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S&P Not-For-Profit Acute Care Sector Outlook Revised To Negative Reflecting Possible Prolonged COVID-19 Impact.

Key Takeaways

- We have revised our not-for-profit acute health care sector outlook to negative due to the quickly evolving COVID-19 pandemic and the subsequent investment market deterioration which could pressure credit quality.
- We believe certain credits, especially those with healthy unrestricted reserves and liquidity, may be better able to manage through this crisis.
- Duration, location, and severity will be important considerations in determining the broader impact of this pandemic on the sector.

S&P Global Ratings is revising its sector outlook on the not-for-profit acute health care sector to negative from stable due to the rapidly evolving COVID-19 pandemic that has created additional and significant uncertainty in the industry and may lead to a higher than typical rate of negative outlook revisions or rating changes in 2020 if the crisis is prolonged. For all health care organizations, we believe the pandemic will result in sizeable increases in operating costs, particularly for labor and supplies, reduced volume and revenues related to elective and non-essential health care needs, reliance on working capital lines of credit, and material declines in unrestricted reserves and non-operating revenue as the investment markets weaken. These added constraints are coming at a time when organizations were already under some revenue and expense pressure related to industry dynamics and balance sheet strength had been a stabilizing factor. (See "U.S. Not-for-Profit Health Care 2020 Sector Outlook: A Precarious Balance As Evolution Continues," published Jan. 9, 2020, on RatingsDirect.)

The duration of this pandemic is certainly one of the key unknowns and if contained to the second quarter of the year, we believe many of our rated organizations will be able to manage through it, although we believe there are certain hospitals and health systems that may not be positioned to hold their ratings and outlooks primarily due to weak pre-COVID-19 credit characteristics. About 30% of our not-for-profit acute health care credits are in the 'BBB' category and below, and 45% in the 'A' category. These credits could feel a more pronounced impact to credit ratings depending on the trajectory of the outbreak, their unrestricted reserves and liquidity, their reliance on non-operating revenue to attain required debt service coverage, and high contingent liabilities including strict covenants that may be breeched. Hospitals located in regions where the virus' prevalence is high, such as urban and suburban providers in densely populated regions, will also likely experience disproportionate cost and revenue pressure. Conversely, multi-state health care systems may be able to use their diversity to help offset the risks in one market with another and some regional systems could use their facilities and locations to manage some of the capacity and resource challenges.

We expect the COVID-19 outbreak will have an overall negative impact on hospital profitability for many not-for-profit systems and standalones, and the extent of that negative impact will be a function of duration, severity, and location of outbreaks. In addition to higher expenses related to labor and supplies, we believe the deferral of elective outpatient services and procedures by hospitals and patients will result in a sizeable negative impact to hospitals and the duration of deferral of those services, as well as the time to ramp operations back up to normal, remains unknown. While some of this is likely to be offset by inpatient revenue related to COVID-19 patients, it will likely not compensate for that full amount. Higher bad debt expense and uncompensated care could also be a factor as individuals face unemployment or underemployment given the secondary impact of certain businesses needing to shut down. For management teams that were focused on operating improvements and new strategic initiatives, those strategies are likely to take a back seat at this time.

Healthy balance sheets were one of the factors supporting our stable outlook in January, but that strength and flexibility will be challenged due to both potential weaker cash flow as a result of operating losses and limited non-operating income, as well as lower reserves caused by investment market declines. Many of the not-for-profit systems and hospitals have built up unrestricted reserves over the last several years. However, we believe that investment market volatility and a recession could put a squeeze on that flexibility depending on the specific credit. In addition, the weakening economy and a recession will have secondary impacts, such as reduction in philanthropy.

While some credits are more insulated than others, analytical considerations that we will monitor related to the COVID-19 pandemic and that could determine credit rating impact include:

- Operating flexibility and ability to use other facilities and hospitals to support the significant demand and capacity resources;
- Low levels of unrestricted reserves and liquidity along with asset allocation;
- Liabilities and cash demands including pension and capital projects; and
- Overall access to capital, liquidity and cash management as investment markets remain challenged.

In addition to the recent investment volatility, short-term borrowings and the long-term bond market have been challenged over the last week and to the extent that this continues, that could be added pressure to access capital and manage liquidity. Any credit rating changes or outlook revisions would be credit-specific.

We recognize that there may be more clarity over the next few months for how long this pandemic will remain in an acute stage, what types of therapies may be available, and how the U.S. health care system will respond and adjust over time. State or federal assistance could support hospitals with funding which could help to offset some of the costs and losses and we expect this will be an ongoing area of discussion. As this remains a very fluid situation, we will continue to review and update our view on the sector as more information is made available.

This report does not constitute a rating action.