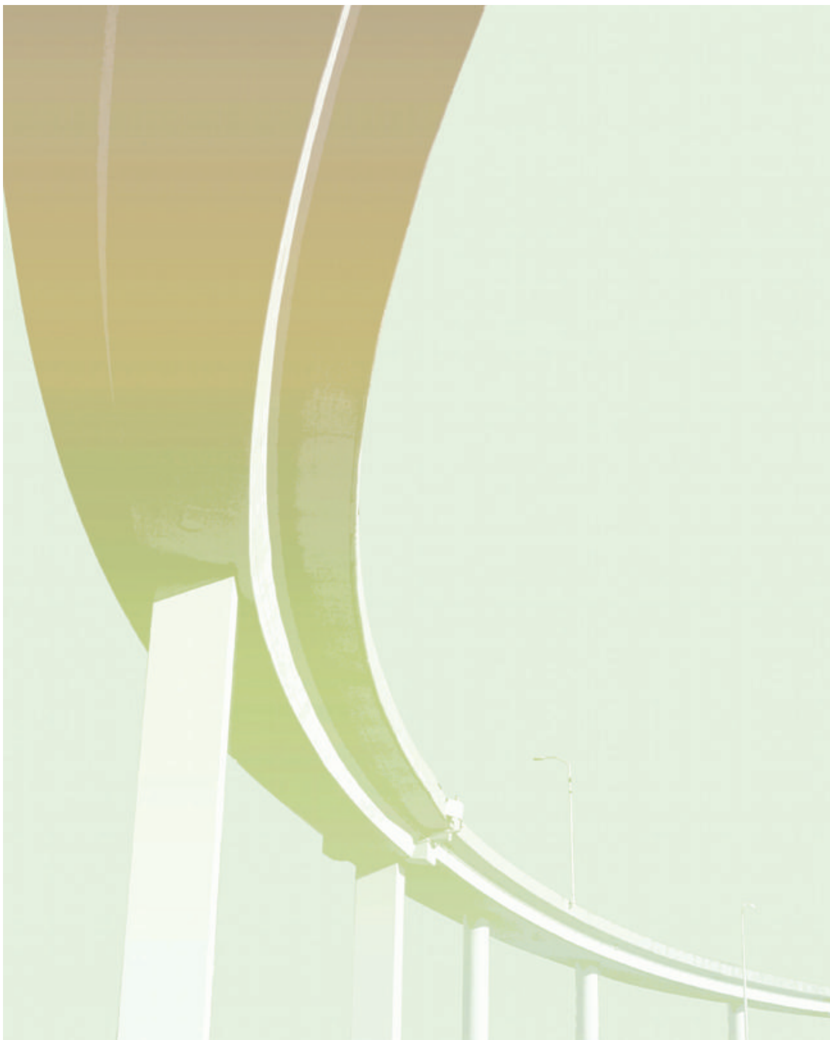
HIGHWAY TO SUCCESS

Understanding Canada's infrastructure crisis and construction trends can help insurers and brokers gain an advantage



Infrastructure is the physical backbone of Canada's economy and society. Our roads, bridges, transportation systems, sewer and water systems, power generation, energy distribution and communication systems, hospitals, schools and recreational facilities – these public and private projects provide the physical framework that bind our communities together.

Economic research consistently shows that robust infrastructure is fundamental to economic growth as it helps attract investment, increases productivity, creates jobs and enhances competitive ability. Put simply, investing in infrastructure has significant economic benefits, while failing to invest has serious negative economic and social consequences.

Canada's infrastructure has aged. Much of our current infrastructure was built in the 1950s and 1960s and, on average, across the country, Canada's infrastructure is about 70 percent through its useful life and is in need of significant upgrade. The Canadian Federation of Municipalities estimates that Canada requires an immediate investment of more than $250 billion just to bring our infrastructure up to acceptable standards, while others estimate that figure is closer to $500 billion. This is in addition to the billions required for new infrastructure to meet the needs of our growing country, and the billions spent each year on simply maintaining what we have.

Our infrastructure shortfall has a real impact on our communities and the real economic costs are manifested in a variety of instances:

- Commuting and gridlock delays in Canada's major cities;
- Purified drinking water leaking into the ground due to breaks and fissures in water mains (estimated to be some 40 per cent in Toronto);
- inability of Canada's oil and gas sector to transport product to key markets
- Deficiencies contributed to the severity of the recent catastrophic floods in Alberta and Ontario; and
- Accidents and vehicle damage due to poor road conditions.

A recent report in The Economist stated, on a global basis, spending on infrastructure is currently approximately $2.7 trillion annually, while at least $3.7 trillion is required. Canada is not alone in its infrastructure deficit.

GOVERNMENT FUNDING PROGRAMS

In 1955, the federal government owned 44 per cent of all Canadian public infrastructure, while the provinces owned 34 per cent and municipalities owned 22 per cent. Today the numbers have reversed with the feds owning 13 per cent, the provinces 35 per cent and municipalities 52 per cent. This has happened despite the fact that the federal government has the most robust revenue source while the municipalities have the least. The burden of capital investment has followed a similar course, with the municipalities now contributing the lions' share, despite the fact that transfer payments to them have declined.

Governments at all levels – federal, provincial and municipal – have wrestled with how to fund infrastructure given competing priorities such as health care, education and an ageing demographic. The good news is that, after decades of neglect and underinvestment, particularly at the federal level, commitments from both the feds and provinces are increasing.

The Government of Canada recently pledged to spend $70 billion on public infrastructure over the next decade, including a new 10-year Building Canada Plan of some $53 billion to assist in funding provincial, territorial and municipal needs (note critics say this is not nearly enough).

While the cost is high, investment in infrastructure is an absolute necessity that will yield significant economic benefits for Canada. With dependable, world-class infrastructure, businesses and investors throughout the world will continue to select Canada as a preferred place to do business. Without adequate investment in our infrastructure, Canada's ability to compete globally will be seriously impaired. Doing nothing is not an option; doing more is imperative.

TRENDS IN CANADA'S CONSTRUCTION INDUSTRY

Increased infrastructure spending and the strong pace of immigration have contributed to growth in the Canadian construction industry. Canada is the 11th largest national economy in the world, but has recently become the fifth largest *construction economy*. This imbalance is due in part to approximately 25 per cent of construction spending in Canada taking place in the oil and gas and mining industries. The Canadian construction industry currently employs over 1.2 million people, over 7 percent of all working Canadians, and drives some 6 per cent of GDP.

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KEY TRENDS EMERGING IN THE INDUSTRY

Construction project sizes are increasing, and bundling of projects has become common. Small to mid-size construction firms risk being shut out of these and so are under pressure to get bigger in order to thrive and survive. This creates significant challenges for these firms.

Public Private Partnerships (P3s) have emerged as a prevalent delivery method whereby "private" enterprises are involved in the ownership, funding, operation and maintenance of projects.

Governments now prefer "leasing" or paying for a project over the life of the project, rather than paying for the entire amount today, even if at a premium to the taxpayer as private enterprise typically cannot borrow as cheaply as government. The cost of financing a project has become a major factor in project award and drives the ultimate cost to Canadians.

Contracts have become more onerous and complicated and risk is being downloaded from owners to contractors.

CONCLUSIONS

It is imperative that all construction industry stakeholders give adequate attention to the growth and evolving procurement and delivery needs of the construction industry going forward. This includes insurance companies and their brokers, sureties, and lenders who will all have to "up their game" in providing guidance and advice to their construction customers. IB

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