September 2021

Financial Effects of COVID-19: Hospital Outlook for the Remainder of 2021

KaufmanHall

Introduction

COVID-19 expected to drive continued hospital losses throughout 2021

America's hospitals face significant, ongoing financial instability as the ravages of the COVID-19 pandemic continue to fester. With cases and hospitalizations at high levels in the wake of the rapid spread of the Delta variant, mostly among the unvaccinated, physicians, nurses, and other hospital personnel are working tirelessly to care for COVID-19 patients. At the same time, hospitals are experiencing profound net income losses that likely will continue throughout the rest of 2021.

Kaufman Hall projects hospitals nationwide will **lose an estimated $54 billion in net income** over the course of the year, even taking into account federal Coronavirus Aid, Relief, and Economic Security (CARES) Act funding from last year.

Our latest analyses examine actual performance in the first and second quarters of this year, and projections for the remainder of 2021. **According to our estimates, more than a third of U.S. hospitals will maintain negative operating margins through year's end.** However, the uncertain trajectory of the Delta and Mu variants in the U.S. this fall could result in even greater losses.

Contributing factors include:

- **Sicker patients.** Hospitals are seeing more high acuity, inpatient cases—including COVID-19 patients—requiring longer lengths of stay than prior to the pandemic in 2019. While such cases are contributing to revenue increases, any gains are offset by higher care costs for treating patients with more severe conditions.
- **Higher expenses.** Expenses are rising across the board, as hospitals face increasing costs for labor, drugs, purchased services, personal protective equipment (PPE), and other medical and safety supplies needed to care for higher acuity patients.
- **Fewer outpatient visits.** Hospital outpatient visits—which tend to have lower expenses and higher margins—continue to grow, but remain depressed compared to 2019 levels. They have yet to fully recover after plummeting with nationwide shutdowns and COVID-19 mitigation efforts in the early months of the pandemic in 2020.

These latest findings reaffirm the results discussed in Kaufman Hall's March report. Details on our key findings are discussed in the following pages.

This report was prepared at the request of the American Hospital Association.

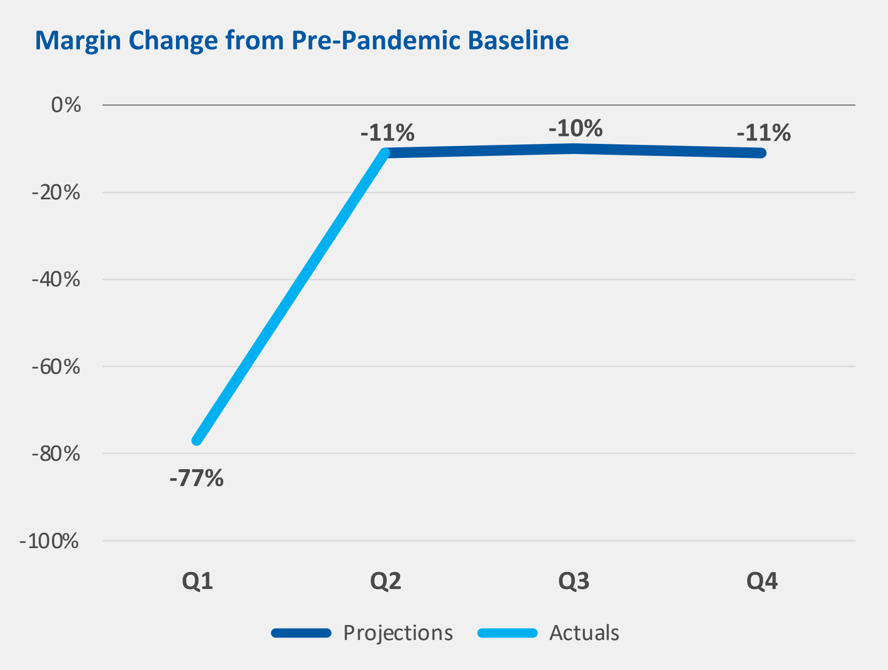
Key Findings

Median hospital margins could be 11% below pre-pandemic levels by year's end

Consistent with our previous report, Kaufman Hall's latest projections show that hospital margins will remain below pre-pandemic levels throughout 2021.

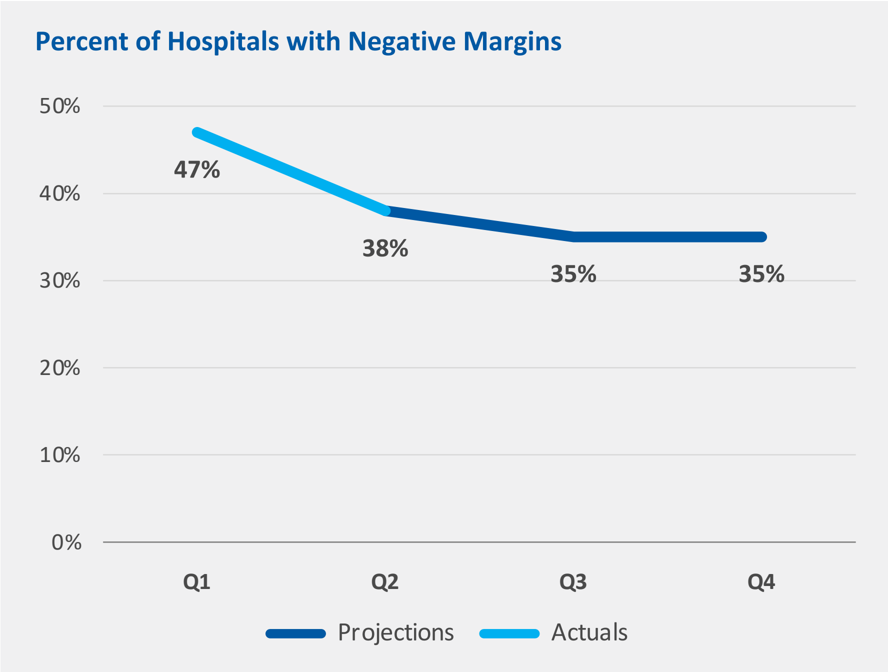
Hospital margins are expected to remain close to Q2 performance, shifting only slightly to 10% and 11% below pre-pandemic levels in Q3 and Q4, respectively. However, it is important to note that these projections do not factor in recent increases in COVID-19 cases from the Delta variant, which could drive margins even lower in the second half of the year.

Our projections reflect margin deficits that will inhibit hospitals' ability to invest in growth or additional community services throughout 2021.



Source: Kaufman, Hall & Associates, LLC

More than a third of hospitals could end 2021 with negative margins



Source: Kaufman, Hall & Associates, LLC

The percentage of hospitals projected to have negative margins in the third and fourth quarters remains virtually unchanged from our previous analysis. Significantly more hospitals will close the year with negative margins than prior to COVID-19.

Actual performance results show that the percent of hospitals with negative operating margins improved from 47% in Q1 to 38% in Q2. Our projections indicate the percent of hospitals with negative margins will improve further to 35% in Q3 and remain at that level through Q4. However, this does not account for the latest surge in cases, which could push more hospitals to operate with negative margins. Regardless, the proportion of hospitals ending the year with negative margins will likely be higher than the 25% seen in 2019.

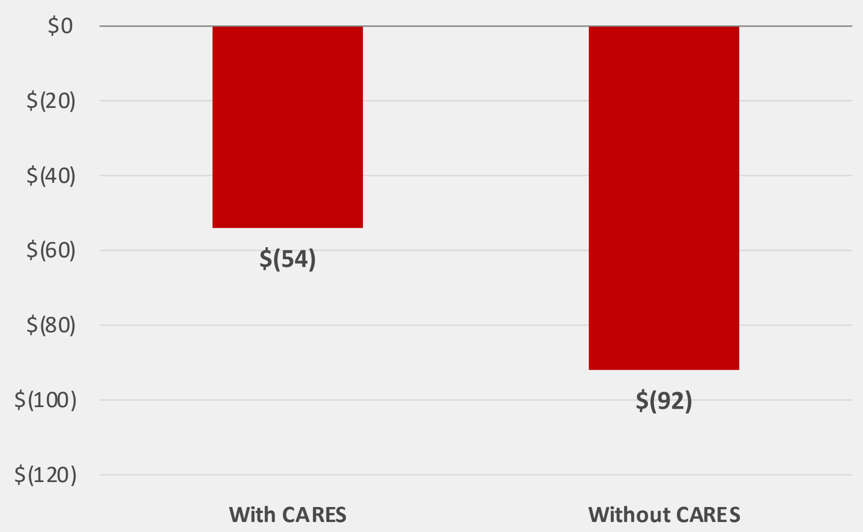
Higher acuity patients and lower share of outpatient revenues contribute to losses

Factoring in CARES Provider Relief Fund aid (including distributions from phase II through phase III and targeted distributions), hospitals across the country are estimated to lose $54 billion in net income in 2021. If there were no such funds from the federal government, losses in net income would be as high as $92 billion, which further emphasizes the magnitude of losses hospitals will likely continue to face through the end of 2021.

An increase in high-acuity patients is contributing to the losses. The median length of stay is up 8% year-to-date compared to 2019 for most hospitals (indicating higher-acuity patients), and up as high as 18% for some hospitals with 500 beds or more.

One-time Provider Relief Fund payments are contributing to a temporary growth in revenues. Also, most hospitals continue to see a shift in revenue, with higher cost inpatient services making up a larger share of overall revenue than prior to the pandemic. Meanwhile, although outpatient revenue is slightly up compared to 2019, the accompanying increase in inpatient services is such that the portion of outpatient revenue to total revenue is down for many organizations.

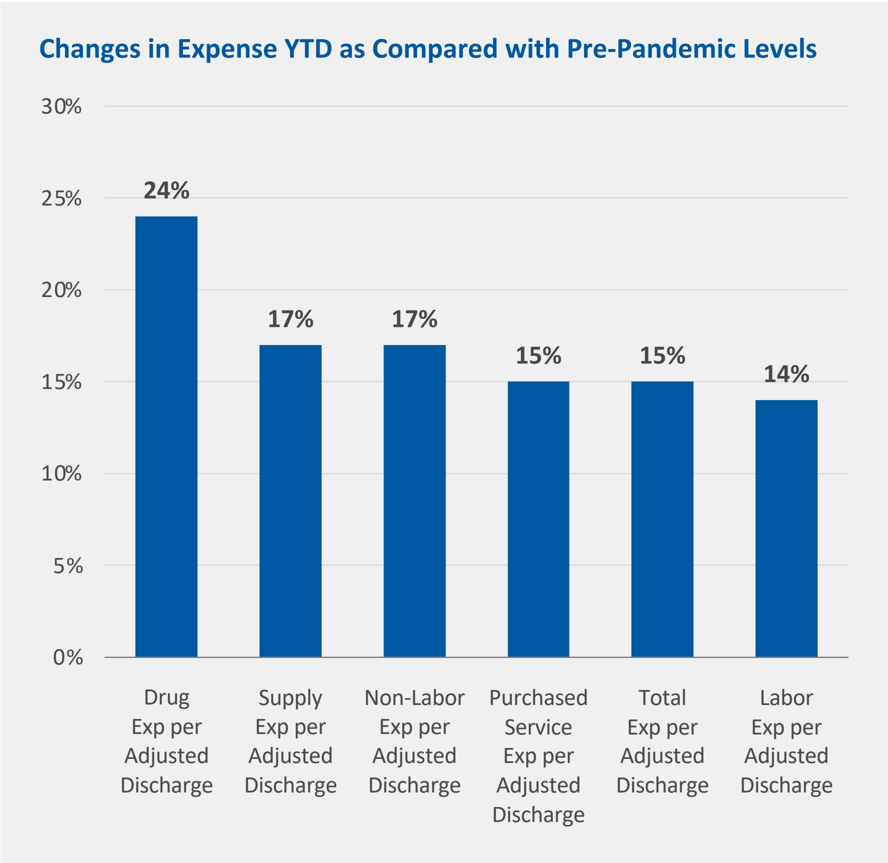
Annualized Income Loss from Pre-Pandemic Levels
(dollars in billions)



Source: Kaufman, Hall & Associates, LLC

This suggests that patients continue to delay outpatient services due to pandemic concerns. At the worst-hit hospitals for this trend, the share of outpatient revenue has dropped 20% compared to pre-pandemic levels.

Expenses continue to escalate as hospitals care for sicker patients



Source: Kaufman, Hall & Associates, LLC

Expenses have increased dramatically in 2021 as hospitals bear the costs of treating greater numbers of high-acuity, inpatient cases. Total Expenses per Adjusted Discharge—which approximates the amount of hospital expenses necessary to care for a patient in the inpatient or outpatient setting—are up 15% compared to before the pandemic for hospitals nationwide.

Non-labor Expenses per Adjusted Discharge are up 17% and Labor Expenses per Adjusted Discharge are up 14%. FTEs per Adjusted Occupied Bed (AOB) decreased 4% year to date. This highlights that—even with hospital actions that have improved overall labor efficiency—the cost of labor has risen significantly due to labor shortages, hazard pay, and other causes.

Drug costs have seen the largest increases, with Drug Expenses per Adjusted Discharge up 24% compared to before the pandemic, driven, in part, by new high-cost drugs coming onto the market.

Supply Expenses per Adjusted Discharge are up 17%, as hospitals continue to purchase PPE and other equipment and supplies needed to care for COVID-19 patients and other high-acuity cases.

Observations

2021 financial recovery unlikely for hospitals as the effects of COVID-19 persist

Our mid-2021 analysis shows that COVID-19 continues to create not only clinical but also financial challenges for hospitals.

Even as overall hospital revenues are improving, they are offset by mounting expenses in caring for greater numbers of sicker, high-acuity patients who require longer hospital stays, more supplies and staff time, and more resources overall.

At the same time, demand for outpatient services remains down compared to before the pandemic. The result is a loss of much-needed outpatient revenues to support hospitals and supplement losses in other areas.

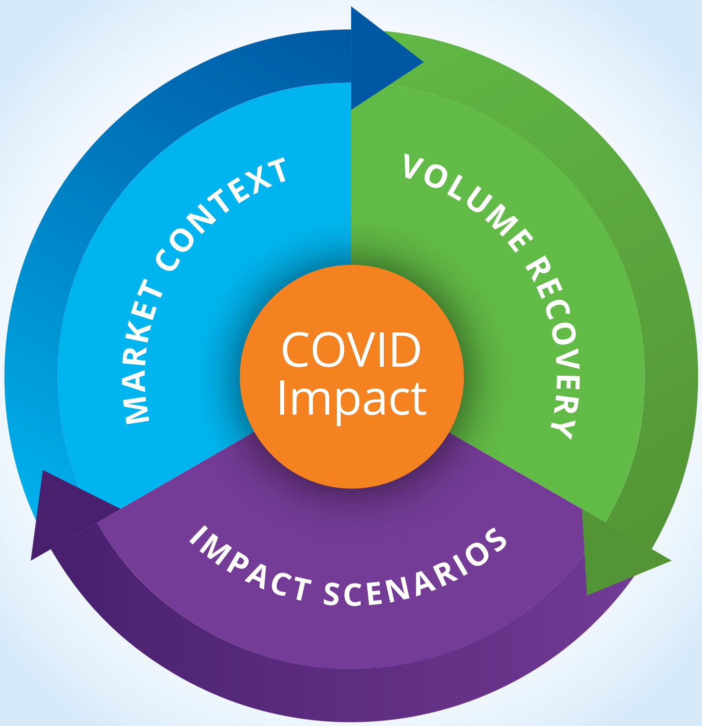
Our projections continue to show that hospitals' financial status will remain below pre-pandemic levels throughout the second half of the year. Compared to before the pandemic, median hospital operating margins will be down, and a greater percentage of hospitals will close the year with negative operating margins.

While many hospital leaders hoped 2021 would provide an opportunity to return their organizations to greater financial stability after the severe losses seen in 2020, those hopes are dimming as the virus continues to circulate throughout the population. In recent months, the spread of the highly contagious Delta variant has set back hospitals back even more. The 7-day moving average of new COVID-19 cases jumped approximately 1157% from 11,634 on June 19 to 146,182 on September 15, according to recent data from the U.S. Centers for Disease Control and Prevention. The 7-day moving average of new hospital admissions of patients with COVID-19 increased 488% over roughly the same period, from 1,900 on June 19 to 11,168 on September 14.

The resulting volatility—including the potential impact of the Mu variant—continues to hamper hospitals' recovery efforts and contribute to widespread uncertainty in their long-term ability to serve the healthcare needs of their communities.

Methodology

Kaufman Hall's approach to modeling potential COVID-19 effects focused on three key questions



1 What market forces will affect volume and financial recovery?

- Unemployment and payer mix shifts
- Consumer price sensitivity and delays in care due to cost
- Patients' willingness to return
- Reduced travel and tourism

2 What are the anticipated volume recovery trends across forecast groups?

- Lag in return to hospital vs. ambulatory
- Required capacity and resource constraints
- COVID-19 hospitalization scenarios

3 How do we anticipate impact across the healthcare provider landscape?

- Link model outputs to global drivers
- Develop potential scenarios and sensitivity analyses

Projections are based on model assumptions as well as real data from 900 hospitals

The model was loaded with actual data from hospitals before the pandemic, during the pandemic, and most current performance to create individual projections for every hospital

- Total operating revenue per patient day
- Total operating expense per patient day
- Total volume
- Total revenue
- Total expense
- Operating margin

The model includes assumptions of:

- Rate of volume recovery based on consumer surveys
- Volume recovery based on COVID-19 archetypes
- Revenue recovery based on payer mix and patient population shifts

Qualifications, Assumptions and Limiting Conditions (v.12.08.06):

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