Not-for-Profit Healthcare: Managing the Pandemic

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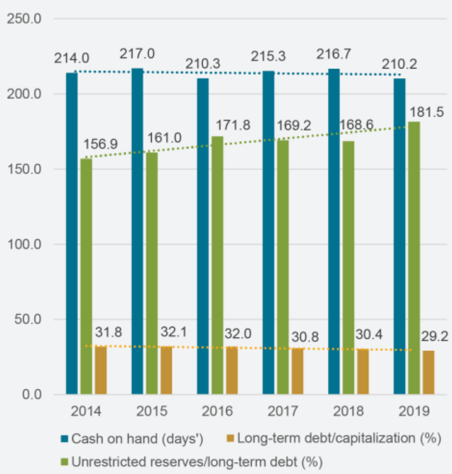
Not-for-profit hospitals entered 2020 on solid financial footing. The sector had been the beneficiary of several years of strong U.S. economic growth, characterized by low unemployment and favorable borrowing rates.

U.S. Not-For-Profit Health Care Trend of Select Balance Sheet Ratios



Source: S&P Global

More specifically, in the August summary of its *U.S. Not-for-Profit Acute Health Care Sector Update, 2019 Median Overview & Highlights,* S&P Global notes that aggregate debt levels remain low, reserves are higher and 2019 ended with a cash cushion equal to more than 200 days of operating expenses.

A sound fiscal position has served the sector well, since the pandemic has resulted in over 7.0 million cases in the U.S. and more than 400,000 hospitalizations. Outbreak epicenters witnessed a surge in virus patients, while starting in mid-March, providers experienced significant volume declines due to stay-at-home orders and the suspension of elective procedures. In late March, Congress passed the Coronavirus Aid, Relief and Economic Stimulus (CARES) Act, a $2.2 trillion federal package that included $175 billion of grants for hospitals. The legislation also increased reimbursement for the treatment of Medicare COVID-19 patients by 20% and offered cash advances equal to six months of future reimbursements. At the same time, healthcare systems tapped and/or expanded existing bank lines and identified savings in discretionary spending, temporarily underutilized services and capital programs.

At its outset, market observers agreed the pandemic would present financial challenges for the sector throughout 2020, given the pressure on expenses and the disruption to revenues. Although most systems suffered operating losses during the second quarter, the deficits have not been as large as anticipated, due to federal assistance, including meaningful grant funds and $100 million of Medicare advances disbursed to date. In its September *National Hospital Flash Report*, Kaufman Hall, a leading industry consultant, shows year to date through August, hospital operating margins fell by 7.9 percentage points versus 2019, yet with the inclusion of federal stimulus, the margins dropped by only 2.3 percentage points versus the prior year.

Additionally, the rebound of patient volumes following the reopening of local economies has exceeded expectations. While the vast differences among healthcare systems in the U.S., including size, regional market presence, services offered and local restrictions, makes certain statistics difficult to summarize, S&P reports patient volumes in July ranged from 70% to 90% of 2019 levels for many issuers. The much-welcomed return of patients reflects not only declining COVID-19 hospitalizations, but also pent-up demand from postponed visits as well as the essential nature of healthcare services. As expected, higher acuity and more urgent procedures such as cardiology, neurosurgery, cancer treatments and orthopedics have recovered more quickly than other less critical services.

The outlook for the sector remains challenging for the remainder of the year and into 2021. The aging of the U.S. population has been shifting the industry's payment structure to lower-margin Medicare plans and away from higher-return commercial insurers. High unemployment levels associated with the recession will translate into higher levels of Medicaid and public exchange enrollees, along with uninsured individuals. At the same time, many states are grappling with budget gaps and may trim Medicaid reimbursement rates to achieve cost savings. Lastly, there may be an upswing in virus cases heading into the colder weather months, yet we are encouraged by the overall trends of fewer COVID-19-related hospitalizations and the shorter length of stay for virus patients. Additional federal stimulus, including assistance for the nation's healthcare system is expected, but the timing and amount remain uncertain.

We continue to assert our belief that high-quality hospital systems with a broad geographic presence, solid operating histories, strong management teams and healthy balance sheets will be best positioned to navigate the financial pressures of the crisis. Well-managed providers have a variety of tools available to alleviate fiscal stress including use of reserves, cash-flow borrowing, debt refinancing, discretionary spending cuts and deferral of non-essential capital projects. Our composite exposure to healthcare consists of 58 issuers with a median credit quality in the AA-range by the three primary rating agencies. While we may witness downgrades to some of our hospital names, we expect rating actions to be minor and do not anticipate any material credit deterioration. As always, we will continue to monitor sector developments to identify potential pitfalls and uncover relative value opportunities.