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Fitch Ratings: Has Acute Care Peaked for U.S. NFP Hospitals?

Fitch Ratings-Austin-15 November 2018: With acute care operating profitability set to decline for a third straight year, questions are being raised among some U.S. not-for-profit hospital investors as to whether acute care has peaked or if there's room for improvement, according to Fitch Ratings in a new report.

In response to falling profitability, large system providers are planning some basic cost-cutting, elimination of waste and rethinking how healthcare is delivered to fall in line with Medicare rates. Smaller providers, however, are at a competitive disadvantage according to Senior Director Kevin Holloran.

"Smaller hospitals are characteristically less able to trim expenses and typically unable to negotiate higher rates from commercial insurers in their markets," said Holloran.

How healthcare will be delivered going forward along with changing reimbursement models are what precipitated Fitch's gradual move away from "classic measures" like maximum annual debt service (MADS) coverage and days' cash on hand and increased emphasis on two new metrics of its NFP hospital analysis: Cash to Adjusted Debt and Net Adjusted Debt to Adjusted EBITDA.

One thing appears clear. Consolidation of NFP hospital systems is set to continue, if not escalate going forward. The quest for increased size and scale, however, has led to some investors asking whether bigger is actually better (a question Fitch plans to answer more substantively in a future report).

"Size and scale are 'better' for a hospital's rating if its enhanced size and scale means improved operations, stronger balance sheets and more market essentiality," said Holloran. "Conversely, a hospital getting bigger just for the sake of getting bigger at time can lead to an initial dip in operating profitability as the two or more organizations come together."

One facility type whose outlook is not encouraging is critical access hospitals. Fitch has a negative outlook for these small inpatient facilities characterized by independent distance from the next closest facility and short stays. "Critical access hospitals have long benefited from higher levels of cost based reimbursement, though even that will likely not be enough to secure a long-term future for these facilities," said Holloran. These facilities will likely either close altogether or become freestanding centers that perform little more than triage services.

'What Investors Want to Know: U.S. Nonprofit Hospitals and Healthcare Systems' is available at 'www.fitchratings.com'.

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