FitchRatings

Fitch Rates The Evergreens (NJ) Ser 2019A Rev Bonds 'BBB'; Outlook Stable

Fitch Ratings-New York-10 July 2019: Fitch Ratings has assigned a 'BBB' rating to the following bonds to be issued by the Public Finance Authority on behalf of The Evergreens. (Evergreens):

--$25.1 million revenue refunding bonds, series 2019A

The series 2019A bonds and $23 million of series 2019B direct purchase bonds, will be used to refund approximately $44.6 million of series 2007 bonds, provide $10 million for various capital projects around the community, and to pay costs of issuance. The bonds are expected to sell via negotiation during the week of July 29, 2019.

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a pledge of gross revenues of the obligated group (OG) and a mortgage lien.

KEY RATING DRIVERS

IMPROVED OPERATING PROFILE: On Feb. 5 2018, ACTS Retirement-Life Communities (Acts) affiliated with Evergreens, giving Evergreens a depth of resources, stability and strategic abilities not typically found at a single-site provider, which has led to a notably improved operating profile. Evergreens is located in a good service area with favorable demographic indicators and enjoys a long operating history. Independent living unit (ILU) occupancy has improved impressively since affiliating with Acts, averaging 72% in 2018 up from 61% in 2017. The improvement is attributed to a re-branding of the community, facility improvements, and updated pricing and entrance fee offerings to further align with Acts' standards. Additionally, Acts has converted several smaller units into larger apartments, updating total available ILUs to 187 from 200 and making them more marketable. Assisted living unit (ALU) and skilled nursing facility (SNF) occupancy were adequate and averaged 67% and 85%, respectively, during fiscal 2018.

STRENGTHENED FINANCIAL PROFILE: As a result of softened occupancy and prior management challenges, Evergreens' financial profile experienced some deterioration from 2015 through 2017. Evergreens' operating ratio, net operating margin (NOM) and net operating margin-adjusted (NOMA) averaged 115%, -2.6% and 13.2% during this time-frame. Since the acquisition, Evergreens operations have markedly improved. As of result of increased ILU demand and various expense reduction initiatives, most notably salaries and benefits; the operating ratio, NOM and NOMA were 106.8%, 2.4% and 30.7%, respectively, as of fiscal 2018 (11 month period ending Dec. 31, 2018). The operating ratio and NOM were weaker than Fitch's 'BBB' category medians of 96.3% and 7.3%; however, this is indicative of LPC's offering primarily lifecare contracts. Evergreens' NOMA was stronger than Fitch's 'BBB' category median of 23.3%.

ADEQUATE LIQUIDITY POSITION: At the end of April 30, 2019 (four-month interim), Evergreens maintained $20.9 million of unrestricted cash and investments. Evergreens' liquidity metrics of 450 days cash on hand (DCOH), 41% pro-forma cash to debt and 7.0x pro-forma cushion ratio compared with Fitch's 'BBB' category medians of 479 DCOH, 72% and 8.4x, respectively.

MODERATE LONG-TERM LIABILITY PROFILE: Upon issuance of the series 2019 bonds, Evergreens will have a moderately high long-term liability profile. Pro-forma maximum annual debt service (MADS) of approximately $2.97 million equates to 15% of 2018 revenues and pro-forma debt to net available totaled 6.6x, compared with Fitch's respective 'BBB' category medians of 12.5% and 5.7x. Pro-forma MADS coverage equates to 2.6x in 2018, better than Fitch's 'BBB' median of 2.1x and reflecting a year of improved operations and solid net entrance fee receipts.

ASYMMETRIC RISK CONSIDERATIONS: There are no asymmetric risk considerations affecting the rating determination.

RATING SENSITIVITIES

FINANCIAL PROFILE: Fitch expects Evergreens to sustain its improved operating performance achieved since affiliating with Acts Retirement-Life Communities. While not expected, a softening of financial performance that leads to lower debt service coverage and weakening of balance sheet metrics could lead to negative rating pressure.

OCCUPANCY IMPROVEMENT: Increased demand that results in occupancy improvements that leads to more favorable operating performance and balance sheet metrics could provide for positive rating action.

CREDIT PROFILE

Evergreens is a Type A (lifecare) life plan community (LPC) with a total of 187 ILU apartments, 58 ALUs and 34 SNF beds. The Evergreens is accredited by the Continuing Care Accreditation Commission (CARF). Evergreens was founded in 1919 by the Diocese of New Jersey of the Episcopal Church, and today Evergreens continues to have an active Ministry, but is separate from the Diocese. Evergreens is located on a 32-acre campus consisting of woods and wetlands, about 15 miles east of Philadelphia, PA in the town of Moorestown, NJ. In addition, Evergreens owns a 72-acre farmland parcel located within two miles of the campus (with an estimated book value of $4.7 million as of Dec. 31, 2018). The farmland will not be included in the mortgage as security for the bondholders.

Effective Feb. 5, 2018, Evergreens became an affiliate of Acts. Acts is the sole corporate member and parent company of Evergreens. Evergreens is also managed by an affiliate of Acts: ACTS Management Services. Acts is one of the largest nonprofit LPC systems in the nation, with 26 communities in nine states: AL (2), DE (3), FL (4), GA (1), MD (4), NJ (1), NC (2), PA (8) and SC (1). Total operating revenues for the system were approximately $450 million in 2018. Fitch rates Acts obligated group 'A-'/Stable.

After becoming an affiliate of Acts, Evergreens resident contracts have been updated to be consistent with offerings at other Acts-affiliated communities. Residents are offered lifecare residency agreements with four different entrance fee/pricing structure plans. The most popular entrance fee plan is the Acts Life Care Premier plan, a traditional plan in which the entrance fee is non-refundable and is amortized at 2% per month over 50 months. Evergreens also offers the Acts Life Care Income Preservation Plan, a non-refundable plan that allows residents assets to fund the entrance fee, Acts Life Care 50, a 50% refundable plan, and Acts Modified Life Care, a non-refundable plan that allows residents to utilize comprehensive long-term care insurance if available.

Prior to affiliating with Acts, The Evergreens offered Type A lifecare, Type B, modified, and Type C fee-for-service entrance fee contracts. Over-time, Acts will begin to offer contract conversions to residents currently on a pre-affiliation contract. As of April 30, 2019, 168 contracts were currently active with 140 on pre-affiliation contracts and the remaining 28 on post-affiliation Acts-like contracts. Any refunds due are subject to payment of a new entrance fee by the next resident that occupies the respective unit. Fitch views the prevalence of non-refundable entrance fee contracts (approximately 80% of total residents contracts) favorably since they provide longer-term cash flow and working capital benefits.

Evergreens is governed by a board of directors, which currently consists of seven members (including two residents of Evergreens), although the board members have terms, there are no term limits. Four of the seven board members are from Acts. Evergreens is the only member of the obligated group for the series 2019 bonds. Total operating revenues for Evergreens were approximately $20.1 million in 2018 (annualized).

OPERATING PROFILE

Evergreens is located in a favorable service area with good demographic indicators. The primary market area (PMA) includes 11 zip codes lying primarily within Burlington County, NJ located in and around the town of Moorestown, NJ and Mt. Laurel areas. Approximately 78% of Evergreens residents have originated from the PMA since 2016. Based on feedback from prospective residents, a majority have a strong preference to remain close to their current neighborhoods. Demand is also sustained by a healthy real estate market, with growing median home values in the Moorestown and Burlington areas. For instance, the Zillow Home Value Index for Moorestown was $746,000 as of June 2019, up 3.4% over the past year. In addition, the Zillow Home Value Index for Burlington was $230,000 as of June 2019, up 3.0% over the past year.

According to data provided by the Evergreens from a third-party source (Environics), the projected growth rate of age and income qualified households within the PMA over the next five years is 14%. Due to Evergreens' current ILU mix of 187 units, Environics believes that a penetration rate of 1.5% within the PMA would be required to maintain occupancy in the mid-90's range.

Evergreens' primary competitors within the PMA are Cadbury Cherry Hill (138 ILUs) (7 miles away), Wiley Christian (137 ILUs) (11 miles away) and Medford Leas (394 ILUs) (11 miles away). All report solid occupancy of approximately 85%. As a point of differentiation, Evergreens is the only community in the PMA that offers type A lifecare contract options.

Since affiliation, Acts has focused on increasing ILU occupancy through an extensive marketing campaign, which has included an increase in staff in the marketing department, as well as through public relations efforts. Upon receiving approval from the state, Acts instituted new contract types and pricing to more accurately reflect the market. Evergreens offers unit types for both high income and middle market prospective residents. These changes have resulted in 32 move-ins since the affiliation with another nine residents currently under contract as of June 2019. Evergreens also continues to reposition the community, resulting in 13 smaller ILUs taken out of service in order to combine into larger more marketable apartments, which has resulted in available ILUs decreasing to 187 from 200. Evergreens believes it can reposition further as units become available and get closer to 180 total units available.

Entrance fees and monthly service fees are based on the size, location and other attributes of the ILU and the number of individuals that are expected to occupy the ILU. Entrance fees are well in line with PMA housing values with a weighted average of $284 thousand. In addition, weighted average for first person monthly service fees total approximately $5,400, with second person averages totaling about $1,500. These fees cover costs for items such as utilities, taxes, maintenance and repairs and other services as provided in the resident contract.

Due to increased resident move-ins, occupancy has improved notably since the affiliation. Under prior ownership and management, ILU occupancy averaged 62% from 2015 through 2017. Post-affiliation, occupancy improved to 72% as of 2018; when including committed residents occupancy totals 76% as of April

30, 2019. Evergreens ALUs decreased to 58 available units from 66 as a result of converting semi-private rooms to private rooms, and occupancy averaged 71% during the first four months of fiscal 2019. Evergreens maintains a five-star rating from the Centers for Medicare and Medicaid Services (CMS) for its SNF, and occupancy was healthy and averaged 83% for the four month period ending April 30, 2019. Evergreens accepts both on-campus and outside admits for Medicare short-stay rehabilitation services, but this only represents 20% of SNF revenues.

FINANCIAL PROFILE

Evergreens' financial profile has impressively improved post-affiliation with Acts. Evergreens has benefited from Acts brand recognition and experienced management team. Operational improvement has been largely driven by increased occupancy levels and expense reduction initiatives.

Expense reduction initiatives post-affiliation have included a notable decrease in salary and wage costs totaling about $1.5 million in annualized savings, a reduction of about $500 thousand in interest costs due to retirement of a construction loan, lowering of depreciation expense as a result of asset revaluation upon affiliation, and supply cost savings. Evergreens benefits from reduced costs related to Acts' purchasing power, economies of scale and insurance coverages.

Prior to the acquisition by Acts, Evergreens' financial profile experienced some deterioration from 2015 through 2017. As a result of softened occupancy and prior management challenges, operating ratio, NOM and NOMA averaged 115%, -2.6% and 13.2%, respectively, during 2015 through 2017. Post-acquisition, operating ratio, NOM and NOMA all improved and were 106.8%, 2.4% and 30.7%, respectively, as of fiscal 2018. Through April 30, 2019, operating ratio and NOM remained solid at 104.6% and 5.0%, respectively. Net entrance fee receipts have been slower through the first four months of fiscal 2019; however, that is a reflection on timing of move-ins and not atypical for LPCs. Operating ratio and NOM were weaker than Fitch's 'BBB' category medians of 96.3% and 7.3; however, that is indicative of communities primarily offering type A lifecare contracts. NOMA was stronger than Fitch's 'BBB' category median of 23.3%. Further enhancing cash-flow, net entrance fee receipts equaled a strong $5.8 million in 2018, which exceeded an average of $3 million during fiscal 2014-2017. Fitch expects Evergreens to sustain its improved levels of operating performance and believes management will continue to proactively monitor all expense categories.

As of April 30, 2019, unrestricted cash and investments totaled $20.9 million translating into 450 DCOH, 41% pro-forma cash to debt, and 7x pro-forma cushion ratio, compared with Fitch's 'BBB' category medians of 479, 72%, and 8.4x. While lower relative to the medians, the metrics are sufficient to support Evergreens current rating level given its various improvements since its affiliation with Acts; including demand, profitability and cash-flow through net entrance fee receipts.

DCOH decreased from 494 days in 2017 as Evergreens paid off a construction loan of $3.9 million in 2018. Fitch expects Evergreens' liquidity position to steadily increase moving forward as it benefits from sustained improvement in operating profitability and capex needs being funded through the new money portion of series 2019 bonds.

CAPITAL SPENDING

With the 2019 bond issuance, Evergreens will have a project fund of approximately $10 million. Evergreens will also release approximately $5 million in DSRFs with the refunding held previously by a trustee from the 2007 bond issuance. Projects being undertaken will include interior renovations with a focus on upgrades to residential living units, a new central facility clubhouse and other common areas. Exterior renovations will include a new gated entrance way and porte-cochere at the main doorway of the community. Evergreens will also use about $5 million in proceeds to renovate currently vacated areas within the health care center into activity space.

LONG-TERM LIABILITY PROFILE

Following the issuance of the series 2019A&B bonds, and the corresponding refunding of its debt obligations, Evergreens will have about $51 million of total debt outstanding. The bonds will consist of $25.1 million in publicly placed bonded debt and $23 million in privately placed bank bonds.

At this time, Fitch understands that both the bank (2019B) and public (2019A) bonds of the debt issuance will be required to maintain a debt service coverage ratio (DSCR) of 1.2x tested annually and a liquidity covenant of 150 days cash on hand (DCOH) tested semi-annually. The bank bonds will have an event of default (EOD) if the DSCR falls below 1.0x in any one year; for the public bonds, an EOD will occur after two consecutive years below 1.0x and if DCOH falls below 150 days. Also, if DCOH falls below 100 days, an EOD will occur for the bank debt. Any EOD of the bank bonds will cause a cross-default of the public bonds, which Fitch views favorably.

All debt will be fixed-rate, have a pro forma MADS of $2.97 million and a final maturity of 2049. Overall, Evergreens' debt profile and long-term liability profile remain moderate as evidenced by pro-forma MADS equating to 15% of 2018 revenues and pro-forma debt to net available equaling 6.6x. Both metrics are a bit weaker than Fitch's 'BBB' category medians of 12.5% and 5.7x. As contemplated by the plan of finance, existing MADS will be reduced by about $1.3 million with the bond issuance. As a result, pro-forma MADS coverage equates to 2.6x, which is stronger than Fitch's 'BBB' category median of 2.1x.

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