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Office of the President

TO MEMBERS OF THE HEALTH SERVICES COMMITTEE:

DISCUSSION ITEM

For Meeting of July 15, 2025

UC MEDICAL CENTER PHARMACY AT THE CROSSROADS OF INNOVATION AND RISING COST

EXECUTIVE SUMMARY

The University of California Health system remains steadfast in its mission to deliver innovative, specialized, and curative care, even as it navigates the rising costs of pharmaceuticals, which are often difficult to control. With over 11 million outpatient visits last year, and 1.25 million inpatient visits, UC medical centers serve a diverse group of patients, from those whose chronic medical conditions require access to both preventative and therapeutic medications, to those with rare and complex illness that are receiving novel—and often expensive—treatment, many of which found their origins in the laboratories of UC scientists. For these reasons, expenditures have become a prominent and growing pressure point, largely influenced by manufacturers and distributor pricing dynamics outside the health system's control. At the same time, beginning in 2026, healthcare entities statewide will be subject to new cost growth targets imposed by the Office of Health Care Affordability (OHCA). As the State's premier teaching hospital and public safety net hospital system, the University's unique tertiary and quaternary care activities are not currently sufficiently considered in OHCA's enforcement of cost growth targets, particularly given UC's focus on patients with highly complex illnesses and often rare diseases. The current topic outlines key drivers behind rising pharmacy costs, identifies strategic levers to manage these expenditures, and presents a future opportunity that will require leadership engagement and systemwide coordination.

BACKGROUND

As demonstrated by the quarterly financial report for the University of California Medical Centers, since 2021 UC Health has faced nearly ten percent average annual drug spending increases. For the same period, national health-system pharmacy spending has risen at a comparative rate of seven to 12 percent. This increase represents one of the fastest rising and most strategically significant cost categories within health systems. UC Health's pharmacy costs are tied to rising prices from pharmaceutical companies as well as differences in delivery models and consumer expectations of availability of new medications. The University faces pressure in multiple directions at once due to UC's unwavering commitment to serving the people of California and State/federal regulatory expectations, all while the University attempts to mitigate

rising drug cost. In response to this pressure, UC Health has implemented a multifaceted strategy that includes formulary governance (e.g. standardization of what medications are available in at UC medical centers), payer collaboration to guide access and how pricing is determined, and stewardship of the Medicare 340B program to reduce drug cost where possible (with reinvestment of savings to preserve access for vulnerable populations). Alongside successful inpatient cost mitigation strategies, the UC Health Pharmacy leadership has also recognized that outpatient pharmacy spending has emerged as a primary cost driver, requiring new approaches to create value while directing patients increasingly to UC pharmacies for access.

Rise in Pharmaceutical Expenditures

Pharmacy expenditure now surpass $2.6 annually and represent over 12 percent of the system's $21 billion total operating costs. With the exception of salaries and wages, this upward trajectory is among the steepest across all expense categories, fueled by persistent inflation, a growing pipeline of specialty drugs, and a systemwide shift toward outpatient care. UC Health's outpatient settings now account for roughly two-thirds of total pharmacy spending, driven by the increasing use of complex biologics, high-cost therapeutics, and broader access to advanced treatments that are uniquely critical to UC's ability to provide complex tertiary and quaternary care to underserved populations. Unlike more fixed operational expenses (i.e. medical equipment, facility costs. IT infrastructure, etc.), pharmacy spending is dynamic and volatile, shaped by external prescribing patterns, decentralized benefit structures, and rapidly evolving market and regulatory forces. Ultimately, this recurring pharmacy expenditure growth trend far outpaces the cost growth targets being phased in by the State's Office of Health Care Affordability (OHCA) and serves as a difficult driver in the ability of the University's ability to minimize the cost of care for the people of California.

Impact of Care Setting on Drug Reimbursement

	Inpatient	**Infusion Centers**	**Home Infusion**	**Retail Pharmacy**
Payment	Capitated	Fee for service		
Reimbursement	Marginal	Moderate	Marginal	Moderate
Influences	Utilization control	Margin reduction	Alternate site of service	340B PBM

Where a patient receives treatment significantly influences how drugs are reimbursed

Pharmacy dispensing occurs in very unique settings across the UC health systems. In hospital inpatient environments, medications are reimbursed through capitated (bundled Diagnosis-Related Group (DRG)) payments, which can constrict direct cost recovery and therefore necessitate strong utilization management approaches. Payments in outpatient departments are on a fee-for-service basis and are paid under Ambulatory Payment Classifications (APCs). **APC** is a Medicare reimbursement system that categorizes outpatient services into groups based on clinical similarity and resource use, determining how hospitals are paid for outpatient care. This offers partial reimbursement, but reimbursement can often fall below acquisition cost. In contrast, ambulatory infusion centers and home infusion settings enable more favorable reimbursement, with margins that are facilitated by lower overhead. Retail and specialty pharmacy medications, reimbursed under health plan pharmacy benefits, can offer better reimbursement and margin, but come with stricter pharmacy benefit manager regulation. Site-of-care strategies that are unique to each setting are essential to optimize cost recovery, maintain patient access, and manage overall pharmacy spending.

Forces Influencing Pharmacy Expenditures[1]

UC Health's pharmacy expenditures are being shaped by a convergence of powerful external and internal forces. These drivers span the healthcare market, care delivery models, and State and federal policy, and together reshape the cost structure, operating environment, and expectations for systemwide pharmacy performance.

A. Care Delivery Evolution: The Outpatient Shift

- *Growth of Outpatient and Ambulatory Care*
  The broader transition from inpatient to outpatient care is structurally reshaping where and how medications are delivered. Growth in **ambulatory clinics, infusion centers, and home health** means more pharmacy activity is occurring in settings with **variable reimbursement and greater operational complexity**. UC pharmacies can sometimes position Medicare 340B pricing, but at the very least operationalizing these variable settings can lead to complex revenue cycle processes to ensure that reimbursement is optimized and efficient.

- Pipeline Complexity and Innovation
  The UC medical centers and health professional schools are unique in their provision of care for those with increasingly complex and novel diseases and illnesses, having been the location where many of these treatments were developed. The pharmaceutical pipeline is expanding rapidly with **specialty and precision therapies** targeting conditions such as cancer, autoimmune disease, and rare genetic disorders. While clinically transformative, these therapies carry high acquisition costs, uncertain reimbursement, and limited alternative treatments, creating **budget volatility and pressure to control demand**. UC Health's position as an early adopter amplifies these

[1] McKinsey & Company. "The Future of US Healthcare: Moving from Siloed to Integrated Delivery." ; National Academy of Medicine. "Trends in Health Care Delivery: Patient Expectations and the Consumerization of Care."

dynamics and calls for advanced forecasting, clinical stewardship, and value-based purchasing approaches.

B. Market Forces: Consumer and Industry Transformation

- Consumer-Driven Expectations
  Patients increasingly expect real-time access, transparent pricing, and personalized service, raising expectations for digital platforms, rapid delivery, and on-demand clinical support. Meeting these expectations requires innovation in pharmacy technology, new staffing models, and infrastructure that can deliver speed without compromising care standards.

- Disruption by Non-Traditional Players
  Positioning UC pharmacies has been made more challenging as major for-profit retailers and tech/logistics companies such as Amazon, CVS, and Walmart emerge. These companies are disrupting pharmacy delivery and benefit management with **aggressive pricing models, massive logistics scale, and proprietary data ecosystems**. For example, aggressive pricing strategies being used include loss leader tactics (pricing generics below cost), cost-plus modeling (Mark Cuban's company), or subscription models (Walmart Rx or Amazon Prime RxPass) where members receive drug discounts and same-day delivery. These for-profit entities are creating significant competitive pressure by creating lower-cost alternatives and capturing market share in outpatient and specialty drug fulfillment that UC Health as a non-profit safety net hospital system has traditionally relied upon to offset costs to preserve access for the underserved. UC Health is considering new strategies to retain patients within the system and preserve margin in pharmacy-related services.

C. Policy Landscape: Regulatory Mandates and Financial Risk

- OHCA Cost Growth Targets[2]

  As California's **Office of Health Care Affordability (OHCA)** seeks to impose annual cost growth targets across all major health sectors, starting at 3.5 percent in 2026 and declining to three percent by 2029, the pressure to mitigate risk in pharmaceutical cost growth has increased. While UC Health shares the goal of improving affordability, the targets currently **do not account for the impact of high-cost, curative therapies**, disproportionately affecting pharmacy budgets and placing innovation at risk. UC Health must navigate this framework through **data transparency, strategic cost governance, and targeted advocacy**. OHCA should consider the impact of these therapies in its enforcement of cost growth targets.

[2]California Department of Health Care Access and Information (HCAI) / Office of Health Care Affordability (OHCA). "Health Care Spending Targets Program – Overview and Rulemaking Updates."

- 340B Program Under Scrutiny
  The federal 340B Drug Pricing Program, which enables safety-net providers like UC Health to access discounted medications for underserved populations, is facing mounting legislative and legal challenges. Reductions in manufacturer participation and restrictions threaten to erode a vital financial pillar that redirects pharmacy savings into **outpatient expansion and charity care**. UC Health locations are considering scenarios where this program is curtailed, seeking to build internal resilience and diversifying revenue recovery strategies.

Why Advanced Therapeutics Should Be Treated Differently

As an academic health system and public safety net hospital system, UC Health uniquely creates access to advanced therapeutics such as gene therapies and CAR-T treatments, which represent a transformative shift in modern medicine. These one-time, potentially curative interventions deliver profound long-term clinical and economic value, but high upfront costs can contribute to cost growth, putting providers of care like the University at risk of exceeding OHCA's spending targets regardless of the reality that UC Health is acting in the best interests of patients. For-profit entities like Amazon, CVS, and Walmart do not offer this category of expensive and life-changing care and strategically position their businesses to outcompete in markets with easier barriers to entry.

To avoid disincentivizing innovation and protect UC's ability to lead in breakthrough medicine, UC Health is actively advocating for the consideration of these advanced therapies in OHCA's enforcement of cost growth targets. Without sufficient consideration in OHCA's framework, institutions like UC Health may face disincentives to offer these breakthrough therapies and this would threaten access to innovation and undermine equity in patient care. UC Health's approach aligns with OHCA's intent while safeguarding UC Health's tripartite mission of research, education, and clinical excellence to lead in access, discovery, and responsible innovation.

UC Health's Eight Strategic Levers for Managing Pharmacy Spending[3]

UC Health uses a multifaceted pharmacy strategy that balances cost containment with its mission to advance access, innovation, and health equity. The following are eight strategic levers that UC Health locations can deploy, combining clinical stewardship, fiscal discipline, and operational excellence, to manage expenditures and sustain value at each site and across the system.

Formulary Management and Utilization Controls

UC Health leverages both local Pharmacy and Therapeutics (P&T) governance and a systemwide High Impact Drug Strategy Council to drive evidence-based, cost-conscious prescribing. Tools such as dose optimization protocols, therapeutic interchange programs, tiered formularies, site-of-care delivery pathways, and prior authorization protocols ensure

[3] Vizient. "Pharmacy Cost Management Strategies in Academic Health Systems."
Premier Inc. *"Playbook for Reducing Drug Spend in Integrated Delivery Networks."

that medication use is clinically appropriate and economically sustainable. These coordinated controls reduce variation, align practice across sites, and help optimize resource use.

Collaboration with GPOs, Payers, and Policymakers

Strategic partnerships play a central role in UC Health's pharmacy cost containment efforts. Group Purchasing Organizations (GPOs) enhance buying power and secure discounted pricing. In parallel, payer collaboration supports the development of value-based contracts and shared savings models, while engagement with policymakers, particularly around 340B protections and OHCA enforcement, ensures that regulatory frameworks consider the realities of academic healthcare delivery and what UC Health uniquely offers in service of the people of California.

Alternative Site of Care and Cost-Effective Therapies

To reduce the total cost of care, UC Health locations can strategically shift the delivery of infused and specialty drugs from hospital outpatient departments to more cost-effective settings such as ambulatory infusion centers, home infusion, and specialty pharmacies. This approach is complemented by clinical efforts to increase biosimilar and generic adoption, preserving access while reducing acquisition costs.

Buy and Bill Model Optimization

Under the buy-and-bill model, UC Health can optimize financial outcomes through improved charge capture processes, ensuring that reimbursement is appropriately aligned with acquisition costs, and forecasting inventory needs to prevent overstocking or waste. These measures are critical when the health system must purchase and administer high-cost therapies upfront.

Use of the 340B Program

As discussed with the Committee at the May 2025 meeting, the 340B Drug Pricing Program is a vital tool for UC Health, enabling significant savings on outpatient drug purchases. These savings are reinvested to expand access in underserved communities, support outpatient growth, and fund uncompensated care. As scrutiny of the program intensifies, UC Health maintains a strong focus on compliance and audit readiness to preserve this critical source of support.

Monitoring Emerging Therapies

Proactive management of high-cost innovation is essential. UC Health employs tools that monitor U.S. Food and Drug Administration (FDA) approvals, assess the financial impact of new drugs in the pipeline, and model therapy-specific budget implications. This future-focused strategy ensures formulary and financial preparedness ahead of market adoption of novel therapies.

Performance Monitoring: Measuring Impact and Future Readiness

UC Health uses real-time dashboards and pharmacy-specific key performance indicators (KPIs) to assess the impact of its strategies. Metrics such as biosimilar conversion rates, adherence to formulary pathways, and drug spending per adjusted patient day help identify performance gaps and guide ongoing improvement and readiness planning.

Hospital vs. Outpatient Pharmacy Balance

Maintaining the optimal balance between hospital-based and outpatient pharmacy services is both a financial and clinical imperative. UC Health continuously evaluates where therapies can be delivered most efficiently and safely, working to ensure the UC specialty pharmacy services are integrated with UC's 340B strategy to preserve both continuity of care and margin retention.

Opportunity: A Pharmacy-Led PBM Strategy for Self-Funded Plans[4]

Pharmacy Benefit Managers (PBMs) act as intermediaries between drug manufacturers, payers, and pharmacies. While originally designed to streamline access and control costs, many PBMs today operate with limited transparency, retaining rebates and generating profits through spread pricing, a practice in which a pharmacy benefit manager (PBM) charges a health plan more for a drug than it reimburses the pharmacy, keeping the difference as profit. In response, UC Health may consider new opportunities itself in pharmacy benefit management, focusing first on the administration of pharmacy benefits for its self-funded employee health plan. A UC PBM strategy would allow the University to move away from third-party PBMs that often operate with opaque pricing structures, limited alignment to clinical value, and retention of rebate dollars that could otherwise be reinvested in care. A UC pharmacy-led PBM model offers the prospect of better transparency with upfront drug pricing (cost plus model), negotiation and retention of drug manufacturer rebates, with the value passed directly back to UC's self-funded health plan and members.

Ultimately, internalizing this function could empower the system to reinvest savings into patient care, benefit design, and high-impact therapeutic access. UC Health's pharmacy teams already manage complex drug regimens, high-cost specialty therapies, and population-level utilization strategies, making this an operationally feasible and mission-consistent next step. A UC-led PBM could represent not just a milestone in operational efficiency, but a model for how academic health systems can deliver equitable, transparent, and patient-centered benefit strategies at scale. UC Health will continue to confer with the University's health plan leadership and UC Health sites to determine the viability and future for such an offering.

[4] National Pharmaceutical Council. "Policy Considerations for Value-Based Pharmacy Benefit Design."