April 2021

COVID-19 in 2021: Financial Pressure Continues for California Hospitals

KaufmanHall

For California's Hospitals, The Financial Effects of COVID-19 Are Far From Over

For California's hospitals, financial health is absolutely necessary in order to deliver needed services to communities, to maintain facilities, to invest in new services and technologies for patient access and care, and to be prepared for unexpected events like the COVID-19 pandemic.

In this report, Kaufman Hall quantifies how COVID-19 damaged the financial health of California's hospitals in 2020, and how that impact could continue through 2021.

Key findings about 2020 include:

- **In 2020, California hospitals suffered a financial loss of more than $14 billion from COVID-19. With federal support to hospitals from the Coronavirus Aid, Relief, and Economic Security (CARES) Act, the loss was reduced, but is still more than $8 billion.**
- **Community hospitals—defined as all nonfederal, short-term general, and other special hospitals—were hit the hardest by the financial effects of COVID-19 in 2020.**
- **Even with CARES Act support, 58% of hospitals lost money from operations in 2020, and 13% struggled to break even, meaning 71% were severely financially challenged.**

Key findings in our forecast for 2021 include:

- **In 2021, California hospitals are expected to continue with an additional loss between $600 million and $2 billion due to COVID-19, depending on vaccination rates and the path of the virus.**
- **Hospital operating margins are expected to decline between 19% and 65%.**
- **More than 200 California hospitals could lose money from operations in 2021, and more than 250 could struggle to break even—more than before the pandemic.**

These findings suggest broad and serious challenges for California's hospitals and the communities they serve. Not only could many hospitals struggle to maintain pre-pandemic service levels, a significant number run the risk of defaulting on bond covenants, losing their ability to function as independent entities, and/or closing.

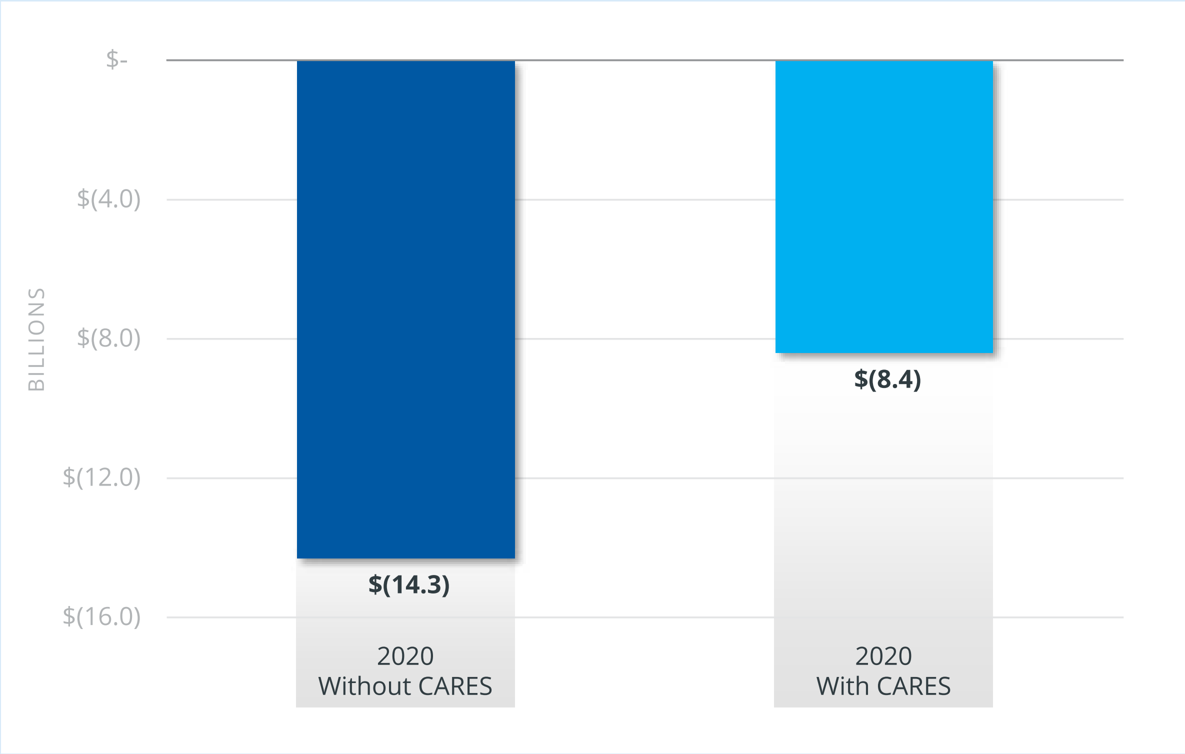
The financial effects of COVID-19 were at their worst in 2020, but the virus will continue to do real and possibly lasting financial damage to California hospitals in 2021.

These findings are built on performance data from 42 California hospitals. See page 11 for the full methodology. This report was prepared at the request of the California Hospital Association.

2020 in Review

In 2020, California Hospitals Lost More Than $8 Billion Due to COVID-19

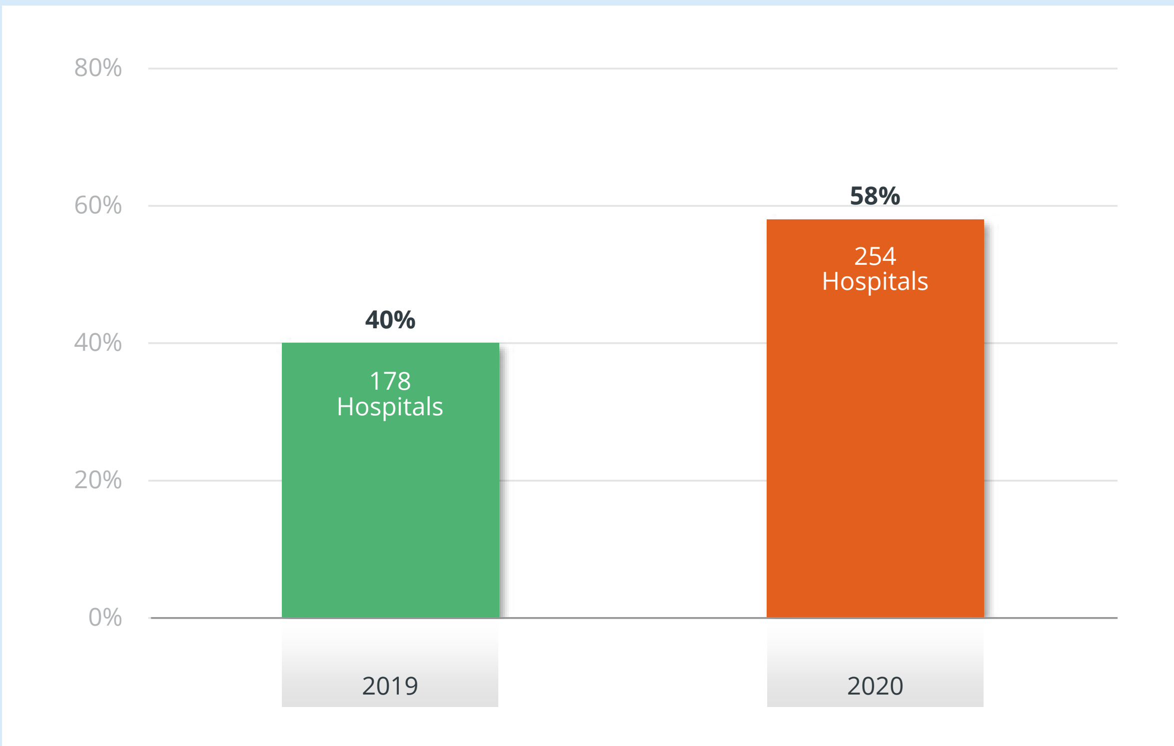
2020 Loss for California Hospitals vs. Pre-Pandemic Levels



- California hospitals endured a loss of $14.3 billion in 2020 without federal CARES Act funding (see p. 1), which was caused both by a loss in revenue and expenses tied to the pandemic.
- Even with CARES Act funding, California hospitals sustained a loss of $8.4 billion.

In 2020, More than Half of California's Hospitals Lost Money on Operations

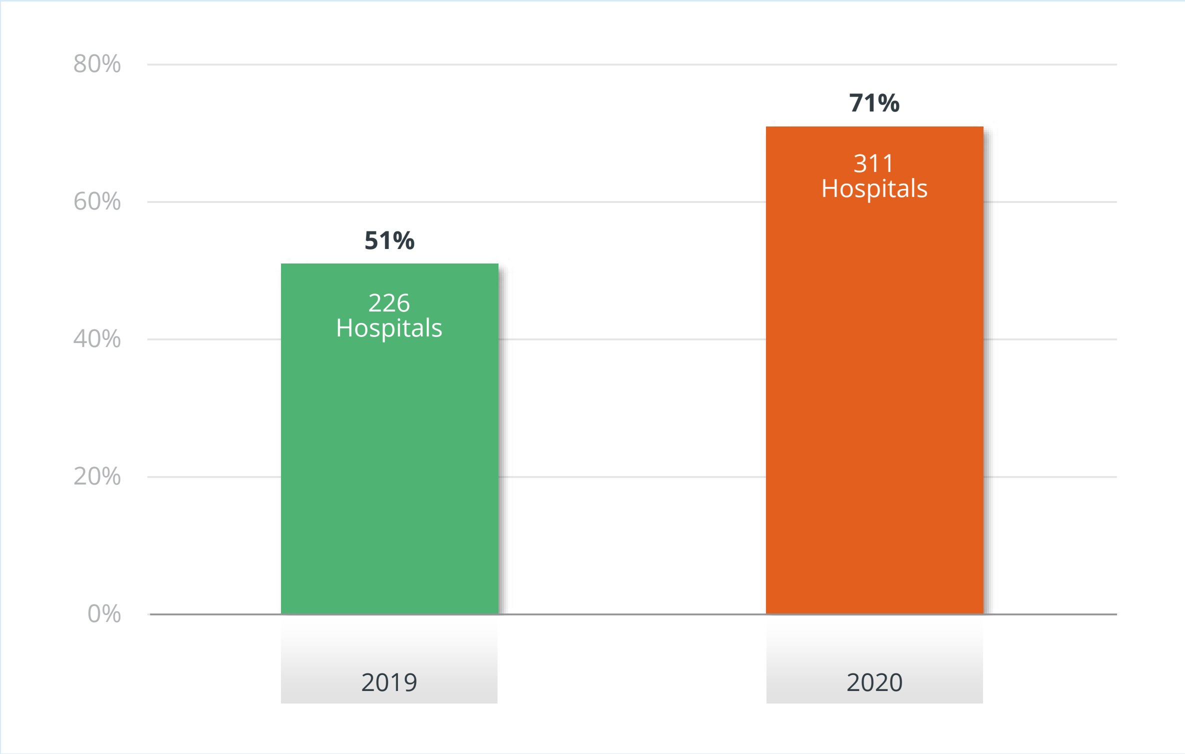
% of Hospitals with Negative Operating Margins 2019 vs. 2020



- 40% of hospitals pre-pandemic in California operated in the red with negative margins.
- The COVID-19 pandemic led to more hospitals losing money on operations, with 58% of hospitals operating with negative margins by the end of 2020.

More than Two-Thirds of California Hospitals Struggled to Break Even

% of Hospitals with Margins 3% or Lower 2019 vs. 2020

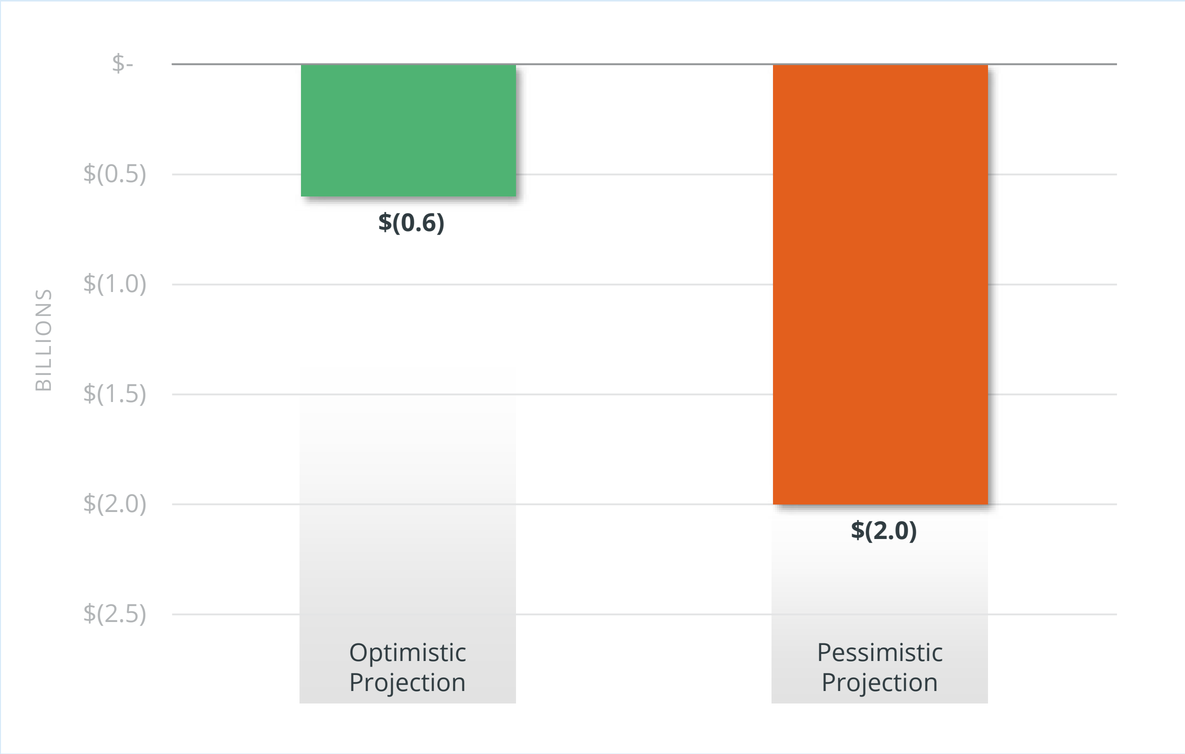


- A margin of 3% or less is considered by financial experts to be barely sufficient for hospitals.
- For comparison, the software sector has an average 30% operating margin and the railroad industry has a 40% operating margin.
- The COVID-19 pandemic led to 71% of California hospitals having an operating margin of 3% or lower, struggling for financial stability, in 2020.

2021 Forecast

In 2021, California Hospitals Are Forecast to Lose an Additional $2 Billion Due to the Continuing Effects of COVID-19

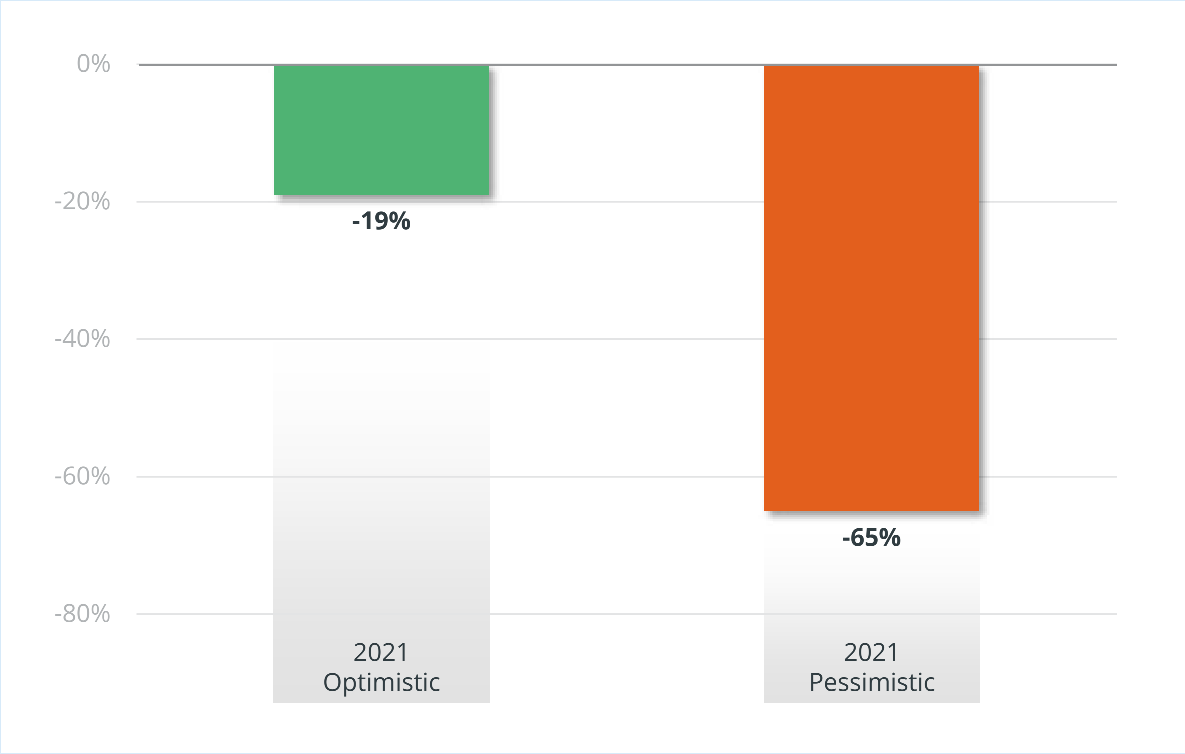
Forecast 2021 Loss for California Hospitals, Optimistic and Pessimistic Scenarios



- The optimistic scenario for 2021 assumes a prompt ramp-down in COVID-19 cases/hospitalizations and rapid vaccination progress.
- The pessimistic scenario assumes cyclical surges in COVID-19 cases/hospitalizations and delayed vaccination progress.
- Optimistic projections show California hospitals moving close to pre-pandemic financial levels, but still suffering an additional loss of $600 million.
- Pessimistic projections indicate an additional loss of $2 billion over the course of 2021.

In 2021, Hospital Margins are Forecast to Decline By Up to 65%

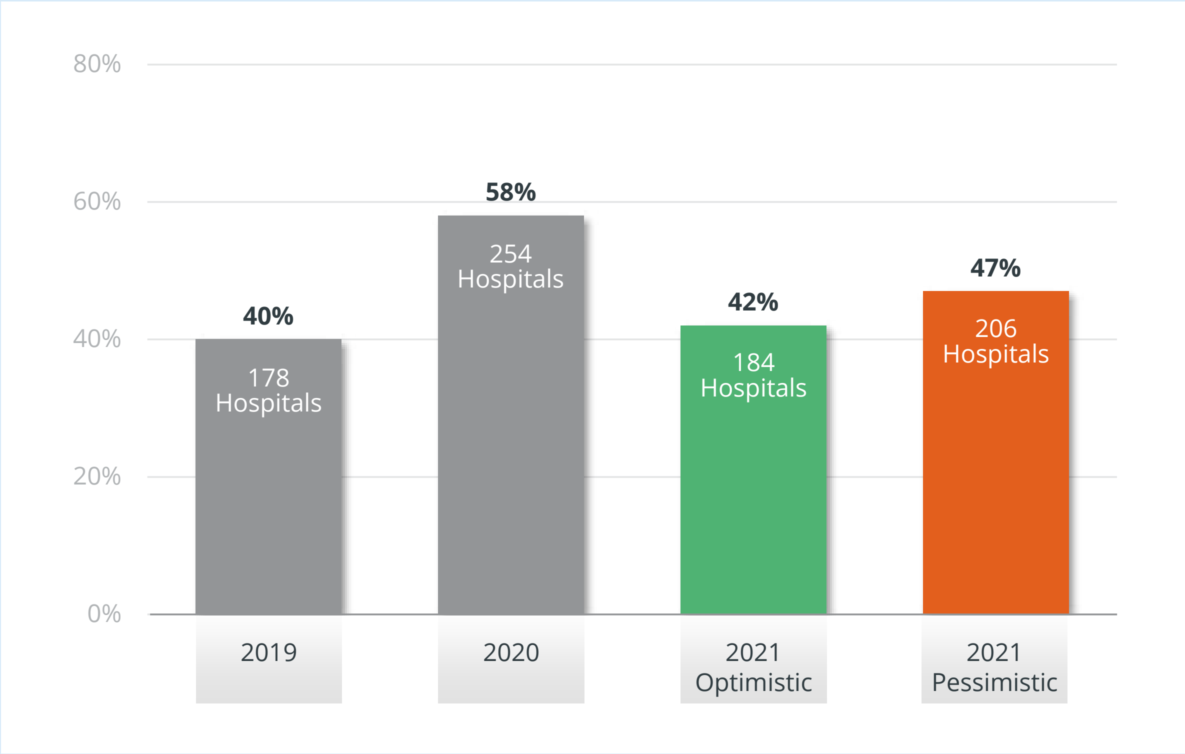
% Margin Decline for California Hospitals in 2021, Optimistic and Pessimistic Scenarios



- Another key to understanding the financial health of hospitals in 2021 is the percentage decline in operating margin from pre-pandemic levels.
- Our analysis shows that under the optimistic scenario, the median operating margin for California hospitals would decline by 19 percent in 2021 compared with pre-pandemic levels.
- Under the pessimistic scenario, margins are estimated to decline by 65 percent in 2021 due to the lingering effects of COVID-19.

Even Under the Optimistic Scenario, More Hospitals Could Have Negative Margins in 2021 than Before the Pandemic

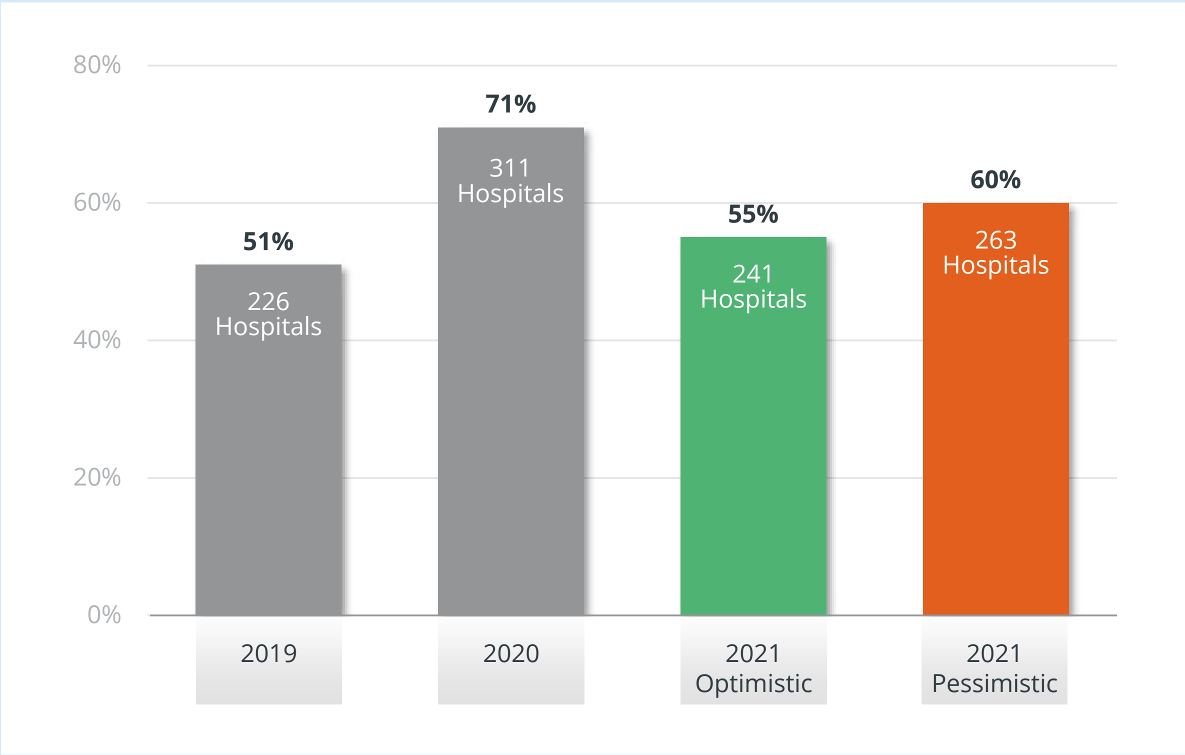
% of Hospitals with Negative Margins, 2019-2021



- Before the pandemic, 40% of hospitals in California operated with negative margins.
- The optimistic projection shows the percentage of hospitals with negative margins moving towards pre-pandemic levels, but still higher, with 42% having negative margins.
- The pessimistic scenario has 47% of hospitals operating with margins below zero by the end of 2021.

And More Hospitals Will Be Financially Struggling in 2021 Than Before the Pandemic

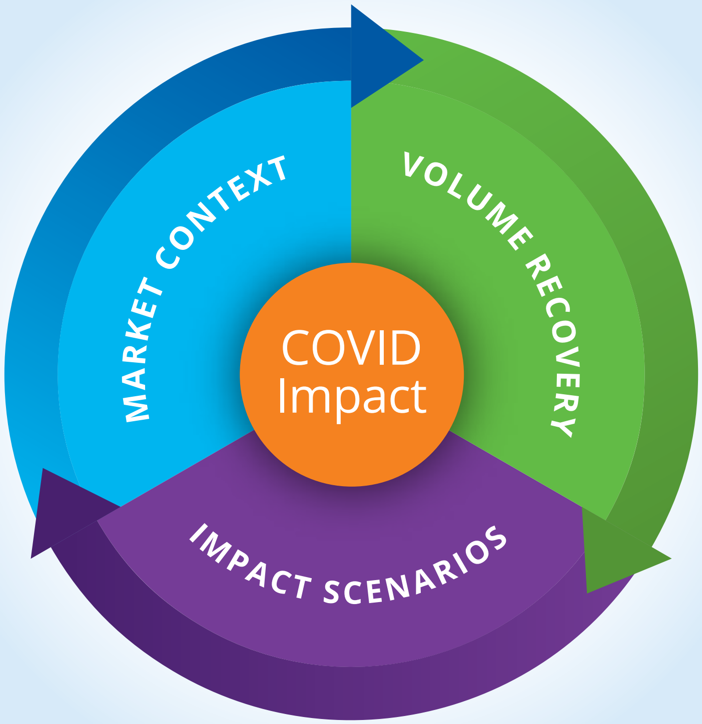
% of Hospitals with Margins lower than 3%, 2019-2021



- Before the pandemic, 51% of hospitals in California operated with barely sufficient margins lower than 3%.
- The optimistic projection shows the percentage of struggling hospitals still higher than the pre-pandemic level, with 55% having operating margins of lower than 3%.
- The pessimistic scenario has 60% of hospitals operating with margins lower than 3% by the end of 2021.

Methodology

Kaufman Hall's Approach to Modeling Potential COVID-19 Effects in California Focused on Three Key Questions



1 What market forces in California will affect volume and financial recovery?

- State 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 in California 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 California's healthcare provider landscape?

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

COVID-19 Scenario Projections Were a Fundamental Input

Our model includes survey data from the California Hospital Association and Kaufman Hall hospital data, representing 42 California hospitals, and approximately 33% of all California hospital revenue.

For each hospital within our data set, we developed a projection model that included historical and current monthly data for the time of recovery of volumes, revenue, and expenses.

Our analysis then modeled optimistic and pessimistic scenarios across California, which assessed multiple potential impacts, including the rate of state vaccinations and COVID-19 admissions, as well as hospital-specific impacts that included the pace of return of expenses and revenues, future volume predictions, and other related factors.

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

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