



The Million-Dollar Bed: Fact or Fiction By Sharon Licht and Brian Massey

Can you separate fact from fiction when it comes to debating hospital costs in today's market? With construction pricing at a level not seen in years, hospitals are considering implementing capital projects before costs begin to rise. Even in the current economic environment, many are taking advantage of alternative financing to execute a much-needed project in order to be more competitively aggressive once the market turns.

As hospital executives consider capital projects, there is a cacophony of voices citing various data about project costs. While most of the information is grounded in truth, due to the ever-changing market, certainty is anything but certain and much of the construction cost information may be viewed as misleading, or worse, a myth.

As an advisor to hospitals looking to implement growth strategies, we have heard many of the myths described below:

Myth #1 – “Hospitals can be constructed for about \$1M per bed.”

The most frequently heard and potentially dangerous axiom is the “myth of the million-dollar bed”. Granted, some hospitals were constructed in the past that averaged \$1M/bed; but to apply that factor across the board may result in a significant underestimation of total project cost. The modern hospital concept has changed, especially within the last five years. The type of hospital, amount of teaching/research, service lines, for-profit versus not-for-profit, and regulations all impact costs.

Although the cost/SF method is more accurate and universally applicable, it must be tailored to the construction project due to extraordinary cost factors. Cost estimation databases are valuable tools for determining applicable market cost factors.

Myth #2 – “The cost/SF for an MOB should be similar to the cost/SF for a hospital.”

Should an MOB cost/SF be the same as a hospital? No. Codes for hospital construction exceed codes required for medical office buildings, which impact the overall costs.

Myth #3 – “World markets do not impact hospital cost pricing.”

It is important to closely watch the world commodities market and its impact on U.S. construction costs. Economically speaking, the “world is flat”. Hospitals are not immune to the impacts of overseas economies. Market knowledge is critical to the success of managing a budget from concept to buyout due to the long design and construction timeframe for a new hospital.

Myth #4 – “According to a recent article, the hospital down the road was recently finished and it cost \$XXX/SF. Therefore, this hospital should cost approximately \$XXX/SF.”

Our firm is often questioned about the cost disparity between a recent article's reported project costs and our client's own project. This can be due to several factors, including: the fluctuating market values, since the cited project was probably budgeted two to five years earlier; and the lack of a straight comparison to the current project and what is included in the cited number.

In addition, using a conservative inflation rate is important as the market moves toward stabilization and an eventual rise. Construction uses a defined list of materials, and monitoring these materials and their availability will aid in the prediction of costs.

Myth #5 – “The cost overruns should be able to be made up in the market buy-out. The bids should cover the budget problems.”

At this time, it is a buyer’s market. Costs will only go up from here, and we may never see this level again. With the risk in the commodity market, reduced skilled labor, aging workforces, uncertainty in material supplies, manufacturing extended lead times, reduced availability of lines of credit, and increased jurisdictional review, the “savings in buy-out” option should not be viewed as a certainty.

In Conclusion

So, what can an owner do to ensure a project is on budget?

- Obtain accurate market pricing from reliable sources.
- Know what is in the costs.
- Understand the impact of the schedule and escalate accordingly.
- Understand the services to be performed and build for flexibility.
- Understand the medical equipment / IT needs. Are they project cost or annual capital?
- Factor in Cost of Capital.
- Plan for the unforeseen with an adequate contingency.
- Control adds not in line with the budget or program.
- Benchmark costs at stages of design and construction.
- Align the budget and program in the beginning and at design milestones.
- Prepare and monitor to keep the budget, schedule and quality in line with expectations.

A successful project meets expectations, achieves goals and performs in its desired capacity. No one has a crystal ball, but a good understanding of the forces impacting the hospital construction market is critical to a successful outcome.

ABOUT THE AUTHORS

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