

2022 Construction Outlook

LOOKING BACK: THE REVIVAL

The pandemic continued to wreak havoc on just about every aspect of daily life for much of the past year, however, Canada and Canadians showed remarkable resilience in adjusting to the upheaval and finding a way forward. In the business and economic landscape, there were even encouraging signs of a recovery, with economic activity bouncing back to pre-pandemic levels in Q3 2021, and the construction industry at the forefront of the revival.

The data bears this out. Growth in the construction sector in 2021, estimated at 6.5%, is expected to strongly outpace projected 4.5% growth in the general economy. New building permits surged, hitting not only their pre-pandemic level in Q2, but their highest level in several years. Canadian surety industry results - as good a barometer as any of the health of the construction industry - saw a drop of almost 20% in surety claims at Q3 versus the prior year, reflective of a notable reduction in contractor defaults. All compelling indicators of a stable, if not thriving, construction economy in Canada in 2021.

What's particularly remarkable about the construction sector's progress is that it did so while facing a host of pandemic related challenges. Issues such as supply chain disruptions, labour shortages, extreme material price volatility, not to mention the difficulties of managing a largely front line, "essential" workforce through rigorous new safety protocols and restrictions, and the wrench this throws into productivity and scheduling.

Despite these hurdles, the construction industry showed remarkable resolve in getting the job done and in so doing, once again validated our long-held view that the construction and development industry has some of the most resourceful and dynamic entrepreneurs on the planet.

WE WELCOME READERS TO OUR 2022 NEWSLETTER



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BENEFIT FROM
OUR
SPECIALIZATION



LOOKING BACK: THE REVIVAL (CONT.)

To be clear, ascribing stability to the construction sector in 2021 is not to suggest it was a banner year for individual operators. Generally speaking, it wasn't. The reality is it was a hard fought year of mediocre results for many in the industry. But on a relative basis - when measured against the economic collapse of the prior year and the prevailing continued weakness in many sectors - mediocrity stands out as a formidable achievement in 2021.

We must also acknowledge the elephant in the room at the time of writing, which is the unexpected end of year spike in pandemic cases, provoking an all too familiar sense of uncertainty with what lies ahead, and the prospect of a slower start to the year.

MOVING FORWARD: SOARING CLOSER TO THE SUN

Notwithstanding any setbacks early in the year, our 2022 outlook for Canadian construction remains optimistic. Non-residential (ICI) construction will continue to benefit from a confluence of new and pent-up demand for construction across just about every region in both the government and private sectors. The irrepressible Canadian housing market, buoyed by record new housing starts (and record immigration) in 2021, will take up massive building capacity over the coming years to execute on the pipeline of work. As it usually does, a strong housing sector will lift the entire construction economy as governments make the necessary public infrastructure investment to keep pace with growing cities.

Taking it a step further, we don't rule out an overheated construction market in some regions in 2022. At the same time, the supply chain, labour scarcity, and other pandemic induced problems that plague construction will not disappear overnight, and could conceivably worsen if surging demand further outstrips supply. The result is the prospect of growing backlogs amidst a higher risk operating environment for contractors, a perilous combination. It recalls the old maxim that contractors generally don't fail from lack of work, rather, over-extension is what most often delivers the knock-out punch: taking on too much work too quickly and ultimately running out of cash to resolve the bigger problems that typically accompany bigger volumes.

Our focus then turns to how best to maximize success and manage through a potential climate of both greater opportunity and higher risk. The solution lies in project selection, or more specifically, being especially thorough in recognizing and managing the inherent risks in new project opportunities, and selective in dedicating resources and focus to the ones that stand the best chance to generate a proper return. And having the discipline to either walk away from, or price accordingly, those jobs that pose more risk than you're comfortable taking on. They may be best left for the competition.





Our friends at the prominent construction consulting firm, FMI, had this to say on the issue:

"Selecting the right work is one of the most important and consequential management activities in an at-risk construction business. Contractors' profit margins are greatly influenced by the quality of their project selection process and decision making. While it may be obvious that good backlog equates to good financial results, the downside risk of poor-quality decision making in project selection is asymmetric. That is, one or a few bad projects can wreck an otherwise profitable year. Contractors' most profitable years are often ones without any major project losses. Thus avoiding catastrophic projects is key to achieving best-in-class profitability, and requires the discipline to say no to opportunities with identifiable issues."



We at WCL are excited for what lies ahead in our industry and look forward to continuing to work closely with our clients to help navigate the choppy waters 2022 is sure to bring.

Good luck out there!

INSURANCE MARKET UPDATE

Most of us are tired of the term "hard market" when discussing insurance, but the truth is, the market has been very challenging since early 2019.

Throughout 2021, insurers continued seeking increased rates, higher deductibles, and more restrictive coverage, and as we head into 2022, the Canadian insurance industry's discipline seems to have paid off with more respectable returns and a stabilizing, yet still somewhat fractured market.

Better managed, longer standing insurers who have realized improved results over the last 3 years will be in the best position to offer more competitive terms.

Having said that, insurers have noted a lull in claims activity, which they attribute to the social restrictions imposed on much of our population throughout the pandemic. As things start to return to a new normal, most expect claims activity to pick back up, especially automobile and general liability claims.

"Social inflation", a term used to describe the increasing cost of settling claims over the past few years, is predicted to continue. Growing backlogs in the courts certainly hasn't helped matters. Further, natural catastrophes continue to occur with greater frequency: of the 10 largest natural catastrophe insurance losses in Canadian insurance history, 8 have occurred within the last decade. Due to these factors, we envision the return to a more competitive insurance market will be more of a slow jog, and not a sprint.



INSURANCE MARKET UPDATE (CONT.)

So, what are the insurance challenges unique to the construction and development industry that we foresee for 2022?

Since the onset of the hard market, many insurers either stopped offering builder's risk insurance or limited their capacity, particularly with wood frame construction. It is now common for insurers to share builder's risk policies with other insurers, requiring more time and effort to negotiate a policy. There is some new, opportunistic capacity entering the market, but it is not naïve, and is also exercising a cautious entrance or re-entrance to builder's risk insurance. Builder's risk deductibles have increased, and nearly all insurers demand significant deductibles for the specific peril of water damage, especially on multi-storey residential construction.

Rebuilding costs continue to escalate due to supply chain shortages. Budgets carried for projects in 2019 and 2020 may not have lined up with the realities of the strained supply chain in 2021, and could lead to some projects being underinsured and claims costing more than anticipated.

Finally, the passing of Bill 11 in May 2021 delivered changes to the BC Insurance (Vehicle) Act and is widely expected to have a positive impact on road maintenance and construction contractors. The Bill removed the right of people injured in motor vehicle accidents to pursue litigation (a complete bar), however, insurers are waiting to see the longer-term effects before implementing wholesale changes to their appetite or rates for these sectors.

Our parting advice in last year's insurance market update was to partner with a construction specialist broker who can leverage their expertise and market relationships to deliver an improved overall insurance experience.

2021 statistics released by a large, international brokerage, referred to "average rate increases upwards of 30% for construction insurance". We're pleased to report WCL clients fared considerably better, as our team of experts worked hard, and strategically, to deliver more advantageous results.

Entering 2022, our advice remains the same: having a construction specialist broker in your corner will continue to pay dividends over the near term and long run.





SURETY MARKET UPDATE

2021 will go down as a strong year for the surety industry, with results showing improvements in both total premiums and losses as of Q3, and these expected to hold for the full year. This comes as a surprise to many who believed the economic impact of COVID-19 would finally catch up to the construction industry in year two of the pandemic and lead to an increase in surety claims. While that has been true in some cases, results suggest contractors are weathering the storm better than expected, although, as mentioned earlier, as activity picks up there is concern associated with over-extension and depleted balance sheets not capable of withstanding the strain of a sharp uptick in backlog.

As much as the surety industry is in a healthy state and capacity remains robust, bonding company appetites are slightly more cautious and discerning, and while well-managed, better performing clients continue to attract favourable terms (as always), there's a higher degree of scrutiny being applied across the board. As a result, even in this stable surety environment, underwriters are following up more diligently for financial reporting and asking more questions aimed at understanding how clients are managing supply chain issues, which to date, show little sign of moderating.

Developer Surety continues to grow within the industry which is good news for the developer marketplace. With a clear understanding of the market's needs and the Surety's appetites, we have provided significant support for clients translating to enhanced cash flow on bonded projects.

Surety markets, initially uncertain about COVID related risks such as delays due to shut downs and erosion of margins due to decreased productivity, are encouraged by minimal disputes, fewer defaults than anticipated and more collaborative project negotiations. They are now eager to pick up new business and support existing clients.

There are some changes anticipated in the Canadian surety space in 2022, and the healthy market is attracting some new surety companies expected to be open for business this year, as well as some notable changes with established players. As a leading surety broker in Canada, WCL is well-connected to the senior decision makers of all Canadian sureties (including the impending new entrants), and we welcome any further inquiries in this regard.

BOND ORDERING PLATFORM

BONDLINE
NAVASURE™

Navacord was very proud to roll out BondLine in 2021, our newly enhanced online bond ordering and management website! Offered exclusively to Navacord Group clients, BondLine allows construction clients to order bonds, track and manage outstanding bids, verify bond rates and premiums, and much more – all online with the click of a virtual button.

Stay tuned for additional information as we roll-out this optional service to WCL clients in 2022!

WCL TEAM UPDATE

Flexibility and adaptation are key ingredients to success, and while we have not had the opportunity to officially christen our new open-concept office space which we moved into in 2020, 2021 provided an opportunity for WCL to hone our operation to keep pace with the rapidly evolving professional services workplace.

We introduced a “hybrid work policy” which has been very successful, enabling more flexible work arrangements for our team while maintaining a seamless service experience for our clients, and the team-based spirit and entrepreneurial culture that are key to our success. The technology side of our business saw continued focus and investment, with the implementation of several IT initiatives aimed at elevating digital security, and improving the ease of doing business and overall experience for both staff and clients.

Our team continued to grow throughout 2021, with five important new additions to the WCL family.

Duljit (DJ) Dillon joined in Q2, and has provided strong support to the always-buzzing insurance service team. Lesley Findlay joined our surety practice mid-summer, picking up where she left off a few years ago while adding to the seasoned bench with her extensive construction related experience and enthusiasm for the industry. Also joining the insurance team over the summer was Jennifer Mills, who hit the ground running and has been an excellent addition to our team of senior associates. Carlyle Machinski brings a wealth of knowledge and technical experience to our insurance team, along with Vivian Fung who rounded out our 2021 roster additions this past fall, both bringing their amazing energy and client service excellence to the fold.

We were very pleased to be able to attend a carefully planned Whistler Weekend trip held in November 2021. The great outdoors, remarkable facilities and universal camaraderie allowed us to truly connect as a team and celebrate the success we have had over the last two years. A large part of that spirit also saw WCL support such worthy causes such as the Indian Residential School Survivor’s Society on Orange Shirt Day, and the Red Cross on behalf of the BC Roadbuilder’s Flood Relief campaign, all in addition to our annual support of the BC Children’s Hospital. WCL is looking forward to more of the same in 2022!



KIM MCCOURT	15 YEARS
NOLAN HEUCHERT	13 YEARS
GRAHAM SIBBALD	13 YEARS
BRIAN LAWSON	13 YEARS
MARY MENDES	10 YEARS



B.C. REGIONAL UPDATE

2021 in B.C. was a year marked by uncertainty due to changing COVID conditions and devastating weather. Record-setting temperatures in summer, followed by what appear to be the new norm of summer fires, and finally by the wettest fall on record, introduced new terms into day-to-day conversation such as 'heat dome' and 'atmospheric river'. Even so, construction volume stayed strong throughout the year through government spending, while emergency funding programs such as CEWS assisted balance sheets.

Significant infrastructure upgrades are underway or forthcoming after the devastation caused by flooding in the Fraser Valley and mountain passes, requiring reconstruction to a higher 'climate proof' standard sooner rather than later. The B.C. road building community exceeded expectations and through their unwavering efforts, saw to the re-opening of key commercial routes far earlier than anticipated. We join the voices of most British Columbians who appreciate and thank the many contractors, many of whom we call our clients, who were instrumental in achieving this important milestone.

Contractors have broken ground on multiple hospital sites across B.C. with more to follow as investment into the expansion and upgrade of existing facilities take priority. Residential construction continues to surge with cranes in the sky on mid and high-rise development projects across urban areas of B.C. WCL is pleased to support the significant uptake on First Nations representation in much of the work taking place in B.C. and the Yukon.

Also of note; Alberta's Bill 37, the Builder's Lien (Prompt Payment) Amendment Act, 2020 is expected to be brought into force by July 2022. This will have a significant impact on any industry involved directly or indirectly in land improvement activity in Alberta, applying to all lienable construction contracts entered after the amendment comes into force.

In B.C., both the Premier and Attorney General support prompt payment legislation but it still requires much stakeholder consultation and planning. A likely date for introduction of draft legislation in B.C. is mid-late 2023, possibly 2024. Ontario's experience with their prompt payment legislation, in full force on construction contracts entered on or after October 1, 2019, is being closely monitored to see if the effective prompt payment regime is resulting in notably fewer disputes requiring adjudication.



NAVACORD UPDATE

It's hard to believe it's been 7 years since Navacord's inception back in 2015, and 4 years since WCL joined Navacord, and we're thrilled to see such extraordinary progress during this time. Navacord is now a top 5 broker in Canada, with total premiums of roughly \$2.5 billion, through 40 leading brokerages from coast to coast, and across various lines; commercial insurance (60%), personal insurance (25%) and life / group benefits (15%). Navacord's construction practice remains our largest industry specialization representing roughly 30% of our business nationally.

In 2021, Navacord welcomed several respected insurance brokerage businesses in Atlantic Canada, Ontario and Western Canada, with the addition of GNK Insurance Services, Lynn Valley Insurance and All West Insurance in B.C. We also made investments in our legal and financial infrastructure, with a large commitment to IT, an especially important investment given the current hostile climate of cyber-crimes.

We put on a very successful virtual construction conference for our contracting clients in the spring, and later in the year brought together 100 of Navacord's construction focused professionals for a virtual "Construction Summit", with technical learning sessions and forums designed to collaborate, share ideas and best practices, and enhance the value proposition for our construction and surety bonding clients.

Finally, Navacord's commitment to our people has been steadfast. In 2021, we are 2,000 exceptional employees, including 200 shareholders actively engaged in the business. Our people, and our broad shareholder base, stand out as strong differentiators in our industry, and a key ingredient to our customer-centric culture.

Feel free to contact us if you have any questions about any of the information contained in this document.

BENEFIT FROM OUR SPECIALIZATION

320 - 151 E 2nd Avenue
Vancouver, B.C. V5T 1B4

604.687.8888
wylicrump.com
info@wylicrump.com