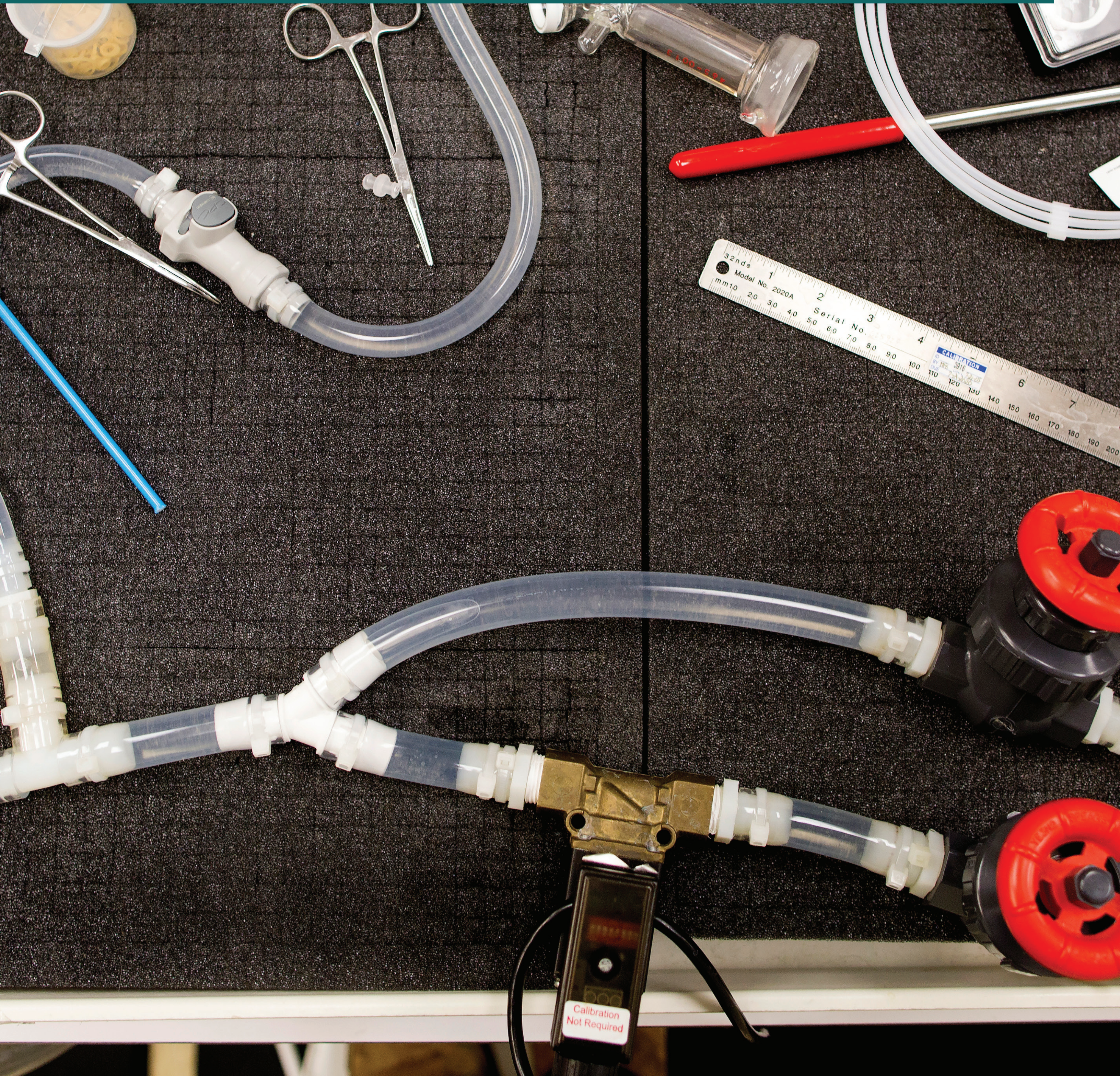
SONOMA COUNTY EDB ECONOMIC DEVELOPMENT BOARD

HEALTHCARE

INDUSTRY REPORT

2020



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SONOMA COUNTY BOARD OF SUPERVISORS

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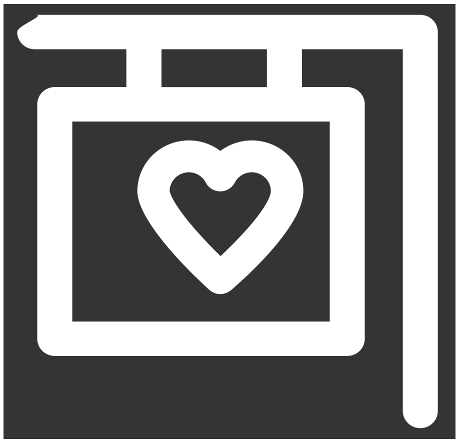
EXECUTIVE SUMMARY

July 2020

The Sonoma County Economic Development Board (EDB), in partnership with the Sonoma County Workforce Investment Board (WIB), is pleased to present the *2020 Healthcare Industry Insider* report. Our research partner, Moody's Analytics, provided the research for this report.

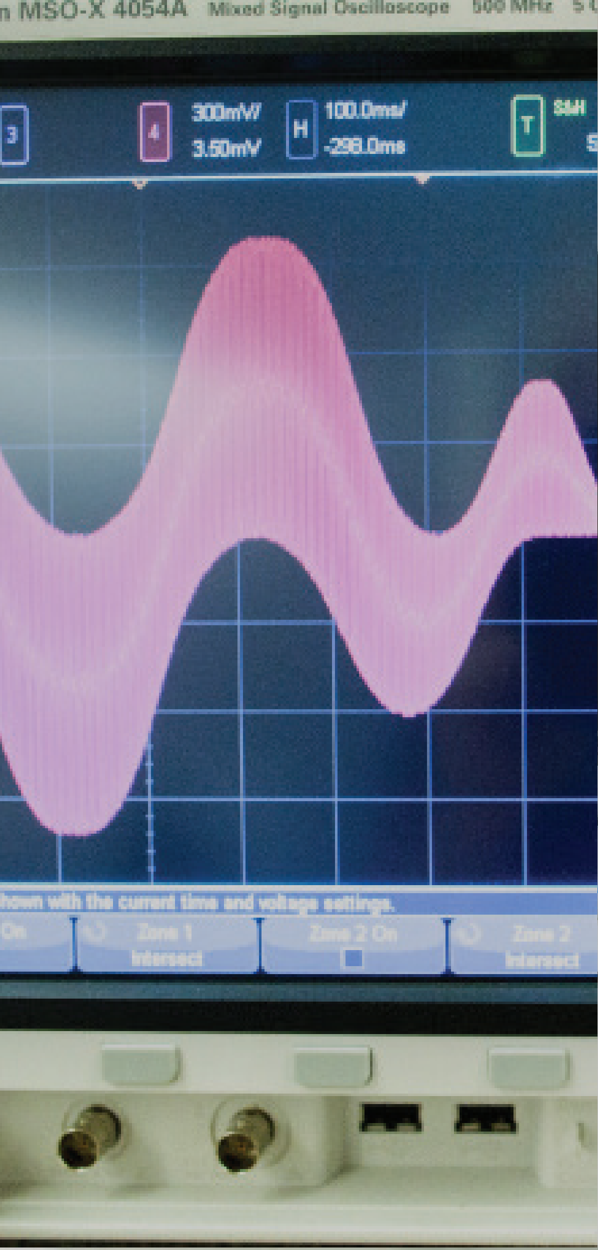
HIGHLIGHTS



The near term outlook for Sonoma County's healthcare industry is uncertain. Prior to COVID-19, the healthcare industry was on track to have another growth oriented year; growing at nearly five times the rate of the overall labor market. This is partially attributed to population demographics and a decrease in uninsured residents. Additionally, Sonoma County healthcare providers continue to exhibit exceptional quality of care to patients. Annual rankings place Sonoma County ninth in the state out of 58 ranked counties. Though Sonoma County's quality and growth in healthcare were shining by 2019 metrics, the industry has not fully dodged damages due to COVID-19.

The decreased demand for elective surgeries and in patient care is eliminating a substantial portion of health care providers' revenues; all the while, there has been a rise in expenses attributed to COVID-19. The combination of decreased revenue and increasing expenses resulted in payrolls falling by four-thousand in April and later stabilizing in May. Moreover, California's public and private insurers have already been dealt an estimated $2.4 billion dollars in COVID-19 related costs. Despite being below the national average, California health insurance premiums were already increasing this year and insurers may now pass on the expense to customers via premium increases. Though there was a sharp nominal decline in health care payrolls, Sonoma County has managed to avoid a relatively large outbreak and healthcare employment is expected to rebound faster than in other industries.

The continuing expansion of the senior population, 65 and older, in Sonoma County will help provide greater demand for healthcare services. Healthcare providers will need to increase payrolls to meet the increasing demand. Furthermore, The Affordable Care Act has significantly reduced the proportion of uninsured Sonoma County residents. Moreover, as hospitals and providers continue to consolidate they gain bargaining power in pricing agreements against insurers and medical supplier alike; softening the blow to their bottom lines. The combination of these factors should result in Sonoma County's healthcare industry faring, and rebounding from, the pandemic much better than most areas.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300mV/
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shown with the current time and voltage settings.
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Zone 2 Intersect

Recent Performance. Sonoma County's healthcare industry was on track for another solid year before the COVID-19 pandemic crippled the nationwide economy. Local payrolls in healthcare advanced 3% in 2019, just below the robust California average but more than 0.5 percentage point above the national average. Healthcare employment gains have outpaced the overall economy's job growth in each of the last four years, and in 2019 grew at nearly five times the pace of the overall labor market, reflecting the growing demand for medical care from older and newly insured residents. The launch of the state healthcare exchange and California's expansion of Medicaid have significantly boosted insurance coverage statewide.

The quality of the care offered by county healthcare providers is outshining that of peers elsewhere in the state and the nation. Annual healthcare rankings by the Robert Wood Johnson Foundation placed Sonoma County ninth in the state out of 58 ranked counties, according to health outcomes, a composite index measure of patient health and well-being. Sonoma has retreated one place in the statewide rankings in each of the last two years but marks an improvement from the 12th place rank it held from 2011-2014.

Healthcare has not been immune to the economic carnage wreaked by the novel coronavirus. Healthcare payrolls fell by 4,000 in April and stabilized in May. Hospital bottom lines are getting shredded by a rise in COVID-19 expenses and reduced revenue from elective surgeries and regular patient care. While California emerged as a hot spot for the virus and has seen case counts climb higher in recent weeks as parts of the state reopened, Sonoma has managed to avoid a large outbreak. Case counts per 1,000 residents are in the bottom quartile of metro areas nationwide. The county continues to meet state benchmarks for containing the virus and therefore there is no need to reinstate strict public health emergency restrictions.

Macro drivers. The outlook for the labor market is as dismal as at any other time in history. Moody's Analytics expects that employment will improve through the third quarter, and by the end of the year we will have regained about half of lost jobs. A full recovery will not occur in earnest until a vaccine is widely available by the second half of 2021. Secondary job cuts will occur as income losses suppress demand for a variety of goods and services. Sonoma County will not return to its pre-COVID-19 employment level until 2023. On the plus side, healthcare payrolls have fared better than overall employment in the early months of the virus, and the likely path of recovery will be faster for healthcare employment than most other sectors. The forecast calls for Sonoma's healthcare cluster to recoup its job losses nearly a full year before total employment recovers to its pre-COVID-19 peak.

The reintensification of COVID-19 infections across much of the country is a mounting threat to the nascent recovery. Containing the virus and supporting the economy are not mutually exclusive. In fact, a healthy population is a necessary condition for a strong economy. Economic activity in states with the most significant increases in cases in recent days, including Arizona, California, Florida and Texas, appears to be pulling back. Hours worked at small businesses, as measured by Homebase, increased sharply in these states between mid-April and late May, but have gone effectively nowhere since. With these states now either reversing their business reopenings or at least considering pausing, even more of a pullback is likely in coming days. Hours worked in the rest of the country have continued to advance, although not so much in the past few days. It is increasingly clear that many governors reopened their states too quickly, reigniting the virus and hurting their economies.

An expanding senior population will provide greater demand for healthcare in the years to come, both nationally and in Sonoma County. Residents age 65 or older make up an above-average 20% of the local population, and the share has grown nearly 4 percentage points in the past four years. As more retirees flock to Sonoma County, this share is forecast to reach 25% by 2028. 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 Affordable Care Act remains firmly in the crosshairs of the Trump administration, but the landmark bill remains in place and will be a key support for the healthcare industry in the near and medium term.

While the ACA has been less successful at containing surging healthcare costs, it has significantly reduced the share of uninsured people across the country, and specifically in California and Sonoma County. Covered California, the state's federally facilitated marketplace for healthcare, saw a surge in sign-ups during the open enrollment period in early 2020, standing in sharp contrast to the federal health exchange figures. California's marketplace saw a 41% increase in new sign-ups from last year, jumping from almost 300,000 to more than 415,000. This was largely because of a longer enrollment period and the reinstated state-level individual mandate fine, which was removed in January 2019 at the national level.

In April and May alone, nearly 500,000 Americans sought coverage through a special enrollment period that allowed Americans who experienced life changes or lost coverage as a result of the coronavirus crisis to apply for coverage under the ACA, according to a Department of Health and Human Services report. This will help ease some of the financial burden on families and should provide some support to hospital balance sheets and payrolls in light of the significant near-term economic dislocation.

Health insurance premiums were already inching higher this year, though rate hikes in California were below the U.S. average thanks to robust competition among insurers. With the outbreak of the pandemic, premiums will likely climb higher. According to a study by the University of California Berkeley, the COVID-19 pandemic has already cost California's public and private insurers an estimated $2.4 billion in testing and treatment. The majority of costs are borne by commercial insurers who could pass the sudden expenditure on to consumers in the form of price hikes on health insurance premiums. The rest of the costs are split among the federally run Medicare program, the state-run Medi-Cal program, and uninsured individuals.

Uncertainty still clouds the total impact of ACA 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 shift fees on to workers. Employer-based premiums have spiked more than 10% since 2013, and employees in California have shouldered 40% of the increase over that period, compared with 30% nationally. 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. While 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.

The one-year projected costs in the commercial market range from $34 billion to $251 billion for testing, treatment and care specifically related to COVID-19. The potential costs for 2020 could range from 2% to 21% of premium if the full first-year costs of the COVID-19 pandemic were priced into premiums. Premium increases in the individual and employer markets for 2021 could be 40% or more solely because of COVID-19 costs in the absence of federal action.

Operating expenses. Operating expenses rose during the onset of the pandemic and likely will rise over the course of the year. Hospitals have faced higher costs for protective equipment for nurses and doctors due to supply shortages, which increased prices. Labor costs likewise rose as overtime hours swelled and hospitals faced growing labor shortages. 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 shredded in recent months and the carnage will likely last until a vaccine is developed. Estimated operating margins had held roughly steady over the last two years, within their five-year average of 3.8%. Furthermore, uncompensated care had been declining as a share of overall operating expenses.

Profit margins at hospitals around the country will fall victim to the fallout from COVID-19. Along with higher operating expenses, the real damage has and will come from reduced revenue from elective surgeries and regular patient care. The cancellation or postponement of nonurgent diagnostics and procedures will fuel job losses in healthcare in the second quarter. The outlook calls for only a partial retracement in jobs in the third quarter as stay-at-home orders are lifted. Some consumers out of work will delay care while others will wait a bit longer for routine appointments until the risk of infection is lower.

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. The reinstatement of the tax penalty for the individual mandate will push uncompensated care costs lower as residents who dropped off in 2019 avoid the new statewide penalty.

Long-term outlook. Sonoma County's healthcare industry will navigate through a tremendous amount of uncertainty in the coming quarters. The outlook will depend heavily upon the epidemiology of the virus and efforts to stem the rise in case counts and ensure that hospitals and the broader economy can return to some normalcy. Hospitals will have a brutal year financially, and many temporary layoffs will become permanent as hospitals seek to cut costs and balance budgets. Sonoma County's healthcare industry should fare better than most areas given its cluster of well-renowned hospitals, lower uninsured rate, and high per capita incomes.

Moving into the medium and long term, Sonoma County's healthcare industry will begin its recovery by the end of this year and 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 30% since 2012, compared with the 23% in California and 22% nationwide. This pace also far exceeds the 2% 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 demands of an aging population and broader patient base.

Upside risks. 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 would 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. UCSF is ranked among the best hospitals in the country and its expanded memory care and aging program and infusion center could drive further growth in health services.

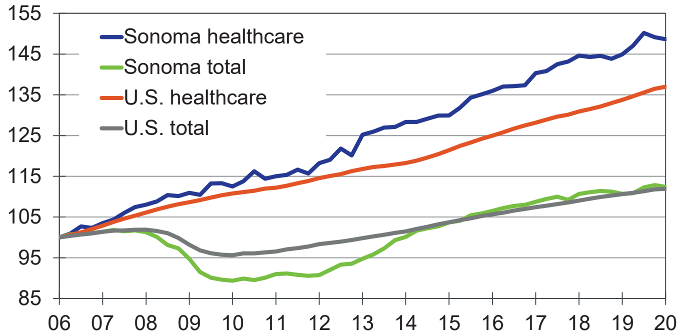
Stronger-than-expected population growth would be a boon to county healthcare providers by expanding the patient pool. Specifically, more in-migration among young adults would soften premium hikes across the board and increase demand at Sonoma County's wellness facilities. Housing affordability has increased to a five-year high following decelerating price appreciation over the past year, and Sonoma may reap the benefits of more remote workers settling in the county in the aftermath of the pandemic.

Downside risks. The most prominent downside risk is a continued rise in COVID case counts that leads to another round of business closures and overwhelms hospitals' ICU capacity. Case counts in Sonoma County have ticked higher in the last month, setting a new record for new daily cases twice in the second half of June. The county is still reaching the benchmark goals to avoid a second shutdown, but rising case counts in the county and statewide have the potential to push Governor Newsom to enact stricter lockdown measures. So far, economic data do not bear a significant negative impact from this recent ramp-up in cases, but as hospitals approach full capacity, more aggressive containment measures may be required.

Colin Seitz
June 2020

Healthcare Employment Sets the Pace…

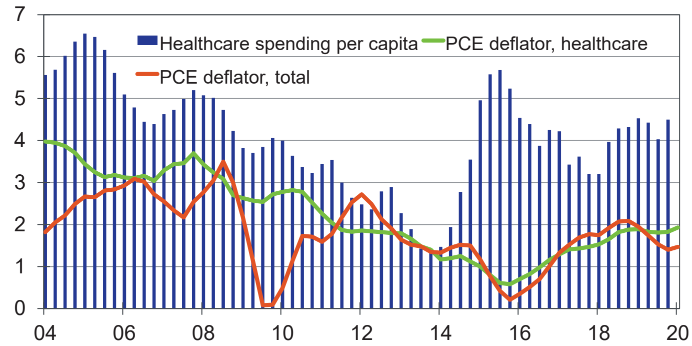
Payroll employment, 2006Q1=100, SA



Sources: BLS, Moody's Analytics

…Alongside Higher Spending and Costs

% change yr ago, 4-qtr MA



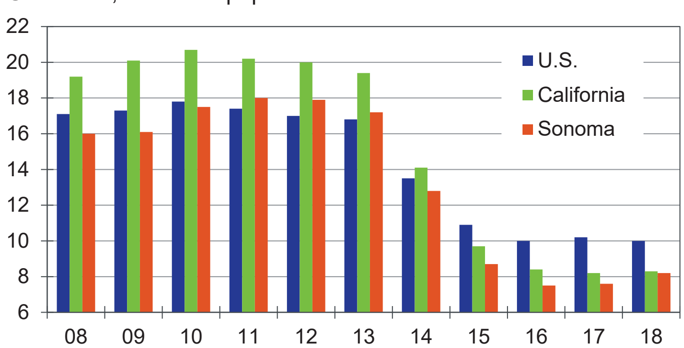
Sources: BEA, Moody's Analytics

Healthcare emerged as a crucial growth driver for the Sonoma County economy prior to the COVID-19-induced recession. An expanding senior population and greater insurance coverage generated robust demand for medical services. The healthcare industry will struggle in the near term amid weakening financials and cost-cutting measures, but employment will recover more quickly than the overall labor market.

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. However, higher premiums will do little to dent healthcare demand in Sonoma thanks to above-average household incomes and a large and expanding retiree cohort.

Insurance Coverage Ranks Favorably

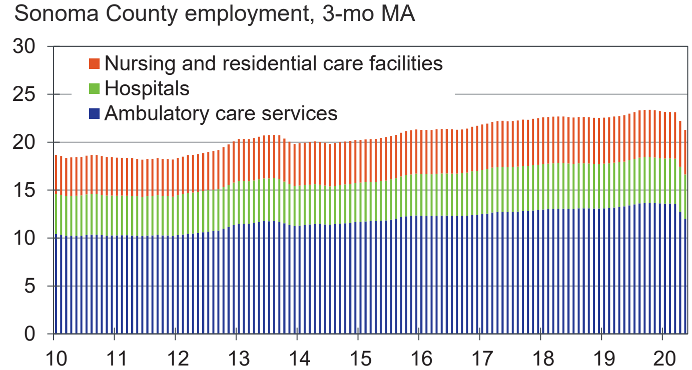
Uninsured, % of total population



Sources: Census Bureau, Moody's Analytics

Outpatient Care Drives Industry Growth

Sonoma County employment, 3-mo MA



Sources: BLS, Moody's Analytics

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. The removal of the federal penalty for forgoing health insurance led to a brief uptick in both California and Sonoma County in 2019, but the implementation of a state fine appears to be paying dividends. The number of new enrollees on the state's insurance marketplace, Covered California, surged 41% this year compared with a year earlier, and the enrollment period has been extended in light of the COVID pandemic.

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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