LTC Properties Inc.

Third Quarter 2016 Analyst and Investor Call

November 3, 2016 at 8:00 a.m. Pacific

CORPORATE PARTICIPANTS

Wendy Simpson, *Chief Executive Officer and President*

Pam Kessler, *Chief Financial Officer*

Clint Malin, *Chief Investment Officer*

PRESENTATION

Operator
Good day and welcome to the LTC Properties Third Quarter 2016 Analyst and Investor Call and Webcast. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question at that time, you may press star, then 1 on a touchtone phone. To withdraw your question, please press star, then 2. Please note this event is being recorded.

I would now like to turn the conference over to Ms. Wendy Simpson, CEO of LTC Properties. Please go ahead.

Wendy Simpson
Thank you, Melissa. Good morning, everyone, and thank you for joining us today. People joining me on this call are Pam Kessler, our CFO, and Clint Malin, our Chief Investment Officer. You'll hear from them both momentarily.

Year to date in 2016, LTC has underwritten $126 million of investments, including $39 million of development commitments. Our under-development projects are down year over year as our operators and we turn our attention to stabilizing all of these new properties. Clint will have more specific comments about our current properties under construction and what we see that will—that may be underwritten in the near future.

However, we have been investing in underwriting for periods beyond 2017. At the end of the quarter, we had $45 million committed to spend on de novo projects at rates between 7.4% and 9%; $3.3 million of those commitments will begin generating income to LTC in 2016 and all of 2017. However, approximately $42 million will provide us with 2018 revenue increases and increases in years beyond that.

Additionally, we have committed to spend $34.5 million, at average rates over 9%, to reposition or renovate properties we owned. Including our Michigan properties, the investment is structured as a loan. The Michigan properties are one of our best performing groups of assets. The operators are innovative, and we have a high likelihood that they will use these capital dollars. Our income increases upon each funding, and therefore, revenue will increase immediately rather than when the entire project is completed. As such, we have provided for additional 2017 growth.

The transaction environment for the deals we are interested in pursuing is not robust at this time. Despite this, I believe LTC is positioned to provide shareholders with real growth in 2017 and 2018 without additional transactions. Additional transactions, which we will continually court will be added growth.

Our balance sheet remains at a conservative leverage ratio. We have sufficient capital available to fund these commitments and do acquisitions that would be accretive to LTC. Clint will discuss our pipeline and our operator statistics. First, though, I'll turn the call over to Pam for our financial review.

Pam Kessler

Thank you, Wendy. Normalized FFO increased 11.6% year over year for the third quarter of 2016 to $29.7 million, or 76 cents a share on a fully diluted per-share basis. Revenues for the quarter increased 16.9%, or $5.9 million, year over year. The improvement primarily reflects acquisitions, completed development, and capital improvement projects; lease amendments as well as an increase in interest income from mortgage loans, resulting from loan originations, capex spending under existing loans, and the amendment to our Michigan loan. This was partially offset by a reduction in revenue from properties sold and mortgage loan payoffs.

Second quarter interest expense was $6.8 million, an increase of $2.5 million over the comparable 2015 quarter, due primarily to the sale of senior unsecured notes and greater utilization of our line of credit to fund investments and development. Transaction costs decreased $568,000 year over year. The 2015 quarter included $537,000 of costs related to the acquisition of a 10-property portfolio. Excluding costs related to the large acquisition in the prior year, transaction costs were comparable between the two quarters.

General and administrative expenses were $4.5 million, or $756,000 higher this quarter compared to a year ago due to increased staffing, short-term and long-term incentive compensation programs, marketing, and various costs associated with being a public company. In G&A for the remainder of the year, I reaffirmed guidance given last quarter of approximately $5.5 million per quarter. During the quarter, we recognized a $1.8 million net gain related to the sale of an assisted living community in Florida and a school in New Jersey.

Turning to the balance sheet, during the quarter, we acquired a parcel of land and improvements in Kentucky for $5.4 million. We committed a total of $24.3 million to construct a 143-bed skilled nursing center. We originated a $1.4 million mezzanine loan in the third quarter that Clint will discuss in more detail. Additionally, we invested $10.8 million in properties under development and capital-improvement projects during the third quarter. We funded $2 million under existing mortgage loans and received $519,000 in principal payments and mortgage loan payoffs.

During the quarter, we repaid $45 million under our line of credit and currently have borrowings of $77 million outstanding and $523 million available under our revolver. Also during the quarter, we sold $40 million of 3.99% senior unsecured notes. These notes have periodic scheduled principal payments and a 15-year final maturity. We also repaid $12.5 million under our private shelf agreement with Prudential and, accordingly, have $12.5 million available for borrowing under that agreement.

During the quarter, we received $7.7 million of net proceeds from the sale of 152,623 shares of common stock under our At-The-Market offering program. The proceeds were used to fund our investment and development activities and pay-down debt.

Subsequent to September 30, we acquired a parcel of land in Illinois for $1.6 million. We committed a total of $14.5 million to construct a 66-unit memory care community. Also subsequent to September 30, we increased our fourth quarter monthly cash dividend by 5.6%, from 18 cents per share to 19 cents per share. At the end of the quarter, LTC maintained investment-grade credit metrics, with a debt-to-annualized normalized EBITDA of 3.9 times, a normalized-annualized fixed charge coverage ratio of 5.4 times, and a debt-to-enterprise value of 22.4%. I'll now turn the call over to Clint.

Clint Malin
Thank you, Pam. Good morning, everyone, and, again, thank you for joining us today. With the announcement of our two recent development projects with Anthem and Carespring, our underwritten investment commitments for the year totals $162 million, as Wendy mentioned. Seventy million dollars of this investment activity comprises acquisitions, with the average age of the five properties acquired being just two years. Additionally, 50% of this year's investment activity has been committed towards private-pay assets. Investments to date in 2016 demonstrate our focus on diversifying revenues derived from private-pay assets and our strategy to continue reducing the average age of assets in LTC's portfolio.

During the third quarter, Anthem Memory Care opened two LTC-owned private-pay memory care communities, and Thrive Senior Living received its certificate of occupancy for an 89-unit assisted living and memory care community. The property to be operated by Thrive is expecting receipt of its healthcare license next week to begin admitting residents. As of yesterday, Thrive has 31 deposits funded for new resident move-ins. We expect one additional private-pay development project to open near year end, bringing our 2016 new development openings to six.

Development financing has played a key role in LTC's growth strategy over the past six years. This growth has brought new private-pay operator relationships to LTC and expanded revenues derived from private-pay assets. Upon completion of our development projects currently under construction, we will have added through development, nearly $300 million of new properties to our portfolio.

As the development cycle matures, our pace of new development commitments has slowed. We attribute this slowing pace to land sites becoming more challenging to identify, as well as increasing costs associated with land, labor, and materials. Year over year, our new development commitments have decreased from $112 million in 2015 to $39 million year to date in 2016. When we began our development financing program in 2011, we anticipated a five-to-seven year development cycle, so the slowing is consistent with our initial expectations.

In the third quarter, we closed on a $1.4 million mezzanine commitment secured by two skilled nursing centers located in Oregon. This investment yields a 15% current-pay interest rate to LTC and establishes a new relationship for us with the recently focused operating company based in the Northwest.

As year end approaches, we are seeing sale-leaseback deal flow moderate, as Wendy mentioned. Deal pricing in the market continues to be at a premium, especially for private-pay assets, and with evolving dynamics in play for skilled nursing, we are being selective in opportunities we pursue at this time. Discipline in our underwriting—in our investment underwriting has served us well historically, and we do not feel current market conditions warrant an aggressive acquisition strategy.

Currently, we have approximately $50 million of development opportunities in the pipeline with existing operating partners. These opportunities are comprised of replacement projects, expansions, and new development, both for private-pay and post-acute care properties. We are continually engaged with our existing operating partners to help them grow their businesses and explore opportunities together.

Looking at our portfolio, Q2 trailing 12-month EBITDARM and EBITDAR coverage on a same-store basis is 2.04 times and 1.48 times for our skilled nursing portfolio and 1.54 times and 1.32 times for our assisted living portfolio. Coverage metrics for the portfolio as a whole remain comparable with the prior quarter. Although coverage in our skilled nursing portfolio experienced a slight decrease of 4 basis points from the prior quarter, we have analyzed recent data, and barring any unexpected changes in Q3 performance from our operating partners, our skilled nursing portfolio continues to target the 1.5 times coverage ratio referenced on last quarter's earnings call. Now we'll turn the call back to Wendy.

Pam Kessler
Thank you, Clint. Before turning the call back over to Wendy, I'd like to make a correction to my G&A statement. There was a collective gasp here in the room. I accidentally said $5.5 million —$4.5 million is the run rate. That's the same expense we had this quarter. I believe that is a good run rate for the rest of the year. So that's $4.5 million per quarter. Thank you.

Wendy Simpson
Thank you, Pam. From LTC's point of view, it is currently difficult to underwrite a new SNF deal that would not be with a strong operator already in our portfolio. In this environment, if we were to add a new operator, they would have to have a strong market presence and provide LTC with appropriate credit enhancements securing the new investment. Underwriting is more complicated until we can see the impact of the several changes happening in the SNF industry. This would include such evaluations as the impact of managed care, the shorter length of stay, the star ratings' impact, to name a few of—of the new challenges.

When we invest, asset quality, scale and span of the operations, and the strength of the operating company in the marketplace are critical factors in our underwriting process. That is not to say we will not invest in SNF assets. We have always been, and remain, capital supporters to this industry. We just currently need more data and history to feel we can properly underwrite certain deals. Last quarter we reduced our guidance from $3.05 to $3.09 to $3.00 to $3.03, so last quarter our range was $3.00 to $3.03, and that reflected our second quarter share issuance under our ATM and the terming of some of our utilized bank line.

In the third quarter, we have had some positive changes, including increasing our dividend by 5.6%, and we've had some positive changes in our current portfolio, so I'm now giving guidance in the range of $3.03 to $3.05. As has been our practice, we are not including possible fourth-quarter transactions or additional terming out of our bank loans.

Thank you, Melissa, and we will turn it over to questions.

QUESTIONS AND ANSWERS

Operator
Thank you. We will now begin the question-and-answer session. To ask a question, you may press star, then 1 on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the star keys. If at any time your question has been addressed and you would like to withdraw your question, please press star, then 2. At this time, we'll pause momentarily to assemble our roster.

Our first question today comes from the line of Jordan Sandler with KeyBanc Capital Markets. Please proceed with your question.

Jeff Gaston
Good morning, everyone. This is Jeff Gaston on for Jordan.

Wendy Simpson
Good morning, Jeff.

Jeff Gaston
Morning. In light of some of the recent transaction announcements made by your peers this week, I was curious about the—how your Brookdale and Genesis portfolios have been performing. Can you, I guess, give us any color there and potentially what coverage is on those portfolios as well?

Clint Malin
Sure, Jeff, this is Clint. I'll take that question. On the Brookdale portfolio that we have, you know, we have 37 properties leased to them, and overall we've had a very strong portfolio with them. I think as an organization, they've had a lot of pressure and a lot of distraction, so we have seen a little bit of deterioration on occupancy on the Brookdale properties but still fairly—very strong overall. And right now the—the coverage without the entire portfolio sits at 1.66 times, which is a very strong and healthy coverage for assisted living communities.

Wendy Simpson
And coverage is after a 5% management fee.

Clint Malin
—with the full 5% management fee, and that's an EBITDAR coverage, which is—I'm still —very strong coverage on the—on the Brookdale portfolio. Genesis is still maintained somewhere to what it was last time, and really no significant change on the Genesis portfolio from where we were at previously with them. So very consistent to the prior quarter for Genesis.

Jeff Gaston
Thanks. Thanks. Given that the—you know, those operators have been announcing large changes to some of their leases, I was curious if you had any interest in doing the same. It sounds like Brookdale is fine, but I was curious if you might have an interest in doing something like that for Genesis.

Clint Malin
Yes, our—our portfolio with Genesis is much smaller. I wouldn't see—we're not at the same size or scale, so I don't see that—something happening in our portfolio.

Wendy Simpson
But we are talking to them about a replacement facility.

Clint Malin
We're actively looking at opportunities with them, and we have a replacement project that we're working on now.

Jeff Gaston
Got it. Thanks. And then, I guess, one last question. You mentioned that the transaction markets are not as robust as they've sort of been leading up to this point. How are they—I guess where is—can you give a little color on some of these deals and how they're stacking up against your underwriting requirements, and, I guess, where the—where the disconnect is?

Clint Malin
You know, we said the first part of the year we saw a lull in transaction activity, and then going into the middle of the year, we saw a big spike in volume of large-scale nursing portfolios being marketed, and usually the aggregation of those portfolios are of a size where it would bring on significant concentration within our portfolio, and we've just seen it not to be an opportunity for us. So now some of those transactions, I think—I know at least one of them was announced by our competitor this week, but now we've seen a lull to where we haven't seen if all those transactions have closed yet or not, so—and we haven't seen a lot of new activity. There's onesie, twosies here and there, but typically on the skilled side, that's been typically older, more challenged assets, which really hasn't fit our—fit our profile of investing on the skilled nursing side.

Wendy Simpson
But on the private-pay side, we're still seeing premium prices with low—with low lease rates, and it's—it's just not penciling out for us. Even with a nice cost of capital, despite the current market, we're—the prices just are too high and the returns too low.

Jeff Gaston
Gotcha. That is all for me. Thanks a lot.

Wendy Simpson
Thank you, Jeff.

Operator
Thank you. Our next question comes from the line of Paul Morgan with Canaccord Genuity. Please proceed with your question.

Joe Ong
Good morning. This is Joe Ong for Paul. Just wondering like that delay at Grandview development and what the catalyst was there? Hello? Good morning?

Wendy Simpson
Yes, hi, Joe. We—we just—

Joe Ong
Hi, good morning, this is Joe Ong.

Wendy Simpson
Yes, we didn't get the—

Joe Ong
This is Joe Ong for Paul.

Wendy Simpson
—name of the property. Okay.

Joe Ong
Oh, okay, sorry. Just wondering like that delay at the Grandview development, like can you comment on what the catalyst was there, because it's delayed for two quarters?

Clint Malin
Sure, I mean, they had—there was a few entitlements—or not a—a few permit items after they got the certificate of occupancy, so just a couple of minor slowdowns but nothing significant, and that—that project is on course right now so nothing—nothing to be concerned about.

Joe Ong
Oh, okay. And my second question is earlier in the year, you had—you had been anticipating a potential bump-up in the cap rates. What has been the more recent trend? Any changes in the cap rate for those markets or the coastal markets in the past three or six months?

Clint Malin
I guess we haven't focused specifically on the coastal markets, but as—as Wendy just indicated, we're seeing that cap rates have not come up, especially on the private-pay side. On—on the skilled side, I think some of the recent announced deals—cap rates have come up on the skilled nursing side, but those were really for larger portfolios, and, again, with those larger portfolios, we don't know the—what's comprised in those—in those pools. So—but on the private-pay side, we've not seen any rise in cap rates.

Joe Ong
Okay. Thanks. That's all for me.

Clint Malin
Thank you.

Operator
Thank you. Our next question comes from the line of Aaron Wolf with Stifel. Please proceed with your question.

Aaron Wolf
Hi, y'all, good morning.

Wendy Simpson
Good morning.

Aaron Wolf
A question on the mezz loan. Is this the only—the only loan of this kind in your book? And, if so, is this something that you might consider doing going forward, more deals like this?

Clint Malin
Sure. We have—we have a couple of other—a couple of other loans in the portfolio. As we've talked about on our—our previous calls, we've started working out a mezzanine in a preferred-equity platform, where we have—the first part of the year, we brought on an individual to run that platform for us, and so it's part of the business we're targeting. We think there's a lot of opportunity for us in using a mezzanine and preferred-equity financing program to reach out to an operator base that has typically not utilized sale-leaseback—sale-leaseback financing as part of their capital structure. And so we view this as a way to grow our relationships and being

able to bring a product offering to operating companies that are—something that are more familiar to them, and as we build relationships with these organizations, the hope is that we can convert those relationships into sale leaseback transactions over time.

Aaron Wolf
Oh, great. That was very helpful. We talked a little bit about operators at the beginning of the call. Do you know if your operators are seeing more pressures in the secondary or primary markets in terms of wage inflation and threats from new supply? Any color on that would be helpful.

Clint Wolf
As far as wage pressures, we haven't seen anything specific regarding wage pressure that's happening today, although it is something that our operators are talking about and something they are cognizant and aware of.

Regarding increased competition, I mean, it's really market to market on whether there is increased competition in—so you can see from our supplemental, we track lease-ups, and overall our projects have been fairly strong. The project I talked about on the prepared remarks that's opening next week with Thrive Senior Living, they already have what—31 deposits out of an 89-unit project. So we view that as a pretty strong lease-up in the Myrtle Beach area, which would be considered a secondary, tertiary market, so it really goes back to the market-to-market, but we have not seen specific concerns, but our operators are talking about and they're aware of the potential, and we have seen, as Wendy mentioned, development with our operating partners slow down as they tend to focus on operations on their existing portfolios.

Aaron Wolf
Great. Well, great. Thanks so much for taking the time.

Clint Malin
Thank you.

Wendy Simpson
Thank you.

Operator
Thank you. Our next question comes from the line of Karin Ford with MUFG Securities. Please proceed with your question.

Karin Ford
Hi. Good morning.

Wendy Simpson
Good morning.

Karin Ford
Wendy, appreciated your comments earlier on your conservatism surrounding skilled nursing underwriting, given the uncertainty and the challenges there. I was just wondering if you saw pricing on the smaller deals follow suit and, you know, sellers adjust expectations up closer to the 9-plus cap rate handle. Would that help you get more comfortable with getting more active, or is the uncertainty just too high that it almost doesn't matter where pricing is today?

Wendy Simpson
No, uncertainty isn't—isn't that deep. It's—it's what the seller wants us to buy into, and if they want us to buy into a trailing 12 with not enough current information in the probably prior 9, to impact the future, but if—if the deals are based on current trends, then we—we are back in the market, and certainly at those returns. But right now what we're seeing is that people—some of the—some of the potential sellers, are hoping that these trends will just go away and—and they'll get back to where they were. And that may happen. We're just not going to buy it right now.

Karin Ford
That makes sense. What coverage—what EBITDAR coverage level are you underwriting or would you look for today?

Wendy Simpson
We're still doing 1.5 on skilled with a 5% and 1.2 on private-pay with a 5%, and we're well aware that some of our—not competitors but other REITs use a much lower management percentage, and so we have—we have consistently used 5%. We have consistently used the operations from the facility, and we don't use a corporate coverage. We have not pruned what we give you in same store by putting some of the assets in a workout category and, you know, taking the more challenged and putting them on another level. So what we give you is absolutely comparable quarter to quarter.

Karin Ford
Thanks. And then just on your skilled nursing EBITDAR coverage, can you just give us a quick update on the two properties that were dragging coverage down? Have they resolved themselves, and how are labor costs doing, and are you willing to call a bottom on this quarter, or do you think we may have another quarter or two to go?

Clint Malin
Hi, Karin, this is Clint. I can take that question. On those two—the two properties that I had talked about previously where there were some challenges, financial performance has changed significantly on those two properties. There's still the open pending licensure challenge at the one property in Texas, but it's on appeal with our operator, and we're expecting a hearing to take place here, hopefully sometime this month or early next month to resolve that, but those two buildings' financial performance has definitely turned.

Wendy Simpson
Up.

Clint Malin
Turned up.

Karin Ford
You didn't say.

Clint Malin
Turned up.

Wendy Simpson
Turned up.

Clint Milan
Positive—

Karin Ford
Is it—so is this quarter the bottom, do you think, Clint?

Clint Malin
As I mentioned, you know, we think that a targeted 1.5 times coverage with—with the vantage point we have into the portfolio and looking not only at trailing 12 off of Q2 but looking at more recent quarters' activity and where it's at, we think that barring any significant changes in the third quarter that we're—that we're not anticipating or that our operators are not anticipating, we feel that the 1.5 is a targeted range. And as we've brought on new investments for skilled— I mean, as Wendy mentioned, we're underwriting at 1.5—as those fold into the same-store coverage, we do expect overall that our coverage in our portfolio on the skilled side would come down—come down to that—that range, and we think that's a consistent level.

Wendy Simpson
And in terms of your question about labor costs, all of the operators we've talked to—we've talked to most of them—are seeing creep in labor costs, but one of the things that they're finding maybe a little bit more challenging is just the pool of labor. So there are a couple of things that they're paying attention to. One is just the increase in labor costs, and the other is the increase—or the decrease in the labor pool, and we all don't want to see something happen where everybody's going back to registry time, which is very destructive. So our operators are paying a lot of attention to employee retention and the cost of the employees. So there is a lot of attention on that, Karin.

Karin Ford
Thanks. And then, just last one for me, you had a property in lease-up in Illinois that looked like leasing had slipped from last quarter to this quarter. Can you just give us some color on that?

Clint Malin
Sure. The operator had an unexpected number of deaths that happened to the memory care community of that property, so we did see, as of what was reported September 30, that that occupancy had come down. But as of yesterday, the occupancy at that property had come back up at 30%, which is just shy of what it was in the previous quarter. So they're starting to see some positive traction to get back to where they were on that. It was just timing on that.

Karin Ford
Okay. Great. Thank you.

Clint Malin
I'd actually gotten—and, Wendy, to make a point, they did actually have the executive director of that community—they did have a change. So in addition, that change in the executive director did have a little bit of slippage on the marketing aspect on that, but, again, they're back at, as of yesterday, 30%, which is just shy of where they were at last quarter.

Karin Ford
That's helpful. Thanks.

Wendy Simpson
Thank you, Karin.

Operator
Thank you. Our next question comes from the line of John Kim with BMO Capital Markets. Please proceed with your question.

John Kim
Thanks. Good morning. Just to follow-up on Jeff's question on restructuring leases or the potential to do that, your SNF EBITDAR coverage is now 1.48, which doesn't sound bad, but it's a drop from last year at 1.7. At what point do you consider restructuring your leases as far as EBITDAR coverage?

Wendy Simpson
Well, again, that's with a 5% over—5% management fee, so you add that on to the profit that the operator is making covering 1.4, and that's a significant profit. I would say I'd consider renegotiating our contracts when our operators are suffering, and I don't—I don't see them suffering. They're—they're turning around a couple of properties that are bringing down that percentage. The fact that we are—we have done so many transactions in the last year that we underwrote at 1.5, that is now bringing down that average, because it's a mathematical calculation.

Pam Kessler
And the Michigan loan.

Wendy Simpson
And the Michigan loan, we added $40 million on that, so—

Pam Kessler
Yes, the $40 million additional funding under the Michigan loan was the primary driver.

Wendy Simpson
—we are far away from having to address a lease change.

Pam Kessler
Yeah, the Michigan loan covers very well—

Clint Malin
The decline in coverage for Michigan was purposeful—

Pam Kessler
—going down from 1.7 to 1.5 was purposeful because we wanted to monetize.

Clint Malin
Acquisitions, newer assets, as well as the Michigan investment, so that's not necessarily deterioration, because of—

Wendy Simpson
Right.

Clint Malin
—challenges, I mean, that was sort of expected with investments that we've—and we deployed capital into, so I think it should be viewed as a positive.

Wendy Simpson
Yes, we don't currently have a workout situation or a situation where we believe that our rent stream is at all in danger, and I think we stand at a zero accounts receivable in terms of rent, so we don’t have any unpaid rent.

John Kim
So when you’re talking about taking into consideration the operator, if they’re struggling or not, is that for the company as a whole or just particular to their assets at least with you?

Wendy Simpson
Well—

Clint Malin
We—we put buildings in master leases for—for reasons, and we want to make sure we have a credit enhancement that looks across just one property but across multiple properties, and if there was a significant challenge in a specific asset we may work with an operator if they wanted to look at possibly selling that asset. I mean, that’s—that’s one way we could look at a solution with an operating partner if there was a challenge within one asset within a master lease.

Wendy Simpson
If we had—if we had an operator that had significant challenges in another part of its business, we certainly would sit down at the table with that company and see if we could participate in some restructuring of their—their business, but I don't see any of that happening with the operators that we currently have.

John Kim
Okay. On occupancy, it looks like you had a decline in occupancy by about 70 basis points on a year-over-year basis. And on the SNF side, it seems like it’s in line with the market, but on the assisted-living side, it appears lower than the mixed averages. Can you just perhaps add some commentary to this?

Clint Malin
I mean, I’d say that the small decline in occupancy quarter over quarter was primarily attributed to the Brookdale properties, which, again, as I mentioned earlier, still have very strong coverage for that portfolio. Obviously, Brookdale’s had a lot of distractions that they’ve been working on, so I think that may be the primary reason why there’s been a small decrease in occupancy change within that portfolio. But, again, the coverage supporting the Brookdale investment is still very strong and healthy.

John Kim
And where do you see that going with supply picking up over the next couple of quarters?

Clint Malin
That’s something that we have to—we will continue to monitor from an asset management standpoint to see where that progresses, so we’re not aware of any significant changes in that at the moment, but it’s something that we’ve—over the last number of quarters on our calls, we’ve talked about Brookdale when there’s been headline news about them, and it’s something that we’re actively engaged with and monitoring.

John Kim
Okay. And then, finally, it's a very small amount, but you sold a school in New Jersey this quarter, and I didn't see that in your supplemental last quarter.

Pam Kessler
Yes, it was in as a subsequent event last quarter in the Q and the press release, but it's only one school that we owned, so it probably wasn't a standout to you.

John Kim
How did you come about owning a school?

Wendy Simpson
It's a long story. It goes back to the 1990s, and we were incubating an education REIT, and we owned quite a few schools at the time, and in the early 2000s, we divested of those, and that was just the last remaining school that we had. It was in New Jersey, and we got an offer for it and sold it to the operator.

John Kim
Great. Thank you.

Wendy Simpson
Thank you.

Operator
Thank you. Ladies and gentlemen, as a reminder, if you would like to ask a question, please press star 1 at this time. Our next question comes from the line of Rich Anderson with Mizuho Securities. Please proceed with your question.

Rich Anderson
Hey, thanks and good morning. So is that the last school? Are you out of the school business?

Wendy Simpson
Are you cheering out there? We don't have to spend 15 minutes of every investor meeting talking about the school anymore.

Rich Anderson
So you're done?

Wendy Simpson
Done, yes.

Rich Anderson
Yes, okay. And then is the—is the Thrive asset, the Wichita asset, in the supplemental?

Clint Malin
No, it's Murrells Inlet in the Myrtle Beach area in South Carolina.

Rich Anderson
Oh, where does that appear?

Pam Kessler
In the supplemental on the Lease Up.

Clint Malin
Yes, Real Estate Activities Lease Up, page—page 10, the last project on page 10 on the lease-up section.

Rich Anderson
Oh, okay. So you're beyond—you're in the lease-up. Okay, I gotcha, okay. So you would—you'd be out of the de novo sort of process, I guess, or that schedule, right?

Wendy Simpson
You know, it's out of the development, because they—

Rich Anderson
Yes, right. That's what I mean, okay.

Rich Anderson
Okay. I just wanted to make sure I understood. Okay. So, Clint, you said you have a $50 million pipeline of future development projects, but in the same breath, you guys have said it's become more difficult to find deals to underwrite, given cost pressures and whatnot. So, how would you describe that $50 million? Is that just kind of almost a formality-type number, or are they real opportunities that—I mean, what—how would you assess the probability of you moving forward in any of that?

Clint Malin
I'd say probably three-quarters is probably very real. It's a project—we're working with operators that are in our portfolio, so I'd say that—I mean, at least three-quarters of that is—is probably fairly likely.

Rich Anderson
Okay. And when do you—you mentioned your guidance increase this quarter. You said good things are happening, you mentioned the dividend, which doesn't have anything to do with the—the guidance, but obviously it's—it's a reflection of good things. But I'm curious, what— we're talking about small numbers, but what got you from—you know, gave you two more cents to—to cheer about this year? Was it mainly internal growth, or was it external growth factors?

Pat Kessler
It was mainly internal growth and—and you probably are not surprised that when we do our projections, we're a little bit more conservative, so when I'm giving you guidance, we have made some assumptions, and, you know, we—we probably assumed that we—there might be a— a rate increase, so our cost of capital—our interest costs might have been a little higher.

We also have a couple of properties that contribute based on additional revenue, so we have some percentage income from—from a couple of our investments. One of them is our preferred investment with the assets in Arizona, so we don't—we don't count that as income until we get it as cash, and they've been doing very well on that asset, so we got a little bit more cash. We got cash from an operator who does—we have a percentage rent increase, so a few of those things add up to $300,000 to $600,000, and then you got a penny or two.

Wendy Simpson
Uh-huh. Yes, it was a little of this and a little of that.

Pam Kessler
Yes, and capitalized interest as well—as well for—

Rich Anderson
Okay. Okay. And then—and mentioning the preferred business, I understand it's kind of incubating now, but how big do you think that that could be? What—what's—what's the size of that pipeline, you know, years from now or four or five years from now?

Clint Malin
Rich, I think probably looking out four to five years is hard to say what that would be, but what we've talked about is putting a threshold of $50 million on that to get it—get that book of business to that level and then—

Rich Anderson
So no—no change—no change? Because that's what you said in the past, right?

Clint Malin
Correct.

Wendy Simpson
Yes. What we're finding right now, Rich, is as—as our—we've been talking to potential operators to invest with, they're finding it a little more difficult to get the senior in place, like a lot of banks are—have done what they want to do for 2016, so it's been a little bit slower than—than we had anticipated at the end of the second quarter, but we—we still think that there's a good—a good market there for us.

Clint Malin
And we're seeing a lot of—

Rich Anderson
So without the senior—without the senior, then—then there's no place for your role, you're saying?

Wendy Simpson
Correct.

Rich Anderson
Okay. And then, finally, I probably ask this question once a quarter, but a lot of financing activities, you know, ATM activity, what would you say, Pam, your dry powder is, even though you may not be seeing a whole lot in the way of investments? Where do you stand on that, where you get to a certain level of leverage before you would have to consider equity again?

Pam Kessler
Yeah, we could do—comfortably, we could do about $250 million more in debt before reaching our leverage threshold, so I feel very comfortable we can fund what we have in the pipeline today and for the foreseeable future.

Rich Anderson
Okay. Perfect. That's all I have. Thank you.

Wendy Simpson
Thank you, Rich.

Operator
Thank you. This concludes our question-and-answer session. I would now like to turn the conference back to Ms. Simpson for any final remarks.

CONCLUSION

Wendy Simpson
Thank you, Melissa, and thank you for everyone on the call, and we look forward to talking to you after year end. Have a great holiday season if we don't see you. Bye-bye.

Operator
Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.