



The UPSIDE To Our Economic DOWNSIDE

By Lindsay Minard

Just when the media began to think there would be nothing to talk about after the Presidential election, they received an early holiday gift: the collapse of the country's financial institutions and big three automobile companies and a full-on economic recession. With the historical election out of the way the media now covers ad nauseum the current economic drama. They make the public well aware that times are really tough, you may not have your job or your house next week and the executives at AIG are going to be hand delivered their bonus checks as they enjoy spa treatments.

There is no doubt that the economy is in bad shape and that Americans are really feeling it, some more than others. The problem is that beating a dead horse never solved anything and that those suffering do not need anyone to tell them things are bad. Certainly there is reason for the high level of anxiety that the country feels. Our economic state is the worst most have seen in a lifetime. Its distinguishing factors are the dissolution of credit because of greedy bankers, record numbers of home foreclosures in record time and

the domino effect our crisis has had on the world's economy that, like it or not, is wholly impacted by Americans' ability to throw caution to the wind and spend spend spend.

The country's economic disaster blind-sided many commercial construction firms as loans, bonding and inevitably new project starts came to a screeching halt. The construction project cycle makes our industry a lagging indicator of the current condition of the economy. Companies, fortunate enough to not already feel the impact of jobs delayed because of client financial woes, must worry about an unreplenished pipeline.

While other industries are wringing their hands about 2009, commercial construction firms currently busy with backlogged work, stretch their worry into 2010 and even 2011. "In order to fuel 2010 and beyond we need to be picking up work in the next couple of years or we think that is going to be an issue," says Leon Blondin, the new head of Balfour Beatty's Federal Group.

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“We are also fearful for the subcontractors that utilize credit to do a lot of their work. Buying of materials is often on credit and they may struggle to have those same opportunities; we are going to feel that at the general contractor level,” Blondin explains.

In an industry defined by the small business owner, the credit crisis is unfathomable. Now more than ever construction teams from the owner to materials supplier will have to be painfully aware of the others’ financial backing. Now more than ever relationships, not the lowest bid will be, if not should be, the deciding factor for determining teams.

Another dynamic of the situation is the fact that Virginia is somewhat insulated from the extent of the trouble that plagues much of the country because of its right to work status, proximity to the federal government and military presence. However, that strength means Virginia is a target for stiff competition from neighboring states. “There is going to be a lot of competition from North Carolina and Maryland and even further out. They will be coming to Virginia looking for work and more competition will drive prices even farther down,” explains Ed Kellam, president of Ware Insurance Co.

With low prices the industry runs the risk of commoditization, losing the ability to be creative and stifling the opportunity to make money. “No one needs a bad job. No one needs a job on which they are going to lose money. No one needs a bad client. You still have to take jobs for the right reasons,” states Blondin.

Take a deep breath. Now for the good news.

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Around 94 percent of the country is employed and what industry players need to master now is settling the knee jerk reactions. At some point in 2009 the economy is going to bottom out and from the bottom there is only one direction to go. If history holds true, the federal government will continue to spend money it does not have and create work in existing and new market segments for the industry. “The federal government spends \$120 billion a year in the D.C./Mid-Atlantic region. Virginia receives a good portion of that in relation to defense,” says Spencer Stouffer, managing director and principal at Cassidy & Pinkard Colliers.

If nothing else a slowdown in work will give industry firms time to improve operations and procedures and test the stamina of their company mission and vision on the economic battleground. Mark Bailey, president of Centennial Contractors Enterprises, Inc. explains the importance of using this time wisely; “It is vital that companies take this time and shore up their processes and make investments in training and developing their people.”

The Segments to Avoid

If your work is primarily focused in the private market then it is probably safe to say

that you are nervous about 2009 and 2010. The recession along with the credit crisis provided the one-two punch that knocked out the private market for the latter part of 2008 and will keep it on its rear well into 2009. “Right now we do around 60 percent federal work out of our division based in Fairfax, Virginia. When we look at our division backlog, in 2009 and 2010 that percentage increases to 70 or 80 percent. There is just not a lot of private work out there,” explains Leon Blondin.

The industry segment that felt the crisis first is the speculative construction market. “You have a slowdown now because of the recession, but before that the financial market crisis put a halt to speculative construction. Even if you can find the money, you have got to figure out how to fill the properties. The speculative market is really off and vertical corporate work is close behind,” contemplates David Williams, managing director and CEO of Grubb & Ellis/Harrison & Bates.

Duke Realty’s core development activities include suburban offices and warehouses and from their perspective any development starts in 2009 are looking insufficient. “We are not going to do anything on a speculative basis. It is incredibly difficult to secure financing for projects and companies are going to have to take a third and fourth look at the financials for not only the company but the tenant they are doing the building for; that is clearly going to have an effect,” affirms Peter Scholz, senior vice president, Washington D.C. Operations for Duke Realty Corporation.

The crisis in speculative construction hits even harder in the Richmond market where on average there is eight million square feet

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of retail space for a population of 1.2 million or 67 square feet per person. “Commercial retail is flat. With the Richmond area having twice the national average of retail space per person, we are going to have to play catch up; absorption has to take place over the next few years,” explains Greg Wingfield.

“I would have a hard time going to our investment committee and asking to purchase land and develop in 2009. It is going to be a real challenge. Some small businesses are going to have to figure out how long they should hang on. There is no magic pill; it is going to take time,” says Scholz.

The Segments to Head Towards

It is important to note that it is likely President Obama will overturn the current ban on project labor agreements and freely institute them on federal work. A project labor agreement (PLA) is when the government awards public construction projects to firms that are exclusively unionized, allowing only unionized firms to bid on government funded work. Those looking to work in this sector will undoubtedly be affected by the reinstatement of PLAs on federal work.

There are industry segments that will stay steady and even potentially grow in 2009. So where is this silver lining? There is cautious optimism that Virginia will fare well because of its afore mentioned qualities. “I think we are fortunate in this area. We have not felt this as badly as other parts of the country,” considers Ed Kellam.

“We have projects we would love to see move forward, mainly commercial office buildings and mixed use projects. The market conditions are serious but manageable. We’ve done a solid job over the last few of

years of proactively reaching out to companies with expansion plans. It is a tough market but we feel we are positioned well,” states Jennifer Ives, director of the Business Investment Group for Arlington Economic Development.

Arlington County was recently named by *BusinessWeek* the number one market to weather a recession. While Arlington may stand out among other counties, Virginia, as a whole, stands out among other states as one that has the ability to maintain through this crisis.

Centennial Contractors’ portfolio is primarily government work and at this time they are seeing steady business and even growth. “In times like these the federal government will use federal contracts as part of a stimulus. We are seeing a steady backlog of opportunity. Our niche is renovation and small new construction projects and that seems to fit where they want to spend dollars,” explains Mark Bailey.

With the December announcement of President Obama’s public works stimulus package, the healthcare, education, military, energy and the infrastructure sectors will undoubtedly provide opportunities for commercial construction across the state.

As previously mentioned, the federal government has a knack for finding money to spend when the rest of us cannot. While the idea that the stimulus package will be signed into law shortly after the new administration takes office is overly optimistic, it is safe to say that at some point in the close-enough future, the industry will benefit from such a stimulus effort. Those in the industry involved in the public works sector should be feeling a real sense of hope right about now.

The new stimulus package could also have the industrial sector making a comeback with a shift in focus to alternative fuels. Renovation and interiors work has real star potential as owners consider fixing up existing properties versus building new ones. As people can no longer afford their homes, opportunities may also arise in the multifamily residential apartment sector. Of course the education and healthcare sectors stand to benefit from federal money flowing their way.

For many companies a shift in thinking and a reconstruction of the portfolio will be needed to keep up with the times; but the fact that diversification is the name of the game should not be a shocking concept. While the presidential election did not go the way many industry business owners would have liked, the state of the economy will without a doubt force our new President to continue his move towards the middle of the aisle, and that can only be better for Virginia’s right to work status.

The Government has Money!?! *Base Realignment Closure (BRAC)*

“The big economic driver we are focused on and where we think we will focus for the next couple of years is BRAC,” affirms Matt Holbrook, senior director of real estate at Opus East, LLC, with major development projects at Fort Belvoir, Virginia and Aberdeen Proving Ground, Maryland.

BRAC, the congressional mandate to consolidate certain government facilities around the state and all projects affiliated with it, has to be completed by September of 2011. This particular BRAC is focused on the efficiency and consolidation of missions and commands. “The increased need for secure office environments and consolidated commands/functions is what fueled BRAC 2005. In spite of the recent economic downturn, BRAC is moving forward at full speed,” explains Holbrook. “Because of that we are responding and supporting the effort.”

With the work around Fort Belvoir, Fort Lee and Fort Eustis, BRAC is providing and will continue to provide work for the industry across the state. "There are still BRAC dollars and they all have to be spent by 2011. There are still opportunities for procurement through 2009, but after that it is going to drop off," states Leon Blondin. Balfour Beatty has seen a lot of BRAC. At Fort Lee alone they are involved in some large design build projects: one at \$111 million and the other at \$197 million. They are pursuing other projects over \$50 million at Fort Eustis and again at Fort Lee. "We are continuing to look at them as good clients that are going to continue to build over the next couple of years," says Blondin.

BRAC may even be good for the private sector as new personnel move into the area. "The Richmond area has BRAC salivating over Fort Lee. There is a lot of construction on base; not quite as much off the base but I suspect we will see some decent multi-family growth in that area," considers David Williams.

Education

Virginia is beyond fortunate to be saturated with higher education establishments that attract students from all over the country. Throughout the state, community colleges, state and private universities are constantly renovating and expanding, providing opportunities for the industry.

During the course of the election, President Obama outlined improvements to the quality of our existing education systems as well as new programs. In addition to creating a means for the several million qualified but financially unable students to attend college, there is also an emphasis on creating more quality daycare and after-school care for children of working parents. Perhaps the first step in that direction is renovation of schools and the installation of computers in every classroom called for in the stimulus plan. Any one of these initiatives will mean work in the education sector for Virginia contractors.

"There is a good amount of education work to be done at Virginia Commonwealth University (VCU) and in our public schools. In fact, Henrico County will announce a new high school project at Staples Mill and VCU is adding onto the medical and academic campus. There are definitely projects in education that are going into the pipeline and contractors seem to feel pretty good about that," says Greg Wingfield.

Gordon Wilder, president of Door Engineering, says that the Hampton Roads area is also seeing continued work in the education sector; "We are seeing a lot of activity and work with the area universities, including Old Dominion and William & Mary," observes Wilder.

Healthcare

Healthcare is a market segment that is protected from nearly any economic chaos surrounding it; no matter how bad the state of the economy, people will continue to need medical attention. "It is a sector that is continually fueled by an ever-aging, expanding population and technology changes; these factors create a work environment for us," explains Richard T. von Gersdorff, CEO of Dominion Construction, Inc.

Dominion's exclusive focus is healthcare and while they still have vulnerabilities including the likely shift away from negotiated towards competitively bid work, overall the firm is not feeling the anxiety of others in the industry.

In any recession, healthcare can be considered a safe sector, but with President Obama's stimulus package and universal healthcare proposal, the market could actually boom. "Virginia has a process known as Certificate of Patient Need (COPN). That is a process where hospital systems have to demonstrate to the state government that there is a need for more patient beds; they cannot simply go out and construct a medical facility because it is their desire. The new administration's focus on universal healthcare translates to me that

there will be a need for more beds and facilities to take care of the growing, covered population," reiterates von Gersdorff.

Infrastructure

President Obama has said that his economic stimulus plan will "be the single largest investment in our national infrastructure" since the creation of the interstate highway system, with money allocated toward electrical grids, investment in alternative fuels and public transport. The plan is to combine existing infrastructure building techniques with new technology and green infrastructure. The hope is that jobs, projects and a better transportation system will be created. According to an article in the *Wall Street Journal* in late November, with the mere idea that the stimulus package might be dedicated to public works, investors significantly bid up several large construction and engineering firms.

This could be really good news for contractors that do infrastructure work. According to the Bureau of Labor Statistics, Virginia lost five percent of heavy/civil engineering jobs from November 2007 to November 2008. Of that loss, 4.7 percent of those jobs were lost from September to November of 2008.

The American Association of State Highway and Transportation Officials (AASHTO) reports that nationwide there are over 3,000 highway projects, with an estimated worth around \$18 billion dollars, that could be started in 30 to 90 days of the stimulus package. "Earmarks for public infrastructure projects will give the industry some momentum. I think it will bode well for the various state highway administrations to put in place some long overdue road and bridge extensions, as well as other related projects. Those segments of the industry should be excited," states Peter Scholz.

Renovation and Interiors

"I can see renovation work gaining momentum. If you are a larger property owner you reassess and reevaluate your existing

holdings and look to modify and adjust versus build new,” states Peter Scholz.

If you are a contractor that specializes in renovations/interiors and works in the public sector, you should have a pretty big smile on your face. But fear not, if your sector is private renovations/interiors, you may also breathe a small sigh of hesitant relief.

David Millard, senior director at Cushman & Wakefield, explains that in Northern Virginia, specifically the Reston/Herndon area, while overbuilt, is still experiencing demand and could provide a significant amount of interiors work for Virginia contractors. “Eleven of the 12 new speculative office buildings have now landed their major tenant or are about to land a major tenant. There is, in fact, demand. I am not going to say the landlords are happy about the rental rates, but the only thing worse than a tenant paying low rent is tenants paying no rent,” explains Millard.

Also under the new administration institutional work will provide prospective jobs for the industry. With an uncertain market, base building is going to wane as the struggling private sector puts a band-aid on existing properties to get through the tough times. “When you cannot go buy a new car, you get the old one repaired. We are seeing a fair amount of renovation work, including the retail and industrial sectors,” affirms David Williams.

Richmond is nearly a 400 year old community and for obvious reasons has been a renovation hub for some time. While Tobacco Row renovation is coming to a close after 25 years, renovation on the commercial real estate side is gaining attention. “We are hearing more about companies relocating to another building or staying in their existing space and renovating the interiors package. We have seen that with office buildings downtown and the surrounding areas. A lot of companies will not be interested in building a new show-place but would rather renovate the two or three floors they are in. It has not hit its full stride yet, but it will as it is simply cheaper to do that instead of building a new building,” confirms John Gillenwater, vice president of business development for KBS, Inc.

Sustainability

Word to the wise: no matter how dire the economy, green is here to stay. “We view sustainable development as a major area of growth. People cannot turn a blind eye to it anymore. The government is finally acknowledging the importance of sustainability; the private sector has been setting and building to sustainability standards for years. Arlington County, for example, now requires a LEED designation at the 4.1 stage,” states Marc DeLuca, Director at ING Clarion Partners. “In Arlington, no new commercial construction projects go before the Board that have not been LEED certified, no

matter the size. Even in this economy Arlington County will not back away from appropriate LEED certification,” affirms Jennifer Ives.

ING Clarion Partners’ project, Metro Park is located between Fort Belvoir and the Engineering Proving Grounds. ING is in the midst of constructing Metro Park 8, a 160,000 square foot building that will be LEED Gold. The entire 1.1 million square foot park will be LEED certified with all newly constructed buildings having a Gold and above rating, with necessary revisions made to prior drawings to insure that rating. “In this park particularly we are looking for contractors that have a real grasp of LEED; that is what the future holds for the industry,” affirms DeLuca.

The President outlined in his campaign a plan to create five million new green jobs and invest \$150 billion over 10 years in clean energy initiatives. While the topic took a backseat to the economy in the latter part of the presidential race, energy efficiency and sustainability are very near the top of our new President’s agenda as is evident in his proposed stimulus package where infrastructure’s only competition is “green jobs.”

The construction industry may have been one of the last to get onboard with green, but now sustainable initiatives are becoming simply a part of the process. As the government continues to focus on all things green, work will be created for the industry and thus should continue to be seen as a positive rather than a costly nuisance. “When there is less business you have to specialize more to capture market share. LEED and green initiatives are growing in importance more and more. Yes it can add cost but it is here to stay because clients are going to demand it,” explains David Williams.

Conclusion

“I think the definition of doing well has changed. Doing well means maintaining,” ponders Spencer Stouffer. The challenges facing the industry are real but as those who have been through one or two of these recessions know, the economy will pull through eventually. The companies that are well run, have a strong network, are diversified and open to new business endeavors will sustain and surface stronger.

“It is Economics 101. Layoffs are coming and profits are down and we are in the middle of it; but nonetheless, companies will start to be profitable again and then before you know it, they will be hiring again,” states David Williams.

Door Engineering located in Hampton Roads is over 70 years old and has weathered economic chaos before. They understand the importance of relationships and diversification in their business model. “Relationships are essential. The fact that we are a fairly

old established company with an established base of customers helps us get work from a wide range of sources. The other part of that being the scope of work we do is diversified. We handle a wide range of products and also act as a subcontractor and install everything we sell. We provide service to existing facilities and work as a contractor to end users. When business lags in one area we supplement with another” explains Gordon Wilder.

It seems relatively clear that public works is the market that is going to fare best through the recession and with the new administration. Companies that focused primarily in the private market are going to have to broaden their client base. “The old adage about not putting all your eggs in one basket is true even in the healthcare sector. It is a good market now but it could become vulnerable, and having multiple clients and diversity in the sector is key,” assures Richard T. von Gersdorff.

Jennifer Ives explains that being proactively diversified has kept Arlington County’s economy balanced. “We have the federal contractors, the associations and non-profits; we have technology companies and the think tanks. Making certain that the economy in Arlington is balanced has been strategic on our part. It did not just happen and is benefiting the community in this turbulent market.”

There is also the thought that government work is going towards design build and thus we will see more partnering between construction and architecture/engineering design firms. The same may follow suit for developers and contractors as they look for ways to get projects financed and started.

Another trend that could gain moment is joint venturing as contractors look for ways to obtain required bonding. “I think you are going to see more joint ventures because that is what the government will want to see so that they feel insulated from contracting issues and they will know the bonding is lined up. If you have Clark and Turner partnering, you probably feel pretty good about the project getting done,” discusses Peter Scholz.

Bottom line, if you are living and doing business in the state of Virginia you are a lot better off than the rest of the country. “We are living through tough times together and now is when relationships are developed that will last through careers. People will have tremendous loyalty now and will continue to honor those relationships as the times turn around,” says Stouffer.

Chesterfield County

SportsQuest recently announced plans for the construction of a \$100 million, 50-acre Olympic Training Facility in the Waterford Business Center at Route 288 and Powhite Parway. Initial phases of the project would include an ice skating rink, aquatics center, sports medicine clinic, fitness center and family entertainment center. Later phases would include a 6,000-seat arena for sports and special events; a hotel; a retail plaza; indoor/outdoor tennis facilities with stadium seating; and a 50,000-square-foot field house.

Goochland County’s First Hospital

In November 2008 the state health commissioner approved a \$183 million proposal to build the West Creek Medical Center in Goochland County. HCA, Inc. has purchased 60 acres for the project in the West Creek business park between Route 288 and Tuckahoe Creek Parkway. The building plans indicate a four-story, 280,000 square feet building that has a projected completion date of 2012.

MetroPark

ING Clarion Partners is developing what will ultimately be a 1.1 million square feet, seven-building office park in Springfield, Virginia. MetroPark 8, a 160,000 square foot project is currently being built by L.F. Jennings, Inc. and is set to deliver in May. “We expect the project to be LEED Gold, so a number of opportunities will be available soon, including the build-out of the 42,000 square feet of leased space already signed, followed by tenant improvement build-outs,” states Marc DeLuca, director at ING Clarion Partners in Washington DC. MetroPark 7 is a 76,000 square foot project and MetroPark 6 is 300,000 square feet. ING Clarion is in the process of interviewing architects for MetroPark 6. They expect to have an architect selected by early January when they plan to start talking with prospective general contractors. The goal is to have a firm on board early in the process.

DoD/BRAC 133 Project at Mark Center

As part of the BRAC, the Mark Center will be the new location of the new office complex for 6400 Department of Defense workers. The facility will be at the intersection of Seminary Road and Beauregard Street at the I-395 interchange. Duke Realty Corporation has a notice to proceed with the development of the 1.7 million square feet office project with the associated parking garages and features that go along with a space of that magnitude. Their partner is Clark Construction Group, LLC and they are beginning to assemble the project team. M.C. Dean, Inc. and The Shockley Precast Group. have already secured contracts. According to Peter Scholz, senior vice president of Washington DC Operations for Duke Realty, Virginia’s commercial construction industry will benefit; “Because the project is located in Virginia, you are going to see a lot of Virginia subcontractors, suppliers and vendors involved. Even though several major components of the team have been assembled, there are still substantial subcontractors that need to be brought into the mix.”

The National Geospatial Intelligence Agency (NGA) and Patriot Ridge

As part of the 2005 BRAC, NGA is moving its headquarters to the Engineering Proving Grounds of Fort Belvoir and there is going to be definite opportunities for defense contractors in the area to support the effort. “We want to be the people building them a home and that home is Patriot Ridge,” explains Matt Holbrook of Opus East, LLC. Patriot Ridge is an off post location intended to support government agencies and defense contractors that need to be close to the NGA. Patriot Ridge is a 978,000 square foot office project with an optional hotel. “There is a lot of work there,” affirms Holbrook.

Springfield Mall

In November 2008 the Fairfax County Planning Commission and Board of Supervisors unanimously approved the plan amendment to reconstruct the Springfield Mall into a mixed used Springfield Town Center. The project has the potential to develop a 1.82 FAR transforming the property into office buildings, retail shops, residential homes and hotels. The mall will be the first portion of the project; renovation will likely start in spring 2009. This development will provide opportunities to the construction industry for many years as the town center concept comes to life.