# Cost Pressures Persist in the Canadian Oil Sands

## Description

Alberta's oil sands have attracted dozens of energy producers from around the world in search of oil. But while they're believed to hold massive untapped reserves, coaxing that heavy oil from the ground is extremely costly.



Making matters worse is the fact that, according to operators and industry sources, capital costs for oil sands projects are currently on the rise, driven mainly by a chronic shortage of workers. An annual report by the Canadian Energy Research Institute sheds additional light on just how expensive some oil sands projects are. Let's take a closer look.

**Costs inflating**

According to the report, costs for in-situ projects have increased by 6.3% year over year to C$47.57 per barrel, while costs for integrated mining facilities (with upgraders) and stand-alone mining projects have risen 10.9% to C$99.02 per barrel and 13.2% to C$68.30 per barrel, respectively.

These costs can be broken down into labour, which accounts for 60% of the total project cost, and materials and equipment, such as iron, steel, concrete and equipment, which make up the remaining 40%.

**Will labor shortages persist?**

While materials and equipment cost inflation is an issue facing most global energy producers, the labour shortage problem is especially severe in Alberta and is likely to persist. According to Cheryl Knight, executive director of the Petroleum Human Resources Council of Canada, the outlook for labour in Alberta's oil sands remains bleak and shortages could continue for several years.

As per her calculations, Canada's oil and gas industry will need to recruit up to 150,000 new workers over the next 10 years – the vast majority of which will be required by the oil sands sector – just to make up for labour losses due to retirements and turnovers.

In addition to labour shortages, rising industrial activity also contributes to cost inflation for materials, since oil sands operators are feverishly competing with one another for a limited pool.

**Cost overruns and abandoned projects**

As a result of these factors, cost overruns have become quite common in Alberta. For instance, **Imperial Oil** (TSX:IMO) said it exceeded its cost estimates for the first phase of its Kearl bitumen mining facility by about C$2 billion. And some companies have even decided to abandon expensive projects altogether.

For instance, **Total SA** recently threw in the towel on its Voyageur Upgrader project, a 200,000-barrels-a-day facility that was designed to "upgrade" bitumen into crude oil. It sold its 49% stake in Voyageur to its joint venture partner, **Suncor Energy** (TSX:SU) , for $500 million, arguing that the project was "no longer justified from a strategic and economic" standpoint. A smart move by Total as not long after, Suncor also decided to abandon the project, for which it took a C$1.5 billion write-down.

**What's the solution?**
One way of boosting oil sands producers' morale would be to green-light **TransCanada**'s (TSX:TRP) proposed Keystone XL pipeline, which would carry as much as 830,000 barrels of crude oil per day from Alberta to refiners along the U.S. Gulf Coast.

Most analysts believe that Keystone and other pipelines would be the most effective way of bringing western Canadian crude oil prices closer in line with similar North American benchmarks, which could help improve the profitability of many oil sands projects substantially.



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1. Investing

**TICKERS GLOBAL**

1. TSX:IMO (Imperial Oil Limited)
2. TSX:SU (Suncor Energy Inc.)

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