

# CONSTRUCTION INSIGHTS

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## 2021 CONSTRUCTION OUTLOOK

Consumer and business behaviours have changed dramatically, and a return to a “normal” looks increasingly tenuous. And predicting what will happen next quarter, let alone next year, is harder than ever. Uncertainty seems to be the only thing that people are certain about.

With that in mind, knowing there still big question marks throughout the industry, we can offer some actionable insights into the current state of the construction and insurance markets that will help you navigate these tumultuous times.

### CONSTRUCTION MARKET

#### Return to Familiar Levels in Second Half of 2020

Despite the headwinds, and a pause in construction that varied depending on segment, the second half of 2020 saw a return to familiar levels of public bidding opportunities for contractors as temporarily delayed procurement processes sought to catch up. Private construction seems to be taking a measured approach, though. While not drying up completely, there are still an increased number of cancellations and delays amid new projects being announced.

#### Ongoing Consolidation

We continue to see ongoing consolidation in the industry across the board with national general contractors, large heavy civil firms, and subs and suppliers all seeing increased mergers and acquisitions.

This concentration of resources is presenting difficulties for contractors to diversify a subtrade base or a customer portfolio. Fewer pricing options is one reason contractors are getting put into more difficult positions, more often.

#### Long Term Care Construction

Supported by financing initiatives either direct from CMHC or through private lenders that were able to take advantage of government program backstops, construction in this area saw massive increases.

Based on an evaluation of the demand vs capacity for these institutions, we would expect a pipeline that is many years long.



*“Looking ahead, the recovery will be slow and gradual...and we see major changes in consumer and business behaviours negatively affecting demand for office and retail space”*

**Pedro Antunes**

Chief Economist with the Conference Board of Canada

*“Overall, the construction industry has stayed fairly safe and kept working. It’s just that we’ve had to adapt on the fly to a lot of change. And there’s been a cost to that.”*

**Sandra Skivsky**

Chair of the National Trade Contractors Coalition of Canada

## Legislative Change

With federal prompt payment and provincial lien legislation updates underway, legislative change is still progressing. The new arbitration regime in Ontario has seen its first cases, and while the volume is not heavy (32 adjudications commenced and just three decisions rendered), it may suggest that the legislation is driving negotiations and settlements, which is its intended goal.

## Supply Chains and Labour Availability

Lead times for all manner of equipment and supplies that were previously in stock, or available within a day or two, are now stretching into the weeks or even months. Employee availability, while statistically abundant, is being impacted suddenly with potential virus exposures and quarantine requirements. There is no insight into how long these types of disruptions will continue.

## Green Energy & Efficiency Retrofits

There is some certainty in where there is expected to be some investment: green energy and building efficiency retrofits are two areas that the Canadian Infrastructure Bank has highlighted, earmarking \$10 billion from its working budget of \$35 billion for sustainable infrastructure.

## Light at the End of the Tunnel

Finally, in terms of forecasts, both 2021 and 2022 are predicted to be strong growth years for the Canadian economy.

For an industry that commands 15% of its nation's GDP, like construction does, this bodes well.



## INSURANCE OVERVIEW

### Hard Market

The 'hard market', and its consequences exacerbated by the global pandemic, brought unprecedented challenges this year. And according to industry executives, this current hard market and its negative impacts are expected to continue through at least 2021.

Insurance companies operating in Canada and abroad are all pressing to return to a healthy and sustainable business model founded on underwriting profits, and not only investment returns. This means rates are likely to remain in an upward trend, and underwriting will remain disciplined.

### Industry by the Numbers

During the first quarter of 2020, the Canadian property & casualty insurance industry reported an earnings drop of over 65% from the same quarter in 2019, primarily the result of lower investment returns due to COVID-19 related financial market turmoil.

The unease in the financial market was only marginally offset by improved underwriting performance, with the industry posting a smaller underwriting loss in Q1 2020 (\$279 Million) versus Q1 2019 (\$951 Million).

Unfortunately, the 2020 Q2 results were not as rosy, and the industry returned to underwriting losses in line with prior years (\$893 Million at Q2 2020, versus \$804.5 Million at Q2 2019).

## Construction Insurance

Being a distinct segment of the insurance industry, construction insurance has its own unique challenges. The smaller pool of insurers who offered Builders Risk insurance in 2020 continue to demand higher deductibles and rates, while restricting coverage for some projects.

However, it is not all bad news as we have seen Canadian domiciled insurers, who have been sitting on the sidelines for some time, start to provide more builders risk capacity – albeit at higher rates than in years past. Professional Liability (Errors & Omissions) insurance has also experienced historic premium increases, due to insurers either restricting the type of industries they will offer this product to, or exiting the space entirely.

Generally, insurers continue to take a highly cautious approach to classes of business that they deem higher risk, which includes many sub-sectors within the construction business. Throughout 2020, commercial insurance buyers, and especially those deemed “high risk”, have seen major premium increases.

## SURETY OVERVIEW

Canadian surety was on pace through the third quarter of 2020 to have a second successive profitable year with claims hovering around 30% of premiums taken in. However, what looms ahead has the industry only cautiously optimistic as many fear 2021 will see the challenges brought about by COVID-19 catch up to financially strapped contractors.

The economic disruption from the pandemic saw an immediate impact on underwriting philosophy and imparted a more cautious approach from sureties in 2020 that largely remains in place as we enter 2021.

For contractors pushing the limits of their bond program, inconsistent profits, or weighed down with high debt levels, dealings with their surety will continue to be tough as underwriters monitor the financial impact of the crisis on their Balance Sheets.



In 2021, Surety underwriters will be looking to see what approach contractors take to rebuild their backlog and whether they remain disciplined with their margins.

It may be tempting for contractors hit hard by COVID-19 to ‘make up’ for a poor year by piling on work, but they should be reminded FMI’s wise maxim that “Contractors don’t starve to death; they die from gluttony. They get too much work, too fast, with inadequate resources, and then they get into financial trouble and run out of cash.” (FMI, Why Large Contractors Fail – A Fresh Perspective, 2016).

As the coming year shakes out we recommend contractors be communicative and transparent with their surety partners about financial reporting and their business in general. This lends itself to a strong, trusting surety relationship, with a well-informed surety more inclined to offer extra support than one who has been kept in the dark, or been the recipient of unwelcome surprises.

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If you have questions specific to your business, or would like additional information, please reach out to your Wylie-Crump Advisor.

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