



## 2017 Financial Institution Guide to U.S. Healthcare

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## Executive Summary

The purpose of this document is to review the current status of the healthcare sector within the United States, to examine trends in the market for health services, and to discuss financing solutions that can aid businesses and professionals serving in this sector of our economy. Few industries have seen as much change in recent years as healthcare. From regulatory adjustments to billing and technology, the U.S. healthcare market is moving quickly. It is also facing unprecedented challenges. There will be increased demand for health services across the country in the years to come due to aging Baby Boomers. There are also significant needs for more healthcare professionals, more efficient reimbursement cycle management, better data integration, and streamlined regulation.

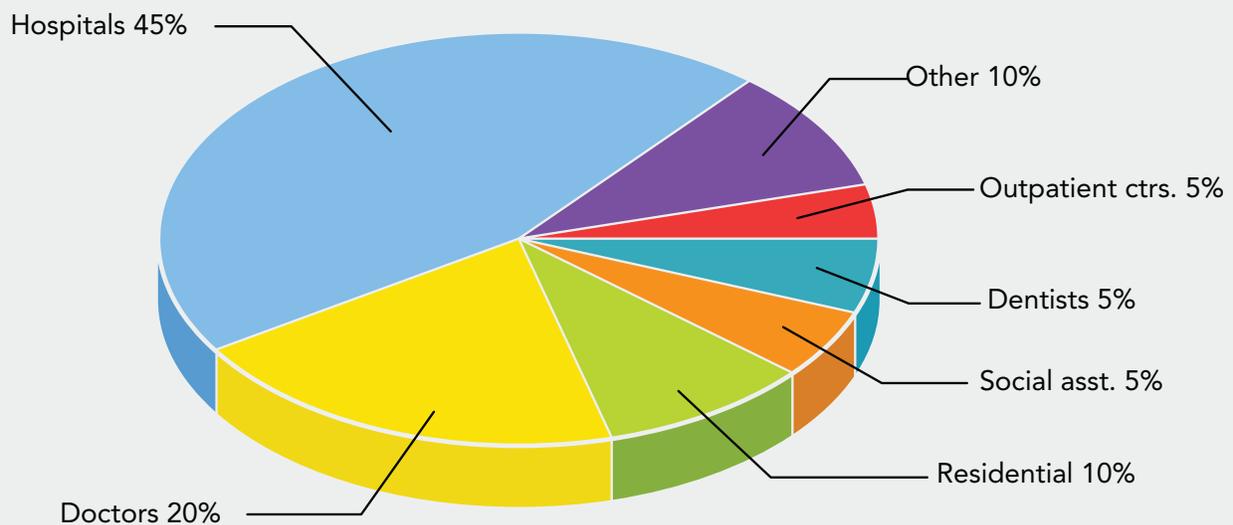
Given the challenges outlined in this document, we anticipate a significant increase in the demand for financing within the healthcare sector. Lending within this space can be beneficial to both financial institutions and service providers. Institutions, however, must understand the nuances associated with healthcare. They cannot simply fund health service providers without an understanding of the industry, its regulations, and its logistics.

## Industry Overview

According to the Centers for Medicare and Medicaid Services, healthcare spending in the U.S. totals about \$3.2 trillion in annual revenue, or 17.8% of our GDP. There are roughly 840,000 healthcare service establishments in the U.S. marketplace, including 7,100 hospitals. Healthcare, however, reaches far beyond care facilities and physicians. It includes a network of support businesses from emergency transport to home healthcare, nursing care, medical devices and equipment, physical therapy, drug treatment, and much, much more.

Both public and private spending on healthcare in the U.S. are greater than most other countries. According to The Commonwealth Fund, private spending on health services and related items was \$3,442 per capita in 2013. This includes out of pocket expenses, health care premiums, deductibles, etc. Public spending was \$4,197 per capita, placing total healthcare spending per capita above \$7,000. Other sources show that number to be as high as \$9,900 annually per capita. About 34% of residents were covered by programs such as Medicare and Medicaid.

### Industry Segment Summary



Source: U.S. Census Bureau

## Key Industry Trends and Expectations

**Growth** - First Research estimates that the healthcare sector will grow at an annual rate of about 6% between 2017 and 2020. Employment in the sector is expected to increase 14% by 2024.

**Demographic shifts** - Healthcare costs for individuals over age 65 is statistically about three times greater than the rest of the population. This segment of the population will increase by about 38% between now and 2025.

**Service structure** - The healthcare system is slowly transitioning from a volume-based to value-based revenue model. This is an attempt to tie physician revenue to performance rather than to the care itself. This is a major shift from the current volume structure, also known as fee-for-service, which encourages more medical procedures and testing.

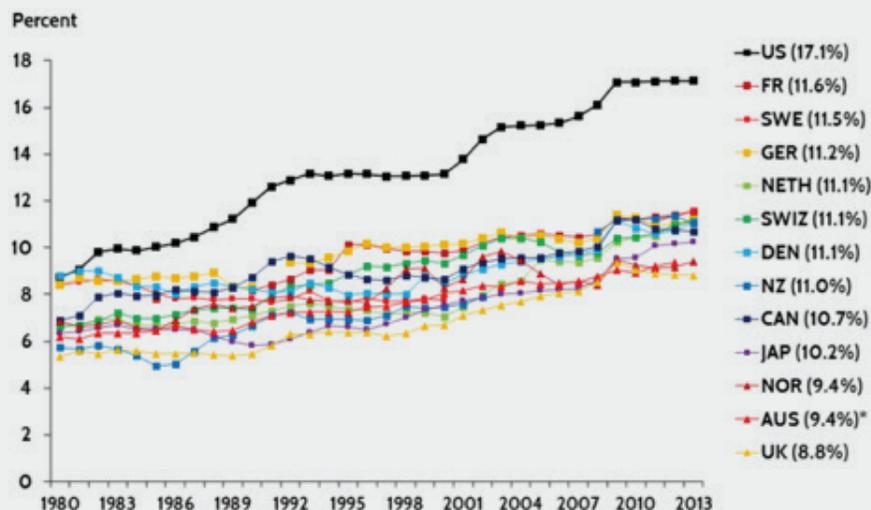
**Physician shortages** - The U.S. has about 2.6 practicing physicians per 1,000 residents, much lower than most other industrialized nations. As demand for services increases, there is concern that access to care could be compromised, especially in rural areas.

**Overall health in the U.S.** - Healthcare dollars do not always translate to better health for the citizens of any given country. In the U.S., our system, for the most part, has been designed around treatment rather than prevention of chronic diseases. Of major industrialized countries, the U.S. ranks last in infant mortality, life expectancy, and obesity. The next 10 years will be very telling in regard to how our healthcare system develops. There will likely be a greater emphasis on lifestyle and prevention, while also trying to address the growing needs of our older generations.

**Shift in health coverage cost** - Due to shifts in the burden of health insurance coverage, there has been a definite trend toward patient education. As patients and others covered by insurance face rising premiums, deductibles, and co-pays, these individuals have had to become more knowledgeable consumers of health services. Gone are the days when you simply went to the doctor or had a procedure and let the insurance company cover the negotiation of service costs.

**Changes to insurance coverage and structure** - The year 2017 will likely see dramatic changes to the Affordable Care Act. This was a key topic of debate during the 2016 election cycle. While the years ahead will reveal how such changes to repeal and replace portions of the act will impact the sector, it would seem that uncertainty will rule the day for now. Changes to insurance coverage are very likely to cause uncertainty regarding reimbursement cycle process and rate of reimbursement itself. Look for service providers to seek short-term flexibility through credit lines to accommodate any payment interruptions.

### Healthcare Spending as a Percentage of GDP, 1980 - 2013



Source: OECD Health Data 2015

## Select Population Health Outcomes and Risk Factors

	Life exp. at birth 2013 <sup>a</sup>	infant mortality, per 1,000 live births, 2013 <sup>a</sup>	Percent of pop. age 65+ with two or more chronic conditions, 2014 <sup>b</sup>	Obesity rate (BMI>30), 2013 <sup>a,c</sup>	Percent of pop. (age 15+) who are daily smokers, 2013 <sup>a</sup>	Percent of pop. age 65+
Australia	82.2	3.6	54	28.3 <sup>e</sup>	12.8	14.4
Canada	81.5 <sup>e</sup>	4.8 <sup>e</sup>	56	25.8	14.9	15.2
Denmark	80.4	3.5	—	14.2	17.0	17.8
France	82.3	3.6	43	14.5 <sup>d</sup>	24.1 <sup>d</sup>	17.7
Germany	80.9	3.3	49	23.6	20.9	21.1
Japan	83.4	2.1	—	3.7	19.3	25.1
Netherlands	81.4	3.8	46	11.8	18.5	16.8
New Zealand	81.4	5.2 <sup>e</sup>	37	30.6	15.5	14.2
Norway	81.8	2.4	43	10.0 <sup>d</sup>	15.0	15.6
Sweden	82.0	2.7	42	11.7	10.7	19.0
Switzerland	82.9	3.9	44	10.3 <sup>d</sup>	20.4 <sup>d</sup>	17.3
United Kingdom	81.1	3.8	33	24.9	20.0 <sup>d</sup>	17.1
United States	78.8	6.1 <sup>e</sup>	68	35.3 <sup>d</sup>	13.7	14.1
OECD median	81.2	3.5	—	28.3	18.9	17.0

Source: OECD Health Data 2015

## Financing Forecast and Considerations

Several trends will impact financing needs during the years to come. They include regulatory changes to insurance structures, demographic shifts, and health trends within the population, the costs related to technological advancement and information technology, and the rising costs of human resources within the sector.

In December of 2016, HealthcareFinance.com stated that cash flow and reimbursement were the biggest challenges facing healthcare providers during 2017. According to this source, **“Almost 70% cited cash flow and reimbursement as their top concerns, with similar numbers saying waiting for payment is painful.”**

On average within the healthcare sector, accounts receivable make up 16% of assets and turn in 27 days. Healthcare services generally operate with net income margins of less than 1%, depending on the type of service. These metrics vary within industry segments depending on the source of payment. For example, government entities such as Medicare typically pay via ACH, which can result in faster claim resolution. As we move forward, great emphasis in all healthcare businesses will be placed on revenue cycle management. This includes effective billing and collection procedures.

Growth in the healthcare sector should translate to more facility expansion, continued increases in research cost, and generally higher levels of working capital assets such as A/R and inventory. In essence, the water level is rising everywhere between now and 2025 – from healthcare expenditures to population, and to the percentage of the population over age 65. This will translate into strong growth in the opportunity to provide financing within the healthcare sector and the industries that support it.

## Key Issues to Consider When Financing the Healthcare Industry

**Reimbursement rate analysis (both historical and forward-facing)** - The most difficult aspect of financing healthcare providers is determining the likely rate of reimbursement for any given claim, based on the payer of that claim and the type of service rendered. This impacts the accuracy of determining advance rates for working capital lines of credit. When offering such services, the financial institution should consider the diversity of claims being generated (concentrations of one claim type or payer), the historical reimbursement rate by payer class, and the likelihood of future changes to reimbursement rates. The institution must also consider that government entities can retroactively adjust reimbursement rates and apply changes to claims that have already been paid.

**HIPAA compliance** - Financial institutions must comply with HIPAA when providing financing to healthcare entities. This includes internal and external protection of private healthcare data. When entering into a financing relationship, the financial institution will document its relationship with a Business Associate Agreement, which describes the protection of such data.

**Government program receivables** - While regulations allow for liens against government accounts, payments sent by government programs must be made directly to the provider of services or products. When attempting to provide working capital financing for such entities, the financial institution should take a lien on the proceeds of such accounts. The institution may also operate controlled sweep accounts to facilitate repayment once proceeds are received.

**Lockbox compliance** - When offering asset-based financing options, it is in the best interest of the financial institution to control the payment stream associated with accounts. That process is a bit more difficult in the healthcare sector. Financial institutions cannot share a common P.O. Box or ACH address among several service providers. Rather, they must separate payments by provider. Payments coming from government program receivables must also be directed first to the provider, then transferred to the financial institution using controlled sweep arrangements.

## Product Spotlight: Healthcare Lending from ProfitStars

ProfitStars Lending Solutions has a long history of providing innovative solutions for working capital finance within the healthcare sector. Since 1995, our team has been helping financial institutions meet the needs of growing businesses in the industry, from hospitals and physicians to ambulatory care service providers, medical equipment companies, staffing companies, and more. In 2016, we released our newest service, a healthcare line of credit powered by our Commercial Lending Management System™. This service involves a traditional line arrangement using the claims themselves as collateral. The key to the service is the reimbursement rate analysis that our team offers. By studying historical payer trends at the provider level as well as continuously tracking claim performance and reimbursement rates, we are able to effectively manage the risk of advancing against medical receivables.

The healthcare line of credit is intended for use when providing revolving working capital financing to providers of healthcare services or products when those entities are being paid by private insurance companies or by government program receivables. Key features of the healthcare line of credit include:

- **Reimbursement rate analysis** during underwriting to determine an appropriate advance rate against the accounts serving as collateral for the line.
- **Ongoing evaluation of the advance rate/reimbursement rate structure** based on rolling four-month trend data coming from the business.
- **An electronic interface between the healthcare provider's accounting system and the Commercial Lending Management System** so that claim data may be sent as often as required by the financial institution to support funding of the line.
- **Reduction of protected health information reaching the financial institution** through the interface, making it easier to comply with HIPAA.

- **Use of the Commercial Lending Management System from ProfitStars Lending Solutions**, which allows the financial institution to track the funding relationship through an electronic borrowing base and the supporting reports.
- **Pricing support for the financial institution** to determine an appropriate target yield based on program costs.
- **Marketing, business development, and risk management support for the financial institution** as defined within the scope of the licensing agreement.

By providing working capital financing to healthcare providers, your financial institution can help the local community while also growing your own lending business. Additionally, you can open the door to multiple cross-selling opportunities for commercial real estate and equipment financing, not to mention the consumer financing and investment opportunities available through many of these relationships.

We encourage you to speak with one of our lending sales executives today and learn how ProfitStars can expand your opportunities in the healthcare sector.

Sources

<https://dupress.deloitte.com/dup-us-en/industry/health-care.html>

<http://www.commonwealthfund.org/publications/issue-briefs/2015/oct/us-health-care-from-a-global-perspective>

[http://data.worldbank.org/indicator/SH.XPD.TOTL.ZS?end=2014&start=1995&view=chart&year\\_high\\_desc=false](http://data.worldbank.org/indicator/SH.XPD.TOTL.ZS?end=2014&start=1995&view=chart&year_high_desc=false)

[First Research – Industry Reports – Healthcare Sector December 2016](#)