FitchRatings

Fitch Revises Philadelphia Presbytery Homes' Outlook to Stable; Affirms Ratings

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Fitch Ratings has affirmed the 'BBB' rating on $87 million revenue refunding bonds, series 2017, issued by Montgomery County Higher Education and Health Authority on behalf of Philadelphia Presbytery Homes, Inc. (PPHI) obligated group (OG), dba HumanGood Pennsylvania (HGPA). Additionally, Fitch has affirmed the 'BBB' Issuer Default Rating (IDR) assigned to HGPA.

The Rating Outlook has been revised to Stable from Negative.

SECURITY

Bonds are secured by a pledge of gross revenues, first lien mortgage and security interest in OG facilities and property, and a debt service reserve fund (DSRF). PPHI's affiliation with HGPA in June 2019 has not affected the composition of the OG or the bonds' security under the master trust indenture (MTI).

ANALYTICAL CONCLUSION

The revision of the outlook to Stable from Negative reflects HGPA's successful fill-up of its Rydal Waters independent living unit (ILU) expansion project and strong rebound of ILU occupancy from an 80.7% average in 2021 to 89% in the first quarter of 2022. Given the successful fill of the project and Fitch's expectation of gradual balance sheet improvement, HGPA's 72% cash to adjusted debt, as of March 31, 2022, is viewed as sufficient for the rating.

HGPA's core operating profitability in the first quarter of 2022 was pressured by high contract labor and overtime expenses. Though the expense increases are material, Fitch believes HGPA has strategies in place to improve operating profitability, which should be realized over the Outlook Period. The additional revenues from the new Rydal Waters ILUs will also provide a long-term benefit to profitability and coverage, solidifying Fitch's view that HGPA's operating ratio and net operating margin - adjusted (NOMA) will gradually improve from the 114.5% and 5.6% produced in the first quarter of 2022.

The 'BBB' rating is also supported by HGPA's affiliation with HumanGood, a large senior living and affordable housing provider with communities in California and four other states, along with the ongoing support from the Bala Foundation, a non-OG affiliate. While the Bala Foundation remains outside of the OG, it has approximately $51 million in investments (as of Dec. 31, 2021) and has consistently provided $1 million - $2 million in annual support to the HGPA OG in recent years.

KEY RATING DRIVERS

Revenue Defensibility: 'bbb'

Improved ILU Occupancy

HGPA's ILU census remained pressured in 2021 and averaged only 80.7% compared to 82.1% in 2020. Despite an overall softening of occupancy in 2021, sales velocity increased in the second half of 2021 with enhanced sales and marketing efforts (which benefitted from HumanGood support), restrictions being lifted on campus and a return to traditional marketing channels. This resulted in improved ILU occupancy at all three campuses and the selling out of the Rydal Waters expansion project (fully occupied as of today) that increased overall occupancy to an average of 89% in the first quarter of 2022. Occupancies in HGPA's assisted living units, memory care units and skilled nursing facility beds have all shown year over year stability or improvement averaging 90.4%, 87.4% and 80.5%, respectively in 2022 compared to 90.6%, 77.6% and 73.5%, respectively in 2021.

While HGPA has competition at each of its three OG campuses, Fitch believes its overall demand indicators, including a favorable local reputation enhanced by its HumanGood affiliation, remain solid. HGPA's three OG campuses are located in demographically strong service areas that are characterized by population growth and wealth/income levels that exceed state and national averages. The Mansion at Rosemont will be adding dedicated memory support beds and Rydal Park will be combining one-bedroom apartments to create more desirable larger units and reinvesting initial entrance fees from the Rydal Waters project into the community. These actions are viewed positively as they should support the long-term competitive positioning of the communities.

HGPA has a track record of annual increases in both its monthly service fees and entrance fees in recent years. Entrance fees are generally lower than local housing prices, which affords the organization pricing flexibility that is consistent with its midrange revenue defensibility assessment. As a result of this pricing flexibility, management was able to implement a 5% entrance fee increase in late 2021 and currently expects to implement an additional entrance fee increase in mid-2022.

Operating Risk: 'bbb'

Improving Cash Flow; Low Debt Burden

HGPA offers traditional (non-refundable) and refundable lifecare (Type-A) and fee-for-service (Type-C) contracts at its campuses. Each residency contract requires an upfront entrance fee and ongoing monthly fees. The breakdown between Type-A and Type-C contracts is approximately equal.

2021 core operations were weak due to softer census, especially in ILUs, weaker than expected home care revenue generation and nursing cost inflation that caused salaries and wages to be 11% unfavorable to budget in the 4th quarter. The combination of these pressures resulted in a weak 106% operating ratio, negative 2.3% net operating margin (NOM) and 10.3% NOMA in 2021. Though the system produced ILU occupancy gains in the first quarter of 2022, significant wage/cost pressures caused profitability metrics to weaken further resulting in a 114.5% operating ratio, negative 7.1% NOM and 5.6% NOMA. HGPA's management team is actively working through multiple initiatives focused on containing costs, addressing recruiting and retention challenges and improving revenue generation. These efforts combined with the successful fill of the Rydal Waters project should help the organization generate sufficient cash flow to cover debt and improve its balance sheet.

HGPA's capital outlays have been elevated in recent years, reflecting its completed Rydal Waters expansion project, which entailed adding 75 new cottages to a 33-acre property contiguous to its Rydal Park campus. All the cottages have been completed and filled and fiscal 2023 will be HGPA's first full year of stabilized operations and

MADS coverage test. $19.5 million and $10.3 million in initial entrance fees were collected in 2021 and the first quarter of 2022, respectively. A portion of the initial entrance fees were used to pay down the construction loan to $20.6 million and the majority of the remaining proceeds are expected to be used to improve the Rydal Park campus. Over the past five years, HGPA has averaged nearly $19 million in annual capex, or 167% of depreciation, translating into a healthy 10.1 years average age of plant as of March 31, 2022.

HGPA's debt burden is very manageable, as evidenced by its MADS equating to 11.8% of its fiscal 2021 revenues. Additionally, revenue-only coverage and debt to net available were good at 1.1x and 8.6x, respectively, in fiscal 2021. Fitch expects the additional revenues from the Rydal Waters monthly service fees, incremental occupancy growth across service lines and margin enhancement initiatives to improve coverage levels and moderate its debt burden over the next two years.

Financial Profile: 'bbb'

Midrange Balance Sheet and Debt Service Coverage

HGPA had unrestricted cash and investments of approximately $80.4 million, which translates into 67.5% cash to adjusted debt and 10.5x cushion ratio. Fitch includes HGPA's $5.5 million debt service reserve fund in its calculation of cash to adjusted debt. HGPA's MADS coverage was adequate for the rating at 2x in fiscal 2021. Fitch's $7.7 million MADS includes the series 2019 bonds and subordinate Bala loans. HGPA's strong coverage of its all-in MADS is viewed favorably as this amount is higher than the $7 million MADS excluding the subordinate Bala loans that the organization will be tested on in fiscal 2023.

Given the current expectation of margin improvement and capex funded from operating cash-flow below depreciation over the next few years, Fitch expects cash to adjusted debt and MADS coverage to show gradual improvement over time. Fitch's stress scenario incorporates an investment portfolio and cash flow stress that are in line with current economic conditions and expectations. HGPA's investment portfolio stress was moderate given its current investment allocation. By year four of Fitch's stress case, cash to adjusted debt is approximately 60% and days cash on hand is well above 300 days, which is neutral to the rating assessment.

Asymmetric Additional Risk Considerations

No asymmetric risk factors are relevant to the ratings.

RATING SENSITIVITIES

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

--Maintenance of ILU census above 93%;

--Accretion of cash flow and liquidity, such that all-in MADS coverage is sustained at or in excess of 2x and cash-to-adjusted debt is consistently above 100%.

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

--An inability to maintain ILU census above 85% that results in a change in HGPA's revenue defensibility assessment to weak;

--A deterioration in key operating metrics such that the operating ratio is steadily above 105%, NOM is below 0% or NOM-adjusted is below 11%;

--Unexpected deterioration in HGPA's unrestricted cash reserves that results in cash to adjusted debt falling below 55%.

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 sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CREDIT PROFILE

HGPA OG consists of a management services group and three communities: Rydal Park (374 ILUs including 75 ILUs from the Rydal Waters project, 32 PCUs, 22 memory care units and 114 SNF beds), The Mansion at Rosemont (114 ILUs and 80 PCUs), and Spring Mill Pointe (33 ILUs, 25 PCUs and 27 memory care units). A fourth community, Broomall (146 SNF beds), was sold in May 2019. Fitch's analysis is based on the OG financial statements. The OG composed approximately 66% of total consolidated assets and 80% of consolidated revenues in fiscal 2021. Total operating revenue of the HGPA OG in fiscal 2021 was $58.4 million.

HGPA OG is part of HumanGood East, fka Presby's Inspired Life, a senior living organization with facilities located in and around the greater Philadelphia region. Non-obligated entities include a large affordable housing portfolio (mostly U.S. Department of Housing and Urban Development housing) and the Bala Foundation, which has approximately $51 million in cash and investments. Bala provides resident assistance and provided capital support through loans to the OG, including for Rydal Waters.

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	RATING			PRIOR
Philadelphia Presbytery Homes, Inc. (PA)	LT IDR	BBB	Affirmed	BBB

ENTITY	RATING			PRIOR
Philadelphia Presbytery Homes, Inc. (PA) /General Revenues/1 LT	LT	BBB	Affirmed	BBB

View Additional Rating Details

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Applicable Criteria

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

U.S. Public Finance Not-For-Profit Life Plan Community Rating Criteria (pub.05-Apr-2022)(includes rating assumption sensitivity)

Applicable Models

Portfolio Analysis Model (PAM), v2.0.0 (1 (https://www.fitchratings.com/site/re/1001560))

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