FitchRatings

2023 Sector Outlook

U.S. Not-for-Profit Life Plan Communities
WHEFA Insights into Capital Finance

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March 27, 2023

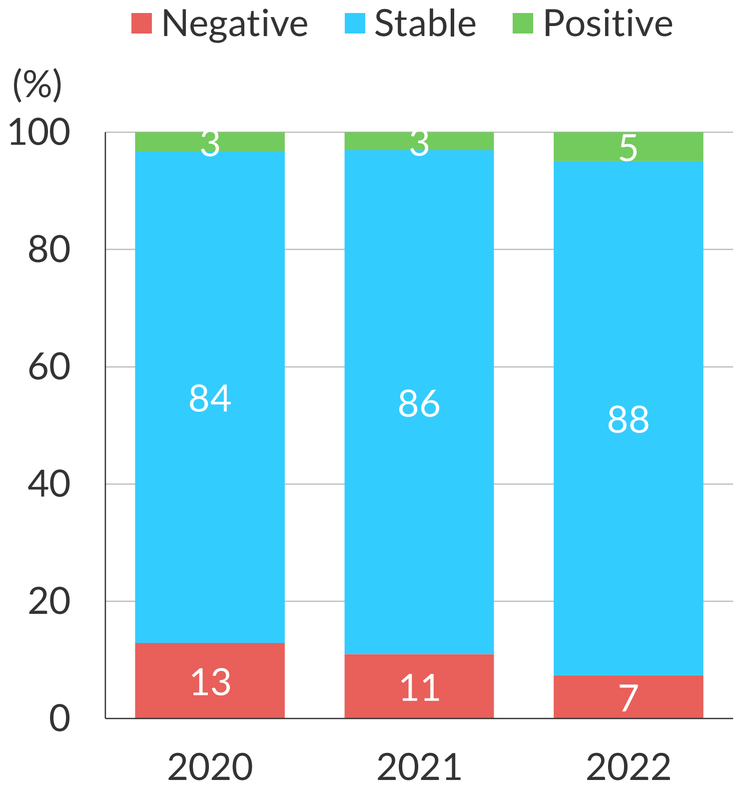
> While Fitch expects demographic trends to continue to support healthy demand, decelerating real estate price growth and cost inflation are significant headwinds that may stall the life plan community (LPC) sector’s recovery in 2023.
>
> Fitch Ratings

Fitch's LPC Portfolio in 2022

Fitch Rates 163 Life Plan Communities (LPCs)

- Median rating is 'BBB' and the number of ratings in this category remains the most numerous at about 50% of ratings versus 21% in the 'A' rating category and 28% below investment grade
- Fitch's net outlook balance recovered in 2022 compared to 2021 and 2020, reflecting an uptick in Positive Rating Outlooks and a decrease in the number of Negative Rating Outlooks compared to the two previous years
  - 2022: Nine (9) Upgrades / 12 Downgrades
  - 2021: Six (6) Upgrades / 17 Downgrades
  - 2020: No (0) Upgrades / 20 Downgrades
- Despite more negative sector outlook, Fitch does not expect a material increase in negative rating actions in 2023

Life Plan Community - Rating Outlooks



Source: Fitch Ratings

LPC Sector Outlook: Demand Remains a Sector Strength

Demographics to Support Healthy Demand

- Fitch expects stable to improving ILU occupancy in 2023, supported by demographics (aging population, Baby Boom generation)
- Independent living unit (ILU) occupancy at most Fitch-rated LPC issuers has been improving over the last two years
- Concerns about broader declines in demand for the LPC model due to coronavirus have proven to be unfounded
- Skilled nursing occupancy continues a slow recovery driven more by staffing challenges than demand issues
- Assisted living and memory care occupancy have recovered more quickly, and occupancy is expected to remain steady in 2023

Drivers of ‘Deteriorating’ Outlook

Labor Shortages Driving Increased Operating Expenses

- Higher wages to recruit and retain staff were the main driver of escalating operating expenses in 2022
- Despite incremental signs of improvement, job openings remain elevated, and most healthcare providers continue to experience shortages of nurses, certified nurse aides, and other staff
- LPCs have more flexibility than hospitals in responding to labor pressures (more limited clinical operations, can take units/wings offline)
- Monthly service fee increases well above typical levels for 2023 should help absorb expense increases, but some longer term concern about the ability of LPC providers to continue to raise rates at elevated levels should inflation persist

Drivers of 'Deteriorating' Outlook (Cont.)

Deceleration in Real Estate Price Growth

- Growth in residential real estate prices is slowing
  - National home prices were 12.2% overvalued as of 3Q22 (source: Fitch's 3Q U.S. RMBS Sustainable Home Price Report)
- Home prices expected to moderate further with elevated mortgage rates
  - Housing market crash as occurred in 2008-2009 is unlikely
- Fitch believes entrance fee pricing can remain largely stable even if home prices decline beyond our overvaluation estimates

Drivers of ‘Deteriorating’ Outlook (Cont.)

Financial Market Volatility / Higher Cost of Capital

- Capital investment will remain a core theme in LPC sector
  - ILU expansions to meet rising demand and satisfy consumer preferences for unit configuration and community amenities
  - “Repositioning” projects to right-size assisted living and skilled nursing facilities or add service lines (memory care)
- Global macroeconomic outlook has deteriorated, cost of capital has risen
  - A negative for LPCs pursuing expansion projects in the current environment
  - Many of our rated LPCs refinanced at lower rates over the last several years
- May result in delayed borrowing plans
  - LPCs have flexibility on capital spending and can generally delay projects
  - A slowdown or delay in borrowing could keep balance sheets stable offsetting investment market volatility

What to Watch: “Tridemic” and Regulatory Environment

An Unexpected Surge in Highly Infectious Disease(s)

An unexpected surge in a highly infectious variant of coronavirus or another disease, or any other disruptor that causes prolonged restrictions on move-ins into an LPC could counteract current strong demand and would pressure issuers and the sector beyond considerations in Fitch’s ‘deteriorating’ sector outlook.

Heightening of Regulatory Requirements

With a few exceptions, most states have not enacted material new regulations on long-term care providers in the last two years. However, meaningful actions by legislators is still possible, especially if viral surges are more severe than currently expected. Heightened regulatory requirements would likely increase operating costs and exacerbate headwinds in the LPC sector.

What to Watch: Mergers & Acquisitions

Mergers & Acquisitions (M&A) to Continue

- Fitch expects the increased pace of M&A activity to continue in 2023
- Competitive pressures are driving smaller LPCs to seek a larger system's resources
- Often the "first" step goal stabilizes and financially improves a newly acquired campus before integrating it into the system Obligated Group

Appendix

Wisconsin LPC Ratings and Contract Types[a] (as of February 22, 2023)

Transaction Name	State	Rating	Outlook	Contract Type
Saint John's Communities, Inc. (WI)	WI	BBB-	Positive	A
Three Pillars Senior Living Communities (WI)	WI	BBB+	Negative	C

[a] Predominant contract type(s) indicated for LPCs that offer multiple contract types

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