



HIGHLAND

HEALTHCARE QUARTERLY Q3

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# Preparing for Uncertainty: Medicaid Reform, Inflation, and Portfolio Alignment

The third quarter of 2025 marked a pivotal point for U.S. hospitals and health systems. While Moody's 2024 medians confirmed steady improvement in operating performance, the broader environment grew more complex. The passage of the *One Big Beautiful Bill Act* (OBBBA) introduced the largest Medicaid funding reform in a decade, reducing federal contributions by nearly \$1 trillion over the next 10 years and leaving rural and government-heavy systems facing heightened uncertainty.

At the same time, healthcare inflation continued to outpace the headline Consumer Price Index (CPI), and the Federal Reserve initiated its first rate cut of the cycle. Together, these shifts underscore the need for disciplined liquidity planning, portfolio alignment, and renewed attention to how investment strategy supports, not isolates from, the operating mission.

MOODY'S 2024

## Stabilization with Divergence

Moody's 2024 medians reflected a sector regaining its footing. Operating cash-flow margins improved across all four U.S. regions, led by the South at 7.8 percent (up from 5.7 percent in 2023). The Midwest reported the strongest liquidity, with a median 216 days cash on hand, while the Northeast continued to trail in balance-sheet flexibility.

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Beneath those averages, performance dispersion widened. Larger, diversified systems captured scale benefits and capital access, while stand-alone and rural hospitals remained constrained by payer mix and fixed cost intensity. The median trends signal stabilization, but not uniform recovery.



## MEDICAID REFORM

## The Uneven Impact of the OBBBA

The OBBBA restructures federal Medicaid participation and introduces a \$50 billion Rural Health Transformation Fund intended to soften the blow of reduced reimbursements. However, one of the drawbacks being discussed is that half of the funds are projected to be distributed equally across states, regardless of rural population or need and that criteria is vague and may not prioritize the most vulnerable communities. The cuts (estimated between \$1.0 and \$1.1 trillion over ten years) will reverberate unevenly across geographies.

- **Expansion States** such as Kentucky, North Carolina, Illinois, Virginia, and New York will feel the sharper effect as enhanced federal matching phases down.
- **Non-Expansion States**, including Texas and Florida, may experience rising uncompensated-care burdens rather than direct funding loss.
- **Rural Providers**, already managing smaller volumes and higher fixed costs, will face the most acute pressure - one in four rural residents depends on Medicaid.

Early evidence suggests some states are beginning to respond. In late September, Massachusetts approved a \$234 million funding package to support hospitals serving rural and uninsured populations. Other states are likely to follow with similar supplemental measures to preserve access to care.

The policy's timing allows systems a brief window to prepare. Scenario planning, liquidity mapping, and funding-source analysis will be critical in 2026 budget cycles as these changes begin to ripple through state reimbursements.

## HEALTHCARE INFLATION

## Costs Outrunning Prices

Despite easing headline inflation, healthcare expenses continue to climb faster than reimbursement. While overall CPI averaged roughly 3 percent this quarter, hospital-specific inflation hovered near 4 percent, and the Employment Cost Index, which captures wages and benefits, remained higher still. For many operators, labor and benefit costs now exceed revenue growth, eroding recent margin gains.

Energy costs also emerged as a secondary concern. Data-center construction and grid strain have driven commercial utility inflation higher, adding incremental expense pressure to large hospital campuses. These dynamics reinforce the importance of maintaining investment allocations that preserve purchasing power over time.

# Liquidity, De-Risking, and Portfolio Strategy

Rate cuts in September prompted treasury teams to reassess liquidity structure. With further interest rate cuts, the yield curve could steepen, allowing for incremental yield to be achieved by modestly extending the investment duration without sacrificing access to capital.

Highland emphasizes three disciplines for this environment:

## 1. Cash Tiering

Define near-term, intermediate, and contingency liquidity horizons (typically 0-30 days, 1-6 months, and 6-12 months+) to align investment instruments with operating needs.

## 2. Need-Based De-Risking

Model baseline, best-case, and worst-case reimbursement paths to ensure portfolio risk aligns with potential operational stress.

## 3. Inflation-Sensitive Allocations

Consider maintaining exposure to private infrastructure and natural-resource equities (areas benefiting from energy-grid investment and global materials demand) to hedge healthcare-specific inflation that traditional CPI-linked assets may not capture.

Together, these strategies ensure that portfolios remain a source of stability and liquidity rather than a potential liability when markets turn.



## Looking Ahead

Q3 2025 showed encouraging financial progress but rising external complexity. Margin gains, liquidity rebuilding, and market performance provided relief, yet policy reform, wage inflation, and energy costs will test that progress in 2026. The most resilient health systems will be those that integrate balance-sheet strategy with mission execution, linking investments, liquidity, and operations in one coherent framework.

Highland Associates remains focused on helping clients manage that alignment, turning financial discipline into strategic advantage.



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