LTC Properties, Inc.
"Third Quarter Analyst and Investor Call"

Friday, November 9, 2012 11 AM ET
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Pam Kessler
Clint Malin
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OPERATOR: Good morning and welcome to the LTC Properties Incorporated Third Quarter Analyst and Investor Call. All participants will be in listen-only mode. Should you need assistance, please signal our conference specialist by press the "*" key followed by "0". After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on a touchtone phone, to withdraw your question, please press "*" then "2".

I'd like to remind everyone that today's comments including the question-and-answer session will include forward-looking statements. These statements are subject to risks and uncertainties that may cause actual results and events to differ materially. These risks and uncertainties are detailed in LTC Properties Incorporated filings with the SEC…I'm sorry, the Securities and Exchange Commission, including the company's 10-K dated December 31, 2011. Please note this event is being recorded.

I would now like to turn the conference over to Wendy Simpson, CEO and President. Please go ahead.

WENDY SIMPSON: Thank you Laura. Hello and thank you for joining us today. The presentations today will being with Pam Kessler, our Executive Vice President and Chief Financial Officer who will comment on our financial results and operating…and our operator coverage statistics. Pam.

PAM KESSLER: Thank you, Wendy. Revenues, I am going to compare second quarter to third quarter and I'll refer you to the 10-Q for year-over-year results. Revenues increased in the third quarter approximately $700,000 due to $1.1 increase…$1.1 million increase in rental income to acquisitions partially offset by interest and other income decrease of $390,000 due to the receipt of $347,000 in the second quarter related to the Sunwest bankruptcy settlement, and a decrease in interest income resulting from the Skilled Healthcare Group bond redemption.

Interest expense increased $984,000 due to an increase in debt outstanding during the third quarter and higher borrowing costs associated with the $85.8 million senior unsecured notes that we sold in the third quarter as compared to short-term floating rates on our line of credit.

Acquisition costs increased $64,000. Operating and other expenses decreased approximately $300,000 due to the general timing of marketing and public company expenditures. Net income available to common shareholders decreased $611,000 due to higher interest and depreciation expense partially offset by the increased revenues resulting from acquisition.

Normalized fully diluted FFO per share was $0.57 this quarter compared to $0.50…$0.56 last quarter. Normalized fully diluted FAD per share was $0.56 this quarter and last quarter.

Turning to the balance sheet, during the quarter we acquired two 144 bed skilled nursing properties in Ohio for $54 million and a 90 bed skilled nursing property in Texas for $6.5 million. Both of these transactions were disclosed as subsequent events last quarter. Subsequent to September 30, we acquired a vacant parcel of land in Kansas for $730,000. Clint will discuss this transaction in a few minutes and I will refer you to the subsequent events footnote in the 10-Q that was filed yesterday for the development funding and rental rate details.

During the quarter, we invested $1.9 million in development and capital improvements at a weighted average yield of approximately 9.2%. During the quarter, we received approximately $480,000 related to the payoff of a mortgage loan and $620,000 in scheduled principal payments on mortgage loans receivable. Recently we received a prepayment notice from a borrower who holds seven mortgage loans secured by seven assisted living properties with a weighted average interest rate at 12.1%. We expect to receive $15.2 million in principal later this month related to the payoff of this loan. During the quarter, we funded $441,000 under other notes receivable.

During the quarter, we sold $85.8 million of senior unsecured notes in a private placement transaction. The notes bear interest at 5.03%, mature in 2024 and have annual scheduled principal payments of approximately $17.2 million in years eight through twelve. The proceeds of this transaction were used to pay down our unsecured line of credit and for acquisition.

At September 30, we had $35.5 million drawn and $204.5 million available under our line of credit. Subsequent to September 30, we repaid $6 million and therefore, have $29.5 million drawn and $210.5 million available on our line…unsecured line of credit. Additionally, we have a $100 million available under our shelf agreement with Prudential. This $100 million of unsecured debt is available to us at any time subject to customary bring down due diligence and will price at the market the day we lock rate.

With LTCs incremental long-term borrowing costs at approximately 5%, we continue to be very competitive on pricing for newer assets located in top markets. During the quarter, our limited partner redeemed a total of 3,294 shares in our limited partnership. We elected to satisfy this redemption through the issuance of 3,294 shares of common stock.

During the quarter, we received $1.2 million related to stock option exercises. During the third quarter, we paid $14.7 million in preferred and common dividends. During the third quarter, we increased our monthly common dividend from 14.5 cents per share to 15.5 cents per share.

In discussing operator statistics, I'll give the general caveat that these numbers come from our operators, are unaudited and have not been independently verified by us. Additionally, the occupancy and lease coverage information is for the trailing twelve months second quarter 2012 compared to the trailing twelve months first quarter 2012.

Occupancy in our same-property ALF portfolio was flat at 78%. Excluding properties leased to assisted living concepts and extended care, occupancy in our ALF portfolio was 88%. EBITDAR lease coverage after a 5% fee was 1.4 times. Before management fee, or EBITDARM coverage was 1.6 times.

Occupancy in our same-property SNF portfolio was 79%. EBITDAR lease coverage after a 5% management fee was 1.8 times. Before management fee or EBITDARM, coverage for our SNF portfolio was 2.5 times.

Occupancy in our same-property portfolio of properties that provide independent living or a combination of independent living, assisted living, and skilled nursing was 86%. EBITDAR lease coverage after a 5% management fee was 1.3 times. Before management fee or EBITDARM coverage was 1.7 times.

The underlying payer mix for the three months ended June 30 for our same-property portfolio, which includes skilled nursing, assisted living, independent, and properties with a combination thereof was 60% private pay, 14% Medicare and 26% Medicaid. Within our same-property SNF portfolio, the underlying payer mix was 25% private pay, which includes managed care and other insurance, 25% Medicare and 50% Medicaid.

I will turn the call back to Wendy.

WENDY SIMPSON: Thank you Pam. Clint Malin, our Executive Vice President and Chief Investment Officer will discuss our current deal flow and pipeline.

CLINT MALIN: Thank you Wendy. 2012 has been a good year for us so far with continued growth of newer assets and development projects. As Pam mentioned, subsequent to the second quarter, we closed our land acquisition in Wichita, Kansas and concurrently entered into a lease agreement making a $9.9 million investment commitment to fund construction of a two story 77-unit combination assisted living, memory care facility. Our lessee is an affiliate of Oxford Development Holdings based in Wichita, Kansas. They currently own and operate two senior housing facilities and manage two additional facilities on a fee-per-service basis, providing assisted living and memory care services. Three of the four facilities are located in the Wichita market, so they are well versed in that local market. Senior management at Oxford has extensive experience in both development and operations of senior housing facilities previously working with or for larger operating companies in the industry. We are very excited about entering into this new relationship with Oxford and look forward to future growth opportunities with them.

Construction on the Wichita project commenced immediately following our land acquisition with a conservatively-estimated completion date of January 2014. This project continues to diversify our private pay assets and increases to eight the number of properties we own in Kansas.

Our pipeline is very strong and remains consistently above the $150 million mark. As expected, we have seen an uptick in deal flow in the second half of the year with a noticeable increase following the NIC conference that was held in September. Currently we have three letters of intent that are fully executed by LTC and other parties. We are in the process of conducting due diligence on these three transactions; and subject to a successful completion of due diligence and execution of definitive agreements, it is possible to close some or all three transactions by year-end.

We are actively negotiating LOIs on other transactions in the pipeline, which consist of unique off market opportunities. The following seven points will provide some detail regarding the composition of our pipeline. First, the pipeline consists of both development opportunities and acquisitions. Second, the development projects consist of a mix of skilled nursing, free standing private pay memory care and assisted living memory care combination facilities. Third, the pipeline is mainly comprised of acquisitions and on balance sheet construction funding, but includes a couple of loans, which in one case is for a development project giving LTC a purchase option exercisable upon stabilization of the property. Fourth, the properties and land sites are located in six different states. In five of the states we currently hold investments, and the asset in the new state will be added to an existing master lease. Fifth, the pipeline consists of both new relationships to LTC as well as existing relationships adding properties to master leases. Sixth, the original dates of construction are no older than 1999 in all existing operational properties we are looking at in the pipeline. And lastly, with the exception of one property, all are located within a top 40 MSA.

Our pipeline is reflective of our focus on acquiring newer more modern assets, expanding our development funding program, increasing diversification of private pay assets, cultivating follow on deals with existing customers, and continually working to establish new relationships with experienced healthcare operators in the senior housing and long-term care space.

Given the current market, we are very optimistic about future growth opportunities for the company and we look forward to announcing deals as they are converted into executed transactions. Wendy.

WENDY SIMPSON: Thank you, Clint. Andy Stokes our Senior Vice President of Marketing and Strategic Planning has some comments on our specific marketing efforts and what he perceives as the broader market available to LTC. Andy.

ANDY STOKES: Thanks Wendy. When I talked to you guys about a year last time, I was very sanguine. I said at that time that things were about as good as I had ever seen them in over twenty years of doing this, and they are at least that good now. I am still very optimistic. There's a lot of churn out there. Market was kind to us in 2012. We expanded on our memory care efforts and our development efforts and the trend that I see there is increased availability to us in terms of having met more people, the developer operator combination. In doing underwriting, you can't have…just have a good operator, you can't just have a good developer. You have to have both. Sometimes that's a team with two, sometime it's that skill resides in the same company, but we are finding more of those. More of them are emerging and we are getting a little bit smarter about where to find them which includes some of the smaller gatherings around the country.

Market prices for SNFs over the last probably six months I think have softened. Newer assets continue to do well, but there is a very large stock of very older, much older assets. We don't own very many of those, very, very few. But there are some and those prices seem to be weaker, and newer assets are…the newer SNF assets are holding up pretty well, but even that price is a little soft and those deals have slowed down a little bit.

Assisted living prices for multi-facility deals are higher and there are still some good deals available, but with our conservative underwriting, we tend to not get as many of those unless it was a special circumstance. But we do look for the special circumstance and we are able to find some of them.

Independent living around the country is doing better. They just kind of caught up with a lot of markets. There was a lot building coming online two or three years ago and that seem to have worked its way through. One of the things that is a change for us is we are kind of going uptown with our marketing, spend more. I spend more and approve more and we go to more expensive events. Partly this is due…the operators have more money to spend to be successful. Just five years ago, people were crying the blues, and now they have a little more money to spend so they are going…they are not going maybe to the Hyatt, maybe more often they are going to the Four Seasons. Well that's not all bad news for me, because I am often there. But we still spend a lot of our time in places like Taunton, Massachusetts, and Tukwila, Washington. There's a lot of deal enthusiasm there, a lot of new faces. The older group of operators that I kind of grow up with, they are kind of older and newer faces are evolving; newer people are starting new businesses. We've put a lot of effort into meeting those folks, working with them on state profits committees, putting their efforts with our operators to try and develop more business and touched on our rate pricing, I'd like to comment on that a little bit at length.

I've heard people say out in the field, but you guys have to grow really fast or you can't…you won't be able to compete on a cross capital basis with the big guys. And from… when I look at our deal flow and our deal risk, and the way Clint and. I work together in handing things back and forth; I believe we can compete on rate basis with anybody. I've gotten form the deals that we have had in the last two or three years at least half of them and maybe more were in direct competition with mega caps. The big three plus others that are maybe…that are in…extensively in our field. We are conservative about what we will pay for the building. We will continue to be that way because that's our best mitigator of risk. However, if it's just a matter of the price, the rate we can do, we can beat these guys and we've done it, so that's the evidence that I am not just making this up.

So I am looking forward to the next couple of years very happily, I think that there is going to be a lot of business. I think there is going to be a lot of assisted and skilled and memory care especially that we develop.

WENDY SIMPSON: Thank you, Andy. In the last several weeks Pam and I have had the opportunity to visit with various current investors and potential investors. We are listening closely to their questions and with Pam communicating very actively with our analysts who cover LTC, we are continuing to provide more and more detailed information about our company to assist analysts and investors in their evaluations of LTC as it is now and how we are directing our efforts for LTC's future.

In our supplemental, we now separately show acquisition deals that total $81.7 million so far this year and development, redevelopment and expansion deals, which total about $40.6 million so far this year. The underwriting and due diligence of the $40 million of expansion in redevelopment is often more extensive and costly than the sale leaseback transaction. This level of activity is not immediately accretive, but about $30 million of this will begin generating revenue some time in 2013. Estimated completion dates are conservatively stated in our supplemental and I think all of the operators are hoping to open in advance of the completions we show on the schedule in the supplemental.

We also provided recent photos of two construction projects already underway. We will provide additional photos on our website as these and other projects progress. Additional new information is in a pie chart on page thirteen of our supplemental, showing the percentage of LTC's investments by MSA. We believe that analysts and investors have the impression that LTC's assets were predominantly rural.

This chart shows that 33.1% of our assets are in the top 31 MSA's and 22% are in MSA's, 32 to 100, only 4.6% of our investments are not in an MSA, a designated MSA. And as Clint said, the transactions we are working on currently are primarily within the top 40 MSA groups.

Since the first of the year, we've reduced our concentration to our three largest operators by a total of 3%. Successful completion of transactions in the pipeline and bringing some development projects online will additionally diversify our investments and revenue sources. Also at the present time, the majority of our pipeline represents private pay assets that would return our portfolio closer to the 45% - 55% profile of invested assets in private pay and skilled nursing.

Our analysts and investors and potential investors continue to focus great attention on our assets leased to Assisted Living Concepts and Extendicare. On page sixteen of our supplemental is some summary disclosure that we have given verbally several times. Of note on this supplemental page is that these properties cover 1.2 times after a 5% management fee. In addition, please go to our website, click on properties, then click on ALC/EXE and you can see recent photos of each of these properties. These photos were taken by our employees when they have made recent property reviews and are not professional photos. But hopefully, they will dispel any notion that these properties are in poor repair.

I am sure many of you have listened to the ALC conference call. Dr. Roadman, the Interim CEO, discussed many improvements that he and his team have implemented and will implement at ALC. They indicated that they are making progress with mending relationships with regulators, employees and residents. They are hiring more caregivers, holding open houses and spending capital to improve properties. We are carefully monitoring the capital being spent on our properties and ALC has been cooperative in addressing our requests. We will ensure that our properties are well maintained in accordance with the provisions of our leases and which are the joint and several obligation of ALC and Extendicare.

Dr. Roadman indicated that ALC is considering some strategic initiatives, one of which was a possible sale of seven owned New Jersey properties. We lease one property to ALC Extendicare in New Jersey. ALC has no authority to include our property in a disposition transaction, nor have they requested that we consider it.

Mark Hemingway, our Vice President of Investment and Asset Management Executive was in Millville, New Jersey last Friday, right after Hurricane Sandy. At that time, the property had only two vacant units with one expected admission. They had purchased new dining room furniture and new living room furniture. I reviewed Mark's report and his photos of some of the interior areas of the building and it's obviously greatly improved since his prior visit earlier this year. Mark made note that the Executive Director returned in July after having been gone four months perhaps because of displeasure with prior ALC senior management. Mark also notes…made a note to go back and assess the roof that had two leaks and may need replacement, but generally the building appears to be in an improvement mode.

As I have said in the past and I reiterate now, there is now reason to assume that LTC will not collect all rents due us under our two master leases with ALC/Extendicare. ALC disclosed in their 10-Q that they might…may violate debt covenants at year-end. Our leases with ALC/Extendicare do not provide that this potential default will be a default under our leases. ALC also stated in their 10-Q that it is working to get waivers. ALC is selling assets. It could give more security to the banks. It could pay higher interest. There appear to be ways to negotiate a waiver. I believe banks in general are not in a panic mode and are willing to work with borrowers.

In this environment where banks have liquidity and the borrower is in a verifiable turnaround situation, it seems counterproductive to put undue stress on a customer. And I stress again, LTC can and will look to Extendicare for any short-fall in rent or capital expenditures. There is no reason to believe that the assets will be in a diminished physical condition at the termination of our master leases. There is no reason to believe that LTC will not be able to collect the same if not more rental income when the master lease terminates on the properties that are now covering 1.2 times after a 5% management fee and have been operated under a challenging turnaround environment. Perhaps we will see some reduction in the coverage ratio for the next twelve months…next trailing twelve months as ALC adds staff and expands…and expends maintenance dollars, but all of that should only improve occupancy and cause coverage again to increase.

Pam mentioned that we received notice of an early payoff of a $15 million loan. This is approximately a year earlier than its due date, but was within its prepayment window. While we will not…while we did not anticipate early payment of this particular loan, the low interest rate environment provided the borrower with an attractive option and we could not and would not meet that rate. The anticipated $15 million in proceeds will be used to pay down our bank line that's currently at $29.5 million. Until we can request re-invest these proceeds plus additional funds, this early pay off will have approximately $0.01 of negative FFO impact for 2012 results, assuming no additional investments that are accretive for 2012.

Should we convert some of our pipeline into funded deals within the next few months, we would use our line to make these investments. Rather than look at more permanent expensive financing early in the year in 2013, we may look to expand our line by an additional $60 million.

It continues to be our strategy to have our debt-to-market cap be no more than 30:70; and right now we have the liquidity and the debt capacity to fund additional accretive transactions and development. When we do projections internally, we have traditionally not included acquisition costs as FFO expense. Because of the GAAP requirement to expense these costs which in the most part are added to investment basis for rent calculations, we've absorbed about $0.01 in reduced FFO year-to-date, compared to what we were looking at…projecting at the beginning of the year.

There is significant activity right now, as Clint said, in push to close transactions — accretive transactions before year end and we look forward to being able to announce the additional positive news.

With the changes in tax law coming possibly under the Obama administration, we may look at personal tax planning within the management group. I am not saying any of us are selling stock before the end of the year, but if people decide to sell stock before the end of the year, it's going to be because of tax planning and not because of issues with LTC. I just want to put that out there since any small selling of stock seems to be of concern. Without any additional accretive incremental investments or incremental acquisition costs, our current projected 2012 fully diluted FFO per share is around…still around 225 to 226.

Thank you for your attention today and listening to our presentation. Laura, I'll now open up for questions.

Q&A

OPERATOR: Certainly. At this time, if you would like to ask a question, please press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pickup your handset before pressing the keys. If at any time your question has been answered and you would like to withdraw your question, please press "*" then "2." At this time, I will pause momentarily to assemble our roster.

And our first question comes from James Milam of Sandler O'Neill.

JAMES MILAM: Good morning, guys. Thanks for all the extra disclosure and dialogue, Wendy. I appreciate that. I guess first question just following up on your guidance commentary, I thought the prior range was 226 to 228 so when you said 225 to 226, that's essentially the same range, but accounting for the mortgage prepayment, is that the right way to think about that.

WENDY SIMPSON: That is correct.

JAMES MILAM: Okay, thanks. And then I guess I'll ask this one as well. You talked about potential coverage declines for the ALC leases from the 1.2 times. I think that's a trailing twelve number from June, I am just curious if you have any sort of quantitative measure of how that coverage has trended through the summer?

WENDY SIMPSON: No we don't. We don't have any current information on operations from our properties.

JAMES MILAM: Okay. And then on the three letters of intent, can you give us the dollar amount for possible invested capital, and are those stabilized assets? I think Clint went over this, but are they stabilized or potential development properties?

CLINT MALIN: Those LOI's are both for development and stabilized acquisitions. You know right now we are under confidentiality agreements, and you know, we are going to due diligence. So not able to give a range right now for a transaction, but we do look at, you know, various sized transactions and as we progress further, and you know, we can bring these to, you know, definitive documents and we are in a position to go ahead and announce, then we will be able to go ahead and provide more detail.

JAMES MILAM: Okay. I guess just one last quick one. There was a potential $10 million SNF disposition before the end of the year. Do you guys have an update on the status there?

CLINT MALIN: We've talked to the tenant and they are actively working on finding financing to exercise the option. They have given us the impression that they think it will be likely, I am not exactly sure what date that will be, but they have until March 31 to accomplish that.

JAMES MILAM: Okay.

WENDY SIMPSON: But right now we haven't received any request to get the documents together for any legal, okay so it's unlikely it will happen before year end.

JAMES MILAM: Okay, got it. Perfect. Okay, thank you, guys. I appreciate it.

WENDY SIMPSON: Thank you, James.

OPERATOR: And our next question is from Karin Ford of KeyBanc Capital.

KARIN FORD: Hi, good morning. I wanted to ask you about an ALC and the board's decision to pursue strategic alternatives. Have they been in touch with you guys about participating in that? Would you be willing to if they did? And have you had discussions with other operators on potentially taking the portfolio over?

WENDY SIMPSON: We've had no further discussions with any other operators. We've had some earlier in the year when Assisted Living Concepts first announced that they were changing management. We've had no discussions with Assisted Living Concept about adding our properties into any disposition. We are not interested right now in selling any of our assisted living properties. We would be more inclined to find new operators if they were going to make those available under the lease, but we are not…they haven't asked and we haven't reached out to say please consider ours in your disposition packages.

KARIN FORD: Okay, thanks. And if you were going to transition those properties, what would a market coverage level be for a new operator today?

WENDY SIMPSON: Well, we are looking at underwriting at 1.2. Aren't we?

CLINT MALIN: 1.2, 1.3, somewhere in that neighborhood.

KARIN FORD: Okay.

CLINT MALIN: Of course, you have to factor in the consideration of being in lease up depending on how stabilized the assets are so…

KARIN FORD: Right, so you might give lower rent for an initial period and then higher rent post-lease up

CLINT MALIN: It would all depend on the circumstances I think. I mean I don't see having to give. You know, our hope is to, you know, find companies that can go ahead and you know, if occupancy has not been increased already through ALC, is to find companies that know the markets, are able to go ahead and achieve you know ramp ups on the occupancy. So I wouldn't say that, you know, we would go in initially with lower rents. That's not our initial expectation.

KARIN FORD: Okay.

ANDY STOKES: This is Andy. When I go out in the world, I routinely get people asking me saying to me, I say routinely three or four times over the last six months with companies that are fairly substantial. If you get in on those backs, I'd like…back, I'd like to rent, I'd like to lease them. And these would be fairly knowledgeable companies usually middle market, but we do get those inquiries. It's just been, you know, I mentioned to Wendy briefly, certainly its preliminary for me to be pursuing it.

KARIN FORD: Okay, thanks. And then solely if you were to consider doing something like that, it would solely be under a new triple net lease. Would you consider a RIDEA transaction on those properties or not?

WENDY SIMPSON: I think that right now it seems like we have more…we have a decent opportunity to do a triple net lease.

KARIN FORD: Okay.

WENDY SIMPSON: If for some reason that wasn't possible and it was going to be beneficial to our shareholders to enter into RIDEA, we might do that, but that's not our first strategy.

KARIN FORD: Choice, okay. And last question, it sounds like from your comments that you are focused on increasing private pay and increasing the assisted living portion of the portfolio. Just talk about, has the pipeline moved more towards assisted living today and what's the split in the stuff you are looking at between ALFs and SNFs?

WENDY SIMPSON: The majority of the stuff we are looking at right now is ALF. It just is the deal flow. There is no, you know there is no standard, it's sometimes just have an opportunity and other times she don't, but right now we've got an opportunity to do some accretive investments in assisted living properties and memory care properties that are already opened and operating. So it would be…they would be sale leaseback transactions.

KARIN FORD: What do you think is driving the increased seller willingness on the ALF side, increased volume of deals there?

WENDY SIMPSON: Taxes.

KARIN FORD: Yeah, okay. Great, thank you very much.

OPERATOR: And the next question comes from Rich Anderson of BMO Capital Markets.

RICH ANDERSON: Hey, thanks. Good morning.

WENDY SIMPSON: Hi Rich.

RICH ANDERSON: So I guess the first question is from a previous question, you said you didn't have any information on how the summer went for your portfolio. And I guess that makes me feel a little uncomfortable. Can you hazard a guess of what will happen to coverages with the full effect of the CMS cuts in the numbers at that point?

CLINT MALIN: Rich, this is Clint. We've been receiving, you know we get monthly financial statements on the…I am sorry quarterly financial statements on those. So we've got the last quarterly statements. We've analyzed through June and as those other statements come in, we will continue to analyze those. And we are constantly in contact with our larger operators, you know talking to them about any things they see on the horizon, whether it's from a state perspective or federal perspective. So we are actively engaged with operators monitoring that, but we typically review that on a quarterly basis.

WENDY SIMPSON: And we are still projecting a 1.9 Rich. I think for the past, you know nine months we've been, you know, as it flows through projecting about, it will shake out to be about 1.9 on a you know, same portfolio basis.

RICH ANDERSON: But that compares to, am I looking at this right 1.83 for the second quarter.

WENDY SIMPSON: What you are looking at on the top part is the portfolio that includes new properties, so properties that we have bought recently at a 1.5 coverage, drive your overall portfolio coverage down. But if you look down below where we isolate the RUGS quarter by quarter that is a stabilized same portfolio basis. That's like, we would say the core portfolio without acquisition.

RICH ANDERSON: Okay.

WENDY SIMPSON: That's going to be at 1.9.

RICH ANDERSON: Okay, okay. Fair enough.

CLINT MALIN: And also Rich, we have started to receive the third quarter financial statements, and we don't have all those, but we are actively working on inputting those for our additional updated analysis. So we do actively, we are monitoring it.

RICH ANDERSON: Okay.

WENDY SIMPSON: Yeah, the companies have 45 days from quarter end to get us their financials, so that's why we just don't usually have them all in time for this call.

RICH ANDERSON: Okay. A bigger picture question on memory care and just thinking that product through – standalone memory care what is it about that that appeals to you so much? Because when I think about it, memory care as a wing or you know on an assisted living facility kind of has a feeder element to it where this standalone product does not. So it seems like it's more vulnerable to turnover and the rest. I am just curious what is it about memory care fundamentally that appeals to you.

WENDY SIMPSON: Right now the demand, the unmet demand is significant. If you talk…you go out and look, talk to operators, the units of assisted living that have…provide memory care are almost 100% full. If you…you don't necessarily transition from assisted living into memory care. You very often have direct admissions to memory care as a memory care patient; and assisted living don't often admit from outside. They keep their units for the transition people. So the market is underserved right at the moment for memory care. It's all private pay. There are smaller properties. There is, you know somewhere between 60 and 80-unit properties. So there is not this, you know, 120-unit property that's very costly to buy. That's what I see and Clint might have some more comments about memory care.

CLINT MALIN: No, I think those are spot on.

RICH ANDERSON: Okay.

ANDY STOKES: This is Andy, Rich. I think we have to think about the decision maker. The decision maker for taking care of mom or dad wants them to go someplace nice and this product is increasingly acceptable. Twenty years ago nobody knew what assisted living was and it became acceptable. The standalone memory care has a place in marketing to up-market folks who have a lot of money and they are…and when they are done and when they've marketed correctly, they are saying, "You don't want to send mom over there. We know how to really take care of her here and we have a building that is designed to add to her comfort and experience and it works." So it's really much…I think it is more at the market size, why these are good investments and they are.

CLINT MALIN: And I guess also to add to that Rich, is that you know, the focus in a dedicated freestanding memory care facility is the staffing ratios and the programming is targeted specifically for care of a certain population, a resident. Whereas in a combination facility or assisted living, memory care, you know, they are running two different programs effectively catering to two different populations. So this is just a dedicated focus on that diagnosis.

RICH ANDERSON: Okay. And maybe a last question for you Clint. Have you noticed or anybody I should say, have you noticed or were you sensing that existing owners of real estate or operators were anticipating and hoping for an Obama win and do you think that will have any influence on your pipeline as you now have some clarity about Obamacare and the healthcare delivery system in general?

WENDY SIMPSON: I think people were anticipating that Obamacare was going to survive and so our operators haven't indicated…our SNF operators haven't indicated any significant concerns about the implementation of all the provisions of Obamacare. In terms of providing service at the lowest cost level, that is still the SNF profile. So we haven't had any indication that our operators are concerned about their revenue. We…I guess it's a little too early to determine whether there is going to be any more deal flow from it. We haven't noticed it in the last couple of days.

RICH ANDERSON: Okay, fair enough. Thank you.

WENDY SIMPSON: Thank you, Rich.

OPERATOR: And our next question is from Michael Carroll of RBC Capital Markets.

MICHAEL CARROLL: Yeah good morning, guys. Has there been any progress on potentially negotiating an early termination at some of the ALC properties?

WENDY SIMPSON: We haven't tried to negotiate an early termination of the ALC properties. Any negotiation that we would…I mean if we opened it up, they would assume we were willing to take some lesser amount in order to get out from underneath this lease. We are very comfortable that we are going to get everything that we are entitled to under this lease. And that at the end of this lease we will have assets that will provide at least the same amount of lease stream if not more. So, I don't see that there is a benefit to our shareholders and our company of negotiating an early termination of this lease other than uncertainty in the marketplace, which I think is overheated.

MICHAEL CARROLL: Okay, can you now talk about a little bit about your mortgage book. Are there any additional investment opportunities out there?

WENDY SIMPSON: I…our mortgages [multiple speakers]

CLINT MALIN: No, we occasionally see opportunities….

WENDY SIMPSON: We are talking about doing it short-term one right now that's going to HUD.

CLINT MALIN: So we are looking at unique opportunities, but as a general line of business in going out and looking for mortgages, you know, with the rates that are available through the agencies and HUD, it's hard for us to compete for those. So other than unique opportunities, I would say it's not a big part what we are looking for…

ANDY STOKES: Well, I think…this is Andy. I…in terms of the charter that I've been given, my marching orders are to go out there and do leases. And we can do more mortgages, but our objective is if somebody starts out with, I would like to do a mortgage then we want to listen to them and see if we can meet their needs with a lease. Their leases serve us better than mortgages. And we from time-to-time will make a mortgage for specific reasons. We mentioned earlier that we are going to start out with one asset, which has a little bit of turnaround risk. We are going to start with mortgage so they have to pay us back, and if it does okay, then we will exercise an option and buy it. That's the kind of circumstance where I think we might use it most.

CLINT MALIN: We also could look at doing a mortgage. We are looking at a development project where we would do a mortgage as I mentioned in my comments, and have an option to purchase. So that would be a unique opportunity where we would look at a mortgage.

MICHAEL CARROLL: Okay. And then do you still expect that you can have about $30 million of development starts a year? Is that your goal and should you be able reach those?

CLINT MALIN: $30 to $50 million in…per year.

MICHAEL CARROLL: Okay, great. Thanks.

WENDY SIMPSON: Thanks Mike.

OPERATOR: And our next question comes from Daniel Bernstein of Stifel Nicolaus.

DANIEL BERNSTEIN: Good morning.

WENDY SIMPSON: Hi, Dan.

DANIEL BERNSTEIN: Hi. I know you don't want to have any more ALC questions, but this one may not be too bad. The master lease, the lease with ALC is split between the master lease one and master lease two. Is there any difference between the lease coverage on those two pools?

WENDY SIMPSON: Yes.

DANIEL BERNSTEIN: And the reason why I ask is that the covenant that is being violated is a leverage covenant, so if there is anything that's, you know, below one or even individual assets of the pools then, then maybe you have a little bit of leverage to negotiate a lease, the early termination of the lease without your having to give up anything.

WENDY SIMPSON: Perhaps.

DANIEL BERNSTEIN: Okay.

WENDY SIMPSON: I don't understand that theory.

DANIEL BERNSTEIN: Well, if you have any individual assets that are leased to them that are not positive EBITDA, if they give it back to you it helps them in their covenant.

WENDY SIMPSON: It helps them in the covenant.

DANIEL BERNSTEIN: Yeah.

WENDY SIMPSON: Both leases cover EBITDARM, so they are making a management fee that the one portfolio covers one time, after 5% fees, so EBITDAR that's the portfolio that has the lower occupancy, the Pacific Northwest portfolio that we've talked about. The other portfolio kind of in the Midwest, which also includes the New Jersey property, covers 1.5 times after 5% fee.

DANIEL BERNSTEIN: Okay.

WENDY SIMPSON: So, I don't think they would want to give up either of these.

DANIEL BERNSTEIN: Right, As long as they gain positive EBITDA on it, it helps their covenant issue.

WENDY SIMPSON: Right.

DANIEL BERNSTEIN: Okay. Okay, I'll move on from them. And then… have you spoken to NHI at all lately about them converting their preferred? I mean given the capital gains tax maybe going up, they might need capital at some point. Have you spoken to them about the preferred at all?

WENDY SIMPSON: We have not.

DANIEL BERNSTEIN: Okay. And I… have you any concerns about sequestration being higher than people expect? You've heard…I've heard all kinds of different, you know, rumors in the last couple of days with the fiscal cliff that the people were worried about sequestration being higher. I don't know if that's true or not, but have you any, you know, concerns from your operators at all about the fiscal cliff or anything, not just Obamacare, but you know, the fiscal cliff or any other issues that are concerning to them?

CLINT MALIN: Dan, this is Clint. I am actively in conservation with our operators on a routine basis and you know that is something right now that they have not stressed any significant concerns about.

DANIEL BERNSTEIN: Okay.

CLINT MALIN: You know also within our portfolio our SNF coverage is pretty strong. So you know they have the ability within our assets to weather you know any cuts on that. Even as it relates to existing portfolios that they have…they have not stressed any concern to me specifically about it. I am sure it's in the back in their mind, but it hasn't been on the forefront of issues they are raising to me.

DANIEL BERNSTEIN: Okay.

CLINT MALIN: Any, have you seen anything?

ANDY STOKES: I think the most common concern say in the last couple of months has been tort reform. It's the progress about tort reform in some states.

DANIEL BERNSTEIN: Okay, okay.

ANDY STOKES: And that's kind of what they talk about and it's in a positive way, and they are sick of the regulations and they are not looking forward to more regulations.

DANIEL BERNSTEIN: Okay, okay.

WENDY SIMPSON: Then they should have voted differently. There was a way to fix that.

DANIEL BERNSTEIN: I was going to say it but, yeah. Okay, I think that's all from my side. Thank you very much.

WENDY SIMPSON: Thank you, Dan.

DANIEL BERNSTEIN: All right.

OPERATOR: And next we have a question from Todd Stender of Wells Fargo.

TODD STENDER: Hi, good morning, guys.

WENDY SIMPSON: Hi, Todd.

TODD STENDER: The length of the lease on Wichita development project seems on a shorter side just, I guess being only ten years. Are you seeing anything, any migration to shorter leased terms in general?

CLINT MALIN: You know, in this case they are expecting…like say construction commenced, you know the day following the acquisition. So they think they are going to have that building, you know, up and operational, I think before January 2014, which is the estimated completion date. So no, I am not seeing any migration towards shorter term leases.

PAM KESSLER: Actually [multiple speakers] they want longer we want less for an opportunity to reset the rate. So…

ANDY STOKES: And my sense is ten years is standard.

WENDY SIMPSON: Yeah.

TODD STENDER: Not fifteen.

ANDY STOKES: In our industry and within our…

WENDY SIMPSON: Not fifteen.

CLINT MALIN: Fifteen would be very unique, at least within our portfolio.

TODD STENDER: Okay, that's helpful. And just looking at the rent stats, if you can give us maybe what some of the monthly rents are for AL in the Wichita market and how they compare to say what you are doing in Colorado and Texas and then versus your overall portfolio.

CLINT MALIN: Sure, the Wichita market is a little different than the Denver market. The rates are definitely a little bit lower on the…

WENDY SIMPSON: Our projected rates or you are talking about…

CLINT MALIN: The projected rates on the Wichita market.

TODD STENDER: That’s right.

WENDY SIMPSON: Is that what you are asking or is it…

TODD STENDER: Yes I am.

WENDY SIMPSON: Okay, you are asking what the operator is going to charge, okay.

TODD STENDER: Correct.

CLINT MALIN: On a blended basis there is $5,000 for the company or an average rate between AL and memory care including services. So on the…this property is skewed more towards AL than it is memory care. So looking probably more in the $5,000 to $5,200 on the memory care side and more in the, you know, low 4s on the, right around the 4 mark on the assisted living side.

TODD STENDER: And how about in Colorado and Texas?

CLINT MALIN: Colorado, we are looking at memory care. The properties in Colorado we are looking at are all memory care, so we are looking probably in the, you know $5,500 to $6,000 per month range on the memory care side in Colorado.

WENDY SIMPSON: And then in Texas.

CLINT MALIN: Texas is a little bit lower probably in the market we are looking at. They are more in line probably with the Wichita market.

TODD STENDER: Okay, thanks Clint. And just staying with you Clint, you gave some coverage numbers before about 1.2 to 1.3, is that…were those reflective of only assisted living or is that…

CLINT MALIN: That was just assisted living on stabilized assisted living.

TODD STENDER: If you tuck-in memory care, does that change the numbers at all?

CLINT MALIN: Well, there is not a lot of existing operational memory care facilities that we’ve looked at. So you know, we would view that as private pay housing similar to assisted living. So we’d probably look at it somewhat similar.

WENDY SIMPSON: But we are projecting a stabilized memory care to cover.

CLINT MALIN: We are looking at about 1.5 times on our development projects.

TODD STENDER: After 5% management fee?

CLINT MALIN: Of course, after 5%.

TODD STENDER: Okay, thank you very much.

WENDY SIMPSON: Thank you.

OPERATOR: And next we have a question from John Roberts of Hilliard Lyons.

JOHN ROBERTS: Hey, Wendy.

WENDY SIMPSON: Hi, John.

JOHN ROBERTS: Most of my questions have been answered, but I do want to echo thanks for the additional information on the supplemental, very helpful. Can you talk maybe a little bit about operating and other expenses going forward? Q3 seemed to come down a bit. I'm just wondering what you were looking at going in the future?

WENDY SIMPSON: I think we are…if you took our year-to-date and divide it by 3; it's probably what we are going to be doing in the future. I think we have… what were we budgeted for the year?

PAM KESSLER: I think we are…our run rate's about $2.6, $2.6 million.

WENDY SIMPSON: $2.6 million.

PAM KESSLER: Yeah.

JOHN ROBERTS: You came in about 2 point, a little over $2.1 million.

WENDY SIMPSON: And that, well…

PAM KESSLER: We had it…this quarter was lower, marketing expenditures in the summer time typically there is not many conferences, there is just not a lot going on. So marketing is quite seasonal. I will expect it to pickup here in the fourth quarter, but I think our run rate has been about 2.6.

JOHN ROBERTS: Okay, great. And Pam you were so organized on your presentation, I was scribbling down stuff so quickly, did you say that you recognize some more Sunwest income this quarter?

PAM KESSLER: We had last quarter and that's why other income went down this quarter because we had that.

JOHN ROBERTS: Okay, all right.

PAM KESSLER: Yeah.

JOHN ROBERTS: Yeah, I remembered you had it last quarter, but I thought you…I was scribbling down stuff so quickly I missed it and wasn't sure if you said this quarter or last quarter, okay great. That's all I have. Thanks.

WENDY SIMPSON: Thank you, John.

OPERATOR: Once again, if you would like to ask a question, please press "*" then "1" at this time. And our next question comes from James…is a follow-up from James Milam of Sandler O'Neill.

JAMES MILAM: Hey guys, I just wanted to make sure I understood that last question on operating and other expenses. Does the 2.6 number include transaction costs and everything else in there?

PAM KESSLER: No, it does not.

JAMES MILAM: Okay. So that's I guess just looking back it looks like it was 2.5, 2.4, 2.2 for the quarters one, two and three; and you are saying the fourth quarter and next year is around 2.6?

PAM KESSLER: Yeah and going forward, you know, I am kind of projecting into 2013 for you guys to give you a good run rate.

JAMES MILAM: Okay, perfect. And then my last one Pam, you or I guess you guys are talking about next year expanding the line of credit and doing more funding on the line of credit rather than drawing on the unsecured shelf agreements. Can we just talk about…I guess to me that sounds like a little bit of a shift in strategy. Is that more timing related or is there a preference there for using the line of credit more?

PAM KESSLER: I think it's reflective of the development strategy as we, you know, start to fund the development. It's more accretive to keep that on the line short-term and then as you get closer to C of O and it switches to being revenue producing then term it out.

JAMES MILAM: Okay, that makes sense. Thank you.

PAM KESSLER: You are welcome.

OPERATOR: And once again to ask a question please press "*" then "1." Showing no further questions this concludes our Q&A session. I would like to turn the conference back over to management for any closing remarks.

WENDY SIMPSON: Thank you. Thank you, Laura. And thanks everyone for participating today. And if you have any follow up questions, please give us a call and we will try to give you additional answers. Again, thank you and we will talk to you in January…all right, February, okay. Thanks a lot. Bye-bye.

OPERATOR: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.