Implications of Economic Implosion to Healthcare

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HealthTech Net
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“We are in unchartered waters.”

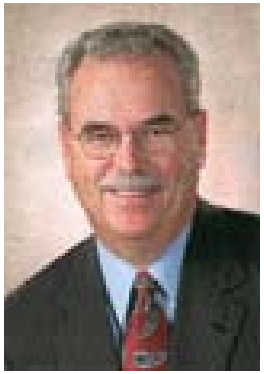
It's tough to make predictions, especially about the future.

(attributed to) Yogi Berra

Major Themes:

- Healthcare costs too much… most people now believe this
- Hospitals have long been the core of the US Health System… they are in danger
- This is not new (BBA, Son of BBA, Physician payment cuts)… but the source is new
- The clock is running… we have another 10-15 years before the last 6 months of Boomers begins to be felt by the system
- Reformers suggest that the economy will have no impact on health reform, only timing
- Others of us believe it will… that stealth reform has long been upon us and is the more likely form of change.
- Recent returns from the state pilots?
- What can we expect over the next few years?

When the AHA acknowledges…



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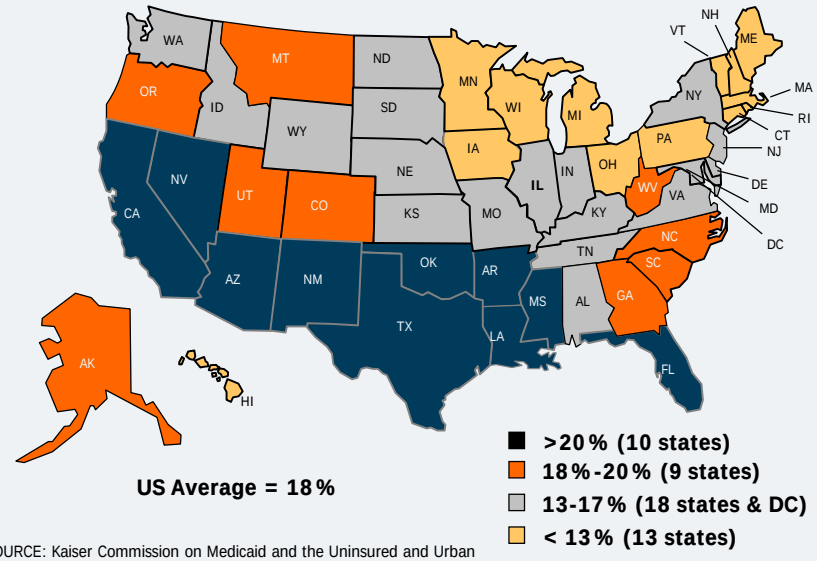
One outcome of a poor economy is growing uninsured and worries about paying for insurance.

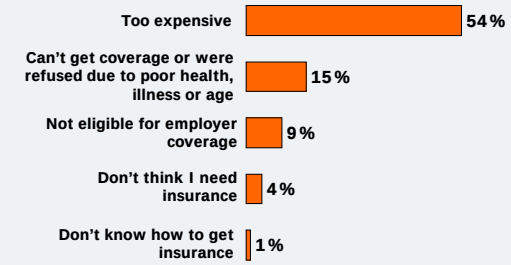
Uninsured Rates Among the Nonelderly, by State, 2005-2006



SOURCE: Kaiser Commission on Medicaid and the Uninsured and Urban Institute analysis of the March 2006 and 2007 Current Population Survey. Two-year pooled estimates for states and the US (2005-2006).

The Uninsured: Reasons for Not Having Insurance

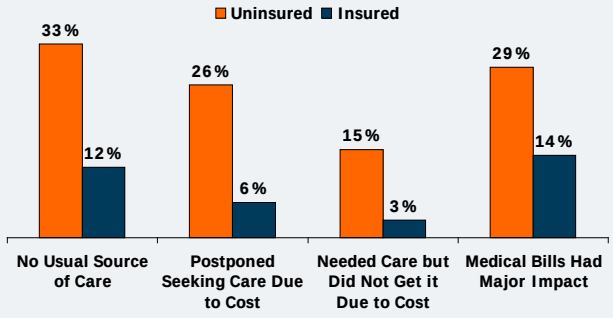
Among the 13% who report being uninsured: Which of the following best describes the reason you don't currently have health insurance?



NOTE: 13% volunteered some other reason

SOURCE: ABC News/Kaiser Family Foundation/USA Today *Health Care in America Survey* (conducted September 7-12, 2006)

Barriers to Health Care Among Nonelderly Adults, by Insurance Status, 2006



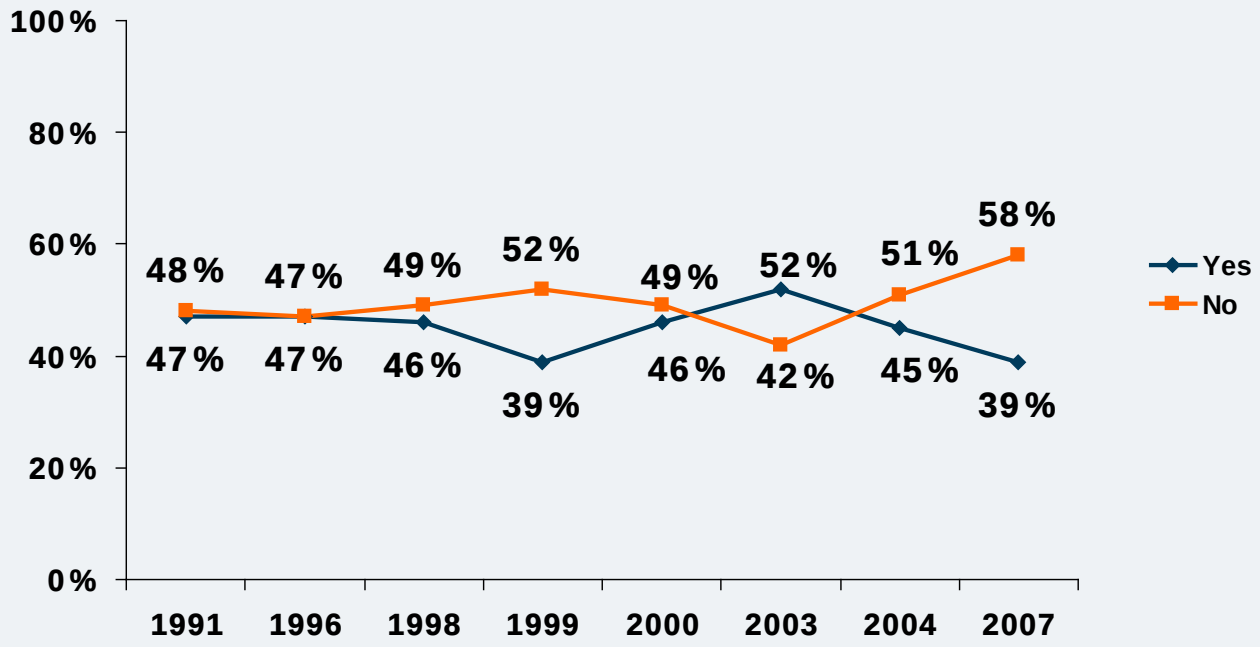
Respondents who said usual source of care was the emergency room were included among those not having a usual source of care. Other than the question about usual source of care, all questions are about access problems in the past 12 months.

SOURCE: Kaiser Low-Income Coverage and Access Survey.

Worries translate into an unwillingness to pay more taxes to extend coverage (despite political rhetoric to the contrary).

Willingness to Pay to Cover the Uninsured

Would you be willing to pay more--either in higher health insurance premiums or higher taxes--in order to increase the number of Americans who have health insurance, or not?

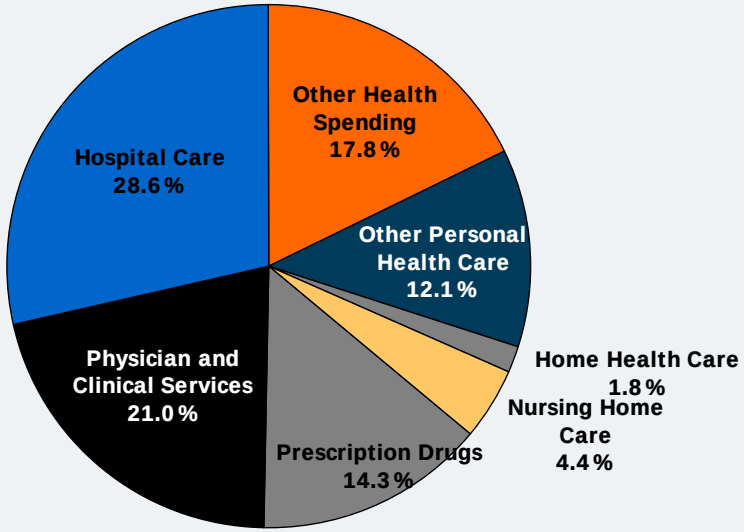


NOTE: "Don't know/refused" responses not shown
SOURCE: NBC News/Wall Street Journal Poll (Jun. 1991), Kaiser Family Foundation/Harvard School of Public Health Polls (Nov. 1996; Nov. 1998; Oct. 1999; Nov. 2000; Feb. 2003; and Nov. 2004), Washington Post/KFF/Harvard Survey (May 2007)

THE HENRY J. KAISER FAMILY FOUNDATION

Hospitals and physicians constitute the bulk of healthcare spending, with personal gaining ground as co-pays and deductibles expand. Both hospitals and physicians are being hurt by the economic implosion.

Relative Contributions of Different Types of Health Services to Total Growth in National Health Expenditures, 1996-2006



Notes: Percentages may not total 100% due to rounding. Other Personal Health Care includes, for example, dental and other professional health services, durable medical equipment, etc. Other Health Spending includes, for example, administration and net cost of private health insurance, public health activity, research, and structures and equipment, etc.

Source: Kaiser Family Foundation calculations using NHE data from Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group, at http://www.cms.hhs.gov/NationalHealthExpendData/ (see Historical; National Health Expenditures by type of service and source of funds, CY 1960-2006; file nhe2006.zip).

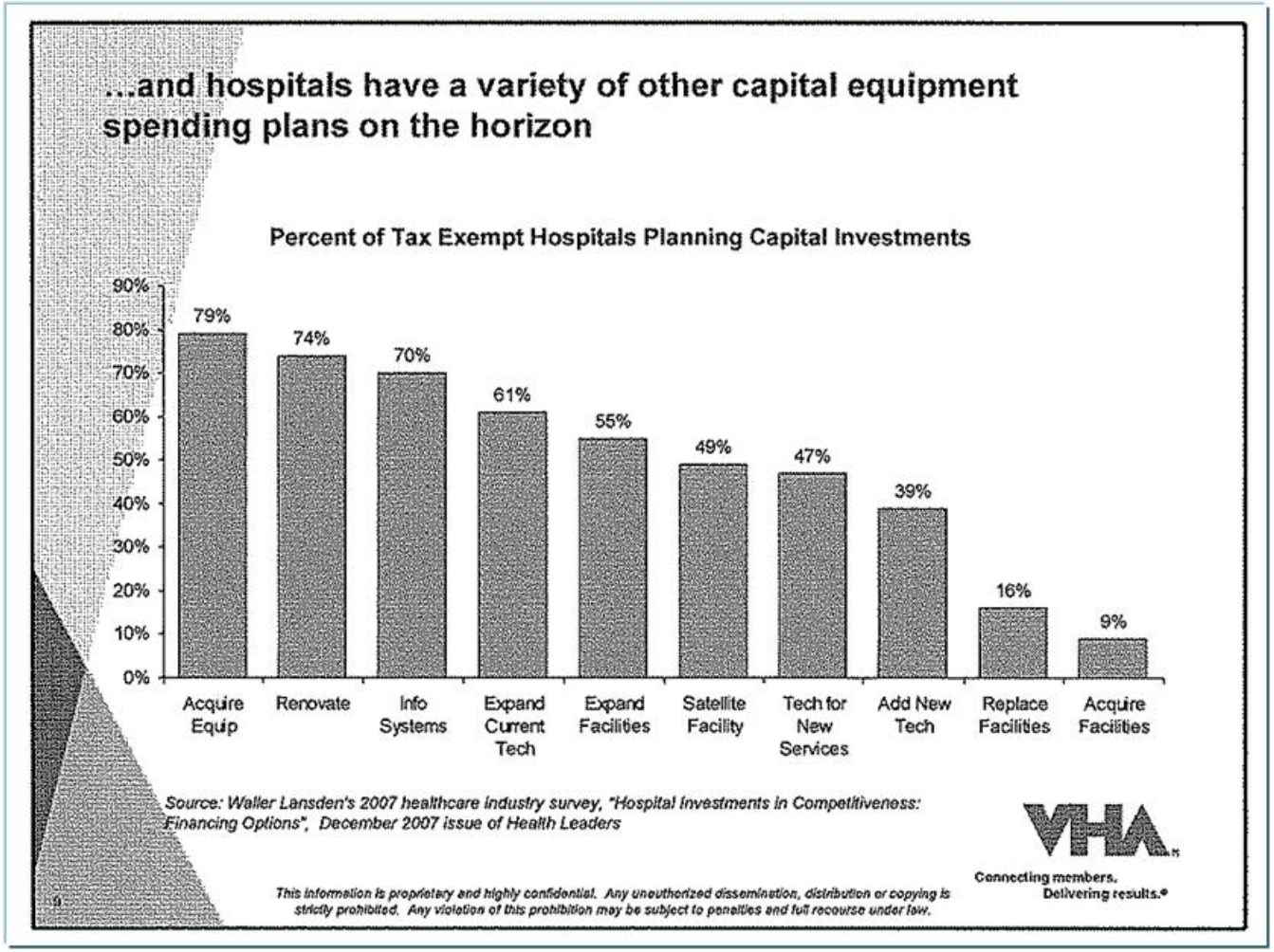
According to a recent survey by CSC Global Healthcare

- Nearly nine in ten hospital executives believe the current economic crisis will impact their facilities more heavily than the downturn of 2001 – 2002
- 15 percent of hospitals surveyed have accelerated IT projects in hopes that the effective use of information will help deal with new patient demands and changing reimbursement cycles while concurrently improving the quality of care. At the same time, 75 percent claim that they will be cutting costs, while 59 percent will be taking the downturn as an opportunity to tighten up their revenue cycle management.
- 43 percent plan to lay off staff, 21 percent anticipate cutting services and fewer than four percent see the need to close facilities.
- Increased cost of living, tightening credit and the job market are creating a "perfect storm" where the uninsured patient base rises and insured patients look for a greater "bang for their buck." Of the hospital executives surveyed, 67 percent expect to see an increase in emergency department visits, while 58 percent expect to see fewer routine checkups. Half of the executives interviewed expect to see fewer patients coming back for follow-up care.

Source: CSC n= 54 c level executives

WHAT IS HAPPENING IN THE TRENCHES?

It is important to recognize that hospitals are both labor and capital intensive.



Most hospitals began to feel the economic pinch in FY 2008…

- Reduction in utilization at all levels (except ED)
- Increase in receivables and aged receivables
- Increase in self pay (i.e. uninsured and underinsured)
- Capital budgets in 2009 reduced 50-70% (informal survey)

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Historic changes in the capital markets will cause permanent shifts in how hospitals finance future projects.

- The market and reimbursement environments for healthcare providers will be extremely challenging over the next several years.
- Despite efforts in government intervention, no one can say with any certainty how the current crisis will play out in terms of severity or duration. However, we can conclude that access to the capital markets for hospitals and health systems has been altered drastically over the last several quarters.
- Investors have lost confidence in bond insurance, making it of little or no value to issuers. As a result, the use of bond insurance by healthcare issuers has plummeted from 39% of total issuance in 2007 to less than 5% in the 3rd quarter of 2008.1
- In the absence of investor demand, virtually all new healthcare bond issues have been postponed.
- This has created a backlog of supply that the market will have to absorb in the future, most likely with price concessions for borrowers. Concurrently, the tax-exempt variable rate demand bond market has also been severely affected. In a flight to quality, tax-exempt money market funds saw outflows of $44 billion during the last three weeks of September. As a result, rates on VRDBs spiked up from under 2% to as high as 10% in some cases during September before sliding back.
- While interest rate swaps may remain a viable tool for some tax-exempt borrowers, fewer hospitals will have an appetite for these types of transactions. Those that do will find fewer viable counterparties and more stringent terms and conditions.

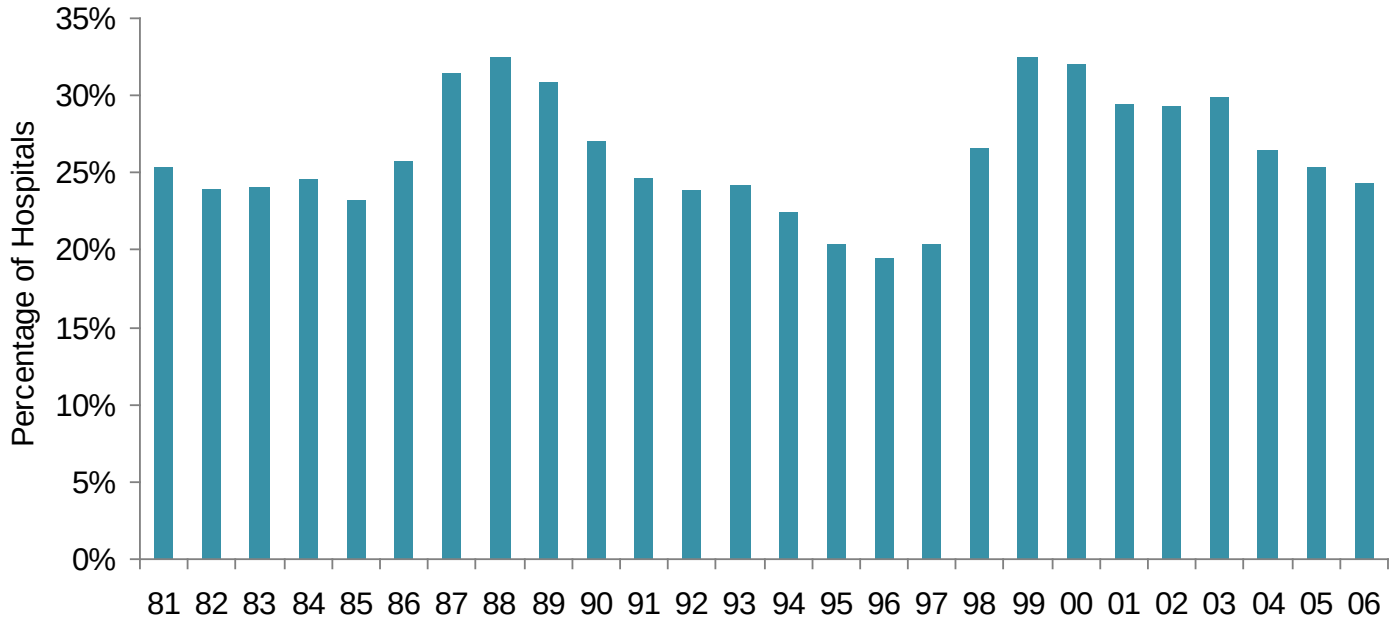
Source: **The Impact of the Capital Markets Crisis and Economic Slowdown on Hospitals and Health Systems** Fall 2008, Shattuck Hammond website: www.shattuckhammond.com/publications

Capital market changes will increase the cost of debt in the future.

"Most health systems will migrate back to traditional long-term fixed rate bonds as the primary source of debt capital because other sources will be either too costly or too risky. Bond insurance will not be available or economical. The use of variable rate debt and swaps to achieve a lower blended cost of debt will decline as these options prove less beneficial. The factors noted above will increase the cost of long-term debt for many health systems, and investors will no doubt demand stricter financial covenants. We also expect that conventional bank and vendor financing for equipment and supplies will be less available and more costly over the next few years."

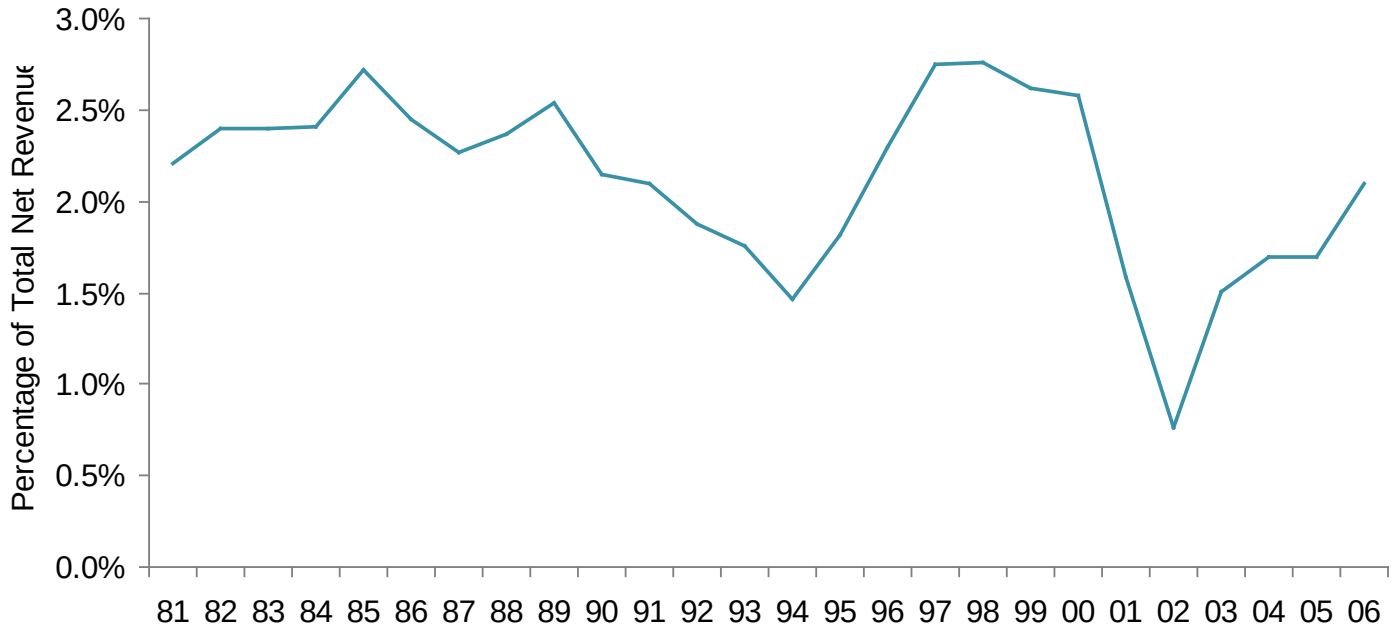
Source: **The Impact of the Capital Markets Crisis and Economic Slowdown on Hospitals and Health Systems** Fall 2008, Shattuck Hammond website: www.shattuckhammond.com/publications

Chart 4.1: Percentage of Hospitals with Negative Total Margins, 1981 – 2006



Source: Avalere Health analysis of American Hospital Association Annual Survey data, 2006, for community hospitals.

Non-operating income



AHA

Average Age of Plant

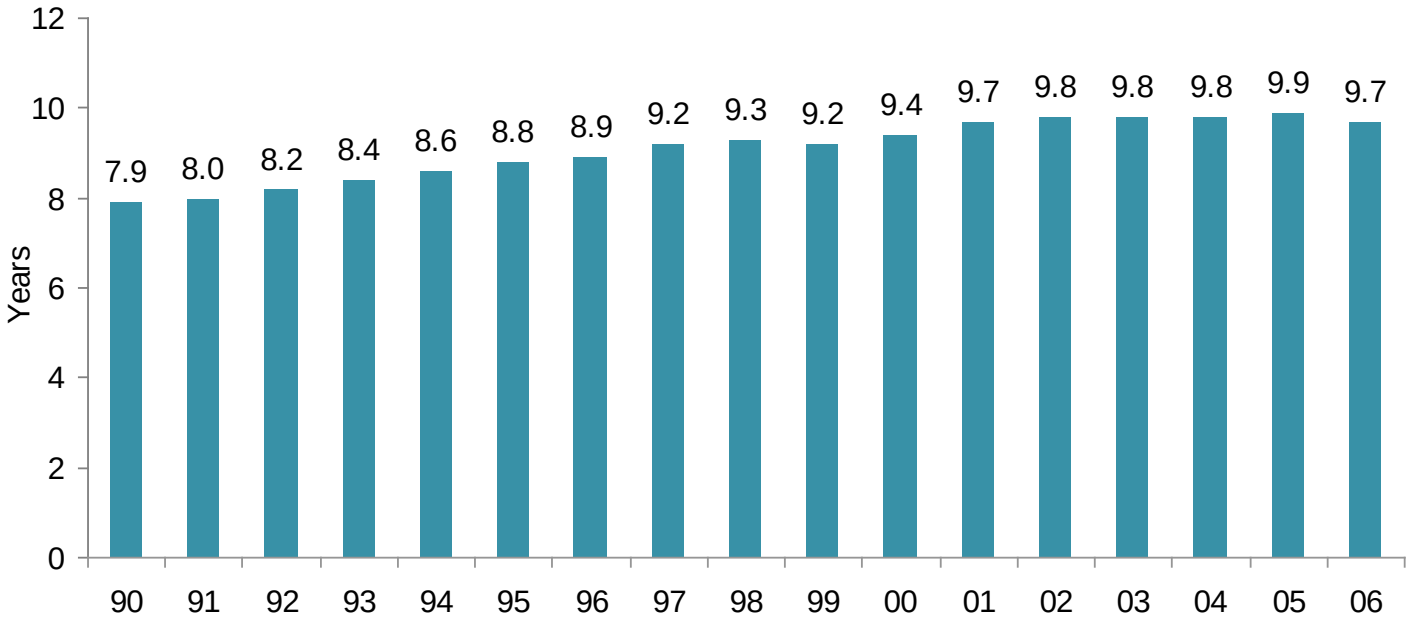


Chart 6.12: Impact of Community Hospitals on U.S. Economy; All States, DC and Total U.S., 2006

State Name	Number of Hospital Jobs (FT and PT)	Multiplier for Employment	Effect of Hospital Jobs on Total Jobs in State Economy	Percent of Total (Non-farm) Employment Supported by Hospital Employment	Hospital Payroll and Benefits ($ millions)	Multiplier for Earnings	Effect of Hospital Payroll and Benefits on Total Labor Income ($ millions)	Hospital Expenditures* ($ millions)	Multiplier for Output	Effect of Hospital Expenditures on Total Output in State Economy ($ millions)
Alabama	83,823	1.9673	164,905	8.32%	$3,716	1.7256	$6,412	$7,895	2.1553	$17,016
Alaska	10,972	1.8833	20,664	6.56%	$752	1.5404	$1,158	$1,440	1.8578	$2,674
Arizona	77,772	2.0659	160,669	6.08%	$4,390	1.7575	$7,715	$9,498	2.1687	$20,598
Arkansas	48,496	1.9083	92,545	7.71%	$2,183	1.6570	$3,617	$4,571	2.0430	$9,339
California	470,001	2.2396	1,052,614	6.98%	$29,524	1.9783	$58,407	$57,500	2.5385	$145,964
Colorado	62,374	2.2153	138,177	6.06%	$3,702	1.9505	$7,221	$7,914	2.4787	$19,617
Connecticut	63,860	1.8816	120,159	7.15%	$3,927	1.7173	$6,745	$7,117	2.1326	$15,178
Delaware	18,315	1.8634	34,128	7.82%	$1,049	1.6184	$1,698	$1,894	1.9732	$3,737
District of Columbia	25,590	1.5373	39,340	5.72%	$1,607	1.3705	$2,202	$3,048	1.3911	$4,239
Florida	266,870	2.0257	540,599	6.75%	$14,762	1.8039	$26,629	$31,322	2.2321	$69,913
Georgia	136,728	2.1334	291,696	7.14%	$7,015	1.9374	$13,590	$14,325	2.4788	$35,508
Hawaii	16,973	2.0943	35,547	5.76%	$1,062	1.7063	$1,811	$2,003	2.0856	$4,177
Idaho	21,626	2.0268	43,832	6.85%	$1,056	1.6801	$1,774	$2,254	2.0409	$4,600
Illinois	237,782	2.1803	518,436	8.74%	$12,498	2.0037	$25,043	$24,244	2.6046	$63,147
Indiana	124,713	2.0080	250,424	8.42%	$6,396	1.7551	$11,226	$13,262	2.2268	$29,533
Iowa	68,791	1.9108	131,446	8.75%	$3,057	1.6650	$5,090	$5,983	2.0554	$12,297
Kansas	49,275	1.9324	95,219	7.03%	$2,408	1.6914	$4,073	$4,847	2.1363	$10,356
Kentucky	78,692	1.9542	153,780	8.33%	$3,834	1.7150	$6,576	$8,594	2.1431	$18,418
Louisiana	82,640	2.0044	165,644	8.92%	$3,812	1.7314	$6,600	$7,692	2.1075	$16,212
Maine	32,779	2.0346	66,692	10.85%	$1,627	1.6824	$2,737	$3,171	2.0564	$6,520
Maryland	88,333	2.0238	178,768	6.91%	$4,841	1.7899	$8,666	$10,120	2.2321	$22,588
Massachusetts	157,105	2.0248	318,106	9.81%	$9,150	1.8252	$16,700	$18,516	2.2851	$42,311
Michigan	200,723	2.0031	402,068	9.26%	$10,920	1.7785	$19,421	$21,187	2.2095	$46,813
Minnesota	107,704	2.1564	232,253	8.41%	$5,982	1.8575	$11,112	$11,335	2.3496	$26,632
Mississippi	54,986	1.8829	103,533	9.06%	$2,630	1.6302	$4,287	$5,238	2.0105	$10,531
Missouri	127,691	2.0651	263,695	9.51%	$6,170	1.8165	$11,208	$13,886	2.2909	$31,812
Montana	20,140	1.9512	39,297	9.06%	$969	1.6224	$1,573	$1,892	1.9664	$3,720
Nebraska	40,989	1.9455	79,744	8.42%	$1,975	1.7060	$3,369	$4,182	2.1064	$8,809
Nevada	21,822	1.9102	41,684	3.25%	$1,540	1.6205	$2,496	$3,080	1.9644	$6,050
New Hampshire	27,306	1.9646	53,645	8.39%	$1,633	1.7711	$2,893	$3,072	2.1229	$6,523
New Jersey	141,201	2.1060	297,369	7.30%	$8,705	1.8925	$16,474	$15,837	2.4329	$38,530
New Mexico	26,878	2.0523	55,162	6.62%	$1,407	1.6443	$2,314	$2,674	1.9675	$5,262
New York	394,238	1.8775	740,182	8.59%	$26,469	1.7057	$45,148	$47,152	2.1628	$101,980
North Carolina	157,787	2.1212	334,698	8.32%	$8,202	1.8418	$15,106	$16,751	2.3413	$39,220
North Dakota	19,673	1.8537	36,468	10.33%	$891	1.5887	$1,415	$1,636	1.9036	$3,115
Ohio	252,032	2.1076	531,183	9.76%	$13,464	1.8467	$24,864	$26,789	2.3444	$62,805
Oklahoma	55,081	2.0895	115,092	7.42%	$2,647	1.7750	$4,698	$5,816	2.2163	$12,889
Oregon	56,629	2.1556	122,069	7.17%	$3,332	1.7595	$5,862	$6,382	2.1885	$13,968
Pennsylvania	275,396	2.1247	585,134	10.17%	$13,862	1.9268	$26,709	$29,144	2.4728	$72,068
Rhode Island	20,851	1.9458	40,572	8.22%	$1,368	1.6873	$2,309	$2,419	2.0523	$4,964
South Carolina	69,364	2.0776	144,111	7.57%	$3,499	1.7698	$6,192	$7,936	2.2559	$17,903
South Dakota	20,268	1.8479	37,453	9.39%	$910	1.5841	$1,441	$1,838	1.9154	$3,520
Tennessee	115,507	2.1489	248,213	8.92%	$5,625	1.8571	$10,447	$11,824	2.3916	$28,278
Texas	316,156	2.2890	723,681	7.20%	$17,311	1.9720	$34,138	$36,937	2.5737	$95,065
Utah	38,350	2.2220	85,214	7.08%	$1,720	1.9095	$3,285	$3,880	2.4462	$9,491
Vermont	12,741	1.9283	24,568	7.99%	$805	1.5950	$1,284	$1,383	1.8848	$2,606
Virginia	105,134	1.9195	201,805	5.42%	$5,628	1.7630	$9,922	$12,620	2.2526	$28,428
Washington	92,217	2.1432	197,639	6.91%	$5,667	1.8034	$10,219	$10,819	2.2743	$24,605
West Virginia	40,791	1.8325	74,750	9.89%	$1,938	1.5628	$3,029	$3,946	1.8436	$7,274
Wisconsin	108,140	2.0058	216,907	7.58%	$5,591	1.7551	$9,813	$11,969	2.1855	$26,159
Wyoming	8,838	1.7345	15,330	5.54%	$445	1.4657	$652	$839	1.7279	$1,450
U.S.	**5,152,143**	2.7003	**13,912,332**	10.24%	**$283,674**	2.4050	**$682,235**	$569,672	3.2927	**$1,875,760**

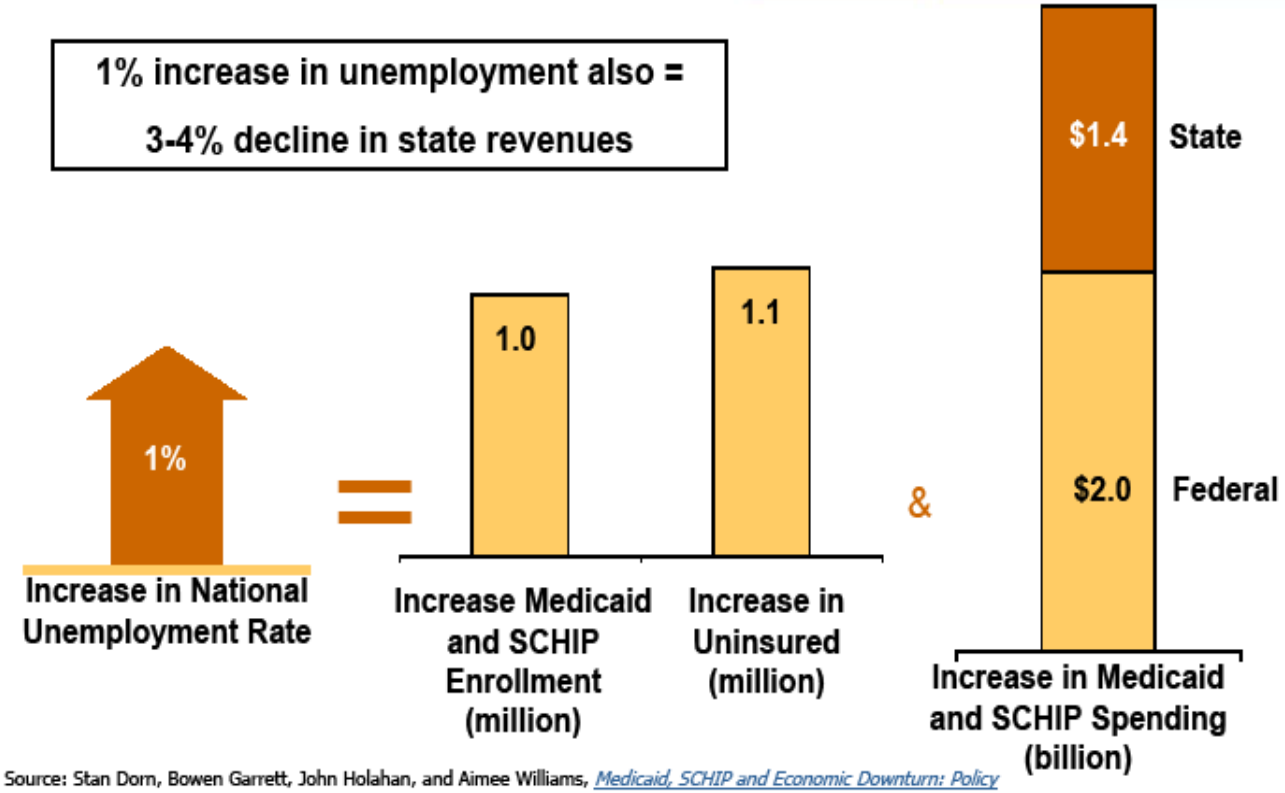
Source: Avalere Health, using BEA RIMS-II (1997/2005) multipliers for hospital NAICS Code 622, released 2006, applied to American Hospital Association Annual Survey data for 2006. Hospital jobs are total part time and full time jobs. Hospital labor income is defined as payroll plus benefits. The percent of total employment supported by direct and indirect hospital employment is based on 2005 BLS data.

*Expenditures are defined as net patient revenue + other operating revenue.

Impact of Unemployment Growth on Medicaid and SCHIP and Uninsured

1% increase in unemployment also =

3-4% decline in state revenues



Source: Stan Dorn, Bowen Garrett, John Holahan, and Aimee Williams, *Medicaid, SCHIP and Economic Downturn: Policy Challenges and Policy Responses*, prepared for the Kaiser Commission on Medicaid and the Uninsured, April 2008.

17

Recent Returns from State Pilots:

- Massachusetts has the most wide ranging reform in place:
  - Good news:more people signed up covered
  - Bad news: it cost $170 more than projected (so far)
  - Bad news: lack of primary care providers to accept new covered patients
- Hawaii is the only state that attempted to mandate SCHIP benefits…it folded before it started due to lack of funds.

WHAT'S NEXT?

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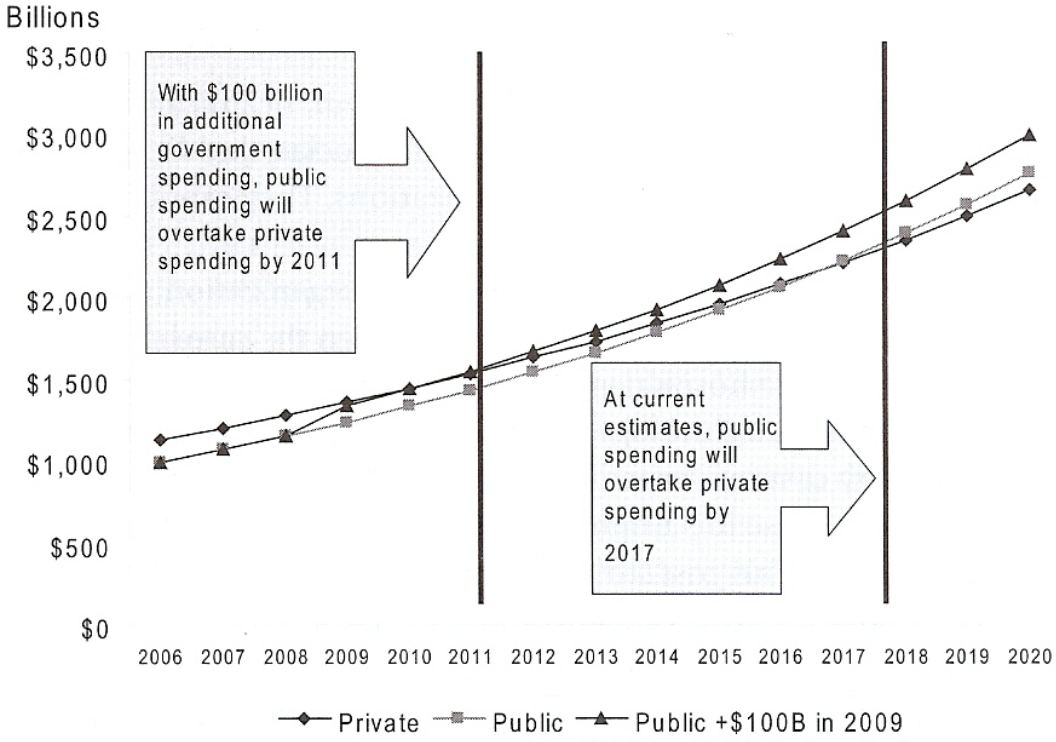
The impact of shifting demographics will alter the private-public spending equation to where public dominates for the first time during this planning horizon. In this way, the US is becoming more like other industrialized nations that have no private insurance.

Federal Government Spending on Healthcare, Public Versus Private



Source: PricewaterhouseCoopers's Health Research Institute. Estimates based on CMS estimates through 2015.

Six options for pursuing health reform (Karen Davis, Commonwealth Fund)

1. Defer legislative action while pursuing administrative changes.
– Create congressional working group or commission to develop recommendations
while undertaking administrative changes by executive order
2. Make a down payment on reform.
– Pursue quick victories on certain limited measures, such as reauthorizing SCHIP
and spurring the adoption of health information technology
3. Use the states as laboratories.
– Fund experimental reforms in five to 10 states to test alternative approaches to
reform
4. Combine long-range vision with incremental first steps.
– Articulate a long-range vision for universal coverage but urge Congress to legislate initial reforms
5. Press for single legislative package with sequential phases and flexible roll-out.
– Combine building blocks for reform in one legislative package that allows flexible
roll-out of various pieces over a six- to eight-year period
6. Seize the moment for comprehensive and immediate reform.

Major Themes:

- Healthcare costs too much… most people now believe this
- Hospitals have long been the core of the US Health System… they are in danger
- This is not new (BBA, Son of BBA, Physician payment cuts)… but the source is new
- The clock is running… we have another 10-15 years before the last 6 months of Boomers begins to be felt by the system
- Reformers suggest that the economy will have no impact on health reform, only timing
- Others of us believe it will… that stealth reform has long been upon us and is the more likely form of change.
- Recent returns from the state pilots?
- What can we expect over the next few years?