LTC Properties Inc.

Second Quarter 2017 Analyst and Investor Conference Call and Webcast

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CORPORATE PARTICIPANTS

Wendy Simpson, *Chairman, 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 Inc. 2Q17 Analyst and Investor Call and Webcast. All participants will be in 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, you may press star, then 1 on your touchtone phone. To withdraw your question, please press star, then 2.

Before management begins its presentation, please know that today's comments including the question-and-answer session, may include forward-looking statements subject to risks and uncertainties that may cause actual results and events to differ materially. These risks and uncertainties are detailed in LTC Properties' filings with the Securities and Exchange Commission from time to time, including the company's most recent 10-K dated December 31, 2016. LTC undertakes no obligation to revise or update these forward-looking statements to reflect events or circumstances after the date of this presentation. Please also note this event is being recorded.

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

Wendy Simpson
Thank you, Brandon, and good morning, everyone. Welcome to LTC's 2017 Second Quarter Investor Call. With me today are Pam Kessler, our CFO, and Clint Malin, our Chief Investment Officer. I'll begin with a few brief remarks and then turn things over to Pam for a discussion of our financial results. Following Pam, Clint will provide more in-depth commentary on our investment activity, pipeline, and operator partner performance.

To start, I'm pleased to report our 27th consecutive quarter of normalized FFO growth, with FFO increasing by more than $630,000 from the prior quarter. Our portfolio activity ramped up in the second quarter with two private-pay acquisitions, one with a new operating partner and the disposition of four properties. Our current pipeline reflects an industry environment that is not particularly conducive to new large property or portfolio acquisitions without assuming a high level of risk, risk that we are not interested in assuming. We don't see much of a change in the environment for the remainder of the year; however, with a historically strong balance sheet, LTC can swiftly convert the opportunities we do identify into value for all of our stakeholders. I continue to believe that we are well positioned for sustainable long-term growth.

After Pam and Clint are done with their remarks, I'll come back to talk more about the industry, our business, and 2017 guidance. Now it's my pleasure to turn the call over to Pam.

Pam Kessler
Thank you, Wendy. NAREIT FFO increased more than 7 1/2% from a year ago. On a diluted per share basis, second quarter FFO grew to $0.79 on nearly 4% more weighted average diluted shares outstanding compared with last year. This expansion was driven principally by increases in revenue from investments, completed development and capital improvement projects, and lease amendments in the latter part of 2016, partially offset by higher interest expense that resulted from trimming out our line of credit in 2016 and 2017 as well as the effect of equity issuance under our ATM earlier this year and performance-based equity awards. That increased more than 10% into the growth drivers previously mentioned as well as contractual rent escalations.

During the second quarter, we invested $54 million in property acquisitions and funded $11 million in various development and capital improvement commitments. We received $14 million from the sale of four properties and $6 million in principal payments and mortgage loan payoffs. We also funded our $0.19 per share monthly common dividend.

As you saw in our press release yesterday, we wrote off approximately $1.9 million of straight-line rent and other assets in the second quarter. Wendy will talk more about this later. Our long-term debt maturities are prudently spaced and remained matched to our projected free cash flow, helping us moderate future refinancing risk. We have no significant debt maturities over the next five years and have significant liquidity to fund our future growth and meet our obligations. Our current availability includes $550 million under our line of credit, $47 million under our shelf agreement with Prudential, $185 million under our ATM program. We plan to continue allocating capital strategically and conservatively to provide maximum value for our portfolio, partners, and shareholders and to help ensure profitable long-term growth.

At the end of the second quarter, our credit metrics continue to compare favorably to the healthcare REIT industry average, with debt-to-annualized-normalized EBITDA of 4.2 times, a normalized-annualized fixed-charge coverage ratio of 5.3 times, and a debt-to-enterprise value of 24.1%.

Now I'll turn things over to Clint for a discussion of our investment activity, pipeline, and portfolio metrics.

Clint Malin
Thank you, Pam. As Wendy noted, investment activity increased in the second quarter. I'll start with our $38.8 million investment, an off-market deal for two properties in Clovis, California, a suburb of Fresno with Frontier Management, a new operating partner for us. These are newer, contiguous properties that create a campus-like environment that provides a continuum of care, which is very attractive to us. For those of you who don't know Frontier, they own, manage, and lease senior living communities in 11 states, and the company's CEO has almost three decades of experience in the seniors housing industry.

One of the Frontier properties is a 107-unit assisted living community constructed in 2014. The other includes 48 memory care units and 25 independent living cottages built in 2016. The initial lease rate is 7%, with 2% annual increases throughout the lease term. The properties were structured as a sale leaseback and were added to a new master lease with affiliates of Frontier Management. One of the nice things about this new relationship is that it originated through initial discussions about mezzanine financing and evolved into a larger sale leaseback transaction.

The remainder of our investment activity during the quarter was driven by our growing relationship with Thrive Senior Living. We invested approximately $15.7 million to acquire a 60-unit memory care community in Westchester, Ohio, a suburb of Cincinnati, that was built this year. Concurrently, we entered into agreements to transition two memory care communities leased to Clarity Pointe, located in Jacksonville, Florida, and Louisville, Kentucky, to Thrive, contingent upon issuance of licensure, which we expect will occur in the September/October timeframe. We proactively elected to bring a new operator into Jacksonville and Louisville to maximize the value of the properties and enhance our relationship, an existing regional operating partner who has been successful in growing their footprint.

Thrive operates 21 communities in the Mid-Atlantic; Southeast, including the Jacksonville area; Texas and Ohio, with a very well versed and experienced management team. While we were initially hopeful about growing our relationship with Clarity Pointe, they are a smaller company without adequate resources to scale the business or remediate some of the lease-up challenges facing our Jacksonville property in particular. However, occupancy at Jacksonville has trended upward to 62% at June 30th compared to 43% at March 31st. This is a result of changes to the admissions policy of introducing companion-suite options.

Annual GAAP rent under the master lease being terminated with Clarity Pointe pertaining to Jacksonville and Louisville, is $2.4 million. The Thrive master lease, prior to addition of Jacksonville, Louisville, and Westchester, was approximately $3.8 million. The new master lease GAAP rent will increase to $6.3 million. The new master lease for Thrive, additionally provides us with variable-rent escalators and the opportunity to receive additional rent as a percentage of growth in revenue above a stated threshold.

During the quarter, we also sold four properties, three in Indiana and one in Iowa. These properties were legacy buildings constructed in the mid- and late '90s, previously managed by Senior Lifestyle. The sales reflect our accommodation of a request by Senior Lifestyle. We do not see them as a strategic fit. The $5 million gain we generated on the sales has already been put to work on the Westchester and Clovis acquisitions.

We plan to continue evaluating our portfolio to identify additional opportunities to recycle capital on assets that are no longer core or strategic to our portfolio. It is possible that a few more sales could occur before the end of the year.

As Wendy discussed, our pipeline is not terribly robust and sits at approximately $40 million, comprised solely of private-pay assets. While we continue to see a number of large marketed skilled nursing and assisted living deals, we do not believe they make sense for our portfolio at this time. With respect to skilled nursing, we remain mostly on the sidelines, given the current political and regulatory climate. Our underwriting and due diligence standards remain stringent, including stabilized rent coverages of 1.5 times for skilled nursing assets and 1.2 times for private-pay assets, including a 5% management fee.

The current pipeline consists of two potential transactions, one with an existing operating partner and another with an operator that would be new to our portfolio. One of the deals is a preferred-equity transaction for the development of an assisted living, memory care, and independent living community near Milwaukee. In conjunction with the preferred-equity financing, we would enter into a joint venture with the property owner, whereby at certificate of occupancy and licensure, LTC would acquire a majority interest in the property and lease it back to an affiliate of the JV partner to operate the property. The other is the acquisition of a newly constructed assisted living and memory care community in the Kansas City market that would be added to an existing master lease.

Finishing up the portfolio statistics, which is provided on a property-level coverage, not a corporate level basis, Q1 trailing 12-month EBITDARM and EBITDAR coverage, on a same-store basis, was 2.03 times and 1.5 times, respectively, for our skilled nursing portfolio, and 1.46 times and 1.24 times, respectively, for our assisted living portfolio. These metrics are stable to prior recent quarters. Remember that our EBITDAR rent coverage is calculated using a management fee equal to 5% of revenues. We continue to believe that EBITDARM is a better metric of comparison to our peer group as different management fee percentages may be used to calculate EBITDAR by different companies.

Now I'll turn the call back to Wendy.

Wendy Simpson
Thank you, Pam and Clint. As I mentioned earlier and as you are aware, our industry is facing several headwinds that have made it somewhat difficult to substantially grow our portfolio through new investments. A number of deals we evaluated have not met our investment hurdles. In fact, we passed on a $40 million deal this quarter included in our pipeline last quarter, resulting from issues identified during due diligence. Sale leaseback deal flow remains tempered; private-pay assets are still selling at a premium; the regulatory environment, including repeal and replace, is tenuous; property staffing concerns persist; and second quarter NIC occupancy data is disappointing. As these issues have been covered quite extensively by others, I won't spend time discussing the particulars.

While the current environment poses challenges and requires some amount of caution on our part, I think it's important to remember that the long-term, underlying trends for senior housing remain very favorable and that we are highly focused on helping our operating partners in whatever way we can based on a philosophy of trust, transparency, and shared success. Instead of focusing on industry challenges that we cannot control, we are using this time as an opportunity to ensure LTC's continued success by thinking outside the box, creating new and different ways to source and structure deals and attract new operating partners.

As we discussed on our last call, one of our competitive advantages in finding new investment opportunities is our ability to identify off-market deals through relationships we've built over the years and through our mezzanine lending platform. Using this platform to source new sale leaseback transactions provides the potential for additional scalability and future growth. The joint venture transaction in our pipeline demonstrates our willingness and ability to explore various lease and investment structures to ensure that we are meeting the needs of our current and future operating partners, while maintaining significant value in our culture of profitable growth.

I now want to provide an update on our Anthem properties which resulted in our issuance of a monetary default notice on our master lease with them covering 11 memory care communities, nine of which are operational and two of which are currently under development. When we began helping Anthem grow their business approximately six years ago, they had a very aggressive growth plan, and, like many great startups, they have suffered growing pains. Anthem's communities are in good locations, many are doing well and generating positive cash flow, and we believe that over time, all will be comfortably stabilized. However, three communities in particular, Tinley Park, Burr Ridge, and Westminster, are dealing with some short-term problems that are currently being addressed — staffing challenges including at the executive director level at three of the communities resulting in distractions that we believe have impacted lease-ups in these buildings.

As of July 31st, occupancy at Tinley Park, Burr Ridge, and Westminster, was 29%, 47%, and 88%, respectively compared with 25% 42%, and 80%, respectively. To do this again June to July, the 25% became 29%; 42% became 47%; 80% became 88%. I am holding a weekly call with one of the Anthem principals to keep them focused on corporate cost reductions and to get more current occupancy reports. I know it is early in the month, but as of yesterday, Tinley Park was plus 5 residents, Burr Ridge was plus 3, and Westminster was plus 6. Nine days does not make a month, but the trend is positive.

I'd also note some challenges at two of our Kansas communities operated by Anthem. Anthem took over operation of these properties post-acquisition and soon realized that turning around existing properties was not part of their core DNA. We are currently in negotiations to transition these two communities to a different operating partner, which would help alleviate some of Anthem's current burden and better allow them to focus on their core competencies.

Aside from making an operator change at the two Kansas communities, we are evaluating all options related to the nine remaining communities. In addition to negotiating with Anthem, we could transition some or all of the remaining properties to a new operator, sell some or all of the properties, or a combination of these two. We will update you on progress as we move forward in the process.

A few final words about our Anthem relationship. We have had additional opportunities to fund new development projects with them but proactively put the brakes on our combined activity after seeing declines in their operating performance at the community levels mentioned. More importantly, I'd like to express that our cost basis in Anthem is well below current market value. If you apply a 7% cap rate to the non-stabilized trailing 12-month NOI on the first four Anthem assets which opened in the Denver area, the potential value per unit basis would be $282,000, and our net book value plus straight-line and other assets is about $197,000 per unit, translating into approximately a $20 million potential value creation.

As a result of the current Anthem challenges, we wrote off approximately $1.9 million of straight-line and other assets in the second quarter related to releasing the Kansas properties. Subsequent to the end of the quarter, the rent paid by Anthem will be recorded on a cash basis, which we currently anticipate to be approximately $1 million per quarter through year end. Because we are currently in negotiations to release the Kansas properties, we have not included any additional rent assumptions related to them in our guidance. To provide additional clarity, annual GAAP rent under the Anthem lease is approximately $11.7 million, and at the end of the second quarter, the net book value of the 11 properties was $111.6 million. We had $8.6 million in straight-line receivable and $6.6 million in other assets on our balance sheet as of June 30th. While we are obviously disappointed in these Anthem developments, I believe that we will emerge with a successful resolution for Anthem and for LTC.

As a result of our investment activity, property sales, the transition of two properties to Thrive, and the short-term challenges at Anthem, I am revising our 2017 guidance. Assuming no additional investment activity, financing, or equity issuances for the remainder of the year, I'm now forecasting FFO between $3.03 and $3.05 per share for 2017, which includes the anticipated quarterly payment of rent from Anthem of approximately $1 million. For modeling purposes, I'd also note that our G&A assumptions have been reduced for the remainder of the year, and we are now looking at a run rate of approximately $4.1 million per quarter. We are currently working through next year's budget and a resolution of the Anthem assets and will provide our thoughts on 2018 at a later date. Our remaining committed capital to date at 2017 totals approximately $61 million, which includes development and major existing property additions and improvements.

I've said before that regardless of activity levels this year, the portfolio we have built will generate FFO this year and next, and I continue to be optimistic about our future opportunities. As we celebrate our 25th anniversary, we are staying the course with our strategy of reducing average portfolio age, expanding our operating partner base, and maintaining a strong coverage ratio while fine-tuning our implementation to help ensure many more years of successful accretion.

Thank you for joining us today. We'll now take your questions.

QUESTIONS AND ANSWERS

Operator
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 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 will pause momentarily to assemble our roster.

Our first question comes from Jordan Sadler with KeyBanc Capital Markets. Please go ahead.

Jordan Sadler
Thank you. Good morning. I'm trying --

Wendy Simpson
Good morning.

Jordan Sadler
Good morning. I'm trying to fully grasp all the information you guys have provided on the call and in your release between Anthem and Clarity. Can you maybe reconcile for us first the difference between the cash rent that you expect to collect from Anthem versus the GAAP rent? I thought you said a million per quarter, which would be $4 million in cash rent. Is that comparable to the $11.7 of GAAP rent?

Pam Kessler
So the cash rent we're expecting per quarter is a million dollars, and the current cash rent that's under the contractual lease obligation is $2.6 million. So the cash rent reduction is $1.5 (million), $1.6 million on a quarterly basis. Does that answer your --

Jordan Sadler
Okay, so that — so you —

Pam Kessler
-- second question?

Jordan Sadler
Well, I think we're getting there, yeah. So —

Pam Kessler
So $0.04 a quarter.

Jordan Sadler
Right, so I may have missed in Wendy's follow-up comments there, what was the cause of the — or the catalyst for the notice of default?

Pam Kessler
Non-payment of —

Jordan Sadler
Non-payment of rent?

Wendy Simpson
Right.

Jordan Sadler
Okay, and that started in July?

Wendy Simpson
It happened in July. They were paid cash through June 30th.

Jordan Sadler
And so in July, they came to you and said, “We can’t pay,” and you sat down and renegotiated the rent on a temporary basis, which is this $1 million per quarter instead of the $2.6 that you would ordinarily expect, plus you’re going to try and transition them out of the two properties in Kanas. Is that the right way to think of it?

Wendy Simpson
That’s the basic way of thinking about it. We haven’t come to a formal agreement with them. Their agreement is they will pay as much cash rent as they possibly can pay, and right now it looks like about a million dollars a quarter, but, yes, they’ve --

Jordan Sadler
Okay, so the million dollars is — sorry.

Wendy Simpson
That’s okay. As we’ve seen the pickup in their occupancy, we hope that that raises the boat, but we’re not counting on it.

Jordan Sadler
Okay, so there’s a possibility — but so they’re still on the hook for $2.6 [million] per quarter.

Wendy Simpson
They are indeed.

Jordan Sadler
But they’re going to pay — okay. And so they owe you contractually that amount, but right now what they can pay is a million, and hopefully the best case scenario is they’ll pay the million until such point they can pay the $2.6 [million] and then —

Wendy Simpson
Correct.

Jordan Sadler
And then —

Wendy Simpson
We’ll talk about —

Jordan Sadler
-- hopefully pay back rent, yeah.

Wendy Simpson
Right.

Jordan Sadler
Okay. Can we run through quickly the same thing on Clarity, what the catalyst was to transition the Jacksonville and Louisville properties to Thrive? Like were they in default as well?

Clint Malin
This is Clint. The main point of that was we saw occupancy challenges as we've talked about the last couple of quarters at the Jacksonville property. They're a small organization, as I mentioned —

Wendy Simpson
That's right, Clarity —

Clint Malin
-- Clarity Pointe, and as I mentioned in my comments, they're a small organization, and similar type challenges about the ability to pay rent on the properties as well.

Jordan Sadler
Okay.

Wendy Simpson
We also had an agreement with Clarity Pointe that they would create an operational company that had real equity in it, and as time went by, it was obvious that they weren't going to be able to accomplish that, so it was prudent for us to get the assets into a portfolio like Thrive's.

Clint Malin
And the Westchester property was actually originally sourced through the Clarity Pointe relationship, but we actually brought Thrive in as they were getting ready, early on in the process, to be the potential operator on that project. So that Westchester project originally was through Clarity Pointe.

Jordan Sadler
And I think you guys lumped sort of the three properties together from the incremental rent from Thrive, the two transitions from Clarity and the new one, and you're getting to a total of $3.8 [million], is it versus the $2.4 [million] that Clarity Pointe was paying?

Clint Malin
Well, after the two properties — after Louisville and Jacksonville received licensure, and those are added into the new Thrive master lease, $6.3 million will be the new GAAP rent under that master lease.

Jordan Sadler
So just for simplification for a simple-minded man like me, how could I — if Clarity Pointe was paying $2.4 [million], what are you getting for those two properties from Thrive?

Pam Kessler

Okay, so I'll — hi, Jordan, it's Pam, and I'll walk through the math, because it is a little complex. The new rent on all the properties will be $6.3 [million]. If you back out the new rent Thrive was paying on the two assets being transitioned, that's $3.8 [million], so that gets you to $2.4 million of rent allocated to the two properties being transitioned and that new Westchester property. Then if you back off Westchester rent, assuming 7%, because if this transaction doesn't close, the rent on Westchester will be 7%, that would be a million dollars. So you back that off of the $2.4 [million] and you get to the new rent on the Clarity Pointe properties, which will be $1.3 million. If you compare that to the old rent on the Clarity Pointe properties of $2.4 million, you get to a reduction in rent on the Clarity Pointe properties of a million dollars or approximately $0.027 per share.

Clint Malin
And in this case, the GAAP rent in this case is lower than the cash rent, because there is no fixed escalator, so in that $6.3 million, there is no straight-line impact of the escalators. And also as I mentioned in my comments, we get a percentage rent increase based on the growth and revenues over a certain threshold.

Jason Sadler
Okay, but Pam's numbers were GAAP, right?

Pam Kessler
They are GAAP, yes.

Jason Sadler
So cash will be a little higher, is your point, Clint?

Pam Kessler
Yes. And as the escalators are variable, you don't do a straight-line rent calculation on them, but as we get those escalators -- they're essentially related to CPI — rent will increase and you'll see that flow through in FFO versus normally you see that happen in FAD.

Clint Malin
And that GAAP rent provided also is the effect of providing some free rent during the course of the lease-up at the properties.

Jordan Sadler
Okay. I appreciate all the color. I'll let somebody else have a crack. Thanks, guys.

Wendy Simpson
Thank you, Jordan.

Clint Malin
Thank you.

Operator
Our next question comes from Paul Morgan with Canaccord. Please go ahead.

Paul Morgan
Hi. Good morning. Just a little bit more on Anthem. Do you have what the coverage is or maybe where it was at the prior rents? And I'm just trying to get a sense of what maybe, at your portfolio coverage, just the stabilized rents would be if you moved to a new operator.

Clint Malin
Well, coverage -- these buildings were new in the lease-up, so it’s hard to give a coverage specific to — because on a combined basis, because of the lease-up.

Paul Morgan
Yeah, but some of them have been — I understand that for a few of them, but, for example, the Denver assets are stabilized and —

Clint Malin
Yep. And we have two of the properties that rolled into the same store in the Colorado market, and the trailing 12-month Q1 coverage on the two initial properties in Denver was 1.4 times coverage, including the 5% management fee, as an example of two buildings that have rolled into same store.

Pam Kessler
Yeah, the issue’s really in the lease-up properties, not the stabilized.

Paul Morgan
Is in the lease-up properties, okay. Did you have a sense from Anthem that they were in a financial position that they wouldn’t be able to continue paying their rents, or how much of a kind of a surprise was this to you when July 1st came around?

Wendy Simpson
Well, I think we talked about it in our last quarter when we were talking about the challenges with the lease-up and that we were going to have to address these issues, but Anthem had been trying over the last six months to raise additional equity, which they did need in that company. They were unsuccessful in raising that equity. We had given them a date certain that they needed to come up with that equity to give us some more confidence in their ability to sustain their business, and when those efforts had failed, that’s when we said, “Well, we need to issue the default, and we need to be able to determine the fate of these properties in a more proactive way.”

Now, they’re doing well. As I indicated, they’re improving their census, but because of accounting issues and reporting issues, we really had to step back and say, “We need to take some time out on booking these things,” even though I think — well, I know the assets are worth much more than we have invested in them. I know they could go to other operators probably at the rents that we had with Anthem, but it’s a very complicated and intense thing to do that, so we’re working through it. We’re looking at — as I said, we’re looking at all of our options.

Clint Malin
And we view it as this is a short-term GAAP period getting to lease-up, and ,there have been some inconsistencies in leadership at some of the communities.

Wendy Simpson
Right.

Clint Malin
And so our viewpoint is this is a short-term hurdle to get over as they’re going through lease-up, but long term the buildings are good locations, and long term are very viable and, as Wendy mentioned in her comments about the value creation specific to the four original buildings in Denver as an example of market value, what we perceive to be market value over our cost basis.

Paul Morgan
So if you look at the lease-up assets that have caused the problem that I think helped precipitate this, how much of the issues are, in your estimation, related to competition in the market with new supply, mistakes that might have been made in the lease-up process in terms of concessions or other things, or something else in the asset? And then have you — in your maybe preliminary discussions with other operators, do they see it in a similar light?

Clint Malin
The one property that we're aware of in regard to competition is the Westminster community, which we talked about, and they've had a fair amount of new supply come out in that marketplace, but even as Wendy indicated, Anthem had reached somewhere in the 80s a number of months ago, dropped back down into the 60s, and then as Wendy indicated in her comments, it's now — they've refocused, they have brought in new leadership at the community level, and occupancy is rising again, so that's probably the one property that stands out that has had the introduction of new competition. But even with that, after refocusing and bringing in the new leadership, they've been able to grow that occupancy, so at this point, it really seems that it's more — well, not market based, but we're actively engaged, as you can imagine this process, in evaluating that and making sure we have a full understanding, is it operator or is it market-driven?

Paul Morgan
Okay. I'll let other people continue with Anthem, but just one other question for me, then, for now is on the Frontier deal, you mentioned that they operate in 11 other states, and it sounded potentially like you might see growth opportunities organically with them as the new partner is that correct? Is there anything that you think could materialize, say over the next year?

Clint Malin
There's nothing specifically on the table at this point. Obviously, that is the hope. We've been working with Frontier. Doug Korey has a long relationship with the Frontier Management team, and this is really something that we've looked at a couple of opportunities with Frontier, at mezzanine and preferred-equity opportunities, and it's translated over a year timeframe into this unique off-market opportunity. So, yes, we hope that this is something that leads to more growth opportunities for LTC.

Paul Morgan
Great. Thanks.

Wendy Simpson
Thanks, Paul.

Operator
Our next question comes from Chad Vanacore with Stifel. Please go ahead.

Chad Vanacore
Thanks for taking the questions. So guidance is coming down around 4% — or $0.04 at the midpoint. Was that solely due to the transition properties and the changing cash rent collection, or were there other changes in the base assumptions that we should consider?

Wendy Simpson
No. It was all related to Anthem.

Chad Vanacore
All right. I like that. That's nice and clean. And then just given some of the issues that you're having with some of these new memory care development lease-ups, does that in any way change your view on the memory care market stability?

Wendy Simpson
Really sort of. The memory care-only properties I think are a little bit more of a challenge in lease-up. The properties that we have financed that our operators convinced us that it's better to have assisted living and memory care, or three levels — independent, assisted, and memory care — have leased up better. However, the memory care-only properties, several of them have leased up as anticipated, but if it's a challenge, it's a bigger challenge, because it's a smaller property and each unit is a bigger percentage of the whole. One of the challenges Anthem had was effective marketing of the dual-suite type of unit, and we spent a lot of time talking with the operators at the facilities and with Anthem corporate, and they've now been able to change their marketing techniques and their marketing strategies and have been being more successful in this dual-occupancy unit. I think Silverado does it quite well, and so if I had it to do over again, I think we would not have gone with as many memory care-only; however, based on the demographics and based on the rise in the Alzheimer's, I believe these are long-term sustainable properties.

Chad Vanacore
All right. So, Wendy, if you were going to underwrite a new memory care development today that's memory only, how would that change your underwriting standards or at least have expectations, actually?

Wendy Simpson
Yeah, we probably want lease-up more in the 24- to 36-month range, and I would look for coverage, still stabilized coverage at 1.2, and I'd also look for more equity in the deal than we've had in the past.

Chad Vanacore
All right. That's great. And since you've been fairly selective on the investment front, what would you need to see to change in the markets to meet your underwriting criteria?

Wendy Simpson
Oh, we have always been supporters of SNFs, and we still support SNFs, but it would really have to be an incredible deal for us to invest in a SNF now if it weren't being added into a well-covered master lease. I can't really say what we would look for underwriting, but I think it would have to be above 1.5.

Clint Malin
And also, that valuation would not just be property-specific. It's really going in and underwriting the company and understanding their ability to navigate sort of a new paradigm and as far as the shift towards managed Medicare and their positioning within a market to be able to demonstrate their ability to navigate the waters of various changes in the reimbursement and regulatory environments.

Wendy Simpson
Correct me if I'm wrong, Clint, that one of the good things about Frontier, Frontier Investment is one of the properties has some room to grow. They had room to grow. So that's important to us. Investing in a property that's already 90% occupied or more, it's hard to say that we're going to get some growth out of that. So price, of course, is one. We'd have to get a return over 7% to make it worthwhile, and we just aren't seeing those types of deals.

Chad Vanacore
All right. Thanks again for taking the questions.

Wendy Simpson
Sure. Thank you.

Operator
Our next question comes from John Kim with BMO Capital Markets. Please go ahead.

John Kim
Thank you. Good morning. So I'll take a crack at Anthem. You characterized the issues of being really related to developments, but when you look at their $12 million in annual rental income that's contractual versus the $4 million that you think they'll pay, annualized, it would seem to suggest that it's more than just the developments. It's the existing stabilized assets that are also underperforming. Is that correct?

Clint Malin
Well, it's primarily the three buildings, which are in lease-up, which Wendy mentioned in her comments.

Pam Kessler
And just to clarify, the annualized number, we are not projecting that into 2018. We gave you an annualized number, but we're really looking just at the remainder of this year of collecting about a million dollars per quarter, and 2018, we have not revised projections on that. We haven't introduced guidance on 2018, but even internally, we're still working on the outcome of this situation, and so it's too premature to say what we really think is going to happen on an actual annual basis.

John Kim
Okay, but these development projects, there's three of them in lease-up, and you have 11 under the master lease. So, again, it seems like when they're paying one-third of the rent that they're —

Wendy Simpson
Eleven includes Kansas, right?

Pam Kessler
Yeah, so the two Kansas properties, we are in negotiations to transition those, and we have not used any rent assumption on that, so if you were looking at modeling for the remainder of the year, you might assume that there would be some rent from those coming, and then the remaining properties, you have stabilized properties, but obviously the EBITDAR from the stabilized properties is not enough to cover rent on stabilized and unstabilized. It covers a portion of it but not all of contractual, so obviously one of the possible outcomes is lowering the rent temporarily to an amount that they can pay, which is what we've done here. Nothing has been done

contractually. We've just said, "Pay what you can pay," and we estimate it's about a million dollars a quarter.

John Kim
Okay. So the $4 million that Anthem can pay, in addition to that, we should add the transitioned assets. And how much rent do you expect out of those two assets?

Pam Kessler
For the two assets that are being transitioned, we're in negotiations, so we're not disclosing that at this point, but we will update you when we have a contract in hand and we finalize negotiations.

John Kim
Do you expect the rent to be similar to what Anthem paid or lower?

Pam Kessler
At this point, it's too premature to say. I'm sorry.

Clint Malin
And just to clarify on the 11 properties, 2 of the 11 are in Kansas that Wendy referred to. Two of those are under construction, and there are 7 that are — outside of Kansas, seven that are operational.

John Kim
I see, okay. Thank you. The facilities EBITDAR coverage ratio that you have on page 12, so this is the same store, and I'm assuming this does not include lease-up assets on page 11. Is that correct?

Pam Kessler
Correct.

John Kim
Okay.

Pam Kessler
Not until they reach the definition of stabilized and same store, so they have to be stabilized for the two comparative periods.

John Kim
So do you have any other tenants that have an EBITDAR coverage at 1 times or below?

Wendy Simpson
Well, we've always talked about Sunrise. Sunrise covers probably about 1, but we're not too concerned about the credit on Sunrise. I don't think we have any others that are 1 or below.

Clint Malin
Nothing material.

Wendy Simpson
Nothing material that's 1 or below.

John Kim
Wendy, you mentioned on an acquisition that you passed on this quarter, there were issues you identified during due diligence. Can you just provide some color on what that was and if it's specific to this portfolio, or do you think it's something widespread?

Wendy Simpson
It's definitely specific to the portfolio. It was an investment in some skilled nursing properties in New Jersey, and as we went through our due diligence, the properties were doing very well, and we expected them to do very well. The company was a private company, and so their financing was very, I would say, convoluted in terms of who had security in what, And so we were unable to get comfortable that we would be able to get the corporate guarantee or the corporate backing without a lot of people standing in front of us to just buy these two assets and lease them back. So we tried very hard, and Clint and Doug worked diligently trying to get that deal done, but in the end, just because of the way they financed it, they grew, and what the banks took as security for their loans, we just couldn't get enough comfort that we'd be able to get these assets free and clear and that the operator wouldn't have encumbrances that we wouldn't want to let them assume.

John Kim
Okay. And if I could just go back to Sunrise for a second, what do you think the resolution is with them?

Wendy Simpson
I don't —

John Kim
And the timing as well.

Wendy Simpson
Yeah, I think their lease is up sometime in '18.

Clint Malin
It is.

Wendy Simpson
We don't expect Sunrise is going to want to renew the lease at its current lease rate. We're not even sure Sunrise is going to want to renew the lease at a reduced rate, because leasing is not their mode of business any longer. So what I think we're going to do is look at opportunities to possibly sell those assets, which we would have a significant gain, most likely, or we'll find another operator who would like this nice group of assets in Ohio and just outside of Ohio in Pennsylvania, and it's likely we'll get a little bit of a reduced rent to begin with, but they're good assets, they're always full, and it's just a matter of pricing.

John Kim
Okay. Thanks for the color. Thank you.

Wendy Simpson
Thank you.

Operator
Our next question comes from Rich Anderson with Mizuho. Please go ahead.

Rich Anderson
Thanks. A lot of my questions have been asked and answered. Just a couple here. So the guidance went down by $0.05 at the midpoint, you're taking an $0.08 temporary hit at least from Anthem and maybe call it a one penny from the Clarity-to-Thrive moving parts, so that's $0.09. That $0.04 differential, is that just from investment activity being accretive? In other words, would you have raised guidance by $0.04 today if not for these two moving parts?

Wendy Simpson
Yes.

Rich Anderson
Okay. That's a perfect answer, nice and quick. And then can you comment on your exposure to memory care? I don't know that you have specifically what amount of it is standalone, what amount of it is intertwined into existing senior housing assets.

Pam Kessler
From a standalone basis Anthem was our primary exposure and Clarity Pointe secondary. The rest are memory care units within a larger assisted living facility.

Rich Anderson
So standalone memory care right now is a couple percentage points of the portfolio, is that right?

Wendy Simpson
Yes.

Rich Anderson
Okay, and then if you look at all of memory care, 5, 6, 7% of the portfolio, something like that, including those that are wings within a senior housing facility?

Wendy Simpson
Yes, it's just senior housing, not including units in skilled nursing. That would be about right.

Rich Anderson
But I'm on the right order of magnitude in terms of exposure?

Wendy Simpson
Correct.

Rich Anderson
Okay. And so on a go-forward basis, even though it's — well, let's just say it's 5 or 6 or 7%, does your disenchantment with what's happened here, does that number probably go down, whether a combination, standalone, or intertwined into a senior housing facility? Do you think that your desire for memory care will result in that number going down or up over the long term?

Wendy Simpson
I think it will. Again, it's going to be so much on location, but as I said, we've stopped doing development with Anthem. We don't have anybody asking us to do development of memory care standalones. I think we need to see the market shake itself out, so right now I don't think we would do another standalone memory care development project, but in four or five years, when the absorption has happened, it might change.

Clint Malin
And, Rich, a lot of that is that most of our memory care projects were through development, and you look at —

Rich Anderson
Right.

Clint Malin
— the pricing point on, as the example Wendy gave on market value of the Anthem Denver assets, that's an example of what is out there to buy if it is stabilized or close to stabilized, so that's where it gets challenging to add into a master lease with coverage. So it's the difference between acquisition and development, and we've been pulling back on development the last year, and that's how we really got into memory care, is investing at cost as opposed to buying at a premium.

Wendy Simpson
And [inaudible] —

Rich Anderson
Okay, and so —

Pam Kessler
We're really reacting to the demand in the market. If you flash back six years ago, memory care standalone was selling at a premium, and there was no supply, so we were first in reacting to that and building, and now others have entered the market, and like any development cycle, it's lumpy. And typically what happens is when there's that big demand, everybody sees it, they build, you have a short-term overbuilding, but in the long run, it works itself out, and I think that's where we are right now, just in that lumpiness of a development cycle.

Rich Anderson
Right. So, yeah, demand for the space, obviously a sad truth, but I'm curious if this experience has you rethinking any other tangential asset classes like behavioral health or something like that, or are you less inclined to break free from the main food groups of senior housing and skilled nursing at this point because of this?

Wendy Simpson
No. I don't think this is a failure. I think this is a short-term challenge, and we've —

Rich Anderson
Okay.

Wendy Simpson
— done challenges before when we worked out Assisted Living Concepts, so we have addressed this type of thing. I think we're proactive. I think we're very clear with our investors and analysts with the challenges we have, so this is not a failure. This is a challenge.

Rich Anderson
No, not implying that. Anyway, you know, thanks for that. I always appreciate your open book on these types of things, so thank you.

Wendy Simpson
You're welcome.

Operator
Our next question comes from Michael Carroll with RBC Capital. Please go ahead.

Robert Carroll
Yeah, just real quick on Anthem again, how have these communities performed versus your underwriting? And I understand the lease-up properties are the ones that have the issue, but don't we have another 6 to 12 months before we hit the 24-month lease-up mark at Burr Ridge and Tinley Park?

Clint Malin
Correct.

Robert Carroll
So how could those be the problem if we're still 6 to 12 months away from that 24-month mark?

Clint Malin
Well, they're below where they were targeted to be at this stage.

Pam Kessler
Yeah, they're below proforma, where we thought they would be and how we had projected cash flows. So we projected cash rent based on cash flows expected from the property based on lease-up to the extent they — their occupancy is lower and they don't have the revenues, you know, that impacts their ability to pay us rent.

Wendy Simpson
And another impact is that Anthem has a corporate office, and so in the proformas, we didn't expect a corporate office to be as expensive as they created a corporate office. So we have worked very closely with Anthem to rationalize their corporate office, and they're very clear that for every dollar they spend in corporate office, it's a dollar of rent we do not get, so at this point in the proformas, we were not expecting such a heavy burden from their corporate office, which is being addressed.

Robert Carroll
Okay, and then can you give us what — where did you expect occupancy to be at for Burr Ridge and Tinley Park in your underwriting?

Clint Malin
On a stabilized basis?

Robert Carroll
Well, you said that they are underperforming underwriting right now, so where is your underwriting versus where they're at right now?

Clint Malin
Where they're at? I don't have that available, but we can provide that after the call.

Robert Carroll
Okay. Great. And then, Clint, can you give us a quick rundown on your other development relationships that the company has, and are any of these operators having similar issues?

Clint Malin
On the — development has primarily been with Anthem, Thrive, Clarity Pointe, and Oxford Senior Living, so it's really been in four relationships, and the occupancy challenges really have been at Clarity Pointe, which we've talked about, on the Jacksonville property, and then on these properties with Anthem.

Robert Carroll
But these other development relationships are pretty clear and free in order to be able to pay their rent right now?

Clint Malin
As of right now, the others are fine.

Robert Carroll
Okay, great. Thank you, guys.

Clint Malin
Thank you.

Wendy Simpson
Thank you.

Operator
Our next question comes from Todd Stender with Wells Fargo. Please go ahead.

Todd Stender
Hi, thanks. You still have funding commitments on the Anthem lease-up projects. Do you finish those before you begin to explore other — either transitioning them or selling them? You're under that commitment. How does that work?

Wendy Simpson
Well, contractually, now we don't have to do that, but we are, of course. We'll be finishing them — in fact, the one in Oak Lawn —

Clint Malin
In Glenview.

Wendy Simpson
Glenview? The one in Glenview is probably opening in October.

Clint Malin
November — or October/November timeframe.

Wendy Simpson
And then the one in Oak Lawn —

Clint Malin
Oak Lawn — will be probably sometime in the first quarter.

Wendy Simpson
It would be difficult to sell those as projects that are under development. They've done the development within their budget, so they've developed a good property. It's their operational missteps that have caused the problem, so we will finish those properties.

Todd Stender
Okay. Thanks. And probably for Pam, the difference in the cash rent, the $2.6 million to the million, how does that accumulate? Is that going to be on the balance sheet? How does that work?

Pam Kessler
Yeah, it was accumulating on the balance sheet. That's the straight-line rent balance, but we've stopped that, so it should not at this point grow any further.

Todd Stender
Or does that –

Pam Kessler
The cash and GAAP are the same right now.

Todd Stender
Okay. What they owe you, that accumulates on a contractual basis, right? They have to cut you a check at some point for all back rent?

Wendy Simpson
Correct.

Pam Kessler
Well, it's straight-line rent, so contractually, it's paid over the life of the lease.

Clint Malin
The portion of straight-line. Yeah, there is --

Pam Kessler
The portion of straight-line, yeah.

Todd Stender
Okay, got it. And then as far as — and I think this is probably for Clint — your acquisition volume or pipeline, rather, is fairly modest. What are some other things you might deploy capital towards, raising the dividend a little more, paying down future debt, maybe we see a little more mezz lending? How do you look at that?

Clint Malin
We tend to source off market transactions. I can see doing mezz and some preferred equity in certain cases, so we are actively seeing deals. As I mentioned, a lot of the deals we're seeing on a marketing basis are expensive or are just things that we're not interested in. But we are actively engaged in — Doug and his team are looking at a number of deals and underwriting opportunities, so we continue to be very engaged on that, and we're hopeful that through our relationships, and,

as Wendy mentioned, our discussions with mezz and preferred equity, tend to lead to other transactions. We had that $40 million deal Wendy mentioned that was in the pipeline, and that actually was initially a mezz conversation that led into this opportunity, but we've always been very prudent in due diligence, and we just couldn't get through those challenges, so we decided to pass on that, but we are seeing opportunities, and we're hopeful that through those relationships we have, we're able to source some more opportunities going forward.

Todd Stender
Okay. Thanks, Clint.

Clint Malin
Thank you.

Operator
Our next question comes from Karin Ford with MUFG Securities. Please go ahead.

Karin Ford
Hi. Good morning. Can you just give us your expectations on a timeframe for the resolution on the Anthem properties? And I know you said all options were on the table. I just want to make sure that one of those options could include potentially leaving all of the nine properties with Anthem. And how much time do you give them to kind of turn around and come back to paying rent?

Wendy Simpson
Yes, one of the options could be leaving them with Anthem. We will have a resolution by the end of the year. If we decide that a path is to sell some of the assets, that takes quite a bit of time and negotiating and that sort of thing. If we leave them with Anthem, it's going to be a bit harder to determine when we will re-establish full rent. I think within the next three months, we will see if the lease-up continues at the pace that they're currently binding it, I think we will be able to re-establish rent on a higher basis pretty quickly, but it's still too many options in the air, Karin, to give you a real specific timeline.

Karin Ford
No, that's helpful. And have you had any discussions with other operators about the properties, and, if so, what's been the reception?

Wendy Simpson
It's been too early. We've talked to a couple of operators about their interest in the portfolios, pretty much looking at the Chicago market and the Denver market separately. We haven't done a broad-based offering of the properties, but we've talked to a couple of operators about interest, and we're continuing those discussions. The problem would be if we leased all of the Denver assets to another operator, that further hobbles Anthem, and they still have the developing Chicago market. So it would be best if we would have somebody very interested in Denver and very interested in Chicago. But I think continuing as we are doing and booking just the cash rent will eliminate — not eliminate, but it will reduce our exposure to any other adjustments, and we'll have upside on this in the future.

Karin Ford
How deep is the pool of replacement operators?

Wendy Simpson
Well, of course, in the Denver area, it's going to be pretty deep, because it's more established operations. In the Chicago area, we don't have as many connections. We haven't reached out to Silverado, which is not a connection of ours, but if we got serious about it, of course we would talk to some of the bigger operators.

Clint Malin
But one of the advantages in the Chicago market is it's a denser area, harder to build, so, you know, with these already in the ground, for other people to look at it, if hey, avoid that whole timeframe of sourcing land, getting approvals, so there is an advantage to that long term in the Chicago market.

Karin Ford
Great. Thanks for taking the questions.

Wendy Simpson
Thank you, Karin.

Operator
We have a follow-up question from Rich Anderson with Mizuho. Please go ahead.

Rich Anderson
Sorry to keep it going, just a quick one for Pam. What are you thinking about in terms of interest expense like on a run rate basis, given some of this moving stuff?

Pam Kessler
Sure. About 7 — $7.7 [million], $7.6 [million] a quarter.

Rich Anderson
Okay. And remind me what caused it to trickle down this quarter?

Pam Kessler
Oh, we repaid outstandings under our line of credit.

Rich Anderson
Oh, okay. Okay, right. Got it. Okay, thank you very much.

Pam Kessler
And I'm sorry, on interest — I'm sorry, $7.8 [million] — about $7.8 [million]. Use $7.8 [million].

Rich Anderson
Okay, sounds good.

Pam Kessler
And then, obviously, if you're layering on acquisition assumptions, you'll need to increase interest expense, but based on where we sit right now, it's about $7.8 [million] a quarter, $7.8 million a quarter.

Rich Anderson
Thank you very much. Appreciate it. That's it.

Pam Kessler
Thank you.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Wendy Simpson for any closing remarks.

CONCLUSION

Wendy Simpson
Yes, thank you for listening to our call today, and, as Pam said, we will be giving you more updated information as we work through all of our issues with Anthem, and look forward to talking to you again after the third quarter. Have a great day.

Operator
The conference is now concluded. Thank you for attending today's presentation. You may disconnect.