Thursday, April 18 2024

Opinion Submission: Fitch Ratings Exposure Draft on U.S. Public Finance Not-For-Profit Life Plan Community Ratings Criteria.

To Whom It May Concern:

LeadingAge represents more than 5,400 nonprofit and mission-driven aging services providers and other organizations that touch millions of lives every day. Alongside our members and 36 partners in 41 states, we use advocacy, education, applied research, and community-building to make America a better place to grow old. Our membership encompasses the entire continuum of aging services, including skilled nursing, assisted living, memory care, affordable housing, retirement communities, adult day programs, community-based services, hospice, and homebased care. We bring together the most inventive minds in the field to lead and innovate solutions that support older adults wherever they call home.

Please note that, we recognize that LeadingAge is not a firm that specializes in capital markets or financial analysis. However, we have an obligation on behalf of our members to illustrate the social, financial, and external market impacts that, while unintended by Fitch, may have long-term, downstream negative outcomes for the burgeoning, vulnerable older adult population that our members serve.

- **Areas of Concern:**

LeadingAge has identified three primary areas of concern within the additions and/or modifications to the Fitch proposed ratings criteria for Not for Profit (NFP) Life Plan Communities (LPCs.) These are: 1) proposed ratings changes with potential social impact to vulnerable older adults; 2) proposed ratings changes with potential financial impact to LPCs, and 3) proposed changes that impact the LPC yet are related to external forces outside of the LPC's control.

LeadingAge is uniquely positioned to engage with Fitch on the potential social impact of the proposed ratings criteria changes. We recognize that Fitch's scope of practice is to offer objective, quantitative investment ratings so that financiers may make informed decisions on their investments, and that the consideration of downstream social impacts of those decisions is not within Fitch's scope. LeadingAge's hope, especially with our comments related to potential social impact, is to partner with Fitch to attenuate some of the proposed ratings criteria changes to ensure that the social impacts on vulnerable older adults – the estimation of which is within LeadingAge's scope of expertise - may be avoided.

1. **Proposed Changes with Potential <u>Social Impact</u>.**

- **Asymmetric Risk Consideration:** Governmental Payor Exposure. "Fitch considers those [LPCs] at which Medicaid is a significant contributor to skilled nursing payor mix (more than 25% of net revenues) to be weaker." (pp 11.)

<u>LeadingAge Comment</u>: According to [Kaiser Family Foundation](), there are 8.5 million over the age of 65 are enrolled in Medicaid (as of 2019.) Our understanding of this proposed change is that LPCs with skilled nursing facilities (SNFs) that receive 25% or more of net revenues from Medicaid will receive a lower rating. If true, effectively, this will penalize our LPCs that participate in Medicaid by making it more difficult to secure capital for growth at affordable rates. The potential social impacts that we foresee are: 1) if these LPCs maintain their Medicaid programs at this level, it will be more difficult over time for these LPCs to grow, renovate, or expand. Or, 2) these LPCs will be adversely incentivized to lower their Medicaid participation, thus making it even more difficult for vulnerable older adults to have access to quality healthcare. Or, 3) anecdotally, we know that very few LPCs substantively participate in Medicaid, not even approaching the 25% of net revenues if they do. It begs the question, what is the purpose of Fitch suggesting a negative ratings impact, if this will only effect, at best, a 'handful' of LPCs?

We respectfully invite Fitch to consider eliminating this proposed change entirely. We welcome a further conversation on this point to that end.

- **Revenue Defensibility:** LPCs with more SNF units than Independent Living Units (ILUs) being capped at a maximum 'bbb' rating.

<u>LeadingAge Comment</u>: Our understanding of this proposed change is that LPCs with more SNF units than ILUs will be capped at a maximum rating of 'bbb.' First, anecdotally, we know that there are not many NFP LPCs (by the commonly accepted definition of offering a full continuum of care, including SNF) that have SNF units in excess of their ILUs. It begs the question, as above, of: what is the purpose of Fitch suggesting a negative ratings impact, if this will only effect, at best, a 'handful' of LPCs? However, if true, this proposed change will specifically penalize our few NFP LPCs that do have large SNF programs by making it more difficult to secure capital for growth at affordable rates. The potential social impacts we foresee are: 1) these LPCs that do not "downsize" their SNFs in proportion with their IL will struggle to renovate, grow, or expand over time in comparison to their peers and market competitors. Or, 2) these LPCs will be incentivized to artificially 'downsize' their SNFs in proportion to their ILU, effectively reducing the number of SNF beds in a given market that could be available to frail older adults. Or, 3) if these LPCs are forced to artificially 'downsize' their SNF beds in proportion to their ILU, this may draw competitors into the market who operate stand-alone SNFs and will assume that

LPC's former position in the market. Is it Fitch's intention to force LPC's to downsize their SNFs, sell their CONs, and enable for-profit stand-alone SNF operators to enter these markets?

We respectfully invite Fitch to consider a different method to reflect the risk inherent in an LPC operation that is SNF-heavy in proportion to ILU, rather than capping the maximum rating at a 'bbb.' We welcome a further conversation on this point to that end.

- **Operating Risk:** Minimum SNF staffing rule and impact on staffing costs. Lower SNF occupancy or reducing the number of LPC SNF beds can positively affect an LPCs operating performance because it reduces staffing costs.

LeadingAge Comment: Our understanding of this proposed change is that lower SNF occupancy and/or lower SNF bed volume is viewed positively by Fitch. Fitch appears to draw the conclusion that an LPC's SNF's vulnerability to regulatory changes such as the proposed minimum staffing rule make high SNF occupancy or bed volume a higher risk assessment (and thus a potential negative ratings impact) because said regulatory changes may lead to higher workforce costs. If true, this proposed change will specifically penalize our LPCs that have high SNF occupancy (which otherwise demonstrates an LPCs management and operational strength, and should be a reliable source of stable revenue over time) and/or high SNF bed volume by making it more difficult to secure capital for growth at affordable rates. The potential social impacts we foresee are: 1) these LPCs that do not "downsize" their SNFS will struggle to renovate, grow, or expand over time in comparison to their peers and market competitors. Or, 2) these LPCs will be incentivized to artificially 'downsize' their SNFs, effectively reducing the number of SNF beds in a given market that could be available to frail older adults. Or, 3) if these LPCs are forced to artificially 'downsize' their SNF beds in proportion to their IL, this may draw competitors into the market who operate stand-alone SNFs and will assume that LPC's former position in the market.

We respectfully invite Fitch to consider eliminating any negative ratings modifier that is predicated on an anticipated, but not yet materialized, regulatory requirement. Further, should such a requirement materialize, we ask Fitch to give NFP LPCs a 'grace period' of time to demonstrate whether they are able to navigate the staffing cost challenges internally. We welcome a further conversation on this point to that end.

Taken together, these three areas of concern are concentric to a LPC's SNF size, occupancy, and payor mix. Should all three of these proposed changes be finalized, we foresee a cumulative effect on the stated potential social impacts as outlined above. The greatest concern is that vulnerable, frail older adults will have fewer available options for care in quality healthcare settings, and that these changes will embolden stand-alone SNF competitors to enter and potentially dominate LPCs' healthcare markets. LPCs will be incentivized, if not effectively forced, to downsize their SNFs and exit government-funded subsidy programs like Medicaid in order to maintain access to affordable capital for growth. We urge Fitch to reconsider these proposed changes in light of the potential negative social impacts we foresee, at least until such point as Fitch engages with LeadingAge to more deeply review and understand these potential impacts.

2. **Proposed Changes with Potential <u>Financial Impact</u>.**

In this section, LeadingAge intends to offer helpful perspectives on other potential financial impacts of the proposed changes discussed, below.

- **Capital Expenditure Requirements:** LPCs that do not maintain average capital expenditures at or near depreciation expenses over time or maintain high average age of plant are considered to have weaker reinvestment.

<u>LeadingAge Comment</u>: Our understanding of this proposed change is that LPCs that do not, in essence, expend the capital necessary to improve their age of plant through renovations or repositioning projects may receive a negative ratings impact. Taken alone, this proposed change seems reasonable in the assessment of future financial risk. However, taken together with the next-referenced proposed change, these two seem self-contradictory. Please see below.

- **Financial Profile Assessment:** Capital Risk Matrix. "Fitch believes that all LPCs are prone to large-scale expansion and are vulnerable to downgrades when financing major capital projects… Fitch will keep a rating lower than the financial profile assessment may indicate and relative to peers and/or downgrade the rating if a major capital project seems very likely in a three- to five-year timeframe." (pp 18.) Continued: "In situations where Fitch believes a project is being contemplated but determines that not enough detail is available … Fitch will calculate leverage headroom… and if limited, we would adjust the rating down."

<u>LeadingAge Comment</u>: Our understanding of this proposed change is two-fold; that, one, an LPC will receive a negative ratings impact while financing a major capital project, and two, that an LPC that Fitch believes is 'due' for a capital project, or may even be considering one, could receive a negative ratings impact. Taken together with the above proposed change, it appears that whether or not an LPC is ready for, engaged in, or perhaps should be engaged it, but chooses not to begin a major capital project, that LPC will receive a negative ratings impact. In essence, in that usual 3-5 year cycle of plant redevelopment, then, it appears an LPC will be automatically rated lower by Fitch, regardless of whether or not the LPC undertakes a major capital project. Is it Fitch's intention to routinely penalize an LPC for its natural life cycle, a cycle that Fitch itself recognizes is a part of the ongoing growth and sustenance of an LPC? Will the LPC then effectively be "double penalized for either being due for or just 'considering' a capital project, and then again when the LPC does undertake said project?

The unintended potential financial impact that we foresee, if these two proposed changes are enacted together, is that LPCs' cost of capital will be automatically increased every 3-5 years, regardless of the status of a major capital project. This will, simply put, make it more expensive for an LPC to grow, redevelop or reposition, a default penalty driven by the inherent life-cycle nature of the model. If all LPCs are thus-subject, then how can any one of their capital projects be any "riskier" than others, all other things equal?

We respectfully invite Fitch to at least eliminate one, if not revise both, of these Capital Expenditure / Risk Matrix ratings changes.

- **Asymmetric Additional Risk Considerations.** LPCs with ALU or SNF expansion projects that do not include an IL expansion will constrain its operating risk assessment, especially if the plan for the ALU or SNF is to accept outside admissions.

LeadingAge Comment: Our understanding of this proposed change is that LPCs with AL or SNF expansion projects that do not also expand the IL will receive a negative ratings impact, especially if the AL or SNF will be open to outside admissions. While the rationale behind Fitch's evaluation of the financial risk of such an expansion project is understood, it is not clear why the plan to accept outside admissions increases this negative ratings impact. In many instances, not only is it financially advantageous for an LPC to receive direct admissions to AL and SNF, many of whom are private-pay, AL and SNF are levels of care that are of great need to frail older adults in the community surrounding the LPC. Within LPCs, many of our members report that IL residents do not wish to move through the continuum, and rather wish to "age in place;" opening an AL and SNF to outside admissions helps the LPC allow the IL resident to "age in place" while still ensuring the AL and SNF occupancy is high, and thus revenues are strong. Those who operate in our field, or are avid observers like Fitch, know that we are about to receive a burgeoning older adult population where the preponderance of comorbidities is higher than previous generations. Added to this, a tightening housing market is requiring older adults to retain their private homes longer, and not move to an LPC until need drives them – often to an AL or SNF level of care. There's good reason to believe that outside demand for AL and SNF will be high for at least a decade or more to come.

We respectfully invite Fitch to modify this risk consideration, in recognition of the potential financial advantage to an LPC to accept outside admissions into AL or SNF. We invite Fitch to engage with LeadingAge to more deeply review and understand these potential social trends and their impact.

3. **Proposed Changes External to LPC Control.**

Lastly, we offer perspectives on Fitch's consideration of the legal, statutory, and regulatory environments in which NFP LPCs operate.

- **Asymmetric Additional Risk Considerations:** Legal and Regulatory Framework. Fitch will form a view on the clarity of the legislative/ regulatory/ legal environment in which an LPC operates, the scope of said environment, and its effect on the LPC's performance, using a list of indicators (pp 20.)

- **Revenue Defensibility:** Preference for stricter state regulatory requirements that create barriers to entry for new providers.

LeadingAge Comment: We wish to discuss these concerns together, and then separately, to illustrate an apparent contradiction in argument. Our understanding of these two proposed changes is that, generally, one: the legal and regulatory framework in which an LPC must operate will potentially negatively impact an LPC's rating, especially as relates to the SNF, but two: a stricter state statutory environment is seen as a positive for LPCs because it is harder for new competitors to enter the market.

Our first quandary is in how Fitch has determined that, quite generally, the strict regulatory/ legal environment creates higher financial risk for investing in LPCs, while a strict state statutory environment does not. While this is a lofty and ambitious endeavor, can it be determined quantitatively that the strict regulatory/ legal environment is more volatile and thus creates more financial risk, than the state statutory environment? Is there a methodology Fitch has applied to establish this as enough of a truism to respectively penalize and then reward LPCs for the throes of legal, regulatory and state legislative they are subject to – all of this being outside the control of the LPC in the first place?

Finally, there are two possible fallacies in the assumption that a stricter state statutory environment is a positive for an LPCs. While it may be true that strict state statutes prohibit new entrants to a market, there are at times steep costs that come with compliance to complex, contradictory and often nuanced states statutes. One of our larger members, for example, as a team of twelve compliance offers just to manage the complexities of meeting states requirements where they operate. Some states require actuarial studies every three to five years, and compliance with that can easily cost an LPC $40-60,000. Such examples are abundant in some states' statutes. Even the fact that strict statutes can prevent new competitors in the market is a bit near-sighted; in one of our most statutorily-regulated states, because new "CCRCs" cannot be easily established, there are two outcomes: 'look-alikes' are abundant and can claim market share at lower costs because they are not beholden to statute, and because of a lack of available quality, legitimate LPCs in the state, older adults move to neighboring states where the desired living accommodations can be found. Lastly, the rise of consumer-initiated legislative proposals pose a threat in some states; while unlikely, if these bills pass, and statues are made more strict regarding the timing of entrance fee refunds, for example, there is a good chance LPCs in those states will suffer financially.

We respectfully invite Fitch to not move forward with any proposed ratings change that is based on legal, regulatory or state statute variance of volatility, until a more consistent and fully developed analysis can be completed. We invite Fitch to engage with LeadingAge to more deeply review and understand how the complexities in these external factors can impact the risk profile of an LPC.

Respectfully, we thank Fitch for review our concerns and considering them ahead of any final decisions on the proposed ratings changes. We invite Fitch to join us in consultation on these areas of concerns, to better understand and attenuate some of the proposed changes so that both LPCs and their potential investors are fairly and positively incentivized to develop an expand the LPC model.

For further discussion, please contact Dee Pekruhn at dpekruhn@leadingage.org.

Respectfully Submitted,

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