The Supreme Court’s recent ruling to uphold the key components of the 2010 Patient Protection and Affordable Care Act (ACA) removes a degree of uncertainty that has been hovering on the landscape of the healthcare industry in the United States. While the law is certain to face ongoing legal challenges and political roadblocks, the ACA is going to have a definite, long-lasting impact on non-profit healthcare providers and associated industries. Healthcare organizations face a unique and wide-ranging set of investment challenges as a result of this legislation, from payment and reimbursement reform to changing delivery system methods aimed at rewarding value over volume.

**ACA Impact on Credit Outlooks**
S&P, Moody’s, and Fitch expect the ruling to have minimal short-term effect on the financial stability of hospitals. As healthcare organizations consider the potential long-term financial impact of the ACA on their organization, they can take some solace in the fact that the rating agencies see little to no short-term impact on credit. The neutral outlook is for the most part a result of proactive measures taken by hospitals in anticipation of the reform.

However, from the perspective of all three major credit rating agencies, the long-term financial outlook for the industry remains generally negative. The changes mandated as a result of the ACA will force non-profit healthcare providers to build and implement financial strategies aligned with growing and protecting the organization’s financial profile. A key to successfully managing these changes and maintaining organizational financial strength will be the prudent and strategic management of the health system’s balance sheet and unrestricted or board-designated investment pool.

**Three Trends Shaping Investment Management**
Although financial planning and budgeting has historically been difficult for non-profit providers, the financial crisis of 2008 and the passage of the ACA have increased the challenges associated with this task tremendously. Below are three trends that could continue to shape investment decisions for non-profit providers throughout the course of the implementation of the ACA.

1. **Cash Retention and Liquidity Levels** – As hospitals continue to face the ongoing impacts of the recent recession and the upcoming changes on operational and reimbursement structures, the development of a strategically-conceived, long-term investment strategy has proven difficult for many providers. Over the past few years, many hospitals have maintained large cash reserves and liquidity positions within their investment portfolios in an effort to partially accommodate unforeseen expenditure.

The views of the three major credit rating agencies on the long-term impact the ACA will have on non-profit providers:

**Standard & Poor’s (S&P)**
S&P questions the sustainability of the financial cushions built as part of recent cost containment efforts, benefits from M&A activity, and reform readiness initiatives. S&P feels this represents the top of the current credit cycle and that credit quality and ratings will be negatively affected as early as 2013.

**Moody’s**
Moody’s projects reform to be a credit negative because of lower reimbursements, changes to payment and reimbursement models, and penalties for high readmission rates. Moody’s notes some credit positive reform components that should reduce the amount of uncompensated care.

**Fitch**
Potential credit negatives associated with the law include Medicare reimbursement reductions and compressed operating margins. Anticipated overall utilization increases and a decrease in uncompensated care will be long-term credit positives.
requirements that may arise from the ACA. Hospitals with a strong market share and favorable demographics are less likely to feel a major financial impact of reform and, as a result, have exhibited less risk aversion within their investment portfolios over the past several years. These trends are likely to continue until the full impact of the ACA permeates the system. As the impact becomes more tangible, providers are expected to forecast future operations and investment strategies with greater certainty and alleviate the need to maintain current levels of cash on hand.

2. Anticipated Expenditures and Capital Planning – Over the past few years, in conjunction to preparing for the changes required by the ACA, healthcare organizations have faced a financial crisis, ongoing volatile investment markets, a decrease in utilization, and an increase in bad debt. New municipal debt issuance has been decreasing annually since the 2008 failure of the auction rate securities market (although commercial bank facilities have increased). According to a recent survey by Fitch, only 39% of hospitals anticipated issuing new money debt in the next two years; however, 55% of hospitals anticipated refunding existing debt in the near term. The demand for capital is expected to increase over time as a result of muted capital spending, an increasingly expensive aging population, information technology costs mandated by reform, and the aforementioned pressures on profitability. Finance executives will be increasingly faced with having to decide whether to use inexpensive debt or withdrawals from the unrestricted investment pool to finance upcoming expenditures. This requires a stringent focus on investment strategies that are well-aligned with organizational CAPEX plans.

3. Mergers and Acquisitions – Merger and acquisition (M&A) activity within the non-profit healthcare sector has increased over the past several years as the need to generate size and scale has become increasingly important. Data released earlier this year revealed 86 hospital M&A transactions in 2011 – the highest record for the past decade. Generally speaking, providers with greater size and scale are expected to have better access to credit, and mergers provide hospitals with a logical opportunity to gain access to a broader range of affordable capital. Non-profit providers considering acquiring or merging with another hospital or health system should review the full scope of the proposed transaction, including anticipated cash and liquidity needs and the projected synergies of the combined organizations.

Conclusion
While the implications of the ACA are yet to be fully realized, health systems and hospitals have done well in positioning their finances in anticipation for the unknown. In the short-term, healthcare executives and investment committees will continue to operate in a changing and uncertain environment and will be faced with decisions surrounding the most efficient way to finance upcoming expenditures that are aligned with CAPEX plans and organizational finances. Leadership teams must continue to strive to anticipate the likely implications of the legislation on their organizations, and account for these issues when crafting investment strategies and setting investment policy risk thresholds. Portfolio risk should be evaluated not only by understanding the absolute risks associated with investments (standard deviation of expected returns, value at risk, etc.), but also in the context of how investment performance can impact the overall financial profile and credit worthiness of the hospital. As the financial implications of the ACA become better known over the long-term, financial planning capabilities will increase, allowing for improved accuracy in aligning investment management strategies with overall organizational finances and goals.

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