Not-for-Profit Hospitals & Health Systems Market Update

Industry Consulting Team | February 2024

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Newsletter Highlights

- 2024 Industry outlook expected to improve in 2024 due to increasing volumes and stabilizing labor costs
- Improving operating margins to end 2023
- New York State implements increased cybersecurity measures driven by increased threats
- U.S. healthcare expenditures still slower than overall spending
- 2024 Health insurance premium not expected to shift to consumer
- Public finance market expected to increase in 2024

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2024 Not-for-Profit Hospital & Health Systems Outlook

Despite improvement in 2023, labor costs are expected to remain the leading expense concern as hospitals continue to decrease contract labor utilization by improving pay, enhancing benefits and offering greater shift flexibility to recruit and retain nurses.

As labor and inflationary stresses ameliorate, we expect operating margins to improve in 2024 driven by higher insurance reimbursement rates and increasing patient volumes.

Lawmakers are expected to continue pressuring regulators to scrutinize proposed healthcare mergers. The FTC recently sued to block a proposed acquisition in California citing that the deal would lead to higher rates for services and reduce incentives to offer quality care. As a result, systems are expected to increase their focus on non-overlapping markets and acquisitions of smaller providers going forward.

Despite increased construction costs and cost of capital, many systems are moving forward with projects. As an example, Indiana University Health is creating a 44-acre medical campus as part of a $4.3 billion project including an 864-bed hospital expected to open in late 2027. We expect project activity to increase further in 2024 should interest rates start to trend lower.

Hospital volumes in 2024 are anticipated to improve led by labor optimization and productivity strategies. The stabilization of staffing turnover rates should lead to a sustained reduction in Average Length of Stay due to more experienced staff and less time spent training. We expect continued increases in outpatient volumes which have already surpassed pre-pandemic levels.

Sources: Modern Healthcare, Moody's Investors Services

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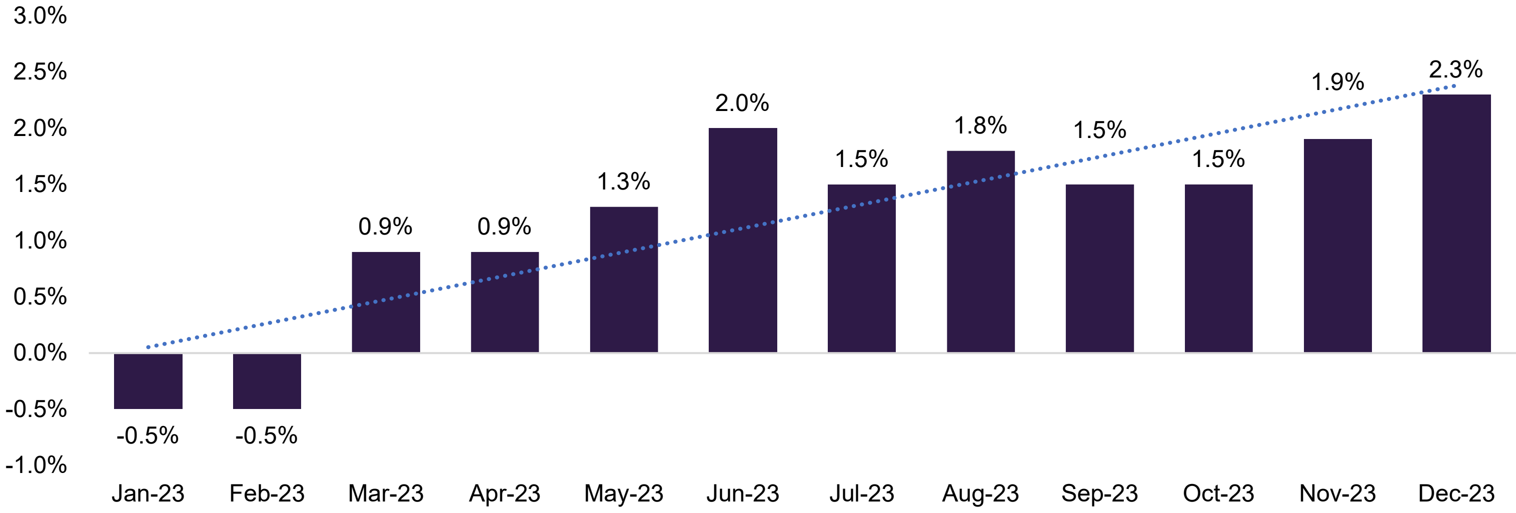
Improved Operating Profitability in 2023

Not-for-profit hospital operating profitability stabilized in 2023 and the median operating margin improved to 2.3% in December as reported in Kaufman Hall's National Hospital Flash Report. The December median operating margin of 2.3% is in line with the average 10-year median as reported by S&P of 2.2%.

On an adjusted basis, revenue per discharge increased (based on the 1,300-hospital sample size) coupled with decreased expense per discharge. These improvements were driven by stable to increasing patient volumes combined with lower contract labor utilization.

2023 Monthly Operating Margins



2023 Worst Ever Year for Cyber Attacks Against Healthcare Providers

According to the National Hospital Association, cyber attacks against hospitals were more damaging and affected more people in 2023 than in any prior year—impacting 106 million individuals, up from approximately 44 million in 2022. Impacted organizations ranged from small community hospitals to large systems including Ardent Health Services, HCA Healthcare, and Prospect Medical Holdings.

Government is taking action by investigating breaches and instituting regulations. In March, the Biden Administration released a "National Cybersecurity Strategy".

State governments are also taking action including Governor Kathy Hochul of New York, who announced a proposal for new cybersecurity regulations for the state's hospitals, which would require providers to establish written procedures, guidelines and standards to keep in-house applications secure, as well as procedures to improve security of externally developed software. Hospitals would further be required to prepare incident response plans and test them periodically.

Check out our recent white paper to learn more about the recent threats to healthcare systems and what actions can be taken to mitigate the risks. Cyberattacks Continue to Threaten Healthcare Systems

Sources: Kaufman Hall | National Hospital Flash Report (January 2024) and Kaufman Hall, Fierce Healthcare

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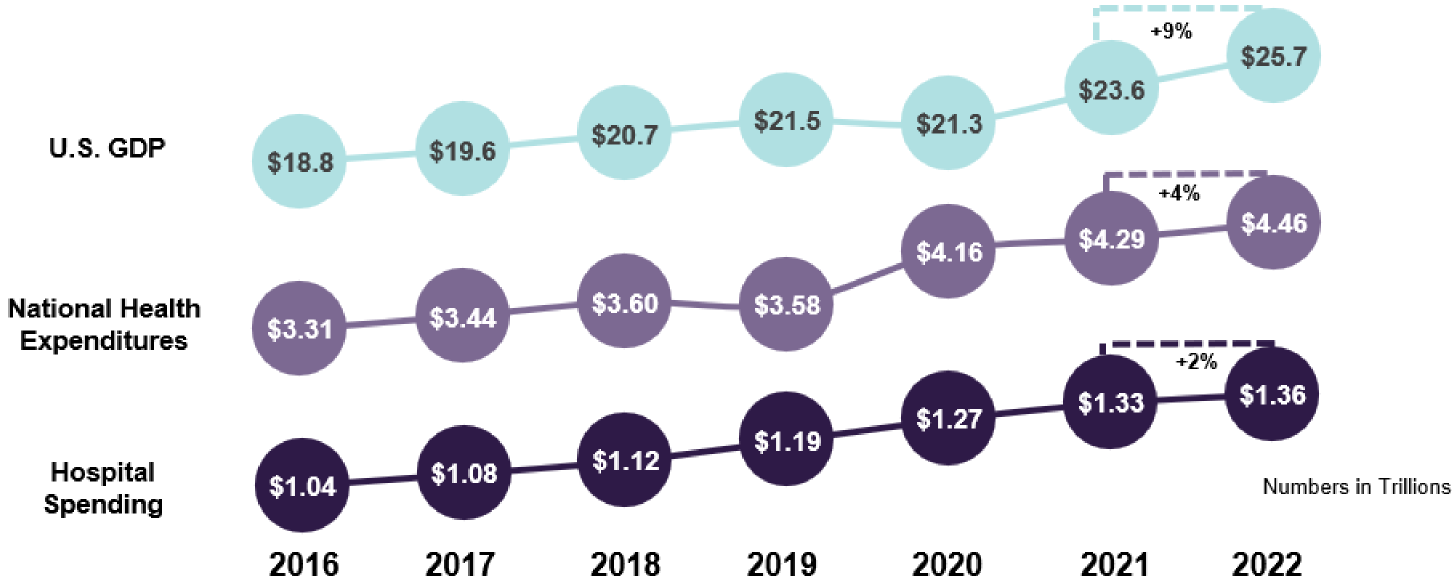
Hospital & Health Spending Grew Slower Than the U.S. Economy in 2022

In 2022, National Health Expenditures increased 4.1% to $4.5 trillion. While this was a sizeable increase, it's important to note that health spending increased at less than half the rate of the overall economy which grew over 9% due to the impact of inflation. Hospital spending increased at an even slower pace of just over 2%.

The impact of these small increases was that healthcare's share of the overall economy—expressed as a % of GDP—declined for the 3rd straight year falling from a peak of 19.5% of GDP in 2020 to 17.3% in 2022.



Rising Health Insurance Costs

Health plans are forecasted to increase 7% in 2024 after a similar increase in 2023 according to a survey conducted by benefits consulting firm Mercer. In 2023, the average cost of health coverage for a family increased to just under $24,000 with employers covering 73% of the cost. While overall health insurance costs have increased over 300% since 2001, the relative cost split between workers and employers has remained static.

In 2024, contributing to the increased costs are increasing utilization, increased use of expensive gene therapies & personalized medicine combined with the rapidly increasing utilization of GLP-1 drugs.

As costs & utilization rise, some patients are struggling to pay their bills—especially as more switch to high deductible plans in search of lower premiums—leading some to defer needed care or medicines. So far, the American consumer has largely been able to weather much of the impact of inflation, but cracks are starting to show as seen by increasing credit card and auto loan delinquencies for consumers at the lower end of the economic scale. As these pain points increase, the result could be an increase in uninsured patients resulting in growing bad debt expense for providers.

Public Finance Update

Not-for-profit healthcare public market issuance slowed in 2023 to $14.8 billion, down 41.5% YoY(1) largely due to a rising interest rate environment. When issuers did go to the market, they increasingly pursued flexibility in their capital structure shown by more variable rate structures hoping that long-term interest rates will improve. As mentioned previously, financials are expected to show continued improvement and should this come to fruition, we believe that 2024 municipal bond issuances should surpass the 2023 totals.

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Sources: (1) Includes public market taxable corporate and municipal not-for-profit healthcare issuances Bloomberg and Bond Buyer, As of 1/12/2024 Health Affairs, KFF.org, Mercer, National Library of Medicine