

Fitch Affirms Deborah Heart Lung Center's (NJ) Revs at 'B'; Outlook Stable

Written by Australian Business

NEW YORK--([BUSINESS WIRE](#))--Fitch Ratings has affirmed the 'B' rating on the outstanding \$17.6 million in series 1993 revenue bonds for the New Jersey Health Care Facilities Financing Authority's. The bonds are issued on behalf of the Deborah Heart and Lung Center (DHLC).

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a revenue pledge and a mortgage on DHLC's facility and additionally benefit from a Subsidy Agreement with the Deborah Hospital Foundation (the Foundation), which is obligated to fund DHLC's cash flow requirements, including operating costs, capital needs and debt service payments.

KEY RATING DRIVERS

IRS PROPOSED ADVERSE DETERMINATION REGARDING SERIES 1993 BONDS: The IRS has notified DHLC of a proposed determination that the series 1993 bonds may be subject to taxability due to issues related to DHLC's 2004 total return swap. DHLC made an offer to settle on terms that would not materially impact DHLC's liquidity, but the ultimate outcome of this issue cannot be determined at the present.

FOUNDATION KEY CREDIT STRENGTH: The Foundation exists for the support of DHLC. As such, the rating incorporates the Foundation's commitment to meet DHLC's obligations. The Foundation contributed a total of \$4.5 million to DHLC in the 2012 fiscal year.

STRONG YEAR TO DATE RESULTS AN EXCEPTION: Following a typical operating loss of \$2.4 million in fiscal 2012, offset by the Foundation contribution, DHLC recorded operating income of \$4.3 million for the nine months period ended Sept. 30, 2013 (the

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interim period), aided by a number of non-recurring items.

WEAK LIQUIDITY: DHLC's liquidity at \$7.8 million continues to be a credit concern. However, on a combined basis with the Foundation unrestricted cash and investments were \$26.8 million at Sept. 30, 2013, equal to 68.2 days cash on hand (DCOH), 6.6x cushion ratio and 130% cash to debt.

RATING SENSITIVITIES

FINAL IRS DETERMINATION: A final adverse determination regarding the taxability of the series 1993 bonds, or a settlement which would materially diminish liquidity, could pressure the rating.

CREDIT PROFILE

Deborah Heart and Lung Center is an 89-bed tertiary care cardiac, pulmonary and vascular care facility located in Browns Mills, NJ (approximately 20 miles from Trenton). DHLC had total revenues of approximately \$145 million in fiscal 2012. The rating affirmation and Stable Outlook reflect the continued support of the Foundation and the benefit of the Lourdes Medical Center satellite emergency department (SED) located on DHLC's campus.

IRS PROPOSED ADVERSE DETERMINATION REGARDING SERIES 1993 BONDS:

DHLC has received a Notice of Proposed Adverse Determination from the Department of the Treasury regarding the eligibility for tax-exemption for the series 1993 bonds. This action relates to a total return swap entered into by DHLC in 2004, relating to the series 1993 bonds issue. The swap is no longer extant.

DHLC is not in agreement with certain findings made by the Department of the

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Treasury regarding the swap. DHLC had received a legal opinion from a nationally recognized law firm prior its execution and is in the process of negotiating a potential settlement. No determination as to the final outcome can be made at this time. Fitch will continue to monitor the situation and take rating action as necessary.

FOUNDATION KEY CREDIT STRENGTH:

The Foundation raised \$4.7 million in fiscal 2012 and \$3.4 million through Sept. 30, 2013. The interim period included \$2.6 million of proceeds from a New Jersey Stabilization Grant program (which is being terminated) as well as \$375,000 from the Robin Hood Foundation and a portion of a large estate, resulting in the interim period fundraising exceeding budget.

Because of accounting regulations, some of the amounts being reported as other operating revenue for DHLC are funds that were raised and recognized as revenue by the Foundation and transferred to DHLC as donor restricted contributions. It is expected that the Foundation will transfer \$4.7 million to DHLC by year end 2013, as planned, despite DHLC's strong operating results to date.

The Foundation has redirected its focus towards more structured development efforts, including corporate giving, direct mail and estates and planned giving, intended to replace what had traditionally been its grassroots fundraising effort relying on a large number of small individual supporters.

Combined DHLC and Foundation unrestricted cash through the end of the third quarter was reported at \$26.8 million, equating to 68.2 DCOH, cushion ratio of 6.6x and cash equal to 130% of debt (DHLC alone had cash and investments of only \$7.8 million). This figure is not adjusted for a \$1 million draw on a line of credit which is secured by a DHLC certificate of deposit and has perpetually remained drawn at \$1 million.

STRONG YEAR TO DATE RESULTS AN EXCEPTION

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DHLC's patient revenues increased by 3.4% in fiscal 2012, which ended with a \$2.4 million operating loss (negative 1.7% operating margin). As is typical, the Foundation contribution of \$4.5 million partially offset the operating loss, resulting in excess income of \$2.4 million. For fiscal 2012, DHLC reported maximum annual debt service (MADS) coverage by EBITDA of 2.0x. Net patient revenues through the interim period remained level with the prior year, but because of significantly higher other operating revenues, total revenues increased by 6.6%, resulting in operating income of \$4.3 million (3.7% operating margin). This is atypical for DHLC, which usually incurs an operating loss as it accepts all patients, regardless of insurance status.

Additional revenue pressure in the coming year and beyond comes from high exposure to Medicare, which represents over 50% of gross revenues. The interim gain was the result of several one-time items, as described above, and DHLC is likely to budget an operating loss for the next fiscal year. Coverage of (MADS) was a stronger 3.0x though the interim period, even before the Foundation transfer expected by year end.

WEAKER VOLUMES

After strong volume growth reported last year, for the interim period DHLC's utilization is showing some weakening. DHLC continues to benefit from the Lourdes Medical Center satellite emergency department (SED) located on its campus, which is owned and operated by Our Lady of Lourdes Health System (Lourdes), part of CHE Trinity Inc. (Fitch rated 'AA/F1+'), following the May 2013 Catholic Health East and Trinity Health merger. The SED generates between 25-30% of DHLC inpatient volumes.

Year to date admissions decreased by 13% and cardiac catheterizations were 2.9% lower compared to the prior year period, responsible for the flat year to date patient revenues. However, open heart procedures remained level with 204 open heart procedures performed through the third quarter. DHLC's plans for boosting revenues include a potential second site for the Joslin Diabetes Clinic, a wound center, launching a bariatric surgery program and equipping a hybrid operating room, which would allow performing complex cardiology procedures.

DISCLOSURE

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DHLC covenants to disclose only annual audited financial information (within 120 days) to the Municipal Securities Rulemaking Board's EMMA system, which Fitch views negatively. However, Fitch does note that DHLC's bond covenants date back to documents produced in 1993 when the expectations for disclosure were not as thorough. Currently, DHLC does provide unaudited interim quarterly and annual audited information to the trustee and the New Jersey Health Care Facilities Authority as well as to bondholders upon request.

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

Applicable Criteria and Related Research:

--'U.S. Nonprofit Hospitals and Health Systems Rating Criteria' (May 20, 2013).

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U.S. Nonprofit Hospitals and Health Systems Rating Criteria http://www.fitchratings.com/cr/ediddesk/reports/report_frame.cfm?rpt_id=708361

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