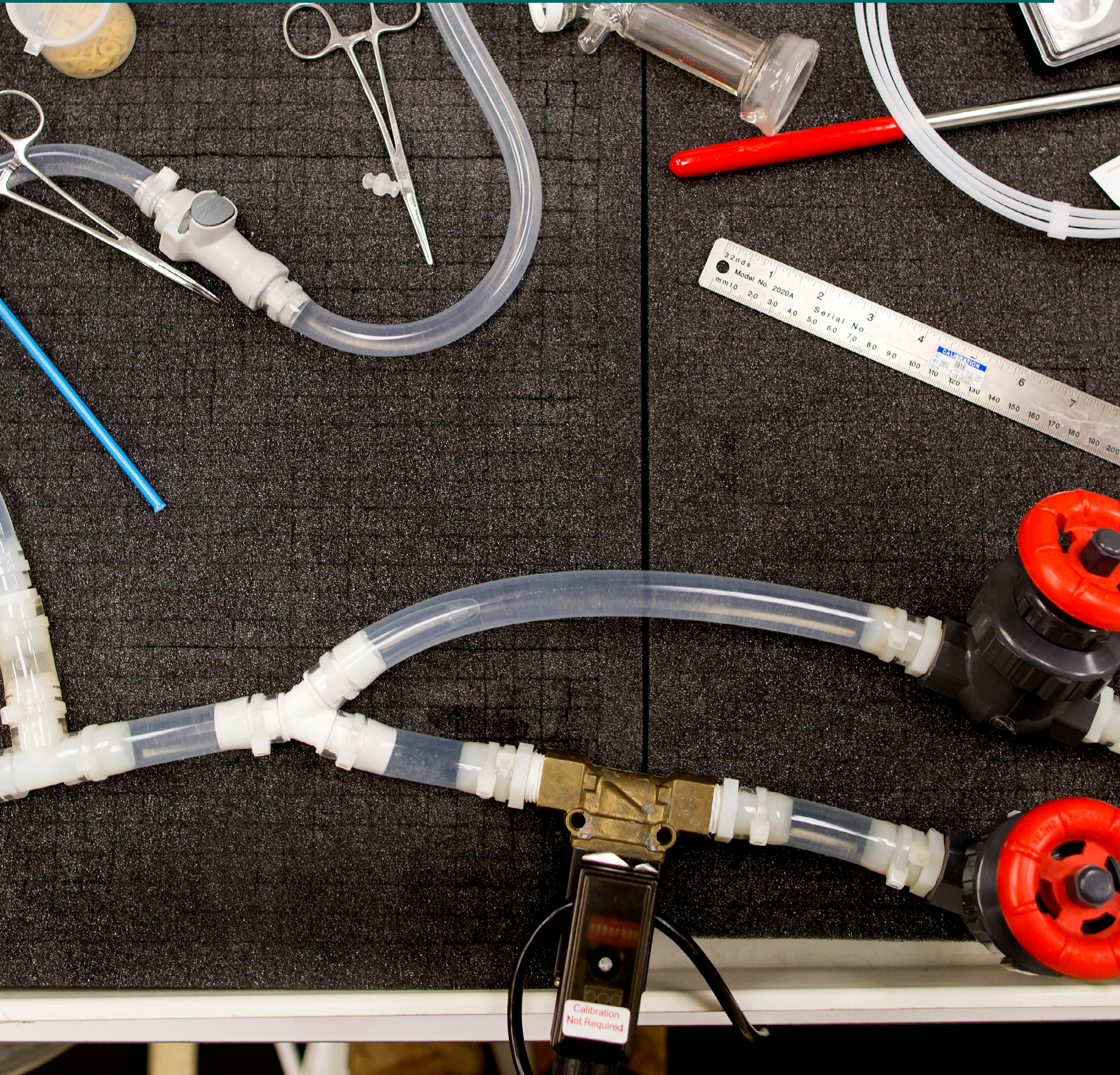




INDUSTRY INSIDER HEALTHCARE

INDUSTRY REPORT

2022



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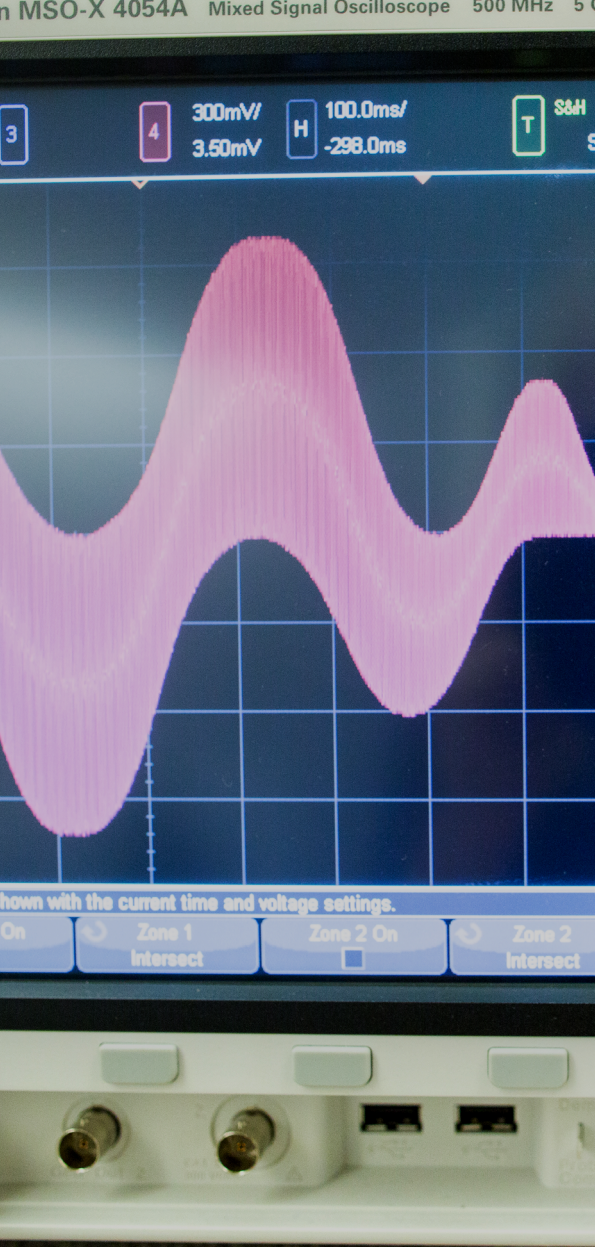
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EXECUTIVE SUMMARY

August 2022

The Sonoma County Economic Development Board (EDB), in partnership with the Sonoma County Workforce Investment Board (WIB), is pleased to present the *2022 Healthcare Industry Insider* report. Our research partner, Moody's Analytics, provided the research for this report.

HIGHLIGHTS



For the five years prior to the pandemic, Sonoma County's healthcare industry outpaced the overall labor market in job growth. Although the healthcare industry fared well in comparison to other industries, with employment falling only 9% in comparison to 19% across all industries, it still struggles to recover. Healthcare providers are having trouble filling open positions. The labor shortages are especially noticeable for nursing homes. Additionally, as the senior population in Sonoma County expands, demand for healthcare will increase. Sonoma continues to provide a high quality of care. Sonoma county consistently ranks in the top 10 counties for patient health and well-being among 58 ranked counties in California.



Policy changes coming out of the pandemic helped to ease the burden for the healthcare industry and bode well for Sonoma County's healthcare outlook. The enhanced federal medical assistance percentage spending helped limit damages to hospital's bottom lines. The American Rescue Plan Act increased credits that make healthcare coverage more affordable by lowering premiums. These tax credits are set to expire at the end of the year, and whether they are extended or not remains to be seen. Medical costs continue to rise. Workplaces are investing more into wellness programs to improve workers' health and reduce insurance claims. Additionally, local wellness centers are prospering as holistic care gains popularity.



Consolidation of hospitals into regional networks will help to reduce operating costs. More than two-thirds of Sonoma County hospitals have joined or are joining a regional network. While operating costs will likely decline modestly this year, they will remain above historic levels. Electronic record keeping and a gradual switch to per-procedure payments will help hospitals be more cost effective. Despite federal help during the pandemic, California's hospitals reported cumulative losses of around \$15 billion in 2020. In 2021, statewide losses were reported at around \$3.7 billion, after accounting for help from federal funding. Hospitals' profit margins should continue to improve as we ease out of the pandemic and consumers release pent up demand.

Thank you for your interest in the Economic Development Board's research. For additional information, questions, comments, or suggestions please contact us at (707) 565-7170 or visit www.sonomaedb.org.

Recent Performance. Sonoma County's healthcare industry is forging an uneven road to recovery following the abatement of the COVID-19 downturn. Healthcare had been a critical growth driver for the county prior to the pandemic, outpacing the overall labor market in job growth in each of the previous five years. Payrolls did hold up relatively well when nonessential business restrictions had battered the broader labor market; healthcare employment fell just 9% compared with 19% for total employment. However, the economic reopening has yet to spark a sustained recovery for Sonoma's healthcare providers. Payrolls are still down 5% compared with February 2020 and now trail the overall labor market recovery, albeit by a small margin.

Although COVID-19 case counts are climbing once again, there is evidence that this wave is causing a far smaller disruption for local hospitals than any of the previous waves. Pandemic-related hospitalizations are less than one-third of the peaks of the Delta and Omicron variants in early 2021 and 2022. Hospital bottom lines that were battered as more profitable elective surgeries and care were postponed have begun to recover.

Despite the slow recovery for employment, Sonoma is holding steady in the quality of care provided. Annual healthcare rankings by the Robert Wood Johnson Foundation placed Sonoma County eighth in the state out of 58 ranked counties, according to a health outcomes composite index measure of patient health and well-being. Sonoma has ranked in the top 10 in each of the last five years.

Macro drivers. The rapid labor market recovery provides the fundamentals that will drive service spending and hence the recovery in Sonoma County's healthcare industry. The pandemic is weighing less heavily on hiring, and the Russian invasion of Ukraine has had little impact. The sustained pace of payroll gains brings employment within around 800,000 of its pre-pandemic level, a gap that is expected to close in several months. Job gains will total about 4.5 million in 2022.

Geopolitical conflicts and inflation fears have caused an extended slide in equity prices, fanning concerns of diminished consumer spending via the wealth effect. The Standard & Poor's 500 is down 14% since December but is still up 23% from its pre-pandemic high. Even with the current selloff, investors have enjoyed double-digit

per annum returns over the past decade. Consumers have begun to draw down their excess savings from the pandemic, but an estimated \$2.5 trillion remains, equal to well more than 10% of GDP. While the bulk of healthcare spending is inelastic, excess savings may provide some extra juice to elective procedures and encourage more Americans to spend more on preventive, outpatient care and wellness centers.

The unemployment rate will fall to only 3.3% by year's end, below its pre-pandemic low, and the labor market will reach full employment in early 2023. The tight labor market will maintain upward pressure on wages, but there is evidence that many healthcare providers are still having difficulty filling open positions. Labor shortages are especially acute in nursing homes, where the latest available data report 28% of nursing facilities with at least one staffing shortage.

An expanding senior population will provide greater demand for healthcare in the years to come, both nationally and in Sonoma County. Over time, outpatient care and in-home health service providers will need to hire additional doctors, nurses and support staff to meet the needs of older residents.

Industry drivers. The continued abatement of the COVID-19 pandemic will spell a return to normal for hospitals in the county. Many residents postponed elective surgeries as hospitals reached critical capacity and care was directed toward COVID-19 treatments. These surgeries are generally more profitable, and the resumption of elective medical care, coupled with lowered costs associated with COVID-19 precautions, is providing a pathway toward repairing hospital balance sheets.

Numerous policy changes in the wake of the pandemic also bode well for the near-term outlook for Sonoma healthcare providers. One of the most significant elements of the COVID-19 relief programs is the enhanced federal medical assistance percentage spending. FMAP rates dictate how states and the federal government share the cost of Medicaid and other social assistance programs. The rates are adjusted depending on a state's average per capita income. The federal government's FMAP share was increased by 6.2 percentage points for all states. This has limited further damage to hospitals' bottom lines.

Medicaid enrollment could decline substantially moving into fiscal 2023 following

the end of the public health emergency and continuous enrollment requirement. State Medicaid directors expect a decline of anywhere from 5% to 13%. State Medicaid spending is still expected to increase assuming the public emergency declaration is not renewed, and the end of the enhanced federal match would mean that states are on the hook for the increase in Medicaid spending.

Covered California, the state's ACA marketplace, relies on federal tax credits to make coverage more affordable for most of its enrollees. The American Rescue Plan Act boosted enrollment in plans offered on the exchange by increasing the size of the credits, which sharply lowered premiums for enrollees, and extended financial assistance to many middle-class families. The fiscal support reduced the average monthly premium cost to Covered California enrollees by 20% this year compared with 2021, according to preliminary estimates, and the lower cost helped push enrollment to a record 1.8 million this year. These federal tax credits are set to expire at the end of the year, but there is a possibility that the ARPA subsidies will be extended longer. Furthermore, Governor Newsom has proposed that the state use a portion of its budget surplus on subsidies if the federal government does not act, but that amount would still mark a significant decline from the federal support.

Uncertainty still clouds the total impact of policy changes on rates and enrollment. Doubt over the future path of policy could prompt carriers to raise premiums to accommodate the anticipated cost of covering on- and off-exchange risk pools or exit the marketplace entirely. Regardless, the federal exchanges cover a minority of residents since most adults get health coverage through their employers.

As medical costs rise, employer-provided healthcare will grow more burdensome for patients as plans increasingly pass fees on to workers. Rising healthcare costs are eating into workers' earnings. In an effort to improve the health of their workers and reduce insurance claims, companies are increasingly investing in workplace wellness programs that promote weight management and health screenings. Though such programs have proven to be effective at advancing diet and exercise habits, the near-term benefits for health outcomes will be limited.

Local wellness facilities will prosper as holistic care grows ever more popular in the U.S.

Sonoma County is home to a constellation of treatment centers, including facilities that provide spa treatments, specialized fitness programs, and massage therapy. As holistic care grows more mainstream, county wellness centers will flourish, attracting health-conscious residents and tourists to the area.

Pricing. As hospitals increasingly consolidate, county healthcare providers will gain pricing and bargaining power relative to insurers and medical device manufacturers. More than two-thirds of hospitals in Sonoma County are either members of or have initiated talks to join broader regional networks. Greater leverage in bargaining will help county hospitals bring down operating costs.

Individual market insurers increased premiums on average by just 1.8% in 2022 compared with a year earlier. Thus far during the pandemic, individual market insurers have remained profitable and loss ratios have been low, on average, so large premium increases would have been hard to justify. That said, the range of assumptions that insurers have made about vaccine costs and availability, enrollee utilization, and general morbidity demonstrate the extent of uncertainty.

Operating expenses. Operating expenses are likely to see some modest respite this year but remain elevated by historical standards.

Labor costs accelerated rapidly in 2021, with the county-level data reporting a near 9.6% increase through the third quarter. Efficiency gains will provide relief as the transition to electronic record-keeping helps hospitals manage more caseloads. Additionally, the transition from the traditional fee-for-service model, which can lead to unnecessary testing and other services, toward per-procedure payments will help by making consumers and hospitals more cost-conscious.

Profitability. Hospital bottom lines were clobbered by the combination of postponed revenue-producing surgeries, surging costs for protective equipment, and staff shortages. According to a report by the California Hospital Association, the state's hospitals suffered cumulative losses of nearly \$15 billion in 2020, offset only partially by the \$6 billion in state funding provided through the CARES Act.

Hospital profit margins improved significantly in the last year, but 2021 was still a difficult year with significant financial strain for hospitals statewide. Statewide losses when accounting for federal funding amounted to \$3.7 billion, less than half of the total in 2020.

Profit margins at hospitals around the country will improve as the fallout from the COVID-19 pandemic wanes. County residents who have postponed revenue-producing elective surgeries are slowly releasing their pent-up demand as contagion fears and hospital capacity restraints ease. Healthcare payrolls are on the mend, signaling that hospitals are responding to increased demand. Local county healthcare payrolls sit just 6% below their pre-pandemic levels, roughly on par with the overall labor market. This stands in sharp contrast to California, where healthcare payrolls have exceeded the pre-pandemic peak, and likely owes to outright population declines in the county over the past four years.

Expanded insurance coverage will help reduce uncompensated care costs. California has seen the largest drop in its uninsured rate of all states since it expanded Medicaid coverage, with just 7% of the eligible population uninsured compared with 10% nationally through 2020, the latest data available. Secure funding for Medi-Cal should help reduce emergency care costs by extending coverage to lower-income adults and children, enabling more preventive care at lower cost.

Long-term outlook. Sonoma County's healthcare industry is emerging from the rubble created as a result of the COVID-19 pandemic. The impacts on the healthcare industry will take some time to unwind, but the industry suffered comparably less dislocation in terms of employment losses thanks to the unique circumstances of the recession.

However, the lingering pandemic, slow employment recovery, and increased economic uncertainty as inflationary concerns ratchet up have turned the outlook darker since a year ago. Still, the baseline forecast calls for the U.S. to navigate a soft landing and the recovery from the pandemic to continue with few hiccups. Hospitals will begin to rebuild payrolls, and healthcare is expected to recoup all its job losses by the end of 2024.

Moving into the medium and long term, Sonoma County's healthcare industry is set to capitalize on the boost from consumption of medical services by older residents. The area's position as a hub for holistic wellness facilities gives the local industry a leg up as residents and visitors increasingly focus on holistic health and treatment.

Even though below-average population growth in the years to come will hamper healthcare's progress, the industry will benefit greatly as the share of senior citizens in

Sonoma County rises faster than the U.S. average. The local population of residents age 65 or older has expanded by 38% since 2012, compared with 30% in California and 29% nationwide. This pace also far exceeds the miniscule increase in Sonoma's total population over the same period. By 2030, one in four individuals in Sonoma County will be at least 65 years old. Longer term, health services will expand at a moderate pace to meet the medical needs of an aging population and broader patient base.

Upside risks. Stronger-than-expected population growth would be a boon to county healthcare providers by expanding the patient pool. The proliferation of work-from-home arrangements could spur more residents from the Bay Area to relocate in Sonoma County. Specifically, more in-migration among young adults would increase demand at Sonoma County's wellness facilities. While outright population declines persisted in 2021, they have slowed in the past two years and the county is now losing residents at a slower pace than the state.

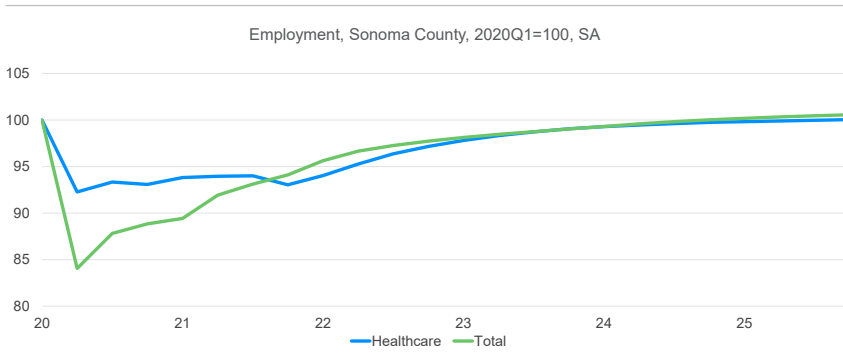
Greater demand for specialized treatments such as joint replacements and gene-based therapies would translate into stronger growth in Sonoma County's healthcare industry and pay dividends for the economy as a whole. A newly formed affiliation between Sonoma Valley Hospital and the University of California, San Francisco Medical Center will create an integrated healthcare network to better serve the needs of Sonoma Valley residents and support research in biotechnology, pharmacological treatments and medical devices.

Downside risks. The COVID-19 crisis presents several downside risks to the U.S. forecast. Hospitalizations remain low despite the sharp increase in recent months, but should they rise or a new strain take hold, it could spell difficulty for hospitals that are just beginning to show signs of life.

Housing affordability has improved since prior to the pandemic, but rapid price appreciation in the county has once again moved affordability concerns to the forefront. This has contributed to a decline in the county's population for three consecutive years. Although forecast to stabilize in the coming years, population growth could disappoint, representing a downside risk to the forecast for the healthcare industry's recovery.

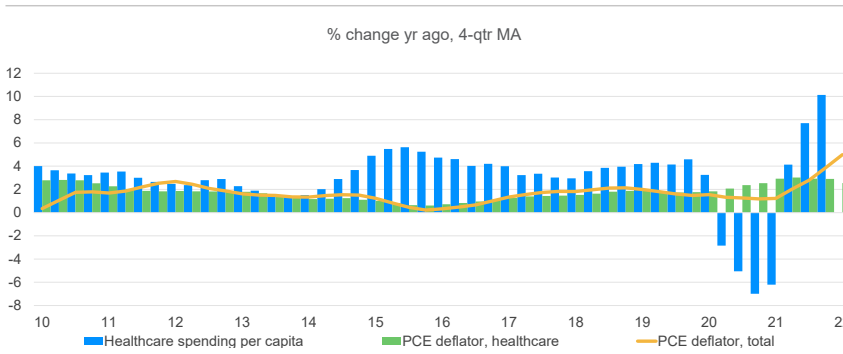
Colin Seitz
June 2022

Healthcare Employment Recovery Stalls



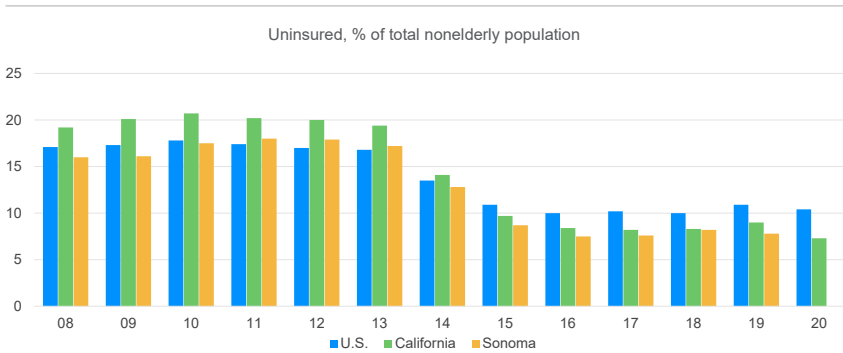
Healthcare emerged as a crucial growth driver for the Sonoma County economy prior to the pandemic-induced recession. An expanding senior population and greater insurance coverage generated robust demand for medical services. While the healthcare industry suffered a comparably smaller hit during the COVID-19 pandemic, the recovery has struggled to find another gear and now sits on par with the broader labor market recovery. Hospital balance sheets are improving and hiring will begin to accelerate over the second half of the year.

Healthcare Spending and Costs Diverge



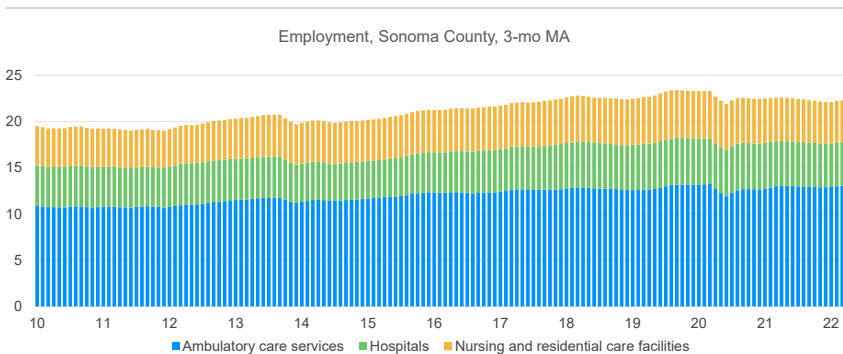
The Affordable Care Act proved to be a temporary salve for increasing healthcare costs. Healthcare costs are on the rise as price pressures intensify and cost containment proves increasingly difficult. Health insurance premiums are rising for both the individual market and employer-based coverage as insurers align premiums with expected costs amid rising outlays for medical services and prescription drugs. Favorable base effects are behind the surge in year-over-year healthcare spending, but this will remain strong as pent-up demand for elective surgeries is released.

Insurance Coverage Ranks Favorably



Health insurance coverage has progressed significantly over the last five years, and Sonoma's uninsured population ranks favorably relative to the state and national rates. Multiple expanded special enrollment periods and a swath of newly unemployed residents led to a record-breaking increase in the number of Californians who received healthcare insurance through Covered California, the state's health insurance marketplace, last year. Enrollment increased by more than 350,000 people over the past two years, with financial help from the American Rescue Plan, which lowered costs.

Outpatient Care Drives Industry Growth



Employment in ambulatory care services increased dramatically over the last several years, in part because the ACA encourages prevention and the use of outpatient services instead of costly hospitalizations. This has also led to growth in wellness centers focusing on programs that promote a healthy lifestyle, such as weight management and rehabilitation programs for those coming off physical therapy. These courses have natural synergy with hospitals and medical centers and help support better health outcomes.



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