FEATURE STORY

Navigating the Future:

Exploring Opportunities in Healthcare Asset-Based Lending

BY JENNIFER SHEASGREEN

Healthcare is an industry that is constantly changing. Lenders wishing to lend into the space need to develop expertise pertaining to the unique financial needs and challenges of the sector. This article explores the opportunities to lend into this space.

Healthcare is an industry sector that continues to grow and highlights a promising avenue for lending institutions to financially aid in the growth of hospitals, medical facilities, and other ancillary providers. Lending into the healthcare space not only provides a viable investment option, but contributes to improved patient care and outcomes and can play a crucial role in shaping the future of healthcare delivery.

National Healthcare Expenditures (NHE) grew 2.7% to $4.3 trillion in 2021 and accounted for 18.3% of the Gross Domestic Product (GDP), according to the Centers for Medicare and Medicaid Services (CMS). Of that amount, Medicare and Medicaid spending accounted for 21% and 17% respectively, amounting to $1,634.8 billion. By 2031, healthcare is projected to account for 19.31% of the GDP.

In an ever-growing sector, lenders that specialize in developing expertise in the unique financial needs and challenges of the sector can help to tailor their lending solutions to better meet the demands of healthcare organizations. Specifically focusing on asset-based, working capital lending, we will explore the opportunities to lend into this space.

Increasing Demand for Healthcare Services

COVID's challenges have sparked new opportunities for the delivery of healthcare. McKinsey & Company reported that scaled-up innovation was prompted by the pressure the pandemic put on the healthcare system. One example of this is the expansion of telehealth. Prior to the pandemic, Medicaid beneficiaries had the flexibility to use telehealth, Medicare beneficiaries did not. During COVID, HHS (Health and Human Services) waived some of those restrictions and expanded coverage to Medicare beneficiaries. That coverage has been extended until December 31, 2024, with providers hoping it will be extended indefinitely.

Additionally, the use of AI (Artificial Intelligence) will have a measurable influence on the delivery of healthcare services. According to Becker's Hospital Review, in 10 years there will be expanded outpatient services that include technology that will be deployed in new and innovative ways, with a focus on increasing home-care setting solutions.

From an economic perspective, the outlook for employment in healthcare occupations is anticipated to grow 13 percent from 2021 to 2031, much faster than the average for all occupations, as reported by the U.S. Bureau of Labor Statistics. Where does all this lead? For healthcare asset-based lenders, it's an opportunity.

Why Healthcare Lending is Ripe with Opportunities

Hospitals and health systems just exited a multiyear battle with COVID-19, resulting in a lack of pharmaceuticals and supplies, increased costs of labor, and staffing shortages. The CARES Act government support programs such as HHS (Health & Human Services) stimulus funding, PPP (Paycheck Protection Program), AAPP (Accelerated Advance Payment Program), and ERTC (Employee Retention Tax Credit) helped to ease the financial burden brought on by COVID, but those programs have just about run dry.

JENNIFER SHEASGREEN
Siena Healthcare Finance

Now dealing with inflationary pressures, healthcare providers are at the battle front again continuing to struggle with low margins. During COVID, hospitals, health systems, and providers were able to rely on the government programs which, in turn, helped to solidify liquidity positions. Operational and financial difficulties have led to lower liquidity positions and increased bank loan covenant defaults, causing many healthcare providers to seek out a refinance or restructure of their working capital loans. This, combined with several recent bank failures, points to an opportunistic time for asset-based lenders to provide working capital loans with more flexible structures while creating an attractive yield opportunity for investors.

Asset-based lenders often have advantages over traditional banks due to the in-depth focus on collateral value. Though factors such as creditworthiness, financial history, and liquidity play an important part in the overall credit evaluation for both types of lenders, the reliance on each component is weighted differently. Additionally, non-bank asset-based lenders aren't subject to FDIC regulation and though they must comply with lender line-concentration limits, those limits are often tailored to the specific type of loan.

As a result of these factors, asset-based lenders can lend to companies that may not be considered creditworthy by traditional bank institutions and those that are creditworthy may look to an asset-based lender to afford more availability in their borrowing capacity. It is important to note that each route, bank or non-bank, has its own pros and cons and it's the borrower that ultimately needs to determine what is important for their business.

Current Economic Landscape and Implications for Healthcare Lending

As inflationary pressures continue and interest rates have risen this year, it is likely that we'll see banks further tightening lending standards in Q4 '23 and Q1 '24 allowing opportunities for non-bank lenders to gain more market share, despite demand for loans declining. It is projected that there will be opportunities for refinance and restructuring of diminished bank credits to a more suitable non-bank structure, primarily due to the rapid rise in interest rates and labor and supply expenses.

Healthcare lenders with expertise in government regulations will be a more strategic partner for healthcare providers looking to maximize their most liquid asset, accounts receivable, and

Key Points

1 The healthcare sector will continue to grow despite inflationary pressures

2 The demand for healthcare services will continue to increase

3 A tightening of bank lending standards make it an opportunistic time for healthcare lenders

4 Lending to the healthcare sector requires knowledge of government regulations

5 Asset-based lending bridges the gap between lengthy healthcare billing and collection cycles

that is because the lender plays a role in ensuring there is compliance. Lending to the healthcare sector requires knowledge of government regulations. The anti-assignment provisions, which prevent the government from making payments under Medicare and Medicaid programs to anyone other than the licensed provider, make obtaining lender control of cash more challenging. HIPAA (Health Insurance Portability and Accountability Act) has stringent regulations about the sharing of PHI (Protected Health Information). Healthcare lenders should be cognizant of what data points are included in their claim detail that supports borrowing base calculations. Most often, PHI is scrubbed from borrower files prior to receipt by the lender. Healthcare lenders that don't have safeguards in place which ultimately protect the lender and the borrower, could find that their non-compliance results in government-related monetary penalties payable by the lender.

How Healthcare Lending Acts as a Bridge

The time it takes for healthcare providers to bill and collect varies significantly by sector and based on factors such as type of service, the multiple components of billing, insurances processes, and the efficiency of the provider's billing practices. Based on these complexities, healthcare providers may have a lengthy gap between billing and collections while needing to cover payroll, inventory, and supplies.

On average, billing and collection cycles can range from several weeks to a few months and, in some cases, providers may only be able to bill once a month for services.

Revolving lenders bridge the gap by providing working capital to healthcare companies during the interim period it takes to collect on healthcare accounts receivable. Additionally, lending on unbilled accounts receivable where services have been performed. Healthcare asset-based lenders have longer cut-off periods for accounts receivable inclusion in borrowing bases, often going to out 150 days on the accounts receivable aging and, in some cases, 180 days, depending upon the sector. Advance rates are typically 85% of the net collectible value of the accounts receivable.

Additionally, understanding of the revenue cycle of different healthcare segments allows for a crafted approach to structuring borrowing bases and, in some cases, eligibility around unique revenue streams such as Upper Payment Limit (UPL), a government program that is handled differently, depending upon the state, can serve as additional borrowing capacity and may provide an opportunity for improved yields for the lender.

Conclusion

Healthcare lending presents opportunities for financial gain, diversification, community impact, and the opportunity to deploy industry expertise. However, it's important for lenders to thoroughly understand the unique aspects of the healthcare sector and manage associated risks effectively.

As healthcare programs become more diverse and complex, the role of healthcare lending becomes even more crucial. Collaboration between lenders that have a deep understanding of the healthcare landscape, and healthcare providers that aspire to grow and excel, can lead to successful outcomes, which may translate to better patient care.

Jennifer Sheasgreen is the president of Siena Healthcare Finance and co-founded the division in 2019. Sheasgreen has over 25 years in healthcare finance is a recognized leader in the healthcare lending space, having started two, profitable, de novo ABL divisions. She is certified as a Fellow through the Healthcare Financial Management Association.