FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Lifespace Communities, Inc. at 'BBB'; Outlook Revised to Negative

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Fitch Ratings - New York - 04 Aug 2023: 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).

Fitch has removed the ratings from Rating Watch Negative and assigned a Negative Rating Outlook.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Lifespace Communities (IA)	LT IDR	BBB Rating Outlook Negative Affirmed	BBB Rating Watch Negative
Lifespace Communities (IA) /General Revenues/1 LT	LT	BBB Rating Outlook Negative Affirmed	BBB Rating Watch Negative

Querencia at Barton Creek (TX) /General Revenues/1 LT	LT	BBB Rating Outlook Negative Affirmed	BBB Rating Watch Negative

VIEW ADDITIONAL RATING DETAILS

The removal of Lifespace from Rating Watch reflects the court's approval of Lifespace's plan to fund approximately $143 million of entrance fee refunds due to residents of Northwest Senior Housing Corporation d/b/a Edgemere (Edgemere, a non-Obligated Group entity, which Lifespace purchased in 2019) as part of Edgemere's Chapter 11 bankruptcy plan, which was approved by the bankruptcy court in June 2023.

Lifespace has agreed to pay these refunds over a period of 19 years and will fund these payments with a combination of all the proceeds from $52.5 million in series 2023A senior debt issued by the Lifespace Obligated Group (Lifespace OG) in May 2023; proceeds from $10 million in corporate bonds issued by Lifespace, Inc. also in May 2023 and purchased by Lifespace Communities, Inc. (non-OG); and internal cash flows of the Lifespace OG.

As this large cash flow liability and associated senior debt issuance are not in the interest of a revenue-producing project, Lifespace's incurrence of these liabilities has eroded its cash-to-adjusted debt, which is already relatively low for the rating category, due to additional borrowings Lifespace has transacted in order to finance its substantial campus redevelopment plan and will, to some degree, inhibit future cash flow growth of the organization. Favorably, Lifespace's redevelopment projects are nearing completion and have strong presales, with initial entrance fees expected to be used to redeem approximately $70 million of temporary debt.

Once these units have filled and if Lifespace can improve its independent living unit (ILU) occupancy, which remains at a low 77% through the first six months of 2023, Fitch believes Lifespace will generate sufficient additional revenues and cash flows to absorb these liabilities and grow its balance sheet, especially since payments to the Edgemere resident's trust are predicated on Lifespace's maintaining certain minimum liquidity thresholds, underscoring the affirmation of the 'BBB' rating.

Fitch's Negative Outlook, however, reflects the significant uncertainty in regards to these expectations. Aside from the fill risk on its new ILUs, occupancy within Lifespace's existing ILUs has been on a declining trend since 2021 and thus far in 2023, has stabilized at 77%, which is not a level that will allow for the operational improvement necessary to support these additional refund liabilities, especially considering weakened operating performance due to escalating staffing expenses in 2022 and 2023.

Moreover, there is considerable refinancing risk associated with the series 2023A bonds, which were purchased in their entirety by one investment bank, and which Fitch considers to be an asymmetric risk to Lifespace's credit profile.

SECURITY

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

KEY RATING DRIVERS

Revenue Defensibility - 'aa'

Fitch views Lifespace's geographically diversified platform as the core strength of its revenue defensibility assessment, offset by concerns regarding flagging recovery in its ILU occupancy since the pandemic. By virtue of Lifespace's size and scale, Fitch believes the organization possesses the ability to 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.

However, 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 and a rating downgrade, given the incurrence of the additional refund liability from Edgemere.

Operating Risk - 'bbb'

Fitch assesses the Lifespace OG's operating risk at '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. Weaker ILU occupancy and increased staffing costs have negatively impacted its operating performance in 2022 and 2023, despite higher than average rate increases. In 2022, Lifespace's operating ratio was 108.8% and its net operating margin (NOM) was negative 3.3%, compared to previous three-year averages of 99.4% and 3.5%, respectively.

Lifespace's operating performance has shown some improvement in the first six months of 2023, with an operating ratio of 101.5% and NOM of 2.0% and its cash flow margins remain consistent with Fitch's 'bbb' assessment of its operating risk. Lifespace's capital-related metrics are somewhat weak, primarily as a consequence of the additional borrowing to finance its campus redevelopment plan and considerable escalation of its maximum annual debt service (MADS) to close to $46 million following the series 2023A debt issuance, but its debt burden should begin to moderate as ILU occupancy improves and the redevelopment projects stabilize. The last of Lifespace's campus redevelopment projects -- repositionings at Friendship Village of Bloomington and Oak Trace -- are on time and under budget and Fitch anticipates that successful execution of the projects will materially benefit Lifespace's credit profile.

Outside of the campus redevelopment projects, Lifespace incurred approximately $85 million in bank debt in the fall of 2022 to finance a modest eight-ILU garden home expansion and renovations to the skilled nursing facility (SNF) and common areas at The Waterford (Waterford Phase I), 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 new ILUs, ALUs and memory support units, but management will only seek board approval for this phase of the project if Lifespace can achieve adequate 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.

Fitch has also reviewed management's articulated acquisition strategy, given the number of new asset purchase since the Senior Quality Lifestyle Corporation (SQLC) transaction (of which Edgemere was a part), and is satisfied that they are taking a disciplined approach to future growth opportunities and notes favorably that all of the recently acquired communities had positive cash flows at the time of acquisition, which, subject to asset transfer covenants, can be upstreamed to the OG even though the communities are not members of the OG.

Financial Profile - 'bbb'

Lifespace's cash-to-adjusted debt is weak, with cash-to-adjusted debt of 31% as of June 30, 2023, which incorporates the bank debt for Waterford Phase I and the series 2023A senior debt issuance. Fitch's forward-looking scenario analysis shows Lifespace's financial profile improving over the next five years, however, this analysis is predicated on Lifespace's successfully filling its new ILUs and improving its existing operating performance.

The scenario further assumes Lifespace will begin funding its deposits to the Edgemere resident trust from internal cash flows beginning in 2026 and incorporates an assumption that the organization successfully remarkets the series 2023A bonds by the end of this year. Also, while the Waterford Phase II project has yet to meet the criteria for board approval, the scenario shows if Lifespace is able to achieve improved operations, it would have capacity to absorb this project at the 'BBB' rating. Any negative deviation from these expectations would call into question Lifespace's ability to service its escalated liabilities and could pressure the rating.

Lifespace's agreement to fund the Edgemere resident trust includes the ability for Lifespace to defer its payments if such deposit would result in a reduction of Lifespace's liquidity to below 250 days cash on hand (DCOH) or if such payment would cause an Event of Default under the Lifespace Master Trust Indenture. On December 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, based on audited financial statements. As of June 30, 2023, Lifespace had 225 DCOH, which Fitch considers to be neutral to the assessment of Lifespace's financial profile.

Asymmetric Additional Risk Considerations

There is considerable refinancing risk associated with Lifespace's series 2023A senior debt, which was purchased in its entirety by one investment bank and which Fitch considers to be an asymmetric risk contributing to its Negative Outlook. The current interest rate on these bonds is 8.00%, but increases to 10% on Dec. 16, 2023. The bonds also have a mandatory tender date on May 15, 2024. If the bonds are not repaid or refinanced by this date, the interest rate will increase to 12% (or the maximum interest rate permittable by law) and principal will be due in six monthly instalments.

Fitch will monitor Lifespace's efforts at remarketing the series 2023A bonds, which the organization expects to achieve by the end of this year. Inability for Lifespace to repay or remarket these bonds could have negative rating implications, given the expected impact to Lifespace's financial profile.

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 weakness in operating performance that leads to compressed MADS coverage at levels of 1.3x or below would pressure the rating.

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

--Positive rating action is unlikely during the Outlook period. It would ultimately be predicated upon successful remarketing of the series 2023A bonds, 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.

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 OG operates 2,981 ILUs; 282 ALUs; 163 MSUs; and 792 SNF beds.

In June 2019, Lifespace completed an affiliation with SQLC and as a result became the sole member of three communities located in Texas -- Querencia; 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. On April 14, 2022, Edgemere and SQLC (collectively the debtors) filed for relief under Chapter 11 of the U.S. Bankruptcy Code. Edgemere is no longer part of Lifespace.

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.

There were two changes to the Lifespace OG that happened concurrently with the series 2021 transaction that priced in August 2021. Querencia joined the Lifespace OG with the issuance of the series 2021 bonds. In addition, on Aug. 1, 2021, Lifespace transitioned ownership of Deerfield Retirement Community (Deerfield) and Grand Lodge at the Preserve (Grand Lodge) to Immanuel (AA/Stable). Grand Lodge exited the Lifespace OG upon the ownership transition. Given their size relative to the overall Lifespace OG, the exit of Grand Lodge from and addition of Querencia to the Lifespace OG has not materially affected its operating performance.

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.

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 February 2023, Lifespace acquired GreenFields of Geneva, an LPC in Geneva, IL. The acquisition was financed with $74.5 million of debt and a $3 million equity contribution all funded outside of the Lifespace OG. GreenFields of Geneva is not a member of the Lifespace OG, however, as part of the financing, the OG committed to an LSA, which currently totals $2 million and will increase to $3 million after three years.

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.

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APPLICABLE CRITERIA

U.S. Public Finance Not-For-Profit Life Plan Community Rating Criteria (pub. 05 Apr 2023) (including rating assumption sensitivity)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Apr 2023) (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

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Iowa Finance Authority (IA)	EU Endorsed, UK Endorsed

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