

Not-for-Profit Hospitals & Health Systems Market Update

Industry Consulting Team | Q4 2021

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Highlights

- COVID outbreaks continue throughout the Midwest and Northeast
- Staffing continues to be a major pain point
- Calls for boosters as vaccine effectiveness appears to be waning
- The industry is closely monitoring the Omicron variation
- Rating agencies forecast a neutral to negative 2022 for Health Systems
- Balance sheets and liquidity remain strong although Medicare advance payments are coming due in 2022
- Partner Highlight – Public Finance

COVID outbreaks continue to be a top focus of hospitals and health systems across the U.S. The Delta surge seen primarily in the Southeast in the early fall has moved to the Midwest and Northeast with hospitals in those regions seeing increasing hospitalizations. Overall cases have been trending higher following the Thanksgiving holiday with national daily cases now exceeding 100,000 per day (see Figure 1). This has led some states, such as New York, to once again suspend elective surgeries.

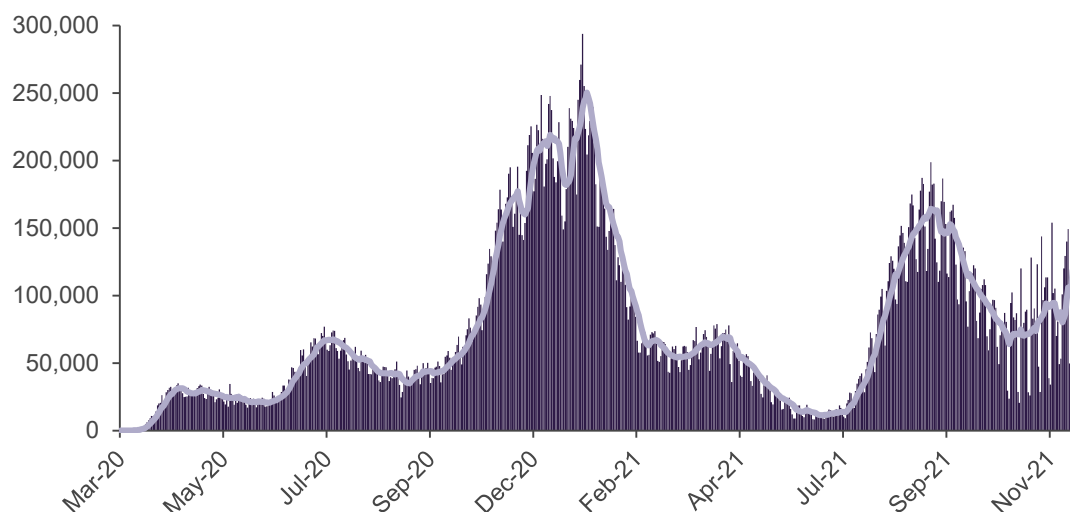
Staffing challenges have only been exacerbated by the continuation of the COVID-19 pandemic. At least four states, including Indiana, Maine, New Hampshire, and New York, have called in the National Guard to help alleviate the strain put on hospitals due to a lack of staffing. Additionally, Kentucky declared a state of emergency in early December due to the nursing shortage in the state. According to an executive order signed by Governor Andy Beshear, the state is running a nursing shortage of 12% to 20% and will need an additional 16,000 nurses by 2024. Some health systems are beginning to loosen or postpone vaccination requirements in an effort to bring more healthcare providers into the workforce.

Vaccination efforts continue to be the focus of most state and local officials as well as healthcare leaders (see Figure 2 on the next page for a letter by healthcare leaders in the Midwest pleading for residents to get vaccinated). On December 9th the CDC enhanced their booster recommendations to include 16 and 17 year olds in an attempt to fight off the virus. Waning immunity has been a concern as vaccinations have shown to be less effective after six to eight months. Massachusetts has become a case study for booster shots as cases continue to rise despite 73% of residents being fully vaccinated and 87%, including eligible children, having received at least one shot. While the majority of patients in Massachusetts hospitals specifically for COVID were unvaccinated (75%) some 25% to 43% of fully vaccinated patients who were in the hospital for either COVID or other reasons still tested positive for the virus.

The Omicron variation has been labeled as a concern by the CDC due to its fast spread across South Africa and beyond. The variation has been found in 34 states with no geographic distinction. While doctors and scientists are still conducting research, initial findings out of South Africa show that despite the variation being more transmissible (almost twice as quickly as Delta), it may not cause as severe symptoms as previous variations have. This new variant is another reason why leaders are so adamant to get populations vaccinated and boosted as Pfizer's research has shown that two doses of their vaccine may only have a 25% efficacy against Omicron while adding a booster increases effectiveness up to 75%.

Figure 1: New COVID-19 Cases by Day in the United States

Source: CDC, as of December 10, 2021



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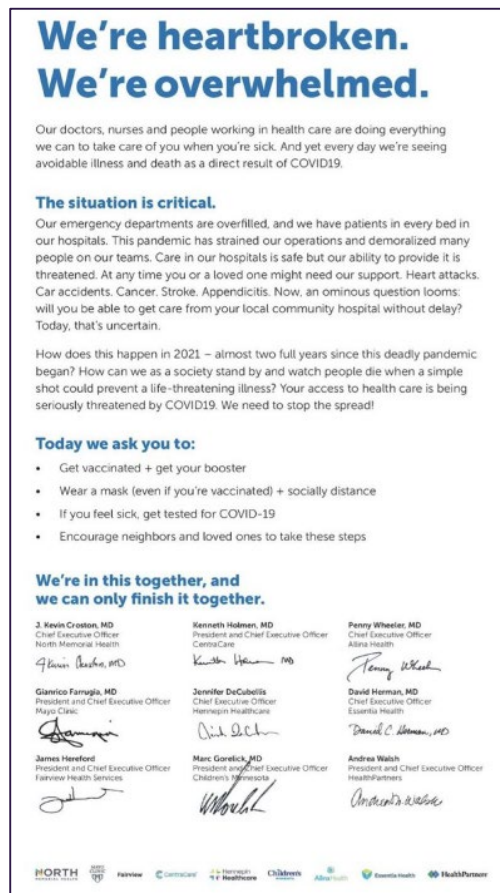
Moody's has issued a negative outlook for the Not-for-Profit Healthcare sector for 2022. Moody's sees a continuation of themes from the past year including higher expenses which will outpace revenue growth. Moody's expects operating cash flows to decline from the previous year. Despite many larger health systems coming into 2022 with strong balance sheets and adequate liquidity, some weakening is anticipated due to the requirements to repay Medicare advance payment funds and deferred payroll taxes.

Medicare advance funds repayment began in April 2021 with the rate due to increase on March 1, 2022 with final repayment due by September 1, 2022. The vast majority of the over \$100 billion issued through the program is expected to be repaid by the due date as any outstanding funds will be subject to a 4% interest rate. Additionally, as part of the CARES Act, hospitals were allowed to defer payroll taxes from March 2020 through December 2020. Half of that deferral is due by the end of 2021 with the remaining half due by the end of 2022. Moody's estimates that these two programs have added between 30 to 40 days of cash on hand to hospital balance sheets.

Reimbursement issues will impact revenue gains as pressure from payers (both commercial and governmental) continue. Moody's expects single-digit increases in reimbursement rates which will not keep pace with inflation and will negatively impact most health systems' profitability. Additionally, the aging population is expected to negatively affect revenue as more baby-boomers shift from commercial insurance to Medicare. In 2020, Medicare made up almost 47% of payer mix compared to 44% in 2013. Finally, it is unclear to what extent telehealth will be covered going forward.

Government legislation including Medicare cuts & the 340B Program have the potential to change the outlook for the year. A potential 2% per annum reduction in Medicare payments has been delayed three months from January 1, 2022 but is still on the horizon. Additionally, the 340B prescription drug program that allows hospitals to purchase drugs at a significant discount could be negatively impacted by the Biden administration's plan to allow Medicare to negotiate prices directly with drug manufacturers. The changes in Medicare Part B & D would lead to lost income for certain previously eligible hospitals.

Figure 2



Partner Focus – Truist Securities

With historically low rates, many health systems are taking advantage of the public markets. Using our public finance expertise, Truist Securities has partnered with hospitals across the country on several recent public transactions to help clients achieve their financial goals.

<p>\$295,425,000</p> <p>VANDERBILT UNIVERSITY MEDICAL CENTER</p> <p>Public Finance</p> <p><i>Co-Manager</i></p> <p><i>November 2021</i></p>	<p>\$1,000,000,000</p> <p>Piedmont HEALTHCARE</p> <p>Public Finance</p> <p><i>Co-Manager</i></p> <p><i>September 2021</i></p>	<p>\$300,000,000</p> <p>Baptist Health South Florida</p> <p>Taxable Bonds</p> <p><i>Co-Manager</i></p> <p><i>August 2021</i></p>	<p>\$124,015,000</p> <p>Children's Hospital of Philadelphia™</p> <p>Tax-Exempt Bonds</p> <p><i>Co-Manager</i></p> <p><i>June 2021</i></p>
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Sources: Becker's Healthcare, Center's for Disease Control, CNN, Moody's Investor Services, The Wall Street Journal