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Research Update:

# Ventas Inc. Ratings Affirmed On Portfolio Recycling And Modest Key Credit Metric Improvement; Outlook Stable

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Research Update:

# Ventas Inc. Ratings Affirmed On Portfolio Recycling And Modest Key Credit Metric Improvement; Outlook Stable

## Overview

- Ventas continues to recycle capital to improve its portfolio quality, and the company will have almost no exposure to higher-risk skilled nursing facilities (SNFs) by year end.
- Ventas also expanded its revolving credit facility earlier in the year, enhancing its liquidity sources and resulting in a revised liquidity assessment to strong.
- We are affirming our ratings on Ventas, including the 'BBB+' corporate credit rating.
- The stable outlook reflects our view that the company's large and diverse portfolio of good quality health care facilities will drive modest yet predictable same-store net operating income (NOI) growth over the next two years.

## Rating Action

On Oct. 5, 2017, S&P Global Ratings affirmed its ratings on Ventas Inc., including the 'BBB+' corporate credit and senior unsecured note ratings. The outlook is stable.

## Rationale

The affirmation reflects our view that Ventas will continue to recycle capital to opportunistically reposition its asset mix and reduce leverage modestly. We also revised our liquidity assessment to strong, reflecting the company's increased capacity under its revolving credit facility as well as our expectation that the company's acquisition pace will moderate somewhat.

Ventas is one of the largest REITs focusing on a portfolio of health care facilities, supported by favorable fundamentals, a large private pay exposure at the facility level, and adequate coverage of its triple-net-leased properties that have modest lease rollover exposure. As of June 30, 2017, Ventas owned 1,300 health care facilities with undepreciated real estate assets totaling roughly $25.8 billion. The portfolio is diversified across senior housing facilities which account for 55% of annualized NOI, (split between RIDEA investments {30%} and triple-net leases {25%}), medical office buildings (MOB; 19%), inpatient rehabilitation facility and long term acute care facility (IRFs and LTACs; 7%), life science (6%), health systems (5%), SNFs (1%), and other facilities/investments (7%).



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Ventas has been among the most active REITs in terms of acquisitions and dispositions over the past several years. It has grown its asset base through several large acquisitions that have diversified its portfolio and largely improved the quality of its asset base. Ventas continues to be active in capital allocation, with around $1.4 billion of investments already completed in 2017 (including a loan investment of $700 million) and commitment to class A senior housing developments or major redevelopments with its largest operating partners, Atria and Sunrise. As the portfolio has grown, so has Ventas' investment in senior housing operating assets, which are more management and capital intensive than triple-net-leased investments and therefore potentially more vulnerable to macroeconomic trends and could exhibit higher cash flow volatility. These acquisitions have also increased Ventas' exposure to higher-barrier markets within the senior housing portfolio. While we expect new senior housing construction deliveries to peak later this year or in early 2018, construction could weigh on NOI growth as new competition enters certain markets. Nonetheless, we expect overall property level cash flow should be fairly predictable over the next one to two years with our expectations of low-single-digit same-store growth. We think supportive demographic trends driving need-based health care, contractual embedded rent escalators on triple-net leases, and modest lease expirations will drive this growth.

Over the past few years, Ventas has focused on reducing its exposure to SNFs (and to government reimbursement risk). With the recent announcement of Kindred to exit its entire skilled nursing business, Ventas is expected to sell 36 SNFs for $700 million at a cap rate of 7%, reducing its exposure to SNFs to just 1% and increasing its private pay revenues to 94%. At the same time, Ventas is focused on expanding its institutional university-based life science business, which currently accounts for 6% of company's NOI. Ventas completed its first tranche of SNF sales (22 properties) on Aug. 31, 2017, generating $488 million in proceeds. The remaining $212 million of proceeds are expected to close by year end.

Ventas' financial risk profile is supported by its sound balance sheet with above-average coverage measures. Ventas' trailing-12-month debt to EBITDA improved to 6.4x at June 30, 2017, and we expect continued improvement to below 6x by year end, benefiting from the SNF asset sales and expected debt repayment. Debt to undepreciated capital is expected to decline to the low-40% from year-end 2017, with fixed charge coverage rising to the mid-4x area.

With a weighted average debt maturity of 6.4 years and a weighted average interest rate of 3.6%, Ventas' debt maturities are well-laddered and manageable over the near term. Ventas has a predominantly fixed-rated debt structure at 80% as of June 30, 2017. We expect floating rate debt to remain around 20% in 2017 and 2018, which is higher than its peers; however, we do not consider it to be overly aggressive. Secured debt is also fairly low at approximately 13% of total outstanding debt as of June 30, 2017 and the unencumbered pool is large at roughly 86% of NOI. Ventas continues to maintain an adequate liquidity position, with $2.5 billion of availability under its

new $3.0 billion revolving credit facility and strong access to various sources of capital.

Assumptions in our forecast include:

- The U.S. economy will continue to grow in the low-single digits (S&P Global Ratings expects U.S. Real GDP growth of 2.1% in 2017 and 2.3% in 2018);
- Low-single-digit same-store revenue growth, primarily driven by contractual rent increases over the next two years;
- Acquisitions of $500 million to $1 billion in both 2017 and 2018;
- Development and redevelopment funding of approximately $300 million to $400 million per year;
- Asset sales of approximately $1 billion in 2017 and between $500 million and $1 billion in 2018.

Based on these assumptions, we arrive at the following credit measures:

- Adjusted debt to EBITDA declines to the high-5x area in 2017 (from 6.2x in 2016) and to the mid-5x area in 2018;
- Fixed-charge coverage rises to the mid-4x area in both 2017 and 2018 (from 4.0x); and
- Debt to debt plus undepreciated equity declines to the high-30% to low-40% range (from 43.6%) for both years.

### Liquidity

We believe Ventas has strong sources of liquidity to cover its projected uses over the next 12 months. Our assessment of the company's liquidity profile incorporates the following expectations and assumptions:

- Liquidity sources will exceed uses by at least 1.5x or more over the next 12 months;
- Liquidity sources less uses will be positive, even if forecasted EBITDA declines by 15% (a REIT specific threshold for strong liquidity);
- Sufficient covenant headroom for forecasted EBITDA to decline by 15% without the company breaching coverage tests, and debt is at least 15% below covenant limits;
- A generally high standing in the credit markets; and
- Well-established and solid relationships with banks.

### Principal Liquidity Sources

- $103.4 million of unrestricted cash as of June 30, 2017;
- Approximately $2.5 billion available under its $3 billion revolving credit facility due April 2021, with two six-month extensions at the company's option;
- $1.5 billion to $1.6 billion of forecasted cash FFO in 2017; and
- $700 million of proceeds from the sale of SNFs in connection with Kindred's plan to exit the skilled nursing business.

### Principal Liquidity Uses

- Principal amortization payments of approximately $20 million to $22

million over the next 12 months;
- Senior unsecured debt of $700 million maturing in February 2018;
- Approximately $100 million to $120 million of recurring maintenance capital expenditures;
- Approximately $480 million to complete development or redevelopment projects that are either active or projects that have been committed to; and
- Roughly $1.1 billion to 1.2 billion of projected common distributions in 2017 and 2018.

## Outlook

S&P Global Ratings' stable outlook on Ventas Inc. incorporates our view that the company's large and diverse portfolio of good quality health care facilities will drive modest yet predictable same-store NOI growth over the next two years. Ventas' revenues and cash flows benefit from long-term leases, good rent coverage, and favorable long-term industry fundamentals. While we expect Ventas will remain opportunistically acquisitive, we believe it will fund acquisitions prudently and consistent with its commitment to maintain a conservative balance sheet and stable credit metrics.

### Upside scenario

Although unlikely over the next one to two years, we would consider raising our ratings if the company pursues growth prudently and profitably and without any meaningful integration issues, while further increasing operator diversity. Ventas would also need to gain a longer track record of successfully managing its more volatile senior housing operating portfolio through a cycle that could ultimately support an improvement to its business risk profile. We would also expect Ventas to improve or maintain credit protection measures at current levels.

### Downside scenario

While also unlikely over the next two years, we would consider lowering our ratings if FCC approaches 3x or lower and leverage increases materially. Debt/EBITDA rising to 7x or higher or debt to capital increasing to 50% or higher on a sustained basis would be pressure points on the ratings from a leverage perspective. Weaker credit metrics could be the result of either large debt-financed acquisitions or underperformance in Ventas' senior housing operating portfolio (possibly caused by increased supply in senior housing) that could cause material deterioration to cash flows.

## Ratings Score Snapshot

Corporate credit rating: BBB+/Stable/--

Business risk: Satisfactory
- Country risk: very low risk

- Industry risk: Low risk
- Competitive position: Satisfactory

Financial risk: Modest
- Cash flow/leverage: Modest

Anchor: bbb+

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

## Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- REITrends: M&A Activity Bolstered Capital Issuance In Second-Quarter 2017, Sept. 5, 2017

## Ratings List

Ratings Affirmed

Ventas Inc.
Ventas Realty L.P.
Ventas Capital Corp.

| | |
|---|---|
| Nationwide Health Properties Inc. | |
| Corporate Credit Rating | BBB+/Stable/-- |

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|---|---|
| Nationwide Health Properties Inc. | |
| Ventas Realty L.P. | |
| Ventas Capital Corp. | |
| Ventas Canada Finance Ltd. | |
| Senior Unsecured | BBB+ |

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.