Date Filed: 12/16/2022

FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Lifespace Communities, Inc. at 'BBB'; Outlook Stable

Tue 13 Sep, 2022 - 11:42 AM ET

Fitch Ratings - New York - 13 Sep 2022: Fitch Ratings has affirmed the 'BBB' Issuer Default Rating (IDR) on Lifespace Communities, Inc., (Lifespace) and the 'BBB' Long-Term rating on approximately $525.4 million of bonds issued through various authorities on behalf of Lifespace.

Fitch has also affirmed the 'BBB' rating on approximately $41.8 million of series 2015 retirement facility revenue bonds issued by the Tarrant County Cultural Education Facilities Finance Corporation on behalf of Querencia at Barton Creek (Querencia).

The Rating Outlook is Stable.

SECURITY

Bonds are secured by a pledge of unrestricted receivables of the obligated group (OG) and a mortgage interest in certain property.

ANALYTICAL CONCLUSION

The 'BBB' rating reflects the expected resilience of Lifespace's financial profile through Fitch's forward-looking scenario analysis, within the context of the strength of Lifespace's business profile. The rating is informed by Lifespace's very strong one of the nation's largest and most geographically diverse not-for-profit life plan community (LPC) systems, and midrange operating risk, with operating and capital metrics consistent with a midrange assessment for a predominantly type-A (lifecare) LPC.

Lifespace's debt burden remains high and its cash-to-adjusted debt relatively low for the rating category, which is largely due to additional borrowings it has transacted in order to finance its substantial campus redevelopment plan, beginning in 2016. Despite Lifespace's significant core credit strengths and Fitch's expectations that its substantial capex will be strategically and financially accretive to the organization once the projects mature, Lifespace's high debt burden, as well as the execution risk that will be associated with these projects, that is ultimately constraining the rating at 'BBB', pending a successful completion and fill-up of the campus redevelopment project and other capital plans.

Fitch is also concerned about Lifespace's recent trend of declining independent living unit (ILU) occupancy, but believes that by virtue of its size and scale, Lifespace possesses the operating flexibility to weather what is expected to be a transitory stress and recover occupancy to levels consistent with historical averages over the next one to two years.

Fitch's forward look shows the Lifespace OG's financial profile remaining consistent with historical levels through a moderate stress scenario, which reflects the stability expected in a provider of the size and geographical diversity of the Lifespace OG. The number of separate campuses is especially relevant to a type-A life contract provider in minimizing the actuarial risk of the health care liability.

KEY RATING DRIVERS

Revenue Defensibility: 'aa'

Sizeable Multi-State Senior Living Provider

Fitch views Lifespace's geographically diversified platform as the core strength of its revenue defensibility assessment. Revenue generation and profitability are well balanced among the 11 OG communities, with no individual community accounting for more than 13% of gross revenue through June 30, 2022. Florida is home to the largest number of Lifespace's LPCs, with five of the OG's 11 communities located there. Lifespace's communities in Florida collectively accounted for under half (about 47%) of gross revenues as of June 30, 2022.

There is limited overlap between Lifespace's respective markets (including between the recently acquired CMW communities and those previously acquired from Senior Quality Lifestyles Corporation [SQLC]). Competition varies by community; however, Fitch views the geographically diversified platform as mitigating single-site demand risk and supporting expectations for a strong overall market position.

Lifespace's ILU occupancy has declined over the last several years, with average ILU occupancy falling to 79% in 2021 and 77% as of June 30, 2022, compared to a previous four-year average of 88%. Management attributes this decline to a stale marketing effort in the face of new competition, which caused Lifespace to cede market share to competitors in certain of its markets. Lifespace has revamped its sales and marketing efforts to incent quarterly (as opposed to annual) sales targets and notes that it has exceeded budget on sales for three consecutive quarters. Overall occupancy across all levels of care was 81.0% as of June 30, 2022, exceeding budget by 1.8%.

By virtue of Lifespace's size and scale, Fitch believes the organization possesses the ability weather what Fitch expects to be a temporary weakness in occupancy, as well as the operating flexibility to compete effectively and recover its market foothold over the next one to two years, and therefore affirms its 'aa' revenue defensibility assessment. If in that time the recovery in ILU slows or declines, it could suggest a more fundamental weakness in Lifespace's market position, which may justify consideration of a weaker revenue defensibility assessment.

Lifespace OG's various markets generally have good economic and demographic characteristics; moreover, the pricing risk is diversified, given the number of separate communities and that no single campus's total units account for more than 13% of the system's total units.

Operating Risk: 'bbb'

Adequate Cost Management, Ongoing Campus Redevelopment Plan

Fitch assesses the Lifespace OG's operating risk 'midrange', reflecting its predominantly type-A contract mix and track record of adequate cost management and substantial capital investment, with projects expected to enhance Lifespace's competitive positioning in its respective markets. Lifespace's capital-related metrics are somewhat weak, primarily as a consequence of the additional borrowing to finance its campus redevelopment plan, but its debt burden is beginning to moderate as the projects stabilize and accrete to cash flow.

Lifespace OG has a track record of adequate cost management, with five-year average operating ratio of 98.5%, net operating margin (NOM) of 3.3% and NOM-adjusted of 16.3% all consistent with a 'midrange' assessment of its operating risk. Recent declines in occupancy have caused Lifespace's operating performance to deteriorate to 104.4% in 2021 and 108.3% as of June 30, 2022. As Lifespace's occupancy recovers, its operating performance should also recover back to levels more in line with Fitch's 'bbb' operating risk assessment.

The series 2021 bonds represented the final tranche of expected public debt that Lifespace will use to finance its multi-campus redevelopment project, which began in 2016, resulting in capex that has averaged about 209% of depreciation over the last five years. Lifespace's average age of plant is a low 8.3 years, indicating that it is adequately investing in its physical plant to remain competitive and meet current market demand for amenities and services.

Campus redevelopment plans include adding assisted living and memory support services at five communities, in addition to enhancing common areas and adding ILUs at certain communities. Total identified projects through 2023 equal approximately $441.5 million, which has been approved by the Board. When complete, the projects will add 258 ILUs, 122 assisted living units (ALUs) and 140 memory support units (MSUs), while decreasing skilled nursing facility's (SNF) by 35 units, due to repositioning toward private rooms. The projects are expected to stabilize between 2021 and 2024. Management expects to use initial entrance fees to redeem temporary project debt.

Lifespace also plans to incur approximately $68 million in bank debt in the fall of calendar 2022 to finance a modest eight-ILU expansion and renovations to the SNF and common areas at The Waterford, as well as some routine renovations at certain other OG communities. Lifespace is contemplating a more extensive phase II expansion at The Waterford that would add 84 new ILUs, 24 ALUs and 16 memory support units, but management will only seek board approval for this phase of the project if Lifespace can achieve 70% presales on the proposed new ILUs and can secure a GMP that results in The Waterford and Lifespace achieving its targeted coverage and liquidity goals.

Lifespace's capital-related metrics are somewhat weak. Pro forma maximum annual debt service (MADS), including the $68 million bank debt referenced above, is approximately $38.5 million and represents an average of 15.1% of revenues in 2017-2021 and pro forma revenue-only MADS coverage has averaged 0.5x since 2017. Lifespace OG's pro forma debt-to-net available was a high 9.4x in 2021; however, this figure is beginning to moderate as the projects fully stabilize and accrete to cash flows.

Financial Profile: 'bbb'

Financial Profile Resilient Through a Moderate Stress Scenario

Given Lifespace OG's strong revenue defensibility and midrange operating risk assessments and Fitch's forward-looking scenario analysis, Fitch expects key leverage metrics to remain consistent with the current financial profile throughout the current economic and business cycle. As of June 30, 2022, the Lifespace OG had unrestricted cash and investments of approximately $192.5 million, representing about 35% of total proforma adjusted debt, including the planned 2022 borrowing for The Waterford phase I project. Lifespace OG has no debt equivalents and had 299 days cash on hand as of YE 2021.

Fitch's baseline scenario, which is a reasonable forward look of financial performance over the next five years, given current economic expectations, shows the Lifespace OG maintaining operational and financial metrics that are largely consistent with the current rating and with historical levels of performance. The scenario analysis also incorporates the expected trajectory of Lifespace's campus redevelopment plan, including the series 2021 and planned 2022 borrowings, related capex and expected repayment of temporary debt with initial entrance fees.

As part of the forward look, Fitch assumes an economic stress (to reflect financial market volatility), which is specific to Lifespace's asset allocation. Lifespace OG's cash-to-adjusted debt levels remain consistent with pro forma levels at YE 2021 and consistent with Fitch's expectations. MADS coverage improves significantly even during the stress, factoring in expectations for successful project completion and fill. However, successful completion and fill of the project and repayment of the temporary debt will need to be evident before Fitch would consider positive rating action.

Asymmetric Additional Risk Considerations

No asymmetric risk considerations were relevant to the rating.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Continued declines in ILU occupancy and/or an inability for Lifespace to recover to ILU occupancy levels more consistent with its previous average of 88% could suggest a lower revenue defensibility assessment, which could negatively impact Lifespace's rating;

--Sustained, material erosion of cash flows that leads to compressed MADS coverage at levels approaching 1.3x or below could pressure the rating;

--Failure to successfully complete planned capital projects and to meet projected targets, or material changes to the either the scope of the projects or unexpected additional bond issuances.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Positive rating action is unlikely during the Rating Outlook period. It would ultimately be predicated upon sustained improvement in Lifespace's ILU occupancy, successful completion of its capital plans and material and significant improvement in its liquidity metrics, with MADS coverage over 2.0x and cash-to-adjusted debt approaching 60% or greater.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CREDIT PROFILE

Headquartered in Des Moines, IA, Lifespace is one of the largest LPC systems in the country, currently operating 17 LPCs in nine states. The OG consists of 11 LPCs in six states -- Abbey Delray, Abbey Delray South and Harbour's Edge in Delray Beach, FL; The Waterford, in Juno Beach, FL; Village on the Green in Longwood, FL Beacon Hill in Lombard, IL; Oak Trace in Downers Grove, IL; Claridge Court in Prairie Village, Kansas; Friendship Village of Bloomington (FV of Bloomington) in Bloomington, Minnesota;

Friendship Village of South Hills in Upper St. Clair, Pennsylvania; and Querencia in Austin, TX. The Lifespace OG had total revenues of about $280 million in 2021. The OG currently operates 2,981 ILUs; 282 ALUs; 163 MSUs; and 792 SNF beds.

ACTIVITIES OUTSIDE THE OG

In June 2019, Lifespace completed an affiliation with SQLC and as a result became the sole member of three communities located in Texas -- Querencia; Northwest Senior Housing Corporation d/b/a Edgemere (not rated by Fitch) in Dallas; and Tarrant County Senior Living Center, Inc. d/b/a Stayton at Museum Way (not rated by Fitch) in Fort Worth. Querencia joined the Lifespace OG with the issuance of the series 2021 bonds. There are no plans to add Edgemere or Stayton to the Lifespace OG.

On April 14, 2022, Edgemere and SQLC (collectively the debtors) filed for relief under Chapter 11 of the U.S. Bankruptcy Code. Pursuant to the debtors' plan of reorganization filed with the Bankruptcy Court on Aug. 3, 2022, Lifespace has agreed to provide Edgemere with $13.5 million in cash and other liquidity support in the form of an unfunded $6.0 million liquidity support agreement (LSA) and approximately $20.0 million in deferred management fees. Approximately $3.5 million of the $13.5 million cash advance and all of the $20.0 million in deferred management fees are expected to be repaid by Edgemere with internal cash flows. The $20 million of deferred management fees does not impact the OG, as those are paid to the parent, outside of the OG.

The provision of the Edgemere LSA is conditioned upon, among other things, a successful outcome in the pending adversary proceeding between Edgemere and its landlord, Intercity Investments Properties, Inc. and confirmation of the reorganization plan by the Bankruptcy Court. The Edgemere LSA would likely be funded with a combination of OG and non-OG cash flows.

As part of the Stayton's debt restructuring, Lifespace entered into a $6 million LSA, with $3 million funded with the trustee currently from non-OG cash and $3 million to be possibly called upon at a later date. The additional $3 million would likely come from the OG if called.

In July 2022, Lifespace acquired three additional communities in Texas that are not related to SQLC -- The Craig in Amarillo; Meadow Lake in Tyler; and Wesley Court in Abilene -- collectively referred to as CMW. CMW encompasses a total of 427 ILUs, 79 ALUs, 34 memory care units and 147 SNF units. The acquisition was financed with $110 million of debt, $11 million of subordinated bonds and approximately $11 million of cash equity all funded outside the Lifespace OG. CMW is not a member of the Lifespace OG, however, as part of the financing, the OG committed to a $7.4 million LSA, which is unfunded at this time.

In July 2021, Lifespace acquired Newcastle Place, an LPC in Mequon, WI. The acquisition was financed with a $60 million taxable bank loan, $8 million of subordinated bonds and approximately $8 million of cash equity all funded by the Lifespace OG. Newcastle Place is not part of the Lifespace OG; however, as part of the financing, the OG committed to a $5 million LSA, which is unfunded at this time.

Lifespace continues to explore additional acquisitions, but Fitch expects these will be financed outside of the OG and thus will not affect Lifespace OG's 'BBB' rating.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR

Lifespace Communities (IA)	LT IDR	BBB Rating Outlook Stable	Affirmed	BBB Rating Outlook Stable
Lifespace Communities (IA) /General Revenues/1 LT	LT	BBB Rating Outlook Stable	Affirmed	BBB Rating Outlook Stable
Querencia at Barton Creek (TX) /General Revenues/1 LT	LT	BBB Rating Outlook Stable	Affirmed	BBB Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Margaret Johnson, CFA
Senior Director
Primary Rating Analyst
+1 212 908 0545
margaret.johnson@fitchratings.com
Fitch Ratings, Inc.
Hearst Tower 300 W. 57th Street New York, NY 10019

Rebecca Greive
Associate Director
Secondary Rating Analyst
+1 312 205 3399
rebecca.greive@fitchratings.com

Kevin Holloran
Senior Director
Committee Chairperson
+1 512 813 5700
kevin.holloran@fitchratings.com

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (including rating assumption sensitivity)

U.S. Public Finance Not-For-Profit Life Plan Community Rating Criteria (pub. 05 Apr 2022) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Portfolio Analysis Model (PAM), v2.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Iowa Finance Authority (IA)	EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

US Public Finance Healthcare and Pharma North America United States