Bond Case Briefs

Municipal Finance Law Since 1971

Fitch Rtgs: Not-for-Profit Hospitals Outlook Stable in Face of Challenges

Fitch Ratings-New York-10 December 2019: Hospitals' and healthcare systems' ability to respond to operational challenges by cutting costs and improving efficiency has placed these entities on surer footing for the continued headwinds they will face in 2020, says Fitch Ratings. Overall balance sheet stability and slight improvements in operational performance reflect the sector's adaptation to pressures, such as high levels of labor and pharmaceutical costs, cost and implementation risks of moving toward more value-based and at-risk reimbursement models, a shifting payor mix, commercial insurance rate increases, and competition from non-traditional market entrants. Most providers have begun to effectively align their cost models to revenue pressures, despite these challenges. Fitch changed its sector outlook from Negative to Stable for 2020 and is maintaining a Stable Rating Outlook for healthcare issuers in 2020.

We believe many providers will continue to pursue consolidation and alignment in order to extract greater efficiencies and gain contracting leverage with payors and suppliers. Although size and scale alone do not necessarily result in success, further consolidation is a logical outcome given current industry pressures.

The increase in the share of the US population over age 65 will generally have a negative longer-term effect on payor mix as seniors shift from commercial insurance to Medicare. The aging population should provide an uplift in volumes, as use rates increase proportionally with age; however, this added volume will only be beneficial if providers can manage to break-even, or better, on Medicare rates. Commercial, or managed care, contract negotiations are critical for providers as they seek to offset the effects of comparatively weaker governmental reimbursement with favorable commercial contracts.

The decades-long focus on outpatient services compared with inpatient services has not moderated, resulting in a mismatch of fixed costs and declining inpatient volume. The transition from volume to value-based reimbursement is a longer-term adjustment but in the short term will result in margin pressures for hospitals as they invest in new systems and see a decline in overnight admissions.

Non-traditional healthcare entrants will continue to be a disruptive factor over the medium to long term and are likely to change the way individuals interact with the sector. Technology and large retail companies, with potentially deeper pockets, sophisticated and consumer friendly distribution channels, and data platforms they are able to leverage are expected to make further inroads into pharmacy and low-acuity medical services. This will result in a more competitive operating environment across the patient spectrum.

Balance sheet measures have reached levels not seen since before the Great Recession of 2007-2009. The sector benefited from favorable investment conditions, positive cash flow, and generally manageable spending on capex. As a result, balance sheet strength has largely mitigated operational pressures faced by hospitals in recent years.

While policy direction in the next few years will be determined by the 2020 US elections, the acute care sector would face significant challenges regardless of the outcome. Any systemic change, whether it be the dismantling of the Affordable Care Act or the implementation of a ‘Medicare for All’ plan, would take some time to implement, and places uncertainty on whether or not our Stable sector and Ratings Outlooks will persist beyond 2020.

Contact:

Kevin Holloran
Senior Director, US Public Finance
+1 512 813-5700
Fitch Ratings, Inc.
111 Congress Avenue
Suite 2010
Austin, TX 78701

Olga Beck
Senior Director, US Public Finance
+1 212 908-0772
Fitch Ratings, Inc.
Hearst Tower
300 W. 57th Street
New York, NY 10019

Sarah Repucci
Senior Director, Fitch Wire
+1 212 908-0726

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com. The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.