

BUILT TO LAST HEALTHCARE CONSTRUCTION SPENDING HOLDING UP WELL

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The sluggish economy has taken its toll on the construction industry, but healthcare is doing its part to keep the concrete flowing and the pneumatic hammers hammering.

With new hospitals replacing old ones, additions being built to accommodate all-private rooms, heart and cancer specialty hospitals introducing competition, and green-field hospitals sprouting up to follow suburban migration, healthcare construction may not be recession-proof, but it's becoming recognized as "recession-resistant."

"That's a good way of putting it," says Steve Gressel, a senior vice president with engineering and construction company Skanska USA Building's National Healthcare Center of Excellence. "Healthcare construction is still going strong. It's not subject to the same cyclical economic trends."

Experts offer varying comparative numbers and apparently gaze into different crystal balls in projecting how the level of competition for healthcare construction contracts will affect prices, but they all agree that it's one segment of the industry that's performing better than most. In fact, Jim Haughey, chief economist with Reed Construction Data, reports that contracts representing a record dollar amount of healthcare construction were signed in June.

"This June was the best month ever," Haughey says, explaining that \$2.7 billion worth of healthcare construction work was agreed to during that month. "That's the value of contracts signed—what the contractor says he'll take to build the entire project."

July, however, fell to \$1.6 billion, which Haughey describes as an "average-minus" monthly total, but he says the deals signed in June will keep people busy for the next 18 months.

Dan White, a vice president in the Chicago office of the Baltimore-based architecture and engineering firm of RTKL, agrees that healthcare construction should remain healthy through the rest of this year and next.

"The overall market for healthcare is strong and, if the overall volume of requests for proposals is any indication, the overall market for next year should be strong as well," White says, adding that healthcare construction in the past several years has accounted for about 22% of his company's revenue, rising to about 28% now.

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Against the tide

Healthcare is only one part of the big construction picture. Haughey projects that total construction spending will drop 4% this year while healthcare construction spending will rise 6%. Those numbers are put in perspective when dollar amounts are attached to the percentages. Haughey expects total construction to drop to \$1.09 trillion from \$1.13 trillion last year, while healthcare construction spending is expected to increase to almost \$45.6 billion from nearly \$43 billion in 2007.

“It’s a much steadier market than the rest of the industry,” Haughey says, adding that other construction industry segments doing well include schools and destination hotels in areas such as Las Vegas and Orlando, Fla.

Haughey and others say one general problem is a shortage of skilled construction laborers. Laborers’ International Union of North America spokesman Jacob Hay cites U.S. Labor Department statistics that show about 522,000 construction jobs have been lost since the start of 2007. Hay attributed the vast majority of those job losses to the ongoing crisis in the housing industry.

Hay also cites statistics from the McGraw-Hill Construction database that show 2008 healthcare construction starts are down 5% from last year, but that’s compared with an 11% reduction in overall construction starts.

Despite those figures, Hay says he thinks healthcare is rebounding, and it’s just a matter of time before the statistics better reflect its strength. “The numbers are lagging behind,” he says. “Healthcare is an industry we expect there to be growth in, although the numbers aren’t showing it yet.”

Because of the nuances of the healthcare market, Haughey says that there should be more competition to build ancillary or support facilities, but the roster of major hospital builders will probably stay the same because many construction companies are not prepared for the complexity that hospital construction involves.

“If a hospital wants to build a new garage for its ambulances, anyone can do that,” Haughey says. But acute-care projects are another story. “Hospital construction is pretty complicated work—and the penalty for doing it wrong is pretty high.” Architects and construction experts cite the technology-intensive designs of healthcare facilities among the thornier issues in their construction.

As a result, some hospitals are having a hard time getting companies to bid on their projects.

Skanska's Gressel says healthcare typically accounts for about 25% of his company's business, and he says it's holding there despite other companies trying to enter the healthcare arena.

"I know other contractors are trying to get into healthcare or expand," Gressel says.

Michael Bolen, chief executive officer and chairman of McCarthy Building Cos., says his company has tripled its volume in just eight years, and healthcare has steadily accounted for half of its business. But he predicts it will account for a larger percentage in the years to come.

"Healthcare will probably represent around 65% of our new sales for this year," Bolen says. "All told, our new sales should run just over \$4 billion."

He says this will continue despite the increased competition for healthcare projects.

"It started with our school work. We noticed the residential construction labor force migrating into education," Bolen says. "People who used to do condos are now concentrating on institutional projects because that's where the money is. Healthcare and other institutional work has acted as a buffer or a safety net for them."

Still, for now at least, Bolen doesn't see an increase in competition cutting too much into the hospital construction pie. Noting that it takes triple the labor hours to finish a hospital than it does an office building of comparable size, Bolen thinks the complexities involved in building a hospital will give an edge to those with experience in such work. While economic factors may result in increased competition to build a hospital's parking deck, building the hospital itself is another matter.

Dealing with complexity

"I think there will be increased competition and more focus on quality," Bolen says. "People who do just fine on less-complex projects have difficulty on the healthcare side. The first things that might start to surface are quality issues."

RTKL's White points to factors such as designing complex systems for emergency power, transport of medical gasses, and sophisticated air filtration as reasons why hospitals will choose the savvy veterans to build their projects instead of rookie companies.

"Almost universally, healthcare administrators are smart enough to know that the low bidder is usually not the best company to build a hospital," White says.

Construction materials will continue to drive the cost of a new hospital higher, Bolen says, but competition could mitigate the price spiral.

“I don’t know if it will lower costs, but it will take the pressure off escalation,” Bolen says of competition. “But the material side is becoming a global issue, and what’s happening in China affects the price of (reinforcing bars) in California.”

In addition to the cost of steel and other materials, White believes that pressure to make large investments in information technology may lessen the money hospitals have for bricks and mortar. He also thinks that, if lawmakers muster enough political capital to introduce some type of universal healthcare, it could slow healthcare construction.

“It introduces an unknown factor into the healthcare equation for providers,” White explains. “It’s the uncertainty of what comes with universal healthcare—not necessarily universal healthcare itself.”

Haughey predicts healthcare construction will continue to show strength, but administrators are “sharpening their pencils,” meaning economic factors may cause projects to take a little longer to be built and to be built on a smaller scale. And some projects might remain on the drawing board.

“You’re going to hear a few sob stories from people who want to build something and can’t,” Haughey says. “You’re going to have more of that in the next year than in the last.”

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