

KaufmanHall

Hospital Services at Risk Throughout California

Commissioned by:



April 2023

Agenda

1. Executive Summary of Findings
2. California Hospital Margin Overview
3. California Hospital Expense Overview
4. California Hospital Revenue Overview
5. California Hospital Volume Overview
6. Methodology

Executive Summary

California Hospital Margins Were Negative in Calendar Year 2022

Since the onset of the COVID-19 pandemic in March 2020, California hospitals and health systems have taken unprecedented steps to care for their communities amid significant pressure on staff and resources.

The financial impact of the pandemic has been staggering. As hospital executives, policymakers, and other healthcare leaders assess the current landscape, key findings about the financial state of California hospitals from the beginning of the pandemic through December 2022 include:

- **One in five hospitals are at risk of closure.** Growing operating losses, combined with declining cash balances and debt loads, place many hospitals in unsustainable financial positions.
- **Margins remain depressed relative to pre-pandemic levels.** Throughout calendar year 2022, the hospital operating margin for California accelerated its years-long decline, resulting in the worst financial performance since the start of the pandemic.
- **Hospitals have experienced a profound financial toll, with no further relief in sight.** Hospitals incurred serious losses relative to pre-pandemic levels—including approximately \$8.5 billion in 2022—increasing strain on California hospitals that need additional support. The losses in 2022 are in addition to the \$12.1 billion in losses incurred over the prior two years.

- **Expenses are significantly elevated from pre-pandemic levels.** Total expenses in 2022 for California hospitals were \$23.4 billion higher than pre-pandemic levels, outpacing increases in revenue. Rising expenses for labor, medical supplies, and purchased services have contributed to the increase.
- **Hospital volumes remain below pre-pandemic levels.** Hospital discharges and emergency department (ED) visits in California hospitals remain below pre-pandemic levels. However, a significant rise in average length of stay suggests that patients visiting hospitals have more severe health needs than prior to the pandemic. Furthermore, labor shortages in post-acute settings and prior authorization policies have prevented timely discharge of patients from the hospitals, leading to an increase in expense without a commensurate increase in revenue.

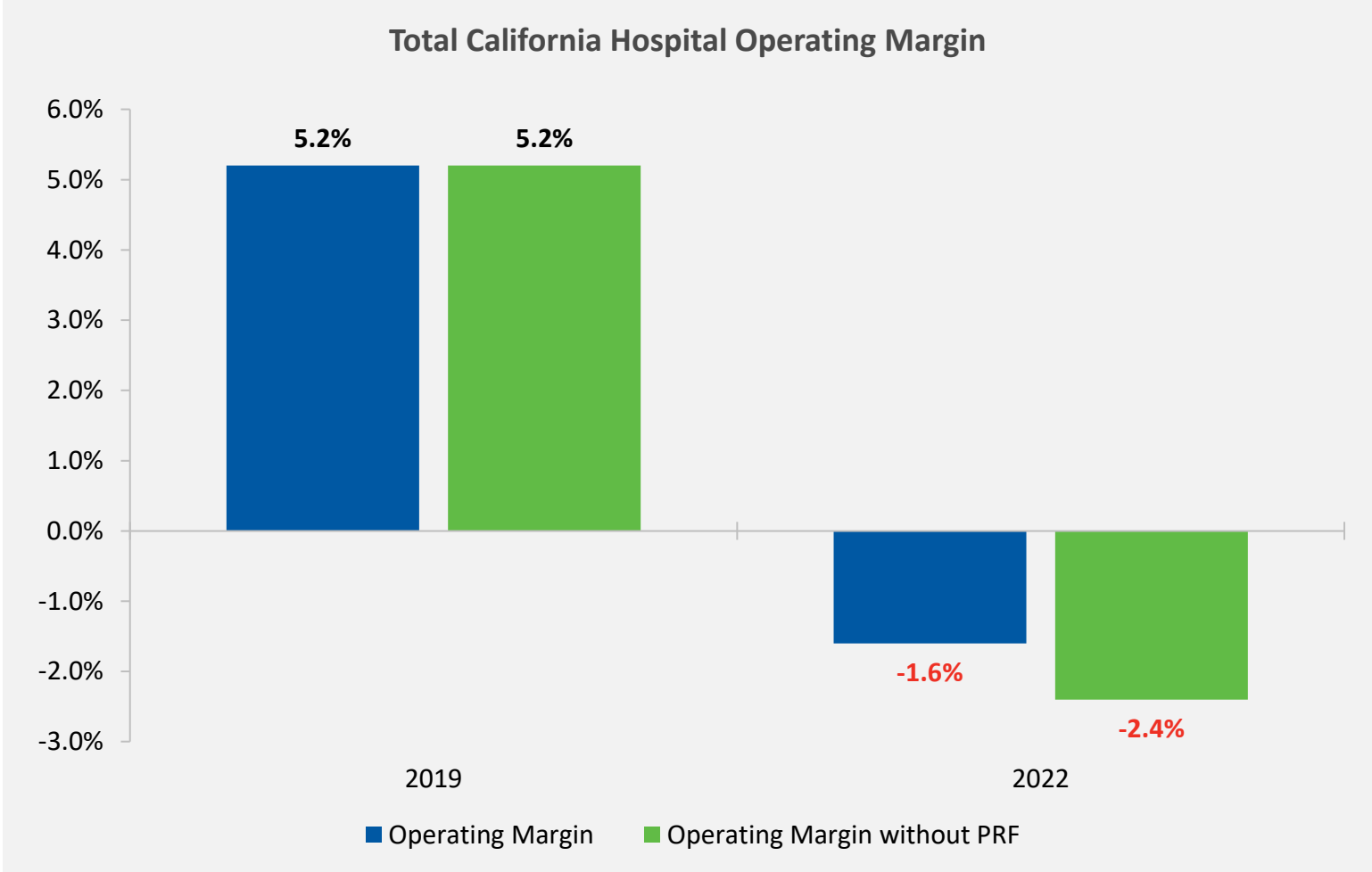
Hospitals faced a host of other related challenges, including workforce shortages and supply disruptions.

These findings underscore the existential financial and operational threats California hospitals continue to face more than three years after the beginning of the pandemic.

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

Operating Margins

California Hospitals' Operating Margins Were Far Below Pre-Pandemic Levels in 2022

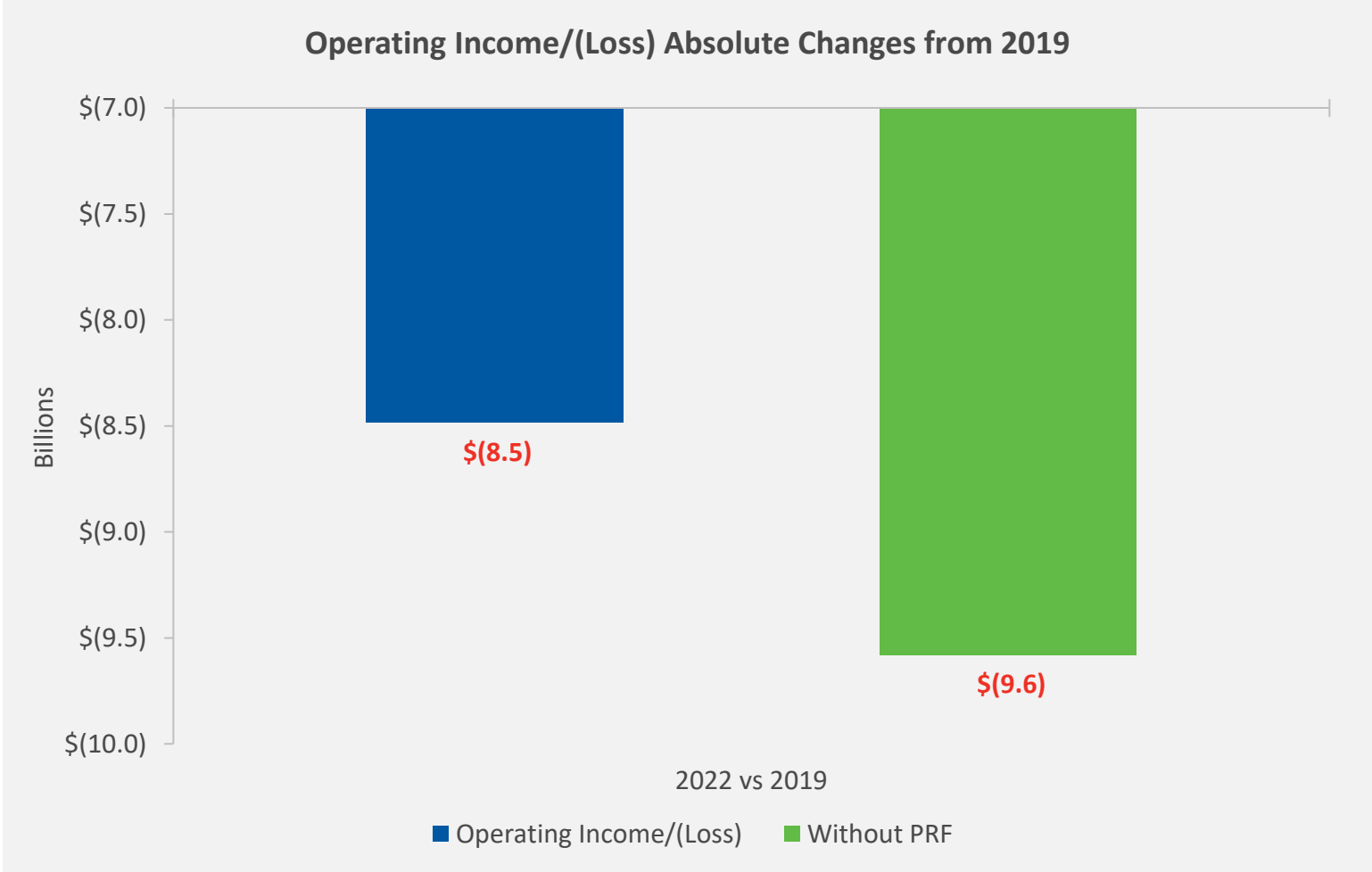


Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

KEY TAKEAWAYS

- California hospital operating margins reached -1.6% in 2022, the lowest level since the pandemic began.
- Payments from the provider relief fund (PRF) bolstered California operating margins, which would have been -2.4% without PRF support.

Total California Hospital Operating Income in 2022 Was \$8.5 Billion Below Pre-Pandemic Levels

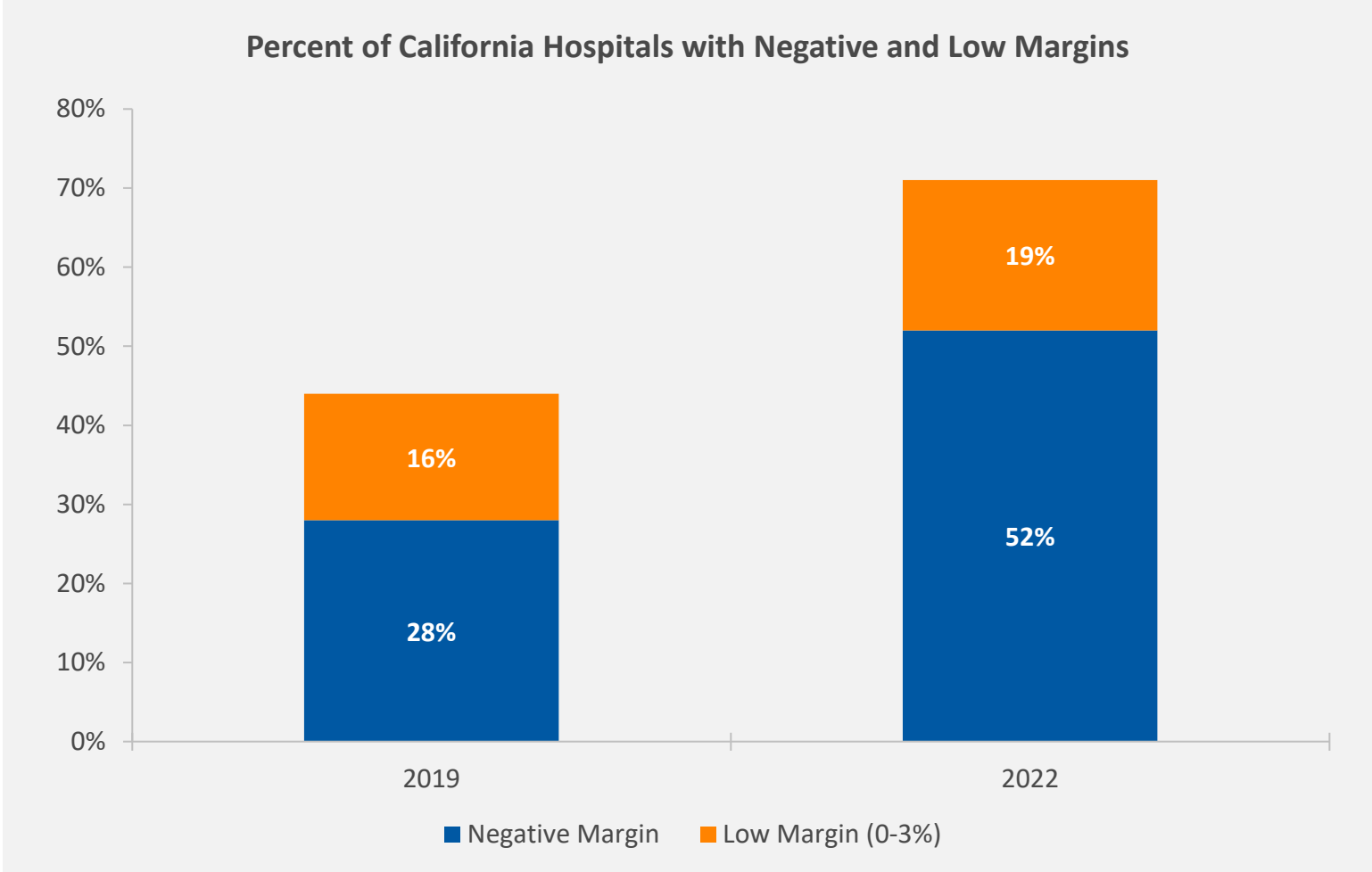


KEY TAKEAWAYS

- California hospitals lost \$8.5 billion in 2022 compared to 2019 operating income.
- Discounting PRF payments, operating income for 2022 was nearly \$10 billion below pre-pandemic levels.

Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

More Than 70% of California Hospitals Now Have Unsustainably Low Margins

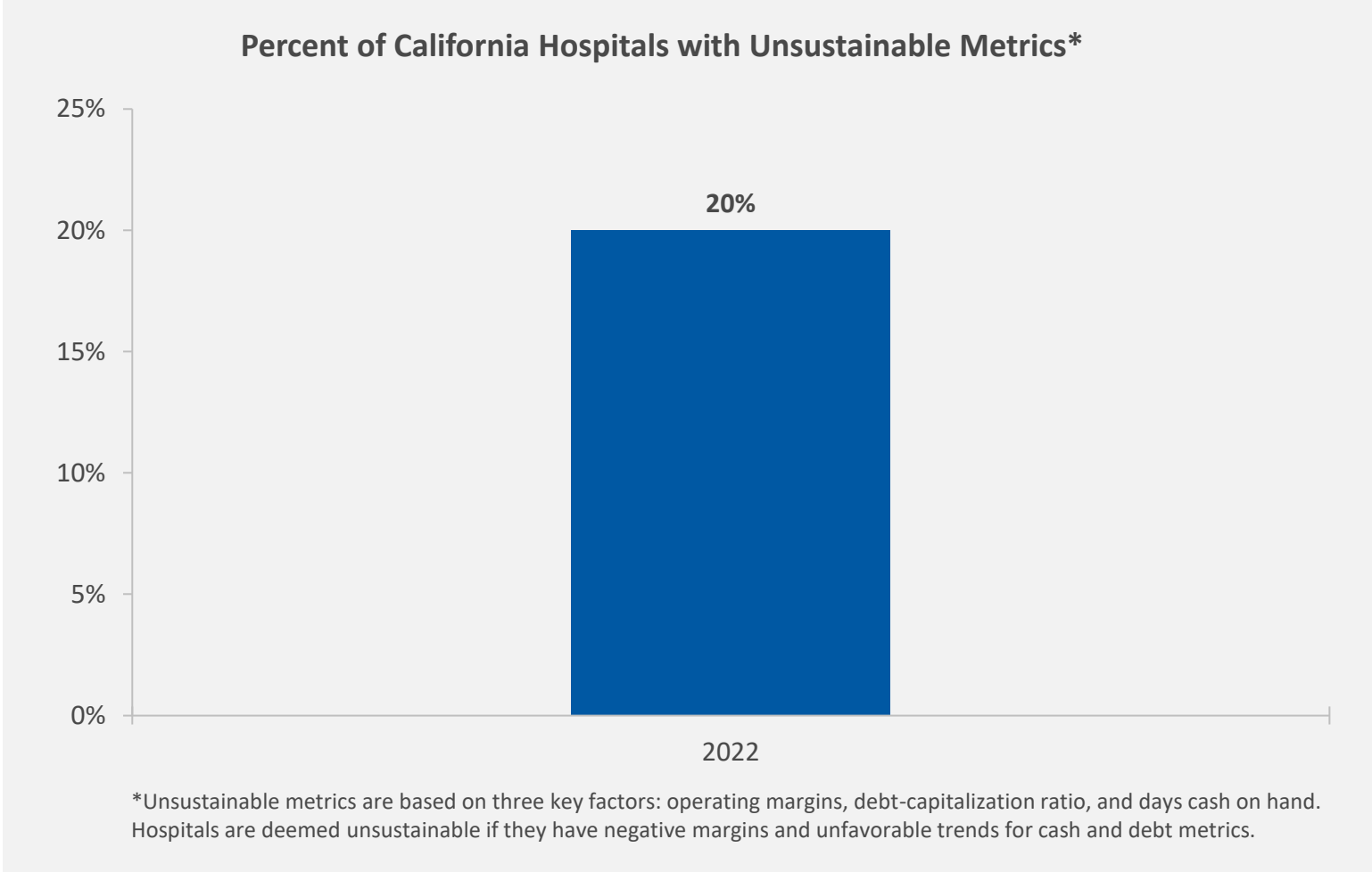


Source(s): 1) Absolute change in California hospital operating expense was produced by Kaufman Hall using data sourced from Syntellis Performance Solutions

KEY TAKEAWAYS

- The percentage of California hospitals with negative margins reached 52% in calendar year (CY) 2022.
- The percentage of low-margin California hospitals has also risen sharply since the beginning of the pandemic. More than 70% of hospitals now have margins at or below 3%.

One in Five California Hospitals Is at Risk of Closure

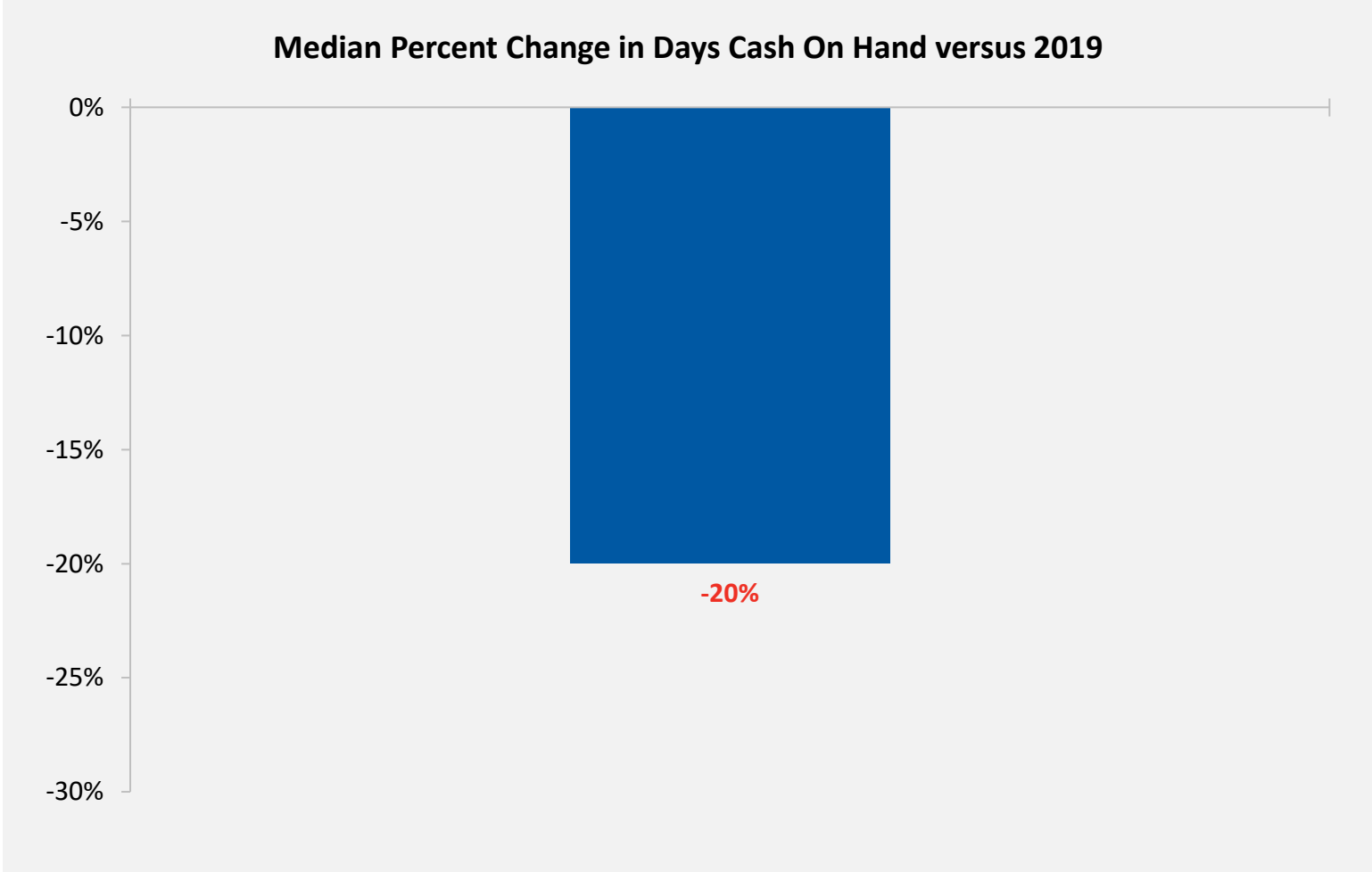


Source(s): Data was produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

KEY TAKEAWAYS

- In 2022, one in five California hospitals experienced an unsustainable combination of negative margins, decreasing cash positions, and increasing debt loads.

California Hospitals' Days Cash on Hand Fell Sharply in 2022



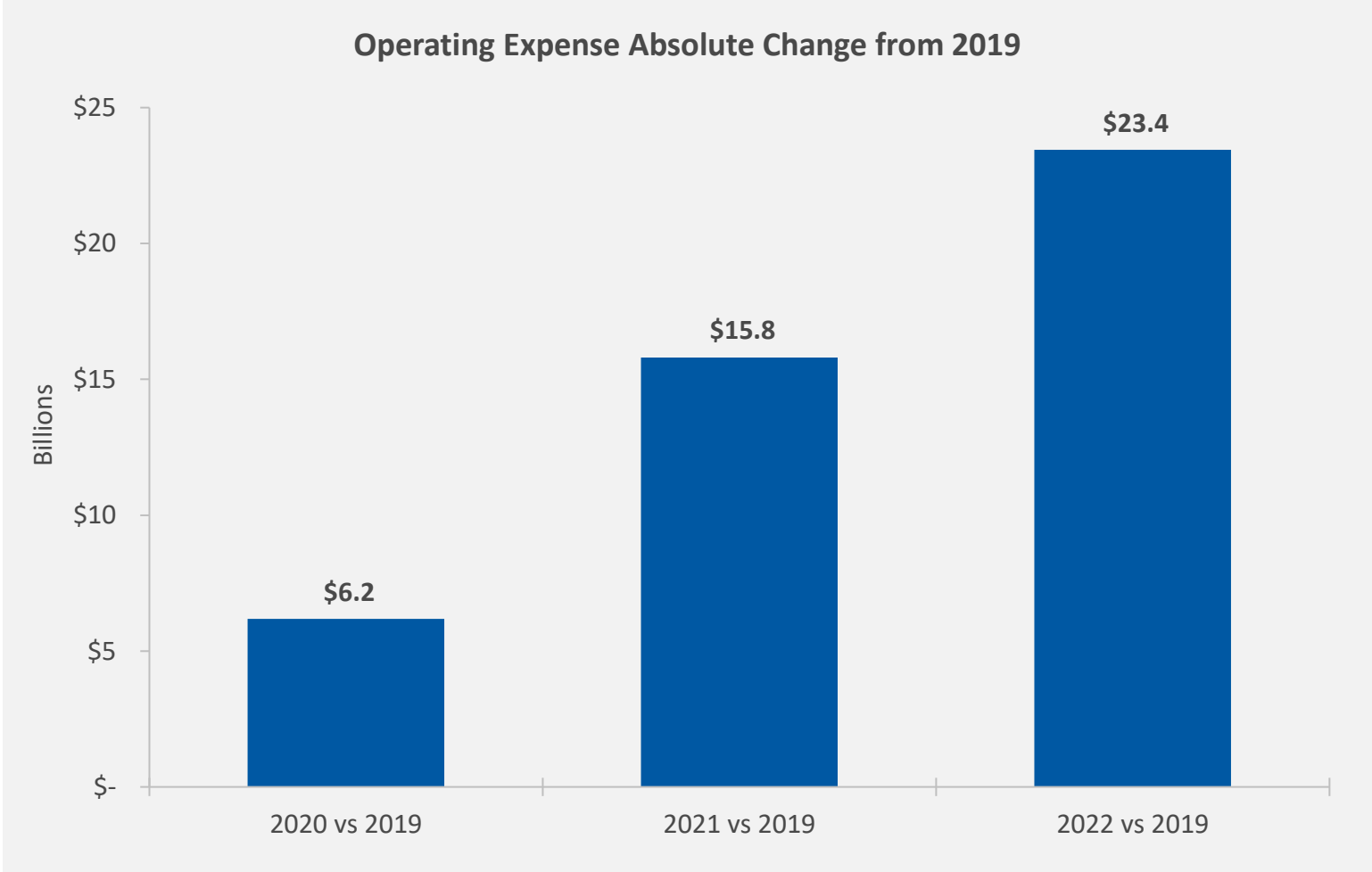
Source(s): 1) Median percent change in health system days cash on hand was produced by Kaufman Hall using data sourced from Syntellis Performance Solutions.

KEY TAKEAWAYS

- Cash balances fell sharply in 2022 as expenses outpaced revenues and many hospitals/health systems experienced negative operating margins.
- Rapid increases in expenses threaten to further decrease days of cash on hand in 2023 and beyond.

Operating Expenses

Total California Hospital Operating Expense Increased \$23.4 Billion Above Pre-Pandemic Levels in 2022

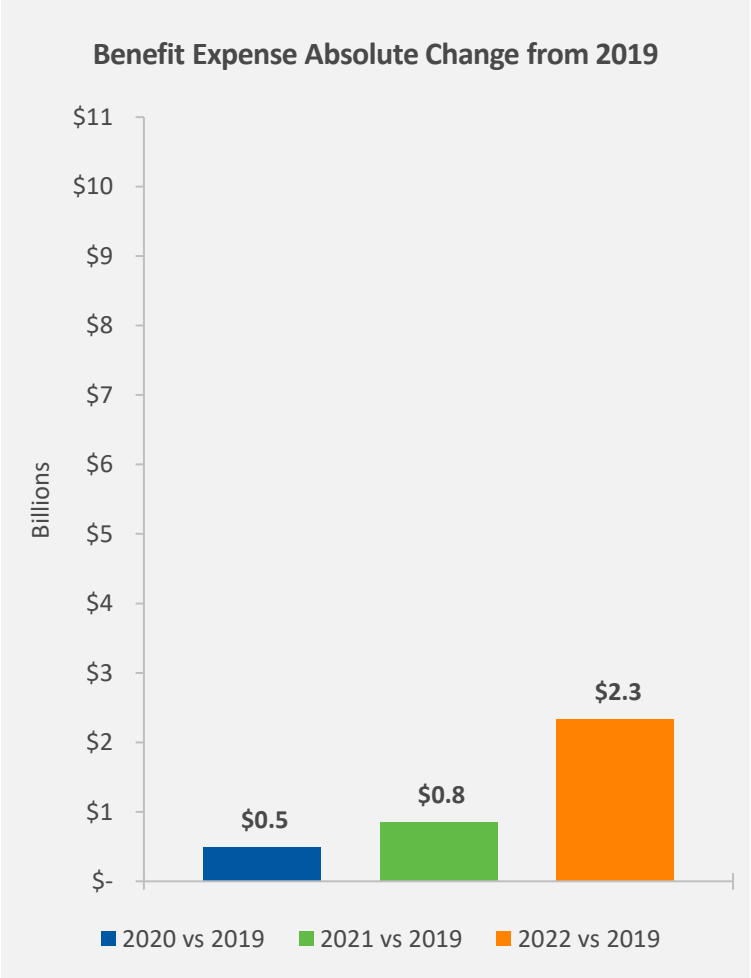
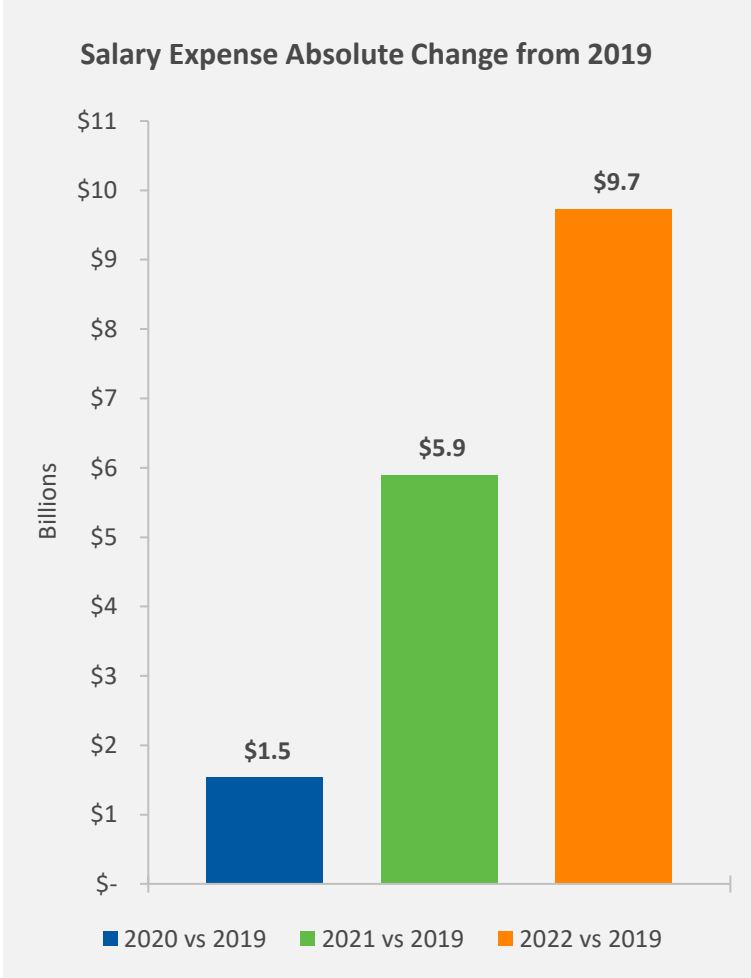


Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

KEY TAKEAWAYS

- Total hospital operating expenses have climbed significantly since the start of the pandemic, reaching \$23.4 billion above 2019 levels in 2022.
- Increasing operating expenses are driven by multiple factors, many of which are outside of hospitals' immediate direct control, including labor and supply chain costs, and drug and purchased services costs.

Rising Labor Costs: \$9.7 Billion Increase in Salary Expense in 2022 Compared to 2019

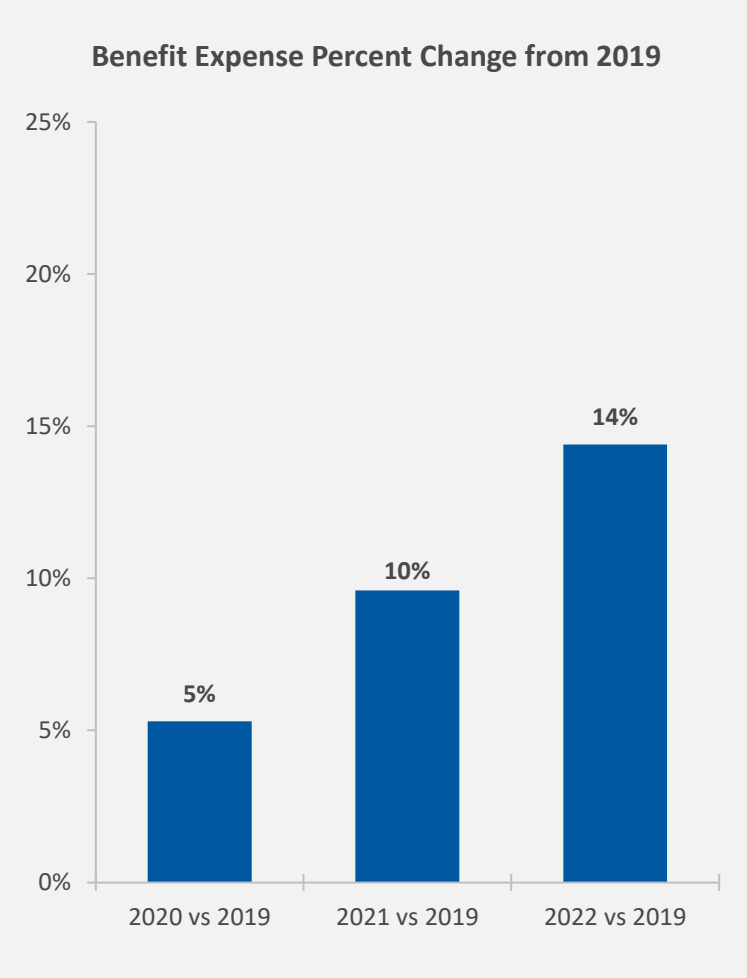
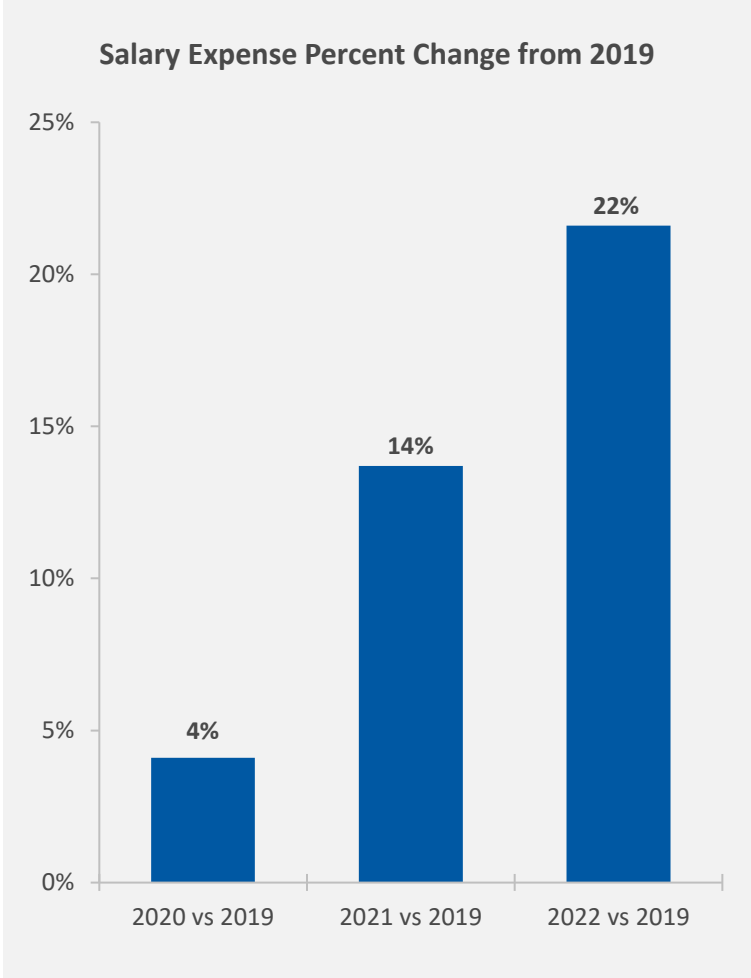


KEY TAKEAWAYS

- Salaries accounted for roughly 81% of the increase in labor expense in 2022 compared to pre-pandemic levels.
- After more modest increases in 2020 and 2021, benefits expense increases rose sharply in 2022.
- In the three years combined following the start of the pandemic, total salary expense has increased \$17.1 billion, while benefit expense has increased by \$3.6 billion.

Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

Rising Labor Costs: 22% Increase in Salary Expense in 2022 Compared to 2019

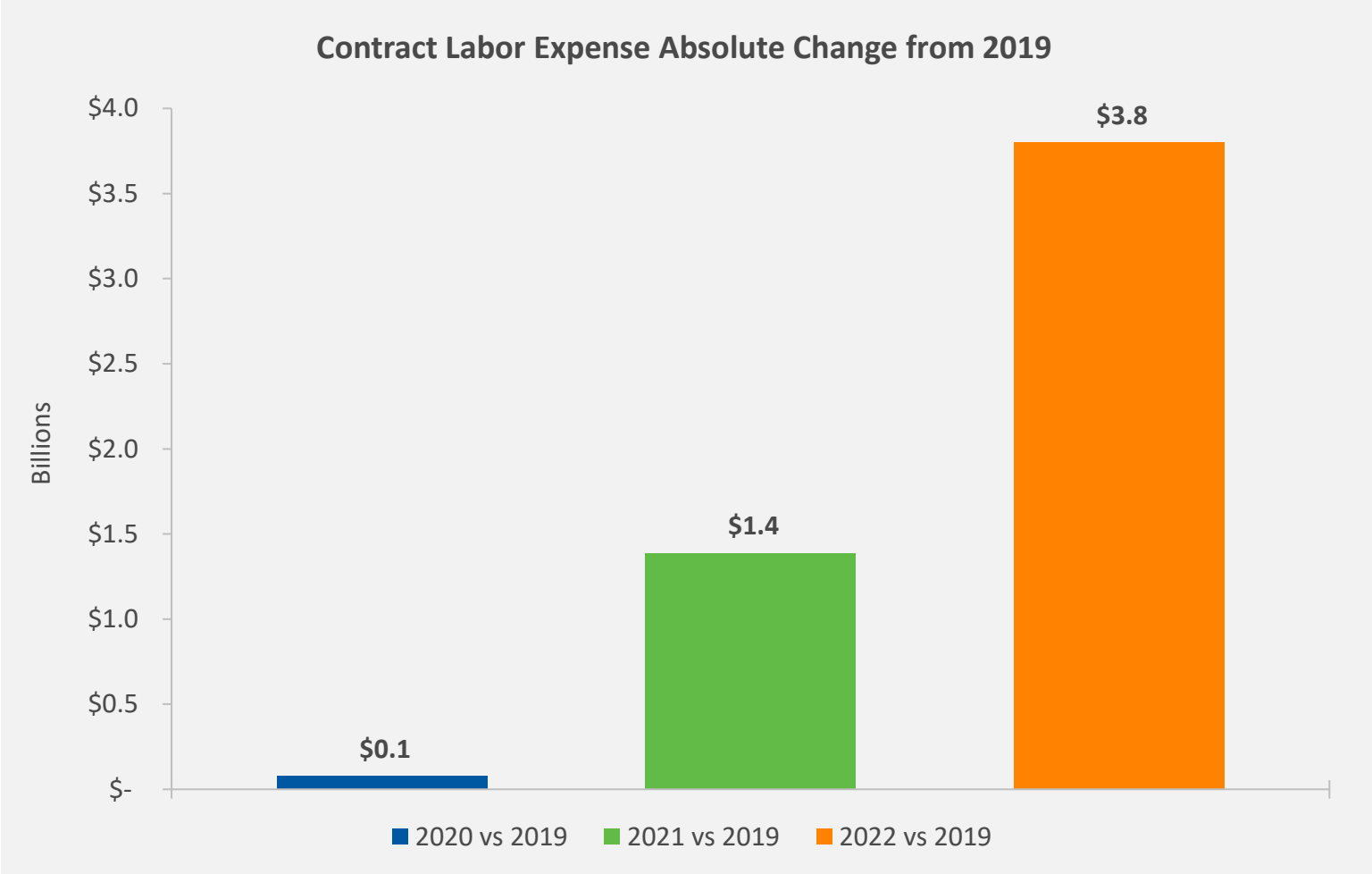


KEY TAKEAWAYS

- Both wages and benefits expenses have steadily increased for California hospitals.
- California hospitals' benefits expense increases have consistently outpaced national trends.

Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

Growing Dependence on Contract Labor: \$3.8 Billion Increase in 2022 Compared to 2019

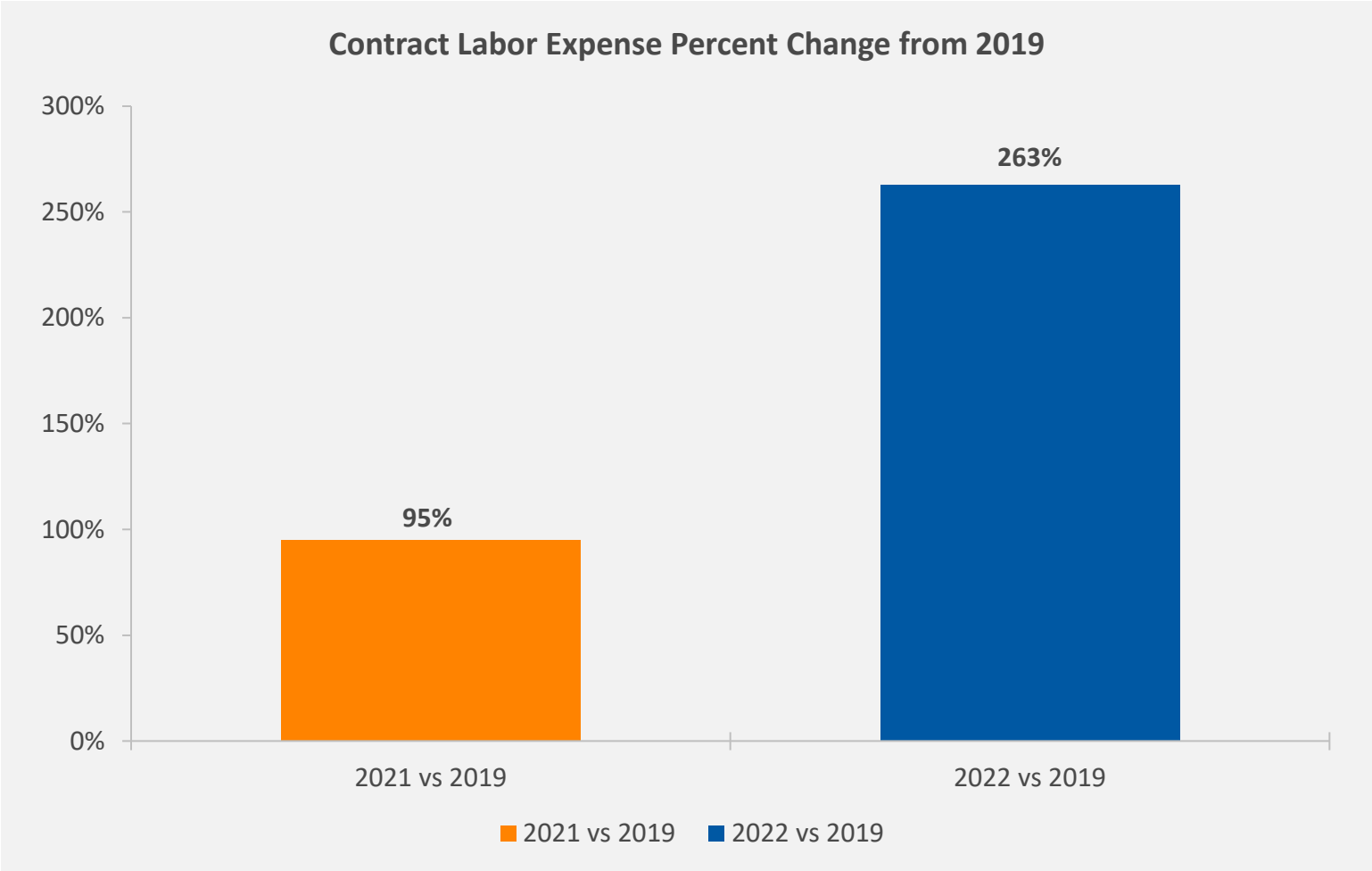


Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

KEY TAKEAWAYS

- Contract labor expenses for California hospitals have risen dramatically from pre-pandemic levels. In 2022 spending for contract labor was \$3.8 billion higher than in 2019.
- In the three years since the start of the pandemic, California hospitals have collectively spent more than \$5.3 billion more on contract labor compared to 2019 levels.

Growing Dependence on Contract Labor: 263% Increase in 2022 Compared to 2019

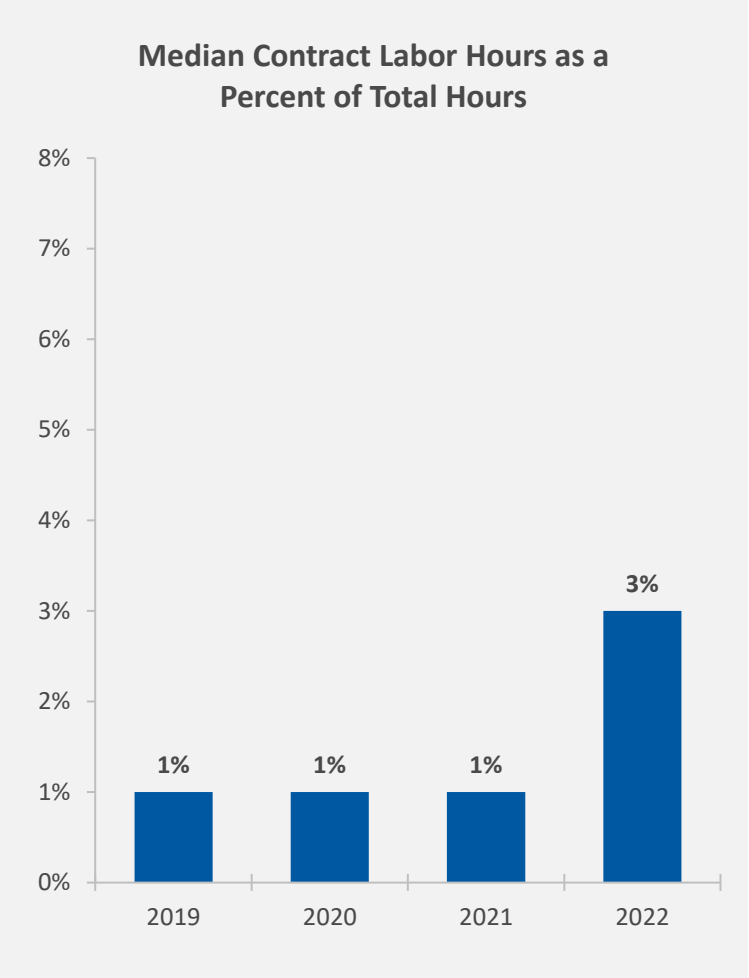
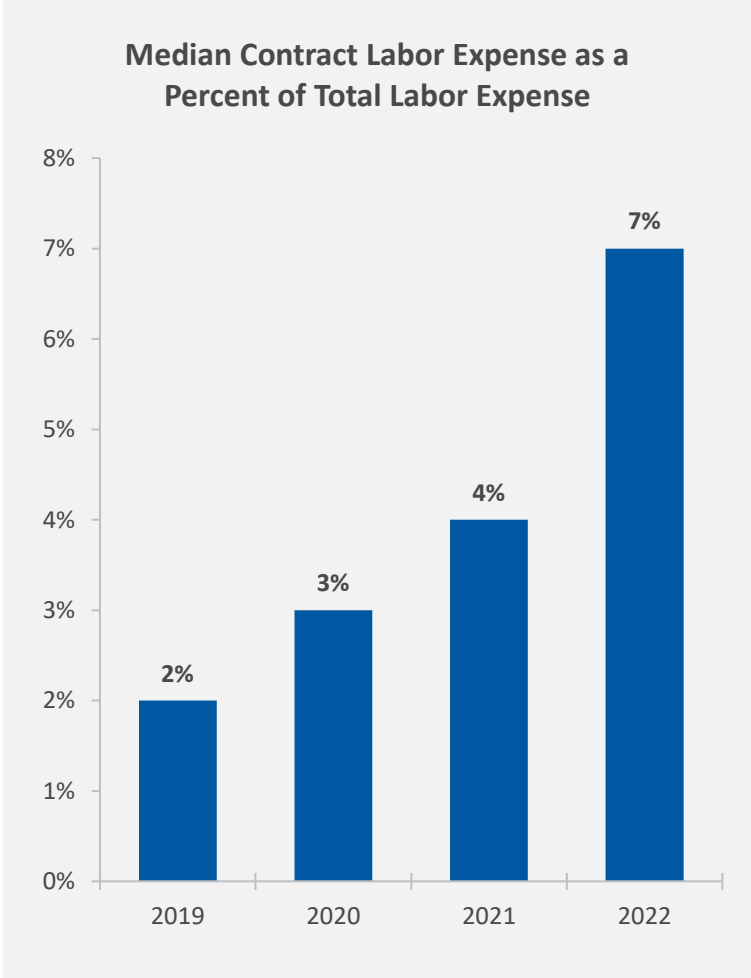


Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

KEY TAKEAWAYS

- Contract labor expenses were more than 260% higher in 2022 than in 2019—and were more than double 2021 levels.

California Hospitals' Contract Labor Expenses Comprise a Growing Proportion of Total Labor Expenses

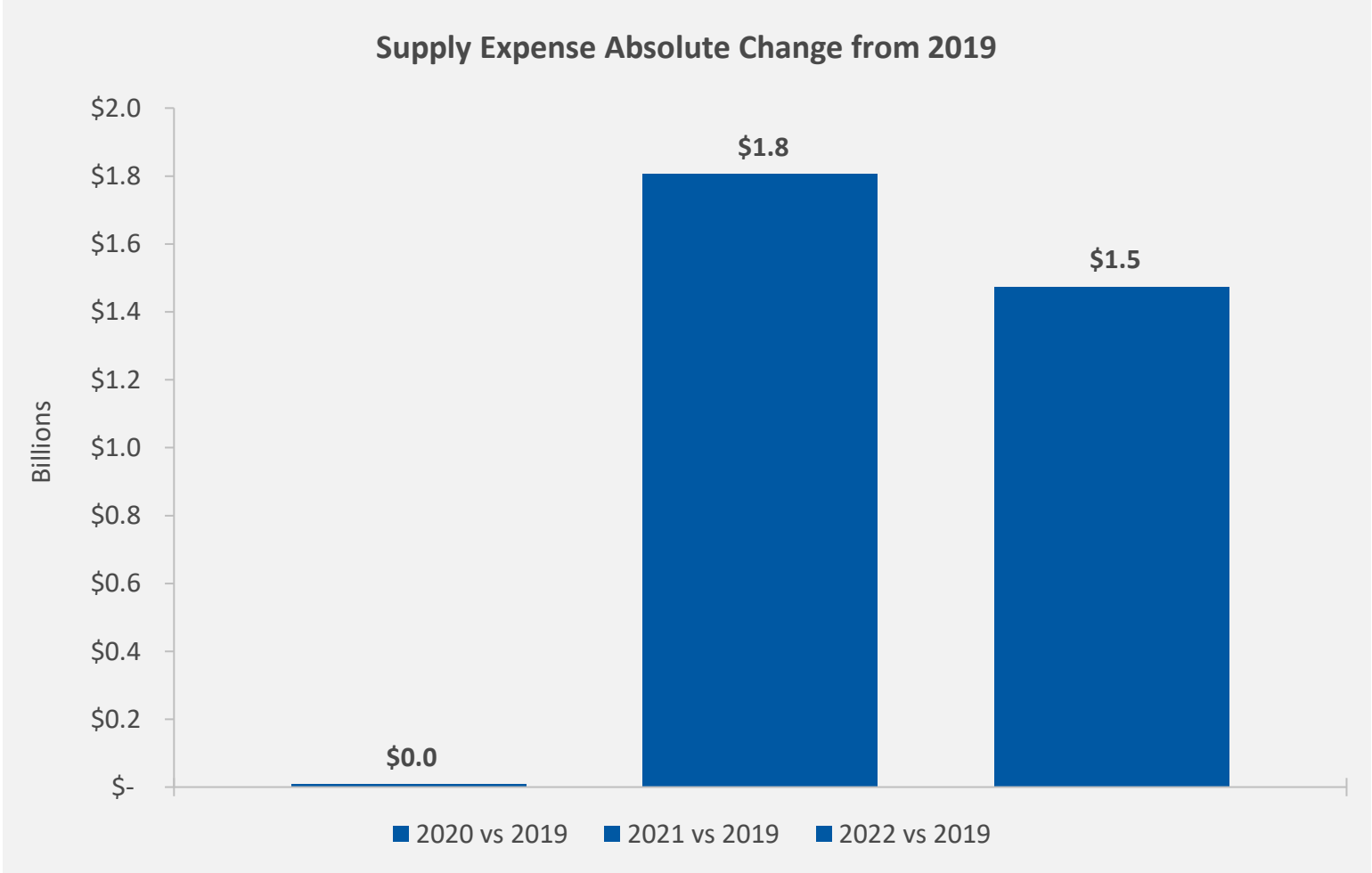


KEY TAKEAWAYS

- Median contract labor expense as a percent of total labor expense increased to 7% in 2022 for California hospitals, while median contract labor hours as a percent of total hours only increased to 3%.
- Growing increases in contract labor expense as a percent of total expense can be attributed to increases in the median contract labor wage rate, which exceeded \$132 per hour in 2022.

Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions

California Hospitals' Supply Expenses Were \$1.5 Billion Higher Than Pre-Pandemic Levels in 2022

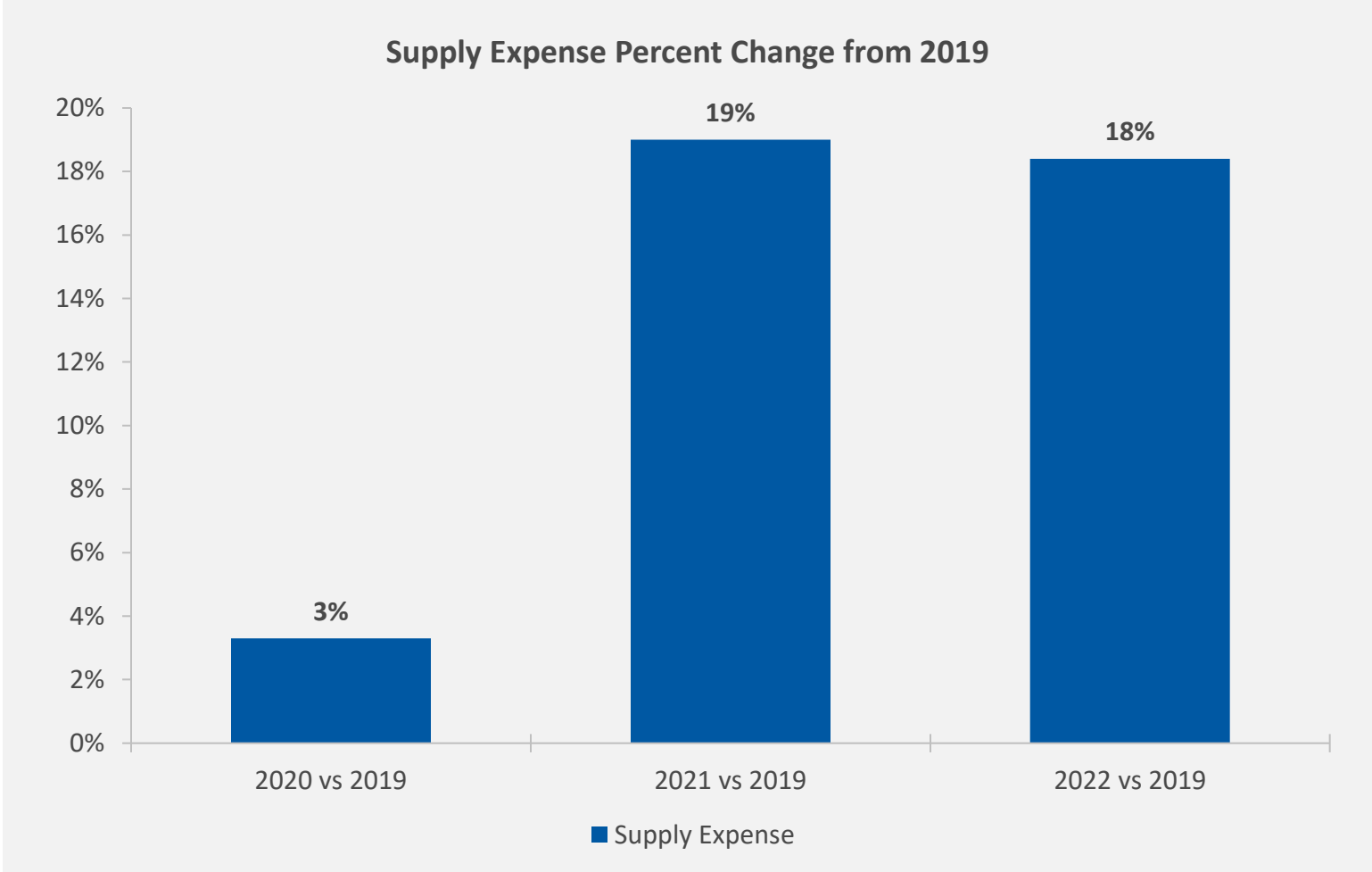


KEY TAKEAWAYS

- California hospital supply expenses increased by \$1.5 billion in 2022 compared to pre-pandemic levels.
- In the three years combined following the start of the pandemic, California hospitals have collectively spent ~\$3.3 billion more on supplies.

Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health. Note(s): Percentages represent the percent change compared to 2019.

California Hospitals' Supply Expenses Were 18% Above Pre-Pandemic Levels in 2022

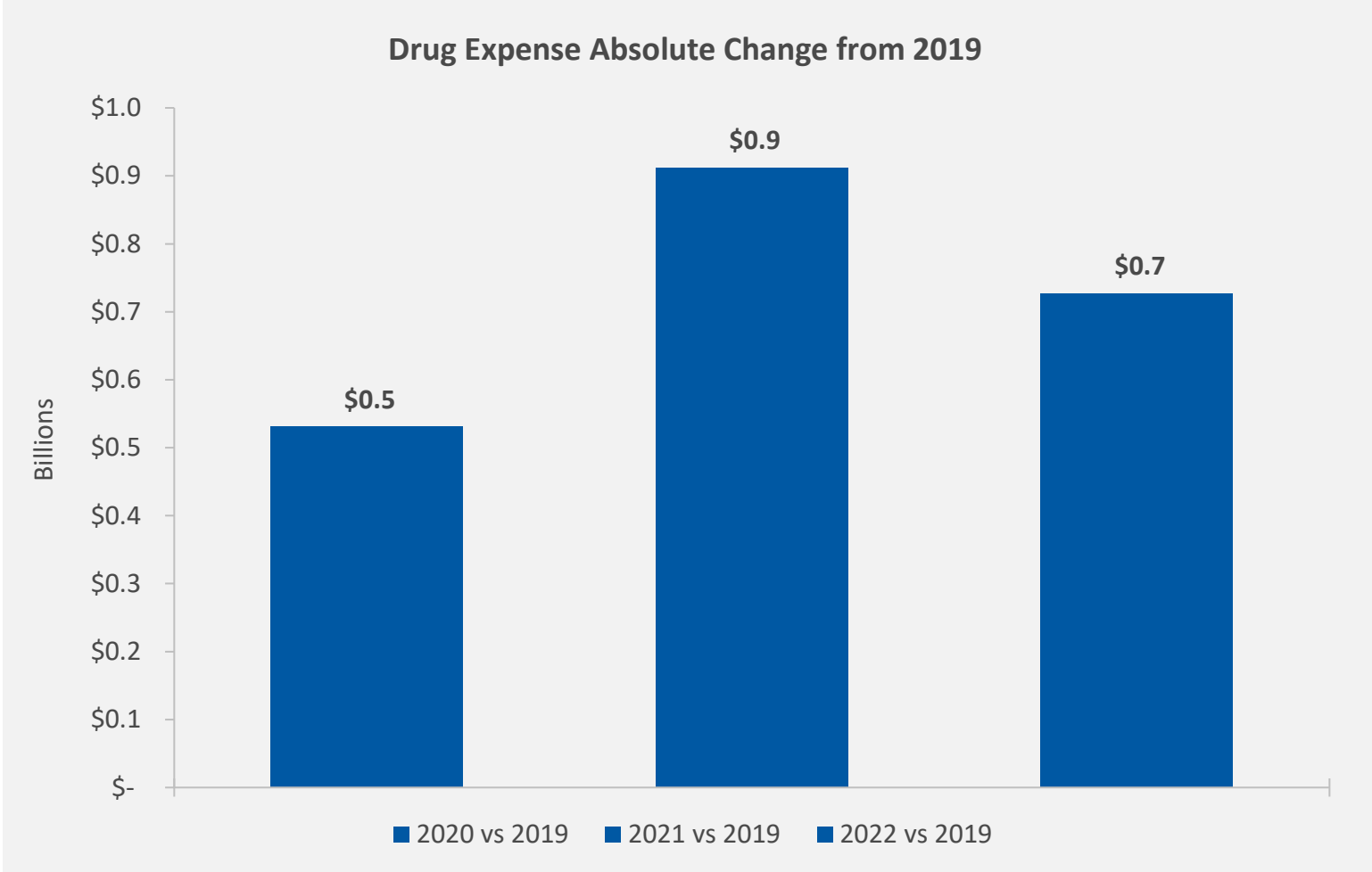


Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

KEY TAKEAWAYS

- California hospital supply expenses increased by 18% in 2022 compared to pre-pandemic levels.

California Hospitals' Drug Expenses Have Risen Dramatically Since the Onset of the Pandemic

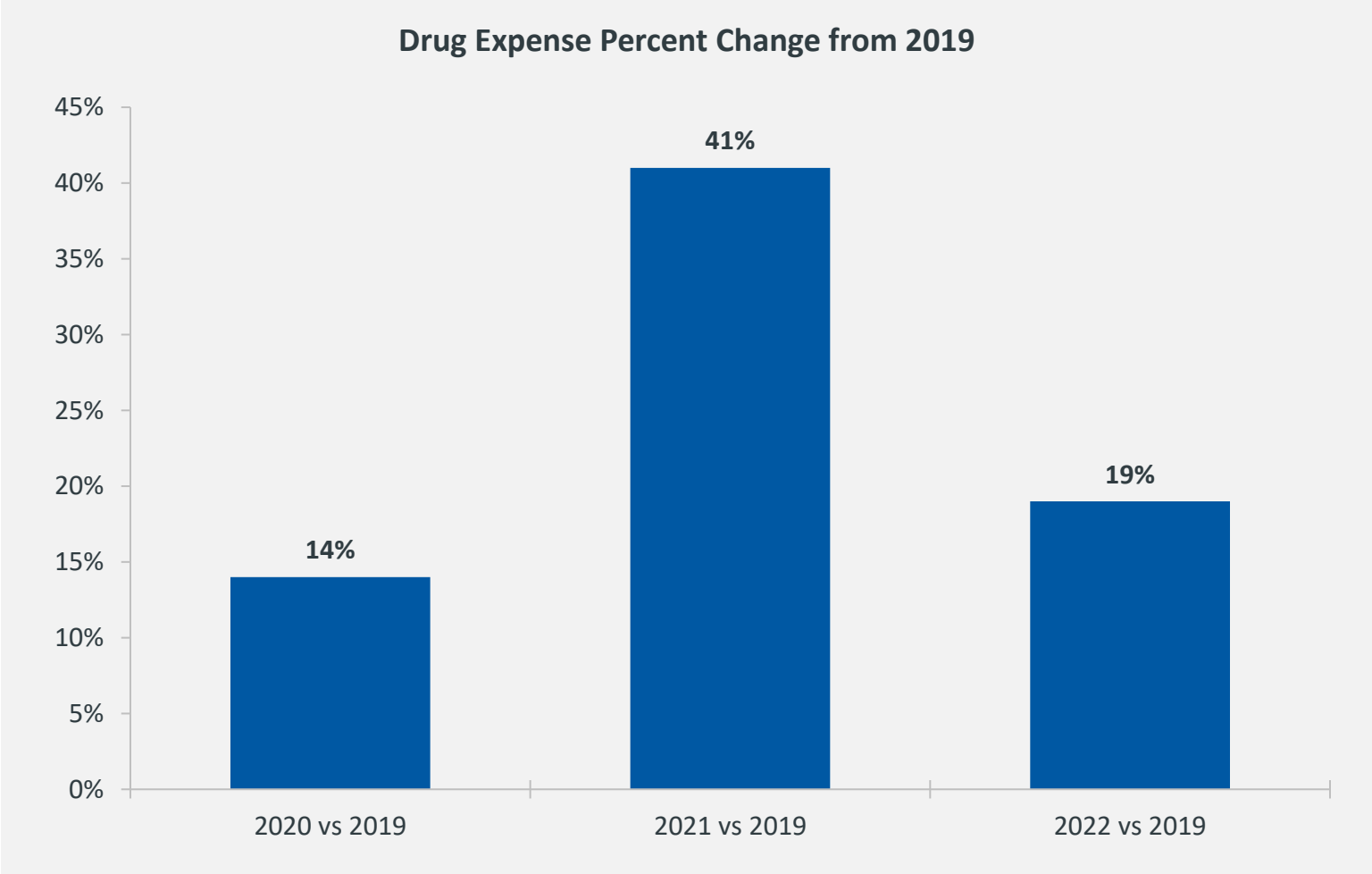


KEY TAKEAWAYS

- Drug expense increased overall for California hospitals in 2022 by roughly \$700 million over pre-pandemic levels.

Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health. Note(s): Percentages represent the percent change compared to 2019.

California Hospitals' Drug Expenses Were 19% Higher Than Pre-Pandemic Levels in 2022

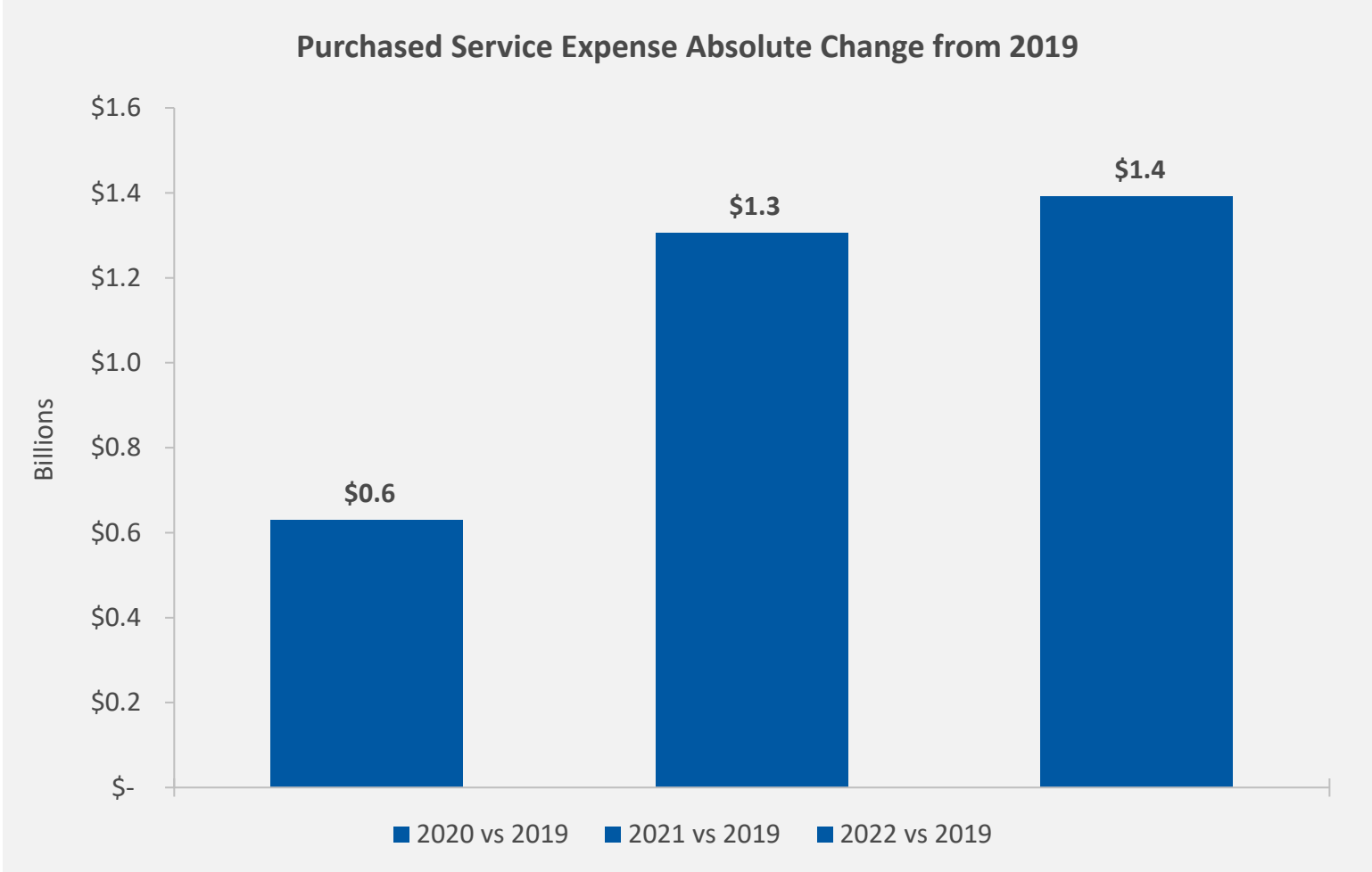


Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

KEY TAKEAWAYS

- Drug expenses for California hospitals increased by 19% compared to 2019 levels in 2022.

Purchased Service Expenses for California Hospitals Grew by \$1.4 Billion in 2022

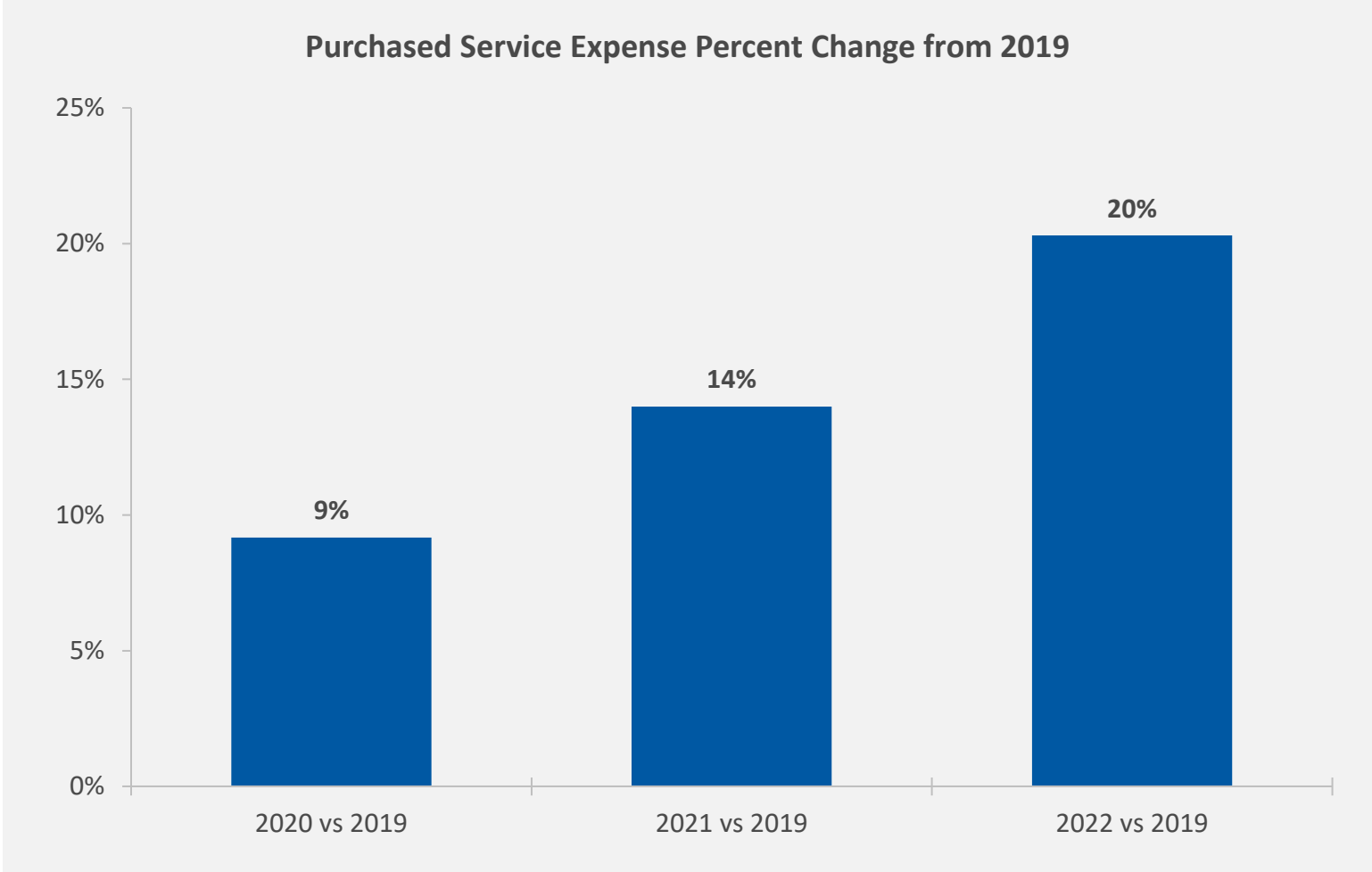


KEY TAKEAWAYS

- California hospitals' purchased service expense has risen each year since the onset of the pandemic, totaling a cumulative \$3.3 billion in the three years since 2019.

Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health. Note(s): Percentages represent the percent change compared to 2019.

California Hospitals' Purchased Service Expenses Grew 20% Above Pre-Pandemic Levels in 2022



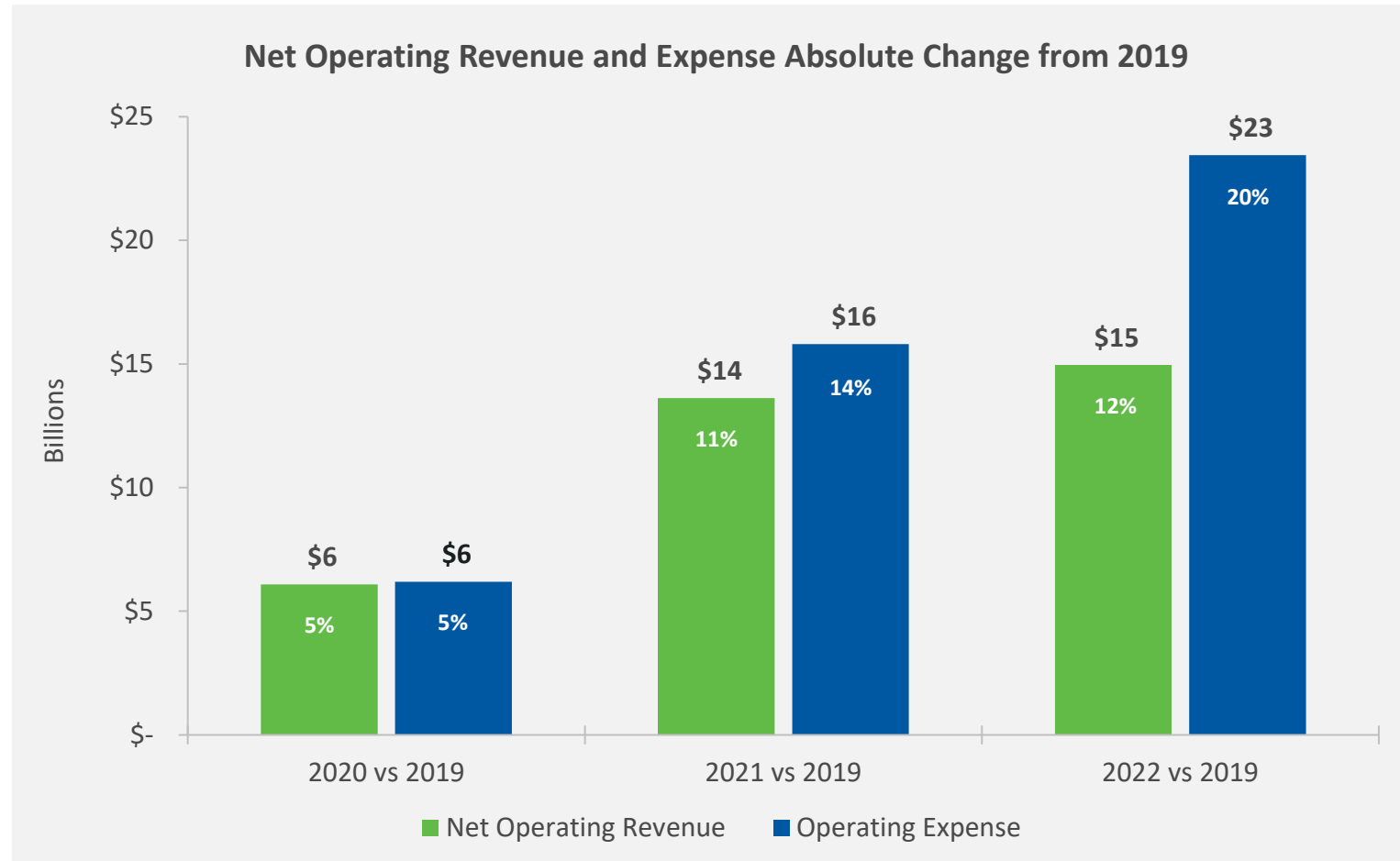
Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

KEY TAKEAWAYS

- California purchased service expenses increased by 20% compared to 2019 levels.

Operating Revenues

Expense Growth Continues to Outpace Revenue Growth



KEY TAKEAWAYS

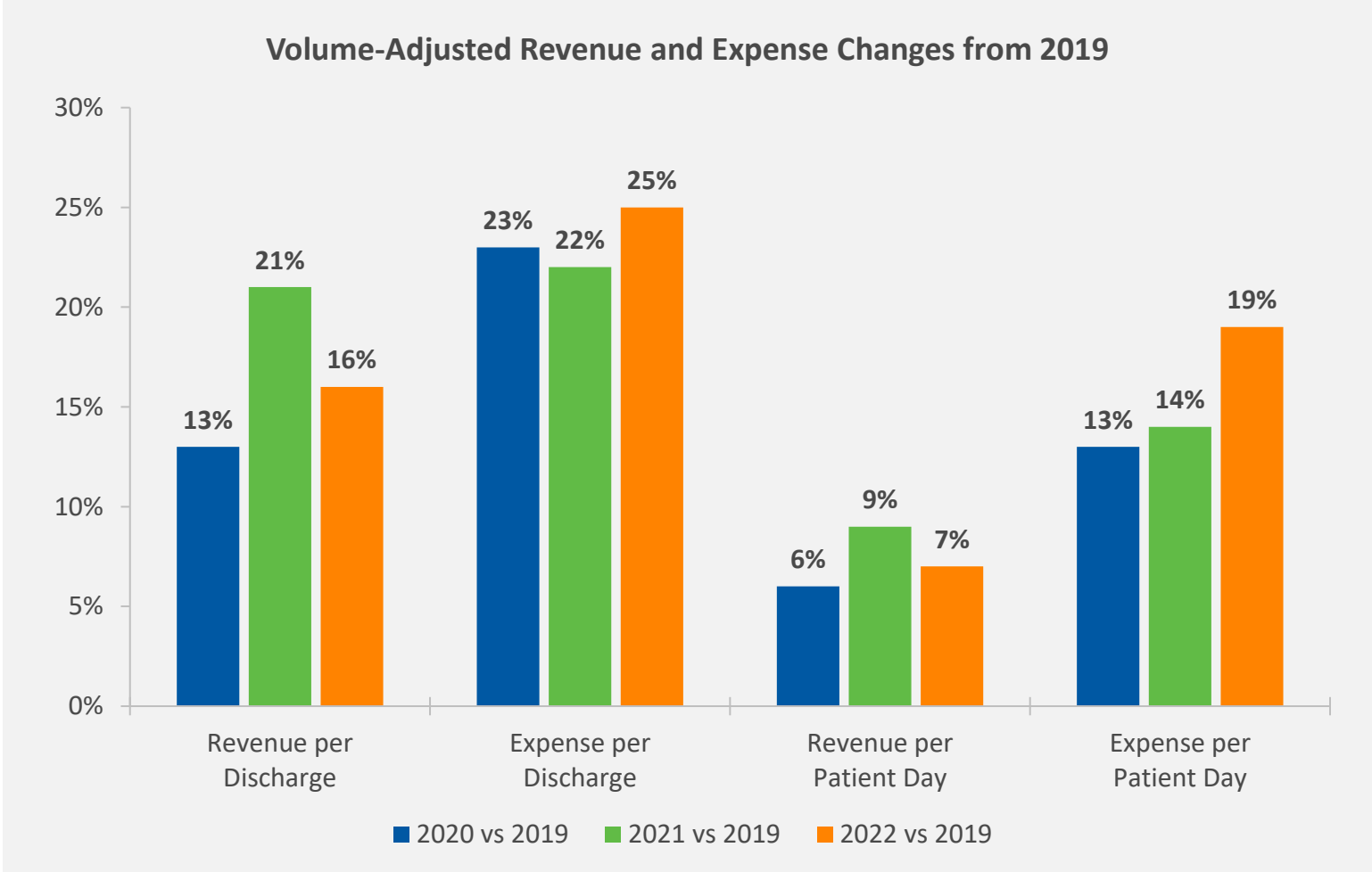
- While California hospital net operating revenues have grown since the start of the pandemic, the gap between expense and revenue increase has grown each year since the start of the pandemic.
- Payments made to California hospitals in 2020 and 2021 from the PRF contributed to the increase in hospital net operating revenues and helped hospitals cover their increasing operating expenses.

Source(s): 1) Absolute change in California hospital net operating revenue and expense were produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

Note(s): 1) Net operating revenue is calculated by taking the gross operating revenue less any deductions.

2) Percentages represent the percent change compared to 2019.

For California Hospitals, Expenses Rose More Than Revenues in 2022 on a Volume-Adjusted Basis



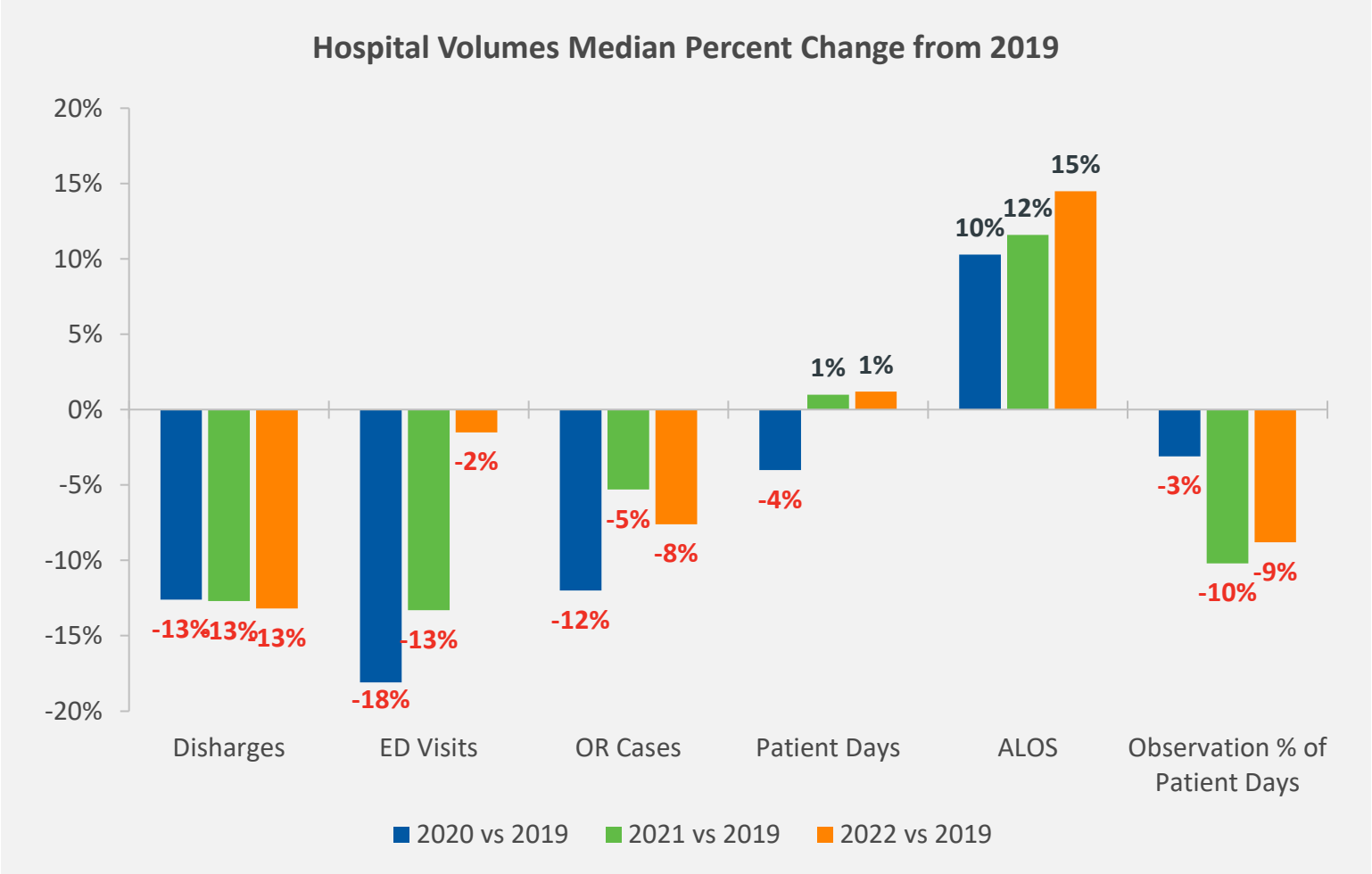
Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

KEY TAKEAWAYS

- While revenues and expenses have increased relative to pre-pandemic levels, expenses in 2022 rose more than revenues, leading to the decline in operating performance.
- Expense per discharge and expense per patient day both outpaced revenue growth due to sicker patients, and longer lengths of stay caused by post-acute care labor shortages.

Volumes

California Hospital Volumes Have Not Fully Recovered to Pre-Pandemic Levels, While Average Length of Stay Has Increased



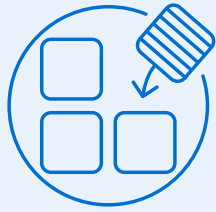
KEY TAKEAWAYS

- As care continues to shift out of the hospital, discharges and ED visits remained lower than pre-pandemic levels in 2022.
- Patient days grew despite the decrease in discharges and visits, leading to an increase in average length of stay (ALOS) and further stressing hospital finances.

Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

Methodology

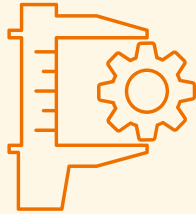
Methodology



1

Generated the Kaufman Hall Sample

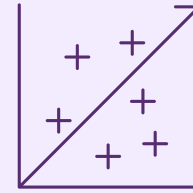
114 California hospitals were sampled from data provided by Syntellis Performance Solutions and financial survey data from the California Hospital Association in a statistically valid and representative sample.



2

Computed the 2019 Baseline

Using data from Definitive Health, the total net operating revenue and operating expense for all critical access, acute care, and children's hospitals within the state of California were calculated for 2019.



3

Calculated Median Percent Change

The median year-over-year percent change was calculated from the Kaufman Hall sample for each metric.

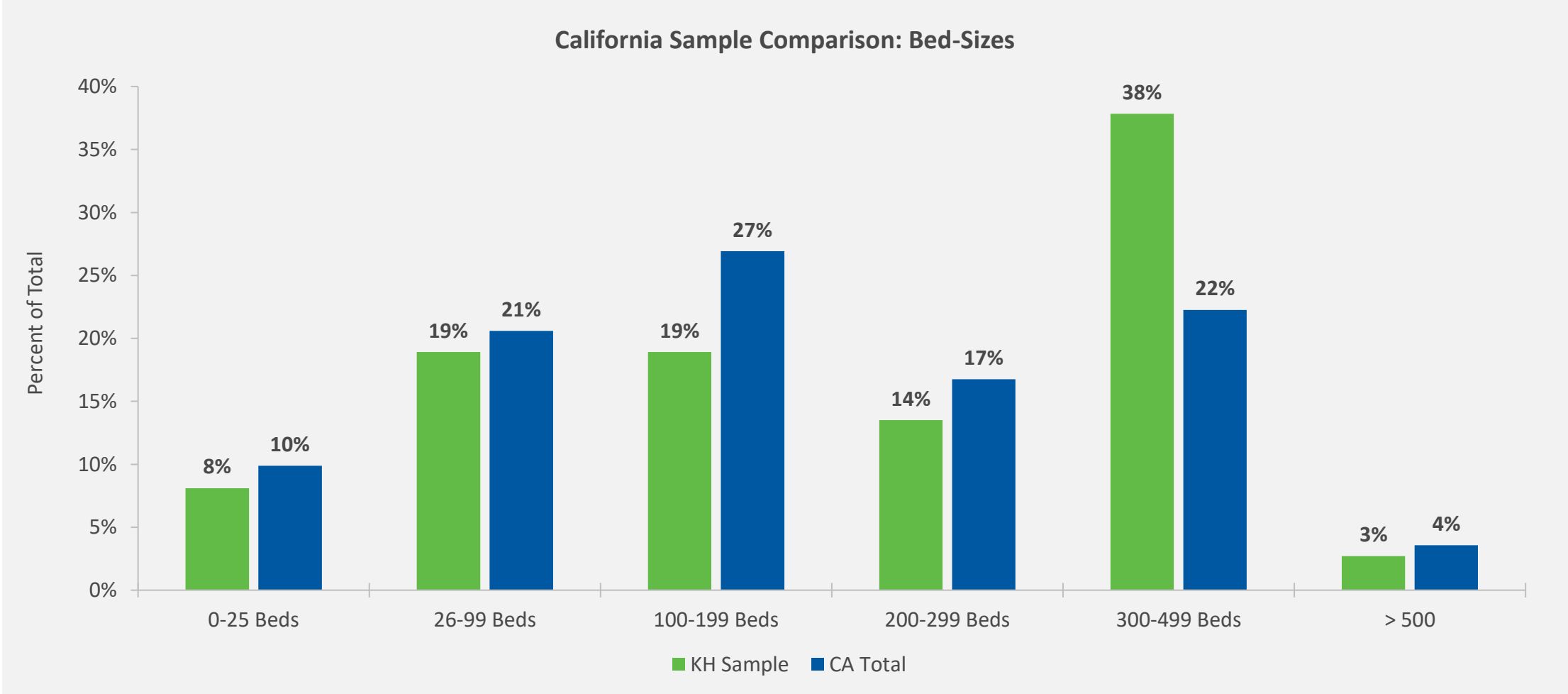


4

Extrapolated the 2020–2022 Absolute Values

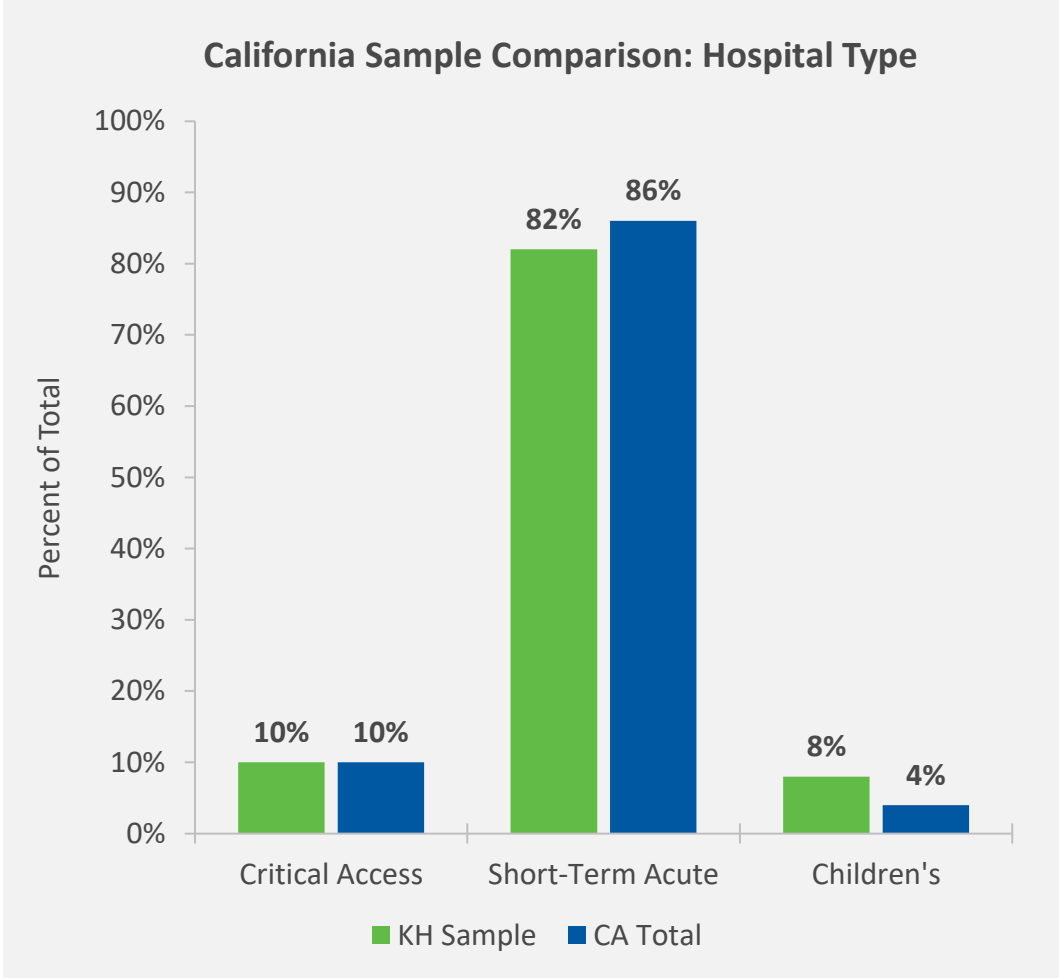
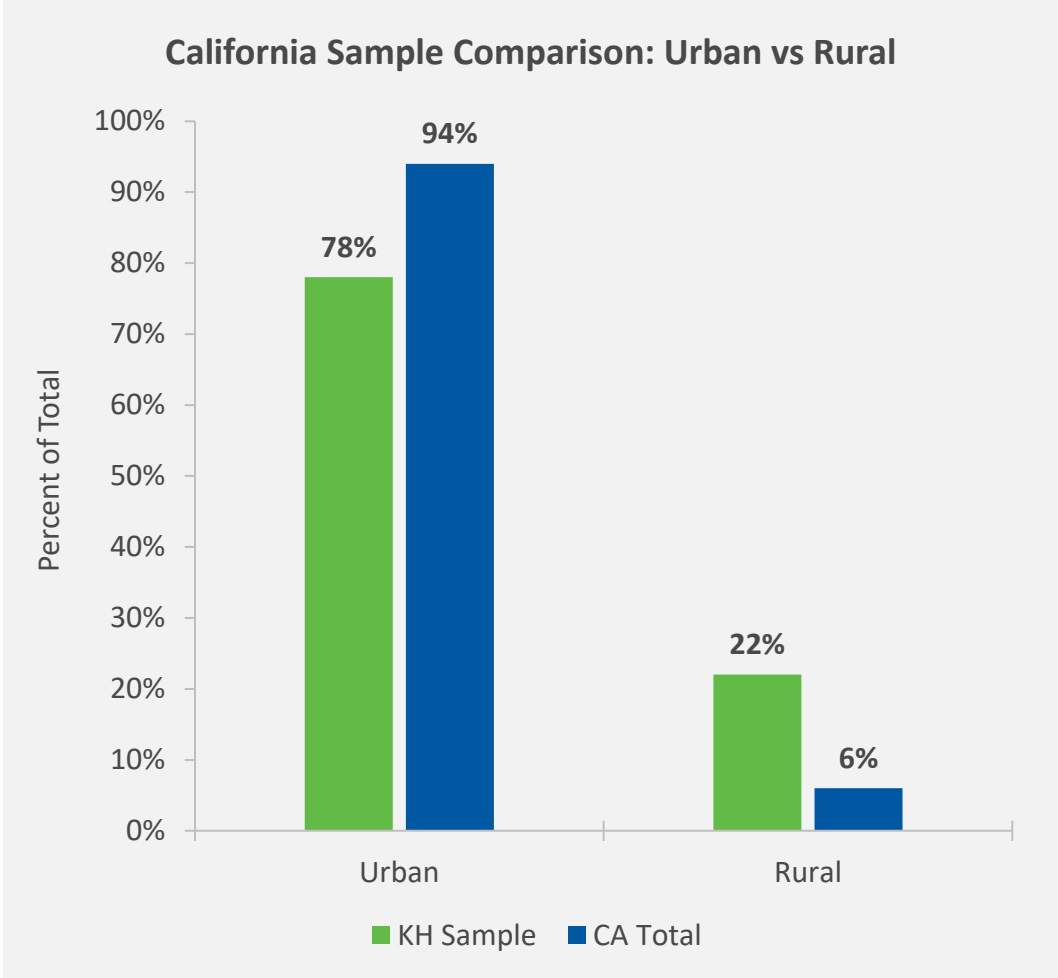
Extrapolated absolute change figures for 2020-2022 were calculated by applying the median year-over-year percent changes from the Kaufman Hall sample to the 2019 baseline metrics.

California Sample Characteristics: Bed-Size



Source(s): Findings produced by Kaufman Hall using data sourced from Syntellis Performance Solutions and Definitive Health.

California Sample Characteristics *(continued)*



Source(s): 1) Hospital counts for the "California Total" were pulled from Definitive Health

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

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