FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Fellowship Village, NJ Revenue Bonds to 'BBB-'; Outlook Stable

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Fitch Ratings - New York - 20 Oct 2023: Fitch Ratings has downgraded the Issuer Default Rating (IDR) of Fellowship Village (FV) and the rating on approximately $46 million in revenue bonds assigned to approximately $87 million of series 2019A&B revenue bonds issued by the Wisconsin Public Finance Authority on behalf of FV to 'BBB-' from 'BBB+'.

RATING ACTIONS

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

VIEW ADDITIONAL RATING DETAILS

The two-notch downgrade reflects Fellowship Village's (FV) substantial liquidity drop related to the use of the Obligated Group's (OG) cash position to acquire non-obligated communities beginning in FY22 and continuing in FY23.

In FY22, FV began transferring funds outside of the obligated group to support the acquisition of additional communities managed by Fellowship Life Inc. In FY2022, approximately $5 million was used to support Friends Village (in Woodstown, NJ). In FY23, the obligated group used an additional $5 million to commence Pines Villages repositioning (in Whiting, NJ). As a result of these acquisitions, coupled with unrealized losses, cash to adjusted debt as of June 30 was 35.9% compared with 60% at the end of calendar 2021. Fitch expects the balance sheet to stabilize at levels consistent with the lower rating, as FV's stated capital plans and the ability to draw down further funds per bond documents down to 180 days cash on hand (DCOH) provide limited opportunity for balance sheet recovery.

While these newly acquired communities may ultimately be of strategic value to FV, Fitch views negatively the aggressive use of obligated group (OG) funds for non-OG related activities, which has been a primary driver of the drop in liquidity over the last two fiscal years. Additional outflows of cash from the OG would likely lead to negative rating action as Fellowship has limited financial flexibility at the current rating. Positive rating movement moving forward will be inhibited given the potential to transfer additional funds outside the OG as long as cash remains above 180 DCOH.

SECURITY

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

KEY RATING DRIVERS

Revenue Defensibility - 'bbb'

Expectation for Improved Occupancy

Fitch assesses FV's revenue defensibility as midrange, which reflects independent living unit (ILU) occupancy of 86%, assisted living (AL) occupancy of 67%, and skilled nursing SNF occupancy of 85%. Fitch had expected occupancy to increase over the past year. However, management attributed the lack of increase in census to higher than usual attrition in second-generation residents.

The campus' location in Basking Ridge, NJ is 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'

Operating Performance Expected to Improve

In Fiscal 2022, FV had an operating ratio of 109.1%, a net operating margin (NOM) of -9.5%, and a NOM-adjusted of 25%. Management attributes the weaker operating performance in FY22 to wage pressures and agency personal especially in AL and SNF coupled with ramping up a therapy-at-home business. As of June 30, operations have improved with FV maintaining an operating ratio of 101.1%, a NOM of 4.7%, and a NOM-adjusted of 19.5%. Fitch expects that the growing revenues the community receives from its other service lines including a CCRC 'without walls' program, Home Care, 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.

FV is on the final stages of an extensive capital plan which began in 2017. Ongoing projects include a fitness center, locker rooms, Med-Spa, Salon, art studio, medical office suites, and further outdoor amenities, with construction expected to be completed in December 2023. 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 1.0x and 4.4x, respectively, in fiscal 2022, offset by MADS representing an adequate 9.3% of fiscal 2022 revenues.

Financial Profile - 'bbb'

Weakened Financial Profile

Fitch assesses FV's financial profile as 'bbb' in the context of its 'bbb' revenue defensibility and 'bbb' operating risk assessments. The community's $32 million in unrestricted cash and investments translates into 233 days cash on hand and 35.9% cash-to-adjusted debt as of June 30, 2023, which is a significant decline from fiscal 2021 levels of 504 days cash on hand and 60.1% cash-to-adjusted debt, attributable to aggressive use of OG cash to fund acquisitions outside of the OG.

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 FV's cash-to-adjusted debt metric will gradually improve as cash flows accumulate and capital spending winds down. Fitch's base case factors in a $4 million transfer, which would decrease cash to around 180 DCOH, reflecting management's demonstrated acquisition strategy. Fitch's stress scenario assumes significant economic stress (to reflect market volatility) followed by a recovery and then stability. In Fitch's stress case, FVs cash-to-adjusted debt declines considerably in year one, but recovers to approximately 38%. Fitch assumes that FSL would cease transfers to non-OG entities in a stressed scenario. While this cash-to-adjusted debt is weak for the rating category, MADS remains between 1.4x and 2.4x in Fitch's stress case scenario, which is consistent with a 'BBB-' rating.

RATING SENSITIVITIES

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%;

--Further deterioration in balance sheet metrics, with cash-to-adjusted debt sustained below 35% beyond fiscal 2024;

--Weakened cash flow such that debt service coverage is consistently below 2.0x.

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

--Given FSL's financial position an upgrade is considered unlikely over the outlook period.

PROFILE

Located in Basking Ridge, NJ, Fellowship Village formerly known as Fellowship Senior Living is a senior living organization with several distinct service lines. Fellowship Village (FV) is Fellowship Life's continuing care retirement community, which offers Type-A (Lifecare) contracts. FV 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), 91 assisted living suites/units (ALUs; including 36 memory care units), and 67 skilled nursing (SN) beds. FV's other service lines includes Fellowship Freedom Plans, which is a CCRC "without walls," Fellowships Home Care, a home health agency, therapy at home, and a Hospice program that was accredited in December 2017.

All service lines of FV are included in the obligated group. FV's total operating revenues in fiscal 2022 were approximately $51.7 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

Fellowship Village, (NJ) has an ESG Relevance Score of '4' for Group Structure due to its intercompany activity with non-Obligated Group entities, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

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

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