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Fitch: Medicaid Expansion May Benefit Some U.S. Nonprofit Hospitals.

Fitch Ratings-Chicago/New York-13 April 2017: Nonprofit hospitals in some states could see a fiscal benefit if their legislatures expand Medicaid under The Patient Protection and Affordable Care Act (ACA), according to Fitch Ratings.

The failure of recent proposed legislation that would have repealed the ACA may have contributed to broader support for Medicaid expansion. Among the 19 states that did not expand the program under the ACA, a number of legislatures have indicated a willingness to expand their Medicaid programs in recent weeks.

North Carolina's legislature filed a bill to expand and Maine will put Medicaid expansion to a voter referendum in November. Additional expansion bills may be introduced in Nevada and South Dakota, according to media reports. Expansion efforts in four states have failed though, as legislatures in Kansas and Virginia did not pass expansion bills while Georgia and Idaho legislatures adjourned without considering them.

Nonprofit hospitals in states that expand Medicaid benefits would initially see similar fiscal impacts to those in the states that expanded benefits following the implementation of the ACA's coverage provisions in 2014. For those providers, meaningful reimbursement benefits resulted in sharp declines in charity care and bad debt.

In subsequent years, providers in certain markets had steady or higher year-over-year inpatient and ambulatory volumes driven by a higher number of newly eligible Medicaid patients. This superseded a broader industry-wide trend of declining inpatient volumes as providers work to reduce unnecessary readmissions and length of stay, and as clinical care shifts further toward ambulatory settings.

Past experience suggests that more states will eventually opt to expand., About half of all states established programs within one year after Medicaid was created in 1965. After four years, all but two states had established programs.

However, the federal government will reduce the enhanced federal matching rate this year to states that expanded Medicaid eligibility effective January 2014. States such as Washington and Connecticut have announced reduced Medicaid reimbursement rates for 2017. This would likely also affect hospitals in the states that expand this year over the longer run.

The Trump administration may afford states more say in Medicaid program requirements. Reduced program funding could result if states choose to narrow coverage and/or eligibility from current levels. Furthermore, renegotiations of supplemental Medicaid funding systems in some states over the next few years could result in program changes or payment modifications.

Fitch has a negative sector outlook on nonprofit hospitals based on our long term view that the sector will be increasingly challenged by regulatory and political uncertainty, the growth in

Medicare and Medicaid payor exposure and meager rate increases.

Nonprofit hospitals in all states will have to contend with additional stresses in the coming years whether or not their states decide to expand Medicaid. Improvement in the labor market is raising the demand for nurses and mid-level clinical staff, resulting in higher salary and benefits costs. The impact is more pronounced in areas with higher levels of hospital competition and population and economic growth.

We also expect nonprofit hospital margins to be pressured when the shift to value-based/risk-based contracts accelerates. The movement toward risk-based contracts by commercial payors is likely to grow around the integrated health systems that have developed in several major metropolitan areas.

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