

## Tariffs, consolidation hitting construction in healthcare

By Alex Kacik

**T**HE ESCALATING TRADE WARS are weighing on healthcare construction.

New or growing U.S. tariffs on goods produced outside the country were a major driver of an “exponential” increase in material costs over the past year, particularly metals, construction and design executives said in conversations and responses to the 2019 Modern Healthcare Construction and Design Survey.

In some cases, they have had to delay projects, companies relayed through the survey of 110 construction management, architecture, development, design and general contracting firms.

The price of steel, for instance, has gone up 10% to 18% in some markets over the past year, which can significantly add to a project’s costs, said Andrew Quirk, national director of Skanska USA’s Healthcare Center of Excellence.

Healthcare providers have been asking the construction firm if they should raise money in the capital markets, put in preemptive orders for building materials before tariffs increase, delay projects or alter designs to minimize costs, Quirk said. Nearly half of

### THE TAKEAWAY

Escalating construction supply costs create yet another ball that hospital executives have to juggle as they manage their operations in a volatile financial environment.



Construction firm Robins & Morton tested prefabrication and off-site manufacturing for the \$256 million Medical University of South Carolina project in Charleston. Much of it was built in an 80,000-square-foot warehouse 15 miles outside the city.

the respondents said supply costs were the biggest challenge, followed by regulatory barriers and less demand due to providers’ financial constraints.

“Tariffs are beginning to weigh on the marketplace,” he said.

The escalation of construction supply costs is yet another ball that healthcare providers have to juggle as they endure other costly changes, such as implementing new electronic health record systems; dealing with drug shortages and lower reimbursement levels; and maintaining aging infrastructure. Additional construction costs could delay other investments, Quirk said.

President Donald Trump continues to use tariffs as a negotiating tactic, as he tries to get leverage in trade talks. He claims that tariffs will bolster the U.S. economy, although that doesn’t appear to be the case for the hospital industry. Trump most recently took closer

aim at China. After trade talks ended without a deal, on May 10 the U.S. raised tariffs on about \$200 billion in Chinese products from 10% to 25%. The administration also proposed new levies on an additional \$300 billion worth of products while Trump pledged to expand tariffs of 25% to virtually everything imported from China.

In addition, the administration subjected \$50 billion of Chinese imports to 25% tariffs last August. A 25% levy on steel and 10% on aluminum imported from a number of countries already kicked in early last year.

Respondents to Modern Healthcare's survey cited as much as a 30% increase in project costs over the past

year, but most were in the range of 3% to 6%.

Construction firm Robins & Morton has seen significant budget increases for projects started 12 to 18 months ago due to price hikes and an oversaturated market for subcontractors, said Robin Savage, the firm's president and chief operating officer.

"We're not seeing a lot of projects being outright canceled, but we are seeing a fair amount of delay while we work very hard to stretch every dollar," Savage said, adding that they have had to reduce a project's scope or make quality reductions.

Higher construction costs can inflate costs for consumers.

## Projects

By construction phase in 2018

	COMPLETED (\$ IN MILLIONS)			BROKE GROUND (\$ IN MILLIONS)			DESIGNED (\$ IN MILLIONS)		
	NUMBER OF PROJECTS	NUMBER OF BEDS <sup>1</sup>	CONSTRUCTION COSTS <sup>2</sup>	NUMBER OF PROJECTS	NUMBER OF BEDS <sup>1</sup>	CONSTRUCTION COSTS <sup>2</sup>	NUMBER OF PROJECTS	NUMBER OF BEDS <sup>1</sup>	CONSTRUCTION COSTS <sup>2</sup>
Entire acute-care hospitals	94	3,641	\$5,503.9	93	6,058	\$12,840.6	130	9,909	\$15,893.1
Acute-care expansions	197	3,200	4,360.6	201	4,190	5,165.7	245	7,307	11,931.9
Acute-care renovations	891	4,554	4,316.9	598	3,588	3,675.4	1,043	4,806	8,730.2
Entire rehabilitation hospitals	27	789	1,008.7	63	1,597	1,188.5	76	1,606	2,173.7
Psychiatric centers/hospitals	108	2,993	1,271.0	63	1,197	897.8	108	5,407	2,942.5
Stand-alone emergency departments	17	51	95.4	23	44	101.1	19	289	416.9
Entire specialty hospitals	45	1,269	3,808.1	37	1,105	2,678.4	46	1,609	3,567.9
Specialty hospital expansions	17	154	219.3	12	36	30.2	35	482	909.1
Specialty hospital renovations	52	163	92.4	47	118	122.7	101	634	908.0
Skilled-nursing facilities	45	512	1,046.6	24	500	356.8	59	586	1,316.9
Urgent-care clinics	11	—	47.7	17	—	34.0	9	—	36.4
Free-standing outpatient expansions <sup>3</sup>	137	—	1,441.0	108	—	1,579.4	147	—	2,723.9
Free-standing outpatient renovations <sup>3</sup>	205	—	1,108.6	168	—	721.2	200	—	992.0
Entire medical office buildings	98	—	2,443.7	88	—	1,914.3	117	—	2,848.4
Medical office building expansions	57	—	251.1	33	—	186.3	53	—	582.6
Medical office building renovations	244	—	559.1	127	—	374.0	251	—	632.5
Research facilities	100	—	4,503.0	59	—	3,334.6	106	—	3,011.4
Other health/medical facilities	125	283	982.3	63	306	992.6	127	3,145	2,142.5
<b>Category totals</b>	<b>2,470</b>	<b>17,609</b>	<b>33,059.2</b>	<b>1,824</b>	<b>18,739</b>	<b>36,193.6</b>	<b>2,872</b>	<b>35,780</b>	<b>61,760.1</b>

Note: Figures are from projects reported by architecture and design/build firms only, representing 45 companies.

Projects reported by construction management firms, general contractors and development firms are excluded to avoid duplication.

<sup>1</sup>Beds are new or replacement.

<sup>2</sup>Dollars in millions.

<sup>3</sup>Free-standing facilities may be on campus, independent or physically connected to the main hospital.

Source: Modern Healthcare's 2019 Construction & Design Survey

Fabricated structural metal product prices increased 14.8% from April 2017 to April 2019 on an unadjusted basis, according to the U.S. Bureau of Labor Statistics' Producer Price Index. Milled steel product prices have gone up 13.8% and milled aluminum prices rose 12.3% over that span. As a result, many contractors are unwilling to honor original bid prices, which can delay projects, construction companies said.

The data suggests the impact of tariffs is already rendering some projects unfeasible and slowing the construction pipeline, said Lisa Strobe, director of research at real estate management firm JLL.

"Tariffs on steel and aluminum imposed in early 2018 have increased the cost of construction and have the potential to dampen healthcare-related development," she said. "Increasing costs are pushing borderline projects past the threshold of profitability across a multitude of sectors."

Costs related to tariffs are hitting consumers, research shows, which could have a downstream impact on access to care and the broader economy.

A recent study estimated that American consumers were saddled with \$69 billion in additional costs last year related to tariffs, according to researchers affiliated with Columbia University's graduate business school, the National Bureau of Economic Research, the University of California at Berkeley, UCLA, the World Bank Group and Yale University.

Bigger than tariffs, some firms said, are impacts related to a tight construction market and fewer qualified workers.

Rising labor prices continue to strain the industry as companies struggle to find skilled tradespeople. This has resulted in delayed openings and lower-quality design and construction, survey respondents said.

"We'll continue to see delays and cost escalation due to the tight labor market for both manufacturing and construction combined with the increase in work," Pepper Construction Group wrote in the survey. For example, the common lead time for elevator systems was up to eight months last year, compared with three to four months previously, the company added.

Prefabrication has mitigated some of the rising costs and recruitment challenges. Building structures off site has expedited the process and drawn top-tier craftsman to more controlled work environments, experts said.

Still, the Bureau of Labor Statistics' projected 2019 employment cost index cites a 14.3% cost increase following a 16.7% surge in 2018. The cost of labor will remain high for the foreseeable future as the craftspeople of the baby boom generation retire and younger generations continue to display a lack of interest in skilled-trade careers, Robins & Morton wrote in the survey.

"Our biggest challenge now continues to be staffing and craft labor, making sure we have adequate resources

to get things done right," Savage said.

## Consolidation's role

While material and labor costs have fluctuated wildly, healthcare consolidation has remained relatively constant as it continues at a fast pace.

It has been a mixed bag for construction and design firms, survey respondents said. Mergers and acquisitions can increase access to capital. But bigger systems with larger boards and more layers of administration can slow projects. Fewer competitors may also translate to fewer clients.

As healthcare organizations evaluate consolidation options, decisions regarding real estate development are typically put on hold to make sure that funds are not spent on projects that might not be relevant post-merger, JLL's Strobe said.

But when deals are completed, they almost always require some renovation and modernization. Even if the facilities do not need to be renovated, there is a push to "brand" the new facility and a need to integrate EHR technologies, Blair & Mui Dowd Architects wrote in the survey.

"The integration of cultures and business models is in some ways slowing things down and creating a more bureaucratic process," ZGF Architects wrote in its survey response. "But of firms in close partnership with the expanding organizations, there is increased opportunity for regional work."

While supply and labor challenges persist, about half of respondents characterized the healthcare construction industry as strong. About a third said it was slow but steady.

The push to improve access, affordability and convenience has translated into a boon for firms that are building more outpatient facilities, urgent-care centers and medical office buildings. Hospitals are updating aging facilities, replacing outdated medical equipment, building around new technology, and shifting to more wellness and retail settings.

Traditional hospital operations are also in flux, requiring new equipment, micro-hospitals, free-standing emergency rooms, and more sophisticated data management centers, which has also benefited construction and design companies, they said.

The national for-profit providers continue to pursue robust capital plans and the not-for-profit sector appears to be following suit as the industry transitions from steady to significant growth, general contractors Brasfield & Gorrie wrote.

Robins & Morton's backlog of projects from 2018 to 2019 was the largest in the company's history, Savage said. That demand has apparently carried over through 2019 as it won the bid for two behavioral hospitals within the past month.

"Presently, it is robust," he said. "I don't see a big slowdown now." ●

## Top general contracting companies

Ranked by 2018 dollar volume

RANK/COMPANY	DOLLAR VOLUME <sup>1</sup> (\$ IN MILLIONS)		SQUARE FEET <sup>1</sup> (IN MILLIONS)		PERCENTAGE OF WORK <sup>2</sup>
	2018	2017	2018	2017	
1 Brasfield & Gorrie	\$969.0	\$846.5	3.7	2.9	37%
<b>2 Robins &amp; Morton</b>	<b>951.9</b>	<b>852.4</b>	<b>3.6</b>	<b>2.0</b>	<b>93</b>
3 McCarthy Holdings	902.8	1,700.8	3.1	3.5	38
4 Layton Construction Co.	855.8	498.6	3.3	1.7	31
5 Walsh Group	843.0	819.5	1.4	1.2	10
6 Clark Construction Group	691.2	813.5	1.0	1.7	13
7 DPR Construction	639.4	1,568.9	1.8	2.8	25
8 Hoar Construction	378.1	436.8	0.5	0.9	15
9 Rudolph and Sletten	370.0	139.0	0.6	0.2	35
10 MEDCO Construction	319.5	94.0	1.4	0.4	90
11 Batson-Cook Co.	258.8	303.2	1.4	1.7	55
12 Okland Construction Co.	225.9	214.8	0.5	0.5	21
13 Balfour Beatty U.S.	189.1	534.4	1.9	1.2	9
14 Rogers-O'Brien Construction Co.	178.4	113.5	1.6	2.0	26
15 Hensel Phelps	167.8	54.3	0.8	1.3	15
16 Kraus-Anderson Construction Co.	165.3	133.5	0.5	0.3	22
17 Rodgers Builders	132.9	160.4	0.4	0.8	30
18 O'Neil Industries	129.0	68.6	0.6	0.3	25
19 The Lemoine Co.	112.2	57.5	0.3	0.2	47
20 Doster Construction Co.	93.1	59.2	0.6	0.2	30
21 J.H. Findorff & Son	55.3	151.8	0.2	0.6	8
22 XL Construction Corp.	46.5	66.0	0.1	0.2	19
<b>Category totals (all respondents)</b>	<b>9,155.0</b>	<b>9,687.1</b>	<b>30.9</b>	<b>26.5</b>	

Note: All figures are rounded.

<sup>1</sup>Figures reflect only completed healthcare construction projects in the U.S. and abroad.

<sup>2</sup>Percentage of firm's total work that involved healthcare projects.

Source: Modern Healthcare's 2019  
Construction & Design Survey