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COVID-19 in 2021: Pressure Continues on Hospital Margins

KaufmanHall

During 2021, COVID-19 will continue to depress hospital margins and ability to serve their communities

A positive operating margin—that is, more revenue than expenses—is critical for any organization to survive over the long term, including not-for-profit organizations. For America's hospitals, positive margins create the ability to invest in new facilities, treatments, and technologies to better care for patients, and to build reserves to be ready for a future made highly uncertain due to the effects of the COVID-19 pandemic.

In our February 2021 report, Kaufman Hall research showed that 2021 hospital *revenue* would likely be down between $53B and $122B due to the lingering effects of COVID-19. In this report, we examine the potential effect of COVID-19 on hospital *operating margins* over the course of 2021, including the following:

- Margins for U.S. hospitals as a whole
- The percentage of hospitals with negative margins
- Margins for America's rural hospitals

The report shows the effects of COVID-19 in two scenarios—one more optimistic, and one more pessimistic. The two scenarios take into account these factors:

- **Recovery of hospital volumes:** The degree and pace at which inpatient, outpatient, and emergency department volumes return
- **COVID-19 vaccine progress:** The availability of vaccines, the speed of distribution, and the prioritization of different populations for vaccination
- **Decline in COVID-19 cases:** The degree and pace at which COVID-19 cases decline, based on public use of social distancing and achievement of herd immunity

Actual hospital data available so far in 2021 pertaining to inpatient revenue and adjusted inpatient days tends to support the more pessimistic scenario.

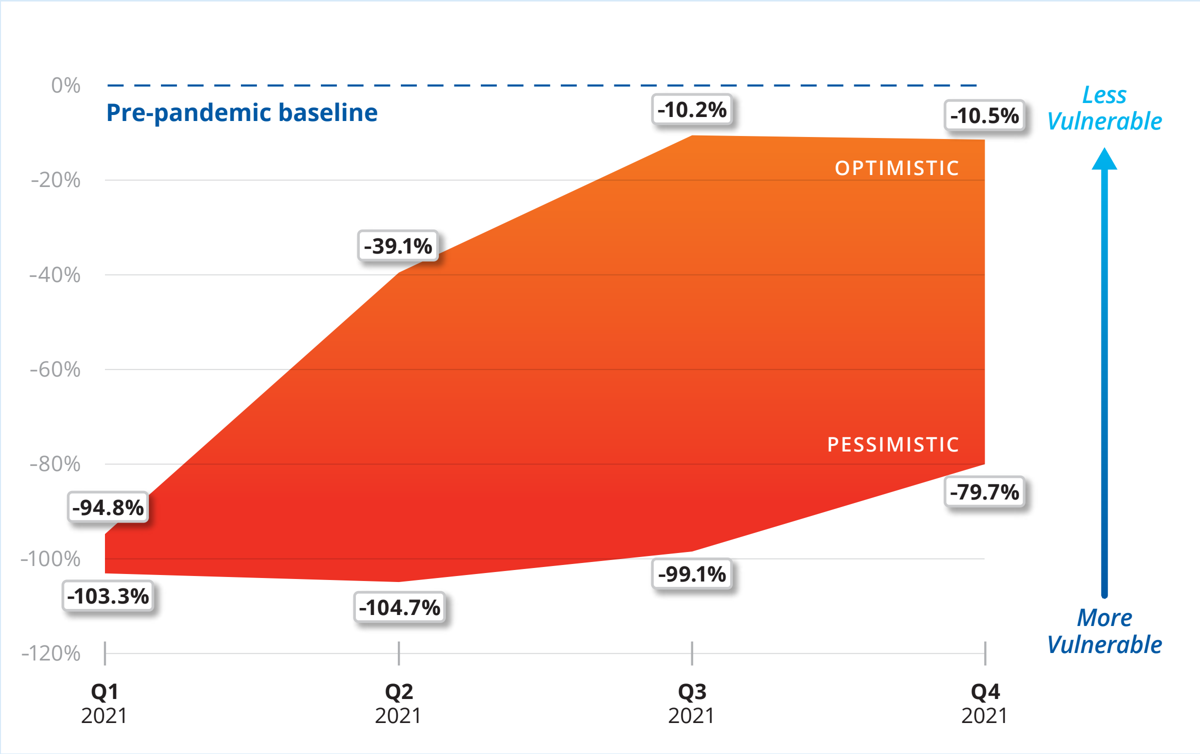
However, in either optimistic or pessimistic scenarios, **margins of America's hospitals will remain depressed throughout 2021, the percentage of hospitals with negative margins will likely increase, and the financial health of rural hospitals will be significantly affected.**

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

Key Findings

By the end of 2021, ***hospital margins could be 10% to 80% below pre-pandemic levels***

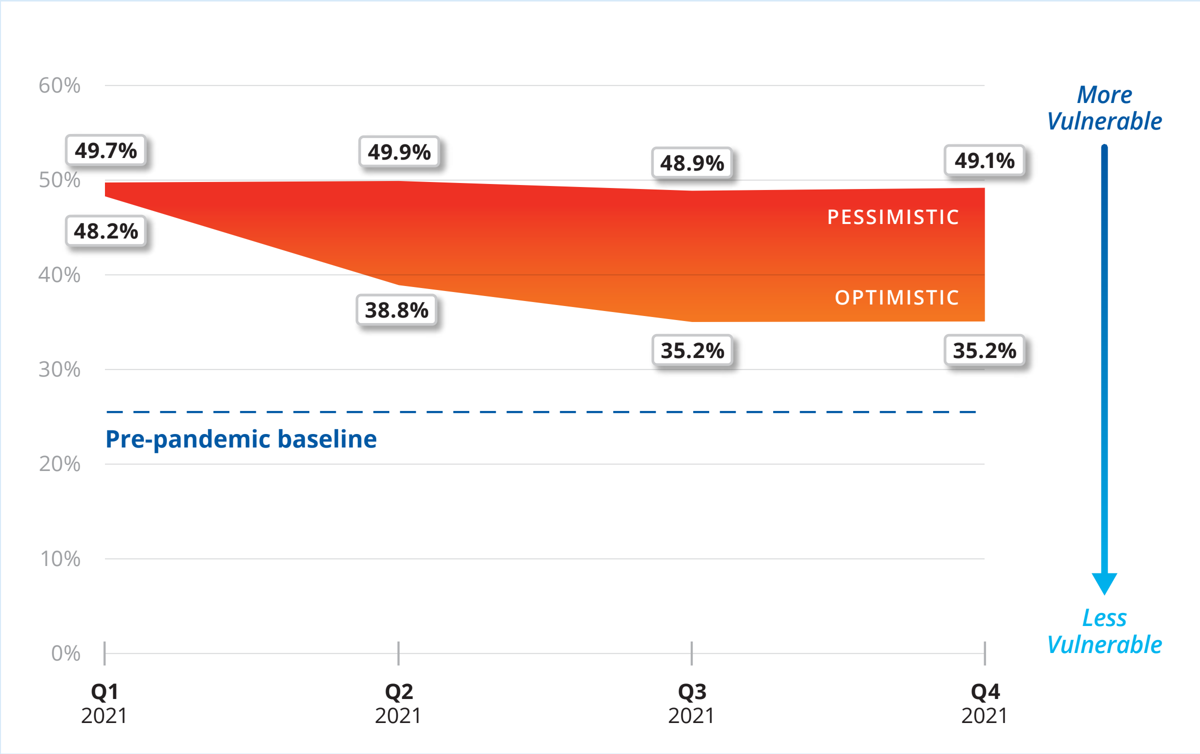
Quarterly Median Operating Margin Projections Change from Pre-Pandemic Levels



Under both optimistic and pessimistic scenarios, hospital median operating margins will continue to be below pre-pandemic levels throughout 2021. The optimistic scenario shows a recovery occurring primarily between the first and third quarter, but margins leveling off at more than 10% below pre-pandemic levels—a sufficiently depressed level to hamper some hospitals' ability to invest in community services. Under the pessimistic scenario, the recovery does not begin until the second quarter, and even then is very slow, culminating in 4th quarter margins that are 80% less than pre-pandemic norms—a devastating level for hospitals still reeling from the financial effects of COVID-19 in 2020.

By the end of 2021, *half of hospitals could have negative margins—far greater than pre-pandemic levels*

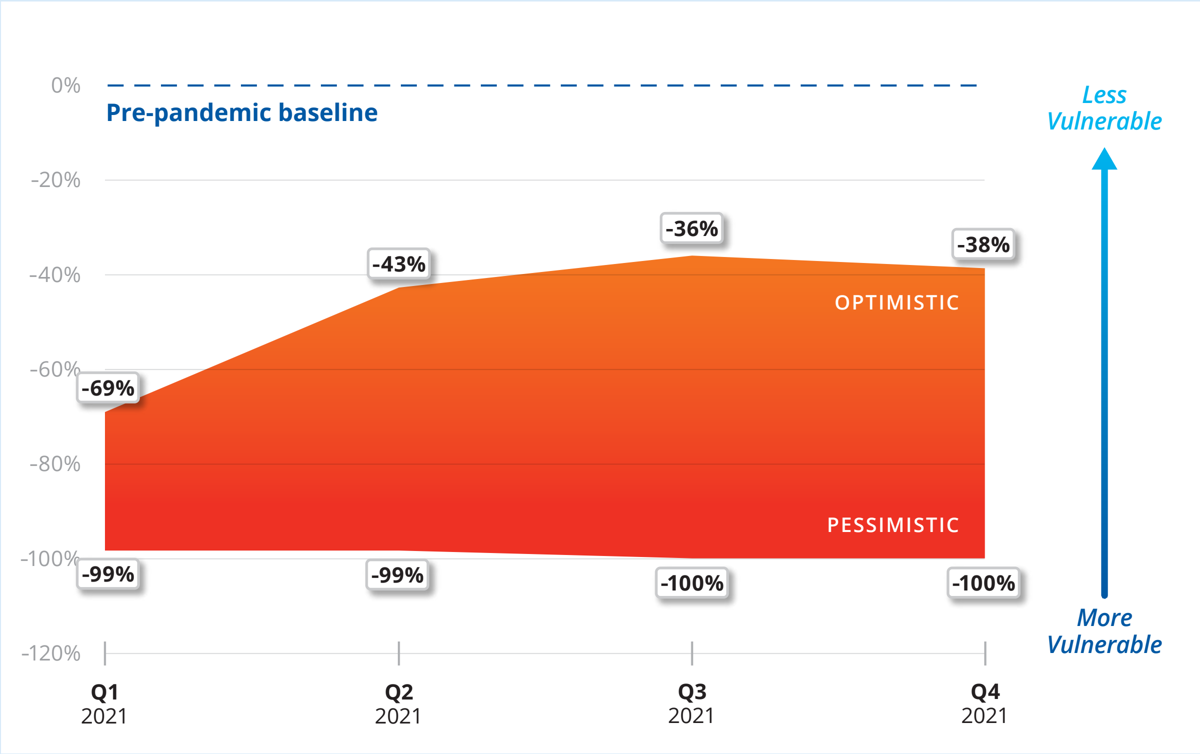
Percent of Hospitals with Negative Operating Margins by Scenario



Under both optimistic and pessimistic scenarios, the percentage of hospital with negative margins could be higher at the end of 2021 than prior to the pandemic. Prior to the pandemic, about one quarter of hospitals had negative margins. At the beginning of 2021, after almost a year of COVID-19, half of hospitals had negative margins. For those hospitals, 2021 will remain a very challenging year. Under the optimistic scenario, an average of 39% of hospitals could have negative margins—still significantly higher than the 25% before the pandemic. Under the pessimistic scenario, the percentage of hospitals with negative margins could be basically unchanged, with almost half of America's hospitals having more expenses than revenue.

During 2021, *rural hospitals could see no improvement in margin*

Rural Quarterly Median Operating Margin Projections Change from Pre-Pandemic Levels*



Rural hospitals could be hit especially hard by the lingering effects of COVID-19 during 2021. Even the optimistic scenario shows only a slow improvement in margins during the first quarter and basically a plateau after that, ending the year with margins 38% lower than pre-pandemic levels. The pessimistic scenario is very bleak for rural hospitals, with no improvement in margin during the entire year of 2021.

* These projections include a portion of the $8.5 billion for rural providers from the recently passed COVID relief package.

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Observations

Throughout 2021, America's hospitals will continue to struggle with the financial recovery from COVID-19

Before COVID-19, the median margin of America's hospitals was a very thin 3.5 percent—a percentage only minimally sufficient for many hospitals to maintain their facilities and operations, while investing modestly to improve their capabilities to meet community needs.

In 2020, the COVID-19 pandemic brought severe blows to hospitals' operating margins along with accountability for managing the effects of an unknown and unpredictable virus.

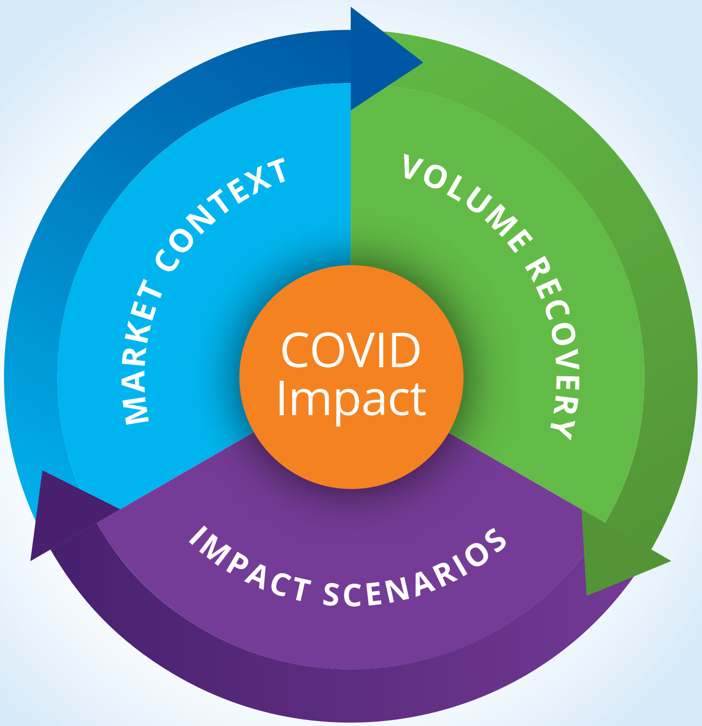
As we enter 2021, hospitals are still managing an unpredictable COVID-19 virus along with the complex process of vaccine distribution. At the same time, the uncertainty about patient volume, revenue, and expenses raises critical questions about how quickly, and to what degree, operating margins might recover.

Unfortunately, our analysis suggests that the answer to this question is not a good one for hospitals. **Both optimistic and pessimistic scenarios suggest that hospitals' financial status will remain below pre-pandemic levels for the duration of 2021. Throughout the entire year, median operating margins will be lower, the percentage of hospitals with negative margins will be higher, and the margins for rural hospitals will be lower compared with already-challenging pre-pandemic levels.**

With COVID-19, Americans depend on hospitals more than ever for their health. However, COVID-19 will continue to make it harder for hospitals to fulfill that role.

Methodology

Kaufman Hall's approach to modeling potential COVID-19 effects focused on three key questions



1 What market forces will affect volume and financial recovery?

- 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 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 the healthcare provider landscape?

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

Projections are based on model assumptions as well as real data from 900 hospitals

- The model was loaded with actual data from hospitals before the pandemic, during the pandemic, and most current performance to create individual projections for every hospital
  - Total operating revenue per patient day
  - Total operating expense per patient day
  - Total volume
  - Total revenue
  - Total expense
  - Operating margin

- The model includes assumptions of:
  - Rate of volume recovery based on consumer surveys
  - Volume recovery based on COVID-19 archetypes
  - Revenue recovery based on payer mix and patient population shifts

- Optimistic and pessimistic scenarios were modeled to understand range in performance

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

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