Not-for-Profit Hospitals & Health Systems Market Update

Industry Consulting Team | Q2 2023

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Newsletter Highlights

- Several hundred thousand Americans will lose health coverage following the unwinding of Medicaid coverage expanded during the COVID-19 pandemic
- The FTC and NC Senate clash over signing of new expansion bill
- Inpatient hospital days are still well above the pre-pandemic average
- US hospitals recruiting immigrants is causing shortages in their home countries
- Term SOFR continues to steadily increase while SIFMA remains volatile

Summary

The severe bleeding in the not-for-profit hospital sector (aka operating losses) appears to have subsided, and near-term outlook appears stable. Reporting from industry consultant Kaufman Hall (see TTM Operating Margins chart on top of page 3) suggests that most systems have seen margin improvement over the past several quarters noting that the significant nursing staffing shortfalls have mostly abated.

Kaufman Hall notes that 90% of the nursing workforce at most organizations is now employed with the remaining 10% being filled by contract labor. According to a recent report from Syntellis, the "Nursing Labor Expense per Patient Day" decreased 7.1% YOY but remains elevated compared to 2021 levels.

While the labor challenges have improved, several headwinds remain including:

- **Decrease in health insurance levels**: According to the most recent data available from the Kaiser Family Foundation over 1 million people in 21 states have lost Medicaid coverage since April 1 following the implementation of the Medicaid re-determination process. The Kaiser Family Foundation projects as many as 17 million people could lose coverage because of the policy changes. Reference page 2 for more on Medicaid unwinding.
- **The financial health of the patient**: The Federal Reserve recently reported that U.S. credit card balances reached $988 billion, an increase of 250 billion since April of 2021 with an average interest rate of 20% according to bankrate.com. With more patients responsible for larger portions of their healthcare bills via high deductible health plans, U.S. hospitals saw 15% increases in bad debt and charity care in April compared to the prior year and 7.6% increase from March to April.
- **Supply shortages**: Certain medical supplies and pharmaceuticals continue to experience supply chain issues. These include:
  - Certain anesthetics
  - Children's Tylenol
  - ADHD medications including Adderall and Vyvanse
  - Certain chemotherapy/cancer drugs
  - Bicillin, an injectable, long-acting form of penicillin most commonly used to treat syphilis in adults as well as childhood infections

Outlook

Our outlook for the remainder of 2023 remains guarded. Hospitals continue to implement cost saving initiatives such as layoffs, renegotiating vendor contracts, adjusting staffing patterns however all proverbial "low hanging fruit" has been harvested. We expect to see an increase in M&A/affiliations & partnerships as Hospitals & Health Systems navigate the changing landscape of healthcare.

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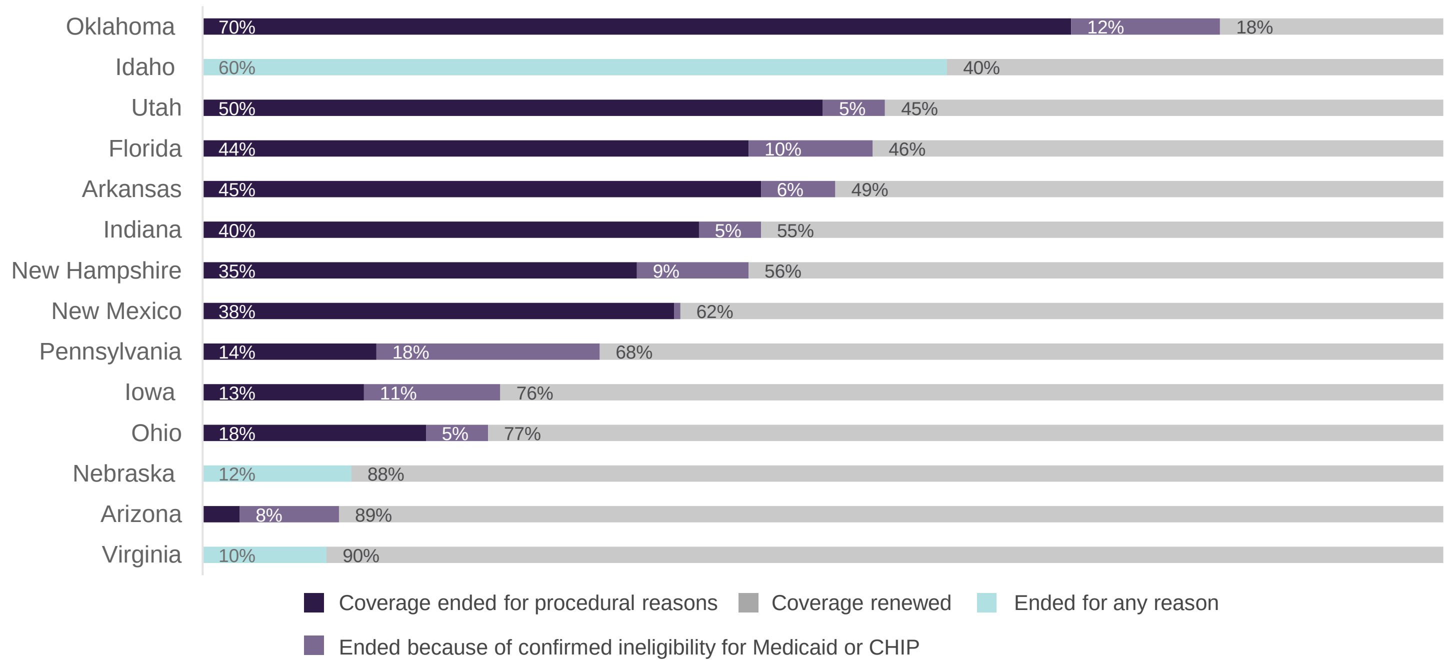
Medicaid Unwinding

- In December 2022, Congress approved a comprehensive spending bill, which separated the Medicaid continuous coverage requirement from the Public Health Emergency. Moreover, it lifted the continuous coverage protection allowing states to resume Medicaid coverage terminations effective April 1st. Americans who do not complete the proper paperwork or are ineligible for coverage will lose their Medicaid coverage.

Medicaid Coverage Status Percentages by State

14 out of the 19 states that have begun the unwinding process reported removing 36% of enrollees from Medicaid coverage.



Source: KFF Health News

- States are handling the unwinding of Medicaid differently causing the number of Americans that have lost coverage to vary significantly by state. So far 19 states have started the unwinding process, and all states except Oregon will have started the process by August.
  - Several states such as Oklahoma are reviewing members that are believed to be ineligible prior to reviewing members who they believe will continue to still qualify for coverage causing significantly higher loss of coverage numbers.
  - Virginia and Arizona aren't prioritizing renewals by likely eligibility which is why approximately 90% of member coverages have been renewed.
  - Overall to date more than 600,000 Americans have lost coverage and 4 out of 5 have lost coverage due to not submitting proper paperwork. Most enrollees claim they weren't aware of required paperwork while in other cases people moved without updating their contact information.
  - The loss of Medicaid coverage may lead to an increase in patients not seeking the coverage they need and contribute to increased charity care and bad debt expenses for U.S. hospitals.

Sources: As Medicaid Purge Begins, 'Staggering Numbers' of Americans Lose Coverage (kffhealthnews.org)
Medicaid changes, end of COVID emergency hampered hospital margins in April (healthcaredive.com)

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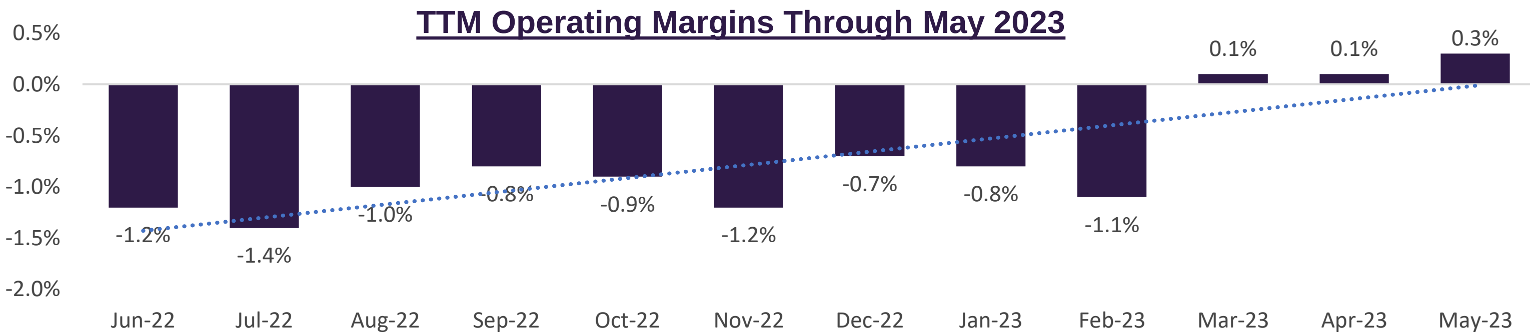
Operating Performance

The improvement in hospital margins (as measured monthly via a Kaufman Hall survey of 900 hospitals) has not been linear but continues to trend positively and reportedly improved to 0.3% as of the end of May. Operating expenses are slowly stabilizing while hospitals closely monitor supply costs. While inpatient volumes improved, hospitals continue to see care shifting to outpatient/ambulatory settings. Contract labor continues to be a major focus at all hospitals. Managing labor rates and contract terms more intensely has contributed to slight margin improvements.



North Carolina Healthcare Update:

N.C. Senate Bill 743 carves out an exemption from antitrust laws for "UNC Health, East Carolina University's medical school and any private-sector providers they collaborate with" (Gronberg). Meaning they are free to merge with any healthcare providers or facilities without scrutiny of Anti-Trust Laws. Apparently, the Federal Trade Commission (FTC) and the Securities Exchange Commission (SEC) are not pleased and have issued letters to the N.C. Senate citing this strategy as "unnecessary and anti-competitive". The letters do make a statement, but with the Bill attached to the fiscal 2023-2025 budget – this appears to be a centerpiece of N.C. healthcare strategy. The basis of the exception and claim is that these two institutions are "state actors", or a part of the university system. This action could be interpreted as a statewide push for further consolidation within the state. The FTC and SEC don't necessarily agree that these institutions are truly arms of the stats so we shall see how this play out.

N.C. State Senate $29.8 billion Spending Plan:

The North Carolina Senate's proposed budget for the next two fiscal years includes several health policy initiatives that may provoke dissatisfaction among hospital leaders in the state. The budget plan, with allocations of $29.8 billion and $30.9 billion for the upcoming years, aims to reshape the healthcare landscape by allowing the establishment of more private medical centers for services like dialysis, MRI scanning, cancer radiation, and ambulatory surgical care in new locations. The plan also grants greater power to larger healthcare systems for expansion, while also making them more accountable to the state treasurer, with the threat of having their license revoked if the savings are not attained. The proposed budget puts pressure on hospitals to reduce costs in the state health plan for employees by $125 million starting in 2024. One of the strategies is to reimburse lower priced premiums for state employees and their dependents who choose to purchase health coverage outside of the state health plan.

Healthcare Access and Stabilization Program (HASP):

The Healthcare Access and Stabilization Program (HASP) is funded by the Centers for Medicare and Medicaid Services (CMS) which aims to provide financial support to hospitals in North Carolina. Its goal is to improve Medicaid reimbursement rates to match those of commercial health insurers and cover the actual cost of providing care. HASP specifically targets critical, safety-net hospitals and rural hospitals, offering them about 90% of their unreimbursed costs. HASP would significantly reduce the Medicaid reimbursement gap, relieving over $1.5 billion in financial strain on the state's health systems and hospitals. Implementation of the program would not require any financial contribution from North Carolina.

Sources:
National Hospital Flash Report (kaufmanhall.com)
FTC criticizes N.C. bill to enable UNC Health expansion deals (businessnc.com)
FTC raises concerns over UNC, ECU Health antitrust legislation (bizjournals.com)
The Senate's proposed $29.8 billion spending plan would revamp NC's health care landscape (northcarolinahealthnews.org)
North Carolina needs the Healthcare Access and Stabilization Program (nchealthcare.org)

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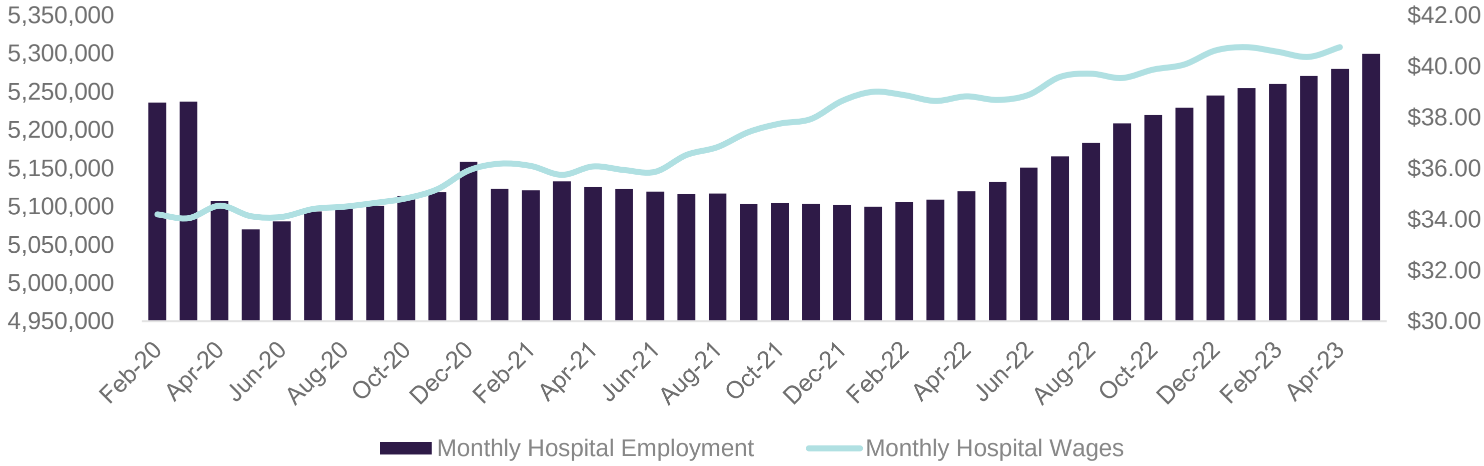
Hospital Staffing:

Hospitals continue to recruit and add staff with overall employment levels now back to pre-pandemic levels. Recovered employment levels have come at the cost of higher wages, which has pressured hospital operating margins.



The Unintended Consequences of Foreign Nurse Recruitment:

Healthcare providers from wealthy countries--such as the United States and Great Britain--have actively recruited nurses and other healthcare workers from lower income countries including the Philippines, Nigeria, Ghana, and Haiti. As a result, hospitals in these lower income countries are struggling to treat patients following staff departures for jobs in the U.S and other wealthier countries.

In the United States alone, nearly 2.8 million immigrants were employed as health-care workers in 2021 accounting for more than 18% of the total estimated healthcare workforce of 15.2 million. Of the 15.2 million, about 3.4 million were nurses, of which 16% were immigrants. Nurses from the Philippines accounted for 27% of the 546,000 immigrants working as registered nurses, followed by those from India (7%), Mexico and Jamaica (5% each), and Nigeria and Haiti (4% each).

The loss of critical health workers in their home countries is so acute that the World Health Organization (WHO) compiled a list of 55 countries with the most urgent health workforce challenges due to a scarcity of doctors, nurses and midwives. The WHO encourages healthcare providers from wealthier countries not to target the recruitment of doctors and nurses from these 55 countries. Despite these efforts, the BBC noted that over 1,200 nurses left Ghana for jobs in the U.K. in 2022.

The practice of foreign recruitment creates the prospect of ESG worries for US-based hospital systems. While the WHO is making the case that the outflow of experienced healthcare workers from poorer countries is leaving the populations disadvantaged, the counterpoint is that restricting the recruitment of these workers also has ethical concerns since a fundamental principal of many developed nations is that workers have the right to work for whomever they choose. Further, the remittance payments from workers working in wealthier countries often has a substantial benefit for the economies of the countries supplying the workers. A difficult situation with no easy solution.

TRUIST

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Interest Rate Update—Variable Rate Indexes:

- Over the past 12-months, the forward-looking term rate based on the Secured Overnight Financing Rate (SOFR) has been steadily increasing in line with the Federal Funds rate.
- The Securities Industry and Financial Markets Association Municipal Swap Index (SIFMA)—while trending higher during this timeframe continues to vary significantly week-to-week.
- When comparing 79% of term SOFR with SIFMA, SIFMA's trailing twelve-month average of 2.5% is currently 60 basis points lower.
- Due to the above trend—and perhaps to provide for diversification across variable rate indices & credit structures—we have seen Hospitals consider issuing variable rate demand bonds in 2023.
- As this structure is contemplated, it is important to review the considerations with both structures including:

Variable Rate Demand Bonds:

- A Letter of Credit or Standby Bond Purchase Agreement is generally required
- Underwriter/Official Statement
- Remarketing Agent
- Rating(s) required
- Renewal Risk
- LC Provider Counterparty Risk
- Put risk
- Interest rate risk (can be mitigated with a swap)

Variable Rate Bank Tax-Exempt Direct Placement:

- No rating or disclosure required
- No Underwriter/Official Statement
- Draw down structure available (reduces interest cost during construction period)
- Renewal Risk in the event the term of Direct Placement doesn't match the final maturity
- Interest rate risk (can be mitigated with a swap)
- The SOFR index is relatively new to the tax-exempt marketplace