

Fitch Affirms United Methodist Retirement Homes (MI) at 'BBB+'; Outlook Stable

Fitch Ratings-New York-22 July 2016: Fitch Ratings has affirmed the 'BBB+' rating on the following bonds issued on behalf of United Methodist Retirement Communities, Inc (UMRC):

--\$11 million Michigan Strategic Fund limited obligation revenue bonds (UMRC, Inc. Project), series 2013.

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a pledge of gross revenues, a mortgage interest in property, and a debt service reserve fund.

KEY RATING DRIVERS

ROBUST OPERATIONAL PERFORMANCE: UMRC maintained its strong operational performance in fiscal 2015 with a 87.1% operating ratio and 11.3% operating margin which are both higher than Fitch's 'BBB' category medians of 96.1% and 8.9%, respectively. The strong operational performance led to maximum annual debt service (MADS) coverage of 2.3x, which is also above the category median of 2.0x.

STRONG OCCUPANCY: Occupancy remained strong across all service lines at both of UMRC's campuses, Chelsea Retirement Community (CRC) and Cedars of Dexter (CoD). At year end fiscal 2015, CRC maintained average occupancy rates for independent living (IL), assisted living (AL), and skilled-nursing (SN) of 92.9%, 94%, and 91%, respectively. CoD's average occupancy was exceptionally strong at 99.7%.

ADEQUATE LIQUIDITY FOR RATING LEVEL: UMRC's liquidity remained sufficient in fiscal 2015 with \$25.9 million in unrestricted cash and investments equating to 333 days cash on hand (DCOH) and 85.9% cash to debt. DCOH trailed the category median of 400 DCOH, while cash to debt was above the median of 60%.

MASTER FACILITIES PLAN: UMRC's board has approved their capital plans for its CRC facility which encompasses adding 41 additional IL cottages, renovating and expanding its SN facility, and construction of a new wellness center. Construction for phase I began in April 2016 and total project costs are expected to be near \$30 million, with only \$10-15 million anticipated to come from debt financing. The affirmation of the rating reflects the current size and scope of the project.

AGGRESSIVE DEBT STRUCTURE: Approximately 65% of UMRC's debt is variable-rate bank placed debt. Fitch views this level of bank exposure and variable-rate debt as aggressive for the rating level. The renewal dates for debt is in 2019 and 2024. Approximately half of the variable-rate debt is swapped. This risk is somewhat mitigated by unrestricted cash and investments covering all variable rate bank placed debt by at least 1 times.

RATING SENSITIVITIES

MASTER FACILITIES PLAN: While UMRC currently has debt capacity at its current rating level to handle the additional \$10-15 million needed for its master facilities plan, should the size or scope of the

debt financing change, there could be negative pressure on the rating. Additionally, any unexpected delays in construction or difficulty in filling up new units at CRC may put negative pressure on the rating.

CREDIT PROFILE

UMRC consists of two facilities, CRC and CoD. CRC is currently a rental CCRC, with 122 ILUs, 66 ALUs, 86 memory care beds, and 85 SN beds located in Chelsea, MI, about nine miles west of Ann Arbor. In May 2016, UMRC received State approval to begin providing entrance fee contracts at CRC in addition to rental contracts. Management plans to begin marketing these entrance fee contracts at the end of 2016. CoD is a 60 unit, type c, entrance fee ILU in Dexter, MI. Operating revenues in 2015 totaled \$33.2 million. Fitch's analysis is based on financial statements of the Obligated Group.

MASTER FACILITIES PLAN

UMRC's board has approved their master facilities plan which entails a two phase capital project at its CRC campus and is expected to cost approximately \$30 million. Phase one is expected to cost approximately \$12 million and will involve the construction of 41 new IL cottages at its CRC campus. The new units are expected to range from 1,100 to 1,900 square feet. Construction began in April 2016 and is expected to be completed by the beginning of 2018.

Following state approval in May 2016, the 41 new IL cottages are expected to offer an entrance fee, fee-for-service contract option once complete. Furthermore, management anticipates beginning to offer these entrance fee contract options, in addition to the rental contract option, on a majority of their IL units at the end of 2016. The offering of fee-for-service contracts at the CRC campus should help improve demand as the fee-for-service product is attractive and widely accepted as evidenced by the strong occupancy rates at UMRC's CoD facility.

Phase II of the master facilities plan is expected to cost approximately \$18 million and encompasses renovating and expanding the existing skilled nursing facility as well as converting all the SN rooms to private from semi-private. The total number of skilled beds offered is expected to remain the same upon completion. In addition to the renovation and expansion of the SN facility, Phase II is also expected to encompass construction of a new wellness center.

Of the \$30 million cost of the capital project, only \$10-15 million is expected to come from debt financing. The remaining cost is expected to be paid by a combination of entrance fee proceeds, fundraising, cash flow from operations, and an equity contribution from UMRC. At its current rating level, UMRC has some debt capacity given its moderate debt burden as illustrated by MADS equating to a low 7.3% of total revenues in fiscal 2015 which compares favorably to Fitch's 'BBB' category median of 12.4%. The \$10-15 million in debt financing is anticipated to have a five-year maturity and is expected to be paid off by entrance fees and cash flow from operations. Given this method of repayment, the medium term maturity of the debt, and UMRC's moderate debt burden, Fitch believes the additional debt should not impact the current rating. However, if capital plans change and the amount and scope of the debt financing increases there could be negative pressure on the rating.

STRONG FINANCIAL PROFILE

UMRC's financial performance remained solid in fiscal 2015 and consistent with its 'BBB+' rating. UMRC's strong operating performance continued in fiscal 2015 with a 87.1% operating ratio and 11.3% net operating margin which are both higher than Fitch's 'BBB' category medians of 96.1% and 8.9%, respectively. This strong operating performance reflects both UMRC's efficient operations as well as its contract types. This strong operating performance translated into sufficient coverage as MADS coverage was 2.3x in fiscal 2015 which is in line with Fitch's 'BBB' category median of 2.0x.

While cash and investments declined for a second straight fiscal year to \$25.9 million, overall liquidity metrics remain sufficient given UMRC's rental and fee-for-service contracts. As of fiscal 2015, DCOH

was 333 days which remains below the 'BBB' median of 400 days. However, UMRC's cash to debt of 85.9% and cushion ratio of 10.7x remain above the 'BBB' medians of 60% and 7.3x, respectively. Fitch's anticipates liquidity metrics to decrease or stay flat in short-term while the capital project is in construction. However, liquidity metrics should improve following the completion of both phase I and II of the master facilities plan and the corresponding switch to offering fee-for-service contracts.

SOLID OCCUPANCY

UMRC's strong financial profile reflects its strong occupancy rates at both its CRC and CoD facilities. CRC is currently a rental community which offers IL, AL, memory care, and SN units. As of fiscal 2015, IL and AL units improved from previous fiscal year's levels with average occupancy levels of 92.9% and 94%, respectively. SN average occupancy dipped slightly in fiscal 2015 but remains sufficient at 91%. Additionally, current average occupancy rates for IL, AL, and SN are solid at 94.1%, 96.5%, and 89.6%, respectively.

CoD is an IL only facility which has demonstrated robust occupancy levels over the last couple years. CoD demonstrated an average occupancy rate of 99.7% for fiscal 2015 and is currently 100% occupied. Additionally, as first generation residents begin to transition through the continuum of care and turnover entrance fees are generated, CoD should help further bolster UMRC's financial performance. However, the contracts at CoD require a refund of the entrance fee regardless of re-occupancy of the vacated unit which could present some financial challenges if UMRC is unable to refill the unit in a timely fashion. This risk is currently mitigated by UMRC's sufficient liquidity position and demand for its services as evidenced by its solid occupancy rates.

AGGRESSIVE DEBT STRUCTURE

UMRC maintains an aggressive debt structure, with variable-rate bank placed debt equating to approximately 65% of total debt outstanding. This high exposure to variable-rate bank debt leaves UMRC highly susceptible to counterparty and interest rate risk. Of the \$30.2 million in outstanding debt as of fiscal 2015, \$8.2 million is privately placed with FirstMerit Bank and \$11.2 million is privately placed with Huntington Bank. These private placements have expirations of 2019 and 2024, respectively. UMRC has entered into floating for fixed rate swaps which effectively hedges 50% of the notional amounts of the variable-rate debt.

ENHANCED FOUNDATION & NON-OG ACTIVITIES

UMRC's enhanced foundation activities are viewed positively as management is positioning the foundation to support UMRC's strategic initiatives. Fundraising has brought in \$4.1 million in fiscal 2015 and \$1.9 million in fiscal 2014. Additionally, management reports that UMRC's local reputation and CRC marketing has been aided by its numerous non-OG entities. Fitch does not view the non-OG entities as a credit risk as OG support for these entities is expected to be limited.

DISCLOSURE

UMRC provides annual and quarterly disclosure on EMMA.

Contact:

Primary Analyst
Ryan J. Pami
Associate Director
+1-212-908-0803
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst

Gary Sokolow
Director
+1-212-908-1186

Committee Chairperson
James Lebuhn
Senior Director
+1-312-368-2059

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email:
elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria

Not-for-Profit Continuing Care Retirement Communities Rating Criteria (pub. 04 Aug 2015)
(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=868824)
Revenue-Supported Rating Criteria (pub. 16 Jun 2014)
(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
(https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1009321)
Solicitation Status (https://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=1009321)
Endorsement Policy (<https://www.fitchratings.com/jsp/creditdesk/PolicyRegulation.faces?context=2&detail=31>)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://fitchratings.com/understandingcreditratings) (<http://fitchratings.com/understandingcreditratings>). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE 'WWW.FITCHRATINGS.COM'. PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Endorsement Policy - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (<https://www.fitchratings.com/regulatory>) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.