HIGHLAND

HEALTHCARE IN CRISIS - COVID-19 AND ITS IMPACT ON NOT-FOR-PROFIT HEALTHCARE ORGANIZATIONS

As the novel coronavirus (COVID-19) outbreak continues to spread within the U.S., not-for-profit (NFP) health-care organizations are becoming particularly stressed. While extreme drawdowns in investment markets and a global recession make this feel like the Global Financial Crisis all over again, the current crisis is likely to have a much more profound impact on healthcare organizations across the country.

During the 2008-2009 period, NFP healthcare systems were primarily impacted through their balance sheet as substantial investment losses and upheaval in debt markets stressed assets and liabilities. The current crisis is unprecedented, and its impact far reaching for healthcare organizations. Although instability in capital markets is certainly stressing NFP healthcare organizations once again, the outbreak is serving as a one-two punch this time around. Healthcare systems are dealing with the heavy strains of carrying out their core mission, which is to provide quality healthcare to the communities and areas they serve.

We have been in constant communication with not only our healthcare clients but also others across the nation. This is certainly a difficult time for CFOs, treasurers, CIOs, and other decision makers at healthcare organizations.

For that reason, we are providing a broad summary of our conversations surrounding how COVID-19 is impacting NFP healthcare organizations nationally.

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How Organizations Are Being Impacted

Most if not all healthcare organizations are already facing severe disruptions to operations. In line with government recommendations, hospitals are canceling all elective/nonessential surgeries to prepare for a surge in coronavirus cases.

This is leading to very low census numbers for organizations as they wait for COVID-19 patients to arrive and lower volumes within areas where hospitals are typically more profitable - inpatient specialty procedures. For academic medical centers, this is especially burdensome as specialty procedures comprise the vast majority of their revenues. With the elderly population most vulnerable to complications with COVID-19, most hospitalizations will require Medicare reimbursements, which are typically lower than those of commercials insurers. This will only add further pressure to margins. Recent government actions should help ease this burden to a small degree.

To prepare for a surge in patients, most hospitals are having to increase their purchases of property, plant, and equipment (PP&E), which is adding further pressure to expenses, an area that was already weighing on margins pre-coronavirus. The vast majority of healthcare organizations are facing a shortage in supplies critical to treating patients with COVID-19, such as N95 masks, gowns, face shields, respirators, and ventilators. We have heard from many healthcare organizations that they are looking for creative ways to solve these shortages, particularly masks. Some are re-engineering older masks to use again, while some are turning to 3D printed respirator masks in the event it faces a shortage.

The hit to revenues and expenses is likely to take a significant toll on operating margins. As organizations begin to forecast financials for the upcoming two to three months, many are anticipating a 2%-3% hit to operating margins. This is significant, as the median operating margin for the Moody's 2018 NFP healthcare universe was only 1.8%. If the COVID-19 outbreak were to persist for six to nine months, the impact to margins would be even more dire. With healthcare organizations needing a lifeline, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which includes key healthcare provisions such as the following:

- Allocating $100 billion to assist eligible healthcare providers for healthcare-related expenses or lost revenues associated with COVID-19. The law requires the Secretary of Health and Human Services to review applications and make determinations about who will receive funds.
- An increase in Medicare reimbursement to hospitals by providing a 20% bump in COVID-19 treatments. Due to a significant influx of elderly patients with COVID-19, an increase in Medicare reimbursements will help alleviate some of the hit to margins.
- CMS will allow hospitals and other facilities to receive accelerated Medicare payments up to six months in advance for the duration of the COVID-19 emergency period.
- Suspension of the 2% Medicare sequester through December 31, 2020.

While the recent stimulus bill includes $100 billion to reimburse NFP healthcare organizations for lost revenues, it may not be sufficient. A recent J.P. Morgan report notes that the healthcare industry generates $100 billion in revenues monthly. If those revenues decline by J.P. Morgan's 50% estimate (due to cancellation of elective procedures), the fund will be consumed in just two months.

Why Liquidity Is More Important Than Ever

The disruptions caused by COVID-19 are forcing NFP healthcare organizations to once again reevaluate their liquidity needs. Most of our discussions with clients are now surrounding liquidity and cash available to navigate through the ongoing crisis.

Organizations are looking to set aside anywhere from 30 to 60 days' worth of cash. With that said, it is critical for healthcare organizations to understand their liquidity sources, from working capital all the way to the investment portfolio. Healthcare investors should be well aware of potential liquidity needs and how those requirements fit within the context of their current investment program. A few healthcare organizations are pausing planned capital projects to ensure they have ample liquidity available. While some of our clients are rebalancing their investment portfolios back to targets given the substantial sell-off in equity markets, some have paused on rebalancing to possibly use those funds to help subsidize operations. Some have been able to use profits from equity hedging programs, which have experienced gains in this environment, as a source of liquidity.

Healthcare organizations are also looking to draw, expand, or put in new lines of credit. This is being driven by the potential need to subsidize operations during the COVID-19 outbreak. However, the increased demand for lines of credit is pressuring most commercial banks and leading to higher pricing for those without a substantial relationship with a particular bank. While operational concerns are leading to a heightened demand for credit, dislocations in short-term municipal debt markets are also leading NFP healthcare organizations to draw on lines of credit to meet potential liquidity demands as debt is remarketed and repayment risks increase. Some are even preparing to buy certain variable rate demand notes back in the event short-term municipal rates increase further. However, while still elevated, short-term rates such as SIFMA have begun to ease amid recent Federal Reserve intervention.

Highland Takeaway

The coronavirus outbreak is taking a significant toll on the NFP healthcare industry. Unlike the 2008-2009 financial crisis, the current crisis is causing unprecedented disruptions in operations and how the industry fundamentally operates. We are observing a renewed focus on liquidity and the role the investment portfolio plays within the entire organization. Our approach to portfolio construction was built for moments like these. Through our proprietary enterprise risk capabilities, our clients are well versed in how their investment portfolios support their organizations, especially in times when both investment markets and operations may be severely stressed. There are many unknowns, and the current crisis remains fluid. We will continue to keep clients updated as events unfold.

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