



## RATING ACTION COMMENTARY

# Fitch Revises Fellowship Senior Living's (NJ) Outlook to Stable; Affirms Bonds at 'BBB+'

Thu 18 Nov, 2021 - 2:54 PM ET

Fitch Ratings - New York - 18 Nov 2021: Fitch Ratings has revised the Rating Outlook for Fellowship Senior Living (FSL) to Stable from Negative, and has assigned a 'BBB+' Issuer Default Rating (IDR). In addition, Fitch has affirmed the 'BBB+' ratings assigned to approximately \$87 million of series 2019A&B revenue bonds issued by the Wisconsin Public Finance Authority on behalf of FSL.

## SECURITY

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

## ANALYTICAL CONCLUSION

The Stable Outlook reflects FSL's improvement in liquidity and the expectation for further growth in independent living (IL) occupancy, which should support operating and balance sheet metrics consistent with the higher end of the 'BBB' rating category.

Following disruptions from the pandemic and a large capital project in the middle of the campus, which resulted in a significant decline in IL occupancy, operating performance has stabilized and IL move-ins have continued to rise. The rebound in IL move-ins has resulted in a significant improvement in balance sheet resources, with cash-to-adjusted debt increasing to 56.9% as of Sept. 30 2021 from 46.2% in fiscal 2020. Fitch expects that with the completion of the extensive renovations and amenity expansions in 2022, IL occupancy will recover to closer to 90%, which supports the revision to a Stable Outlook.

## **KEY RATING DRIVERS**

### **Revenue Defensibility: 'bbb'**

#### Expectation for Improved Occupancy

Fitch assesses FSL's revenue defensibility as midrange, which reflects an expectation for IL occupancy improvements over the near term. The IL census has declined in recent years due to extensive capital projects and disruptions from the pandemic, which hindered marketing efforts; falling to 80% in fiscal 2020 after averaging in the mid-90% range in previous years. Occupancy has only slightly improved through the first nine months of fiscal 2021 to 82%, but FSL is expecting a record 40 move-ins this fiscal year with a similar number of move-ins expected for fiscal 2022, which should lead to IL occupancy levels improving to closer to 90% over the outlook period.

The expectation of improved occupancy levels is supported by the campus' location in Basking Ridge, NJ, a desirable and affluent suburb, with household income levels and housing prices well above state and national averages. Further supporting the community's market position is the extensive capital projects completed in recent years that included common space renovations, a new health center with private skilled nursing facility (SNF) and assisted living (AL) beds, and other desirable amenities. The community also has a history of regular entrance

fee and monthly service fee increases and fees are affordable relative to local housing prices and resident wealth levels.

### **Operating Risk: 'bbb'**

#### Improving Operating Performance

Operations have continued to improve in fiscal 2021 despite lingering pandemic disruptions. FSL had an operating ratio of 85.7%, a net operating margin (NOM) of 15.1%, and a NOM-adjusted of 37.4% thus far in fiscal 2021 which is improved over 2020 performance. Operations were supported by a \$4.1 million PPP (Paycheck Protection Program) loan that was forgiven and booked this year. While profitability is not expected to be sustained at this level going forward, Fitch expects that the growing revenues the community receives from its other service lines including a CCRC 'without walls' program, Fellowship Helping Hands, a home health agency, therapy at home, and a hospice program will help support operating performance consistent with the 'bbb' assessment while IL occupancy continues to recover.

FSL is on the final stages of an extensive capital plan which began in 2017. Ongoing projects include a renovation and expansion of the ALUs and memory care, the final phase of the SNF project, and further amenities, with construction expected to be completed in the spring of 2022. The final projects are expected to be funded in part by the approximately \$8 million in remaining series 2019 bond proceeds. Outside of these projects, capital spending is expected to be routine.

Capital-related metrics are currently mixed, with revenue-only MADS coverage and debt-to-net-available weaker at 0.2x and 9.0x, respectively in fiscal 2020, offset by MADS representing an adequate 11.5% of fiscal 2020 revenues.

Capital-related metrics have improved in fiscal 2021 and FSL's debt burden is expected to continue to moderate as performance stabilizes.

### **Financial Profile: 'bbb'**

#### Solid Financial Profile

Fitch assesses FSL's financial profile as 'bbb' in the context of its 'bbb' revenue defensibility and 'bbb' operating risk assessments. The community's \$53.7 million in unrestricted cash and investments translates into 499 days cash on hand and 56.9% cash-to-adjusted debt as of Sept 30, 2021, which is a solid improvement over fiscal 2020 levels of 394 days cash on hand and 46.2% cash-to-adjusted debt

Through Fitch's baseline scenario, or Fitch's best estimate of the most likely scenario of financial performance over the next five years given current economic expectations, Fitch expects that FSL's cash-to-adjusted debt metric will gradually improve as cash flows accumulate and capital spending winds down.

Fitch's stress scenario assumes both a significant economic stress (to reflect market volatility) and business cycle stress followed by a recovery and then stability. Despite the stress, FSL improves its cash-to-adjusted debt to close to 60% by year four and MADS coverage averages 2.6x through the scenario, which is viewed as adequate for a 'bbb' financial profile.

## **RATING SENSITIVITIES**

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

--Given FSL's financial position as it rebuilds IL occupancy following the large construction projects, an upgrade is considered unlikely over the outlook period.

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

--Failure to continue to improve IL occupancy, where occupancy is sustained below 88%;

--A deterioration in balance sheet metrics, with cash-to-adjusted debt sustained below 60%;

--Weakened cash flow such that debt service coverage is consistently below 2.0x and unrestricted liquidity growth flattens.

## **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>.

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, which offers Type-A (Lifecare) contracts. FSL offers traditional contracts which become non-refundable after 50 months and 90% refundable contracts; however, most have chosen the traditional option.

FV currently has 256 independent living residences/units (ILUs), 81 assisted living suites/units (ALUs; including 17 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, therapy at home, 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 2020 were approximately \$47.6 million.

### **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](http://www.fitchratings.com/esg).

## RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR
Fellowship Senior Living (NJ)	LT IDR  BBB+ Rating Outlook Stable  New Rating	
Fellowship Senior Living (NJ) /General Revenues/1 LT	LT BBB+ Rating Outlook Stable  Affirmed	BBB+ Rating Outlook Negative

[VIEW ADDITIONAL RATING DETAILS](#)

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**APPLICABLE CRITERIA**

[U.S. Public Finance Not-For-Profit Life Plan Community Rating Criteria \(pub. 02 Mar 2021\) \(including rating assumption sensitivity\)](#)

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

## **APPLICABLE MODELS**

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

Portfolio Analysis Model (PAM), v1.3.2 (1)

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