CONSTRUCTION INSIGHTS

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PETRELA WINTER BONDING • RISK ADVISORS

NAVACORD®

2020 Construction Outlook

Our objective is not to predict the future of the construction business, rather, it is to help our clients prepare for whatever the future holds for the construction business.

OPTIMISM ABOUNDS...

Those of you that read our year end newsletters of the last couple of years may recall our optimism with the healthy state of affairs and positive outlook for the Canadian construction industry. With the benefit of hindsight, our confidence was, generally speaking, on point, and we've been thrilled to bear witness to some of the more buoyant times in construction in recent memory over the last couple of years (with some regional exceptions noted, particularly in Alberta, the Prairies and Newfoundland). After all, construction is a risk fraught, volatile and competitive industry, and the business owners and stakeholders who engage in it - our clients and industry friends - are some of the most dynamic, courageous and resourceful entrepreneurs on the planet, so it's immensely gratifying to see them succeed.

Indeed, as we write this, most of the key drivers of a healthy national construction economy are humming along at a steady clip. This includes a sustained emphasis on infrastructure spending by governments at all levels, major affordable housing investment initiatives in B.C. and Ontario, unprecedented public transit infrastructure expansion and renewal across the country, a continued influx of private sector investment in construction (fueled by low interest rates and an overabundance of institutional money globally), several notable industrial and energy related mega-projects, and last but certainly not least, continued overall strength and stability in the residential sector.

WE WELCOME READERS TO OUR 2020 NEWSLETTER

INSIDE THIS ISSUE

More good news: we expect the positive momentum in Canadian construction to carry through to 2020. By and large, many regions of the country, including B.C., Ontario and Atlantic Canada will continue to thrive. Even in Alberta, energy sector investment is picking up and there's a renewed sense of (cautious) optimism for 2020. Ontario will lead the way, fueled by an unprecedented concurrence of major projects in virtually every big city, as well as a resurgent industrial and mining sector to the north, and a Toronto high rise market (condos and offices) that continues its inexorable rise, setting new records for building activity and making tower cranes the signature feature of the Toronto skyline. On the whole, things continue to look up.

OPTIMISM ABOUNDS (CONT.)

By now, long time readers of our year end newsletters are likely thinking all this gushing optimism doesn't sound like PWA; "when will the euphoria wear off"? Not wanting to disappoint our loyal readership, we'll temper our enthusiasm with a healthy sprinkling of prudence and restraint. As we contemplate the current rather encouraging state of affairs in construction and move our sights to the longer term outlook (beyond 2020), we can't help but wonder how much longer the good times will last.

Our colleagues at the US construction thinktank, FMI, recently put out an interesting perspective on the state of the US economy. They pointed out that the average US business cycle since WWII is just 5 ½ years, and since the current US economic upswing is now about 10 years strong, a recession is long overdue. Not surprisingly, the Canadian data is similar, and by that same logic, we too are overdue for an economic downturn. We're already in a period of slowing economic growth and the consensus amongst economists is that a slow down or worse, a recession, is likely in the next 12 – 24 months.

The construction economy - at least the government sector - is not necessarily tied to the general economy (thanks to the modern era phenomenon of governments spending disproportionately more on construction during recessions, ie: "stimulus spending"), however, we don't think anyone will dispute that a downturn in the general economy will have an adverse effect on the construction economy. And if one accepts the notion that in certain regions construction activity has been strong for the last several years and contractors in those regions have steadily built up their overheads to manage growth - substantially in some cases - then one must also accept that any downturn in construction could have significant consequences for those contractors.

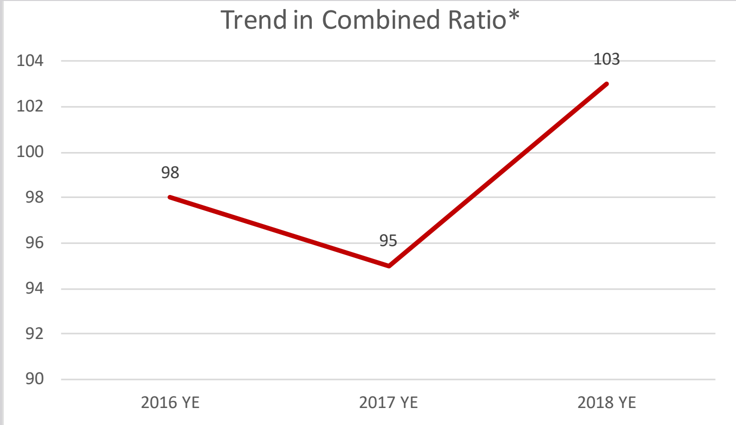
Which brings us to the main thrust of our message this year. Our objective is not to predict the future of the construction business, rather, it's to help clients prepare for whatever the future holds for the construction business. If the data and indicators hold true and the construction economy loses steam in 2021 and beyond, then 2020 will be a transition year for some contractors and a period of preparation for what's ahead. As always, well-managed construction companies who remain disciplined in their focus and business principles, and agile and adaptive to any changing environment, will fare best if the market turns. 2020 is a good time to take stock in your business and give thought to and prepare for the longer-term uncertainty ahead.

In the coming months we will be sharing more information to help contractors better manage a changing economic environment. Until then, we hope you enjoy our update this year and wish you much continued good luck out there!

INSURANCE MARKET UPDATE

Call it what you will: a challenging market, a disciplined market, or, as industry jargon would have it, a 'hard market' — the insurance landscape is changing in Canada, and consumers are paying more for insurance. As always, the extent will vary, depending on the nature of the business, prior loss history, risk profile and risk management strategy, but the story that emerges is clear; underwriters in the Canadian and Global insurance market are demonstrating unprecedented discipline, and that means higher premiums and more restricted coverage for all insurance consumers.

For years, during 'soft' market conditions, we all recognized that the rate reductions couldn't last forever, it was just a matter of time until the losses exceeded the premiums, and the model needed to change. In 2018, the Canadian overall insurance market paid out $1.04 in costs & claims for every dollar they had come in. After accounting for investment income that lead to an R.O.I. of roughly 1%, which is not a sustainable business model. 2019 did not fare much better, and so it is highly likely that rate increases and capacity constrictions will continue throughout 2020.



*The COR (Combined Operating Ratio), is a representation of the Insurance industry's expenses (claims and costs) as a function of their premium revenues. CORs in the 90-95% are targeted. CORs above 100% represent very poor industry R.O.I. resulting in meaningful action.

No class of construction is immune to the hardening market, but some are worse than others. Builders risk capacity has declined significantly, with Lloyd's all but pulling out of the market entirely. In addition, liability coverage for certain contractors is particularly difficult, such as plumbers (because of water losses), industrial roofers (water and fire losses) and contractors with winter maintenance operations (because of a growing trend of costly slips and falls)

Insurers will continue to apply rate increases to their business, shed poor risks, and more diligently underwrite risks until they return to profitability. We expect that the action the Insurers have made to date, and are making now, will improve their overall performance, and by the time 2021 comes around they'll realize they've fixed the structural problems and be open for business once again.

But in the short to medium term, they'll be looking for any reason possible to shed poor accounts and increase pricing materially, so contractors should continue to invest in risk control measures, to avoid claims, and their indirect effects.

The cheapest loss is the one avoided.

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SURETY MARKET UPDATE

The Canadian Surety Industry welcomed 2019 like a breath of fresh air following a disastrous 2018 that went down as its worst year on record. Losses stemming from the large contractor defaults of 2018 have now largely been digested by the primary sureties involved and re-insurance interest in Canada remains high with few rare exceptions.

At this writing the Office of the Superintendent of Financial Institutions (OSFI) has posted 3rd quarter results showing premiums in 2019 are up 10% over the same period last year and the loss ratio is down to 17% (this compared to a loss ratio north of 100% in 2018). Given the year-over-year rebound many sureties are upbeat about prospects for 2020 although chatter continues about a rise in the frequency of claims and disputes. Keep an eye on PWA's LinkedIn feed in the spring where we will post the final surety results for 2019 when they are available.

Perhaps the biggest news in surety in 2019 was the acquisition of The Guarantee Company of North America (GCNA), formerly the oldest bonding company in Canada, by Intact. By volume the sale combines two of the top writers of surety in the Country and furthers Intact's market leading position to where they now account for approximately a third of the premium written by the entire industry. The impact of the sale will be a story worth following closely in 2020.

This past year also saw new entrants to the Canadian marketplace in the form of both US based sureties and multinational re-insurers who have opened primary surety writing departments. Contrary to the insurance industry which is in a hard market, the surety market remains very competitive, particularly in the small to mid-market space (contractors under $100M in annual sales).

As Prompt Payment begins to take grip across the Country, contractors are reminded that those who manage their companies well and avoid adjudication and disputes will be looked at more favourably by their surety. Be selective and underwrite all of your partners: your success is impacted by the parties you work for, the trades and suppliers you select, and the business advisors (including your bond and insurance broker) you choose.

BONDLINE™

NAVASURE™

Fast, Secure & OnLINE

Bond customers of PWA will be familiar with "Bondworks", our secure online bond ordering system.

We are excited to announce that we've developed a new and enhanced version of the portal, which will be branded as "BondLine". BondLine permits contractors to order bonds online (including from your mobile device), convert successful tenders into final bond requests, and to review your backlog.

Soon you will also be able to order your Insurance Certificates through the portal as well. BondLine is offered exclusively (and at no cost) to clients of Petrela, Winter & Associates and Navacord.

Coming in Spring 2020!

PWA TEAM UPDATE

2019 saw a number of changes at PWA:

Erilyn Jaspe joined us as Office Manager. Erilyn is wearing several hats: in addition to ensuring the seamless operation of our expanding team and footprint, heads our marketing team, and is currently leading several major IT initiatives that are at various stages of development and implementation. Be sure to say Hola! to Erilyn!

Marie Pinack comes to PWA with nearly 15 years of commercial insurance experience, including some time with another Navacord broker partner. We welcome Marie to our busy insurance services team! You are going to love our clients.

With mixed emotions, we bid farewell to our long time receptionist **Margaret Barclay**, who has retired after a long career. As the initial point of contact for any call to our office for the last twelve years, nearly all of our clients and market contacts will have had some interaction with Margaret. A proud Scot, Margaret brought a level of professionalism and efficiency to our office, mixed with a wonderful sense of humour, that will be difficult to replace. Fortunately for us, we have found just the right replacement with **Angela Radcliffe**. Angela has very quickly assumed control of the front desk, and hasn't missed a beat. Welcome Angela!

We also look forward to welcoming back **Aline Martins** in early 2020, who is returning from maternity leave.

CELEBRATED

GREG PETRELA	25 YEARS	ALINE MARTINS	Had a Baby Boy
ROY FERREIRA	15 YEARS	ROY FERREIRA	Had a Baby Boy
KIM GRANT	15 YEARS	DAVID RAE	Got Married!
TOULA GOVAS	10 YEARS	MICHAEL SAN	Got Engaged!
WOODY BROWN	5 YEARS		
DAVID RAE	5 YEARS		
ALINE MARTINS	5 YEARS		

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REGIONAL CONSTRUCTION UPDATES

Atlantic Region

PEI leads the nation in economic outlook, building on a strong 2019. Influx of immigration, spending and investment are all driving increased construction activity in the province, both private and public. NL construction activity is being driven by some mega projects: while Muskrat Falls construction phase is now complete, there are new P3 opportunities and the ongoing concrete gravity structure project that are providing a boost. Net falls in population are impacting growth and revenues for the province, a trend that does not look to be reversible soon. Strong infrastructure spending will continue to provide opportunities in NS, though overall growth expectations are tempered. NB is expected to have a bounce back year, with nation leading affordability and residential housing starts offsetting a lackluster private investment outlook.

Ontario Region

In Ontario, October 1, 2019 saw the introduction of prompt payment and its backing adjudication system which will be tested for the first time in 2020 as new projects that fall under the prompt payment regime begin. Contractors in Ontario need to familiarize themselves with what constitutes a Proper Invoice and the various timelines for making payments or sending notices of non-payment.

Ontario's new Construction Act forms (http://ontariocourtforms.on.ca/en/construction-lien-act-forms/) include Form 31 Payment Bond and Form 32 Performance Bond that are required forms for the prime contractor on public projects $500,000 and greater in value. We remind contractors that it is your responsibility to submit bond forms that comply with the Act.

On the building front Ontario remains one of the hottest construction markets in Canada with industry recruiting to keep pace with rising employment demands. Contractors in Infrastructure and the large-scale ICI space are quite busy while mid-market and smaller contractors continue to face heavy competition, but a healthy pipeline of work opportunities is providing some relief. For qualified contractors surety credit remains readily available in Ontario where all major sureties are active and underwriters don't share the pessimism of their Western Canadian colleagues.

Western Region

In Alberta 2019 brought a Provincial Government change, however, optimism was curtailed by the continued exit of capital from the Energy sector. The Construction industry saw increased insolvency activity and it seemed that no industry was immune, as Energy Contractors, Heavy Contractors, GC's as well as Major Sub-trades all incurred losses.

The heavy construction industry is seeing strong headwinds in 2020 with the Alberta Transportation Spending cut. Alberta Infrastructure has announced the re-emergence of the P3 program for schools. While AI has not cut spending to the same level as Transportation, the P3 Program will limit who has the ability and capacity to build these projects. Though the hope is Alberta is through the worst of the economic downturn, there is much trepidation.

B.C. Region

The construction market in B.C. remains strong with several large infrastructure projects including the Patullo Bridge, Skytrain expansion, LNG works and Trans Mountain pipeline all starting this year along with multiple hospitals and schools.

Though the media continues to talk about a housing slowdown, there are several large residential developments that will begin construction this year.

Surety markets in B.C. remain somewhat soft, and markets are still hungry for new business to replace the losses and lost business in Alberta. In contrast to the surety market, the insurance market globally has seen a considerable loss in capacity and overall hardening that is affecting B.C. contractors, especially those with poor claims history.

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NAVACORD UPDATE

We're pleased to say that our Navacord partnership has continued its positive trend, and that 2019 was a busy year for Navacord. We invested in 9 insurance brokerage businesses across Canada: 3 employee benefits' businesses, and 6 property & casualty brokerages, including a team of highly regarded construction and surety professionals whose prior experience was serving some of the largest contractors in Canada.

In 2019, Navacord surpassed the $1 Billion premium mark, which comfortably positions us in the top 5 commercial brokerages in the country, and top 3 in the surety and construction insurance segment, which of course is Petrela Winter's long term specialty and unique focus.

The collective brokerages that form Navacord continue to operate independently but are able to equally access the expertise, knowledge and best practices of each partner firm in order to benefit each one of our clients.

NAVACORD®

How does this benefit you and your business with PWA?

Market Leverage & Buying Power: Navacord is the third largest construction brokerage in the country with preferred access to ALL Insurance & Bonding markets, including our proprietary Lloyds syndicate, Tri-Point.

Unsurpassed Technical Expertise: Outside of the immense technical expertise within PWA alone, Navacord provides access to internal technical insurance "experts" on loss control best practices & specialty insurance products (ie. Cyber, D&O, etc.).

Networking / National Intelligence: Opportunities to connect our clients to reputable like-minded, owners, GC's and sub trades in the same or expanding geographic regions with "boots on the ground" intelligence and project synergies.

The culmination of this Partnership strength was evident in a late summer, day long internal Construction Summit which brought together over 40 of the top construction risk management minds in the industry, residing within the Navacord partners. Co-chaired by Greg Petrela, and colleague Nolan Heuchert from Vancouver, this collaborative session touched on different facets of an ever changing Insurance & Surety landscape, and continued to develop strategies on how our partners collaborate and share experience, guided by the ultimate goal of providing the most creative and cost effective solutions for our contractor clients from coast to coast.

We hope this update provided value to you and we wish you a prosperous 2020.
Feel free to contact us if you have any questions about the information presented in this document.

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