

Healthcare Construction: Slack Demand Makes 2009 a Good Year to Build

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The financial crisis and recession of 2008 will continue to leave a mark on most industries this year, not the least of which is construction. The mortgage crisis continues to take its toll on residential construction while tighter credit markets have other industries scrambling for funds or in some cases delaying capital expenditures in 2009.

Not all areas of construction are equally affected by the economic downturn.

The Associated General Contractors of America recently singled out hospitals as one of the brighter spots for construction in 2008 and 2009. We at Mortenson agree with that assessment. Other strong segments include power, energy and higher education construction. By comparison, hospital construction should perform relatively well this year.

Commodity prices fall

Following incredible run-ups earlier this decade the cost of copper, structural steel and other commodities used in construction has declined from their 2008 peaks as demand slackens worldwide. After reaching nearly \$5.00 a gallon last summer the cost of diesel fuel has been nearly halved. Meanwhile the cost of crude oil dropped even more dramatically, from \$146 a barrel last summer to the low \$30s in December. The drop in commodity prices will benefit owners of hospitals under construction right now.

The current economic conditions are unprecedented and have created a double-edged sword. While commodity prices are down, financial circumstances for trade contractors have changed. Some are struggling. Banks are tightening credit, performance bonds are more difficult to secure and there are fewer jobs on which to bid. That leads some contractors to submit riskier bids. It is questionable whether all will remain viable so it is important to work with a qualified and well capitalized firm.

Meanwhile hospitals as well face uncertainty over their own financial condition as the credit crunch has widened. Overall, there has been a collective mood swing to a more conservative, "let's sit back and wait and see what develops" attitude, all triggered by the October financial crisis.

We have heard that some hospital projects will be put on hold for 2009. None of those projects affect Mortenson; however they will affect the construction market. In our view, the slowdown will likely run through 2009 and into the second quarter of 2010 before we see a measurable upswing.

As we see it today

2009 is a good time to build. Owners will benefit from favorable material costs and the availability of construction trade labor. Those owners with funds or financing are going to get projects delivered at better prices today than in the last two years. Owners will find a better square-foot cost than 2007 or 2008. For those with projects already in the works, there is a good chance your project will come in at or below budget. Some projects may save millions of dollars over earlier cost projections.



One caveat: If you think the construction slowdown will lead to more competitive bids you are half right. Some contractors feeling the pinch may opt to reduce bids just to keep working. However, wage increases for 2009 and beyond have already been negotiated with unions, so labor rates will increase 5-6% this year in spite of tighter market conditions.