

THE 2026-27 BUDGET: DISTRESSED HOSPITAL GRANTS IN MAY REVISION

Below is our initial analysis of the proposed funds for distressed hospitals. We begin with background on hospital finances and previous state efforts to assist distressed hospitals. Next, we summarize the proposal in the May Revision. We then analyze it and provide associated recommendations.

BACKGROUND

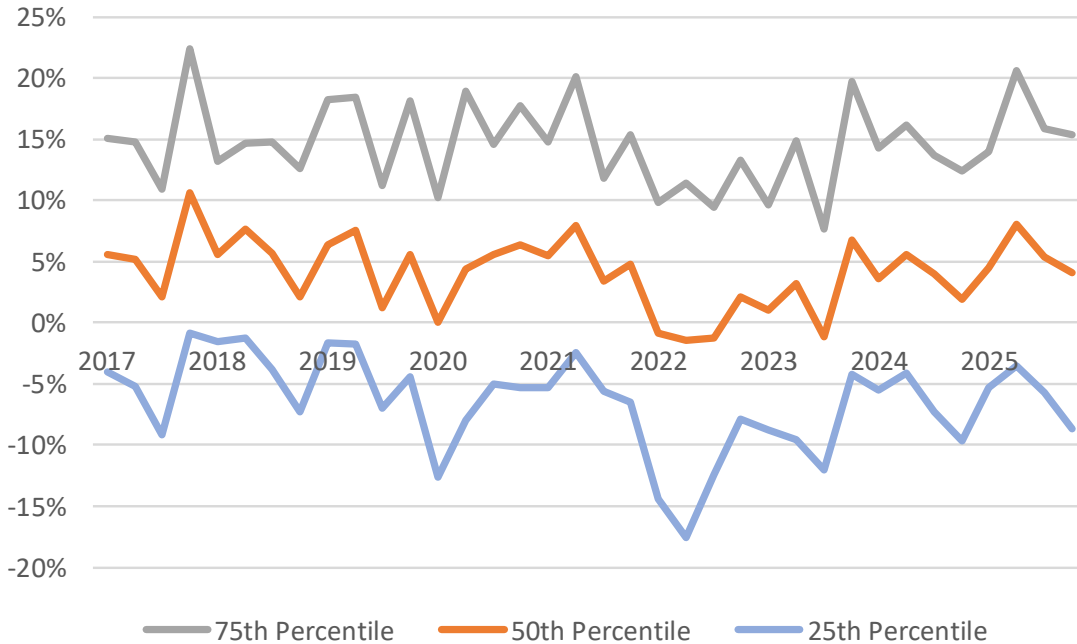
Hospital Profitability Notably Fell in 2022. California's over 400 general acute care hospitals have experienced a turbulent market in recent years. Hospital patient volume notably fell during pandemic, and then operating costs notably rose due to inflation. Overall industry profitability, however, generally remained healthy. [Previous research](#) has attributed this trend in part to many hospitals generating revenue from other sources, such as investment and endowment income. In early 2022, however, these sources fell rapidly as inflation rose and investment returns slowed. As a result, a typical hospital's margin (the percentage of revenue earned after covering costs) fell to nearly 0 percent, with many hospitals facing deficits this year.

California Created Loan Program to Help Distressed Hospitals. Following the dip in profitability in 2022, many anecdotal reports emerged of hospitals facing significant financial distress and near closure. In response, the Legislature created the Distressed Hospital Loan Program. Under the program, hospitals could apply for zero-interest loans to help stay afloat. The Legislature allocated \$300 million for the program (\$150 million each from the General Fund and the managed care organization tax). The Department of Health Care Access and Information (HCAI) administered the program, awarding loans based on several metrics of financial distress. In total, the department awarded loans to [16 hospitals](#).

Hospital Profitably Generally Has Rebounded...As Figure 1 shows, hospital margins have somewhat rebounded since 2022. For a typical hospital, quarterly margins in 2025 (the most recent year of data available) appear to be similar to pre-pandemic levels, though the trends vary each quarter. Trends have improved even for the least profitable hospitals (at the 25th percentile), though they remain somewhat below pre-pandemic levels.

Figure 1
Hospital Profitability Has Since Rebounded

Quarterly Total Margins

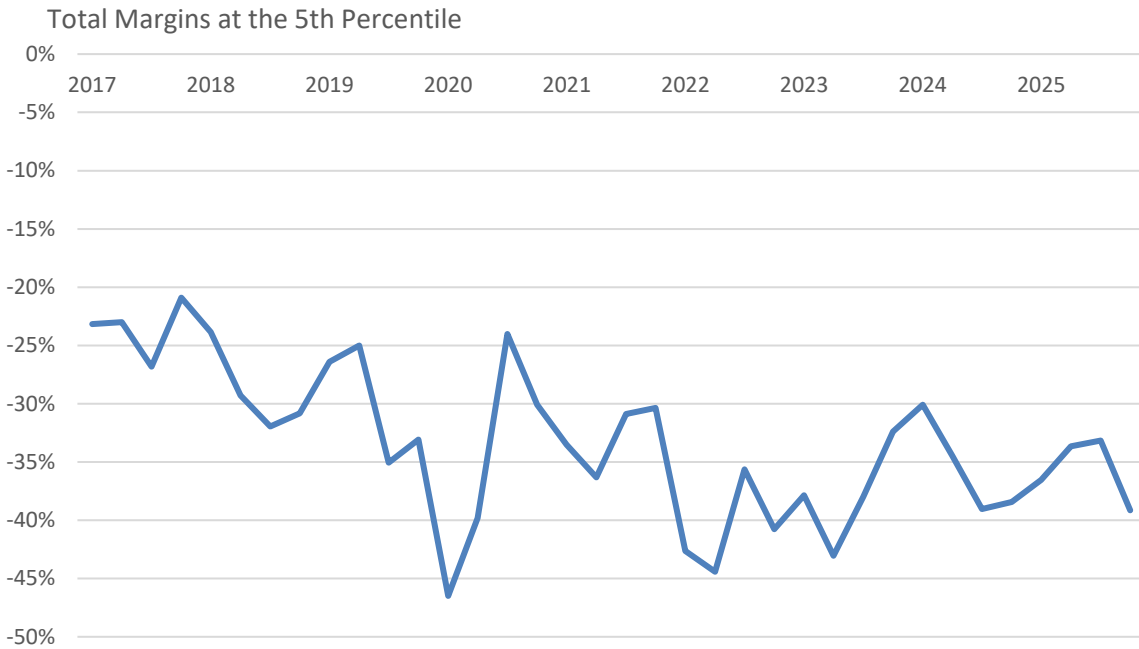


Note: Excludes certain hospitals, such as Kaiser hospitals and facilities with a long-term care emphasis, that the Department of Health Care Access and Information does not consider comparable for the purposes of financial analysis.

...But Some Hospitals May Be Still Distressed. While the hospitals industry seems to be in an upward trajectory, some hospitals may still be facing distress. Identifying these hospitals is challenging due to certain data limitations (described later). However, HCAI reported earlier this year that around half of the loan recipients had applied for a portion of their debt to be forgiven—potentially an indication that some hospitals have not completely turned around their financial situation. As Figure 2 shows, margins for very least profitable hospitals (the 5th percentile) also remain lower than pre-pandemic levels.

Figure 2

Margins for the Least Profitable Hospitals Remain Below Prepandemic Levels



Legislature Recently Approved Additional Support for Distressed Hospitals. As part of this year’s early action legislation, the Legislature approved \$25 million one-time General Fund in 2025-26 for distressed hospitals. The funds differed from the previous Distressed Hospital Loan Program in several respects. The funds were for grants, rather than loans. A narrower set of hospitals also could apply for funds, namely those with just ten days cash on hand and at least half of their payor mix comprised of government payors and the uninsured. HCAI can also develop additional criteria, in consultation with the Department of Finance.

PROPOSAL

Provides More Grant Funding for Distressed Hospitals. The May Revision proposes allowing up to \$50 million one-time General Fund for grants to distressed hospitals. Other than the higher amount, the grant program would be identical to the \$25 million program recently approved in this year’s early action. The summary of the May Revision also states, “the administration will continue to work with the Legislature on this issue.”

ASSESSMENT

Level of Need Among Distressed Hospitals Is Difficult to Gauge. In concept, the state could track distressed hospitals utilizing HCAI’s extensive hospital financing data. In our initial review of the data, however, we identified some key limitations. For example, hospital stakeholders have indicated that HCAI’s data, which reflect point-in-time estimates, might misrepresent a hospital’s financial situation throughout the year. (We are still working with HCAI to better understand some of these issues.) Accordingly, we could not identify a clear basis to come to a precise estimate of hospitals’ financial need. That said, given the demand for the state’s previous

\$300 million loan program, it seems probable that the state could easily spend \$50 million to address hospital financial constraints.

New Proposal Raises Three Key Concerns. As Figure 3 shows, the proposal considers far fewer parameters to determine eligibility than the state's previous loan program. This raises four key concerns:

- ***Funds Could Be Poorly Targeted.*** The state is not obligated to assist every closing hospital. Arguably, the state's interest in preventing closures heightens when they put vulnerable populations' access to care at risk. The state's loan program considered metrics aimed at capturing community need. For example, it considered a hospital's distance to the next hospital—with more distant facilities getting greater priority for loans. While this proposal includes one community need metric (payor mix), the proposed metrics are far less robust.
- ***Hospitals Could Be Distressed in Other Ways.*** Cash on hand is just one measure of whether a hospital is distressed. Accordingly, the state's loan program considered a wider array of measures, including negative margins and current ratios (current assets divided by current liabilities).
- ***Existing Measures Could Be Too Extreme.*** Based on discussions with stakeholders, we understand that a hospital with ten days cash on hand is in extreme distress. Hospitals with slightly higher days on hand than this threshold, however, also could be at risk of closure. For comparison, the state's loan program gave greater priority to hospitals with no more than 30 days cash on hand.
- ***No Certainty of Long-Term Success.*** In concept, one-time funds can only preserve a hospital if there is a long-term plan in place to turn around its financial situation. Accordingly, hospitals were required to submit such a plan to access state loans. Without such a requirement in this year's grants, the state runs the risk of spending funds with little long-term impact.

While the proposal allows HCAI to determine additional criteria, such an approach offers the Legislature no certainty that the funds would be allocated according to legislative priorities.

Figure 3
Proposed Grant Program Has Far Fewer Eligibility
Criteria

Criteria to Be Eligible for Loan or Grant

	Previous Distressed Hospital Loan Program	Proposed Distressed Hospital Grant Program
Liquidity		
Days cash on hand	✓	✓
Current ratio	✓	
Access to working capital	✓	
Profits/Losses		
Operating margins	✓	
Cash compared to operating loss	✓	
Turnaround		
Plan to turnaround finances	✓	
Community Need		
Distance to nearest hospital	✓	
Whether hospital will preserve lines of service	✓	
Location in underserved area	✓	
Payor mix	✓	✓

Note: Proposed grant program allows Department of Health Care Access and Information to establish other criteria, in consultation with the Department of Finance.

Distress Among Hospitals—as Well as Clinics—Could Increase in the Future. As we noted in our recent publication [*How Will the Changing Landscape Affect California’s Health Care System*](#), hospitals—as well as clinics—could face heightened fiscal pressures in the coming years. These pressures stem from expected disenrollments from the Medi-Cal program and lower reimbursement rates due to H.R. 1 and certain state budget solutions. In light of these changes, additional hospitals could face increased fiscal pressure in the coming years. We also found that clinics could be more financially vulnerable than hospitals, as they are smaller and more likely to serve Medi-Cal and uninsured patients.

RECOMMENDATIONS

Weigh Proposal Against Priorities in Context of Constrained Budget. As we note in our [*initial comments report*](#), the budget continues to have a structural deficit in the May Revision and is ill-prepared to whether a downturn if one were to occur. Accordingly, we recommend adopting tens of billions of dollars more in solutions *in addition* to what the Governor proposes. Given this environment, the Legislature will want to weigh any new spending proposals carefully, as it would have to find dollar-for-dollar reductions elsewhere in the budget.

If Proposal Remains a High Priority, Consider Modifications. If supporting distressed hospitals remains a high budget priority, we recommend the Legislature consider the following modifications:

- ***Weigh Adjusting Funding Amount.*** While the precise need is not known, demand probably is higher than the proposed \$50 million. The Legislature could adjust this amount, based on how many dollar-for-dollar reductions it is willing to undertake elsewhere in the budget.
- ***Expanding Parameters.*** We recommend the Legislature expand upon the metrics used to allocate grants, rather than giving the administration flexibility to determine them after the funds are appropriated. As a starting point, the Legislature could build from the metrics used in the state’s previous loan program. At a minimum, it likely will want to ensure grant recipients have sufficient turnaround plans to ensure long-term viability after they spend their one-time state awards.