FitchRatings

Fitch Affirms HumanGood California Obligated Group's Ratings at 'A-'; Outlook Stable

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Fitch Ratings - Austin - [publication date will be automatically inserted] Fitch Ratings has affirmed the 'A-' Issuer Default Rating on HumanGood California Obligated Group (HGCOG) and the 'A-' rating on the $120 million revenue bonds series 2021 and $142 million revenue and refunding bonds series 2019A issued by the California Municipal Finance Authority on behalf of HGCOG and the $20 million in series 2019B HGCOG taxable bonds. Additionally, Fitch has affirmed the 'A-' rating on the $40 million revenue bonds series 2015 issued by California Statewide Communities Development Authority (CSCDA) on behalf of American Baptist Homes of the West (ABHOW), which is now known as HumanGood Norcal (NorCal).

The Rating Outlook is Stable.

SECURITY

The bonds are secured by HGCOG's gross revenues. The NorCal series 2015 bonds are also guaranteed by the income earned on HumanGood Foundation West's unrestricted net assets.

ANALYTICAL CONCLUSION

The 'A-' ratings primarily reflect HGCOG's diverse operating platform consisting of 14 life plan communities (LPCs) across the state of California. Fitch believes this diversity reduces overall operating risk relative to a single-site borrower, allowing the system to manage through occupancy variations at individual communities and the pandemic's pressures on sales, marketing and external admissions. Overall occupancy declined slightly to 85.3% in 2021 from 87% in 2020, but HGCOG was able to generate higher total revenue through rate increases across service lines and an improved payor mix where Medicare and private pay generated 70% of skilled nursing net revenues in 2021 compared to 67.5% in 2020. Strong corporate oversight has also provided for prudent expense and capital management that resulted in a 13% increase in liquidity year over year.

Similar to other life plan communities, HGCOG began to acutely experience higher contract labor and overtime cost pressures in the second half 2021 that have continued into early 2022. Management is proactively addressing these issues through improved recruitment/retention efforts and efficiency initiatives geared toward producing higher profitability. Entrance and monthly service fee increases at select communities are expected, but management is also prepared to implement multiple marginal operating changes that will collectively generate material cost savings and revenue enhancements without significantly impacting affordability, which Fitch views favorably.

Fitch still expects HGCOG to produce weaker core operating profitability over the next two years compared to historical averages. Fitch's forward look shows that HGCOG should still be able to grow its liquidity position in both a base case and stress case scenario, reflecting the stability expected in a provider of the size and geographic diversity of HGCOG. The long-term increase in liquidity in the stress case also reflects Fitch's view that HGCOG can produce sufficient cash flow to absorb any remaining pressures from the coronavirus pandemic at the current rating level.

KEY RATING DRIVERS

Revenue Defensibility: 'aa'

Diverse Operating Platform; Solid Historical Census

Fitch assesses HGCOG's revenue defensibility at 'aa', primarily reflecting its diverse operating platform, solid historical census, and strong pricing flexibility. HGCOG operates 14 LPCs across the state of California with approximately 3,500 units in service. The geographic and revenue diversity reduces overall volatility and market risk, leading to more consistent operating performance.

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HGCOG's overall occupancy slipped slightly to 85.3% in 2021 from 87% in 2020. This overall decrease included slight declines in the independent living units (ILUs), assisted living units (ALUs), and skilled nursing facility (SNF) beds and occupancy stability in the memory care units (MCUs). Management notes that the organization is experiencing year over year growth in lead generation that has led to an increase in overall occupancy to 86.2% in the first quarter of 2022. This overall occupancy level translates to an average occupancy of 88.9% in the ILUs, 89.8% in the ALUs, 91.4% in the MCUs, and 73.1% in the SNF beds. ILU census has shown a steady increase since April 2021 and is expected to continue improving, which is notable given the significant margin and cash flow benefits from these units and the fact that ILU resident service fees account for approximately 43% of HGCOG's net resident service revenues.

HGCOG's various communities are located in strong service areas with favorable demographics and real estate trends, which afford the organization a strong degree of pricing flexibility. This pricing flexibility allowed management to offset revenue losses from an overall decrease in occupancy with entrance fee increases in late 2021 and plan for an additional mid-year entrance fee increase in 2022. Even with multiple price increases over the past few years, HGCOG's entrance fees remain in line or less than local housing prices, which supports the strong 'aa' revenue defensibility assessment.

Operating Risk: 'bbb'

Consistent Operations; Manageable Debt Burden

HGCOG primarily offers traditional, 50% refundable, and 75% refundable modified (Type-B) contracts at its campuses. The combination of solid demand across multiple campuses and the Type-B contracts have translated into good operating performance from 2018 to 2020. Profitability declined in 2021 due to occupancy below budget across service lines and $4.8 million in COVID-related expenses that was only offset by $1.2 million in CARES Act stimulus funds. First quarter 2022 results continued to be pressured, especially by the impact of inflated labor expenses, that caused HGCOG's operating ratio and net operating margin (NOM) to weaken to 103.5% and negative 0.1% respectively. These metrics are expected to rebound as HGCOG received $19 million in PPP loan forgiveness to date in 2022 ($21.1 million in PPP loans received total) and is working through multiple initiatives to optimize operations. While core operating profitability was unfavorable compared to historical results, good net entrance fee generation offset profitability losses, resulting in a solid 19.2% and 15.3% NOM-adjusted in 2021 and the first quarter of 2022, respectively.

HGCOG's capex levels have averaged approximately $34 million over the last four fiscal years, or 82.6% of depreciation, translating into a good 11.3 years average age of plant as of March 31, 2022. Fitch expects HGCOG's capex to increase in upcoming years as HGCOG draws down on its taxable bank loan and utilizes funds from its series 2021 debt issuance to fund capex that improves the overall marketability of its campuses. HGCOG's debt burden is manageable even after the issuance of $120 million in series 2021 debt. MADS equates to a low 8.4% of 2021 revenues and debt to net available of 6.2x and revenue-only MADS coverage of 0.9x are consistent with HGCOG's midrange operating risk assessment.

Financial Profile: 'a'

Stable Financial Profile Despite Stressed Environment.

In the context of its strong revenue defensibility and midrange operating risk assessments, Fitch assesses HGCOG's financial profile at 'a', reflecting its adequate liquidity position and robust coverage levels in recent years. As of March 31, 2022, HGCOG had unrestricted cash and investments of $348.3 million, which translates into 440 days cash on hand (DCOH), 71.8% cash to adjusted debt and 12.7x cushion ratio. Fitch includes HumanGood SoCal's $9.2 million PPP loan that has not been forgiven and a 5x multiple to HGCOG's annual operating lease expense as a debt equivalent in its adjusted debt calculation.

Fitch expects HGCOG's operating ratio will remain slightly above 100% over the next few years and decline to be at or below 100% in the later years of the base case scenario. Very high capital spending is anticipated over the next few years - this incorporates an assumption that capex funded from unrestricted cash and investments and cash flow will be below depreciation while HGCOG draws down on the $32 million remaining on its drawable taxable bank loan and $155 million in undrawn funds held for construction projects (as of Dec. 31, 2021). The base case also assumes that net entrance fee generation will be above the $49 million average generated over the past four years as HGCOG benefits from entrance fee price increases and improving ILU sales activity.

Through Fitch's forward-looking scenario analysis, HGCOG is expected to maintain its solid leverage metrics even amidst a stressed environment. The stress scenario incorporates both an investment portfolio and cash flow stress that are in line with current economic conditions and expectations. HGCOG's investment portfolio stress was moderate given its diversified investment allocation. Under these assumptions, HGCOG's key leverage metrics and coverage levels remain consistent with its 'a' financial profile assessment, with cash to adjusted debt that remains at or above 65% and MADS coverage that is consistently above the debt service coverage ratio covenant of 1.2x.

Asymmetric Additional Risk Considerations

No asymmetric risk factors were applied in this rating.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:
--Maintenance of historically solid census and strong coverage levels, coupled with cash growth such that cash to adjusted debt is above 100%.

Factors that could, individually or collectively, lead to negative rating action/downgrade:
--Unexpected deterioration in census or cash flow that consistently results in MADS coverage below 2.5x and/or

cash to adjusted debt consistently below 65%;
--Any unexpected transfers, advances, or other financial support to non-OG entities that deteriorates HGCOG's key leverage metrics.

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.

CREDIT PROFILE

Effective May 1, 2016, ABHOW (now known as HumanGood NorCal) and Southern California Presbyterian Homes (SCPH; now known as HumanGood SoCal) affiliated and the organizations created a common governance and management structure known as HumanGood. Prior to the affiliation, ABHOW's sole corporate parent was Cornerstone Affiliates. Also prior to the affiliation, SCPH was doing business as be.group and served as the controlling member of its senior living and care system. With the affiliation, the sole member of NorCal and SoCal is HumanGood. Cornerstone Affiliates, now known as HumanGood Cornerstone, became a subsidiary to HumanGood and is the sole corporate member of the HumanGood affiliates that are not members of HGCOG.

HumanGood's integration activities since its inception include one executive management team, common payroll and benefits, group purchasing, and a single financial data platform. Other items accomplished include corporate services consolidation, a combined affordable housing business, and the creation of another obligated group that includes two of HumanGood Cornerstone's four non-California retirement communities.

The California Obligated Group, HGCOG, which was formed in August 2019 concurrent with the date of the issuance of the series 2019 bonds, primarily includes HumanGood's California retirement communities operating within NorCal and SoCal, with NorCal serving as the obligated group representative. Additionally, HGCOG includes the corporate office of HumanGood. The HumanGood corporate office provides management services and shares overhead expenses with HGCOG members and HumanGood Cornerstone's four retirement communities. The corporate office also provides certain functions through annual cost recoveries from other affiliates. HumanGood Fresno and HumanGood East were a members of NorCal's obligated group prior to 2012 but was removed in order to accommodate a repositioning project that included a substantial increase in debt. The campus stabilized in 2016 and is performing well.

NorCal consists of eight life LPCs that include Terraces at Los Altos in Los Altos, CA, Grand Lake Gardens in Oakland, CA, Piedmont Gardens in Oakland, CA, Plymouth Village in Redlands, CA, Valle Verde in Santa Barbara, CA, Rosewood in Bakersfield, CA, and Terraces of Los Gatos in Los Gatos, CA and HumanGood Fresno (which joined in 2019). SoCal includes six LPCs in southern California. Two of the LPCs are located in north central Los Angeles County (Westminster Gardens in Duarte and Royal Oaks in Bradbury), two in Orange County (Windsor in Glendale and Regents Points in Irvine), and two in San Diego County (White Sands in La Jolla and Redwood Terrace in Escondido).

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Fitch's analysis is based upon the obligated group financial statements. In fiscal 2021, HGCOG reported total operating revenues of $314.7 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

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

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RATING ACTIONS

ENTITY	RATING			PRIOR
HumanGood California Obligated Group (CA)	LT IDR	A-	Affirmed	A-
American Baptist Homes of the West (CA) /General Revenues/1 LT	LT	A-	Affirmed	A-
HumanGood California Obligated Group (CA) /General Revenues/1 LT	LT	A-	Affirmed	A-

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Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (pub.01-Sep-2021)(includes rating assumption sensitivity)
U.S. Public Finance Not-For-Profit Life Plan Community Rating Criteria (pub.05-Apr-2022)(includes rating assumption sensitivity)

Applicable Models

Portfolio Analysis Model (PAM), v2.0.0 (1 (https://www.fitchratings.com/site/re/1001560))

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