Special Report
— Canadian Construction Outlook

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- Construction activity — comprised of residential building and renovations, business investments in structures and government spending on buildings and infrastructure — is projected to expand an average of about 5% (inflation adjusted) this year and next, roughly double the expected rate of growth in national output.

- The fundamentals underpinning construction are still quite supportive. The primary factor is the ultra-low level of borrowing costs that continue to anchor affordability, though rising prices in some sectors are beginning to chip away at this mainstay.

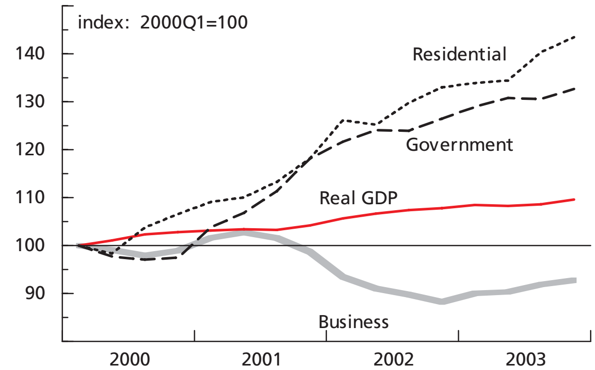
- In the single-family residential sector, supply conditions are still playing catch-up to demand. Governments have ramped up their expenditures on major infrastructure projects. In contrast, business investments in structures are generally constrained by oversupply conditions that appear to be developing in the multiple-unit housing market.

- Much of the growth in construction is front-end loaded. Building activity should moderate to more sustainable levels later this year and into 2005, in line with the slower pace of overall economic momentum and job creation now expected in Canada. However, public sector building expenditures are likely to remain relatively strong as governments focus on upgrading aging and inadequate infrastructures.

- Though the current economic and interest rate environment is relatively benign, record levels of indebtedness leave Canadian households exposed to any reversal in economic fortunes. In particular, debt-service burdens are highly leveraged to a significant rise in borrowing costs. No less problematic would be a sharper deterioration in underlying economic circumstances, such as a protracted period of job losses, slower income growth, or a substantial decline in home prices.

Boom in homebuilding and infrastructure spending lead the expansion

Real construction investment in Canada



Overview

Construction activity is expected to remain one of Canada's top performers in 2004, a year of sub-par growth nationally. Measured on an economy-wide GDP basis, this industry — which includes residential building and renovations, non-residential investments in plants and government-related spending on infrastructure — has expanded at an inflation-adjusted 5% annualized rate of growth during the first four years of the new millennium. Looking ahead, we expect that this overall pace of construction will persist through 2005 (expanding by almost 6% this year and 4% next year), a rate that is about double the average advance we anticipate for Canadian output growth.

The construction industry is an integral part of the Canadian economic landscape. Over the past three years, it has accounted for about one quarter of real GDP growth, yet represents just a little over 11% of the total economy. This relative outperformance reflects a hefty production multiplier, where a sizeable share of the country's labour and products are sourced domestically. Currently, construction has been helping to prop up domestic activity at a time when the economy's foundation is being eroded by the softness in exports. Most of Canada's large export-intensive industries are facing intensifying competitive pressures from the combination of lower-cost offshore producers, the sharp appreciation of the Canadian dollar over the past year, and a lacklustre productivity performance.

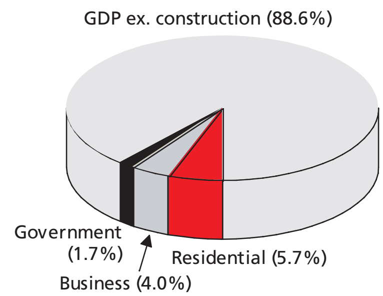
From a sectoral perspective, residential activity should remain buoyant. Single-family residential home construction retains considerable momentum, with supply conditions still playing catch-up to demand. A number of factors are still very supportive — demographic trends and immigration flows, more diversified and regionally balanced economies and very low borrowing costs are helping to broaden home ownership. The strength of residential activity in recent years could be prolonged if foreign investment interest in Canada's housing market persists. Even so, high and rising prices are beginning to eat away at affordability, while softening employment conditions point to more cautious household spending as the year progresses.

In contrast, multiple-unit residential construction will likely weaken following its multi-year growth spurt. This segment's balance appears to be tilting towards oversupply at a time when the apartment rental market, where vacancy rates are rising and prices are flat or falling, is offering more competition. Nevertheless, the extent of any erosion should be limited this year. Overbuilding in the major urban markets in Canada is not as prevalent as in prior cycles, with demand and prices still benefiting from the trend, both domestically and internationally, to diversify investments.

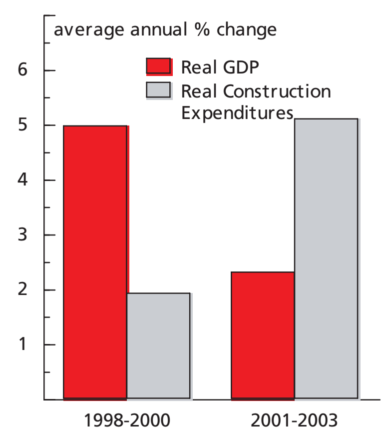
Renovation activity is likely to remain in the fast lane of construction growth, building upon the record level of existing home sales. This segment has consistently posted increasing gains, with homeowners taking advantage, not only of low borrowing costs and incentives to improve the operational efficiency of their dwellings, but the rapidly growing market for home improvements.

Construction activity is also getting a timely boost from the broad array of government-funded projects. New and expanded health care and education facilities will continue to be a top priority, as will road improvements, public transit and electricity transmission. Municipal governments are rebuilding their infrastructures, water and sewage treatment facilities for example, that have failed to keep pace

Construction's comparatively small share of Canada's economy in 2003



Construction's comparatively large share of Canada's growth



with needs of expanding local economies. Congested border crossing points will be upgraded to ensure that time-sensitive goods can be transported quickly even during periods of heightened security concerns.

Nevertheless, there are some weak links in the overall construction outlook. Business spending on non-residential construction will remain on the soft side. Oversupply conditions are prevalent in the commercial and industrial sectors, though specific market segments — big-box retailers for example — should continue to hold their own. A bright spot remains the resource sector, where rising shipments and prices, primarily in the oil & gas and the metal sectors, are supporting a number of significant expansions.

More fundamentally, firms are reassessing their domestic building requirements in the wake of the Canadian dollar's rise that has severely compressed profitability in the export-intensive manufacturing sector. Businesses already are favouring increased expenditures on productivity-enhancing equipment, and further currency strength could potentially deflect new investments in structures to lower cost regions abroad.

In addition, much of this year's strength in construction activity is front-end loaded. A weaker-than-expected Canadian economic performance, triggered by any renewed slump in the U.S. and global economies, would result in a much weaker outlook for construction activity in 2005. Both households and businesses also face the prospect of higher property-related costs as provincial and local governments grapple with their strained budgets.

Residential Construction
— Still booming, but set to moderate to more sustainable levels

The multi-year boom in Canada's housing sector is so far showing few signs of letting up. Existing home sales hit a record last year, average prices posted the largest increase in over a decade, and housing starts hit a 15-year high. From 2000-2003, real investment in residential construction (i.e. new construction, renovations and transfer costs) increased at an average annual rate of over 9%.

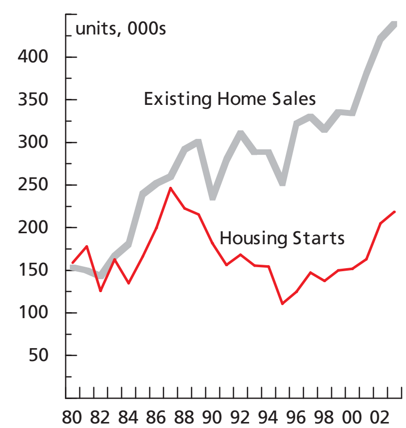
The outlook for the residential sector remains generally positive, though the overall pace of activity is likely to cool somewhat. We expect residential construction expenditures will increase an average of 6% in 2004-05.

Supply-demand conditions in the housing construction sector are relatively well balanced, especially when compared to the situation that existed prior to the 1991 housing market correction, with less evidence speculative buying or overbuilding. The inventory of completed but unsold new homes remains moderate, about half the level of 1990.

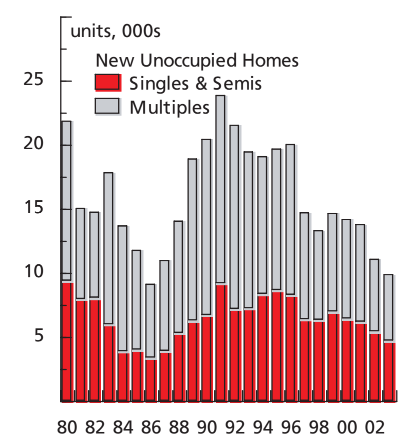
At the same time, demographics of the population suggest the current pace of housing construction is unsustainable, even if ownership rates were to move even higher. The number of private households has been increasing by about 150,000 annually in recent years, well below the 200,000-plus pace of housing starts. Based on immigration trends, the largest urban centres — Toronto, Montreal, Vancouver, Ottawa, Calgary and Edmonton — will continue to outperform.

Multiple-unit construction will likely lag single-family starts, with the wave of first-time homebuyers leading to much more competitive rental market conditions. In

Canada's housing fundamentals are still supportive



Housing inventories are quite manageable



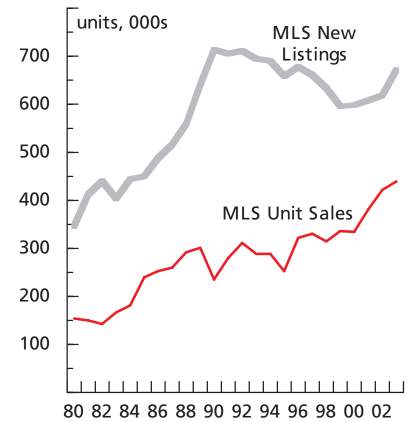
Toronto, one of the nation's tightest rental markets just a few years ago, average rents actually fell slightly in 2003 as the vacancy rate shot up more than a percentage point to 3.8%.

Supply conditions are tighter in the resale market, where a shortage of new listings relative to demand is helping to maintain prices increases as well as new home construction. The ratio of MLS sales to new listings averaged 0.75 in 2003Q4, essentially unchanged from a year ago and well above the 20-year average of 0.50.

Despite the steady rise in home prices, affordability is being maintained by ultra-low borrowing costs. The current 5-year mortgage rate is 5.7%, establishing a new cycle, and well below its 10-year average of 7.8%. Mortgage interest payments as a share of disposable income averaged just 4.6% at the end of 2003, almost a full percentage point below the historical mean.

Even so, underlying economic fundamentals from a household perspective are probably becoming slightly less supportive. Pent-up demand for new housing, particularly among first-time buyers, has been largely exhausted, with home ownership rates at record levels. Private sector job creation has slowed noticeably over the past year relative to the prior three-year hiring spree.

A shortage of new listings in Canada is helping to support the rise in home prices



Government — Upgrading An Aging Infrastructure

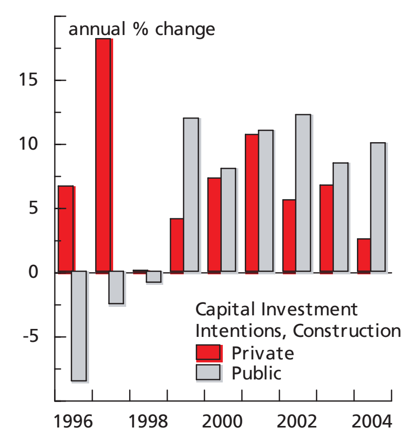
Real expenditures by all levels of government on construction-related activity is expected to increase a solid 5% in 2004, extending the multi-year spending boom that has averaged 8% since the beginning of the decade. However, the renewed fiscal restraint being imposed by most provinces to deal with emerging budget deficits, especially in the three largest provinces of Ontario, Quebec and B.C., will likely temper the pace of public-sector spending later this year and into 2005.

Infrastructure improvements are the focus of policy, with significant upgrades to roadways bolstering the continuing expansion of airports. A number of projects involve expansion of the Trans-Canada highway across the country. Preliminary engineering work is getting underway in B.C. to widen the Sea-to-Sky Highway ahead of the 2010 Winter Olympics, with full construction underway by 2006. Alberta is improving the transportation corridor between Edmonton-Calgary and the U.S. border. Ontario is planning to upgrade its roadways and public transit systems, especially in the Toronto area. Montréal's Trudeau International Airport is slated for another major expansion as passenger service is consolidated from Mirabel.

In the wake of the massive blackout that enveloped Ontario last August, energy-related investments are quickly moving up on the list of 'things to do'. This has involved major overhauls of the province's nuclear capabilities, and increasingly, transmission capabilities. Additional sizeable expenditures are being directed to upgrade municipal utilities, water and sewage systems for example.

Governments are also funding the 'social deficit', with continuing investments in health and education still high on the agenda of virtually every province. Hospital and other health facilities are big beneficiaries of the new spending. Demographic factors are also at play, with rising enrolments triggering a sizeable expansion of capacity in the post-secondary education systems. Cultural institutions, particularly in the major urban centres, are also getting the green light.

Canada's public sector is upgrading an aging infrastructure



Business Non-Residential Construction — A Slow Recovery

In contrast to the boom-like conditions in the residential and government sectors, non-residential construction continues to languish. After expanding at just over a rather tepid 3% average rate in 2000 and 2001, real outlays on industrial and commercial projects contracted by over 10% in 2002 and edged up a mere 0.7% last year. The value of non-residential building permits has yet to show any discernible upward trend.

Prospects for this sector remain more challenging, but should gradually improve from the depressed levels of recent years. We expect real expenditures on industrial and commercial construction will increase at around a 4% annual rate in 2004-05 — with growth in this sector reviving on the back of the expansion in resource-sector projects.

Industrial

The current supply of industrial space is relatively snug, reflecting the slow construction of new space in recent years. The national industrial vacancy rate continues to hover slightly below 5% — half the comparable U.S. level. The economy-wide industrial capacity utilization rate bounced back to 82.9% in the fourth quarter of last year, slightly above its long-term average.

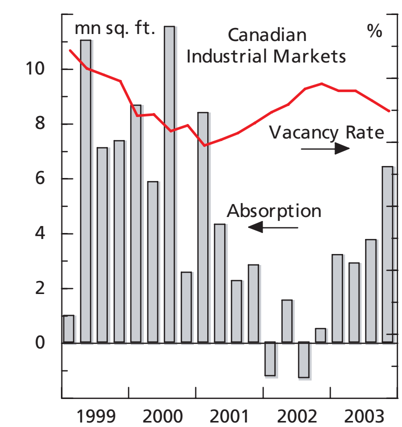
On the demand side, there is a need for upgrading of buildings and plants to adapt to ever-changing technology requirements and to bolster operational efficiencies, made more urgent by the lack of investments in recent years. Meeting Ottawa's Kyoto agreement targets and climate change commitments will require multi-year investments in a range of private sector areas, including building retrofits to increase energy efficiency and improved landfill management.

Overall, however, business investment plans are likely to remain on the cautious side. The manufacturing sector, while benefiting from the revival in U.S. industrial activity, is being pinched by the record-breaking run-up in the Canadian dollar. Corporate profits are recovering, but outside of the energy and financial sectors remain under pressure.

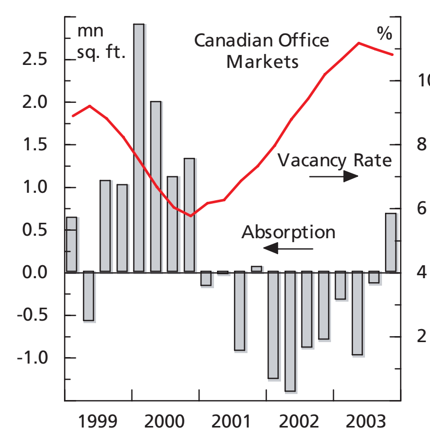
In this environment, restructuring and consolidation aimed at reducing costs and bolstering productivity will remain the primary focus. This favours capital investments in machinery & equipment over expanding plant capacity, especially given the lower cost of imported technologies and the potential acceleration of capital depreciation allowances.

One bright spot in the outlook is the resource sector, which is being underpinned by rising prices and strong demand, especially in the oil & gas and metals industries. Several major oil sands projects are under way, while the number of natural gas exploration wells drilled in Canada this year is expected to climb 15% to a record level. Two major natural gas pipelines to ship Artic gas to Canadian and U.S. markets are currently in the planning phase, though construction is still several years away. Mining activity is being supported by surging demand from China alongside tight global supplies.

Low vacancy and high absorption rates should help support industrial construction in Canada



High vacancy rates and low absorption rates should keep a lid on commercial construction in Canada



Commercial

Excess capacity will likely hold back the recovery in office construction, even as business conditions firm. The national office vacancy rate edged lower in late-2003 but remained in double-digit territory at 10.8%, suggesting that the absorption of existing space will take time. On a regional basis, vacancy rates are slightly lower in central markets reflecting the stronger growth in suburban construction in recent years.

The Ottawa region remains one of the strongest office space markets, at least its downtown, with the strong pace of public sector hiring in recent years driving down the central area vacancy rate to under 4% at the end of 2003. Looking ahead, however, renewed federal civil service hiring restraint should ease supply pressures somewhat, while the suburban Ottawa market remains heavily oversupplied due to the extensive consolidation that has occurred in the region's tech-dominated suburbs.

Construction of new and redeveloped retail space has remained relatively firm over the past several years, supported by the strong pace of consumer spending, particularly in the housing and renovation markets. Within this segment, 'big-box' developments remain popular across the country, both among national chains expanding traditional formats as well as among warehouse retailers.

Much of this construction activity, however, may prove to be front end loaded, particularly if the recent slowing in private sector job creation leads to more cautious consumer spending plans, or profit pressures force further industry consolidation. Statistics Canada's survey of public and private intentions reported a 1% decline in planned retail sector construction expenditures this year following an increase of nearly 10% in 2003.

Soft tourism markets, still reeling from the September 11 terrorist attacks in the United States, the spring SARS outbreak and the substantial rise in the Canadian/US exchange rate, will continue to weigh on the hospitality and entertainment sectors. Even with a gradual recovery in tourism flows since mid-2003, the number of international visitors to Canada is averaging just over 3 million a month, well below the pre-9/11 average of 4 million. Hotel occupancy rates and margins in particular remain weak.

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