Industry Sector Report
Health Industry Insider

2011
SONOMA COUNTY

EDB
Sonoma County
Economic Development Board
July 2011

The Sonoma County Economic Development Board (EDB), in partnership with the Sonoma County Workforce Investment Board, is pleased to present the 2011 Health Care Industry Insider Report. Our research partner, Moody’s Economy.com, provided the analysis for this report.

The report provides an overview of Sonoma County’s performance on a number of healthcare-related indicators. The indicators selected for this report detail a broad scope of economic measurements, including health provider capital spending, demographic changes, and health coverage costs.

Highlights of the 2011 Health Care Industry Insider Report include:

• Total operating revenues for Sonoma County health care companies increased 9.3% in 2009 and total operating expenses surged 10.6%, marking the second consecutive year in which net revenue was negative. The proportionally higher number of elderly residents, many of whom need expensive technologies for treatment, may be a key factor in those elevated expenses.

• Payroll employment of medical providers in Sonoma County edged upward through the third quarter of 2010, bucking the trend in the nation and elsewhere in California and offsetting the declines experienced in 2009.

• Uncertainty surrounds the future of state-funded healthcare. Governor Jerry Brown has proposed $6 billion in cuts to health and human services spending and caps on Medi-Cal doctor visits, significantly increased premiums and copayments for low-income families, and large cuts to Medi-Cal providers for the 2012 fiscal year. Even if the cuts go through, the courts may strike it down.

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.

Sincerely,

Ben Stone
Executive Director
Recent Performance

The Sonoma County healthcare industry is adapting ahead of implementation of new federal healthcare policy and an increasing shift toward outpatient and community health-based delivery of medical services.

According to the California Office of Statewide Health Planning and Development, total operating revenues for Sonoma County healthcare companies increased by 9.3% in 2010. However, total operating expenses surged by 10.6% in 2010, the largest increase since 2005. With expenses outpacing revenues, net income was negative for the second consecutive year.

Bucking the trend in the nation and elsewhere in California, payroll employment of medical providers in Sonoma County edged upward through the third quarter of 2010, offsetting the declines experienced in 2009. Payrolls were boosted by two of the counties’ largest community healthcare networks—Saint Joseph Health System and Summit Health.

Overall demand for healthcare in Sonoma County stabilized in 2010. An improving economy and the ramping up of community health offerings translated into a small increase of total patient days—the first increase since 2005—even as the average usage of staffed beds plummeted by 12%.

Capital spending projects by Sonoma County healthcare providers contracted for a third consecutive year in 2010 as the pipeline of current projects thinned out ahead of a state mandate for hospitals to upgrade their seismic safety ahead of a 2015 deadline. Kaiser Permanente unveiled its $233 million expansion of its Santa Rosa medical center in October. The new tower expands the medical center’s space by 146,400 square feet, which includes the largest emergency room in the county and 59 new hospital beds.

A growing elderly population and Medicare expenditures will put pressure on Sonoma County’s healthcare industry. With a higher than average population aged 65 years or older, the county will be among the first to feel the impact of aging baby boomers, the first of whom reached retirement age in 2011. Expenditures on Medicare jumped ahead of this demographic milestone after 2005, when a Medicare prescription drug program went into effect. Due to the county’s rural classification, medical providers receive lower Medicare reimbursements than neighboring counties.

Initial construction activity is also under way at the site of the new Sutter Medical Center in Santa Rosa, the county’s first new hospital and the most expensive construction project in two decades. Planning, design and construction of the hospital will employ 1,500 workers and is set to be completed by the end of 2014.

In response to increasing demand, the county’s smaller community healthcare providers are also eyeing expansion, particularly in the northern portion of the county where small clinics are serving a rapidly growing number of patients. However, expansion plans are largely at the preliminary stage and are dependent on increasingly scarce and endangered public sources of financing.

Employers will face increasing costs and new rules on employee health benefits over the next several years. The recession and slow recovery did manage to slow the increase in healthcare premiums for employers; however, employees with private coverage face higher deductibles and drug costs. Beginning in 2014, companies with more than 50 employees must provide private insurance to their workers or pay a penalty of $2,000 per worker. The cost of employer-provided insurance will be capped at no more than 9.5% of an employee’s household income.
Macro Drivers

The U.S. recovery will retain its staying power in the near term despite a variety of economic headwinds including rising energy prices and disruptive domestic and international natural disasters. In the first quarter, U.S. GDP growth slowed to its lowest level since the middle of 2009. Growth is projected to fall short of 3% in 2011 but surpass 4% in the second half of the year as the full effects of the latest federal stimulus takes hold. Total growth in 2012 will exceed 4% as the U.S. economy enters a period of above-potential growth and approaches full employment by the end of 2014. Fueling the outlook for above-potential growth starting in 2012 is improving business financial health, rapidly deleveraging households, and a well-capitalized financial system. The Moody’s Analytics forecast assumes that a key downside risk to this outlook—the federal government’s rising debt load—will be addressed in a reasonably timely way.

Sonoma County’s pace of economic improvement jumped ahead of the U.S. and California in 2010 and the first quarter of 2011, boosted by expanding tech production and recovering demand for visitor-dependent industries. While moving in the right direction, the county’s job gains since the beginning of 2010 account for a very small fraction of the 20,000 jobs lost during the recession. The improving labor market will help Sonoma County households to regain private health insurance benefits. The unemployment rate will continue to fall, approaching both 8% and the U.S. rate by the end of 2012. Improvements will also extend to credit quality, a positive driver for Sonoma County’s healthcare industry. According to data from Equifax, all types of consumer delinquency rates are declining, although mortgage delinquencies remain above the U.S. average. While the foreclosure rate is falling in the county and is well below the harder-hit housing markets in the Central Valley and other parts of California, they remain above that of the U.S. and close to the peak levels reached in 2009, according to RealtyTrac. This still sizable pipeline of foreclosures and distressed house sales will continue to weigh down on house prices in the near term.

Sonoma County’s population outlook is positive despite the weakest decennial population growth in more than five decades. The county’s population increase of 5.5% from 2010 was less than half the rate for California and the U.S. However, this poor performance masks a large end-of-the-decade improvement when net domestic migration turned positive amid worsening of labor and housing markets outside the county that have been traditional magnets for residents. The Census Bureau’s midyear estimate of 2010 population revealed only a slight slowing in growth from 2009. Despite thawing labor and housing markets elsewhere, Sonoma County will outpace California and the U.S. during the recovery period in terms of population growth. Sonoma County’s above-average share of residents aged 65 and older will provide some support for its healthcare industry, particularly in outpatient centers, nursing homes and home-health settings.

Lingering consumer credit delinquencies, especially for mortgages, will threaten to increase delinquent payments for Sonoma County healthcare providers in the near term. Although lower than the state average, the severity of the recession in the county elevated the foreclosure rate above that of the U.S. Foreclosures have fallen from their 2008 peak but have shown little improvement in the past year. Along with adding to the existing pipeline of potential distress home sales, delinquent homeowners may be forced to cut back on the consumption of and payment for medical services.

A growing elderly population and Medicare expenditures will put pressure on Sonoma County’s healthcare industry. With a higher than average population aged 65 years or older, the county will be among the first to feel the impact of aging baby boomers, the first of whom reached retirement age in 2011. Expenditures on Medicare jumped ahead of this demographic milestone after 2005, when a Medicare prescription drug program went into effect. Due to the county’s rural classification, medical providers receive lower Medicare reimbursements than neighboring counties.
Industry Drivers

The first components of the America’s Affordable Health Choices Act of 2009 to be implemented have helped to increase the number of persons covered by private health insurance and services offered under public programs. These measures include tax credits for small businesses that offer insurance, annual wellness exams, and prescription drug discounts for seniors; the ability for young adults to be covered by their parents’ plans until age 26; and the prohibition of rejecting coverage of children with pre-existing conditions. More costly measures that will reduce the profitability of healthcare providers, such as higher taxes and the coverage of adults with pre-existing conditions will be implemented in stages by 2014.

Some uncertainty surrounds the future operation of California’s health benefit exchange—the first in the nation to be legislatively authorized—which will create a health insurance marketplace for up to 8 million uninsured and Medi-Cal eligible persons beginning in 2014. Rules and regulations for private health insurance companies that choose to participate in the exchange have yet to be formulated and issued. Opposition to healthcare reform in the GOP-controlled U.S. House of Representatives could result in defunding or cuts in needed appropriations, which could delay the implementation and operation of the exchanges.

California’s chronic budget shortfalls cast a darker near-term outlook for state-funded health insurance programs, threatening to reduce the financial incentives for healthcare providers in Sonoma County to service needy patients. Governor Jerry Brown has proposed $6 billion in cuts to health and human services spending and caps on Medi-Cal doctor visits, significantly increased premiums and copayments for low-income families, and large cuts to Medi-Cal providers for the 2012 fiscal year. The proposed cuts come as increased federal stimulus funding for state Medicaid programs such as Medi-Cal expire on July 1. Even if the proposed Medi-Cal cuts are adopted for the new fiscal year, they may ultimately be blocked by the courts. The U.S. Supreme Court has agreed to hear a challenge to the cuts by a group of healthcare providers and patient advocates. The 9th U.S. Circuit of Court of Appeals rejected earlier cuts proposed by Governor Brown’s predecessor, Arnold Schwarzenegger.

A proposed fix to the federal government’s Medicare reimbursement system would increase payments to healthcare providers in Sonoma County. The county is considered rural by Medicare. As a result, local physicians are reimbursed at the lowest rate for California counties, below their counterparts in neighboring Marin, Napa and Solano counties. These inequities faced by physicians in the county put it at a comparative disadvantage when attempting to attract new physicians to the area. A proposal last year to amend California’s county definitions, including Sonoma County, was attached to a bill that extended federal long-term unemployment insurance benefits, but it was removed by the U.S. Senate.

The total population that is uninsured in Sonoma County is projected to decrease from 60,000 to only 15,000 residents after health care reform. Health care reform will mainly increase the amount of people with private insurance and will replace the CMSP program with coverage by Medi-Cal and private insurance. Increased Medi-Cal enrollment under health care reform includes approximately 15,000 previously uninsured and 4,000 individuals formerly enrolled under CMSP. Increased enrollment in private insurance includes approximately 30,000 previously uninsured and 5,000 people formerly insured under CMSP.

The above estimate does not account for population growth, the aging demographic, the impact of the economic downturn, or other factors that may impact an individual’s health care insurance coverage.
Pricing
Hospitals and health insurers managed to increase premiums in 2010; however, the growth rate of premiums slowed from 2009. According to the Kaiser Family Foundation, premiums paid by U.S. families for health coverage increased by 3% last year. Despite the slowdown in total premiums, workers paid a greater share of the cost of employer-provided benefits—an average increase of 14%. Employees also now face higher annual deductibles. The percentage of workers facing annual deductions of at least $1,000 increased from 22% in 2009 to 27% last year.

Concerns about the rising cost of health coverage will stimulate interest in health reimbursement and savings accounts. In 2010, the share of the U.S. population covered by such programs increased by 1 percentage point to 5% from 2009, according to the Employee Benefit Research Institute. Employers’ contributions to account-based plans did decline for the second consecutive year amid the slow pace of the recovery and tightening of compensation expenditures. As a result, the average balance of such accounts declined slightly in 2010.

Operating Expenses
Compensation costs for Sonoma County healthcare companies will outpace improvements in the economy in the near term, but at a slower rate than in the recent past. Healthcare salaries and wages in the county rose faster then other industries in 2010 but the gap narrowed. Cost containment by medical providers ahead of the implementation of the most expensive components of the federal healthcare reform will keep compensation growth further in check.

In addition to rising compensation costs, Sonoma County’s healthcare providers will face higher than average patient-adjusted operating expenses relative to the state. Whereas patient-adjusted operating expenses in California averaged $11,527 in 2010, the county’s hospitals averaged $14,560, 26% higher and up from 23% higher a year earlier, according to OSHPD data. A growing elderly population is one factor contributing to higher costs per patient, as new technology provides more expensive options for care of chronic and debilitating illnesses.

Profitability
Rising costs and downward pressure on federal and state reimbursement rates for medical services will limit growth of profits for healthcare providers in Sonoma County. In 2010, the industry’s operating margins resumed their negative trend after a one-year increase of profits. A strengthening economy and new outpatient and community-focused facilities may help to push some healthcare companies into the black.

Adoption of electronic health records will provide another avenue for cost controls. A portion of the federal stimulus included funding and a mandate for the use of electronic records. Redwood Community Health Network of Petaluma was awarded $2 million in 2010 to expand the use of electronic records throughout the consortium’s 15 community health centers located in the North Bay and Northern California. Starting in 2015, health-care providers not using electronic records will be subject to financial penalties. Some of the movement toward electronic records predates the mandate included in the federal stimulus. Kaiser Permanente’s electronic record system is the world’s largest civilian electronic record system.

Long-Term Outlook
Despite remaining downside risks in the near term, the long-term outlook for the health service industry in Sonoma County is generally positive. The county’s demographics in particular point to growing local demand. County residents are generally wealthier and older than the average Californian or the average American. The aging of baby boomers, concurrent with a boom in healthcare technology and a growing life expectancy, will support consumer demand.

The most significant change to the long-term outlook for managed care stems from the implementation of the federal healthcare reform legislation. Higher taxes and increased regulations that will be imposed on healthcare providers will offset the gains from increased coverage and put a floor under the number of insured in future economic downturns. Long-term concerns regarding the financial viability of Medicare were reduced by the federal healthcare reform law but not completely eliminated. The recession and slow recovery has moved up the expected period when the Medicare trust fund begins to pay out more than it takes in to 2024 from 2029, according to the most recent trust report.

Upside Risks
Technology is an upside risk for the healthcare industry. Greater use of the internet and budding wireless technologies—many designed and produced in Sonoma County—will provide significant operational and cost efficiencies. Similarly, the continued rapid development of medical technologies, including recent advances in biotechnology, offers significant potential for providing more efficient care to a larger and aging population.

Downside Risks
Some downside risk remains for healthcare providers in Sonoma County, mainly in the form of weaker than expected labor market improvements and budgetary pressure in Sacramento. A stalling recovery or a double-dip recession would boost unemployment and suppress spending on employee benefits, including health insurance. The deterioration of California’s budget situation risks triggering additional cuts to Medi-Cal and other state-funded health programs, eliminating a key source of income for healthcare providers. The combination of an increase in unpaid medical bills and a reduction of reimbursements would strain the finances of healthcare companies in the county.
With Acknowledgment and Appreciation to Local Key Businesses Supporting Sonoma County Economic Development:

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