FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms The Pines at Davidson's (NC) Ratings at 'BBB+'; Outlook Stable

Mon 25 Oct, 2021 - 9:55 AM ET

Fitch Ratings - New York - 25 Oct 2021: Fitch Ratings has affirmed the 'BBB+' rating for the following bonds issued by North Carolina Medical Care Commission on behalf of The Pines at Davidson, Inc. (The Pines):

--$42 million retirement facilities first mortgage revenue bonds, series 2019A (The Pines at Davidson Project).

In addition, Fitch has affirmed The Pines' 'BBB+' Issuer Default Rating.

The Rating Outlook is Stable.

SECURITY

The 2019A bonds are secured by a gross revenue pledge and mortgage pledge.

ANALYTICAL CONCLUSION

The affirmation of the 'BBB+' rating reflects the resilience of The Pines' financial profile throughout Fitch's forward-looking scenario analysis in the context of its strong demand profile and adequate operations. Operating performance has deteriorated over the last two years due to disruptions from the coronavirus pandemic and an independent living (IL) and skilled nursing facility (SNF) expansion project.

However, Fitch expects that the community's strong demand, as evidenced by consistently high occupancy and a robust waiting list, will support a quick turnaround in performance as operating pressures ease. The Pines' has successfully completed and filled the expansion projects and incremental revenues from the new units should lead to steady cash flow accretion going forward.

KEY RATING DRIVERS

Revenue Defensibility: 'a'

Strong Demand Profile

The strong revenue defensibility assessment reflects The Pines' history of high occupancy across its service lines with ILU occupancy that has historically been maintained above 94%. IL occupancy declined in fiscal 2021 to 89% due to the curtailment of marketing efforts during the coronavirus pandemic but has recovered to 93% as of Sept. 30, 2021 with over 97% of units currently reserved. Assisted living (AL) and SNF occupancies have both recovered to above 90% through Sept. 30, 2021 and the community has successfully filled the majority of the new SNF beds from the expansion project with outside admits.

The strong occupancy is attributable to limited competition in the service area and high-quality service lines. The community also has a beneficial relationship with Davidson College which allows residents to audit classes at no cost that, along with North Carolina's reputation as a favorable retirement destination, helps draw residents from outside of the service area. Further indication of The Pines' strong market position is the waitlist of over 750 residents. The community has a history of regular entrance fee and monthly service fee increases and fees are affordable relative to local housing prices and resident wealth levels.

Operating Risk: 'bbb'

Midrange Operating Risk, Manageable Capital Needs

The midrange operating risk assessment reflects The Pines' history of adequate operating performance, with an operating ratio, net operating margin (NOM), and NOM-adjusted that averaged 93%, 7.3%, and 26.9%, respectively from fiscal years 2016 to 2019. Operating performance deteriorated in fiscal 2020 and fiscal 2021 due to disruptions from the coronavirus pandemic and higher expenses from the expansion project. Through the first six months of fiscal 2021, the operating ratio and NOM worsened to 112.1% and negative 2.9%, respectively, which is consistent with how management expects to end fiscal 2021 and a failure to improve operating performance in fiscal 2022 could lead to negative pressure.

However, operations were supported by a significant increase in turnover net entrance fees and operations are expected to recover to close to historical levels in fiscal 2022. Additionally, the $1.5 million Payroll Protection Program (PPP) loan was forgiven in 2021 which will help offset operating losses. The Pines offers type-B modified lifecare agreement with up to 14 free healthcare days a year and the majority of residents are on non-refundable contracts.

The Pines has completed the majority of the ILU and SNF expansion project that was funded by the series 2019 bonds. The 38 new ILUs are 100% occupied and the 24 new SNF beds have been mostly filled with external admits. The majority of the common space and dining renovations has been completed as well, with the final renovations expected to be completed soon. The community has also constructed three IL cottages out of cash reserves that are expected to be completed by the end of the year. Following the expansion project, capital needs are considered manageable. The Pines' has town approval to build 48 additional ILUs but this project is likely several years away and Fitch will assess the financial impact of the potential expansion project as more details become available.

Following the 2019 debt issuance, capital-related metrics deteriorated with maximum annual debt service (MADS) representing a high 16.9% of fiscal 2020 revenues and with debt to net available a high 9.4x in fiscal 2020. Revenue-only MADS coverage was also very weak at negative 0.3x. However, capital-related metrics are expected to improve considerably to levels consistent with the midrange assessment as revenues from the additional ILUs and SNF beds come online and operating pressures from the pandemic ease.

Financial Profile: 'bbb'

Solid Financial Profile

Fitch assesses The Pines' financial profile as 'bbb' in the context of its 'a' revenue defensibility and 'bbb' operating risk assessments. The community's $43 million in unrestricted cash and investments translates into 663 days cash on hand and 65.7% cash-to-adjusted debt as of June 30, 2021. The Pines have drawn down approximately 95% of the series 2019B temporary bank loan and all such draws have been fully paid off with initial entrance fees from the ILU expansion.

Through Fitch's baseline scenario, or Fitch's best estimate of the most likely scenario of financial performance over the next five years given current economic expectations, Fitch expects that The Pines' cash-to-adjusted debt metric will gradually improve as cash flows accumulate and new revenues from the project come on-line.

Fitch's stress scenario assumes both a significant economic stress (to reflect market volatility) and business cycle stress followed by a recovery and then stability. Despite the stress, The Pines improves its cash-to-adjusted debt to above 70% by year four and MADS coverage averages 2.1 through the scenario, which is viewed as sufficient for a 'bbb' financial profile.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A sustained improvement in liquidity levels with cash-to-adjusted debt sustained well above 100%.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A significant capital project and/or debt issuance that leads to cash-to-adjusted debt sustained below 60%;

--A failure to improve operating performance in fiscal 2022, with an operating ratio sustained above 100% and NOM sustained below 3%.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sectorspecific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

The Pines is a type-B life plan community located in Davidson, North Carolina, approximately 20 miles north of Charlotte. The Pines has 288 ILUs, 30 ALUs, and 75 SNF beds. In fiscal 2020, The Pines generated total revenues of $23.1 million. The vast majority of residents have chosen the non-refundable entrance fee contract offering, which is viewed favorably by Fitch as it provides greater cash flow and balance sheet stability.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Pines at Davidson, Inc. (The) (NC)	LT IDR	BBB+ Rating Outlook Stable	Affirmed	BBB+ Rating Outlook Stable

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• Pines at Davidson, Inc. (The) (NC)	LT	BBB+ Rating Outlook Stable	Affirmed	BBB+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Not-For-Profit Life Plan Community Rating Criteria (pub. 02 Mar 2021) (including rating assumption sensitivity)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Portfolio Analysis Model (PAM), v1.3.2 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

North Carolina Medical Care Commission (NC)	EU Endorsed, UK Endorsed

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