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Analysis: California Hospitals Endured Significant Financial Strain in 2021

KaufmanHall

Financial Pressures Continued in Year 2 of the Pandemic

For California's hospitals, maintaining financial health is essential to caring for their communities, investing in new care models and technologies, and preparing for future pandemics and other unexpected emergencies.

In this report, Kaufman Hall quantifies the financial health of California's hospitals in 2021, the second year of the COVID-19 pandemic. Key findings include:

- In 2021, California hospitals experienced **financial losses of nearly $6 billion** on a volume-adjusted basis,* more than triple previous projections. With federal support to hospitals, the loss was reduced, but was still approximately $3.7 billion. These are **in addition to losses in 2020 totaling $8.4 billion**.
- California hospitals experienced a **26% median reduction in operating margin** in 2021 from pre-pandemic levels.
- More California hospitals are experiencing **negative or unsustainable margins** (51% and 4%, respectively) compared to pre-pandemic levels (40% and 10%).
- While fewer people are visiting hospitals, patients that are showing up have more severe illness, demonstrated by a 7% decline in adjusted discharges but a 4% increase in patient days and an **11% increase in average length of stay compared to 2019**.
- Expenses are dramatically accelerating, offsetting increases in revenue and driving reductions in margin. **Total California hospital expenses rose 15%** in 2021 from pre-pandemic levels, compared with 11% nationally.
- Ongoing workforce shortages continue to drive increases in labor costs. **Contract labor costs have nearly doubled** from the start of the pandemic. **Staff wage rates are also rising** from already high rates in California relative to the rest of the U.S.
- Global supply chain challenges are driving up other expenses. **Supply expenses are up nearly 20%, drug expenses are up 41%, and purchased or outsourced services are up 14%** from 2019.

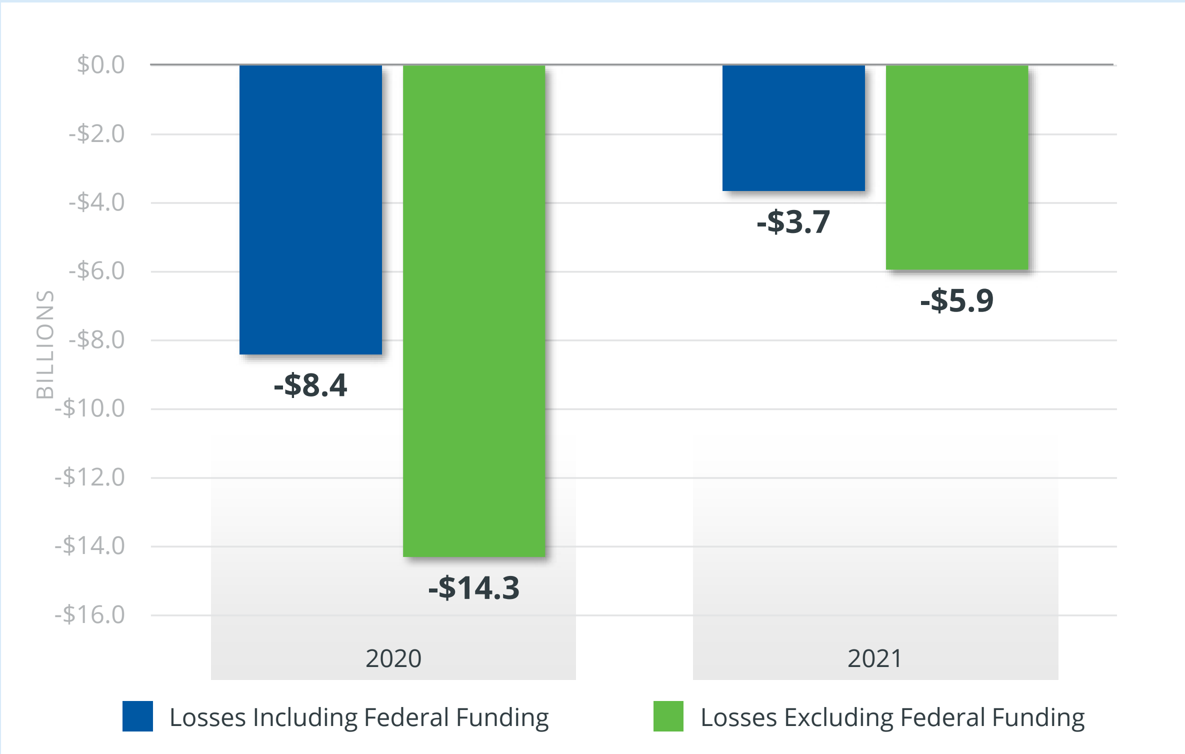
These findings underscore the broad and serious threats California's hospitals have faced throughout the COVID-19 pandemic—and the challenges they will face from the pandemic's lasting impact moving forward.

*These findings are built on performance data representing 79 hospitals. See pages 14 and 15 for the full methodology and a glossary of metrics.

This report was prepared at the request of the California Hospital Association.

Hospitals Experienced Losses in 2020 and 2021 Relative to 2019

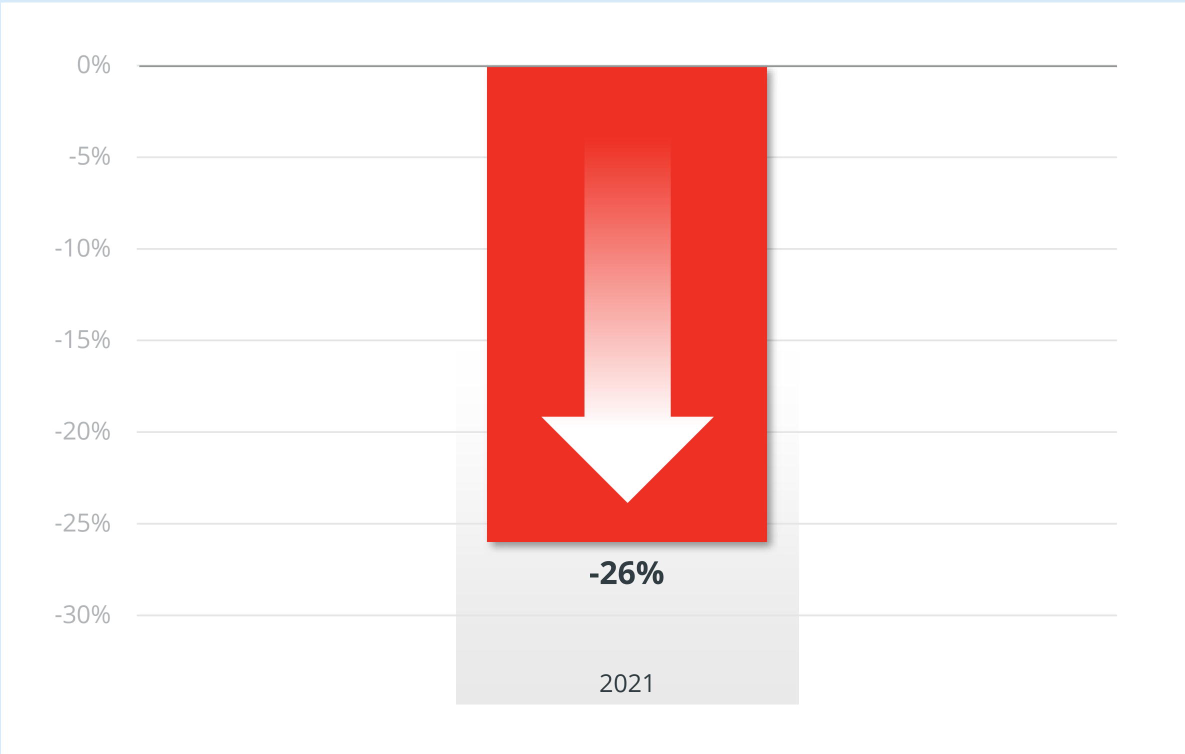
California Hospital Losses in 2020 and 2021 Compared to 2019 (in Billions)



- California experienced **cumulative losses of $12.1 billion in 2020 and 2021** compared with 2019 when including federal funding, and more than $20.2 billion when excluding federal funding.
- Much of the loss was due to **increases in expenses**, which outpaced the modest—and still not at pre-pandemic levels—growth in revenue.

Margins Are Still Well Below Pre-Pandemic Levels

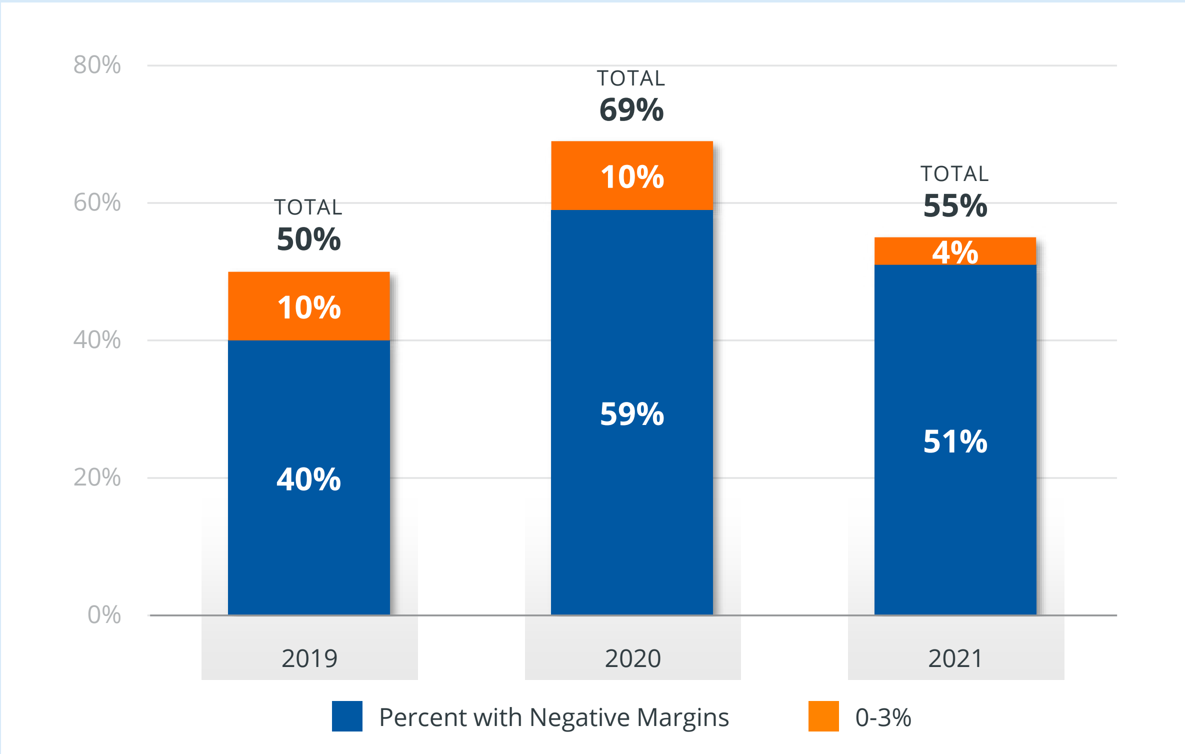
Median Decline in Hospital Operating Margin from 2019 to 2021



- **California hospitals' 2021 margins were 26% lower** on average than pre-pandemic levels.
- This change is due largely to expenses rising faster than revenues in 2021.
- See the pages that follow for more detail.

Many Hospitals Are Still Losing Money on Operations

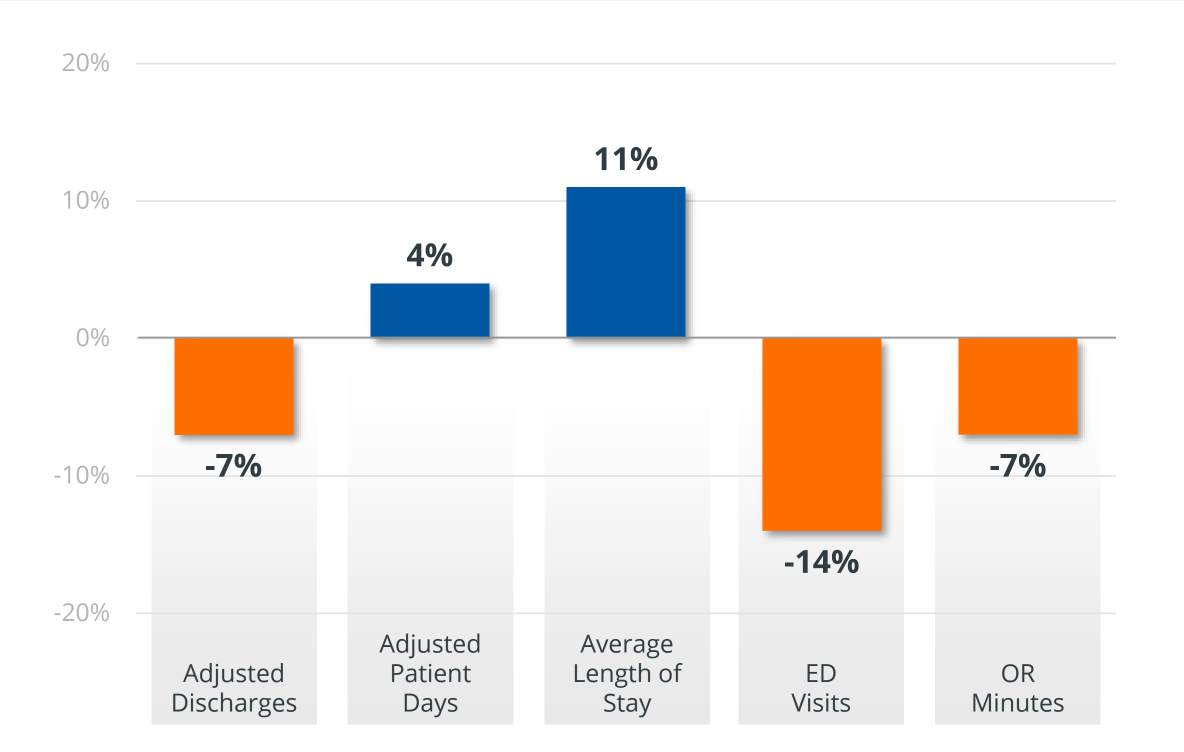
Percent of California Hospitals with Low and Negative Margins



- More California hospitals are experiencing negative margins—that is, losing money on operations—or unsustainable margins than before the pandemic.
- Before the pandemic, 40% of California hospitals had negative margins, and 50% had unsustainable margins (3% or less).
- **In 2021, 51% of California hospitals had negative margins, and 55% had unsustainable margins.**

The Number of Patients Cared for Remains Well Below 2019 Levels

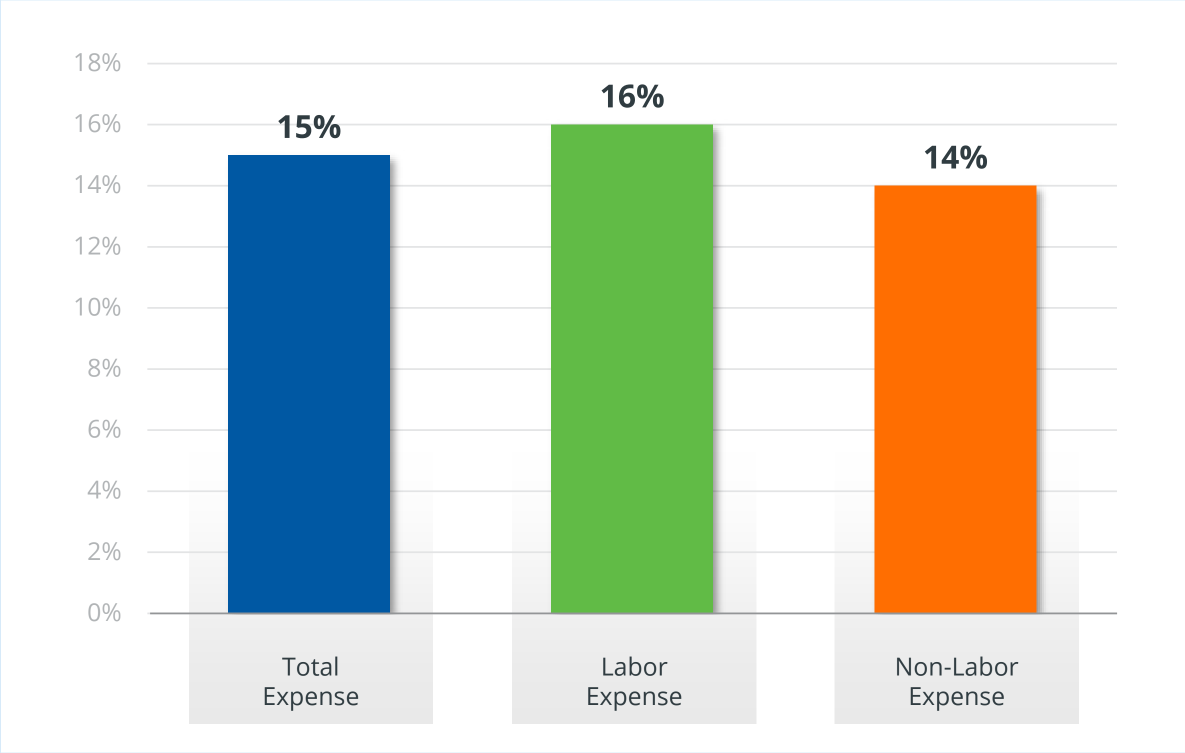
Median Volume Changes for California Hospitals from 2019 to 2021



- **California hospitals treated fewer people in 2021, but those patients had more severe illness and stayed in the hospital longer.**
- Adjusted discharges are down by 7% and patient days are up by 4% from pre-pandemic levels, leading to an 11% increase in average length of stay.
- Emergency department visits are down by 14% from pre-pandemic levels, and operating room minutes are down 7%.
- Fewer admissions and longer lengths of stay create additional financial pressures. Hospitals are commonly paid a fixed amount per admission, so organizations typically lose money if their stay requires longer than anticipated care.

Expenses Are Dramatically Accelerating

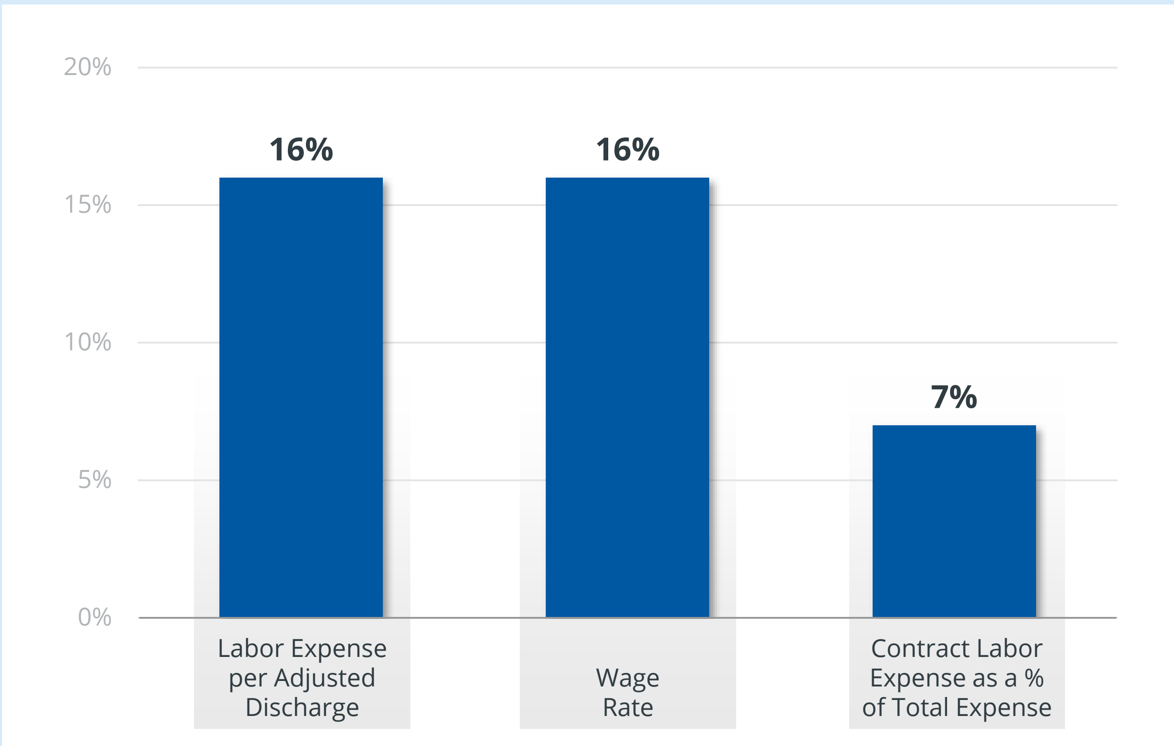
Median Expense Changes Per Adjusted Discharge from 2019 to 2021



- 2021 was characterized by significant increases in expenses, despite reduced volumes.
- These expense increases offset meager revenue improvements, driving margin reductions.
- Total California hospital expenses rose 15% in 2021, outpacing the 11% national average.
- Labor costs increased 16%, while non-labor costs rose 14%.

Labor Shortages Are Driving Higher Expenses

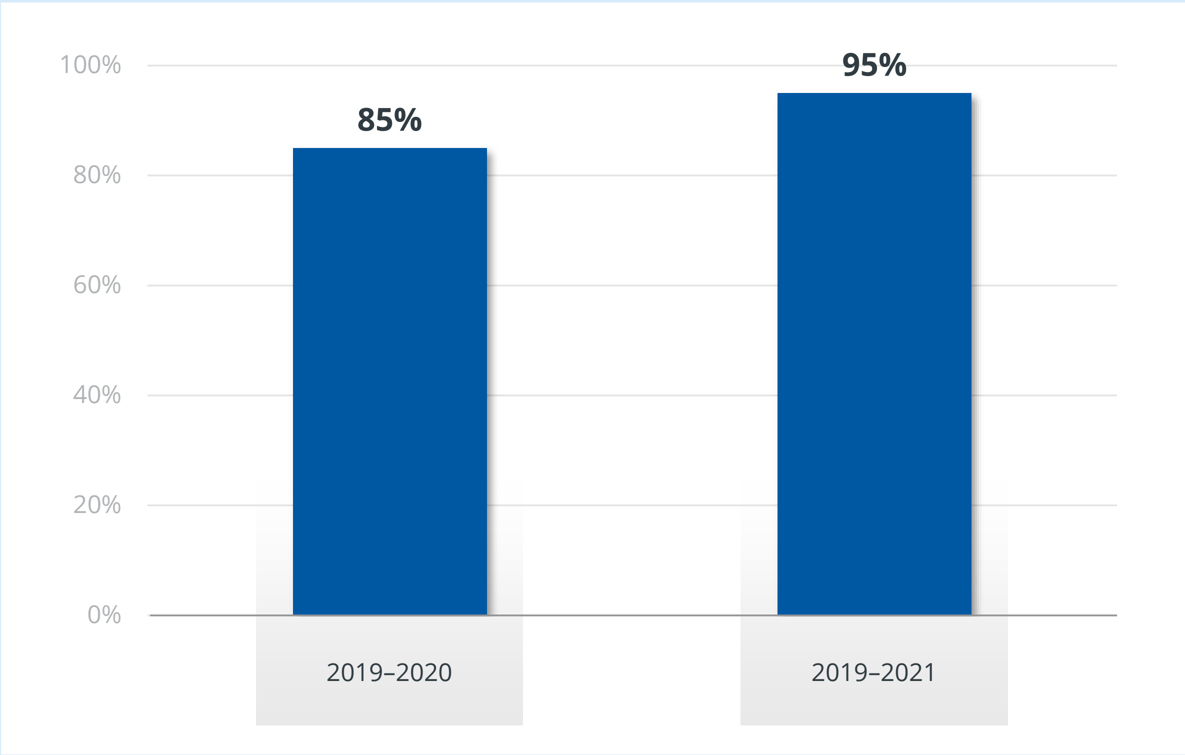
Median Labor Expense Changes for California Hospitals from 2019 to 2021



- The labor shortage has decreased the size of the healthcare workforce.
- Labor expenses continued to rise in 2021, driven by the increased use of contract labor and increases in base wage rate for employed staff.
- Increased turnover also drives elevated expenses, from increased reliance on contract labor and premium pay to the costs of recruiting and hiring new staff.

Contract Labor Is Growing as a Proportion of Labor Expense

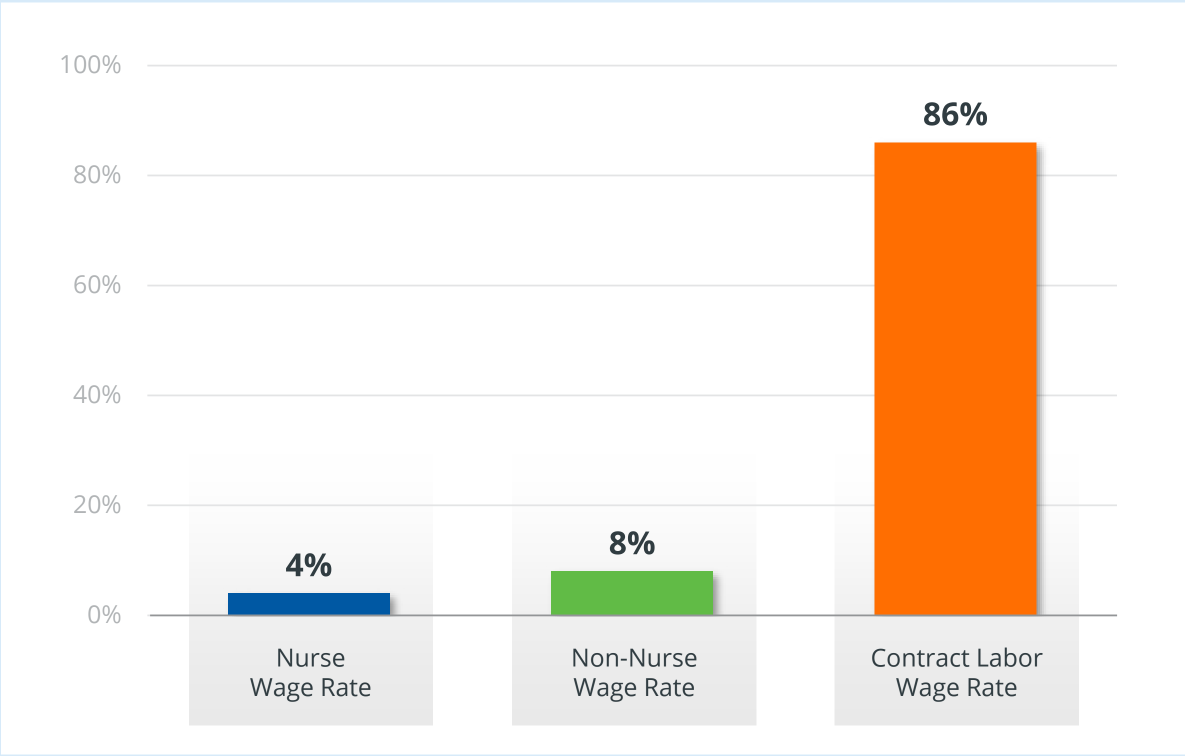
Median Increase in Contract Labor Expense for California Hospitals from 2019 to 2021



- There has been a dramatic increase in the use of contract labor as well as the proportion of labor expense that it commands.
- The expense associated with contract labor as a proportion of labor expense has nearly doubled, highlighting how many organizations are using contract labor to meet demand.

Contract Labor Rates Are Driving Major Wage Rate Increases

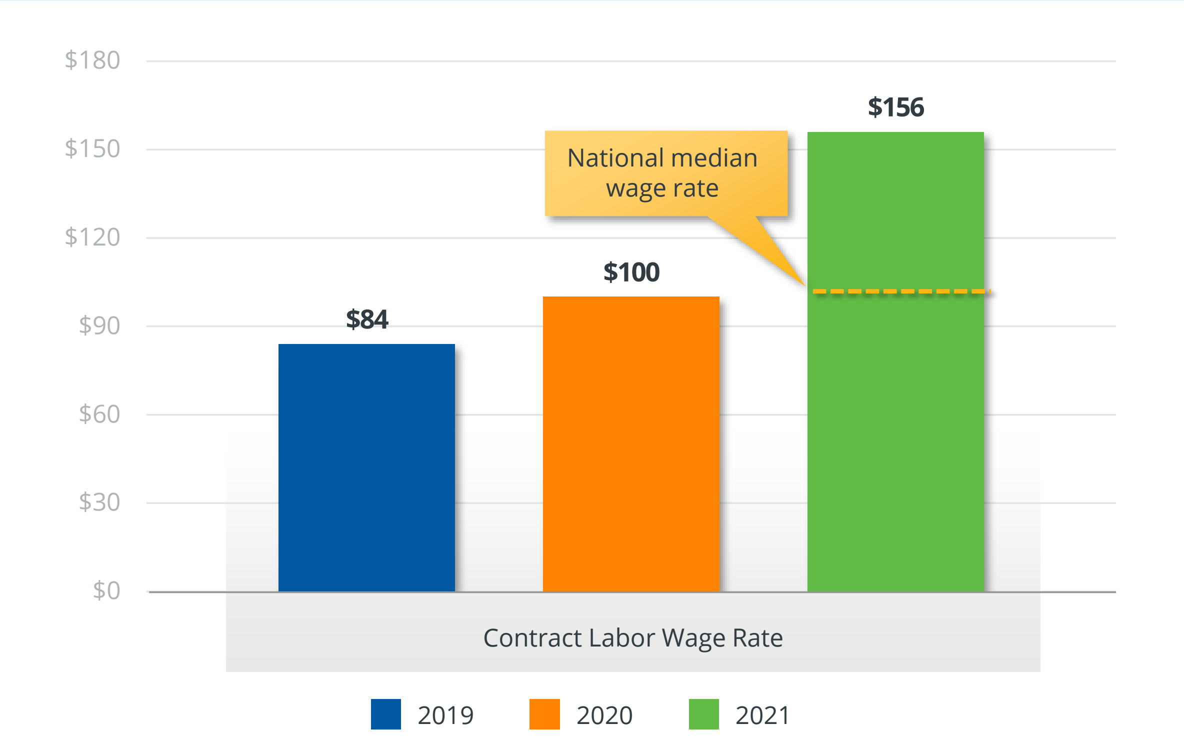
Median Increases in Wage Rates for California Hospitals from 2019 to 2021



- The contract labor wage rate has nearly doubled from pre-pandemic levels.
- While employed nurse wage rates have risen by about 4%, the high rate of inflation and cost of living in California may lead to increased turnover.
- Non-nurse wage rates have also gone up by 8%, but these roles typically command a lower overall rate.

Contract Labor Wage Rate Jumped in 2021

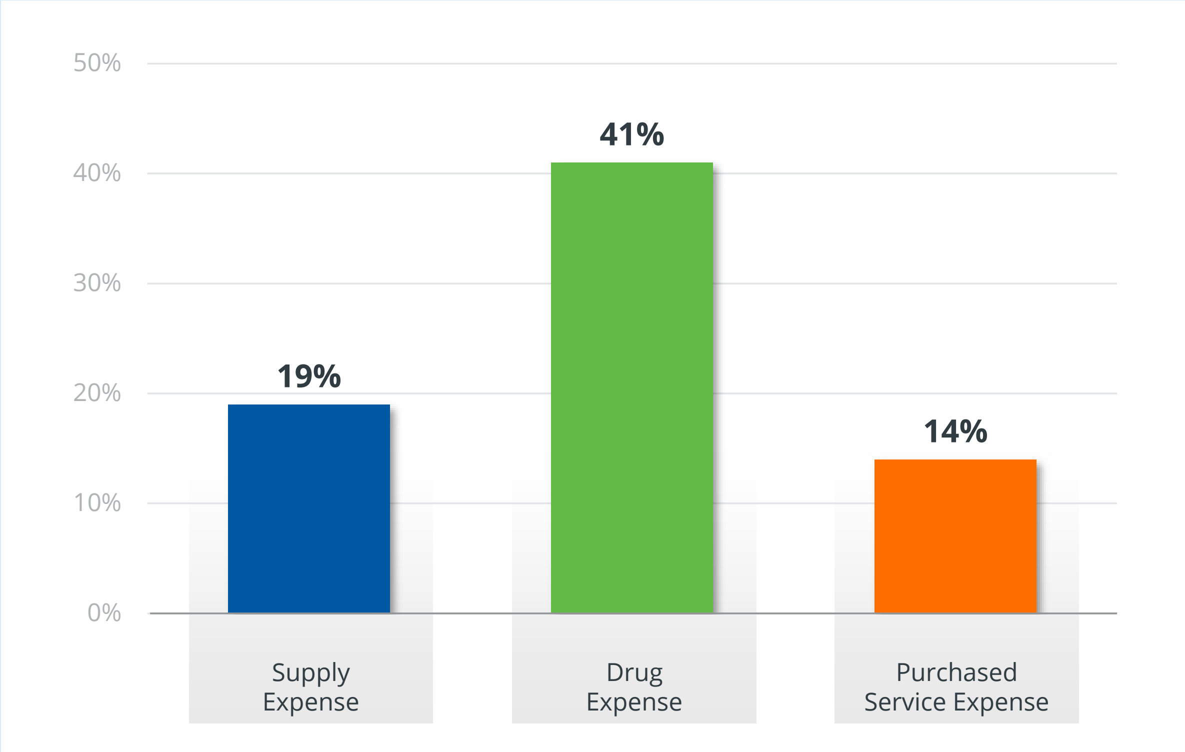
California Hospital Contract Hourly Wage Rate Medians by Year



- Contract labor rates increased especially dramatically between 2020 and 2021.

Supply Chain Challenges Are Leading to Higher Non-Labor Costs

Median Non-Labor Expense Changes Per Adjusted Discharge from 2019



- Global and national supply chain challenges have led to increased costs for hospitals.
- Supply expenses have risen nearly 20%, drug expenses are up 41% and purchased or outsourced services are up 14%.

Challenges Will Persist Throughout 2022

- Hospitals have continued to face significant financial pressures in the first two months of 2022, according to initial hospital performance data.
- Median hospital margins were negative in the wake of the Omicron variant's peak in late 2021 and early 2022. Even if hospital performance rebounds later this year, margins may remain depressed for several months to come—or for the remainder of 2022.
- The pandemic outlook for 2022 is still unclear, given the prospect of new COVID-19 variants and the impact on consumer behavior and hospitalization rates, ongoing labor shortages, supply chain challenges, and rising interest rates. However, median margins are likely to remain below pre-pandemic levels, with the prospect of additional losses.

Methodology

Hospital data was derived from a California Hospital Association member survey and Kaufman Hall's proprietary database, and represents 79 hospitals in total.

Given the large shifts in volume during the COVID-19 period, both in types of patients presenting to the hospital and the acuity of those patients, comparisons of expenses and revenues have been adjusted in order to account for those volume changes.

Adjusted discharges (inpatient discharges * inpatient/outpatient adjustment factor) was used as the volume metric by which revenue and expenses were divided, which creates consistency when comparing different time periods to ensure that the utilization of expenses or recognition of revenue reflect the per-case rates as currently being experienced by California hospitals.

Glossary of Metrics

Profitability Metrics

Operating Margin (including Federal Funding): (Net Operating Revenue – Total Expense) / Net Operating Revenue

Operating Margin (excluding Federal Funding): (Net Operating Revenue – Federal Funding - Total Expense) / (Net Operating Revenue – Federal Funding)

Volume Metrics

Adjusted Discharges: Discharges * Inpatient / Outpatient Adjustment Factor

Adjusted Patient Days: Patient Days * Inpatient / Outpatient Adjustment Factor

Average Length of Stay: Patient Days / Discharges

ED Visits: The number of visits tracked in the emergency department

OR Minutes: The number of minutes tracked in the operating room

Expense Metrics

Total Expense: Labor expense + Non-Labor Expense

Labor Expense: Salary Expense + Benefits Expense

Non-Labor Expense: Includes bad debt expense, professional fee expense, purchased services, depreciation expense, rent/lease expense, maintenance/repairs expense, utilities expense, insurance expense, interest expense, medical supplies expense, drug expense, and other non-labor expenses.

Labor Expense per Adjusted Discharge: Labor Expense / Adjusted Discharges

Full Time Equivalent Employees per Average Occupied Beds: FTEs / (Patient Days / Calendar Days)

Wage Rate: Salary Expense / Paid Hours

Contract Labor Expense as a % of Total Expense: Contract Labor Expense / Total Expense

Contract Labor Expense as a % of Labor Expense: Contract Labor Expense / Labor Expense

Nurse Wage Rate: Nurse Salary Expense / Nurse Paid Hours

Non-Nurse Wage Rate: Non-Nurse Salary Expense / Non-Nurse Paid Hours

Contract Labor Wage Rate: Contract Labor Expense / Contract Hours

Supply Expense: Total supply expense (includes medical supplies, drugs, and other supplies)

Drug Expense: Total drug expense

Purchased Service Expense: Total purchased service expense (i.e., any services performed by a third party; could include waste management, food services, and many others)

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

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