FitchRatings

Fitch Affirms Peconic Landing at Southold, Inc (NY) Revs at 'BBB-'; Outlook Stable

Fitch Ratings-New York-25 October 2017: Fitch Ratings has affirmed the 'BBB-' rating on the following bonds issued on behalf of Peconic Landing at Southold, Inc. (PL):

--$19,555,000 Southold Local Development Corporation Revenue Bonds, Series 2015 (Peconic Landing at Southold, Inc. Project);
--$26,940,000 Suffolk County Economic Development Corporation revenue refunding bonds series 2010 (Peconic Landing at Southold, Inc. Project).

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a gross revenue pledge, mortgage interest on the land and all buildings except the ILU/Co-op units, and a debt service reserve fund.

KEY RATING DRIVERS

CAPITAL PROJECT COMPLETED: PL has successfully completed its campus repositioning and expansion project. As of Sept. 30, 43 of the 46 expansion independent living units (ILUs) were occupied, and the final three units are in contract. The new memory care units (MCUs) were 100% occupied, and the new SNF beds were nearing 90% occupancy. PL paid down $16 million in short term debt with funds from the new entrance fees, which removes a material risk from PL's credit profile.

SOFTER OPERATIONS: PL's operating ratio was 100.5% and net operating margin (NOM) 3.4% in fiscal 2016, which while consistent with the prior year performance remained weaker than historical levels and Fitch's 'BBB' category medians of 97.4% and 7.7%, respectively. However, Fitch expected the performance to remain soft during the construction and fill-up periods and expects PL's financial performance to improve in the coming year as the new revenues from the project come fully online.

SOLID OVERALL CENSUS: PL's favorable location and limited competition has supported strong demand across all service lines. As of the six-month interim period (ending June 30, 2017), PL had occupancy rates of 91% in its ILUs, 89% in its assisted-living units (ALUs), and 88% in its skilled-nursing facility (SNF) beds.

STABLE LIQUIDITY POSITION: In fiscal 2016, PL's $27.4 million in unrestricted cash and investments translated into a healthy 376 days cash on hand (DCOH), 56.8% cash to debt, and 8.1x cushion ratio which are all on par with Fitch's 'BBB' category medians of 396, 61.5%, and 8x, respectively.

ADEQUATE MADS COVERAGE: PL covered its maximum annual debt service (MADS) of $3.6 million at 1.7x in fiscal 2016 and 1.1x during the six-month fiscal 2017 interim period, relative to a 'BBB' median of 2x. PL's debt service coverage per the MTI covenant calculation, which uses a lower debt service figure of $2.1 million that does not include the construction debt, was solid at 3.4x in fiscal 2016. PL will be tested on the higher MADS at the end of the current fiscal year.

RATING SENSITIVITIES

IMPROVED OPERATIONS/COVERAGE: With stabilized occupancy levels in its new independent living units and its temporary debt paid off, if Peconic Landing's operational performance begins to improve and coverage levels increase to near 'BBB' median levels, there could be upward rating movement.

CREDIT PROFILE

PL is located on the North Fork of Long Island and consists of 109 single-story cottages, 187 apartments, 26 enriched housing units (ALUs), 16 MCUs, and 60 SNF beds. Utilizing a co-op model, PL primarily offers a Type-A contract. In 2016, PL obtained approval from the state of New York to begin offering Type-C contracts as well. Fitch views the Type 'C' contract as a credit positive, believing it will help expand the pool of potential residents, especially those interested in the cottages, which generally attract younger seniors who are better suited for the Type 'C' contract. PL reports that, while no residents have chosen this Type-C contract yet, it has improved overall marketing results. In 2016, PL had total operating revenues of $27.9 million.

SOLID CENSUS

PL has demonstrated strong demand across all service lines as evidenced by occupancy rates of 91% in its ILUs, 89% in its ALUs, and 88% in its SNF beds through the six-month interim period (ending June 30, 2017). These solid occupancy rates factor in the additional units from PL's recent campus expansion project, which were not yet fully occupied through the interim period. Fitch expects overall occupancy rates to improve by year-end. Additionally, historical census levels have been strong as PL has averaged occupancy rates of 95% in its ILUs, 90% in its ALUs, and 96% in its SNF beds in the three fiscal years prior to its recent expansion (FYs 2013-2015).

PL's strong census levels are attributed to its favorable location and limited competition in the demographically attractive Long Island market. PL continues to benefit from its large and attractive campus located on the North Fork of eastern Long Island, which includes a private beach. PL also benefits from the limited competition for prospective residents as there are currently only two other CCRCs in the Long Island market, both of which are outside its primary service area. There is also a third CCRC in the planning phase, which just began accepting entrance fee deposits. However, this CCRC is outside PL's primary service area and is expected to have little-to-no impact on census levels. Overall, Fitch feels PL's attractive campus and location, coupled with its favorable competitive landscape, should continue to support demand for its services.

SUFFICIENT FINANCIAL PROFILE

PL's operational performance remained weak in fiscal 2016 as evidenced by its 100.5% operating ratio and 3.4% NOM which both compare unfavorably to Fitch's 'BBB' category medians of 97.4% and 7.7%, respectively. While weak, PL's operational performance was expected to remain soft until occupancy stabilizes from its recent campus repositioning and expansion project which should occur by year end. PL's operational performance should improve in fiscal 2017 and begin to approach historic norms in fiscal 2018, when PL's operations will have a full fiscal year worth of enhanced revenues from the recent capital project. PL averaged a 92.4% operating ratio and 8.5% NOM in the two fiscal years prior to the start of the expansion project.

Additionally, PL's liquidity position remained stable through fiscal 2016 as evidenced by its $27.4 million in unrestricted cash and investments which translates into a strong 374 DCOH, 56.8% cash to debt, and 8.1 cushion ratio. All three metrics are on par with Fitch's 'BBB' category medians of 396 DCOH, 61.5% cash to debt, and 8.1x cushion ratio.

PL's MTI coverage calculation remained strong in fiscal 2016 at 3.4x. However, Fitch notes that this calculation was only on a $2.1 million MADS and does not factor in the additional debt issued in 2015 for the capital project. MADS of $3.6 million, which includes the series 2015 bonds, will begin to be used once IL units reach stabilized occupancy levels which should occur for fiscal 2017's MTI calculation. Overall, given its sufficient balance sheet levels, if PL is able to demonstrate a consistent operational performance near historic levels and improve debt coverage to 'BBB' median levels, there could be upward rating movement in the near term.

CAPITAL PROJECT COMPLETE

In 2016, PL completed its major campus repositioning and expansion project, with the first residents moving into the new IL apartments in April 2016. Overall, despite a small delay due to a harsh winter in 2015, the project was completed on-time and under budget. The project added 46 new IL apartments, 16 new MCUs, and 16 new SNF beds. Currently, 43 of the 46 ILUs have been occupied and it is expected that the remaining three will be occupied by fiscal year end. All 16 MCUs are occupied, while the SNF beds are averaging occupancy rates near 90%. Overall, the project is expected to be accretive to PL's financial profile and should help improve its operational performance with an expanded revenue base moving forward.

DEBT PROFILE

PL had a $16.5 million short-term, floating-rate construction loan with Citizen's Bank, which was paid off in July 2017 with new IL entrance fees. The $46 million in outstanding series 2010 and 2015 bonds is PL's only current outstanding debt. The bonds are all fixed-rate and have final maturity dates of 2040 and 2045, respectively. Debt service increases from $2.7 million to $3.3 million in 2019, where it remains level until 2040. From 2040-2045, debt service is only $1.3 million.

Following the payment of its temporary debt and the additional revenues from its recent campus repositioning project, PL's leverage position and debt burden are manageable. PL's MADS of $3.3 million represents a manageable 12% of total fiscal 2016 revenues which compares favorably to Fitch's 'BBB' category median of 12.4%. Fitch expects this metric to improve further as PL's revenue base begins to expand further from additional revenues of the project, which can be evidenced by MADS equating to 11.3% of total revenues through the six-month interim period (ending June 30, 2017).

DISCLOSURE

PL covenants to provide audited financial statements within 120 days after the end of each fiscal year and quarterly financials within 45 days after the end of each quarter to MSRB's EMMA system.

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Applicable Criteria
Not-for-Profit Continuing Care Retirement Communities Rating Criteria (pub. 04 Aug 2015) (https://www.fitchratings.com/site/re/868824)
Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017) (https://www.fitchratings.com/site/re/898969)

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