LTC Properties, Inc.

2022 Second Quarter Conference Call

July 29, 2022

C O R P O R A T E P A R T I C I P A N T S

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P R E S E N T A T I O N

Operator

Good morning, everyone. Welcome to today's LTC Properties Inc. 2022 Analyst and Investor Call.

After today's presentation, there will be an opportunity to ask questions.

Before management begins its' presentation, please note 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's Property filings with the Securities and Exchange commission from time to time including the company's most recent 10-K dated December 31, 2021. LTC undertakes no obligation to revise or update these forward-looking statements to reflect events or circumstances after the date of this presentation.

Please note, this event is being recorded.

I would now like to turn the conference over to Wendy Simpson.

Wendy Simpson

Thank you, Operator.

Welcome everyone to LTC's 2022 Second Quarter Conference Call. Joining me today are Pam Kessler, Co-President and Chief Financial Officer, and Clint Malin, Co-President and Chief Investment Officer.

I will start today by continuing to share my enthusiasm for LTC and its future. Too often, over the past several years, we have spent time discussing COVID, economic headwinds, and the challenges facing our operators. While the industry is not completely out of the woods, and LTC still has a few specific issues to resolve in the short-term, I believe our Company is on sure footing and is operating from a position of strength.

Since the beginning of COVID and to date, we have successfully transitioned several portfolios to strong regional operators with whom we can grow. Most recently, we took important steps to rectify ongoing rent abatements and deferrals by transitioning our marketing properties for sale that have made up the majority of our ongoing assistance. You'll hear more about that later in the call. We have continued to make successful investments that generate positive returns for our investors, especially through creative and flexible structured finance vehicles, have taken a number of steps to enhance the quality of our portfolio, including reducing its average age and have divested properties that no longer fit with our longer-term goals.

To date this year, we have invested over $110 million in senior housing and care, slightly ahead of the entirety of last year, and have generated net proceeds from strategic sales of approximately $72 million, which is $19 million in excess of our gross book value of $53 million. We are continuing to identify additional strategic investments and have been busy touring sites and building relationships. I cannot thank the entire LTC team enough for their hard work in helping us to execute on our goals. While there are still some heavy lifting needed by our operators to return to a pre-pandemic environment, including occupancy and rent increases, a more permanent solution to ongoing staffing issues, and an easing of the inflationary pressures being felt by us all, we are steadfastly moving in the right direction with a strong sense of hope for the future.

Occupancy in our portfolio is gradually increasing and we're hearing from some of our partners that temp agency utilization is dropping and rent increases have been implemented by several of our private pay operators. Multiple signs are pointing in the right direction and I believe our industry, and LTC specifically, is successfully emerging from the worst of the COVID crisis.

As I said before, needs based care is a vital part of our economy and that favorable demographics and the growing fundamental needs of our senior population speaks to the long-term health of the seniors' housing and care industry. I'm confident that much of the angst we've managed through is now in the rear-view mirror, and we can focus more clearly on growth.

We maintained our $0.19 per share monthly dividend during the second quarter, with a total payout to shareholders of $22.6 million. Throughout the pandemic, many REITs elected to cut their dividends, but I'm proud to say that, LTC's conservative financial approach has allowed us to continue paying a steady current return to our shareholders.

Our FAD payout ratio moderately decreased to 88% for the second quarter, down from 89% from the first quarter. We continue to believe that our FAD payout ratio will approach our target of 80% in the fourth quarter of 2022. Our guidance for the third quarter anticipates that FFO will be slightly higher than this past quarter. This excludes non-recurring items from both periods.

I will now turn the mic over to Pam.

Pam Kessler

Thanks, Wendy.

Total revenue grew by $4.9 million from the second quarter of 2021. The increase resulted from a $1.8 million increase in rental revenue, primarily due to a lease termination fee received in connection with the sale of the 74 unit Assisted Living community. Other contributing factors included rent received from the former Senior Care and Senior Lifestyle portfolios, rental income from completed development projects and annual rent escalations, and higher property tax income. The increase in total revenue is partially offset by reduced rents, resulting from property sales as well as a temporary rent reduction to Anthem, which we discussed on our last call.

Interest income from mortgage loans increased by $2.2 million, primarily due to mortgage loan origination, while interest and other income increased $907,000, principally related to a mezzanine loan origination and additional funding under working capital loans, partially offset by loan payoff.

Interest expense increased $663,000 from last year's second quarter, mainly due to term loan originations, the issuance of $75 million of senior unsecured notes in the second quarter and higher interest rates, partially offset by a lower outstanding balance on our line of credit and scheduled principle pay downs on our senior unsecured notes.

Transaction costs and income from unconsolidated joint ventures were comparable to the year-ago period. But property tax increased by $219,000, primarily due to our acquisition of a four-property portfolio in Texas during the second quarter.

Our provision for credit losses increased $305,000 primarily due to mortgage loan originations, partially offset by principal pay downs. As a reminder, upon origination, we record a loan loss reserve estimate equal to 1% of the loan balance. This reserve is amortized as the loan principle of paid down. G&A increased by $374,000, mainly due to higher costs related to conference sponsorships and travel, higher non-cash compensation charges, and increases in overall costs due to inflationary pressures.

Net income available to common shareholders increased $35.9 million, mainly resulting from a higher gain on sale of real estate, loan originations, and the increase in rental revenue previously discussed, partially offset by the higher interest expense, G&A, and provision for credit losses also discussed.

Fully diluted NAREIT FFO per share for the 2022 second quarter was $0.64 versus $0.57 in the second quarter of 2021. Excluding non-recurring item, FFO per share was $0.62 this quarter compared with $0.57 in last year's second quarter. The increase in FFO, excluding non-recurring items, was related to higher revenues from loan originations and the net increase in rental revenue previously discussed partially offset by higher interest expense, G&A, and provision for credit losses.

During the second quarter, we recognized a gain on sale of real estate of $38.1 million related to the sale of four properties. Two of the properties were Assisted Living communities in California, which we sold for $43.7 million and reported a gain on sales of $25.9 million. Another property was an Assisted Living community in Virginia, which we sold for $16.9 million and reported a gain on sale at $1.3 million. The final property was a Skilled Nursing center in California, which we sold for $13.3 million and reported a gain on sale of $10.8 million. Of note, two of the Assisted Living communities were approximately 25 years old and a Skilled Nursing center was more than 50 years old. We have been very successful at recycling capital into newer properties to further reduce the average age of our portfolio.

Moving now to our second quarter investment activity. We purchased four newer Skilled Nursing centers located in Texas for $51.5 million. The centers, which we discussed in detail last quarter, are being operated by Ignite Medical Resorts. We continue to anticipate recording cash and GAAP rent of approximately $1 million in each of the third and fourth quarters of 2022 and $4.3 million in 2023. We also originated two senior mortgage loans for $35.9 million secured by four Assisted Living communities operated by an existing LTC partner, as well as a land parcel in North Carolina. The Assisted Living communities have a combined total of 217 units with an average age of under four-years. The land parcel is approximately 7.6 acres adjacent to one of the Assisted Living communities and is being held for the future development of a senior housing community.

Regarding our former Senior Lifestyle and Senior Care portfolios, I will provide some additional details on expected rents going forward. For the six buildings in the former Senior Lifestyle portfolio under two separate leases with quarterly market-based rent resets, we received $20,000 in the second quarter, approximately what we expected, but now anticipate receiving $160,000 in the remainder of the year, which is down from our prior projections, due to slower-than-expected lease up and continued cost pressures. Our expectation for 2023 is that we will sell these assets or set a more permanent rent.

Regarding the former Senior Care portfolio, we have received rent of $1 million in the second quarter, as expected. As we discussed last quarter, we continued to anticipate receiving approximately $2.5 million in each of the third and fourth quarters of this year. We are continuing to work toward amending and extending our lease with HMG Healthcare, the operator to whom we transition the portfolio prior to its current maturity in September. We also received $5.3 million of principle paydown on the $25 million working capital loan with HMG. The loan has a current outstanding balance of $13.3 million.

During the second quarter, we sold 75 million aggregate principal amount of 3.66% senior unsecured notes. The notes have an average 10-year life, scheduled principal payments and mature in May, 2033. We also repaid a net of $101.9 million under our unsecured revolving line of credit, at a weighted average rate of 1.9%. We sold 909,800 shares of common stock, for a total of $34.2 million in net proceeds under our ATM program. We used the proceeds from the sale to paydown our unsecured revolving line of credit, which we had used to fund investments and for general corporate purposes.

Subsequent to the end of the second quarter, we paid $20.2 million in regular scheduled principal payments under our senior unsecured notes at a weighted average rate of 4.9%, borrowed a net of $20.5 million under our unsecured revolving line of credit at a weighted average rate of 2.7%, and sold 125,200 shares of common stock for a total of $4.8 million in net proceeds under our ATM program.

Presently, we have $6.4 million of cash on hand, $323.5 million available on our line of credit, with $76.5 million outstanding and $160.3 million available under our ATM. This provides us with total liquidity of just over $490 million. We have no significant long-term debt maturities over the next five years.

At the end of the 2022 second quarter, our credit metrics remained solid with a debt to annualize adjusted EBITDA for real estate of 5.7 times and annualized adjusted fixed charge coverage ratio of 4.3 times and a debt to enterprise value of 32.1%. Although our debt to annualize Adjusted EBITDA for real estate metric remains higher than our long-term target of below five times, we believe we will achieve this metric by year end as a result of increased rent from the properties previously leased to Senior Care and Senior Lifestyle, recent investments that we expect to start producing revenue, debt reductions from principal pay downs on our line of credit from asset sales, and scheduled principal pay downs on our senior unsecured notes.

During the 2022 second quarter, we provided a net of $702,000 in rent deferrals, including $114,000 of repayments and $1.2 million in rent abatements. Again, to the same small subset of operators that have been receiving assistance from us. This amount does not include Anthem, which Clint will discuss in a moment.

Off note, as Wendy mentioned, we recently took steps to resolve the portfolio challenges related to the majority of the deferrals and abatements. Clint will also discuss these actions.

Now, I'll turn things over to Clint.

Clint Malin

Thank you, Pam.

Addressing the set of operators that Pam just referenced on July 1, we successfully transferred a 12 property, 625-unit Private Pay portfolio across five states to an affiliate of ALG Senior, a current LTC operator. The former operator who is not in our top 10 in terms of concentration, was one of the few for whom we had provided assistance in the form of rent, deferrals, and abatements. In conjunction with this transaction, we provided the former operator a $500,000 lease termination fee, which will be recognized as a one-time charge in the third quarter, in exchange for cooperation and assistance and facilitating an orderly transition.

We also have forgiven the former operators deferred rent balance of $7.1 million, which was not previously recorded since the lease is on a cash basis. The transition communities are pursuant to a new master lease with a two-year term with zero rent for the first four months. Thereafter, cash rent will be based on a mutually agreed upon fair market rent. We also provided the new operator with a $410,000 lease incentive payment, which will be amortized as a yield adjustment to rental income over the term of the lease. Working with the new operator, we are currently determining whether we will retain all of the buildings or sell all or part of the portfolio, we will keep you updated.

We also are in the process of resolving the other contributor to our deferral and abatements by marketing for sale a 180-unit Private Pay campus, offering the services ranging from independent living cottages to memory care. We are not receiving any rental income from this campus currently. So.by selling it, we can redeploy the capital into income producing assets. For the third quarter, we have agreed to abate the operator's full contractual rent of $720,000.

Now, for a quick update on Anthem and on a portfolio with another operator, not in our top 10 concentration. As we noted, we are providing assistance to Anthem as they work through some operating challenges related to COVID. In the 2022 second quarter, we provided them with a $600,000 temporary rent reduction. We also agreed to provide them with a $900,000 temporary rent reduction for the third quarter of 2022, bringing their anticipated third quarter rent payment to $1.8 million. Upon Anthem's the receipt of additional stimulus funds in the fourth quarter, we expect to receive the $1.5 million of rent we temporarily reduced, bringing Anthem's total annual cash rent to $10.8 million this year. Anthem is up-to-date on the modified rent payments through July of 2022.

We also agreed to defer $150,000 of the $445,000 monthly contractual rent for August and September from a lessee that operates eight Assisted Living communities under a master lease with us. The operator requested rent assistance due to a protracted lease up with their portfolio during COVID. We anticipate receiving the $300,000 of deferred rent in 2023 upon the operators' receipt of additional stimulus funds. This operator is current on rent through July, 2022, and as I mentioned earlier, is not in our top 10 in terms of concentration.

Next, I will provide an occupancy update on the former Senior Lifestyle portfolio, which includes 18 communities with the May licensure and transfer of one remaining community. Occupancy at June 30, 2022 was 85%, which was up from 83% at March 31, 2022, and 81% at January 31, 2022. For the six communities, under the two separate leases with quarterly market-based rent resets, occupancy was 80% at June 30, 2022, up from 76% at March 31, 2022, and 69% at January 31, 2022.

For the 11 properties, former Senior Care portfolio that we transitioned to HMG, occupancy for the month of June, 2022 was 56%. The same as for the month of March, 2022 and compared with 57% for the month of January, 2022. While occupancy has been relatively flat since the transition, we expect HMG's efforts to reposition this portfolio and re-establish referral relationships to result in occupancy gains over the next 6 to 12 months.

Moving now to our portfolio numbers with the usual disclaimer that we do not believe coverage is currently a good indicator of future performance at this time given the pandemic and the challenging environment it created. For clarity, recently transitioned properties, including the former Senior Care and Senior Lifestyle portfolios, as well as the 12-property portfolio already discussed, no longer qualify for our same-store metrics, so they are excluded from these numbers.

Q1 trailing 12-month EBITDARM and EBITDAR coverage as reported, using a 5% management fee was 1.04 times and 0.82 times respectively for our Assisted Living portfolio. Excluding stimulus funds received by operators, coverage was 0.95 times and 0.73 times respectively. For our Skilled Nursing portfolio, as reported EBITDARM and EBITDAR coverage was 2.14 times and 1.68 times respectably. Excluding stimulus funds, coverage was 1.52 times and 1.08 times respectably.

Moving now to some recent occupancy trends, which are as of June 30, 2022 and are for our same-store portfolio. Our partners have given this data to us on a voluntary and expedited basis, so the information we are providing includes approximately 55% of our total same-store Private Pay units, and approximately 92% of our same-store Skilled Nursing beds. Private Pay occupancy was 83% at June 30, compared with 81% at March 31, and January 31, 2022. For our skilled portfolio, average monthly occupancy was 72% in June of this year, compared with 71% in March, and January 2022. As a point of reference, our average Skilled Nursing occupancy in 2019 was 80%.

I'll conclude my remarks with the discussion regarding our pipeline. As Wendy mentioned, so far this year, we have closed about $110 million in investments, and we are on-track to close another $60 million to $70 million by the end of this year. With interest rates rising, the spread between bank rates and our investment rates have greatly contracted, particularly related to the cost of a complete capital stack. This has driven demand not only for our structured finance solutions, including unitranche loans, mezzanine loans, and preferred equity investments, but also for our accretive triple net lease structures. While we can effectively compete on plain vanilla transactions, such as bridge financings, we also excel at more complex transactions, including construction and acquisition financing. Importantly, the way we structure transactions encourages operators to fully maximize their own value in part, by not diluting ownership. This is a significant competitive advantage for LTC in the marketplace.

We plan to continue identifying new ways to offer a wide assortment of diversified products that are tailored to the needs of operators who otherwise may not think of a REIT for their financing needs. We are ready and able to capitalize on great opportunities as they arise.

Now, I'll turn the call back to Wendy for her closing remarks.

Wendy Simpson

Thank you, Pam and Clint.

Our focus for this year remains on strategic and sensible growth. Seniors' Housing and Care is here to stay and I truly believe that the industry will, once again, flourish. LTC has taken the steps to make sure we are an integral player in the market.

Positioning LTC as a partner of choice in today's market is not a difficult decision to make. We not only have the creativity to provide financing solutions to an extensive range of solid regional operators, but we have the balance sheet to back it up.

Operator, we're now ready to take questions.

Operator

Thank you, everyone.

We will now start today's Q&A session.

Our next question is going to be from Michael Carroll from RBC. Your line is now open, Michael.

Michael Carroll

Yes, thanks.

I wanted to touch on the other tenant that you guys have been highlighting for the past several—I guess several quarters. It was recently transitioned to a new operator. What is the condition of those buildings, and is occupancy and cash flow fairly weak? Is that the reason why you had to provide the lease incentive to the new operator?

Clint Malin

No, Mike. This is Clint. This is a portfolio we've talked about over the last few quarters and we have mentioned previously that it was operationally cash flow positive. That lease incentive payment we made to the new operator covered transitional things, cost for the transition, buying out some equipment, vehicles, things of that nature, so more transitional in nature.

Michael Carroll

Okay. Then when you're saying that you are evaluating options for this portfolio, can you go through some of the options that you are thinking about and possibly the timing of when those could be executed?

Clint Malin

Sure. Well, I mean, as I mentioned in my prepared mark. We're going to look at sales as well as releasing to the new operator. It's something we're working on right now and I think we'll move fairly quickly in that evaluation process.

Wendy Simpson

Mike, several of those assets who are former ALC assets. So, they are the smaller assets that we have a very low book value on and they're in smaller marketplaces. The condition of the properties is good. I mean, everybody wants to put some capital into a property that they currently take. One of the things that was an advantage to us in moving so quickly and paying a $500,000 lease termination was that the prior operator allowed the current operator to operate under their lease, or under their license for a period of time. In order to expedite everything, we spent some dollars to make it happen, and it's likely that we'll sell most of the ALC properties. There is not a great market—there is not a great national market for those types of properties. There is local markets for those type of properties.

Some of the—a few of those assets may stay with the current operator, but it is likely we'll sell most of those old ALC assets.

Michael Carroll

Okay, great. Thanks for that.

Wendy Simpson

You are with us long enough to know who ALC is. I'm sorry (inaudible).

Michael Carroll

I do remember, yes. The six former SLC assets, what drove the change in the rent forecast there?

Clint Malin

You know what, we've seen occupancy grow. It has really been more on the cost side, Mike. It's been through the first quarter surge with COVID, everybody has talked about agency staffing issues just general inflationary price pressures. That's been the main driver of what modified our guidance on those properties. But occupancy has been there and as we see that they have been able to capture rate growth, it's really the right sizing on the expense side.

Pam Kessler

Yes, and there were a lot of marketing dollars that went into those early on to get that occupancy growth. Hopefully, the marketing dollars will moderate.

Clint Malin

Again, as Wendy mentioned, that we may look at evaluating whether either the performance improves or we look at selling some of those assets as well, so we have options to consider.

Michael Carroll

Okay, great. Then just last one for me, the new tenant issue that popped up that you provide $300,000 of deferred rent. Should we think about that as more of a one-time type thing? I mean, is there concerns that that issue could persist as you go into the fourth quarter?

Clint Malin

I think it is really a function of the ERC credits being funded by the IRS. It is really a function—you've heard that timeframe has been four to six months, after application, it could change as well. I think it is really a function of that timing.

Michael Carroll

Okay, great. Thanks, Clint.

Clint Malin

Thank you.

Operator

Our next question comes from Connor Siversky from Berenberg. Your line is now open Connor.

Connor Siversky

Good morning out there. Thanks for having me on the call.

A quick question on the dispositions completed during the quarter. Apologies if I missed this earlier, but could you provide a sense of what rent those facilities were providing prior to the disposition?

Clint Malin

Well, I don't know the actual rent numbers, I have the cap rate that we provided last time on last quarter's call. The skilled asset we sold had a 6.3 cap rate. One of the AL sales had at a 5.7 cap rate, and the AL where we had the termination fee paid to us was 7.1% cap rate. We had some attractive cap rates on those sales.

Connor Siversky

Okay. Thanks for that.

I know you mentioned this before, just the difference in occupancy recovery between ALS and SNFs. I'm wondering, just from your point of view, is that still due to pressures in the labor markets, inability to fill headcount within these facilities, or if it is just kind of the summer months and a slowdown in elective procedures that might put some downward pressure on the occupancy recovery for SNFs in general?

Clint Malin

I think summer months typically has been slower. I think that is probably a contributing factor. The other thing to think about, too, is skilled providers increase occupancy. They open wings of buildings as a higher staffing element to open a wing of a building to accommodate increased occupancy. With that higher staffing level, it's a function of the expense side of being able—how much they can admit to be able to offset that increased cost.

Connor Siversky

Okay, understood.

Last one, maybe for Pam, I know we have gone over this in the past, but just given the sharp spike we've seen in rates and the way the multiples held in quite nicely for LTC, as you kind of look at this forward investment pipeline, how do you look at the debt equity mix on acquisitions going forward?

Pam Kessler

Yes, we are still at 70% equity, 30% debt, and that's been the way we've consistently looked at it, even when that was really cheap, relative. I mean, I think debt historically is still pretty cheap if you look at the past decade. But when it was really, really cheap, we still were very disciplined in looking at our weighted average cost of capital with that blend.

Connor Siversky

Okay.

Within that same context, do you see some of the private equity players now stepping back from these deals, maybe opening up some more opportunities for LTC to be involved in acquisitions or certain acquisitions that you may have been mispriced.

Pam Kessler

Yes, yes exactly. I think, the movement in rates has really helped us. Because the private equity players, they use a lot more debt and so that part of their capital stack has really increased their cost. I think the increase in rates perversely have been positive for LTC and rates in general. We're feeling much more competitive now.

Connor Siversky

Got it. Well, maybe positive for LTC, but I don't know about all REITs. I appreciate the comments.

Thank you.

Operator

Thank you.

Our next question comes from Steven Valiquette from Barclays. Your line is now open.

Steven Valiquette

Great. Thanks. Hello everybody. Thanks for taking the question.

I guess just for Anthem Memory Care, you mentioned on page 12 in the supplement, you expect their occupancy to recover, and also, they're expecting to receive some additional stimulus funds to be used to pay the deferred rent. I guess I'm just curious when you think of all the things that could be involved in improving their operations, what is the most important variable at the end of the day? Is it the occupancy that you cited? Is it more just the pricing power they might have? Also, I'm curious how much pricing they can do mid-year versus Jan 1. Aso how critical is the labor pressure subsiding? Just kind of balancing rank order what is the biggest variable you think, in your mind, on their recovery?

Thanks.

Clint Malin

I think it's definitely—it is a combination of occupancy and staffing. As we've talked to operators across the board in Skilled as well as Private Pay, there has been a reduction in the temporary staffing costs. That's a positive for the properties. Just growing occupancy after COVID, right now, they have reforecast their expectations for the remainder of the year. They are on target for that, that by the end of the year we feel that their operations will be able to cover rent. They've had dips in the past, as we have mentioned on previous calls, and they have been able to bounce back. At this point we feel confident they will be able to do that.

These stimulus dollars through the ERC program or the Employer Retention Credit program, is very helpful. We think that once those funds are made available, they will be sufficient for them to cover their deferred rent we've provided.

Wendy Simpson

And have a cushion.

Clint Malin

And have a cushion.

Steven Valiquette

Did you guys provide a number around that? We could probably figure out roughly what it is anyway. Did you actually give a number? I might have just missed it in the commentary, but do you—what is the rough amount they might get?

Clint Malin

We haven't given a number for it, but I would say that when you think of the ERC credit, I would think it sort of in the context of PPP funds, as far as the magnitude of dollars.

Steven Valinquette

Okay, got it. Okay. All right, thanks.

Clint Malin

Thank you.

Operator

Our next question comes from Austin Wurschmidt from KeyBanc Capital Markets.

Arthur Porto

Hey good morning. This is Arthur Porto on for Austin today.

Just a quick question on deferrals for the quarter. With respect to the new deferrals in the third quarter specifically the $150,000 in August and September. Can you provide some more detailed size of the operator? Maybe how many properties they operate and also how occupancy is trended? I think that would be pretty helpful. Also, what gives you the confidence that they can repay rent in 2023?

Thanks.

Clint Malin

Sure. The confidence in our ability to collect rent on that is similar to Anthem in this ERC Credit. What's happened is, is as that program was expanded in 2021, a lot of operators assessed whether or not they qualified. Once they determined they qualified, they went through a lot of offers, have gone through a process of where they have actually created their audit trail in advance of applying, to make sure they fully understand the restrictions that affected them and then they apply.

That's what gives us confidence that the ERC funds will be beneficial, usually the timing of receipt of that. We do have some additional credit enhancements with this operator, they are not in our Top-10, but it is a target operator that has a regional presence within the country or operate approximately 20 plus buildings.

Arthur Porto

All right, that is helpful. Thank you.

Clint Malin

You are welcome.

Operator

Our next question comes from Tayo Okusanya from Credit Suisse. Your line is now open.

Tayo Okusanya

Yes, good morning, everyone. A couple of quick ones from me. First one, could you give us an update from a regulatory perspective? Again, it is kind of past July, so most states have set their Medicaid rates. Curious what you kind of saw and also from a CMS Medicare perspective, what you may be expecting down the line as it pertains to the final ruling?

Clint Malin

From a regulatory standpoint, there haven't been a tremendous amount of changes, but we have noticed some, for instance in the state of Florida where there was a recent Medicaid rate increase, and part of that reduced the staffing requirements. That was a positive regulatory change combined with the rate increase. It was very positive for the State of Florida. We are hopeful that will become noticed and could take place in other states, but nothing that we have seen largely from a regulatory standpoint. Wendy or Pam?

Pam Kessler

I mean, I know the Skilled Nursing industry is hoping for a phase in of the cuts and that is always a possibility and that would be beneficial. I haven't heard if that is gaining traction or if there is a preview into the final decision.

Tayo Okusanya

Gotcha. Okay. That is helpful.

Pam, I think there was a comment earlier on from a guidance perspective. The expectation is that, 3Q FFO will be higher than 2Q. I guess when I'm looking at the moving pieces, I'm struggling a little bit to reconcile that because you have given—you have this 12-asset portfolio that is transitioning and assuming (phon) that reduces your rent in 3Q, because the new tenant doesn't have to pay rent for four months. You also have higher interest rates, you have net sales in 2Q of ‘22, which is diluted to earning. Could you help us understand a little bit about how FFO per share in 3Q should be higher than 2Q?

Pam Kessler

Sure. Well, the transition portfolio, we weren't receiving rent on that over the past several quarters. The free rent that was given for the first four months affecting the entire third quarter, that will be the same as the second quarter. No rent. There is nothing that changed in the guidance there.

Where the lift is coming from is HMG. That’s the lease of the former Senior Care portfolio. They paid a million this quarter and that’s increasing next quarter. That guidance on page—for your model is on page 13.

Tayo Okusanya

For the transition portfolio, even though you give them a 600K abatement in June, you really weren't collecting any rent anyway?

Pam Kessler

In June, I'm sorry. Say again Tayo.

Tayo Okusanya

For the transition portfolio, I think you did give them an abatement of their rent of 600K or so?

Pam Kessler

Yes, but they were previously getting a deferral. It's—call it deferral, call it abatement, they are on a cash basis. There was no rent reported. Also in the third quarter, we'll be getting a full quarters' rent from our acquisition with Ignite the Texas Skilled Nursing portfolio, that is not in the second quarter. There is quite a bit that is happening in the back half of the year for us.

Tayo Okusanya

Got you, okay. Then just the next question again, all the news around again, rising COVID cases, BA5, what are you hearing right now from your tenants about any potential impact from all that?

Pam Kessler

I'm sorry, the impact from what?

Female Speaker

BA5.

Tayo Okusanya

From BA5 and rising COVID cases.

Pam Kessler

I'm sorry. I hope, Tayo, I hope we would get through this entire call without talking about COVID.

Tayo Okusanya

I'm sorry to spoil the track record.

Pam Kessler

You did. You did. We haven't heard that it is affecting our operators as much as the prior variants. Obviously, staff being out sick, that hurts, but it is not to the same magnitude as it happened in January. That variant seemed to hit all at once and like everybody seemed to be out with COVID and agency use was quite high in the first quarter. The good news is to the resident population in both Skilled and Assisted, neither the variant that happened in the first quarter or the variant that is happening now, this summer, seems to be causing much in terms of complications or a higher mortality rate like two years ago. The original variant was just awful and that was prior to the vaccines and the resident population is highly vaccinated and boosted. I don't see COVID, right now, creating a ton of headwinds. It is really—occupancy needs to continue to grind higher. Again…

Clint Malin

When you talk to our operators, it is really inflationary cost pressures as well as staffing. Those are the real two things that are on the operator's minds. When you think of the variant, from a Skilled perspective because of the public health emergency, you could scale in place as well. From the Skilled side, they can look at that as an opportunity in the interim to accommodate and be able to not have people go back into hospitals to keep those to keep capacity in the hospitals. That’s really staffing and just cost pressures generally are the main focuses.

Pam Kessler

Yes, and perversely a slowdown in the economy might help the labor problems for our—the labor challenges, the staffing challenges that our operators have. Things could possibly get better in the second half of the year from that standpoint, from just a labor supply standpoint.

Tayo Okusanya

Got you. Thank you.

Clint Malin

Thank you.

Operator

Our next question comes from Daniel Bernstein from Capital One. Go ahead Daniel.

Daniel Bernstein

Hi good morning.

Pam Kessler

Hi, Dan.

Daniel Bernstein

Can you hear me?

Wendy Simpson

Yes, we can hear you.

Daniel Berstein

Okay, I have a new headset, so I wasn’t sure. I wasn’t sure. I just wanted to go back to the 12-property tenant that you transitioned. The ALC assets you might sell there, notwithstanding, how should I think about what rent or cash you receive in 4Q and then going into ‘23? I assume at that point after the four months of free rent, you might receive something?

Clint Malin

You know I think that is really a function, Dan, of the new offer getting in and working continue to increases in occupancy, evaluating expenses. I think at this point it is hard to say, but for our next quarter, hopefully we can provide more of an update on where we are at on that, but it is hard. We haven't given guidance for that yet.

Daniel Bernstein

Okay. Are the ALC assets cash flow positive? Sorry go ahead. Sorry.

Clint Malin

The portfolio as a whole is cash flow—operationally cash flow positive.

Daniel Bernstein

Are the ALC assets cash flow positive?

Clint Malin

We are just providing information about the portfolio as a whole, so.

Daniel Bernstein

Okay. Then I went to a question on labor, I guess it could apply both to Seniors Housing and Skilled Nursing. I’ve been hearing from some operators that they had some increase in net hiring. I was just wondering whether some of the commentary you had on agency labor use reflects the decrease in COVID or maybe more so the increase ability of operators to hire.

Clint Malin

We have heard from some operators that they have made progress in hiring. That is something we have heard from a number operators that is starting to trend up. Again, as Pam's comment, with the economy and maybe that is a benefit to our industry.

Daniel Bernstein

Okay. The last question I had was I think, Pam maybe alluded to some commentary on the cost of debt to private buyers. Have you actually seen any evidence yet of that impact? Are you seeing any assets being re-traded, assets that you bid on that lost that are coming back to you now that you’re looking at again? Just some kind of firm indication that maybe some of the private buyers are backing out, whether that AL or SNF side, I don't know, but maybe talk a little bit about what we are seeing out there in detail?

Clint Malin

Again, I think it is too early in the process with the rates just recently rising. I think that’s going to be something that becomes more of indication next quarter is where I think we see assets come back around or if we have submitted a bid on a transaction that brokers come back to us, and indicate, well maybe this is a price that works. We are hopeful that we see that, but we will have to wait and see how it plays out, but I think it is just too early right now to answer that question.

Daniel Bernstein

Okay. Okay. That's all I have. I appreciate the time. Thanks.

Clint Malin

Thank you, Dan.

Wendy Simpson

Thank you, Dan.

Operator

Our next question comes from Juan Sanabria from BMO Capital. Your line is now open.

Juan Sanabria

Hi, good morning. Thanks for the time.

Maybe just a question for Pam on the earnings following up on Tayo's question. The two payments, one to the prior operator of the 12 assets that are transitioned and the payment to the new operator, are both of those going to be one-time in nature and backed out of NAREIT FFO for a normalized number?

Pam Kessler

The $400,000 to the new operator is considered lease incentive. It is amortized over the life of the lease. So not a one-time. The $500,000 paid to the former operator, yes that will be a one-time charge.

Juan Sanabria

Okay. Then for the acquisition pipeline, I forget who mentioned it. I think $60 million or $70 million was talked about for good assumption for the back half of the year. Can you just give us a little flavor of what kinds of assets? Are those traditional-fee simple, or more structured finance transactions and what kind of yields we should expect on those?

Clint Malin

Sure. Now, this would be an acquisition. I can tell you, it is Skilled Nursing, and it is an off-market transaction actually bringing in new operator into our portfolio. Similar with the portfolio we acquired with Ignite, would be newer Skilled Nursing. I think this off-market transaction speaks highly of the capabilities of our business development team to source these type of transactions.

Juan Sanabria

That would be kind of an eight or nine type of yield?

Clint Malin

We haven't given it, but you think similar to Ignite, which was in the 8% range.

Juan Sanabria

Okay. Then just a general question with regards to lessons learned from COVID. I mean, it seems like a lot of the issues have not been on the Skilled side, but on Assisted Living and maybe with smaller assets. Does that change what the opportunity set is going forward, or broadly any lessons learned about what kind of assets you do want to buy and maybe what now you think maybe is not such a great idea? Sharing any color on how you think about what you've learned as a result of COVID and stress testing? Thanks.

Clint Malin

I think it reemphasizes having a balance in the portfolio between Skilled Nursing and Private Pay. One of the main drivers in the difference is the amount of stimulus funds made available to Skilled providers as opposed to Private Pay providers. Having that balance, because you don't know what environment, what market you may be in. Definitely reiterate balance within the portfolio.

Pam Kessler

Yes. I agree. I think, Skilled Nursing prior to the pandemic, some investors maybe were not as bullish on Skilled Nursing or as an asset class, it wasn't as favorable. But I think the pandemic showed that from the Federal Government standpoint and the states that Skilled Nursing is recognized as a valuable part of the continuum of care for the elderly.

I think that is a positive thesis going forward. I mean, Skilled Nursing is always changing and evolving and certainly they proved during the pandemic that they can take the higher acuity patient and have very good outcomes. I think just from a global standpoint, looking at Skilled Nursing, it is an integral part of our healthcare system and was supported by the government and I think will continue to be. I do scratch my head at the cuts, I think that the timing of them is questionable. I don't understand why the Federal Government would essentially support this industry through the pandemic, and not wait until the recovery has been complete because the recovery is not complete for Skilled Nursing, before introducing these cuts. I am hopeful that the lobbying efforts on Capitol Hill will either delay or at least phase in the cuts, but that remains to be seen. That's politics, and I don't get involved in that.

Juan Sanabria

Just maybe as a follow-up there, I mean, particularly some of the smaller AL assets have been an issue, not just for yourself, but others, some of your peers and maybe just the volatility around what the break-even occupancy is challenging, and obviously pretty high, particularly with higher labor costs. Are you still having an appetite for those smaller secondary market, more middle market priced AL type assets, or are those now maybe not as exciting as they used to be?

Clint Malin

I mean, it is not so much secondary markets. I mean, our goal has been over many years now to focus on strong, regionally based operating providers. That is really who we're trying to target. We think operators who have that presence in a marketplace, that know their markets, that are not too diluted across different parts of the country, we still think that is an ideal operating partner for us. Some of the smaller companies ironically, if they have benefited from PPP funds, as well as the ERC credit which have been targeted towards smaller operators where some of the larger operators haven't had—on the Private Pay side, haven't had the benefit of stimulus funds.

Pam Kessler

Sometimes the smaller markets, they don't have as much competition as the larger markets. Larger markets, they have suffered greatly from oversupply. We really look at each individual asset and at market when we are acquiring and we don't really have any blanket statements like we like only major metropolitan areas, or we only like suburbs, or we only like secondary markets, it is really on an individual basis that we look at our acquisitions.

Juan Sanabria

Got it and maybe just one last quick one for me. The Ignite purchase of this Texas SNFs, why give the—or maybe you can give a little background on the rationale behind giving purchase options up in between year six and seven?

Clint Malin

Well, I think it is just a function of looking at the opportunity and people have choices of capital providers and we try to provide some flexibility and Ignite has done a very good job of performing on assets we have had with them before the Texas acquisition. They performed very well on the Texas portfolio to date with occupancy ahead of our projections. I think for them, it is a way to capture value. We are willing to work with them on that. Hopefully, we can find other transactions between now and then that we can maybe there is a way to modify that where we—they buy a couple, we keep a couple—there's different dynamics that come into play in building these relationships. This was an important aspect for Ignite. We were willing to accommodate it and partner with them on this transaction.

Juan Sanabria

Got it. So, more about the relationship. Thank you.

Clint Malin

Absolutely. Thank you.

Operator

Thank you everyone. That concludes today's Q&A session. I will now refer you back to Wendy Simpson for closing remarks.

Wendy Simpson

Again, thank you for joining us. We are very hopeful for the rest of the year, and we are very grateful to be where we are right now. Thanks for the attention you have given us. Bye-bye.

Operator

That does conclude today's session. You may now disconnect your line.