FitchRatings

Fitch Rates Brooks Rehabilitation (FL) 2017 Revs 'A-'; Outlook Stable

Fitch Ratings-New York-30 August 2017: Fitch Ratings has assigned an 'A-' rating to the following revenue bonds expected to be issued by the city of Jacksonville, FL on behalf of Brooks Rehabilitation (BR):

--$77.8 million series 2017.

In addition, Fitch affirms its 'A-' rating on the following bonds:

--$54.6 million city of Jacksonville (FL) series 2015;
--$87.9 million Jacksonville Health Facilities Authority series 2007.

The series 2017 bonds are expected to be issued as fixed-rate. Proceeds will be used to current refund the series 2007 bonds, fund a swap unwind, and pay for costs of issuance.

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a pledge of gross revenues of the obligated group and a mortgage on Brooks Rehabilitation Hospital.

KEY RATING DRIVERS

SOLID LIQUIDITY: BR's liquidity metrics remain solid for the lower end of Fitch's 'A' rating category. Unrestricted cash and investments of $301.8 million at June 30, 2017 (six-month interim period) equated to 574.6 days cash on hand (DCOH), 18.7x cushion ratio, and 118.7% cash-to-pro forma debt, comparing well to Fitch's medians of 215.5 days, 19.4x, and 148.6%, respectively.

LEADING MARKET POSITION: BR has a dominant 95% market share of inpatient rehabilitation services in the North Florida and Southeast Georgia market, a large and growing network of outpatient clinics, a home health agency, as well as a skilled nursing and an assisted living facility. Fitch views BR's favorable market position as a primary credit strength at the current rating level, which mitigates some concern over historically weaker operating performance.

ELEVATED PRO FORMA DEBT BURDEN: BR's strategic expansion efforts, while viewed favorably by Fitch, have resulted in an increased debt burden over the last three years. Pro forma maximum annual debt service (MADS) of $16.2 million, while improved from the prior $17.3 million, still equated to a high 8.8% of total 2016 revenues. Debt service coverage was a low 1.5x in the same year.

SOFT OPERATING RESULTS: Fitch has historically viewed the significant liquidity and commanding market share as a mitigant against BR's weaker operating performance. BR's operating EBITDA margin has averaged 5% over the last four audited years and was at 5.9% through the six-month interim, unfavorable to Fitch's 'A' median of 10.3%. Operating profitability has historically been negatively impacted by several elective community benefit programs provided by BR.

RATING SENSITIVITIES

STRENGTHENING OF CORE OPERATIONS: Fitch expects Brooks Rehabilitation to produce stronger core operating results and to reduce its reliance on investment returns given the organization's aggressive investment portfolio. Additionally, Fitch expects successful execution of BR's ongoing projects to be accretive to their core financial profile over the medium- to longer-term.

MAINTENANCE OF LIQUIDITY PROFILE: Large declines in BR's unrestricted liquidity, or significant increases in leverage metrics, would likely lead to negative rating pressure.

CREDIT PROFILE

BR is located in Jacksonville, Florida and consists of Brooks Rehabilitation Hospital (BRH, 160 beds); University Crossing at BRH, an 111-bed skilled nursing facility (SNF); Bartram Crossing, a 100-bed SNF; Bartram Lake, an assisted living (AL) facility with 61 AL rooms and two 12-bed memory care units; 32 outpatient centers; Brooks Health Development, Brooks Health Foundation, Brooks AmeriCare, a comprehensive home health service; and BH Holdings. BR had total revenues of $183.3 million in 2016.

LEADING MARKET POSITION

BR holds a leading market share of 95% of the inpatient rehabilitation admissions within a 60-mile radius around Jacksonville and is the dominant provider of rehabilitation services in North Florida and Southeast Georgia. BR's commanding market position and historical success under several bundled payment arrangements largely mitigate concerns over the specialty nature of the organization. While inpatient admissions to BRH have remained relatively flat, increasing just 2.5% from 2013 to 2016, outpatient visits have increased by a sizable 20% over the same time period. An HCA-owned facility opened a 20-bed rehab unit in 2015 at one of its hospitals 20 miles from BR; however, management reports that the impact to BR has been minimal, and overall, the organization faces very limited competition for complex rehab services in its market.

BR is also implementing a strategy of being a provider of a comprehensive spectrum of post-acute services. The organization currently operates two SNFs, an assisted living and memory care facility, a home health agency, as well as 32 outpatient clinic sites. In addition, BR operates a 40-bed rehab unit at Halifax Health ('BBB+'/Stable) as a joint venture and operates a 35-bed SNF at St. Vincent's Southside Hospital, which is focused on the treatment of joint replacement patients. Fitch views BR's favorable market position as a primary credit strength at the current rating level, which mitigates some concern over historically weaker operating performance.

ELEVATED PRO FORMA DEBT BURDEN

Most of BR's debt metrics are soft compared to Fitch's 'A' category medians and remain a credit concern. Pro forma maximum annual debt service (MADS) as a percent of revenues of 8.3%, pro forma debt-to-EBITDA of 8.5%, and debt-to-capitalization of 50.4% through the interim, all compared unfavorably to category medians of 2.7%, 2.9%, and 36%, respectively. Debt service coverage of 1.9x was also unfavorable to Fitch's 'A' median of 4.5x. However, given significant investment in plant and expansion efforts over the last few years, BR's capital plans are tempered over the next two years, which should help the organization moderate its debt burden.

BR draws on several lines of credit, totaling $39.2 million (renewed annually), which were included in total long-term debt for Fitch's analysis. Additionally, Fitch view BR's investment allocation as aggressive with 82% invested in equities and hedge funds.

SOFT OPERATING RESULTS

BR's operating EBITDA margin has averaged 5% over the last four audited years, while EBITDA margin has averaged a strong 17.1% over the same time period, reflecting significant reliance on investment returns to supplement operations and community benefit programs. BR had 4.2% operating EBITDA and 12.3% EBITDA margins in 2016, compared to Fitch's 'A' medians of 10.3% and 12.6%, respectively. Fiscal 2016 was impacted by two significant factors: start-up expenses of the University Crossing SNF facility which was completed in late 2016 and the lower than projected performance of AmeriCare Home Health agency, which was acquired in 2015. AmeriCare's softer performance to date has been attributed to IT implementation expenses and early changes to management within the service line.

Operating EBITDA margin improved to 5.9% through the six-month interim period, but management is expecting 2017 to continue to be impacted by ramp-up costs at University Crossing and the full integration of AmeriCare. Fitch expects BR's expansion efforts to be accretive to its operations over the medium term, which should improve operating income and help preserve the organization's liquidity position.

DEBT PROFILE

Post refinancing, BR will have the series 2017 and 2015A bonds, as well as one fixed-rate and two variable-rate private placement loans (totaling $83.8 million) with maturities ranging from 2025 to 2033. Pro forma MADS (smoothed for balloon maturities as per the Master Trust Indenture) is $16.2 million and was provided by the underwriters. The refinancing is expected to produce approximately $10.9 million in net present value savings to the organization.

Excluding swaps, BR's pro forma long-term debt composition will be 26% variable- and 74% fixed-rate. The mark-to-market valuation of the swaps was a negative $2.7 million at March 31, 2017 and there is no collateral posting requirement on the largest $87.9 million basis swap associated with the series 2007 bonds. The other variable-to-fixed-rate swaps have collateral posting at $10 million; posting is currently not required.

DISCLOSURE
BR has covenanted to provide quarterly disclosure within 45 days of each fiscal quarter-end and audited financial statements within 120 days of each fiscal year-end to the Municipal Securities Rulemaking Board's EMMA system.

Contact:

Primary Analyst
Dmitry Feofilaktov
Associate Director
+1-212-908-0345
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Olga Beck
Director
+1-202-908-0772

Committee Chairperson
Joanne Ferrigan
Senior Director
+1-212-908-0723

Media Relations: Benjamin Rippey, New York, Tel: +1 646 582 4588, Email: benjamin.rippey@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria

Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017) (https://www.fitchratings.com/site/re/898969)
U.S. Nonprofit Hospitals and Health Systems Rating Criteria (pub. 09 Jun 2015) (https://www.fitchratings.com/site/re/866807)

Additional Disclosures

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