

Commercial construction outlook: Adapting to a new market

Build-to-suit projects, health-care facilities, public works key to surviving building slowdown

by Dan Rafter, Editor

Pat McCown and Brett Gordon point to their company's Shawnee Justice Center project as proof that there is commercial building work to be found in the Midwest, even as the nation's economy continues its freefall.

Kansas City, Mo.-based McCownGordon Construction completed the Justice Center project - a new municipal building housing the police station, fire station and courthouse complex in the city of Shawnee, Kansas - in just 17 months. That included both construction and design work.

Contractors built the center, which covers 29 acres in a campus-like setting, using the design/build construction method. Because all the contracting teams involved

in the project were selected at the same time, the city was able to start construction of the building even while the interior finishes were still being designed, saving precious time.

"This project would have taken at least an additional four months - and that's only if everything went right - if we had gone with an alternative design method," said Arlen Kleinsorge, division manager with McCownGordon Construction.

Kleinsorge, along with other construction pros interviewed for this story, agreed that build-to-suit projects are becoming more popular among municipalities, especially as these municipalities seek ways to keep their budgets under control in tough economic times.

"More municipalities are looking for expedited delivery of their projects," McCown said. "Going with the design/build method is one way for municipalities to move projects along quickly and save money. You get the best

team in place to execute a project. You're not working with companies who happened to be the low bidders and are only responsible for one portion of the project. In design/build, you're working with a team dedicated to bringing the project in on time and on budget."

The growing popularity of the design/build method of construction is just one trend that commercial construction professionals cited when looking at the state of their industry as 2008 nears its end. They also pointed to continued demand for new healthcare facilities and research-and-development centers as providing a boost to a commercial construction market that is in the midst of a slowdown.

Interviewees also had kind words for municipal public works projects as one other area of the commercial construction industry that continues to thrive.

But other sectors - retail, certainly, and industrial and office in many markets - are slowing down. This means that it's those

general contractors and developers who adapt to what is certainly a changing market are those who will survive the slump, developers said.

"When things were on a roll, everyone and their mothers were opening a construction company," said Bill Plesich, director of marketing with Columbus, Ohio-based Renier Construction. "These more challenging times will weed out a lot of the weaker contractors. The ones who are financially set, who are able to adapt to current market conditions, are the ones who are still going to be here when the economy starts to improve again. It's just like in the housing industry. The ones who weren't financially secure have gone out of business already."

Preparing for a tough 2009

Commercial construction work may have slowed in 2008. But industry experts worry that this year may only be the beginning of a long stretch of sluggish building

activity.

Commercial developers interviewed for this story said that 2009 may prove to be a tough year for the industry. The commercial markets in the Midwest tend to react to economic woes anywhere from six to nine months after they hit. Because the nation's economy is suffering now, it makes sense, then, that the region will see a significant slowdown in commercial construction next year.

Part of the challenge is that developers will continue to find it difficult to obtain financing for their projects, said R. Hank Bellina, director of the division of major accounts for St. Louis-based ARCO Construction.

Banks and lending institutions are already requiring more equity on all types of construction projects, Bellina said. They are also looking for projects that already have several tenants attached to them.

"There is no such thing as a slam dunk for financing anymore for construction projects," Bellina said. "It doesn't matter how great your credit rating is. There are no more slam dunks."

Speculative projects are drying up, and will continue to do so in 2009, he said. At the same time, the number of new retail projects, industrial centers and warehouse distribution centers is steadily falling, Bellina said, something that will only intensify in 2009.

"A lot of those projects have been put on hold," he said. "It doesn't look great for 2009. There are a lot of sectors that are definitely slowing down."

Bellina does see some good news, though. The demand for healthcare and medical facilities continues to grow, and should do so throughout 2009, he said. Midwest construction companies are being called upon to build more biotech research

laboratories and the developments that spring up around them.

Senior-living facilities are becoming a mainstay in the commercial construction industry, Bellina said. And public-works and university-sponsored construction projects are also providing a boost to the industry, he said.

"The universities and the public sector have money. They don't necessarily have to go out and acquire these more difficult-to-get loans and project-financing that a typical developer would have to get," Bellina said. "That's part of the reason that those markets are still active."

Staying active

Woodridge, Ill.-based Morgan/Harbour Construction is one of those construction firms that is adapting. The company, which specializes in design/build projects, is currently developing a 120,000-square-

foot two-story public works facility for the village of Wheeling, Ill.

The facility, which will sit on nearly 12 acres of land, is another example of both the public-works projects and design/build construction method that is now fueling building activity.

As Warren Seil, vice president with Morgan/Harbour, says, the Wheeling project is a true public-works project. The village will house its police, public-works department, engineering staff, vehicles and equipment and road-salt dump in the facility.

"They have everything covered there," Seil said.

Greg Frechauf, vice president with Morgan/Harbour, said he expects to see municipalities continue to rely on the design/build method even more frequently in the coming months and years.

"Design/build for the most part has

been popular in the private sector. But now we're seeing more of it in the public sector," Freehauf said. "It is attractive to both the builder and the public municipality because it gives you the advantage of fast-tracking a project and compressing its schedule. It gives you a better value for your dollar. Right now the private-sector work is slow. The public work is helping us maintain our construction volume."

The village has been schedule-conscious throughout the process, Seil said. That's why going with design/build, and the speed and flexibility that it allows, was so important, he said. The goal now, he said, is to complete the project by Jan. 31.

It's a compressed timetable that never would have been possible with more traditional construction methods, Seil said.

"We don't necessarily have to do all the drawings, put them out for pricing and then wait for responses," Freehauf said. "We can go out for pricing on those items that do require a long lead time, the precast and the steel, say, and get those in order so we can rush the schedule for both design and construction."

Under traditional construction methods, the possibility of delays is high, Freehauf said. In the standard way of building, the owner of a project hires an architect and then puts those drawings out to bid. This

very beginning stage of the process is a lengthy one itself, as it can take anywhere from a month to two months for the architecture team to draw the plans and about four more weeks for the bidding process to play out.

There could be early problems, too. What if the bids all come in too high? The design process has to start over again, costing more precious time.

This is avoided in the design/build method.

"In design/build, we are working with pricing much closer," Seil said. "We can put together a budget much quicker. That's what we did on this particular project, and it is paying off in a compressed construction schedule."

William Birck, president of Chicago-based Reed Illinois Corporation, a general contractor and construction manager, says that his firm has relied upon a diverse pipeline of projects to ride out the construction slowdown so far.

Reed is doing what other survivors are doing: The company does not focus its efforts on one particular sector of the market. Instead, it tackles projects in all fields.

"We are strong believers in diversification," Birck said. "We are active now in health care, in corporate construction and in institutional markets. We will even get

involved in hospitality and retail projects. Of course, at this point in time those markets have slowed, it not stopped."

And that's the point. Reed is able to overcome the slowdown in the retail and hospitality businesses by focusing on the other areas of its practice that are doing well, such as healthcare and public-works projects. In fact, Reed is now involved in about a dozen hospital projects in the Chicago area, Birck said.

This focus on diversity has led Reed to have an active first two quarters of the year. Business has slowed in the third and fourth quarters, Birck said, but his company will still have a profitable and successful year.

"You have to always be looking for those markets that are doing well," Birck said. "If you look at healthcare, you see that hospitals are driven by the demographics of the population. No one is getting any younger. Hospitals also benefit from the development of new technology. That's a driver to more hospital work, too. As new technology comes in, hospitals have to embrace it."

Several different projects have helped keep Reed busy during even these slow economic times.

"Our company has been through the Great Depression. We've been through two World Wars," Birck said. "We've survived the recessions of the '70s, '80s and '90s. What we've learned is that all you can do is maintain good relationships with your clients, and provide them with the best service you can. That is what has kept us going this long. It's not exciting, but it works."

Happy to be in the Midwest

When Paul Chuma reads the headlines that bemoan the state of the housing and construction industries across the country, he has one quick thought: "I'm glad I work in the Midwest."

Chuma is president of Meridian Design Build in Deerfield, Ill. His company has seen the effects of the slowdown, of course. But it's also staying active with several projects, including many that are renovations and adaptive re-uses, work that has remained steady in the Midwest.

"When the economy goes through its cycles, being in the middle of the country

and in the Midwest seems to really help," Chuma said. "We don't experience the high highs or the low lows that other parts of the country experience. It definitely helps."

That being said, Chuma isn't denying that the construction industry is a bit sluggish these days, even in traditionally steady markets like Chicago.

"The velocity in the market has definitely declined," he said. "There is definitely cause for concern, but there are opportunities out there for those companies that are willing to put forth the effort to figure out how to get a deal done."

For Meridian, that involves tackling the company's specialty, design/build projects. The company is now working on a 30,000-square-foot facility near the old stock yards area in Chicago for Gypsum Supply Co. and a 103,000-square-foot build-to-suit headquarters for Auto Truck Group in

Bartlett, Ill.

"The big-box spec development has slowed," Chuma said. "It hasn't stopped entirely, but it certainly has significantly slowed. We've seen several developers who had planned projects that are sitting on the sidelines now. They may eventually happen, but now is not the time. Now it seems that the developers and the commercial brokers are focusing more on pursuing build-to-suit clients."

Russ Henke, principle at Edwardsville, Ill.-based Contegra Construction, said that not all is gloom-and-doom in his industry. It's impossible to predict when the commercial market will shake out of its doldrums, Henke said, but he's looking for positive signs to start showing up as soon as the November presidential elections wrap up.

"We could definitely use some positive news," Henke said. "There have been

enough people waiting it out. I think people are looking for any reason to kick loose and move ahead. Look at it this way, owners are going to see in this coming fourth quarter and the first quarter of next year some of the best construction pricing from a materials and installation standpoint than they are going to see in a long time.

"There are still companies wanting and planning to grow," he said. "That is the good news. There is nothing worse than the status quo. There are still market sectors that are strong. There are still opportunities on the horizon to take advantage of."