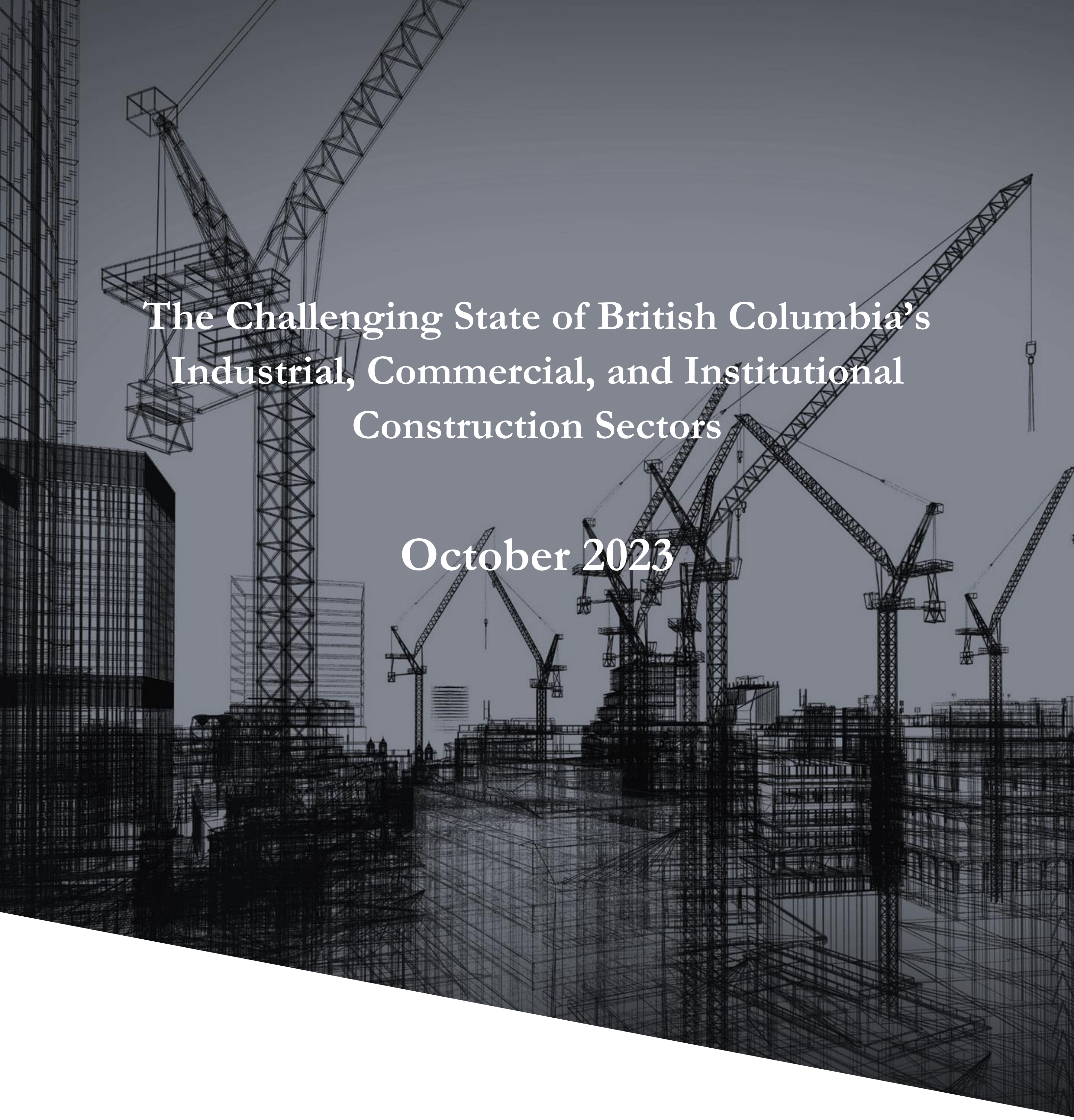


The Challenging State of British Columbia's Industrial, Commercial, and Institutional Construction Sectors

October 2023

bcca British Columbia Construction Association

SAGE policy group

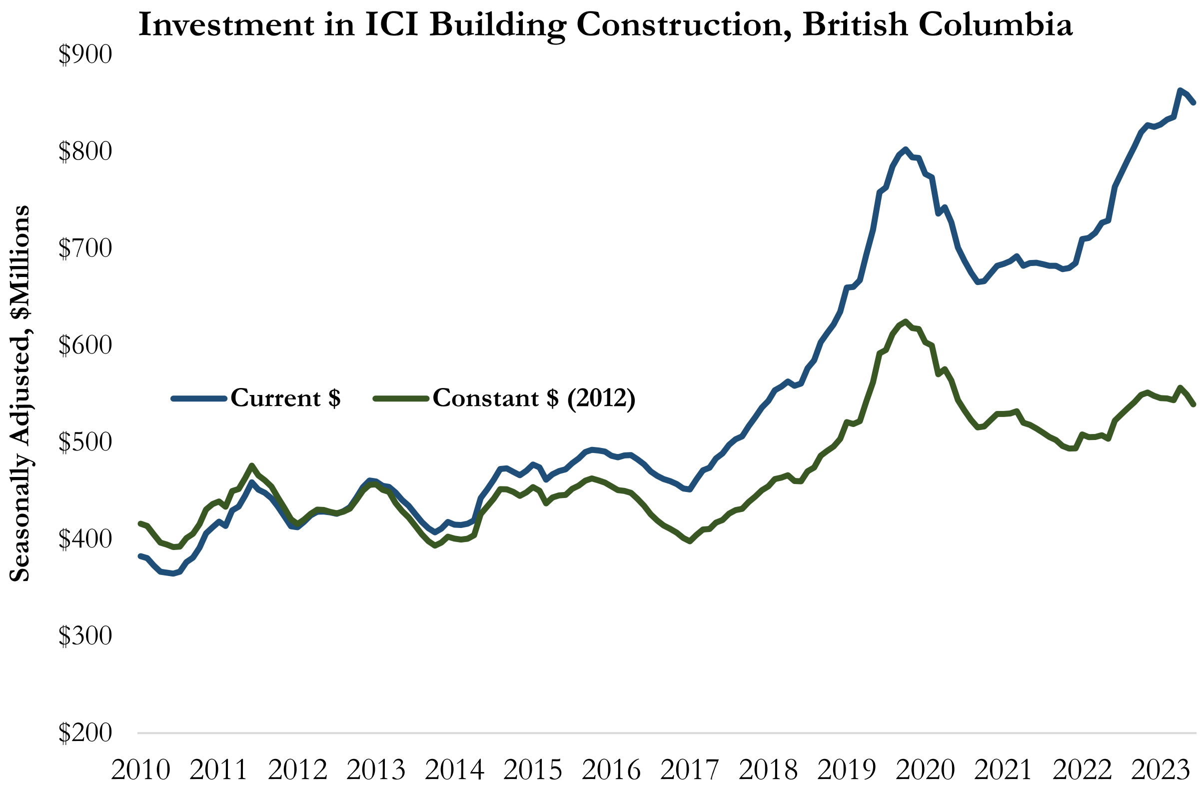
Macroeconomic Overview

INVESTMENT IN BUILDINGS REMAINS SUBDUED

The value of inflation-adjusted investment in industrial, commercial, and institutional/government construction in British Columbia plummeted during the first two years of the pandemic, declining 21% between the all-time high attained in October 2019 and December 2021. While real investment rebounded more than 10% during the first nine months of 2022 as the economy reopened and pent-up demand was released to the marketplace, that momentum has since dissipated.

A combination of high interest rates and the corrosive impacts of excess inflation have conspired to reignite the slump. Through the first half of 2023, real investment in ICI construction has been essentially flat (-1.6%) and remains nearly 14% below its 2019 peak.

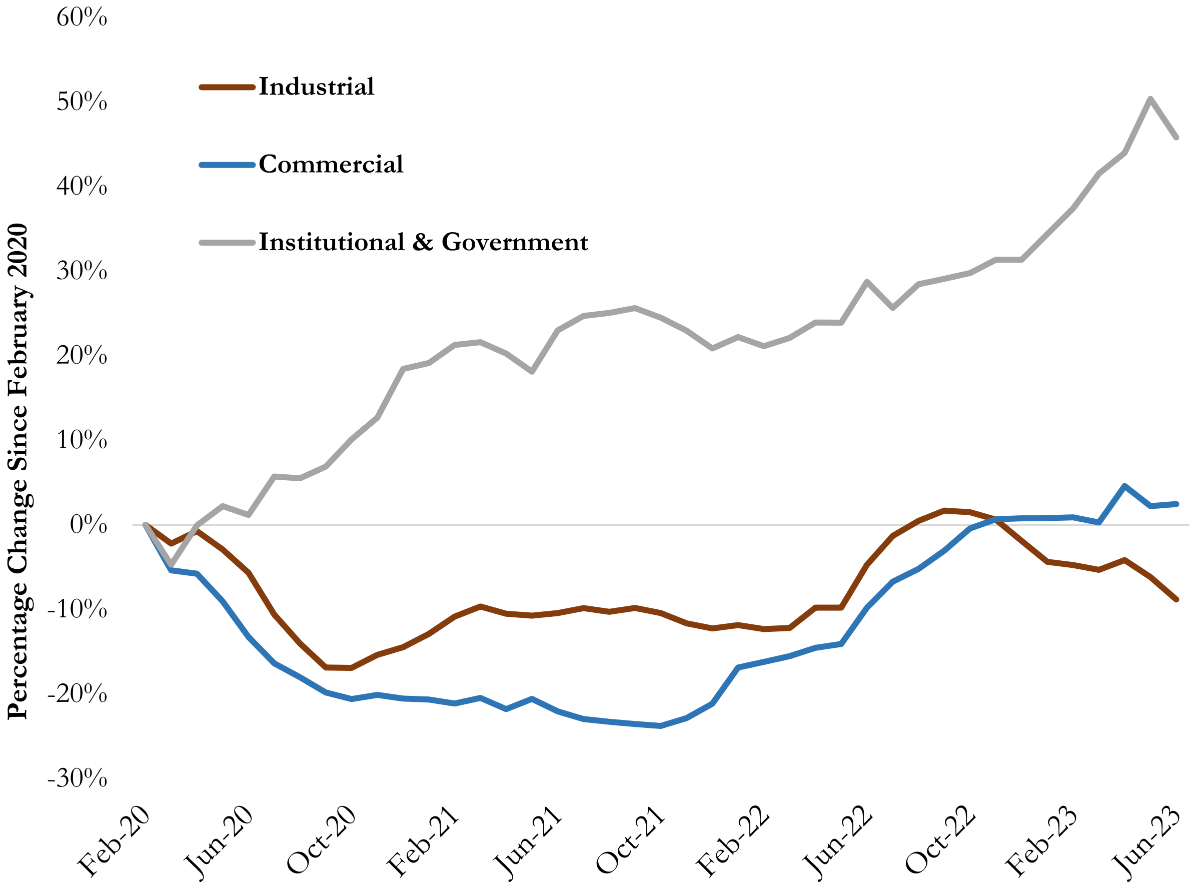
Matters look different when considered in nominal terms (current $). Spending on building construction exceeds pre-pandemic levels, up 10.0% since February 2020, but only because the cost of delivering construction services has expanded due to worker shortages, lengthy lead times for equipment and other construction inputs, and challenges obtaining timely payment from purchasers of construction services.



Source: Statistics Canada. Table 34-10-0175-01 Investment in Building Construction

Institutional and government construction has been the only growth segment since the start of the pandemic, and that has obscured a lack of momentum in other categories. Investment in that segment has expanded by more than 45% since February 2020 in nominal (not inflation-adjusted) terms.

Investment in ICI Building Construction, British Columbia



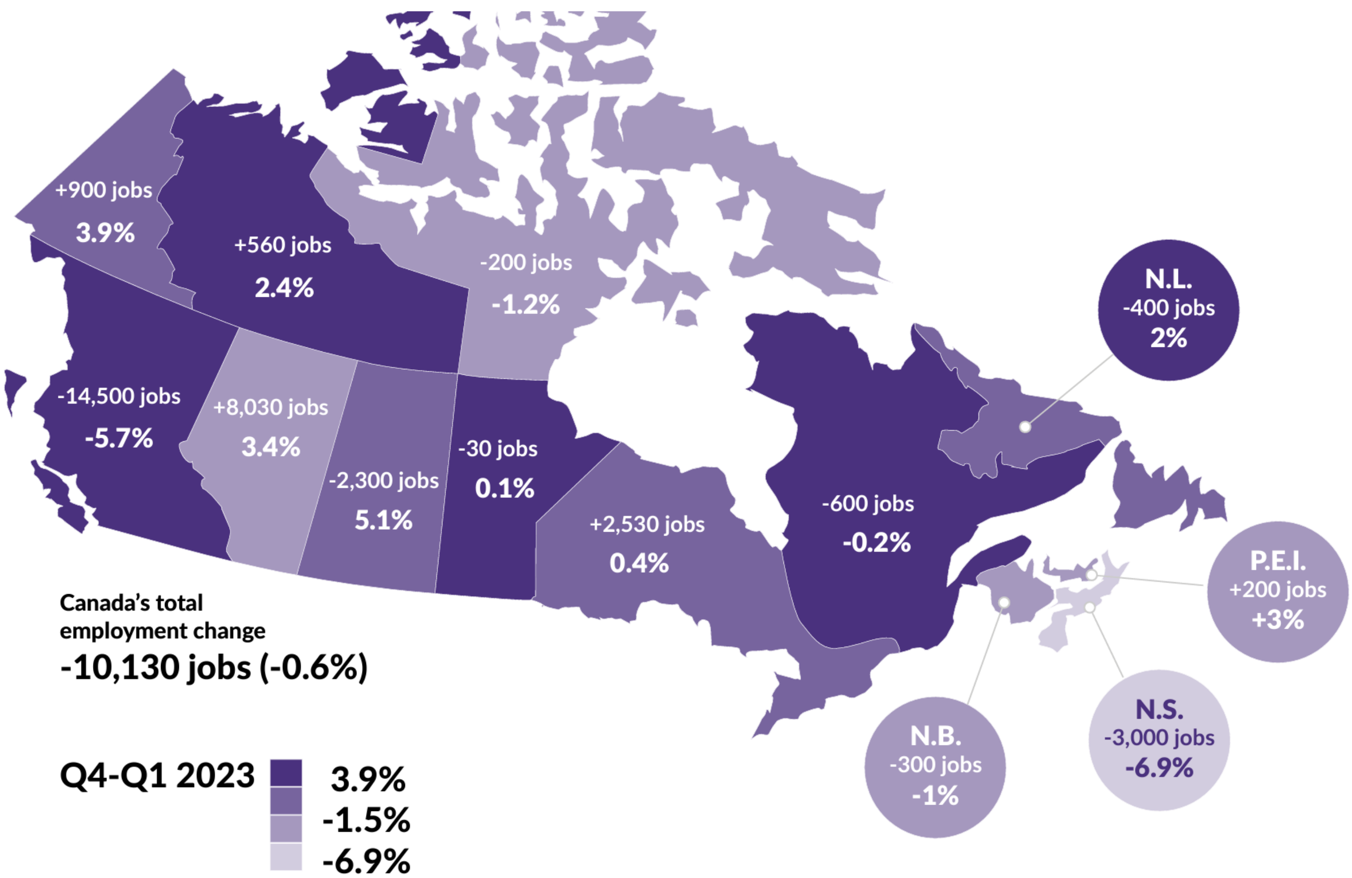
Source: Statistics Canada. Table 34-10-0175-01 Investment in Building Construction

By contrast, industrial construction in British Columbia remains stagnant, down 12% in real terms and 4% in nominal terms over the past year and 9% since the start of the pandemic (nominal). The lack of industrial construction in British Columbia is likely attributable to many factors, but one of them is America's industrial policymaking, which through federal tax credits is inducing large manufacturers to shift supply chain capacity to the U.S. despite the strength of the U.S. dollar (which frustrates export growth) and the relative weakness of the Canadian dollar.

CIRCUMSTANCES ARE MORE PROBLEMATIC IN BRITISH COLUMBIA

From the first quarter of 2023 to the second, British Columbia's construction employment base declined by 14,500 workers, a decline approaching 6%. That was easily the worst performance of any Canadian province in both absolute and percentage terms.

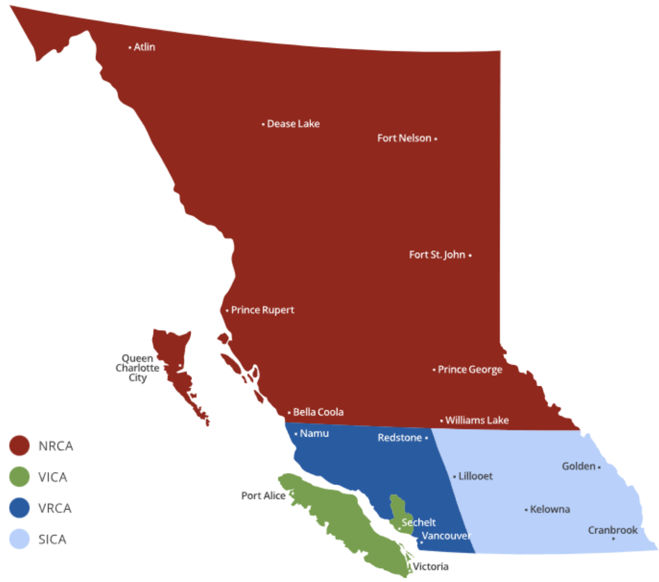
Quarterly employment change in construction activities
Q1-Q2 2023



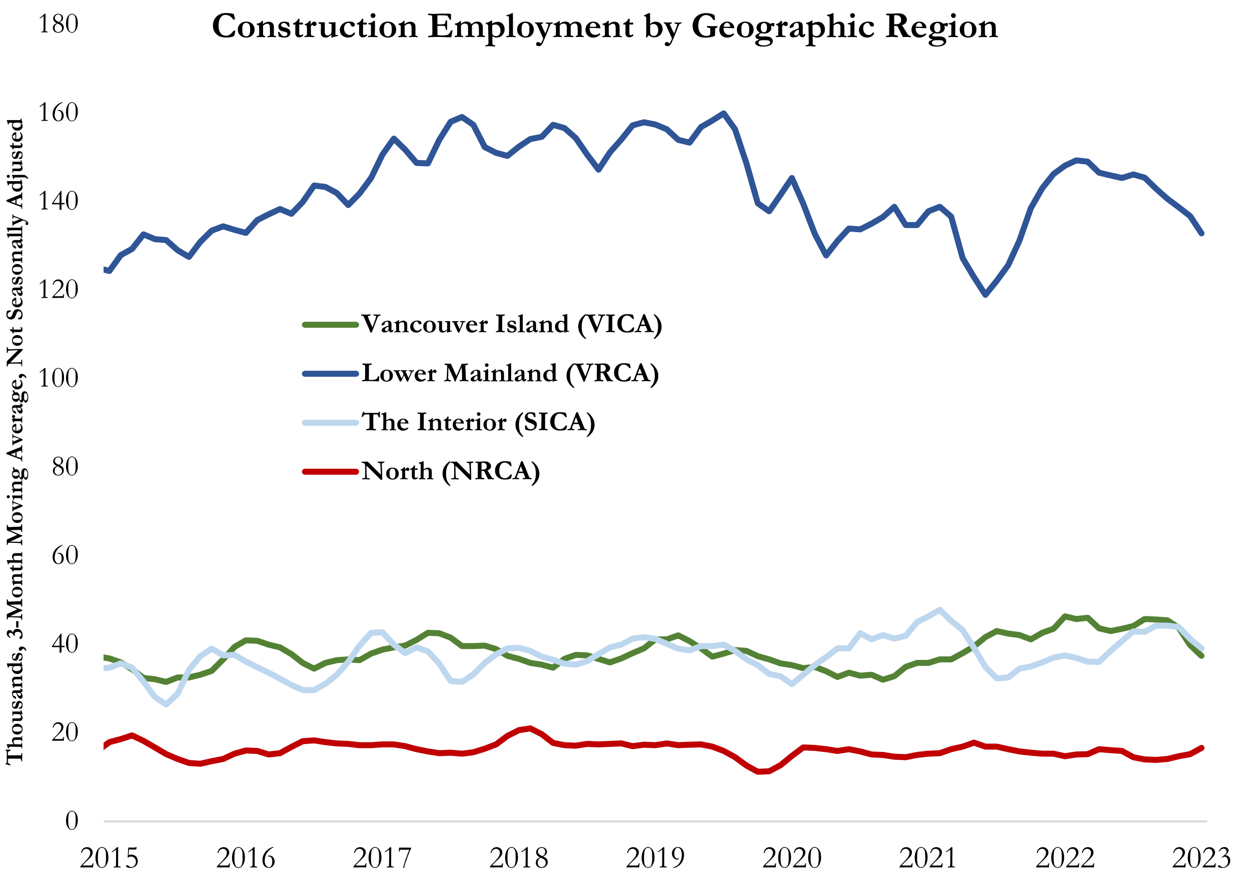
Source: Canadian Construction Association, Statistics Canada

Those job losses have been concentrated in the geography covered by The Vancouver Regional Construction Association (VRCA). The VRCA is associated with the largest employment base of the four British Columbia Construction Association (BCCA) regions, accounting for nearly 60% of provincial construction jobs. In part because of centrifugal forces that have been unleashed by the pandemic, including the pervasiveness of remote work, many households have left large and expensive cities for more affordable environments. Not coincidentally, as of August 2023, contractors in the VRCA collectively employed 27,100 fewer workers than in February 2020, a decline of 16.9%.

Among the BCCA's four regions, only the Northern Regional Construction Association (NRCA) reports more construction jobs than it did pre-pandemic. The NRCA's construction employment base is up 4.4% since February 2020. However, the NCRA is the BCCA's region with the fewest construction employees and its growth amounts to just 700 net new jobs.



Within the geographies covered by the Vancouver Island Construction Association (VICA) and Southern Interior Construction Association (SICA), construction employment has been roughly flat over time, with both regions currently less than 1,000 jobs away from obtaining pre-pandemic employment levels.



Source: Statistics Canada. Table 14-10-0388-01 Employment by industry

CONSTRUCTION COSTS SURGE

Between 2020's first quarter and the second quarter of 2023, Statistics Canada's nonresidential building price index (a reflection of how much more it costs to construct a building) rose 29%. This was meaningfully above the 25% increase observed over the course of the decade preceding the pandemic. In short, construction delivery costs have been surging, though the pace of construction cost increases has moderated since mid-2022 as supply chains become more fully operational and global commodity prices retreat from prior price spikes. Over the past year, nonresidential building prices are up a more modest 7%. That said, a dearth of technical talent continues to place substantial upward pressure on wages. Based on available demographic information, that is not set to change.

Source: Table 18-10-0276-01 Building construction price indexes, by type of building

MATERIALS PRICES

For much of the pandemic recovery period, skyrocketing materials prices were one of the industry's principal challenges. Many contractors report client dissatisfaction because of rampant cost increases, but in large measure contractors have simply been passing along price increases that they confront in the marketplace for construction inputs.

However, the availability of construction inputs has improved recently, helping to limit cost growth. According to the Global Supply Chain Pressure Index, supply chains are presently experiencing their fewest disruptions in nearly a decade. Along with moderating demand both domestically and abroad, improved supply chain functioning has exerted downward pressure on many key ICI sector inputs.[1] Over the past year, lumber prices have fallen 15.1% and ferrous metal products prices have pulled back 7.2% according to Statistics Canada's Industrial Product Price Index.

While recent declines are a welcome development for contractors and project owners alike, materials prices remain severely elevated by pre-pandemic standards. Many commodity categories are up more than 40% in price since February 2020. Barring additional supply shocks, input price escalation should remain relatively tame during coming quarters, but already elevated price levels will continue to suppress project volume going forward.

WORKER & SKILLS SHORTAGES

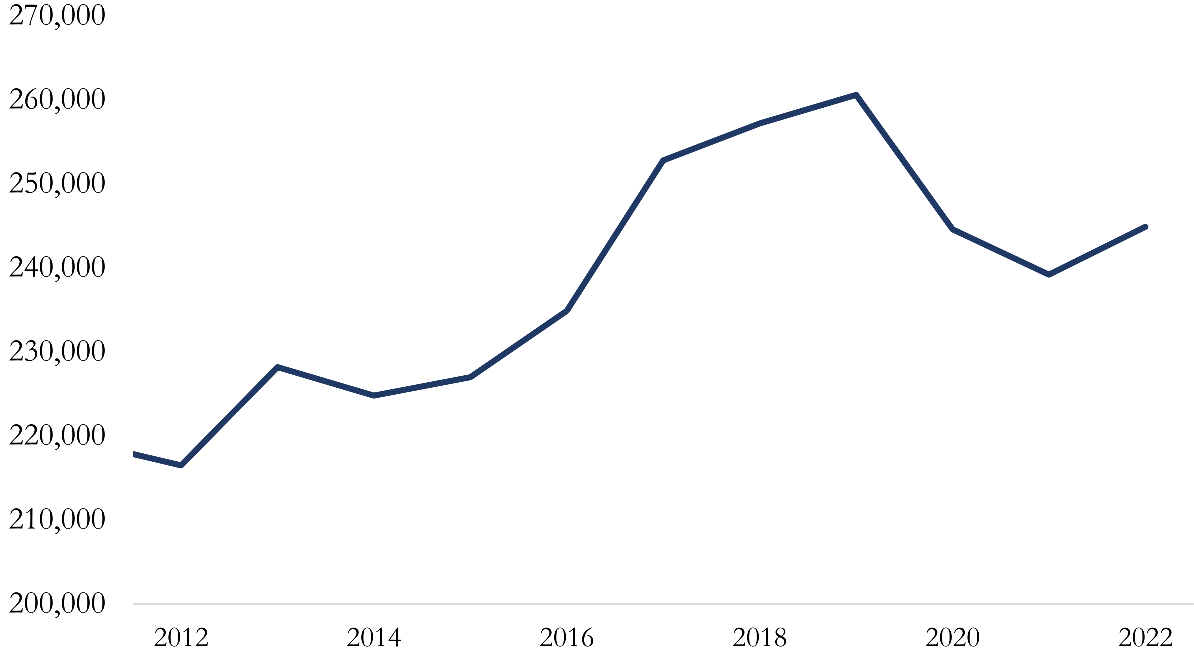
Construction labour is historically tight in British Columbia. The industry unemployment rate was already at an all-time low during the months preceding the pandemic, averaging 3.7% during the year ending August 2019. It reached a new low of 3.5% during the twelve months ending January 2023. While the industry unemployment rate has risen modestly since early 2023, the province's construction unemployment rate remains a full percentage point below the analogous Canadian industry unemployment rate.

Source: Statistics Canada. Table: 14-10-0022-01 Labour force characteristics by industry

[1] Federal Reserve Bank of New York, Global Supply Chain Pressure Index. https://www.newyorkfed.org/research/policy/gscpi#/overview

Declines in the size of the local labour force are at the heart of problematic skills shortages. Between 2019 and 2021, British Columbia's construction labour force shrank 8.2%. It has since partially rebounded as the COVID-19 health emergency has passed, expanding 2.4% or by approximately 5,700 workers in 2022. Despite these gains, the supply of construction labour in British Columbia remains 6.0% below 2019 levels. The result has been extremely low industry unemployment rates and rising compensation costs in the context of rampant human capital shortfalls.

Construction Labour Force, British Columbia
1976-2022



Source: Statistics Canada. Table 14-10-0023-01 Labour force characteristics by industry, annual

Economic theory indicates that when something becomes scarcer, it becomes more expensive. That is precisely what has occurred with respect to the province's construction labour market. Construction wages in Canada are up nearly 15% since the start of the pandemic. Provincial industry wages have increased at a faster rate than nationwide construction wages (up 18.4% since the start of the pandemic) in four of the past six years, according to data from Statistics Canada.

From contractor and construction service purchaser perspectives (including government), industry compensation costs are likely to become more problematic during the years ahead. It is said that demographics are destiny, and therein lies the issue. A forecast from BuildForce Canada projects that more than 244,000 construction workers will retire over the next ten years. Until the provincial labour supply improves, compensation costs will continue to exert upward pressure on provincial construction costs.

Additional Considerations & Challenges

LACK OF PROMPT PAYMENT LEGISLATION

While several provinces recently enacted prompt payment legislation, British Columbia policymakers have not. This places additional financial pressure on contractors, who already face rising costs and stagnant demand in several key segments. Ontario amended its law to require an owner to pay a contractor within 28 days of receiving an invoice and a contractor to pay a subcontractor within seven days of receiving payment. In the event of nonpayment, Ontario's policy requires strict adjudication.

Alberta and Saskatchewan have also enacted prompt payment legislation in recent years and similar efforts are ongoing in Quebec, New Brunswick, Nova Scotia, and Manitoba.[2] At the federal level, legislation that would require prompt payment on federal construction projects received royal assent in 2019 but is not yet in force.[3]

The ongoing lack of prompt payment legislation poses several risks for British Columbia's construction industry. It forces contractors to raise their bid prices due to higher risk mitigation costs, increasing overall construction costs and ultimately diminishing the volume of investment.

According to BCCA's 2023 Construction Industry Survey, 82% of contractors were paid late for work at least once, while more than a third of contractors were paid late more than a quarter of the time. Not coincidentally, 35% of contractors have entered into a fixed price contract dispute over the past 12 months.

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Notably, the lack of prompt payment legislation weighs most heavily on the province's smallest contractors. According to BCCA's 2023 member survey, small companies (those with 20 employees or fewer) were more likely than their larger counterparts to file a contract dispute.

[2] "What Prompt Payment Legislation Will mean for Contracts and Projects in B.C." Clark Wilson. January 12, 2023. https://www.cwilson.com/get-ready-for-prompt-payment/#:~:text=Ontario's%20prompt%20payment%20legislation%2C%20found,%2Dpayment%E2%80%9D%20within%2014%20days.
[3] Nicholas Russell, "Federal Prompt Payment Regulations Proposed, Still no Legislation Tabled in B.C." Alexander Holburn. May 3, 2023. https://www.ahbl.ca/federal-prompt-payment-regulations-proposed-still-no-legislation-tabled-in-b-c/

Because late payments can frustrate contractor cash flow while needlessly expanding financing costs, the lack of such policymaking creates greater probability of firm failure. When one firm fails, this can cause projects not to move forward or to face significant interruption. That in turn jeopardizes the existence of other contractors while resulting in an increasingly stagnant built environment. As other provinces pass their own prompt payment legislation, British Columbia is at a growing disadvantage in terms of attracting additional firm formation. That may induce newly emerging firms to opt to conduct business in other communities, leaving British Columbia further behind.

PAID SICK LEAVE

As of January 1, 2022, employers in British Columbia are required to provide at least five days of paid sick leave to any employee who has worked for the organization for at least 90 days. Employers are required to pay their employees their regular wages on these days. The law applies to both full- and part-time workers.

This policy has further strained an industry already saddled with rising labour costs, acute worker shortages, and severely elevated input prices. This policy exacerbates cost pressures on contractors, especially in the context of provincial construction wages rising significantly faster than nationwide construction wages in 2022.

HIGH BORROWING COSTS

The Bank of Canada has raised its benchmark overnight rate to 5.0%. With inflation running at a 4.0% annual rate (August 2023), further rate increases remain a distinct possibility. High borrowing costs will continue to exacerbate the effects of elevated construction costs, meaning that an increasing share of project owners are likely to be reluctant to move forward with projects given both high construction delivery costs and elevated cost of financial capital.

A Risk Profile for a Typical ICI Contractor

According to research supplied by the British Columbia Construction Association, the typical contractor operating in British Columbia:

- Is relatively small—92% of construction companies in British Columbia employ 20 workers or fewer;
- Has less than a decade of experience; the median contractor has been operating for only 5 to 10 years and is therefore often fragile financially and otherwise (lack of demonstrated experience);
- Is concerned about skilled labour shortages (50% of contractors);
- Is concerned about the lack of a provincial prompt payment policy (50%);
- Has been paid late for work completed (82%); and
- Has seriously contemplated leaving the industry (61% of small contractors).

Levels of concern vary by firm size. Large companies (those with more than 100 employees) are more likely to be concerned about site safety, which typically falls under their purview while working with multiple subcontractors. As a general proposition, smaller contractors tend to be more concerned by labour shortages. Given their smaller profit margins and shakier finances, they are often unable to compete with larger contractors on wages, including because larger contractors are more likely to have the ability to provide more flexible scheduling.

Conclusion

Real investment in ICI structures in British Columbia is nearly 14% below the all-time high attained in late-2019. Only the institutional and government subsector has exhibited a meaningful degree of spending momentum since pandemic onset. Investment in commercial and industrial construction has been roughly flat over the past several years.

Despite stagnant demand, contractors continue to struggle to find workers. Half of BCCA members indicate concern regarding worker shortages. As a result of human capital shortages, construction wages in British Columbia increased 70% faster than economywide wages in 2022, placing particular financial pressure on newer and smaller contractors.

Pressures applied by higher wages and still-elevated materials prices are severely exacerbated by the province's lack of a prompt payment policy. Until British Columbia catches up legislatively with the balance of Canada regarding such policymaking, provincial contractors will continue to struggle with outsized financial risks and be more likely to falter.

About Sage Policy Group

Sage Policy Group is an economic and policy consulting firm headquartered in Baltimore, MD. Dr. Anirban Basu, Sage's chairman and CEO, founded the firm in 2004. Over a period spanning nearly two decades, Sage has managed to create a client base that encompasses more than forty states and seven countries and includes Fortune 500 companies, NFL teams, aquariums and zoos, state and local governments, insurance companies, banks, brokerage houses, major medical systems, trade organizations, and law firms, among others.

The company is especially well known for its analytical capabilities in economic impact estimation, school enrollment forecasting, economic development, economic forecasting, fiscal impact analyses, legislative analyses, litigation support, and industry outlooks, and has significant experience in the subject areas of construction, environmental economics, healthcare, energy, real estate, manufacturing, professional sports, lotteries, agriculture, tourism, entrepreneurship, government contracting, secondary and post-secondary education, and the economics of retirement. The firm is also known for its superior communications and messaging skills.

In addition to leading Sage, Dr. Basu has emerged as one of the nation's most recognizable economists. He serves as the chief economist to Associated Builders and Contractors, the Maryland Bankers Association, and the International Food Distributors Association and as the chief economic adviser to the Construction Financial Management Association. He chaired the Maryland Economic Development Commission from 2014 to 2021 and currently chairs the Baltimore County Economic Advisory Committee. He has been interviewed by Bloomberg, CNBC, CNN, Fox Business, Axios, the New York Times, and many others.

Dr. Basu's lectures in economics are delivered to audiences across the U.S. and abroad. In recent years, he has focused upon health economics, the economics of education, and economic development. He has lectured at Johns Hopkins University in micro-, macro-, urban, and international economics, and most recently, global strategy. He is presently the Distinguished Economist in Residence at Goucher College, where he teaches History of Economic Thought.