FitchRatings

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

Fitch Ratings - Austin - 11 Jul 2023: Fitch Ratings has affirmed HumanGood California Obligated Group's (HGCOG) Issuer Default Rating (IDR) at 'A-'. Fitch has additionally affirmed at 'A-' the $120 million revenue bonds series 2021, $141.7 million revenue and refunding bonds series 2019A issued by the California Municipal Finance Authority on behalf of HGCOG, and $16.8 million series 2019B HGCOG taxable bonds.

Fitch has also affirmed the 'A-' rating on the $38 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.

The affirmation of the 'A-' IDR and bond ratings reflect HGCOG's improved occupancy across service lines and performance improvement initiatives that supported favorable cash flow generation in 2022. The rating also incorporates HGCOG's diverse operating platform consisting of 12 life plan communities (LPCs) across the state of California (down from 14 due to a damaging fire that led to the closure and delicensing of Grand Lake Gardens in Oakland, CA and the divestiture of Windsor, an LPC in Glendale, CA). 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.

HGCOG's financial profile is mixed. Cash-to-adjusted debt of 71% at Dec. 31, 2022 falls outside Fitch's criteria's suggested rating category, while maximum annual debt service (MADS) coverage is consistent with an 'a' assessment, averaging 2.8x over the last five fiscal years (as calculated by Fitch). The emphasis Fitch places on MADS coverage acknowledges HGCOG's consistently strong cash flow generation, with net entrance fee receipts averaging $53.3 million over the last five years -- nearly 2.0x MADS of $27.5 million.

Fitch expects that HGCOG will continue to generate solid MADS coverage above 2.5x and that operating results will improve from current levels through incremental occupancy growth, reduction in utilization of external labor and technology and campus enhancements that solidify the organization's competitive positioning.

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.

KEY RATING DRIVERS

Revenue Defensibility - 'aa'

Diverse Operating Platform; Improved Occupancy

Fitch assesses HGCOG's revenue defensibility at 'aa', primarily reflecting its diverse operating platform, solid historical census, and strong pricing flexibility. HGCOG operates 12 LPCs across the state of California with 3,422 units in service as of 1Q23. The geographic and revenue diversity reduces overall volatility and market risk, leading to more consistent operating performance.

HGCOG's overall occupancy grew to 87.3% in 2022 from 85.3% in 2021 as a result of slight increases in occupancy across all service lines. Management notes that strong lead generation has led to an increase in overall occupancy to 89.5% in the first quarter of 2023. This overall occupancy level translates to an average occupancy of 92.2% in the independent living units (ILU), excluding Grand Lake Gardens units taken offline on April 6, 2023, 90.5% in the assisted living units, 88.6% in the memory care units, and 80.4% in the skilled nursing facility 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. In addition, skilled nursing revenues have been growing as management has been focused on increasing post-acute admissions while maintaining a favorable payor mix, which is seen in the fact that Medicare and private pay generated 70% of skilled nursing net revenues in 2022.

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 implement 8% entrance fee and 5.4% ILU monthly service fee increases in 2022 to help offset inflationary pressures. ILU entrance fee increases are budgeted to range from 0 to 10% in 2023 and ILU monthly service fees are budgeted to increase by 7.9% in 2023.

Fitch believes that even with the price increases over the past few years, HGCOG's entrance fees remain in line or less than local housing prices and monthly service fees are affordable relative to resident wealth and income levels, 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. Fitch's 'bbb' operating risk assessment reflects operating metrics that are consistent with expectations for a Type-B lifecare system, adequate capital spending and a manageable debt burden. HGCOG's core operating profitability rebounded in 2022, as improved occupancy, fee increases, cost containment/revenue optimization efforts and $21 million in PPP loan forgiveness recognized as revenue in 2022 helped balance against a significant increase in labor, purchased services and utilities expenses. As a result, the operating ratio fell to 96.4% in 2022 from 100.2% in

2021. In addition to improved core operating profitability, HGCOG had a strong year for entrance fees.

Net entrance fees were $70.3 million in 2022 compared to a $49 million average from 2018-2021, producing a 23.2% net operating margin - adjusted, which was favorable to the 19.7% average from 2018-2021. Fitch expects staffing improvements, monthly service fee increases around inflationary levels, continued implementation of operational efficiency initiatives and sustained occupancy improvements will allow HGCOG to maintain profitability metrics that are sufficient for a 'bbb' operating risk assessment going forward. In addition, the removal of Grand Lake Gardens and Windsor from the obligated group should improve financial performance as the two communities had produced financial losses over the past few years.

HGCOG regularly invests in improvement, modernization and redevelopment of all facilities to remain competitive. Capital spending has averaged approximately $37 million over the last five years, or 89% of depreciation, translating into a good 11.2 years average age of plant as of Dec. 31, 2022. Fitch expects the system to continue spending on routine needs and utilizing its financial strength to grow strategically through OG and non-OG activity. HumanGood's strategic focus on growth was recently executed on through the acquisition of Hillside, an LPC in McMinnville, Oregon from Brookdale Senior Living.

The acquisition was financed through a senior secured interaffiliate note from HGCOG, which HGCOG funded through a $31.6 million draw on its taxable bank loan and through funds received from the sale of Windsor. HGCOG has received board of directors approval to extend a $10 million construction loan to Hillside, financed through draws upon its existing undrawn $11 million series 2020 line of credit with Washington Federal Bank, to finance the development of new cottages at Hillside.

HGCOG's capital-related metrics are consistent with a 'bbb' operating risk assessment. MADS represented a moderate 7.8% of 2022 revenues. In addition, debt to net available has ranged from 4.5x to 6.3x and revenue-only coverage has averaged 0.9x over the last five years. Given the rebound in performance and recognition of PPP loans, MADS coverage was very strong at 3.4x in 2022.

Financial Profile - 'a'

Stable Financial Profile Despite Investment Losses in 2022

In the context of its 'aa' revenue defensibility and 'bbb' 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, 2023, HGCOG had unrestricted cash and investments of $354.1 million, which translates into 425 days cash on hand (DCOH), 74.4% Cash-to-adjusted debt and 12.9x cushion ratio according to Fitch's calculations. Fitch includes a 5x multiple to HGCOG's annual operating lease expense as a debt equivalent in its adjusted debt calculation.

Fitch's base case scenario, which is a reasonable forward look of financial performance over the next five years given current economic expectations, shows the HGCOG maintaining operating ratios just below 100% and net operating margin - adjusted around 20%. Routine capital spending is expected to remain consistent with historical levels. The base case also assumes that net entrance fee generation will be above the $53 million average generated over the past four years as HGCOG benefits from entrance fee price increases and good 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 case 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 above 65% and MADS coverage that averages 2.9x. DCOH remains comfortably above 200 days through the moderate stress which is neutral to the rating outcome.

Asymmetric Additional Risk Considerations

No asymmetric risk factors were applied in this rating.

RATING SENSITIVITIES

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.

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%.

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.

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 five 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 five retirement communities.

The corporate office also provides certain functions through annual cost recoveries from other affiliates. HumanGood Fresno was a member 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 six LPCs that include Terraces at Los Altos in Los Altos, 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. SoCal includes five 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), one in Orange County (Regents Points in Irvine), and two in San Diego County (White Sands in La Jolla and Redwood Terrace in Escondido). HumanGood Fresno was added to HGCOG in 2019.

Fitch's analysis is based upon the obligated group financial statements. In fiscal 2022, HGCOG reported total operating revenues of $356.5 million, which includes the recognition of $21.1 million in PPP loan forgiveness.

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.

Fitch Ratings Analysts

Richard Park
Director
Primary Rating Analyst
+1 512 813 5704
Fitch Ratings, Inc. 2600 Via Fortuna, Suite 330 Austin, TX 78746

Rebecca Greive
Associate Director
Secondary Rating Analyst
+1 312 205 3399

Emily Wadhwani
Senior Director
Committee Chairperson
+1 312 368 3347

Media Contacts

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
HumanGood California Obligated Group (CA)	LT IDR	A-	Affirmed		A-

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• 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-

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (pub.27 Apr 2023) (including rating assumption sensitivity)

U.S. Public Finance Not-For-Profit Life Plan Community Rating Criteria (pub.05 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

Solicitation Status

Endorsement Status

HumanGood California Obligated Group (CA)	EU Endorsed, UK Endorsed

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