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SUBJECT: Simulations of Affordable Care Act Medicare payment update provisions on Part A provider financial margins

In appendix C of the *2024 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, the Trustees discuss simulations of the impact of the Affordable Care Act (ACA) Medicare payment rate update provisions on Part A provider financial margins.[1] This memorandum details those simulations.

Specifically, the findings are as follows:

- From 2022 through 2027, the simulations suggest that more hospitals would experience negative total facility and that roughly 7 percent more would experience negative Medicare margins.
- By 2040, simulations suggest that roughly one-third of hospitals, and over 50 percent of skilled nursing facilities (SNFs) and home health agencies (HHAs) would have negative total facility margins.

The Trustees note that, over the short range, behavioral changes by hospitals (for instance, efforts to improve efficiency in lower-performing hospitals) could mitigate some of the impact of the ACA payment provisions, though there is considerable uncertainty regarding these types of changes. Over the long range, however, the simulations suggest that, absent other modifications, significant financial pressures will arise for providers, increasing the possibility of access and quality of care issues for Medicare beneficiaries.

The remainder of this memorandum discusses the data, methods, and assumptions used to conduct the simulations and briefly summarizes the results.

[1] The ACA requires that Part A Medicare payment updates be based on the increase in the market basket less the 10-year moving-average growth in economy-wide private nonfarm business multifactor productivity.

Data, Methods, and Assumptions

We used Medicare Cost Report (MCR) data for Medicare revenues, Medicare expenses, non-Medicare revenues, and non-Medicare expenses to compute total facility and Medicare margins for 2022.[2] However, we excluded COVID-relief payments from the 2022 SNF *total facility revenue*, as these are temporary payments, which comprise approximately 2.4 percent of total facility revenue for SNFs. Only providers that are paid under the Medicare prospective payment systems (PPS) and that have submitted an MCR are included in this analysis; providers that were determined to be outliers are excluded.

For each year after 2022, we made assumptions regarding the trends in revenues and expenses. Only key factors, such as price increases, were assumed to affect these measures; that is, we made no additional assumptions about changes in utilization or intensity of services. We assumed that Medicare revenues would grow by the payment updates required by current law. These payment updates were based on the 2024 Trustees' assumptions for both input prices (or "market baskets") and the ACA-required productivity adjustments.[3] We also assumed that the short-range Medicare revenues would incorporate other legislatively required payment adjustments.[4] Additionally, the Medicare revenues reflect the reduction in disproportionate hospital share (DSH) payments required under the ACA.

We assumed that provider expenses and non-Medicare revenues would grow based primarily on input prices and health care provider productivity. We used two sets of assumptions for health care provider productivity: historical experience and achievable productivity. Based on historical measures of hospital productivity growth, we assumed that such growth would be zero under the historical experience scenario and 0.4 percent per year under the achievable productivity scenario.[5] For SNFs and HHAs, we assumed that productivity growth would be zero under the historical experience scenario and 0.1 percent per year under the achievable productivity scenario.[6]

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[2] For the hospital simulations, we used the average of 2021 and 2022 revenue and expenses to compute the base year margins to address the volatility in the total facility margins for these years caused by a few unique factors, most notably significant swings in investment gains and losses.

[3] The law requires the productivity adjustment to be based on the growth in economy-wide private nonfarm business multifactor productivity. Beginning with the November 18, 2021, release of the productivity data, the Bureau of Labor Statistics (BLS) replaced the term *multifactor productivity* with the term *total factor productivity*, a change in name only as the underlying methods and data were unchanged.

[4] Examples of other legislatively required payment adjustments include documentation and coding changes, budget neutrality, and sequestration.

[5] Information on updated estimates of hospital productivity is available at https://www.cms.gov/files/document/productivity-memo.pdf

[6] We assume that, because SNFs and HHAs are significantly more labor intensive than hospitals, they would not be able to achieve the productivity gains assumed for hospitals.

Findings

As shown in the simulation results presented in table 1, the proportion of hospitals, SNFs, and HHAs that experience negative margins increases over time.

The proportion of hospitals experiencing negative total facility margins is simulated to increase slightly from 2022 to 2027. There is an approximately 7-percentage point increase in the percentage of hospitals experiencing negative *Medicare* margins between 2022 (73 percent) and 2027 (77-80 percent). It should be noted that these simulations are simplistic in that they do not include other factors that could affect margins, such as new efforts by hospitals to improve efficiencies in response to lower Medicare payment updates. However, there is a wide range of uncertainty associated with these types of behavioral changes. By 2040, the simulations suggest that roughly one-third of hospitals would experience negative total facility margins, again holding all other factors constant.

Table 1. Simulated Proportion of Part A Providers with Negative Total Facility Margins

			Historical Experience		Achievable Productivity Scenario	
Provider Type	2011	Current Base Year 2022*	2027	2040	2027	2040
Hospital**	30%	29%	31%	36%	30%	31%
SNF	40%	61%	62%	66%	61%	65%
HHA	36%	37%	49%	58%	48%	56%

* For hospitals, the base year reflects the average of margin data for years 2021 and 2022, as described in footnote 2.

** The percentage of hospitals with negative Medicare margins was 66 percent in 2011 and 73 percent in 2022, increasing under the historical scenario to 80 percent in 2027 and to 89 percent in 2040, and under the achievable productivity scenario to 77 percent in 2027 and to 80 percent in 2040.

By 2027, the simulations suggest roughly 50 percent of HHAs would experience negative total facility margins, with most of the increases from 2022 caused primarily by other payment provisions, and over 60 percent of SNFs would experience negative total facility margins. By 2040 the percentage of SNFs experiencing negative margins increases by roughly 5-percentage points; for HHAs the increase is roughly 20-percentage points.

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