FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Lifespace Communities, Inc.'s (IA) at 'BBB'; Outlook Stable

Fri 16 Oct, 2020 - 3:08 PM ET

Fitch Ratings - New York - 16 Oct 2020: Fitch Ratings has affirmed the 'BBB' rating on approximately $489 million of outstanding bonds previously issued through various authorities on behalf of Lifespace Communities, Inc. (Lifespace):

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a pledge of unrestricted receivables of the obligated group (OG), a mortgage interest in certain property and a master debt service reserve fund.

KEY RATING DRIVERS

LARGE CAPITAL PROJECTS: The 'BBB' rating incorporates the anticipated impact of an ongoing multi-phase borrowing being undertaken by Lifespace to fund its campus redevelopment plan. The plan is expected to result in the issuance of approximately $252 million in new permanent debt, net temporary debt and planned bond redemptions, and will culminate with an approximately $138 million borrowing planned for 2021. Lifespace reports that the projects are on time and on budget, although it did elect to postpone Phase II of its Oak Trace redevelopment due to lack of sufficient presales (there are adequate initial entrance fees from Friendship Village at Bloomington to repay the temporary debt that was associated with this aspect of the project). Fitch generally views the projects favorably and notes that while the large combined size of the projects does expose Lifespace to execution risk, the phased approach to the projects has allowed Lifespace to remain flexible during the volatility brought about by the coronavirus pandemic.

ELEVATED DEBT BURDEN: Lifespace's forma debt burden is elevated, but consistent with the current rating. MADS represented approximately 11.9% of 2019 revenues (fiscal YE Dec. 31), which though increased from prior levels, remains consistent with the 'BBB' category median of 12.4%.

STRESSED PRO FORMA LIQUIDITY: Cash-to-debt was a stressed 36.9% as of June 30, 2019, with a pro forma ratio compressed to about 33.4% when factoring in the total planned additional permanent debt from the capital plan. However, Fitch believes this ratio should improve over time as the capital projects are expected to be accretive to Lifespace's financial profile.

DIVERSE OPERATING PLATFORM: Operations are well diversified across 11 communities in the OG located in six states with no individual community accounting for more than approximately 14% of gross revenue in 2019. The diverse operating platform has helped sustain consistent occupancy despite fluctuations at individual communities.

STABLE CORE OPERATIONS: Lifespace's net operating margin- adjusted (NOMA) of 17.1% and operating ratio of 97.6% in 2019 represented a stable to improving trend in operating performance. MADS coverage of 1.7x in 2019 is consistent with Fitch's expectations for Lifespace's performance during the construction period. Cash flow metrics in the six-month interim period (ended June 30, 2020) were considerably depressed with NOMA of 4.5% and MADS coverage of 0.5x; however, this was attributable primarily to Lifespace taking apartments out of service to support the campus redevelopment project (paid out refunds, but did not receive new entrance fees) as well as to the effects of coronavirus pandemic on unit turnover. Fitch notes favorably that Lifespace's core operations improved during this time period, with an operating ratio of 96.4% (including about $4.0 million of Coronavirus Aid, Relief, and Economic Security [CARES] Act funding) and that its 288 days cash on hand provides an adequate financial cushion to weather further operational volatility.

ASYMMETRIC RISK FACTORS: No asymmetric risk factors were relevant to the rating.

RATING SENSITIVITIES

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

--Positive rating action is unlikely during the Outlook period. It would ultimately be predicated upon successful completion of the campus redevelopment project and/or material and significant improvement in Lifespace's liquidity metrics, with MADS coverage over 2.0x and cash-to-debt of 60% or greater, which is not expected until the project matures.

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

--Sustained MADS coverage of between 1.5x and 2.0x, consistent with Lifespace's projections, is necessary to mitigate concerns related to cash-to-debt levels that are projected to remain weak over the next few years. Sustained, material erosion of cash flows that leads to compressed MADS coverage below these levels could pressure the rating;

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

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

Lifespace, headquartered in Des Moines, Iowa, operates 15 life plan communities (LPC's) in eight states, 11 of which are in the OG. The OG accounted for about 79% of consolidated total revenues and 60% of consolidated total assets in 2019, which included the revenues and assets of the Senior Quality Lifestyles Corporation (SQLC) communities with which Lifespace affiliated in June 2019.

Lifespace is one of the largest LPC systems in the country. As of June 30, 2020, the OG operated 2,839 independent living units (ILUs), 174 assisted living units (ALUs), 90 memory support beds, 776 skilled nursing facility (SNF) beds and 53 boarding care beds.

Of the 11 communities in the OG, five are located in Florida, with the remaining communities located in Illinois, Kansas, Minnesota, Pennsylvania and Nebraska. Revenue generation and profitability are well balanced with no individual community accounting for more than 14% of 2019 gross revenue. The communities in Florida collectively accounted for about 50% of gross revenues in 2019.

In June 2019, Lifespace completed an affiliation with Senior Quality Lifestyles Corporation (SQLC) and as a result is now the sole member of three communities located in Texas -- Northwest Senior Housing Corporation, d/b/a Edgemere (Edgemere, Fitch rated B+/Negative)in Dallas; Barton Creek Senior Living Center, Inc., d/b/a Querencia at Barton Creek (Querencia, BBB-/Stable) in Austin; and Tarrant County Senior Living Center, Inc. d/b/a Stayton at Museum Way (The Stayton, not rated by Fitch) in Fort Worth. Egdemere, Querencia and The Stayton are separately financed. These communities are not part of the OG and there are no immediate plans to add them to the OG.

Lifespace received notice in late 2017 of a False Claims Act investigation being conducted by the United States Attorney's Office for the Southern District of Florida. The investigation has been resolved and the accrual for $3.2 million to cover potential damages was reversed in 2019.

The recent outbreak of coronavirus and related government containment measures worldwide has created an uncertain environment for the entire healthcare system. Material changes in revenue and cost profiles have and could continue to occur across the sector, as the pandemic evolves. Fitch's ratings are forward-looking in nature, and Fitch will monitor the severity and duration of the virus outbreak on the sector, and incorporate revised expectations for future performance and assessment of key risks.

CAMPUS REDEVELOPMENT PLAN

Lifespace continues to execute its multi-campus redevelopment project. 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. Prior to this project, Lifespace's communities had limited ALU and memory support services, which are now necessary to remain competitive, given industry trends. Total identified projects through 2023 equal approximately $520 million, of which $422 million has been approved by the board. Approximately $205.9 million had been spent on related projects as of June 30, 2020.

When complete, the projects will add 279 ILUs, 122 ALUs and 140 memory support units, while decreasing SNF's by 35 units, due to repositioning towards private rooms. The projects are expected to stabilize between 2021 and 2024.

Project funding sources include the series 2016A/B bonds ($65.7million), the series 2018A/B bonds ($165 million), the series 2019A/B bonds ($106 million), and about $125 million of the proceeds from approximately $138 million in debt expected to be issued in 2021 and operating cash flow. Management expects to use the anticipated $174 million in total initial entrance fees to redeem temporary project debt and other outstanding high-interest rate debt. Approximately $26.9 million of the series 2019 bonds and $52.7 million of the series 2021 bonds are expected to be issued as temporary debt to be paid off by 2023.

Incorporating expected bond issuances (permanent debt), Fitch expects pro forma MADS to increase to approximately $29.5 million from its previous $15.6 million. Fitch has incorporated the expected future bond issuance into the current rating as well expectations for operating performance.

Successful execution of the projects is expected to materially benefit Lifespace's credit profile. However, failure to successfully execute the projects, including initial entrance fee generation and the related expected pay down of debt, will likely result in negative rating action. Material changes to either the scope of the projects or planned bond issuance would also likely impact the rating.

ACTIVITIES OUTSIDE THE OG

Lifespace entered into an agreement in October 2015 to guarantee approximately $36 million of series 2014A, C and D bonds issued on behalf of Deerfield Retirement Community (Deerfield, not part of the OG) in exchange for deferral on debt service payments through May 2018 and parity status for any future capital expenditures for repositioning provided to Deerfield by Lifespace with Deerfield's senior indebtedness. Lifespace currently owns the outstanding series 2014C and 2014D bonds. Therefore, Lifespace's exposure under the guaranty is limited to approximately $23 million of outstanding series 2014A bonds.

As of June 30, 2020, payments of approximately $2.5 million were called upon due to the Lifespace guaranty of Deerfield's series 2014A bonds. Management estimates that in the event of a maximum funding of the guaranty by Lifespace, the net impact would be a reduction of MADS coverage by approximately 0.1x.

The communities acquired from SQLC are not part of the OG. However, as part of the ongoing debt restructuring on The Stayton, Lifespace entered into a $6 million liquidity support agreement, 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.

Fitch generally believes that Lifespace has adequate liquidity to cover its obligations outside of the Obligated Group, but will continue to monitor the potential impact of the Deerfield guaranty and the SQLC liquidity support agreement for any impact on the OG's credit profile.

DEBT PROFILE

Post issuance of the series 2019 and 2021 bonds, total permanent debt is expected to increase to approximately $568 million from $218.2 million at YE 2017. Fitch estimates the pro forma debt will consist of approximately 95% underlying fixed rate bonds and 5% underlying variable rate bonds. Lifespace is not counterparty to any swaps.

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)				
• Lifespace Communities (IA) /General Revenues/1 LT	LT	BBB Rating Outlook Stable	Affirmed	BBB Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Not-For-Profit Continuing Care Retirement Community Rating Criteria (pub. 29 Mar 2018) (including rating assumption sensitivity)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Illinois Finance Authority (IL)	EU Endorsed
Illinois Health Facilities Authority (IL)	EU Endorsed
Iowa Finance Authority (IA)	EU Endorsed
Kansas Development Finance Authority (KS)	EU Endorsed
Palm Beach County Health Facilities Authority (FL)	EU Endorsed

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