Fitch: US Life Plan Community Fees Buffered from Home Price Declines, Sales May Slow

Fitch Ratings-New York-11 October 2022: Fitch-rated life plan communities' (LPCs) pricing will hold up to home price declines in local real estate markets, as entrance fees have grown by just a fraction of home price appreciation over the last few years, Fitch Ratings says. Home sales are typically the main source of revenue that allow residents to pay the LPC entrance fee. However, slowing home sales could also weigh on independent living (IL) sales, delaying the sector's robust revenue recovery.

A slowdown in IL sales and net entrance fee receipts could constrain LPC's near-term financial flexibility in addressing near-term inflation. Stellar net entrance fee receipts for many Fitch-rated LPCs have allowed them to rebuild IL occupancies from pandemic-related lows. Strong entrance fee receipts blunt some negative inflation effects on operations and support stable debt service coverage.

LPCs should not need to make material adjustments to current entrance fee pricing, as fees have only increased by 2%-4% per year even as home values grew roughly 40% since March 2020. As a result, entrance fee pricing has some cushion and need not decline along with housing prices.

Fitch's latest U.S. RMBS Sustainable Home Price Report notes that national home prices grew by 15.8% yoy and are overvalued by 12.2%. While we anticipate home price corrections, a housing market crash, as was seen during 2008-2009, is highly unlikely. Home prices are expected to moderate further with elevated mortgage rates. Even if home prices decline beyond our overvaluation estimates, we believe LPC entrance fee pricing can remain stable. Fitch-rated LPCs are generally located in more affluent areas, with residents who generally have greater economic resiliency and may be better able to cover LPC entrance fees without relying on the proceeds from the sale of their homes.

However, a decline in housing prices may slow the current strong pace of independent living (IL) sales. A prospective resident's decision to move into an LPC can be sensitive to recessionary pressures, including declines in home values, inflation concerns and weaker investment performance. A slowdown in IL sales would lengthen the time for an LPC to refill turned-over IL units, thus reducing IL occupancy.

Inflation remains the main variable that could negatively affect margins. LPCs continue to boost revenue and alleviate costs, namely by delaying capex (including expansion plans), keeping skilled nursing beds offline, raising monthly service fees and reconfiguring services, such as dining.

Our rated LPCs experienced stress on both IL occupancy and net entrance fee receipts during 2008-2009 as prospective residents delayed decisions to move as a result of the economic uncertainty. This was the case even as their net worth, including home values, qualified them for entry into LPCs.

Judicious use of marketing and sales strategies can sustain sales and ease the move into an LPC, as happened in 2008-2009. These include real estate sale and moving services, promissory note programs and other incentives, such as apartment upgrades or service fees waivers for the first month or two of residency. Additionally, the IL lifestyle is a significant draw of the LPC product, and there is a practical time constraint on decisions to move into an LPC before health issues may disqualify prospective residents from IL.