Article Title: Criteria | Governments | U.S. Public Finance: Senior Living Data: (EDITOR'S NOTE: —On April 28, 2021, we republished this criteria article to make nonmaterial changes. See the "Revisions And Updates" section for details.) The majority of rated credits in S&P; Global Ratings' not-for-profit senior living sector are either single-site continuing care retirement communities (CCRCs), or multi-facility organizations where CCRCs comprise the majority of the organization. CCRCs typically offer independent living, assisted living, nursing care, and additional services to senior citizens pursuant to a long-term resident contract. These contracts may include payment of an entrance, or advance fee as well as a monthly maintenance fee. CCRCs appeal to many elderly people because of the variety of living and service arrangements available, and the security of convenient access to nursing care and other support services if, and, as they become needed. Ratings tend to cluster in the lower end of the investment-grade spectrum because of industry-risk factors, including the competitive and fragmented nature of the business, the small size of many CCRCs, the discretionary nature of the services provided, and the significant demand for capital to update facilities in order to attract an increasingly sophisticated and demanding resident population, resulting in generally high leverage and debt burden. Historically, the industry has generally been reliant on investment income to offset operating losses and keep annual price increases to a minimum. In the past several years, however, the industry in general has focused greater efforts on generating positive income from operations, since market volatility can often lead to unstable earnings and coverage trends. This shift is one of the drivers behind the recent stabilization of long term care credit ratings. S&P; Global Ratings analysts typically evaluate a CCRC's creditworthiness based on the organizational structure (including whether it is a standalone facility or a multi-site organization), the strength of the organization's governance and management, demonstrated demand for existing and planned facilities, and the adequacy and predictability of key revenue sources. The mix of private versus governmental revenue sources is also relevant to the analysis, as Medicaid and Medicare reimbursement can be unpredictable. Additionally, because of the service-oriented nature of this business, the ability to keep revenue increases in line with labor and other costs is a factor in S&P; Global Ratings' analysis. A strong emphasis is placed on adequate liquidity, to meet operating and debt-service costs, as well as future capital needs and future service liabilities if the organization offers life care contracts. In addition, the service offerings, location, and the condition and attractiveness of the physical facilities are usually compared with those offered by other competitors in the service area, as well as the merits of the proposed project and financing. Financial performance is evaluated, including the use of ratio analysis, to determine the ability of the organization to meet operating costs and existing and planned fixed-capital costs. Future capital plans, as well as potential projects at affiliated organizations, are also considered. Organizational Structure System ratings generally are higher than ratings for single-site facilities because of the financial and nonfinancial synergies and the dispersion of risk that generally accrues to systems. S&P; Global Ratings' approach to rating senior living systems is similar to that used for single-site facilities. In both cases, creditworthiness depends on certain qualitative, quantitative, and legal factors. However, a system's credit standing can be enhanced by geographic, financial, and product line dispersion. When rating systems, S&P; Global Ratings tries to evaluate the extent to which these credit-enhancing qualities exist. Key rating considerations typically also include the system's structure, management's fiscal and administrative philosophy, and overall system level financial track record--which naturally reflects any economies achieved through the consolidation of financial and management resources. Management S&P; Global Ratings' analysis of the organization and management of a CCRC is extensive. While the management strength and expertise of board members in the industry has grown significantly, this area was at one time a significant weakness. S&P; Global Ratings representatives typically meet with key members of the administration and board, and management company (if under independent management contract). It is also desirable for representatives of the sponsoring organization to attend this meeting to discern their role in, and commitment to, the continuation of the enterprise. An organization's track record is one strong indicator of management's ability and the board's role in oversight. However, similar to the acute care sector, senior living has been impacted by outside pressures such as economic forces, rising insurance costs, reimbursement pressure and staffing challenges in skilled nursing, to name a few. S&P; Global Ratings' analysis of management seeks to determine whether the management team exhibits the depth and experience to identify and react to upcoming challenges, to budget effectively, monitor and control financial and personnel resources, and develop and implement a dynamic strategic plan to enhance the overall health of the organization. Management's ability to assess its institution's strengths and weaknesses and to develop sound strategies to enhance the institution's competitive position is usually an important contributor to continued success. Management teams should be prepared to discuss these topics. The provider's management, information, and capital budgeting systems are expected to be appropriate for the size, type, and complexity of the institution. S&P; Global Ratings typically discusses with management the types and frequency of monitoring and reporting to the staff and to the board of trustees. Credit considerations include the organization's: Mission; Governance structure and financial goals; Compliance procedures with regulatory authorities; Accreditation; Financial planning and budget preparation; and Role of the Board in reviewing and providing input into the issues noted above. Demand, Market Position And Demographics Demand is an important indicator of the financial health of a CCRC, and demand is driven by both competitive characteristics of a facility (the attractiveness of the product, the service offerings and amenities, as well as pricing), and the demographics and economic characteristics of the service area. In this regard, S&P; Global Ratings typically evaluates the appropriateness of the CCRC's marketing program, product offerings and pricing relative to service area characteristics. Management and/or its financial representatives usually prepare a competitive market profile of existing and proposed CCRCs and other organizations that could be viewed as competitors in the service area, including stand-alone assisted living, skilled nursing facilities, or other senior residential communities. The analysis will often include census by contract and/or unit type and where available indicate the fees in effect for each major type of contract or service offered. Area population trends, per capita wealth and income levels, as well as median home prices are usually requested as part of the analysis. Additionally, the relation of a project's entry fees to area median home prices, as well as trends in the real estate market, are explored. In addition to service area and competitive information, S&P; Global Ratings reviews a range of operating statistics, including occupancy by level of service, unit turnover rates (due to move-outs and deaths), and fill-up rates of any new units, as these measures are also generally viewed as indicators of a facility's demand and desirability. Contract Types There are a variety of important financial factors that S&P; Global Ratings examines in addition to an organization's audited financial statements and ratios. For example, three main contract types are used by CCRCs, either singularly or, more recently, in combination. However, certain contract types are riskier than others. The first type is known as a Type A, or life-care contracts. The distinguishing feature of this contract type is that the resident pays one monthly fee regardless of the level of service received (i.e., whether the patient is in independent or assisted living or skilled nursing). Type A contracts pose the highest level of risk, as the organization needs to manage the cost of resident care effectively with more limited ability to recoup costs through higher fees. For all providers, entrance requirements and screening procedures (financial and health-oriented) are analyzed, but this may be most critical to life-care organizations, which are essentially offering long-term care insurance to residents. The Type B, or modified, contract typically offers the same range of service levels and amenities as a life-care contract, except that the contract typically provides only a fixed number of skilled nursing days at no charge, with any excess utilization subject to a full or discounted per diem charge. The total number of fixed days can vary depending on the organizations specific contract details. When a resident moves permanently to a higher level of care, he/she pays higher rates for that service level. Typically, entrance fees and monthly maintenance fees are lower for CCRCs offering Type B contracts, reflecting the substantial reduction of the potential health care liability. The third contract type is the Type C, or fee-for-service contract. Facilities employing this contract type charge different rates for each level of care, and may also offer more services and amenities on a fee-for-service basis. Residents are guaranteed access to nursing care, but pay full per diem rates. Other features now offered by CCRCs are refundable advance or entrance fees; with these contracts, the refund amount is negotiated in advance, and usually tied to length of occupancy and/or resale of the unit. A 90% refund model is becoming more common; entry fees under this type of contract are typically significantly higher than non-refundable entry fees, but the organization has limited ability to significantly build reserves after initial fill-up as subsequent resident turnover only generates limited cash flow. Refund policies, while fulfilling a market demand, add an element of risk.

Strong actuarially determined reserves help offset these risks. Because CCRC providers frequently offer refundable advance fees as an option, more scrutiny is devoted to how monthly fees are determined and subsequently adjusted, as well as the conditions for the entry fee refund (primarily whether it is dependent on unit reoccupancy). Even the refundable contracts that are dependent on reoccupancy usually have language that sets a fixed time frame for resale before the refund will be returned, typically up to one year. However, this concern is somewhat mitigated if an organization has a history of strong demand and typically refills a unit in a much shorter time frame. Financial Performance One of the basic factors that determine financial stability is an organization's ability to match its revenues to its cost structure. In the senior living industry, one basic factor influencing this is the contract type, as noted above. Additionally, a history of monthly and entry fee rate increases as well as pricing philosophy are evaluated in the analysis. Additionally, S&P; Global Ratings examines the organization's contracts and pricing methodology vis-à-vis its ability to recoup the cost of providing services. On the cost side, S&P; Global Ratings evaluates trends, particularly with regard to more recent pressures such as liability and workers compensation insurance, and nurse staffing and other labor costs. Finally, S&P; Global Ratings evaluates the CCRC's overall financial performance and, if available, projections. Key financial indicators include operating and excess margins, revenue and expense growth rates, coverage of pro forma maximum annual debt service, debt burden, and days' cash on hand. The sources and reliability of nonoperating income--including contributions, and endowment earnings-–are also evaluated. Balance Sheet And Capital Program Cash reserves and overall leverage measures play an important role in evaluating a senior living organization's creditworthiness. A solid balance sheet can offset the risk of the health care liability of a life-care facility, for example, or earnings volatility related to cost spikes or occupancy pressures. Important debt ratios include debt service as a percentage of revenues, the debt-to-capital ratio, debt-service coverage, and the cash-to-debt level. A review of investment policies, asset allocation and endowment spending policies are usually also examined. To determine whether the cash flows of the CCRCs are sufficient to meet the future health needs of the resident population, S&P; Global Ratings will typically review the most recent actuary's report. As in all revenue-bond analysis, S&P; Global Ratings focuses on the structure of a proposed debt issue from an economic and legal standpoint to ensure that the proposed structure is feasible in light of the obligor's existing financial performance, commitments, and debt capacity. Project-related financings are generally supported by an independent feasibility study prepared by a consultant with extensive experience in the CCRC industry. In addition to the project that is the subject of the bond issue being rated, S&P; Global Ratings asks about an organization's strategic and financial plans over a three-to-five year period, including annual capital spending as well as any significant upcoming development projects or future debt plans. S&P; Global Ratings incorporates to some degree any expected debt or spending that is planned to occur within a one-to-two year time frame, but also seeks to understand the longer-term strategic direction and planned financial goals of the organization. Legal Criteria S&P; Global Ratings' legal criteria for CCRC financings are similar to those for health care revenue bond financings. They typically include a revenue pledge of the CCRC. In addition a mortgage may also be offered. Depending on the rating a fully funded debt service reserve fund at bond closing is usual. Residents' and other creditors' claims to entrance fees are typically subordinate to debt-service payments. Factoring Non-Recourse Debt In Senior Living (This section has been deleted because it was superseded by "Group Rating Methodology," published on July 1, 2019.) Revisions And Updates This article was originally published on June 18, 2007. Changes introduced after original publication: Following our periodic review completed in 2016, we updated the contact list and added the "Related Criteria And Research" section. Following our periodic review completed on March 23, 2017, we deleted sections that were superseded by "Group Rating Methodology" (the GRM criteria), published Nov. 19, 2013. Specifically, the analysis of ring-fencing in these sections was superseded by the analysis of insulated subsidiaries in the GRM criteria. Following our periodic review completed on March 20, 2018, we updated the contact list and deleted the sentence "The annual ratio report for CCRCs explains our ratios in detail" because the annual report is no longer published. We also updated the contact information. On May 7, 2019, we republished this criteria article to make nonmaterial changes. We deleted noncriteria text referring to the existing rating distribution of the senior living portfolio; deleted text that was superseded by the "Group Rating Methodology" criteria, published Nov. 19, 2013; and updated the contact information. On April 27, 2020, we republished this criteria article to make nonmaterial changes to update the contact information and criteria references. On April 28, 2021, we republished this criteria article to make nonmaterial changes. In the "Management" section, we deleted noncriteria language pertaining to process. We also updated the contact information. Related Criteria And Research Related Criteria Group Rating Methodology, July 1, 2019 Principles Of Credit Ratings, Feb. 16, 2011 These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as S&P; Global Ratings assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.