

# MUNICIPAL CREDIT REVIEW

## JANNEY FIXED INCOME STRATEGY

August 30, 2010



### Underlying Ratings

Moody's: No rating  
Standard and Poor's: No rating  
Fitch: No rating

### Security

Pledge of revenues  
Mortgage lien on certain property  
Debt service reserve fund

### Use of the Bonds

The Series A of 2008 bonds financed an expansion and renovation project, refunded outstanding bonds and paid for a swap termination fee.

### Issuer Description

The bonds were sold by The Brethren Village Retirement Community. Brethren is a 96-acre continuing care retirement community located in Lancaster, PA which serves approximately 700 residents. It provides a continuum of care, aligned with conservative Christian values and has had a long-standing presence in the Lancaster community going back to 1897.

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## Brethren Village CCRC

**Issuer: Brethren Village Continuing Care Retirement Community through the Lancaster County Hospital Authority, Pennsylvania**

### Revenue Bonds

### CREDIT STRENGTHS

- Brethren has a long standing presence in the area. The development consultant (Greystone) was not the driving force behind the project.
- Very strong independent living (IL) occupancy rate record before the 2008 expansion (98% or higher from 2003-2008).
- 130 pre-sale reservations have been made on the new independent living units. That is 96% of the 135 new units and 15 above the June covenant requirement.
- Construction is almost completed and has been on schedule and at or under budget. Only the last phase remains which includes the new assisted living (AL) facility which is scheduled and on target to be completed in Aug. 2010 and operating by Nov. 2010.
- Other positive factors for Brethren include: the recent addition of life-care contract options and Greystone's experience as a development consultant.

### CREDIT WEAKNESSES

- Elevated fill-up risk due to difficult economic environment. Brethren is currently in violation of its occupancy covenant by seven units. 101 of the 135 new IL units are occupied as of June 2010. Occupancy has been below the requirement since Oct 2009.
- Financial performance as measured by the operating ratio (operating expenses/operating revenue) was 113.28% ending Dec 31, 2009. This result was better than the adjusted 116.70% covenant requirement but higher than the most recent Fitch "BBB" median of 99.60%.
- Liquidity as tracked by the day's cash on hand (total cash/daily operating expenses) ratio came in at 251 days as of Dec 31, 2009. This was 72 days lower than 323 forecast in 2008 but still above the 120 day covenant requirement. The most recent Fitch BBB median was 336 days.
- The average standard entrance fee of \$227,000, is higher (by \$41,000) than the average sale price of a house in Lancaster County as of the first quarter of 2010. 75% of the new residents are from the Primary Market Area (PMA), with the other 25% in close proximity to the PMA.
- The local area is very competitive with thirteen continuing care retirement facilities in or very close to the PMA.

### CREDIT SUMMARY

Falling real estate prices, lower investment portfolio valuations and the broader economic downturn have negatively impacted recent fill-up of new independent living Continuing Care Retirement Community (CCRC) units. Brethren, has also experienced a slow-down in demand, like the broader CCRC market. Occupancy has lagged behind requirements and Brethren submitted a required Corrective Occupancy Plan on June 30, 2010. The plan identified incentives management is using to persuade potential residents to sell their existing homes and place deposits on Brethren's units. However, the project remains exposed to the destructive economic forces which were not contemplated at the time of the 2008 financing.

Brethren remains exposed to the negative economic forces which were not contemplated at the time of the financing such as falling real estate prices, lower investment portfolio valuations and the broader economic downturn.

CCRCs include an elevated level of risk based on limited revenues and a higher default probability. Investors should be prepared to regularly follow CCRC's financial results, especially in the current economic environment.

There was \$14.8 million of available funds as of March 31, 2010 to pay off the \$10,000,000 July 1, 2012 intermediate bond maturity.

Home and investment portfolio values have fallen and are unlikely to return to pre-2007 levels in the near term. Potential residents are waiting for just that type of recovery to occur before committing to the community. Therefore, the near term viability of the project is and will remain linked with the economic recovery and the ability of Brethren's management to balance financial performance after the project's completion. If rated, this credit would be below investment grade, in our opinion, due to speculative characteristics including a structure which relies heavily on new unit entrance fees and its recent negative financial performance.

## GENERAL DISCUSSION

### General Discussion of Continuing Care Retirement Facilities

CCRCs are senior housing retirement living facilities/communities which cater to the changing life-stages of its residents, who are generally over the age of 75 (Brethren requires a resident to be at least 62 years old). Typically, CCRCs provide housing and defined health-care plans pursuant to an agreement for a resident's life or other contractually agreed upon time period. Accommodation types differ in size and range from smaller communities, which may be little more than a stand-alone apartment complex, to large multi-acre campuses with apartments, townhouses and single-family homes. Regardless of the residential accommodations and amenities, CCRCs are known to offer a "continuum of care" which includes independent living "IL" accommodations, access to Assisted Living "AL" and healthcare/skilled nursing facilities "HC." It is this range of care options which distinguishes CCRCs from other housing options for residents while allowing them to remain in one place and move to higher levels of care within the same community as needs arise.

CCRC bond issues offer a method to invest in projects which are dependent upon demographic changes, the real estate market, the delivery of health-care care services, and actuarial risk among other factors. These higher yielding investments include an elevated level of risk based on limited revenues and higher default probability compared to traditional municipal bonds. It is this higher level of risk that causes Janney Fixed Income Strategy to believe investors should proceed with caution when considering investment in these bonds but also be prepared to receive a higher return for the inherent risk. Keeping this risk in mind, we believe this is an area of municipal bond investing which can offer diversification away from traditional municipal bond options. But, investors should be prepared to regularly follow CCRC's financial results, especially in the current economic environment. Many CCRCs will file regular disclosure reports with the Municipal Securities Rulemaking Board (MSRB) and these disclosure updates are posted on the MSRB's Electronic Municipal Market Access (EMMA) data base.

### Sign up for Disclosure Alerts on EMMA

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## BRETHREN VILLAGE PROJECT UPDATE AND CREDIT DETAILS

There are two broad types of CCRC financings. The first are new or start-up project financings where all proceeds are used to build completely new facilities. Other types of CCRC financings use bond proceeds for expansion and/or updates. This second type is typically less risky, as in the case of Brethren Village's most recent project. It is usually more difficult to start a community from scratch, than to expand or update one.

It has been positive news that the renovation and expansion to Brethren Village has proceeded on or very close to its original schedule. The update and addition to the existing Fieldcrest independent living facility, the new welcome center, and healthcare center additions were completed in 2009.

### Summary of Brethren Village Units

Category	Units Prior to Expansion	Change Due to Expansion	Total Units After Expansion
Independent Living Units	407	109	516
Assisted Living Units	79	61	140
Healthcare Center Units	175	-55	120
<b>Total</b>	<b>661</b>	<b>115</b>	<b>776</b>

Source: Brethren Village & Janney FIS.

Brethren's 1.10x debt service coverage (dsc) ratio requirement does not take effect until June 2012 (1.20x June 2013 and after). The community's dsc ratio was approximately 1.30x for nine months ending March 2010, which includes entrance fees from the new IL units. Achievement of the dsc ratio requirement will depend on Brethren's ability to balance financial performance after the project's completion.

Occupancy rates and financial performance of both new and expansion CCRCs have suffered during the recent economic downturn. Many have not achieved their occupancy goals.

The addition of a life care option introduces additional risks to bond holders because of the uncertainty of future health care costs and actuarial risks.

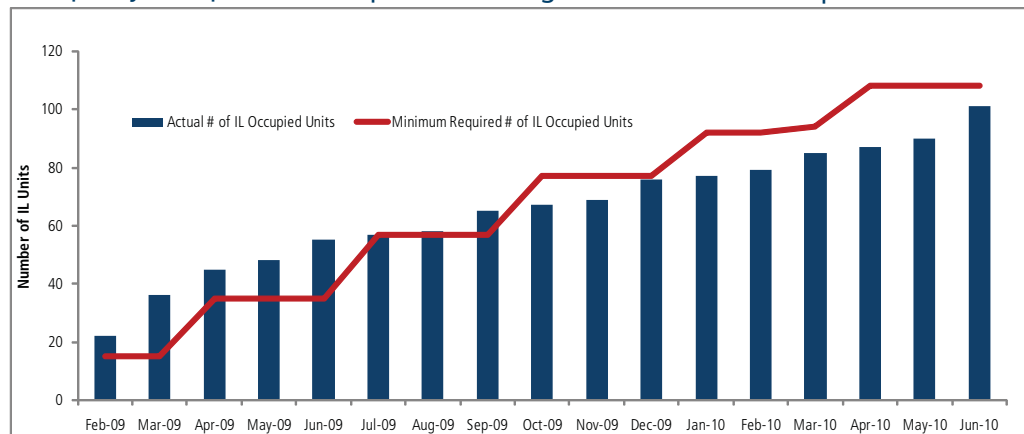
The new assisted living facility, the final phase of the expansion, is scheduled to conclude in August 2010 and should receive final certifications and be ready for use by November 2010. Brethren's renovation and expansion was partly initiated in response to changing market demand for updated IL units and because management believed it was a priority to change the make-up of the unit categories. The number of units within each category was shifted to a more traditional business model as shown in the table on page 2.

### Brethren Village's Occupancy

CCRC industry occupancy rates and financial performance of both new and expansion CCRCs, especially those undertaken 2005 to date, have suffered during the recent economic downturn. Many have not achieved their occupancy goals. Resident CCRC demand has stalled because many potential residents are hesitant to sell their current homes in the down real estate market. This hurts occupancy, could potentially put a strain on facility operations and may cause the organization to dip into reserves to subsidize every day business. In extreme cases, occupancy problems can lead to covenant defaults or even missed bond payments.

June 2010 occupancy data for Brethren's new IL units show there are 101 occupied independent living apartments, seven less than are required by the June indenture occupancy covenant. Brethren's occupancy is being affected by the general overall trends affecting the rest of the CCRC market but it is only slightly behind its requirements. Occupancy for the pre-existing units has been in the 97% and 99% range since Brethren's new project was undertaken in 2008.

### Occupancy in Expansion Independent Living Units is Below its Requirement



Source: Brethren Village Disclosure.

### Resident Contracts, Entrance & Monthly Fees and Discounts

Notable among management updates, in addition to the physical updates and expansion are the new resident contract choices. Historically, Brethren offered only fee-for-service contracts. Residents can now select from one of four options. This adjustment in resident contracts offered is a positive for marketing to potential residents. The most notable was the addition of a life care option, or option for a resident to move from IL, to AL to HC as needs arise. However, the life care option introduces additional risks to bond holders because of the uncertainty of health care costs and actuarial risks.

### Resident Contract Options for New IL Units

Resident Contract Plan	# of Reservations	%
Option 1) Life care and full resident services	45	35%
Option 2) Life care and limited resident services	48	37%
Option 3) Defined healthcare and full resident services	16	12%
Option 4) Fee for healthcare and limited resident services	21	16%
<b>Total</b>	<b>130</b>	<b>100%</b>

Source: Brethren Village disclosure.

Entrance fees for the new IL units are near a higher price-point considering the average sales prices of the surrounding area.

Entrance fees for the new IL units range from \$172k for a one bedroom unit to \$342k for a two bedroom. The average entrance fee is \$227k, a high price-point considering the average sales prices of the surrounding area. Residents must also pay a monthly fee which ranges from \$1,445 to \$3,095, depending upon the contract selected or incentives offered. There are now several entrance fee refund options in a case where a resident terminates a contract or in case of the death of a resident. Choices include options offering a 90% entrance fee refund or lower percentage refunds down to a 0% refund. The lower refund percentage options reduce the upfront or monthly fees. New marketing incentives include deferral plans, moving expense subsidies and entrance fee discounts of up to 10%. In the current economic environment many CCRCs, such as Brethren, are being forced to offer incentives and discount fees when faced with lower than anticipated occupancy.

### Debt Service Reserve Fund and Additional Indebtedness

The Series A of 2008 issue's debt service reserve fund (DSRF), the money set aside and held by the trustee, offers bondholders additional protection during times when revenues might fall below debt service requirements, currently has a balance of \$8.4 million, equal to maximum annual debt service. It is invested in a money market equivalent investment bearing minimal interest. We do not anticipate additional bonds being sold in the near future.

### CONCLUSION

While Brethren is in one of the higher risk sectors of the municipal bond universe its credit is near the middle of the CCRC risk spectrum. Brethren's long standing presence and positive financial results prior to 2008 are key strengths. We believe Brethren's near term performance and viability rests with potential residents' reaction to the broader economic situation and management's ability to balance future financial performance. If housing prices and investment portfolios rise, then occupancy could strengthen and remain stable. But, Brethren's financial performance could suffer if the economy takes a "double dip" or if it remains contracted for a long period of time.

The Series A of 2008 issue's \$8.4 million DSRF offers bondholders additional security during times when revenues might fall below debt service requirements.

### Summary of Series A of 2008 Bonds

Maturity	Original Par Amount (\$)	Coupon	Price at Issue	Optional Call	CUSIP
7/1/2008	\$85,000	4.40%	100.000%	Matured	514045 YM9
7/1/2009	860,000	4.60%	100.000%	Matured	514045 YN7
7/1/2010	905,000	4.90%	100.000%	Matured	514045 YP2
7/1/2011	955,000	5.10%	100.000%	None	514045 YQ0
7/1/2012	1,005,000	5.25%	100.000%	None	514045 YR8
7/1/2013	1,560,000	5.50%	100.000%	None	514045 YS6
7/1/2014	1,650,000	5.60%	100.000%	None	514045 YT4
7/1/2015	1,740,000	5.75%	100.000%	None	514045 YU1
7/1/2016	1,840,000	5.80%	100.000%	None	514045 YV9
7/1/2017	1,945,000	5.85%	100.000%	None	514045 YW7
7/1/2012	10,000,000	5.20%	99.918%	7/1/10 @ 101%	514045 ZC0
7/1/2019	4,245,000	6.00%	100.000%	7/1/17 @ 100%	514045 YY3
7/1/2022	7,375,000	6.10%	99.710%	7/1/17 @ 100%	514045 YZ0
7/1/2026	12,140,000	6.25%	99.024%	7/1/17 @ 100%	514045 YX5
7/1/2030	15,505,000	6.375%	99.228%	7/1/17 @ 100%	514045 ZA4
7/1/2040	60,905,000	6.50%	100.064%	7/1/17 @ 100%	514045 ZB2
<b>\$122,715,000</b>					

Source: Brethren Village Series A of 2008 official statement and Janney FIS.

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Stable: Janney FIS believes there are factors which point towards stable issuer or sector credit quality which are unlikely to result in either potential credit ratings upgrades or downgrades.

Cautious: Janney FIS believes there are factors which introduce the potential for declines in issuer or sector credit quality that may result in potential credit ratings downgrades.

Negative: Janney FIS believes there are factors which point towards weakening in issuer credit quality that will likely result in credit ratings downgrades.

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Marketweight: Janney FIS expects the target asset class or sector to perform in line with the comparable benchmark (below) in its asset class in terms of total return

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Agencies: Janney FIS ratings employ the "Barclay's U.S. Agency Index" as a benchmark.

Mortgages: Janney FIS ratings employ the "Barclay's U.S. MBS Index" as a benchmark.

Investment Grade Credit: Janney FIS ratings employ the "Barclay's U.S. Credit Index" as a benchmark.

High Yield Credit: Janney FIS ratings for employ "Barclay's U.S. Corporate High Yield Index" as a benchmark.

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