FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - San Francisco - 04 Nov 2024: Fitch Ratings has affirmed the 'A' Issuer Default Rating (IDR) for Front Porch Communities & Services 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. Fitch has also removed the ratings from Under Criteria Observation.

The Rating Outlook is Stable.

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

The 'A' rating reflects Front Porch's sound financial performance, solid demand indicators, and diverse and sizable market position since completing its 2022 merger with Covia Communities. Financial results in fiscal 2024 provided solid coverage of a moderate debt burden, and manageable capital spending should allow for continued improvement in balance sheet resources over time.

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 California. Fitch expects that operating results will incrementally improve over the medium term as Front Porch continues to benefit from economies of scale and efficiencies post-merger.

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

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 approximately 80% of total assets and 92% of total revenue of the combined consolidated financials in FY 2024 (March 31, 2024; audited).

KEY RATING DRIVERS

Revenue Defensibility - a

Solid Occupancy; Strong Revenue Diversification

Front Porch's revenue defensibility is assessed at 'a', which reflects the organization's diverse operating platform, solid 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 independent living units (ILUs) average occupancy of 88% and 90% occupancy in its memory care units over the past four fiscal years. Five months through fiscal 2025 (Aug. 31, 2024; unaudited) ILU occupancy improved to 90.4% with management anticipating additional improvement going forward, which should support enhanced overall operating performance.

Skilled nursing facility (SNF) occupancy has had softer census more recently, averaging a lower 65% over the past four-year period, which continues to reflect a broader national trend related to pandemic-related operating challenges and labor pressures. Front Porch's communities are located in strong service areas with favorable demographics and real estate trends, which allow for a strong degree of pricing flexibility.

Although varying per campus, Front Porch's entrance fees remain in line or below local housing prices across its various markets. 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

Consistent Operating Performance; Manageable Capex Expectations

Eleven of Front Porch's facilities are entrance fee life plan communities, while the others are rental multilevel retirement communities. Approximately 53% 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 the remainder, based on fiscal 2024, which is similar to historical performance.

The combination of solid demand across the continuum and rental fees associated with the Type-B contracts were somewhat offset by higher expenses related to operating post COVID-19, which includes heightened labor and inflation-related expense pressures. Fitch continues to view Front Porch's operating performance as sound and consistent for the rating level. In fiscal 2024, it generated improved operating performance with an operating ratio of 90.6% and net operating margin adjusted (NOMA) of 18.5%, which was up from the prior year's 96.6% and 13.4%, respectively.

Over the five-year forward look, Fitch expects incremental improvement in operating performance with Front Porch to realize continued benefits from the merger, including a consolidated supply chain, elimination of some duplicative services, consolidating corporate offices among other things.

Front Porch routinely invests in improvement, modernization and redevelopment of all facilities to remain competitive. System wide, capital spending has been well above depreciation expense over the past three years with Front Porch spending approximately 143% of depreciation, which Fitch views favorably. Going forward, Fitch's five-year forward looks assumes capital spending will be more manageable at around the level of annual depreciation.

Financial Profile - a

Sound Financial Profile

In the context of its strong revenue defensibility and midrange operating risk assessments, Fitch assesses Front Porch's financial profile at 'a' reflecting its sound liquidity position, solid debt service coverage levels, and Fitch's expectation that the metrics will remain in line with the assessment throughout the forward look scenario analysis. At FYE 2024, Front Porch had unrestricted cash and investments of approximately $468 million, which translated into a sound 556 days cash on hand and 112% cash to adjusted debt position. MADS coverage was good at 3.5x.

In Fitch's forward-looking scenario analysis, Front Porch's sound 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, at around 100% of depreciation expense. Additionally, Fitch assumes that revenue growth will meet and/or exceed expense growth in the later years of the forward look as the organization improves its census and realizes further efficiencies as it continues with organizational integration.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--A significant increase in debt without commensurate growth in associated revenues and unrestricted balance sheet resources;

--Unexpected deterioration in occupancy or cash flow such that MADS coverage is negatively affected and is below 2.5x for a sustained period.

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

--Continued successful integration and sustained improvement in demand that bolsters operating results to be more consistent with a strong operating risk 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.

PROFILE

In April 2021 Front Porch Communities & Services became the sole corporate member of Covia Communities, one of the largest not-for-profit senior living providers in the country. Front Porch employs more than 2,900 employees serving over 7,500 residents. It operates 16 multi-level senior living and three active adult monthly rental communities with limited services containing 3,316 ILUs, 171 memory support units, and 728 care center beds. All of the communities are located in California, except for two active adult communities in Louisiana and Florida.

Front Porch also develops, owns and/or manages 31 affordable housing communities in California and one in Arizona. Its 2,650 affordable housing units serve more than 3,400 residents, including seniors, families and children who are economically, physically, mentally or developmentally challenged. Fitch's analysis is based on the obligated group, which excludes affordable housing and the foundation. In fiscal 2024, Front Porch's obligated group had approximately $380 million in revenues.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by data 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.

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APPLICABLE CRITERIA

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub. 12 Jan 2024) (including rating assumption sensitivity)

U.S. Public Finance Not-for-Profit Life Plan Community Rating Criteria (pub. 19 Aug 2024) (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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