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MID-YEAR WAKE-UP CALL

2026: Pressure, Persistence and Portfolio Discipline

The first half of 2026 brought more of what healthcare leaders have come to expect: costs climbing faster than reimbursement, policy uncertainty reshaping the funding landscape, and investment portfolios asked to play an increasingly significant role.

What looked like a turning point in 2025 is proving harder to hold onto than many systems anticipated. Expenses grew twice as fast as prices last year. Federal Medicaid cuts are on the horizon as part of the One Big Beautiful Bill passed in 2025, and a tightening labor market is introducing new variables that even well-prepared systems have not fully accounted for.

This edition of Highland's Healthcare Quarterly distills what matters most right now, and what healthcare organizations should be thinking about as they manage through the second half of the year.

SECTOR UPDATE

Credit Stability in a Fragile Environment

U.S. not-for-profit acute care hospitals ended 2025 with greater credit stability than the prior year, continuing a three-year improvement trend. Rating activity from both S&P and Moody's reflected the same broad theme: more upgrades, fewer downgrades, and roughly 80% of issuers maintaining stable ratings[1] and outlooks. Many of the upgrades were driven by mergers and acquisitions, reflecting the consolidation premium that larger, integrated systems continue to enjoy.

When downgrades did occur, they were typically single-notch actions concentrated among standalone hospitals, most often in the 'A' and 'BBB' rating categories. No defaults were reported among rated issuers. The regional picture remained uneven: the Northeast continued to face greater pressure, while the West and Southwest showed stronger performance.

"Scale and integration continue to matter. Systems with diversified revenue, broader payer mix, and access to capital are absorbing pressure that standalone hospitals simply cannot."

Moody's 2026 sector outlook is stable, with modest margin improvement anticipated. Operating cash flow has stabilized below pre-pandemic levels, and the constraints ahead (labor costs, rising expenses, payer complexity, and longer-term policy risks) remain firmly in place.

The gap between health systems and standalone hospitals has narrowed somewhat, but systems retain a meaningful structural advantage through scale, diversification, and access to capital.

COST PRESSURES

Expenses Are Outrunning the Recovery

Hospital expenses grew approximately 7.5% in 2025 - more than double the growth in revenues.[2] This reflects a structural imbalance that has been building for years and shows limited signs of near-term correction.

Where the cost growth is coming from:
Drug and supply expenses led the increase, while workforce costs, already representing roughly 60% of total hospital expenses, continued their upward climb.[2]

Reimbursement has not kept pace. Medicare covers approximately 83 cents of every dollar hospitals spend on care. Across all payers, the shortfall exceeds $100 billion annually.[2] The administrative burden compounds the problem.

Hospitals spent approximately $43 billion in 2025 attempting to collect payments with bad debt increasing meaningfully year over year.[2] These are not marginal inefficiencies: they represent a significant and growing drag on operating performance.

Volume has grown alongside cost, yet more patients and more complex cases have not translated to better margins. Reimbursement continues to fall short of what it costs to treat them.

POLICY HEADWINDS

Medicaid, 340B, and the Stakes for 2027

Healthcare has navigated difficult policy environments before, but this one has an unusual number of variables moving simultaneously. Federal legislation (H.R. 1 (119th Cong.), which includes nearly $1 trillion in Medicaid cuts over 10 years) is moving forward, with the most significant financial impacts expected to begin in 2027.[3]

The cuts are broad. Work requirements and stricter eligibility rules are expected to reduce Medicaid enrollment, increasing the share of uninsured patients and, with it, uncompensated care. Bad debt and charity care have already risen approximately 10% year over year, and that trend could accelerate as policy changes take hold.[4] Hospitals currently reimbursed at roughly 71 cents per dollar will face additional downward pressure, particularly safety-net and rural systems that depend most heavily on Medicaid volumes.

340B under pressure
The 340B Drug Pricing Program, which allows eligible hospitals to purchase outpatient drugs at significant discounts while receiving full reimbursement from insurers, faces meaningful policy risk in the current environment. Future Medicaid cuts may reduce the share of Medicaid patient days used to determine 340B eligibility (the Disproportionate Share Hospital percentage) placing some hospitals' program status at risk. For systems that have relied on 340B savings to cross-subsidize care for underserved populations, any reduction in eligibility would carry direct financial consequences.

Medicare Advantage: volume with strings attached
Medicare Advantage continues to grow as a share of the Medicare population, stabilizing patient demand and encouraging care delivery in lower-cost settings. The financial terms, however, have not been favorable for hospitals. Medicare Advantage often reimburses at rates below traditional Medicare, while imposing meaningful administrative burden through prior authorizations and claim denials. For standalone hospitals with limited negotiating power, the combination of lower reimbursement and higher administrative cost produces thinner operating margins and greater operational complexity. Scale and system integration are increasingly required simply to participate on acceptable terms.

LABOR

A Workforce Under Pressure

Healthcare labor has been one of the most actively discussed topics thus far this year. The picture is nuanced: systems are cutting in some areas while hiring in others, and new risks are entering the picture from directions that traditional workforce planning has not fully addressed.

Where the cuts are happening

Many U.S. hospitals and health systems are reducing their workforces in 2026 in response to financial pressures and operational restructuring. The reductions are concentrated in nonclinical and administrative roles. Clinical hiring is largely continuing, reflecting the persistent demand for patient-facing staff. The pattern is consistent across systems of different sizes and geographies: cut overhead where AI and workflow automation can absorb the work, protect the clinical workforce where demand is growing.

Examples from recent months include workforce reductions at Asante, UMass Memorial Health, HCA Healthcare, and others. Reasons cited consistently include lower reimbursement rates, rising labor and supply costs, and the need to restructure for long-term financial sustainability.

The immigration variable

A recent consequential U.S. Supreme Court ruling has direct implications for healthcare workforce capacity. On June 25, the Court voted 6-3 permitting termination of temporary protected status of Haitian immigrants, roughly 21,000 of whom work as nursing assistants and caregivers across the country.[5] The full effect of the ruling along with other immigration policy changes for foreign-borne labor remains to be seen. The possible downstream effects (recruitment costs, overtime, capacity limitations, etc.) fall disproportionately on systems already operating with thin margins.

> "Workforce reductions in nonclinical roles are not only reactive; they may reflect a deliberate shift toward AI-enabled operations."

AI and the administrative workforce

Workforce reductions in nonclinical roles are not only reactive; they may reflect a deliberate shift toward AI-enabled operations. Automation is increasingly being applied to workflow, administrative efficiency, and imaging. The near-term impact is most visible in administrative headcount, but the longer-term implications for care delivery and operational models are still being worked out.

PORTFOLIO STRATEGY

Portfolio Positioning in The Current Environment

Investment portfolios have always played a supporting role in healthcare financial strategy. In the current environment, that role has grown. With operating margins constrained, Medicaid funding uncertain, and healthcare inflation outpacing general price growth, portfolios are being asked to bridge gaps that operating performance alone cannot close. Highland's conversations with CFOs, treasurers, and board members reflect a clear and consistent message: portfolio performance must keep pace with margin compression and healthcare-specific inflation to continue supporting operations.

Three priorities are shaping how systems may consider positioning their portfolios right now.

1. Re-evaluate asset allocation. Margin volatility may warrant a fresh look at whether current asset mix still aligns with your system's operating realities and board expectations. The risk profile that made sense two years ago may not be appropriate today, particularly for systems with significant Medicaid exposure or 340B dependence. One key area to focus on in a higher inflationary environment is the fixed income portion of the portfolio. Many investors tend to focus on the portfolio's nominal yield, but in inflationary environments it is essential to consider the real yield of the portfolio (the nominal yield less the rate of inflation). Investors with higher fixed income allocations are at risk of losing purchasing power in these situations and may benefit from shifting some fixed income into inflation-linked bonds to help mitigate this risk.

2. Understand and plan for liquidity needs. Delayed investment distributions, uncertain Medicaid funding timelines, and potential service restructuring all make a clear picture of short- and mid-term liquidity increasingly important. Access to capital, including letters of credit and near-term debt capacity, is a priority for systems that may need to move quickly on acquisitions, physician practice purchases, or operational pivots. Allocations to private investments should be reviewed to understand the true liquidity of the underlying assets and what future cash flows into or out of the investments may be required. Underlying companies within private investment funds may also face needs for additional cash, which would require additional capital contributions from investors who may not have sufficient liquidity to make those when needed. Over recent years, many investors have increased their allocations to assets such as private credit in an effort to increase returns and lower volatility, but recent headlines have shown that redemption gates make getting that capital challenging and uncertain.

3. Maintain exposure to inflation-sensitive assets. Healthcare inflation continues to outpace headline CPI. Portfolios may benefit from exposure to assets that respond to healthcare-specific inflation, not just broad CPI-linked instruments. Infrastructure and natural-resource exposures that respond to energy and materials cost dynamics are worth maintaining for systems where those cost categories are materially moving. While not a traditional inflation-sensitive asset, equity investments in software and artificial intelligence companies could provide some inflation protection related to new expenses. As software and AI gain adoption to decrease expenses within administrative and operations functions, those tech companies grow their customer base and earn higher revenue. In turn, investment portfolios may benefit as those companies generate additional profits.

Strong liquidity has been one of the primary factors supporting balance sheet resilience in the current period, even as operating cash flow remains below pre-pandemic norms. Protecting that cushion (and positioning it to work harder) is the clearest near-term priority.

STRATEGIC TAKEAWAYS

Consider Reassessing Portfolio Risk

Given margin volatility, revisit whether your current asset mix still aligns with your system's operating realities and board expectations.

Consider Revisiting Liquidity Planning

Uncertain Medicaid funding and potential service restructuring make a clear understanding of short- and mid-term liquidity needs more critical than ever.

Consider Preparing for Policy Impact

Model scenarios for Medicaid cut timelines, 340B eligibility changes, and Medicare Advantage growth to understand the range of outcomes your system may face in 2027.

Continue Monitoring Labor Picture

Workforce restructuring is ongoing. Track both the AI-driven shift in administrative staffing and the immigration-related risks that could affect clinical capacity.

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Looking Ahead

The pressures described in this edition may persist over the near to intermediate term. Systems that treat investment strategy as part of their operating plan, not separate from it, could be better positioned when the harder decisions arrive. Highland remains focused on supporting clients in navigating these conditions.

1. "U.S. Not-For-Profit Acute Health Care 2026 Outlook: Resilient For Now, With Increased Credit Risks On The Horizon" – S&P Global
2. "Costs of Caring: Challenges Facing America's Hospitals as They Care for Patients in 2026" – American Hospital Association
3. H.R. 1, One Big Beautiful Bill Act, 119th Congress
4. "Hospital bad debt, charity care up 10% in 2025" – Becker's Hospital Review
5. "Trump's Immigration Fight Threatens Haitian Elder-Care Workers" - Bloomberg