HEALTHCARE MANAGEMENT ADVISORS

Can Your Hospital Maintain Independence? 5 Financial Questions to Explore

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When it comes to developing a financial recovery plan for COVID-19, independent hospitals face more of an uphill climb than other hospitals.

With 40 percent of hospitals reporting their revenue had been cut in half during the first month of the COVID-19 pandemic alone—and 55 percent reporting they had less than six months of days cash on hand—the financial impact of the pandemic is likely to be even worse for independent hospitals. These hospitals typically have less than two months of cash reserves, with rural hospitals in particular feeling the financial pinch. Before COVID-19, financial performance for independent hospitals had the potential to go from bad to worse in a matter of months. Now, performance can quickly move from bad to catastrophic unless leaders move quickly to assess their financial trajectory, pursue emergency assistance, and develop a strategy for protecting their community's investment.

With so much on the line, how can hospital leaders determine whether maintaining independence is possible after COVID-19? There are five financial questions leaders should explore.

Question No. 1: Will our capital investment strategy need to change? Consumer sentiment following COVID-19 may demand a change in approach. For example, while hospital volumes recovered slightly in May due to a return to elective services in some areas, emergency department (ED) and urgent care volumes were still down 35 to 50 percent, a Moody's Investors Services analysis showed. This could reflect a decrease in accidents, such as automobile accidents, during the pandemic, but it could also indicate consumers' reluctance to enter a hospital for lower-acuity care following the coronavirus outbreak, according to Moody's. Meanwhile, a recent survey shows 40 percent of consumers plan to delay needed elective procedures. In this environment, independent hospitals should review their plans for capital investment to ensure that patient demand continues to support investment in facilities and infrastructure.

Question No. 2: Can we get back to where we were, financially? If so: How fast? An American Medical Group Association survey found 40 percent of health systems anticipate that it will take at least a year to return to pre-COVID revenue levels, and nearly one in four aren't sure they will ever return to normal. Independent hospitals that already were struggling financially before the crisis may be drowning under the weight of increased expenses related to COVID-19 and a plunge in income, especially if a surge in coronavirus-related volumes never materialized. Even independent hospitals that were doing well before the coronavirus crisis could stumble financially in the months ahead if a large proportion of revenue has traditionally been based on outpatient services and surgical volume. Now is the time for leaders to take a hard look at the organization's financial trajectory for the remainder of 2020 and in the year ahead to determine what it would take to regain financial health, the expected timeline for recovery, and the extent to which the hospital has the financial resources to weather this storm.

Question No. 3: What is the variance from our pre-COVID financial targets? Leaders should assess whether their projections for market share and volume still hold true in a post-pandemic environment. They also must consider whether changes in consumer behavior and preferences, such as a sudden rise in the use of telehealth globally and expectations that providers will expand use of virtual care beyond COVID-19, necessitate not just investment in telehealth infrastructure, but also reassessment of the organization's "sacred cows." Renewed focus on cost savings and revenue enhancement will be vital, with heavy emphasis on ways to achieve increased operational efficiency, opportunities to partner around provision of specific services, identify and offset the potential impact of a recession on utilization, and more. Leaders also need to stay on top of payer trends, some of which changed in response to the coronavirus outbreak. One example: telehealth reimbursement (Will payers continue to support payment parity once the pandemic is over?).

Question No. 4: What is our cash position? The speed with which COVID-19 spread throughout the United States took hospitals off guard, and independent hospitals felt the disruptions in service most acutely. Those most vulnerable: hospitals with lower financial liquidity. Some hospitals have been forced to put employees on leave due to lower-than-expected volumes. While such efforts are designed to keep hospitals financially stable, they are a short-term stop-gap measure. Long-term relief requires a more strategic focus on strengthening the hospital's cash position, such as through a focus on volumes, cash flow, and credit fundamentals.

Question No. 5: When will we violate our debt covenants? With 30 to 40 percent declines in revenue and a steep drop in cash flow, more hospitals likely will experience technical defaults than in previous years. This occurs when hospitals fail to meet required covenants in their borrowing agreements, such as maintaining specific metrics for days cash on hand or debt service coverage. The risk is that lenders could declare a hospital in default of its borrowing agreement. Independent hospital leaders should carefully review all borrowing agreements to assess the potential for tripping debt covenants and approach lenders to determine the likelihood that lenders will accelerate debt if a breach occurs. Other actions independent hospitals may wish to take to avoid a breach, according to Moody's, include:

- Liquidating investments to recognize realized gains to boost debt service coverage
- Drawing on lines of credit to temporarily boost cash reserves

Proactively conducting a baseline assessment based on these five questions provides a glimpse into the organization's financial stability. The next question for leaders is: "Where do we go from here?" This depends in part on the hospital's timeline for financial recovery, its cash position, and its ability to access capital.

Independent hospitals that were financially strong prior to COVID-19 may find they can weather the storm in the year ahead on their own or with loose partnerships around specific services to increase efficiency, meet consumers' changing preferences for care, and improve revenue. Those that are unsure how they will make up revenue shortfalls may need to make tough decisions around whether they can stay independent quickly—including around whether to pursue a merger or sale—to secure their future.

By proactively conducting a baseline assessment of the organization's financial stability, leaders will be better prepared to take the actions needed to protect their community's investment.

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