FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Lifespace Communities, Inc. Ser 2024A&B Rev Bonds 'BBB'; Outlook Stable

Thu 21 Nov, 2024 - 11:31 AM ET

Fitch Ratings - New York - 21 Nov 2024: Fitch Ratings has assigned a 'BBB' rating to approximately $142.5 million series 2024A revenue bonds and $6.0 million series 2024B taxable revenue bonds to be issued by the Iowa Finance Authority on behalf of Lifespace Communities, Inc. (Lifespace). The Rating Outlook is Stable.

Proceeds from the series 2024A&B (collectively series 2024) bonds will be used refinance Lifespace's series 2021D bonds, refinance the taxable loan Lifespace used to purchase Newcastle Place LLC (NCP), pay for new capex at NCP and fund capex for the Obligated Group (OG). Additionally, proceeds will be used to pay the costs of issuance. As part of the financing, Fitch anticipates that NCP will become a member of the OG. The bonds are expected to price the week of Dec. 9, via negotiation.

Separate from the series 2024 financing, Lifespace has executed an asset purchase agreement (APA) to divest of Abbey Delray from the OG, with an expected closing date in Dec. 2024.

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

The 'BBB' rating and Stable Outlook reflect Fitch's expectation that Lifespace's proposed changes to its OG will be financially accretive. Together with recent improvements in independent living unit (ILU) occupancy, these changes should allow for better operating performance. The rating and Outlook also reflect nearing completion of Lifespace's redevelopment projects, which have strong presales.

Once these units have filled and if Lifespace can maintain improvement in its ILU occupancy, Fitch believes Lifespace will generate sufficient additional revenues and cash flows to absorb its additional debt plans, settlement payments owed to the Edgemere resident trust, and grow its balance sheet. This would allow the rating to remain stable at the 'BBB' level.

SECURITY

Pledge of unrestricted receivables of the OG and a mortgage interest in certain property.

KEY RATING DRIVERS

Revenue Defensibility - 'a'

Large, Geographically Diversified Platform; Improving ILU Occupancy

Fitch views Lifespace's large, geographically diversified platform as the core strength of its revenue defensibility. The addition of NCP to the Lifespace OG will expand its footprint to a new state (Wisconsin). While Florida will remain home to the largest number of Lifespace's communities (four of 11 in the OG) following the divestiture of Abbey Delray, Fitch believes this concentration does not detract from the benefits of Lifespace's overall revenue diversity, with none of Lifespace's individual communities accounting for more than 13% of gross revenues of the new OG.

Lifespace OG's ILU occupancy struggled to recover in the immediate post-pandemic period, averaging 78% in 2021-2023, but the organization has since experienced five consecutive quarters of improving ILU occupancy, standing at 83% as of Sept. 30, 2024. Fitch believes this trend, combined with the additions and divestitures Lifespace plans to make within the

OG, will place the organization on a realistic trajectory to achieve its target of sustained 90% ILU occupancy over the next several years. NCP had overall campus occupancy of 94.6% as of Oct. 20, 2024.

Lifespace OG's various markets generally have good economic and demographic characteristics and there is limited overlap between Lifespace's respective markets. 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.

Operating Risk - 'bbb'

Improved Operating Performance; OG Changes Expected to be Accretive; Capital Plans on Track

Fitch assesses Lifespace OG's operating risk at 'Midrange', reflecting its predominantly type A contract mix, adequate cost management track record and substantial capital investment. These projects are expected to enhance Lifespace OG's competitive positioning in its markets. Weaker ILU occupancy and increased staffing costs compressed Lifespace OG's operating margins in 2021 and 2022, despite higher than average rate increases. However, performance improved in 2023, with an operating ratio of 102.6% and net operating margin (NOM) of 1.8% compared to average operating ratio of 106.6% and NOM of negative 1.3% in the previous two years.

Lifespace has sustained these operational improvements in 2024, with an operating ratio of 102.0% and NOM of 5.0% in 3Q24. Lifespace's NOM-adjusted has remained consistently midrange, averaging 21.0% from 2021 to 2023 and equaling 31.3% in 3Q24.

For calculating Lifespace's operating performance, Fitch treats the settlement loss associated with Edgemere as a non-recurring non-operating expense.

Lifespace expects to apply approximately $24 million of the expected series 2024 bond proceeds that will fund new capex at NCP, including common area renovations in independent living and the higher levels of living, updating resident rooms in the higher levels of living and the addition of 13 new cottages. Fitch believes the addition of NCP to the OG will be accretive the OG's operating performance. NCP had net operating profit (NOP) of $3.8 million in 2023, which was the highest when compared to the NOPs the other OG communities.

Lifespace expects to apply the proceeds from the anticipated sale of Abbey Delray to capital investment within the state of Florida. Management has not determined whether this will come from investment in an existing campus, or the acquisition of a new community in the state. Fitch believes the disposition of Abbey Delray from the OG will improve its operating profile, given Abbey Delray's consistent history of operating losses as the lowest performer among the OG communities.

Lifespace's most recent campus redevelopment projects,- a repositioning at Oak Trace and a phase I ILU expansion and ILU/skilled nursing facility (SNF) renovation project at Waterford, are progressing as expected. The Oak Trace project is filling successfully with 82.9% of the new ILUs occupied as of Sept. 30. The Waterford phase I project is under construction and is expected to be completed in 1Q26, with all eight of the planned new ILU patio homes reserved with 10% deposits. Fitch anticipates that the projects' continued successful execution and planned OG changes will materially benefit Lifespace's operating performance.

Lifespace is also contemplating a phase II expansion at The Waterford that would add new ILUs, assisted living units (ALUs) and memory support units (MSUs). However, this project is in the planning stages and has been considerably scaled down from original plans. Management will only seek board approval for this phase of the project if Lifespace can achieve adequate presales on the proposed new ILUs that result in The Waterford and Lifespace achieving targeted coverage and liquidity goals.

Lifespace's repositioning projects and expanded footprint have generated additional top-line revenue, stabilizing its capital-related metrics, albeit at weaker levels. This reflects its substantial capital redevelopment plan over the last several years and borrowing to fund payments to the Edgemere residents trust in 2023. Lifespace's pro forma MADS is expected to increase to about $61.0 million from approximately $51.0 million following the series 2024 financing.

Pro forma MADS represented a very high 20.0% of revenues and negative 0.1x revenue-only MADS coverage in 2022. However, these ratios have improved to 18.1% and 0.2x in 2023 and 16.7% and 0.2x in 3Q24, which Fitch believes is indicative of stabilized levels going forward. Lifespace OG's debt-to-net available was a high 11.5x in 2023, but this figure should moderate as campus redevelopment projects fully stabilize and existing ILU occupancy improves.

Financial Profile - 'bbb'

Weak Financial Profile, but Expectations for Improvement

Lifespace's leverage metrics are weak, with unrestricted cash of $184.8 million representing a slim 28.2% of its adjusted debt as of YE23. Lifespace's cash-to-adjusted debt was a similarly weak 28.6% as of Sept. 30, 2024, but pro forma MADS coverage improved to 1.1x as of YE23 and 2.3x as of Sept. 30, 2024.

Fitch's forward-looking scenario analysis shows Lifespace's financial profile improving over the next five years, even in a stress case scenario. However, this analysis is predicated on Lifespace successfully filling its new ILUs and improving its existing operating performance as expected. Failure to achieve this could hinder expected financial profile improvement and Lifespace's ability to absorb the Edgemere settlement payments, possible Waterford Phase II borrowings, and maintain the 'BBB' rating level.

The scenario further assumes Lifespace will begin funding its deposits to the Edgemere resident trust from internal cash flows beginning in 2026. It also incorporates an assumption that the changes to the OG occur as expected.

Lifespace's agreement to fund the Edgemere resident trust includes Lifespace's ability to defer its payments if the deposit would result in a reduction of Lifespace's liquidity to below 250 days cash on hand (DCOH), or if the payment results in an event of default under the Lifespace master trust indenture.

On Dec. 15 of each year, Lifespace will calculate its DCOH to determine the deposit amount. Within 150 days after the YE, the deposit amount will be trued-up, as necessary. Lifespace had 216 DCOH as of YE23 and 198 DCOH as of Sept. 30, 2024, which Fitch considers neutral to the assessment of Lifespace's financial profile, although a sustained liquidity ratio of below 200 DCOH may justify an asymmetric risk to Lifespace's financial profile assessment, which could pressure the rating.

Asymmetric Additional Risk Considerations

No asymmetric risk considerations are relevant to the ratings.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Any reversal in the current trend of improving ILU occupancy could suggest a lower revenue defensibility assessment and pressure Lifespace's rating;

--A reversal in Lifespace's current trend of improving operating performance that leads to compressed MADS coverage at levels of 1.3x or below would pressure the rating;

--Sustained slim liquidity ratios with cash-to-adjusted debt below 30% and/or DCOH below 200 would trigger negative rating pressure.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Positive rating action is unlikely pending the completion of Lifespace's capital projects and clarification on the size and scope, and plan of finance for the Waterford phase II project.

PROFILE

Headquartered in Des Moines, IA, Lifespace is one of the largest life-plan communities (LPC) systems in the country, currently operating 16 LPCs in nine states. The OG consists of 11 LPCs in six states. These include 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, KS; Friendship Village of Bloomington (FV of Bloomington) in Bloomington, MN; Friendship Village of South Hills in Upper St. Clair, PA; and Querencia at Barton Creek (Querencia) in Austin, TX. The OG currently operates 2,916 ILUs, 282 ALUs, 163 MSUs, and 792 SNF beds.

NCP, which Lifespace acquired in July 2021, is located in Mequon, WI. It has 158 ILUs, 36 ALUs, 16 MSUs and 47 SNF beds and had total revenues of $22.5 million in 2023.

DATE OF RELEVANT COMMITTEE

08 November 2024

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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

Mark Pascaris
Senior Director
Committee Chairperson
+1 312 368 3135
mark.pascaris@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

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub. 12 Jan 2024) (including rating assumption sensitivity)

U.S. Public Finance Not-for-Profit Life Plan Community Rating Criteria (pub. 19 Aug 2024) (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

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Iowa Finance Authority (IA)	EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

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. Fitch Ratings makes routine, commonly-accepted adjustments to reported financial data in accordance with the relevant criteria and/or industry standards to provide financial metric consistency for entities in the same sector or asset class.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

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.