FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Front Porch Communities & Services, CA at 'A'; Outlook Stable

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Fitch Ratings - New York - 05 Aug 2022: Fitch Ratings has affirmed the 'A' Issuer Default Rating (IDR) for Front Porch Communities & Services (Front Porch) and the 'A' revenue bond rating for the series 2017A, 2021A and taxable series 2021B bonds issued by California Statewide Communities Development Authority on behalf of Front Porch.

The Rating Outlook is Stable.

SECURITY

The bonds are joint and several obligations secured by a gross revenue pledge of the Front Porch Obligated Group (OG). The OG accounted for 78% of total assets and 92% of total revenue of the combined consolidated financials in FY 2022.

ANALYTICAL CONCLUSION

The 'A' reflects Front Porch's favorable financial performance and growth in liquidity demonstrated since its April 1, 2021 merger with Covia Communities. Financial results provide solid coverage of a moderate debt burden and manageable capital spending should allow for continued improvement in liquidity. The 'A' rating also reflects Front Porch's position as one of the largest non-for-profit senior living providers in the nation with a diverse operating platform that includes 16 LPC's across the state of California and solid historical demand indicators throughout the continuum. Fitch expects that operating results will improve from current levels as Front Porch continues to benefit from economies of scale driven by the merger, allowing for balance sheet accretion.

The Stable Outlook reflects Fitch's expectation that Front Porch's diverse operating profile and strong demand will continue to support sound operating performance and a strong financial profile.

KEY RATING DRIVERS

Revenue Defensibility: 'aa'

Stable Demand and Solid Occupancy

Front Porch's revenue defensibility is assessed at 'aa' primary reflecting its diverse operating platform, good historical census, and strong pricing flexibility. Front Porch is a large and diversified senior living provider with 16 Life Plan Communities, three active adult communities, and 32 affordable housing communities located in desirable locations throughout the State of California.

Front Porch has maintained solid census levels across all of its campuses historically, as evidenced by the average 88% occupancy in its independent living units (ILUs) and 88% occupancy in its memory care units and assisted living units (ALUs). Skilled nursing facility (SNF) occupancy was more modest in fiscal 2022 averaging 71%, reflecting a broader national trend during the coronavirus pandemic. Front Porch's various communities are located in strong service areas with favorable demographics and real estate trends, which allow for a strong degree of pricing flexibility.

Overall Front Porch has demonstrated a solid degree of annual fee and rate increases across its various campuses that have ranged between 2.75%-5.25% on monthly and entrance fees. Although it varies per campus, Front Porch's entrance fees remain in line or below local housing prices. Along with a sophisticated and centralized management structure, the community's revenue diversity offsets risks relating to operating volatility and competitive pressures.

Operating Risk: 'bbb'

Sound Operating Performance

Ten of Front Porch's facilities are entrance fee continuing care retirement communities, while the others are rental multilevel retirement communities. Approximately 54% of Front Porch's revenues (as a percentage of residential living and assisted living revenue) are derived from entrance fee contracts with rental contracts accounting for 46%, based on fiscal 2022.

The combination of solid demand across the continuum and the Type-B contracts has translated into sound operating performance. Front Porch generated a net operating margin (NOM) of 9%, net operating margin adjusted (NOMA) of 23% and an operating ratio of 90% in fiscal 2022. Results were driven by solid occupancy, annual rate increases, effective cost management and synergies driven by the merger, despite facing macro headwinds of inflation and labor pressures.

Over the five-year forward look Fitch expects incremental improvement in NOM and NOMA and that Front Porch's operating ratio will be maintained in the low 90% range. Management expects to realize continued benefits from the merger in FY 2023, including a consolidated supply chain, elimination of some duplicative services, consolidating corporate offices among other things.

Front Porch regularly invests in improvement, modernization and redevelopment of all facilities to remain competitive. System wide, capital spending has been above depreciation expense over the past three years with the legacy Front Porch spending on average 124% of deprecation while Covia Communities spending levels had been lower in recent years. Fitch's five-year forward looks assumes capital spending will remain just above depreciation at approximately $60 million.

Front Porch's debt burden is light as evidenced by MADS equating to 6% of total fiscal 2022 revenues and debt to net available of 6.2x. Additional, revenue MADS only coverage was strong at 3.3x in FY 2022. Given its strong revenue base and lack of additional debt plans, Fitch expects these metrics will be maintained over the longer-term.

Financial Profile: 'a'

Strong Financial Profile

In the context of its very strong revenue defensibility and midrange operating risk assessments, Front Porch's financial profile is assessed at 'a' reflecting its sound liquidity position, strong coverage levels, and Fitch's expectation that the metrics will remain in line with the assessment throughout the forward look. At FYE 2022 Front Porch had unrestricted cash and investments of $542 million, which is equal to 685 days cash on hand and 124% cash to adjusted debt. MADS coverage was strong at 5.6x.

In Fitch's forward-looking scenario analysis, Front Porch's solid financial metrics are expected to remain consistent with its current rating level through a stress case. Fitch assumes that capex levels remain manageable over the next five years, just over 100% of deprecation. Additionally, Fitch assumes that revenue growth will meet or exceed expense growth in the later years of the forward look as the organization improves its census and realizes the expenses savings as it continues with integration.

Asymmetric Additional Risk Considerations

No asymmetric risk considerations were relevant to the rating.

RATING SENSITIVITIES

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

--Continued successful integration and sustained improvement in occupancy with combined operating results more consistent with a strong assessment;

--Further strengthening of the financial profile with improvement in cash to adjusted debt levels consistently in excess of 150%, even in a stress scenario.

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

--A material increase in debt without commensurate growth in liquidity;

--Unexpected deterioration in occupancy or cash flow such that MADS coverage consistently falls below 2.5x.

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 sectorspecific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CREDIT PROFILE

On April 1, 2021 Front Porch Communities & Services became the sole corporate member of Covia Communities forming one of the largest not for profit senior living providers in the country. The newly combined organization retained the Front Porch name. Front Porch created a new obligated group that secures the 2021 bonds as well as legacy bonds previously issued by Front Porch. All bonds are parity debt.

Front Porch employs more than 2,900 employees serving over 7,500 residents. Front Porch operates 16 multi-level senior living and three active adult monthly rental communities with limited services containing 3,313 ILUs and ALUs, 166 memory support units, and 671 skilled-nursing beds. All of the communities are located in California, except two of the active adults' communities which are located in Louisiana and Florida.

Front Porch also develops, owns and/or manages 32 affordable housing communities, all located in California except for one located in Arizona, with 2,650 affordable housing units serving more than 3,400 residents, including seniors, families and children, who are economically, physically, mentally or developmentally challenged. The analysis is based on the obligated group which excludes affordable housing and the foundations.

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

Front Porch's ESG Relevance Score for Group Structure has been revised to '3' from '4' to align the issuer with sector guidance.

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

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Front Porch Communities & Services (CA)	LT IDR	A Rating Outlook Stable	Affirmed	A Rating Outlook Stable
Front Porch Communities & Services (CA) /General Revenues/1 LT	LT	A Rating Outlook Stable	Affirmed	A Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

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

U.S. Public Finance Not-For-Profit Life Plan Community Rating Criteria (pub. 05 Apr 2022) (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

Solicitation Status

Endorsement Policy

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California Statewide Communities Development Authority	EU Endorsed, UK Endorsed

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