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Special Series
Credit Risks in Turbulent Times

SECTOR COMMENT
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Not-for-profit hospitals – US

Federal coronavirus aid package provides modest relief; ratings reflect support

The Coronavirus Aid, Relief and Economic Stimulus (CARES) Act, the $2.2 trillion federal package signed into law on March 27, contains several provisions for US not-for-profit hospitals that will support their operations and help provide access to critical supplies. Key provisions include $100 billion in funding to compensate for lost revenue and coronavirus preparation costs, increased Medicare reimbursement, and liquidity support through advances on future Medicare reimbursement. While the extraordinary level of federal aid offers the sector some relief, however, it is unlikely to fully cover the material revenue decline facing hospitals as a result of the pandemic, and cash flow will likely be materially lower for the next several months. As such, our outlook for the sector remains negative.

Federal package's $100 billion fund will provide relief for hospitals though it will not fully compensate for lost revenue

The $100 billion fund contained in the CARES Act is intended to provide relief to hospitals, supporting their operations and providing access to critical supplies. However, it is unlikely to fully compensate the sector for the two main financial challenges facing providers as a result of the coronavirus outbreak. These challenges are i) a material decline in revenue and cash flow as profitable elective surgeries, procedures and other services are postponed to preserve resources and avoid spreading the virus, and ii) difficulty curbing expenses as surge preparation costs offset any expense reductions from postponed or canceled services.

Postponed services will likely reduce hospital revenue by 25%-40% per month on average and strain cash flow significantly, according to early anecdotal information. This reduction is occurring even in regions and hospitals that, to date, have not seen many coronavirus patients. Many states have mandated that hospitals suspend nonessential services for an indefinite period, creating uncertainty over when hospitals can resume providing services. Moreover, hospitals in regions with large outbreaks are already experiencing, or will soon experience, a surge in coronavirus patients, placing additional strain on operations and supplies and increasing labor expenses.

While the $100 billion provides some compensation, it will likely be insufficient to fully cover this lost revenue, particularly if the outbreak is sustained over a long period, and elective and other nonessential care remains suspended into late spring or summer. Based on data from the Centers for Medicare and Medicaid Services (CMS), $100 billion is the approximate national spend on hospital services per month. The $100 billion in the federal package is intended not only to compensate for lost revenue but also to cover emergency preparedness. Given that affected services will almost certainly be suspended for over a month, and that the $100 billion is available to not only hospitals but other non-hospital healthcare providers (such as nursing homes and clinics), it will not likely be enough to cover lost revenue from suspended services. Additionally, the application process and timing of such funds is unclear.

Advances on future Medicare reimbursement will provide fastest liquidity relief

Expansion of the Medicare Accelerated and Advance Payment Program, as proposed, will provide the fastest liquidity relief to hospitals because it expands on an existing program. The program allows hospitals to receive six-month's worth in expected future Medicare reimbursement in cash today, with repayments deducted from future Medicare reimbursement over the next year. Medicare is the primary payor for about half of all hospital charges and we estimate this program could provide cash payments equal to about 10% of a hospital's annual revenue, making the potential liquidity support from this program significant.

Deferral of payroll taxes, increased reimbursement for coronavirus cases will also support liquidity

Several other provisions of the CARES Act are intended to benefit hospitals and support liquidity over the next several months, including the ability to defer the employer portion of federal payroll taxes. Over the second half of 2020, the suspension of Medicare sequestration, which effectively increases all Medicare reimbursement to hospitals by 2%, and a 20% increase in Medicare reimbursement to hospitals for coronavirus patients will also provide some financial support.

Other federal actions will also benefit hospitals

Legislation passed two weeks ago increased the federal share of Medicaid funding (FMAP) by 6.2%. Although less than requested by state governors, the increase will alleviate states' Medicaid spending, which is likely to grow substantially as job losses increase the number of individuals qualifying for Medicaid. Support from the military, including hospital ships and plans by the Army Corps of Engineers to build hundreds of temporary hospitals, will allow hospitals to focus on the sickest patients. Nevertheless, the surge in patients in the most affected areas is still likely to overwhelm hospitals in those regions.

Ratings will incorporate support provided by the CARES Act

Our credit analysis and recent ratings incorporate the level of support provided by the CARES Act for the hospital sector. For example, Bon Secours Mercy Health, a $10 billion revenue multi-site health system, was upgraded recently to A1 stable from A2 positive. The system's ample liquidity of over $5 billion and likely benefits of additional funding via the CARES Act should allow it to manage the impact of COVID-19, along with other factors.

Expansion of the Medicare Accelerated and Advance Payment Program will likely provide an immediate injection of liquidity to hospitals that elect to participate. Reportedly, many hospitals throughout the nation have submitted applications under the program, and CMS has said it will review such applications within seven days of receipt to expedite funding. In addition to the liquidity boost, the 20% increase in Medicare reimbursement for coronavirus cases will cover some of the costs associated with the outbreak.

Larger systems will be better able to weather the pandemic

Factors in addition to the federal aid package will also support credit quality. Larger systems which have regional diversification and strong absolute and relative liquidity will be better able to weather the pandemic. Many larger systems have access to capital through the form of bank lines or revolvers, while others have quickly established new bank lines of credit. For example, lines of credit helped to establish a ratings floor with a stable outlook when we downgraded University of Pittsburgh Medical Center (UPMC) to A2 stable from A1 negative (approximately $21 billion in revenue). The stable outlook also reflects some benefits that UPMC will garner from the CARES Act. Any reimbursement of coronavirus costs will help offset expenses, though likely not enough to make hospitals whole.

Bigger systems will also benefit from other factors. Some academic medical centers, for example, will find a source of credit strength in being owned by large universities and thereby having a "parent" as a liquidity source.

Smaller hospitals face greater liquidity difficulties

Smaller, single-site hospitals may face near-term liquidity challenges because many are unable to access alternative capital sources such as bank lines. Even those hospitals with only a few COVID-19 patients may suffer significantly because of the suspension of elective services. The impact of these suspensions will likely be more pronounced for small hospitals than for larger systems with more flexibility in their operations. If these credit effects materialize, ratings will face the possibility of negative outlooks or downgrades, with the degree of movement depending on the severity of a hospital's situation.

Extent of credit impact will also depend on length of the coronavirus outbreak

A key uncertainty underlying the CARES Act is the duration of the pandemic. If the outbreak is prolonged and there is no additional legislation passed to support hospitals, the impact on credit will be all the greater.

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