10 DEC 2024

Fitch Upgrades HumanGood California Obligated Group (CA) to 'A'; Outlook Stable; Removed from UCO

Fitch Ratings - Austin - 10 Dec 2024: Fitch Ratings has upgraded HumanGood California Obligated Group's (CA) (HGCOG) Issuer Default Rating (IDR) to 'A' from 'A-'. Fitch has also upgraded the series 2021 revenue bonds and series 2019A revenue and refunding bonds issued by the California Municipal Finance Authority on behalf of HGCOG and HGCOG's series 2019B taxable bonds to 'A' from 'A-'. The Rating Outlook is Stable.

Fitch has also upgraded the rating on the series 2015 revenue bonds issued by the California Statewide Communities Development Authority (CSCDA) on behalf of American Baptist Homes of the West (ABHOW), which is now known as HumanGood NorCal to 'A' from 'A-'.

Fitch has removed HGCOG's IDR and bond ratings from Under Criteria Observation (UCO).

The upgrade to 'A' from 'A-' reflects HGCOG's improved balance sheet metrics and consistently robust operating performance. The organization's unrestricted cash and investments increased to $458 million on Sept. 30, 2024, from $392 million on Dec. 31, 2023, resulting in growth in both its days cash on hand and cash-to-adjusted debt metrics.

Management notes that draws on HGCOG's bond funds and fund received from the termination of HumanGood SoCal's legacy-defined benefit pension plan in 4Q24 have led to further balance sheet accretion. This improvement solidifies the organization's financial position for the higher rating level.

Fitch expects HGCOG to continue to capitalize on its economies of scale and centralized strategic resources to manage through industry-wide operating pressures. Strong management practices should allow the organization to effectively manage costs, maintain a healthy sales pipeline and high occupancy rates, and implement entrance and monthly service fee increases that drive high cash flow generation, thereby enhancing the balance sheet.

The 'A' rating continues to reflect HGCOG's diverse operating platform consisting of 12 life plan communities (LPCs) across 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.

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 - 'a'

Diverse Operating Platform; Improved Occupancy

Fitch assesses HGCOG's revenue defensibility at very strong, primarily reflecting its diverse operating platform, solid historical census and strong pricing flexibility. HGCOG operated 12 LPCs across the state of California with 3,243 units in service as of 3Q24. The geographic and revenue diversity reduces overall volatility and market risk, leading to more consistent operating performance.

HGCOG's independent living unit (ILU) occupancy grew to 93.4% through 3Q24 from 89.5% in 2022 as a result of census at nearly every community in the obligated group that has either improved yoy or stabilized at high levels. Fitch attributes the favorable results to concentrated efforts to provide high-quality services and amenities, and transparent communication, which have led to good resident satisfaction.

Management notes that HGCOG's 2024 sales pipeline is currently trending above the 2023 level, which should lead to additional growth in ILU occupancy through the remainder of the year. Increasing ILU census 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.

Occupancy in skilled nursing, HGCOG's second-largest service line (35% of net resident service revenues in 2023) improved to 83.7% through 3Q24 from 76.8% in 2022. Growth in skilled nursing occupancy, the reduction of external and overtime labor, reimbursement increases and the maintenance of a favorable payor mix (68% of net revenues derived from Medicare and private pay in 2023) have helped HGCOG improve skilled nursing profitability in recent periods.

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 entrance fee increases as high as 10% and monthly service fee increases of 7.9% in 2023 to help offset inflationary pressures. ILU entrance fee increases were budgeted to range from 0% to 5% in 2024 and ILU monthly service fees were budgeted to increase by 5.6% in 2024.

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 very strong 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 midrange 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 remained stable in 2023, even after a strong year in 2022 that was supported by $21 million in Paycheck Protection Program loan forgiveness recognized as revenue.

HGCOG demonstrated continued improvements in core operating profitability from 2023 to the most recent interim period. The operating ratio improved to 94% through 3Q24 from 96.3% in 2023 as a result of the maintenance of high ILU occupancy and incremental healthcare occupancy improvements.

The net operating margin (5.3%) and net operating margin-adjusted (23.2%) have also improved in the interim period, underscoring HGCOG's ability to manage costs effectively while maintaining stable and predictable operating results, positioning the organization well for future financial stability and growth and a midrange operating risk assessment.

HGCOG regularly invests in improvement, modernization and redevelopment of all facilities to remain competitive. Capital spending has averaged approximately 88% of depreciation and increased to 131.5% of depreciation through the interim period. Given the organization's solid cash flow generation and $124 million in undrawn bond funds held for projects (as of Dec. 31, 2023), Fitch expects HGCOG to continue spending on strategic and routine needs to enhance the competitive positioning of its facilities.

HGCOG's capital-related metrics are consistent with a midrange operating risk assessment. Maximum annual debt service (MADS represented a moderate 7.0% of annualized nine-month interim period revenue. In addition, debt to net available has ranged from 3.9x to 6.3x and revenue-only coverage has averaged 1x over the last five years --- improving to 1.7x in fiscal 2023 and 1.5x through the fiscal 2024 interim period.

Financial Profile - 'a'

Improved Financial Profile

In the context of its very strong revenue defensibility and midrange operating risk assessments, Fitch assesses HGCOG's financial profile at 'a', reflecting its increased liquidity and robust coverage levels in recent years. As of Sep. 30, 2024, HGCOG had unrestricted cash and investments of $458 million (up from $392 million as of Dec. 31, 2023), which translates into 523 days cash on hand (DCOH), 99.1% cash-to-adjusted debt and 16.6x 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 at financial performance over the next five years given current economic expectations, shows HGCOG maintaining operating ratios just below 100% and net operating margin - adjusted around 20%.

Capital spending is expected to be above depreciation over the next few years as the organization uses organic cash flow and undrawn funds from the 2021 debt issuance for routine and strategic needs. The base case also assumes that net entrance fee generation will be above the $57 million average generated over the past five 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 amid 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 rebounding to 110% by year four of the stress case and MADS coverage averaging 3.4x. DCOH remains comfortably above 200 days through 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 85%;

--Any unexpected transfers, advances or other financial support to non-obligated group entities that deteriorate HGCOG's key leverage metrics.

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

---Maintenance of HGCOG's strong operations and coverage levels, coupled with growth in its unrestricted reserves that result in cash-to-adjusted debt approaching 150% throughout Fitch's stress case scenario.

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 and consolidated corporate services, common payroll and benefits, group purchasing, a single financial data platform and a combined affordable housing business.

The California Obligated Group, HGCOG, which was formed in August 2019 concurrent with the date of the issuance of the series 2019 bonds, includes HumanGood's California retirement communities operating within NorCal, SoCal and HumanGood Fresno, 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 other 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 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, including 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 consists of The Terraces at San Joaquin Gardens.

Fitch's analysis is based upon the obligated group financial statements. In fiscal 2023, HGCOG reported total operating revenue of $371 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

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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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
HumanGood California Obligated Group (CA)	LT IDR	A	Upgrade		A-
• American Baptist Homes of the	LT	A	Upgrade		A-

ENTITY/DEBT	RATING			RECOVERY	PRIOR
West (CA) /General Revenues/ 1 LT					
• HumanGood California Obligated Group (CA) /General Revenues/ 1 LT	LT	A	Upgrade		A-

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

[U.S. Public Finance Not-for-Profit Life Plan Community Rating Criteria (pub.19 Aug 2024) (including rating assumption sensitivity)]

[U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub.12 Jan 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

Solicitation Status

Endorsement Status

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

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