Hospitals and health systems on the front lines of the COVID-19 crisis are in the midst of an intense battle to meet mounting, unprecedented demands on their resources and capacity. Right now, they are laser-focused on addressing immediate and anticipated patient and provider needs to save lives and combat the virus’ spread. However, they will rapidly need to answer questions like these:

- What would be the cash flow impact of losing 4-6 weeks of elective surgeries?
- What impact might COVID-19 have on length of stay and CMI?
- What portion of our workforce will be directly impacted, and what contract labor costs will be incurred?
- What is the potential magnitude of extraordinary inventory costs to manage supply shortages?
- What is the impact to our investment income and balance sheet if the ~25 percent YTD market losses hold (or increase) for the year?
- Do we have pension, swap, or other liabilities that will be hurt by declining interest rates?

Once these critical questions are answered, organizations will need to gauge longer-term strategic and financial implications. Organizations will need to use scenario planning to quantify the potential impacts of the virus, and the longer-term effects of an anticipated recession, taking lessons both from current events and the Great Recession of 2007-2009. Key questions to ask include:

- How should the strategic plan be adjusted in light of the clinical crisis and its impact on organizational bandwidth?
- What are realistic revised financial performance targets for 2020?
- Which capital projects are essential, and which could be adjusted or deferred?
- What are our near-term borrowing plans and how should those be adjusted?
- Should we evaluate near-term performance improvement opportunities to address budget gaps?

Short-Term Financial Effects of COVID-19

The COVID-19 pandemic has created unprecedented disruption worldwide. The capital markets continue to show significant volatility, and credit and liquidity markets are in disarray. March 16, 2020 was the worst day since the “Black Monday” market crash of 1987. Two days later, Moody’s changed its sector outlook from stable to negative, with an expectation of lower cash flow than 2019, compared to previously predicted growth of 2-3 percent. The Fed cut interest rates in an attempt to mitigate the impacts, but many economists say a recession is increasingly inevitable.

In the short term, hospitals and health systems face tremendous operating disruptions related to the pandemic, including:

- **Capacity Shortages**: Many lack sufficient Urgent Care, ER, and ICU capacity to address the surge in COVID-19 volume. Organizations are moving quickly to open up additional bed capacity, shift services to outpatient settings, and suspend certain services. These issues will become increasingly acute as testing capacity grows and confirmed cases spike in the coming weeks.
- **Service Mix Shifts**: Healthcare providers already are reporting declines in elective procedures as patients cancel due to social distancing and other factors, or health systems postpone procedures to free up capacity for COVID-19 patients. Many organizations will see service mix shifts the first half of 2020—and possibly beyond—that will significantly impact financial performance.
- **Workforce Disruption**: Health systems need more staff to deal with the emerging crisis, but face the same workforce issues as employers nationwide. Some employees cannot work due to illness, quarantine, or lack of childcare, and organizations will increase the use of contract labor and locum tenens to bridge these gaps, resulting in added costs.
- **Supply Chain Disruption**: The convergence of high demand with significant supply shortages and supply chain disruption could result in extraordinary inventory and increased supply costs for hospitals in the near term.
- **Balance Sheet Stress**: As the value of invested assets continues to decline, health systems are closely monitoring their liquidity needs and investment losses, whether realized or not. Further pressures are mounting from unfunded pension liability and collateral posting requirements related to derivatives.

The full operating and financial implications of COVID-19 are still coming into focus. Some leadership teams already are tracking COVID-19 related financials for possible Extraordinary Item reporting classification. The sooner organizations implement related processes and procedures, the easier such reporting will be.
**Longer-Term Financial Implications**

If the economy falls into recession, hospitals and health systems will experience meaningful operating impacts well beyond the current crisis.

Some organizations already have begun to incorporate recession scenario analysis into their financial planning to better understand the potential impacts of an economic downturn, and inform decisions on how to respond. Longer-term financial implications of COVID-19 and relevant insights from the last economic downturn follow. All of these would need to be part of scenario planning.

**Capital markets volatility.** In 2008, both operating performance and balance sheet positions weakened and the Dow Jones Industrial Average fell 33.8 percent. Coupled with increasing expenses, the sector saw its first drop in days cash on hand in six years. Fast-forward to today. As of publication, trading has halted three times and Goldman Sachs predicts the S&P 500 will reach a mid-year low of 2,000. Longer-term bond rates have declined from already historically low levels, but credit spreads are widening. Low interest rates may create favorable borrowing or refinancing opportunities for some, but the recent volatility has made it difficult to bring new debt offerings to market. Most organizations have seen their investment portfolio values decline, and may be carrying unrealized losses. These portfolio losses could have long-term consequences, with investment returns on a reduced portfolio and diminished risk tolerance. If interest rates remain low (or continue to fall), many also will grapple with increased unfunded pension liabilities, mark to market losses, collateral posting requirements on derivatives, and other negative impacts. Debt covenants also may become a factor as health systems wrestle with accounting for these effects through their income statements.

**Volume declines.** In its 2010 sector outlook, Moody’s listed “lower patient volumes” as the first of several impacts of a weakening economy on hospitals. Volume declines were a significant factor in rating downgrades across ratios and rating categories during the Great Recession. Many health systems are experiencing higher volumes now due to COVID-19, albeit coupled with service mix erosion. In the event of a recession, volumes likely will soften and service mix may be slow to rebound.

**Changes in revenue mix.** The Great Recession saw meaningful declines in revenue and profitability for many health systems due to unfavorable changes in payer and service mix. High unemployment was a major contributor, jumping from 5 to 10 percent from 2007 to 2009. Loss of employer-sponsored healthcare coverage resulted in increases in Medicaid and self-pay mix, charity care, and bad debt for providers. Many patients who retained commercial coverage nonetheless deferred care, and both public and private payers pressured providers to reduce costs. Many organizations saw materially lower average annual payment increases, and struggled to manage expense growth.

**Lower levels of philanthropy, governmental support, and research/grant funding.** Outside funding—such as research funding, philanthropy, and governmental and public support—invariably declines in a downturn. During the last recession, overall charitable giving declined significantly, business R&D spending fell about 10 percent, and government funding flat-lined. Federal funding is being set aside for COVID-19 crisis relief, including increased Medicaid support that could help hospitals by decreasing uncompensated care, but long-term federal funding levels remain uncertain.

**Balance sheet expansion.** Health systems should consider how/whether to keep investments deployed in a recession. Funding short- to intermediate-term strategic, capital, and liquidity needs with credit alternatives may allow hospitals to participate in asset re-inflation of their investment portfolios in the future. Balance sheet expansion via debt issuance, lines of credit, and other means of strengthening liquidity reserves would take pressure off investment portfolios.

**Liquidity management.** Hospitals and health systems facing significant financial and operational disruption will need to tighten liquidity. Significant communication will be required across the organization, and providers should look to expand banking relationships to bolster capital access. Scenario analysis can help leaders determine appropriate liquidity needs.

**Preparing for the Future**

These short- and long-term factors all will need to be put into a framework for formal scenario planning, using necessary tools and technology: identifying key risks, quantifying and projecting potential impacts, planning responses to each of the potential scenarios, and implementing plans as actual scenarios come into focus.

The healthcare industry has adapted to a “new normal” in the years since the last financial crisis. Organizations continue to cope with lower government payment increases, the ongoing shift of care from inpatient to outpatient, slow but steady movement toward value-based payment models, disruptive competition, and heavy cost pressure from multiple sources.

These are uncertain times for the global economy in general, and for healthcare providers in particular. The short-term effects are painful, and the long-term effects likely will be felt for years. A structured approach to modeling these effects will be critical for adapting to yet another new normal.