



Fitch Affirms Fellowship Senior Living, NJ Revs at 'BBB+'; Outlook Stable

Fitch Ratings-New York-01 February 2019: Fitch Ratings has affirmed the 'BBB+' rating on the following Wisconsin Public Finance Authority bonds issued on behalf of Fellowship Senior Living, NJ (FSL):

--\$45 million (Fellowship Senior Living), variable-rate tax-exempt revenue bonds series 2013A;
--\$37 million (Fellowship Senior Living), variable-rate tax-exempt revenue bonds series 2013B.

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a revenue pledge, mortgage, and a debt service reserve fund.

KEY RATING DRIVERS

ADEQUATE OPERATIONAL PERFORMANCE: Operations have softened over the last three fiscal years as FSL averaged an 93.9% operating ratio, 5.6% net operating margin (NOM), and 23.6% NOM-adjusted, mixed results compared to Fitch's 'BBB' medians of 96.3%, 7.3% and 23.3%, respectively. Weaker operations are driven by a decline in occupancy as FSL's undergoes its current campus repositioning project. Fitch expects operations to improve upon completion of the project in 2020.

CAPITAL PROJECT UPDATE: FSL began its campus repositioning project in April 2017. Following delays due to a lengthy approval process, the project is on-schedule and expected to be completed by 2020 and will cost approximately \$58.7 million, with \$45 million being funded by the 2013A bonds and \$13.7 million in equity contributions by FSL. Overall, the project is viewed positively and is expected to improve FSL's competitive position following completion.

ELEVATED LONG-TERM LIABILITY PROFILE: Including the full draw-down of the series 2013A bonds, FSL's debt burden remains elevated as maximum annual debt service (MADS) of \$7.3 million equates to a high 17.0% of fiscal 2017 revenues, which is weaker than Fitch's 'BBB' category median of 12.5%. However, debt to net available equated to 4.3x, better than Fitch's median of 5.7x. FSL's debt burden is expected to moderate over the medium term as benefits from the project and other service line initiatives grow revenues. Additionally, over the last three fiscal years, FSL has averaged a 1.5x coverage of MADS and 2.2x coverage of actual annual debt service (AADS).

SUFFICIENT LIQUIDITY: At Sept. 30, 2018, FSL's unrestricted cash and investments totaled \$41.6 million, which translates into 453 days cash on hand (DCOH), 77.5% cash to debt, and 5.7x cushion ratio. As anticipated, cash to debt declined year over year as FSL drew down bond funds to pay for its capital project. Liquidity is expected to decline further as FSL made its final equity contribution of \$5.7 million in December 2018; however, it remains sufficient for the current rating level.

STRONG MARKET POSITION: FSL is located in Basking Ridge, NJ, a desirable and affluent suburb, with household income levels and housing prices well above state and national averages. FSL has historically demonstrated solid demand, with independent living unit (ILU) occupancy in the mid-90% range, despite the presence of competition. IL occupancy has softened and averaged approximately 90% over the last two fiscal years due to various on-going construction projects which has disrupted marketing efforts. Fitch expects occupancy to return to historical levels upon project completion.

ASYMMETRIC RISK FACTORS: The rating is constrained somewhat by FSL's aggressive debt structure, which consists entirely of direct placement bond obligations with three providers. The bonds include a mandatory tender on Dec. 30, 2023 in advance of maturity, which creates refinancing risk. To hedge the interest rate risk on the bonds, FSL has secured four interest rate swaps for the debt.

RATING SENSITIVITIES

FINANCIAL PROFILE STABILITY: Weakening in operational performance due to project delays or failure to improve occupancy to historical levels that result in deterioration of Fellowship Senior Living's liquidity or coverage levels could put negative pressure on the rating.

CREDIT PROFILE

Located in Basking Ridge, NJ, FSL is a senior living organization with several distinct service lines. Fellowship Village (FV) is FSL's continuing care retirement community (CCRC), which offers Type-A (Lifecare) contracts. FSL offers traditional contracts which become non-refundable after 48 months and 90% refundable contracts; however, currently all residents have chosen the traditional option. FV currently has 257 independent living residences/units (ILUs), 81 assisted living suites/units (ALUs; includes 14 memory care units), and 54 skilled nursing (SN) beds. FSL's other service lines includes Fellowship Freedom Plans, which is a CCRC 'without walls', Fellowship Helping Hands, a home health agency, and a Hospice program, which was accredited in December 2017.

All service lines of FSL are included in the obligated group. FSL's total operating revenues in fiscal 2017 were approximately \$42.3 million.

CAPITAL PROJECT UPDATE

Following an extensive delay, FSL has received all the necessary approvals for its campus repositioning project, which began in April 2017. The project entails constructing a new AL and SN building, expanding and renovating existing AL and SN suites, constructing two dedicated memory care households, building a new 240-seat cultural arts center, extensive renovations to its main entryway, and completing minor capital projects around campus. The renovation and expansion of skilled nursing, AL, and memory care should be financially accretive to FSL, while the cultural arts center is expected to enhance FSL's already strong market position.

As of January 2019, opening and resident move-ins for the first three households are expected in February. The cultural arts center, new entrance and lobby are anticipated to open sometime in mid-2019. The expansion and renovation, which includes an additional 13 SN beds and 11 ALU beds should be completed in 2020. Also, FSL will be constructing a new over 100 seat bar and lounge in existing space on the campus with construction set to begin in May 2019 and be completed in the spring of 2020. Fitch expects that these projects will help position FSL positively for current and future residents.

ADEQUATE FINANCIAL PERFORMANCE

FSL's strong market position, good census levels, and successful expansion of service lines have translated into adequate operational performance. Over the last three fiscal years, FSL has averaged a 93.9% operating ratio, 5.6% NOM, and 23.6% NOM-adjusted, which are mixed to Fitch's 'BBB' medians of 96.3%, 7.3% and 23.3%, respectively. The weakening of operations is attributed to a softening census in ILUs and lower net entrance fee receipts, with IL occupancy averaging approximately 90% over the last two years, relative to historical occupancy in the mid-90% range. The lower occupancy is due to the on-going construction projects at FSL.

Fitch expects that occupancy and operations should improve upon completion of the projects, as the recent softening is somewhat attributable to reduced marketing efforts while management focuses on its campus repositioning project, including construction of FSL's main entrance.

Another driver of FSL's operational performance has been its ongoing expansion of auxiliary service lines, which has diversified its revenue base and is viewed as a credit positive. To date, FSL's additional services include a home health agency and a CCRC 'without walls' program that have been accretive to FSL's financial profile and have been a key driver of revenue growth in recent years. In particular, home health agency revenues increased 28% year-over-year through Sept. 30, 2018. FSL's total operating revenue has increased 17% in fiscal 2017 over 2013 levels.

SUFFICIENT LIQUIDITY POSITION

As of the nine-month 2018 interim period, FSL unrestricted cash and investment position was \$41.6 million, which translates into an adequate 453 DCOH, 77.5% cash to debt, and 5.3x cushion ratio and shows mixed results when compared to Fitch's 'BBB' category medians of 479, 72%, and 8.4x, respectively. Despite strong historical operational performance, FSL's liquidity position has remained relatively flat in recent years due to elevated capital spending for the project. Over the last five fiscal years and nine months into 2018, FSL's capital expenses have averaged 185% of depreciation.

Fitch expects FSL's overall liquidity position and cash to debt position to deteriorate in the short-term as FSL draws down its series 2013A bonds and provides a \$13.7 million equity contribution to the projects, including the final \$5.7 million payment in December 2018. Fitch expects cash to debt to begin to improve following project completion and remain commensurate with its 'BBB+' rating level.

DEBT PROFILE

The series 2013A and 2013B bonds remain FSL's only outstanding long-term debt. The series 2013A bonds were issued to fund FSL's current capital repositioning project and the bond proceeds are currently being drawn down, with approximately \$12.1 million drawn through September 2018. The series 2013B bonds were issued to refund all of FSL's outstanding long-term debt. Both series of bonds are variable-rate debt, with FSL paying 65% of LIBOR plus 120 bps. Both series are fully hedged with four fixed payor swaps, which were executed with two separate counterparties and have fixed net-rates of 3.385% to 3.99%. The current fair value of the swaps is approximately negative \$2.6 million.

While FSL currently has approximately \$50 million of outstanding long-term debt, its overall debt position is expected to increase as the 2013A bonds are drawn-down. Concerns over FSL's increased leverage position and debt burden following the draw-down of the series 2013 A bonds are partially mitigated by the rapid amortization of the series 2013B bonds, which has approximately \$3 million-\$5 million in principal amortized annually.

Furthermore, FSL has averaged sufficient MADS coverage of 1.5x over the last three fiscal years, incorporating the full draw-down of the series 2013A bonds. While this remains lower than Fitch's 'BBB' category median of

2.1x, Fitch expects coverage levels to approach or exceed 2x following project completion. FSL has averaged a strong 2.2x AADS coverage over the last three fiscal years.

FSL's debt burden remains elevated as MADS equates to a high 17% of total fiscal 2017 revenues, which is unfavorable to Fitch's 'BBB' category median of 12.5%. However, debt to net available equated to 4.3x, which was better than Fitch's median of 5.7x. MADS as a percentage of revenue is expected to moderate following project completion, with management projections illustrating MADS equal to a more manageable 14% in fiscal 2021. There could be negative pressure on the rating if FSL's operations deteriorate over the medium term as leverage increases.

Contact:

Primary Analyst
Matthew Shapiro
Associate Director
+1-212-908-0823
Fitch Ratings, Inc.
300 West 57th Street
New York, NY 10019

Secondary Analyst
Gary Sokolow
Director
+1-212-908-9186

Committee Chairperson
Joanne Ferrigan
Senior Director
+1-212-908-0723

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)

U.S. Public Finance Not-For-Profit Continuing Care Retirement Community Rating Criteria (pub. 30 Mar 2018)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ALL 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](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. 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](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2019 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. 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.

SOLICITATION STATUS

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

Endorsement Policy

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Fitch Updates Terms of Use & Privacy Policy

We have updated our Terms of Use and Privacy Policies which cover all of Fitch Group's websites. [Learn more.](#)