indebtedness (now 168 per cent of disposable income) is the greatest vulnerability in our economy, says BoC.

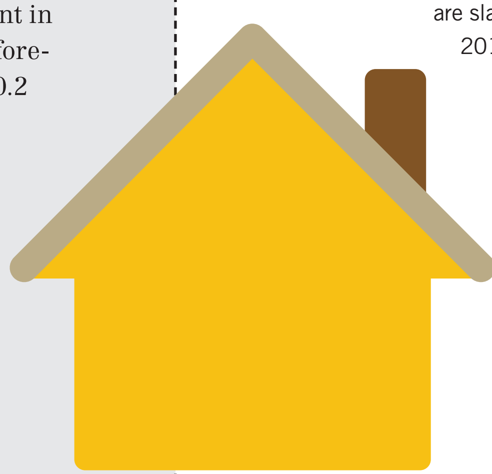
Fuelling high prices is offshore speculation. At the beginning of August, the B.C. government instituted a 15-per-cent tax on foreign buyers of Greater Vancouver-area homes. Immediately, in September, property sales fell 32.6 per cent year-over-year. To put that in context, sales in the Greater Toronto Area climbed 21.5 per cent that month, year over year.

The federal government also moved, announcing new tax and mortgage measures in October. Included are tougher mortgage-qualification rules and the elimination of capital gains tax loopholes for non-residents.

Royal Bank of Canada economist Robert Hogue noted: “Our preliminary estimates show a projected decline of nearly 11 per cent in home resales in Canada in 2017 compared to our previous forecast for a 3.7-per-cent decline, and a small price decline of 0.2 per cent compared to a rise of two per cent previously.”

Late in October, CMHC entered the fray, increasing its overall risk rating on Canada’s housing market from “moderate” to “strong.” Red-flagged are Vancouver, Calgary, Saskatoon, Regina, Hamilton and Toronto, with several other markets assessed as “moderate” risk.

Housing starts should range from 181,300 units to 192,300 units in 2016 and 172,600 to 183,000 units in 2017, a slowdown from 2015’s 195,535 starts, says CMHC.



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across the country. The country is witness to roadbuilding and transit megaprojects of unprecedented scope, as referenced in previous editions of *On-Site*.

"A lot depends on the federal government and the provinces getting together to work out the details of the new program and get all the paperwork out of the way. Once that's done, we still need to see the projects tendered. The vast majority of those projects are not tendered by the federal government," says Atkinson.

A NATION OF REGIONS

Atkinson notes that this avalanche of stimulus spending is regional as well as federal. "Massive programs have been announced provincially as well. A lot of that work is not in the hopper yet."

Fiscal constraints are going to be a factor. Even without impact from the U.S. election, weak GDP growth has been forecast for the provinces in 2017.

Atlantic: According to the 33rd annual Major Projects Inventory published by the Atlantic Provinces Economic Council (APEC) in June, 412 projects worth $125 billion are planned or underway in Atlantic Canada. The document predicts that investment in major projects will total $12.8 billion in 2016, down about two per cent from the previous year.

A further decline is expected for 2017, offset by stimulus spending and Vale SA's nickel mine in Labrador. Increased offshore exploration and mining activity could bring investment back into positive territory, APEC noted.

Quebec: Spending of $88.7 billion over 10 years was announced through the province's infrastructure investment program, an increase of $300 million from last year's program.

Ontario: There are plans in place to spend more than $137 billion over the next 10 years on roads, bridges, public transit, hospitals and schools and other public infrastructure. Combined with previous commitments, $160 billion will be spent on public

Champlain Bridge

Banking on infrastructure

The other shoe has dropped for the Canadian Infrastructure Bank (CIB), mentioned in the government's Spring budget.

The premise is simple: the federal government will leverage its infrastructure spending by using its credit rating and lending authority to make it easier for municipalities to build projects. The CIB may also provide loan guarantees and capital contributions to ensure the projects are built.

The finance minister's advisory council has recommended that the CIB be capitalized with at least $40 billion over 10 years. That is expected to leverage at least $160-billion in private capital. Morneau predicted that it would oversee some $15 billion in government money supplemented by an estimated $20 billion from private sources.

Question number one is: where is the money coming from?

One obvious source is the existing commitment to spend $60-billion on infrastructure over 10 years. It's not that simple, though. Some of that money has already been allocated to Phase 1 of the infrastructure plan, and negotiations on some $48-billion in Phase 2 spending are already underway.

The Federation of Canadian Municipalities (FCM) has voiced concern that the CIB might be financed with funds that the government has already promised for major projects.

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infrastructure over the 12 years starting in 2014–15.

Manitoba: $1.8 billion has been allocated for strategic infrastructure, including roads and bridges, flood protection, hospitals, educational institutions, as well as municipal infrastructure in Budget 2016.

Saskatchewan: More than $3.5 billion is being invested in infrastructure projects in 2016-17. Energy distribution, power transmission and telecommunications networks, schools, hospitals and highways are part of a record single-year infrastructure investment plan.

Alberta: Capital Plan 2016, part of the 2016 budget, allocates some $34.8 billion over five years to reduce the province's infrastructure deficit. The focus is on planning, building, maintaining and improving schools, hospitals, transportation systems and other public infrastructure.

British Columbia: The 2016 budget will inject $12 billion into the economy over the next three years. Major investments are planned for transportation infrastructure, including highway upgrades and transit infrastructure; new and upgraded health care projects; post-secondary facilities; and K-12 school facilities.

IRREVERSIBLE CHANGE

The industry will evolve in response to fierce challenges. "You can no longer sit on your own island and not worry about what's going on on the other island… There is a real desire to embrace technology and new methods – perhaps a lot quicker than before – particularly when they bring productivity or competitive edges," notes Atkinson.

Labour will remain an industry concern. According to BuildForce, 11,000 new jobs will be created due to market expansion, replacing retirees will require an estimated 250,000 workers. Even allowing for improvements to interprovincial mobility 27,000 new recruits from outside the industry and likely outside of Canada will be required.

The industry can expect some contraction, partly due to demographics. "You're going to see more mergers and acquisitions. You're going to see some of the smaller and medium size companies start to disappear," says Atkinson. "Demographics plays not just on your personnel, but also on company ownership. Some of those fourth-generation firms don't have a fifth generation that is available or interested."

"Those types of influences are irreversible."

Atkinson suggests keeping a close eye on Phase 2 of the Building Canada Plan. "I think the public-sector infrastructure projects will be the big ones, particularly in the water and sewage treatment areas, LRTs, mass transit." ☐

Jim Barnes is a contributing editor to On-Site.Send comments to editor@on-sitemag.com