

## **FITCH UPGRADES HARROGATE, INC.'S (NJ) REVS TO 'BBB-'; OUTLOOK STABLE**

Fitch Ratings-New York-23 April 2010: Fitch Ratings takes the following rating action on Harrogate, Inc., New Jersey as part of its continuous surveillance effort:

--Approximately \$13.6 million New Jersey Economic Development Authority revenue bonds, series 1997, upgraded to 'BBB-' from 'BB+'.

The Rating Outlook is Stable.

### **RATING RATIONALE:**

--A financial profile that is more consistent with an investment grade rating. Moreover, Harrogate's large scale expansion and renovation project that caused Fitch to downgrade the rating remains on indefinite hold.

--Satisfactory liquidity, with \$15 million of unrestricted cash and investments amounting to 335 days operating expenses as of Dec. 31, 2009. This level of cash matches Fitch's 'BBB' category median of 336 days operating expenses.

--Low debt position, evidenced by 8% maximum annual debt service (MADS) as a percent of revenue and 110% cash to long-term debt in fiscal year (FY) 2009. These levels compare very favorably to Fitch's 'BBB' category medians of 11.8% and 48%, respectively.

--Favorable management from Life Care Services LLC, one of the nation's leading nonprofit managers of continuing care retirement communities (CCRC). Life Care Services enjoys a long history of successfully operating CCRCs and adds value through innovative marketing and budgeting programs.

--Softening demand, with average independent living unit (ILU) occupancy at 85.5% in FY 2009 from 91.6% a year earlier. Additionally, skilled nursing facility (SNF) occupancy declined to 89.7% in FY 2009 from 92.7% in FY 2008. Lower occupancy is being driven by slack in the local real-estate market from declining home values and lower sales velocity.

--Inconsistent operating results. Harrogate's profitability continues to be uneven, with negative excess margins in three of the last six years. However, despite the weaker occupancy, effective cost controls helped produce a \$226,000 bottom line in FY 2009 resulting in a 1.3% excess margin. Adequate amounts of net entrance fees received boosted MADS debt service coverage to 1.3 times (x) in FY 2009 from 1.1x a year earlier.

### **KEY RATING DRIVERS:**

--Harrogate's continued ability to operate profitably at lower occupancy levels that are prevalent in the current real-estate environment.

--The potential for significant capital spending to improve its facilities and make them more appealing in the long term. This may be evidenced by a 17.9 year average age of plant, versus a Fitch 'BBB' median of 10.6 years. If Harrogate proceeds with its prior large-scale capital plans to expand into assisted living and renovate skilled care and common facilities, negative rating pressure could result.

### **SECURITY:**

The bonds are secured by mortgage on certain property and equipment and a debt service reserve fund.

### **CREDIT SUMMARY:**

The upgrade to Harrogate's rating is primarily based on a financial profile that is more consistent with a 'BBB' category rated CCRC. Additionally, a \$38 million debt issuance to finance a large capital project that caused Fitch to downgrade the rating remains postponed with uncertain future plans. As a result, Harrogate enjoys operating and financial metrics that reflect an investment grade rating. Despite enjoying a solid market position in a good location with limited direct competition,

ILU occupancy is challenged by the poor state of the real estate market. According to data from the National Association of Realtors, median home values in Ocean County, New Jersey are down about 23% since 2006 and amounted to \$289,900 in 2009. ILU occupancy slipped a bit further during the first quarter of FY 2010 to about 82.2%, but improved budgeting practices and cost cutting is keeping profitability positive. For the three month period ending March 31, 2010, Harrogate generated a healthy \$674,000 of excess income. Fitch's main concern is Harrogate's ability to maintain positive operations in light of the soft ILU occupancy. Conversely, SNF occupancy is rebounding and averaged 95.6% for the first three months of the year. The other rating driver is the potential for Harrogate to issue additional debt to finance the aforementioned capital plans.

Harrogate is a type A CCRC located in Lakewood, New Jersey with 275 ILUs and 68 SNF beds. Total revenues in FY 2009 were \$17.8 million. Harrogate provides its annual financial statements to the Municipal Securities Rulemaking Board's EMMA system.

Applicable criteria available on Fitch's web site at '[www.fitchratings.com](http://www.fitchratings.com)':

--'Revenue-Supported Rating Criteria', dated Dec. 29, 2009;

--'Rating Guidelines for Nonprofit CCRCs', dated Dec. 15, 2008.

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