LTC Properties, Inc.

1Q23 Earnings Call

Friday, April 28, 2023 8:00 AM PDT

CALL PARTICIPANTS

EXECUTIVES

Wendy Simpson *Chairman & CEO*

Pam Kessler *Co-President, CFO & Corporate Secretary*

Clint Malin *Co-President & Chief Investment Officer*

ANALYSTS

Aditi Balachandran *RBC Capital Markets*

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Austin Wurschmidt *KeyBanc Capital Markets Inc.*

Connor Siversky *Wells Fargo Securities, LLC*

Presentation

Operator

Before management begins its presentation, please note that today's comments, including the questions 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 Securities and Exchange Commission from time to time, including the company's most recent 10-K dated December 31, 2022. 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 pass the conference over to Wendy Simpson.

Wendy Simpson

Thank you, operator, and welcome everyone to LTC's first quarter 2023 conference call. I am joined by Pam Kessler, co-President and Chief Financial Officer, and Clint Malin, co-President and Chief Investment Officer.

So far in 2023, we have put nearly $180 million to work through new investments. We have already eclipsed last year's total, which, before now, was our strongest investment year since 2015. Additionally, we have generated $32 million in proceeds from property sales year-to-date, generating net gains of $15 million and reducing the average age of our portfolio.

Going forward, while there are several opportunities we are reviewing, we are cognizant of current market conditions and are prioritizing judicious capital allocation and disciplined portfolio management to identify the most appropriate opportunities. We will continue to diversify our operator base and recycle capital.

Our strategy for dispositions remains unchanged, with a focus on methodically divesting non-core assets and recycling capital at or around annual historical levels of $35 to $40 million. This year, however, we may exceed that amount due to the anticipated sale of certain Brookdale portfolio properties toward the end of this year, which Clint will discuss later.

Regarding industry reimbursement, we were happy to see the proposed CMS rule for fiscal 2024, which included a net market basket increase of 3.7% for SNFs beginning October 1, 2023. At the same time, given the substantial challenges the skilled sector has been navigating through for more than three years, it's likely not enough to result in a much faster recovery. On the private-pay side, we are seeing rate increases implemented without significant declines in occupancy.

As expected, our FAD payout ratio, excluding non-recurring items, increased to 82% for the first quarter, due to not having the benefit of the non-run rate items we discussed on last quarter's call. However, our long-term historical goal remains at 80%.

We did not cut our dividend throughout the pandemic, and this quarter, we again maintained our same monthly dividend payout of $0.19 a share. Our conservative philosophy has served us well through myriad real estate and financial cycles, and we do not plan to stray from that focus.

Our guidance for the second quarter anticipates FFO, excluding non-recurring items, will be in the range of $0.63 to $0.64 per share. This guidance includes the assumption of decreased rent associated with an upcoming operator transition, as Pam will discuss shortly.

It is no secret that our industry's recovery from the pandemic has been choppy, and, in some cases, drawn out. And, while certain operators have made progress on improving occupancy, increasing revenue and reducing costs, others remain challenged. LTC's portfolio is not immune.

While we cannot ignore market conditions and market volatility, I want to be very clear that I remain optimistic about LTC's long-term future and the future of our industry. Demographics are on our side as needs-based care continues to grow, and the population continues to age and live longer. Although the recovery may continue to move slowly, and the path to get there may not be linear, I am a firm believer that by using our collective experience, tenacity and flexibility, we can emerge stronger and more resilient.

Now I'll hand the call over to Pam.

Pam Kessler

Thank you, Wendy.

For the first quarter of 2023, total revenue increased by $8.7 million from last year's first quarter. The year-over-year improvement included a $1.4 million increase in rental revenue, primarily related to higher rent from transitioned portfolios, rent received from our 2022 acquisition of four properties in Texas, annual rent escalations, and rent increases from completed development projects. The increase in total rental revenue was partially offset by lower rent from sold and transitioned properties.

Interest income from financing receivables increased by $3.8 million from the 2022 first quarter, related to the acquisition of 11 assisted living and memory care communities in the 2023 first quarter, and three skilled nursing centers in the 2022 third quarter. In accordance with GAAP, we recorded these transactions as financing receivables because we purchased the properties from an entity, and then leased the properties back to the same entity under a master lease with a purchase option.

Interest income from mortgage loans increased by $1.6 million, primarily due to mortgage loan originations in the 2023 first quarter and 2022 second quarter.

Interest and other income increased by $1.9 million from last year's first quarter, mainly due to the payoff of two mezzanine loans and the related exit IRR and prepayment fee we received during the 2023 first quarter, as well as a mezzanine loan origination during the 2022 first quarter.

Interest expense increased by $3.5 million from last year's first quarter, primarily due to a higher outstanding balance and higher interest rates on our revolving line of credit, as well as the issuance of $75 million senior unsecured notes during the 2022 second quarter. The increase was partially offset by scheduled principal paydowns of our senior unsecured notes.

Our provision for credit losses increased by $1.4 million, mainly due to larger loan originations in the first quarter of 2023 than in the same quarter of 2022. As my quarterly reminder, upon origination, we record a loan loss reserve estimate equal to 1% of the loan balance. This reserve is amortized as the loan principal is paid down.

G&A increased by $486,000 compared with the prior-year period, primarily due to higher non-cash compensation, increases in overall costs due to inflationary pressures, and the timing of certain expenditures.

During the 2023 first quarter, we recorded an impairment loss totaling $434,000 related to a 70-unit assisted living community located in Florida that was sold subsequent to March 31, 2023.

Net income available to common shareholders rose by $18.7 million, primarily due to an increase in gain on sale of real estate, higher interest income from new investments and exit IRR interest income received in connection with mezzanine loan payoffs, and an increase in rental revenue, partially offset by higher interest expense, the provision for credit losses, and increased G&A costs.

Fully diluted NAREIT FFO per share was $0.66 for the 2023 first quarter, and $0.60 for the 2022 first quarter. Excluding non-recurring items, FFO per share was $0.67 this quarter, compared with $0.61 in last year's first quarter. The increase in FFO excluding non-recurring items was due to higher interest income from new investments and the increase in rental revenue I discussed earlier, partially offset by higher interest expense, and increased G&A costs.

Clint will cover our investment activity, and I'll speak to recent divestitures and loan payoffs. In the 2023 first quarter, and as previously announced, we sold two skilled nursing centers with a total of 235 beds located in New Mexico for $21.3 million, and recorded a gain on sale of $15.3 million. We also sold a 60-unit memory care community in Kentucky for $11.0 million. Subsequent to the end of the first quarter, as I mentioned earlier, we sold an assisted living community located in Florida for $4.9 million, and recorded a $434,000 impairment loss during the first quarter related to the property.

During the first quarter, we received $4.5 million from a mezzanine loan prepayment, which included a prepayment fee and the exit IRR totaling $190,000. The mezzanine loan was originated in 2021 for the refinancing of a 136-unit independent living community in Oregon.

We paid $7.0 million in regular scheduled principal payments under our senior unsecured notes, and paid $23.6 million in common dividends in the 2023 first quarter.

We borrowed $140.1 million under our unsecured revolving line of credit, which was primarily used for our first quarter investments. Subsequent to the end of the first quarter, we repaid $6.0 million under our line.

We sold 48,500 shares of common stock for $1.8 million in net proceeds under our ATM program, and used those net proceeds to pay down our revolving line of credit.

Presently, we have $5.5 million of cash on hand, approximately $136 million available on our line of credit, with approximately $264 million outstanding, and approximately $129 million available under our ATM. This gives us total liquidity of nearly $270 million. We have no significant long-term debt maturities over the next five years.

At the end of the 2023 first quarter, our debt to annualized adjusted EBITDA for real estate was 5.8 times, and our annualized adjusted fixed charge coverage ratio was 3.6 times.

Regarding the operator for whom we have been providing abatements, we still anticipate receiving $300,000 in rent in 2023. We continue to evaluate options for the two properties that operate as a senior living campus that provides independent living, assisted living and memory care services. Separately, we agreed to defer rent totaling $467,000 for each of April and May for an operator to whom we have provided assistance in the past. We expect to transition this portfolio of eight assisted living communities with a total of 500 units in Ohio, Michigan and Illinois, to an existing LTC operator during the second quarter. After the portfolio is transitioned, cash rent will be based on mutually agreed upon fair market rent.

Additionally, we have agreed to defer $1.5 million in interest payments due on a mortgage loan secured by 15 skilled nursing centers located in Michigan which are operated by Prestige Healthcare. The deferral will be available from May through September capped at $300,000 per month, or 18% of monthly contractual cash interest due from that loan. The deferral is to assist them financially until the Michigan Medicaid rebasing and Medicare rate increases take effect on October 1. We are working with Prestige to forecast how the anticipated rate increases will affect this portfolio's future budgeted performance in light of elevated costs and lower occupancy growth to determine if additional financial assistance is warranted.

Now, I'll turn it over to Clint.

Clint Malin

Thanks, Pam.

I'll start today with our first quarter investment activity. As discussed during last quarter's call, we entered into a joint venture with an affiliate of a current LTC operating partner. The transaction included the purchase of 11 assisted living/memory care communities in North Carolina, which are being operated under a 10-year master lease, with two five-year renewal options. As Pam detailed, the purchased assets are presented as a financing receivable on our balance sheet because the JV acquired the communities through a sale-leaseback transaction subject to a lease that contains a purchase option.

Also, as previously disclosed, we invested $51.1 million in Corso Atlanta by purchasing a participation in an existing mortgage loan. Corso Atlanta is a new, luxury 203-unit gated independent living, assisted living and memory care community owned and operated by an affiliate of Galerie Living, an existing LTC partner. The borrower used funds from LTC to pay off certain current banks as well as LTC's outstanding $7.5 million mezzanine loan, which was funded in 2019 for the community's construction.

Next I'll discuss Brookdale, as I'm sure you're all interested in our plans for this 35 assisted living community portfolio. First, Brookdale is contractually obligated to pay rent on the portfolio through the end of the lease term on December 31, 2023. Second, broadly speaking, the rate growth and occupancy trends we're seeing in our Brookdale portfolio are similar to those they have publicly disclosed for their overall portfolio. Third, we are working to replace the income we're generating from Brookdale through a combination of re-leasing and redeploying sales proceeds over time, while diversifying our operator relationships. Our current plan includes selling about 50% of the properties, while re-leasing the other 50%. We have engaged third parties to help run the process, and they are underway. We will, of course, provide you with updates when there is something significant to report. Although transitioning 35-properties can be challenging, we believe we have the experience necessary to complete the transitions in a timely fashion, and welcome this opportunity to reduce operator concentration.

I'll quickly update you on our transitioned portfolios. We continue to anticipate receiving $8 million in rent from HMG this year, however, the rent we received from them in the first quarter was $250,000 less than the expected $2 million. This shortfall should be made up in the second quarter. Regarding the other transitioned properties we've previously discussed, projected rent for 2023 is expected to be $630,000.

During the 2023 first quarter, we sold a property in Kentucky as Pam mentioned, and transitioned a 60-unit memory care community located in Ohio to Anthem, a current LTC operator. These properties were part of a master lease that was due to mature this year and generated $1.5 million of income during 2022. The Ohio property is leased to Anthem under a new two-year lease with no rent through May 2023, after which cash rent will be based on mutually agreed upon fair market rent. Currently, a very small percentage of our total rental income relates to leases maturing this year with an open renewal option.

Moving next to our portfolio numbers, which exclude properties transitioned on or after July 1, 2021. Q4 trailing 12-month EBITDARM and EBITDAR coverage, as reported, using a 5% management fee, was 1.10x and 0.87x, respectively, for our assisted living portfolio. Excluding stimulus funds received by our operators, coverage was 0.92x and 0.70x, respectively. Because these metrics are given in arrears, this private pay coverage does not include potential future upside related to recent rate increases.

For our skilled nursing portfolio, as reported EBITDARM and EBITDAR coverage was 1.70x and 1.22x, respectively. Excluding stimulus funds received by our operators, coverage was 1.51x and 1.03x, respectively. Pro forma for the proposed 3.7% Medicare market basket rate increase Wendy mentioned earlier, skilled EBITDAR coverage, excluding stimulus funds, would have been 1.09x.

I'll also provide some recent general occupancy trends, which are as of March 31, and are for our same store portfolio. Because our operators provide this data to us on a voluntary and expedited basis, these numbers include approximately 66% of our total same store private-pay units, and approximately 93% of our same store skilled nursing beds. Private-pay occupancy was 80% at March 31, 2023, compared with 79% at January 31, 2023 and 81% at September 30, 2022. For our skilled nursing portfolio, average monthly occupancy was 73% in March, compared with 71% in both January of this year and in September 2022. For comparative purposes, our private-pay occupancy in 2019, pre-pandemic, was approximately 87%, and our average skilled nursing occupancy was approximately 80%.

I'll finish today with some commentary on our pipeline. We've made significant investments so far this year, and currently have a pipeline of an additional $100 million in investments under LOI. These transactions are diverse as to financing vehicle and operator, and skew toward private-pay assets. All are with current LTC operators, and all are off-market deals based on our existing relationships.

With respect to bank lending and interest rates, current turmoil in the markets has resulted in unanticipated volatility that is impacting everyone's ability to finance new investments. We continue to believe that LTC is a solid capital partner, but being mindful of this turbulence, we are being even more selective with respect to new investments, and will continue to be judicious capital allocators.

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

Wendy Simpson

Building on last year's success, we are pleased to have closed nearly $180 million in investments since the beginning of 2023. As Clint just said, amidst significant turbulence in the capital markets at this time, we are maintaining our focus on conservative financial management, while continuing to identify strategic opportunities. No matter the environment, we will act as responsible stewards of the capital with which our shareholders have entrusted us. We remain flexible and mindful as we work to reinforce LTC's position as a REIT partner of choice for the seniors housing and care market.

Operator, we're now ready to take audience questions. Thank you.

Question and Answer

Operator

[Operator Instructions] Our first question is from Austin Wurschmidt with KeyBanc Capital Markets.

Austin Wurschmidt

Can you guys just share a little bit more detail as to how you're planning to carve up the Brookdale portfolio and determining which assets to sell. And as of now, do you plan to package that as a portfolio sale or one-offs?

Clint Malin

This is Clint. As I mentioned in the prepared remarks, we're looking at selling approximately 50% of the portfolio. And we have 2 different intermediaries that we're working with to run the processes for those. So we're really looking at it on a state-by-state basis given that the portfolio is comprised in 8 different states.

Austin Wurschmidt

And does 50% of the properties or roughly 50% equate to a similar amount of the contractual cash rent? Or how does that sort of break up between what you're looking to sell and what you're looking to keep?

Clint Malin

I would say that the portfolio and the 50% we're looking at keeping has much higher EBITDAR associated than the properties we're looking at selling.

Austin Wurschmidt

Okay. Got it. And then, I guess, can you just give us a sense as you're in the negotiations with potentially backfilling the properties you're planning to keep? I mean what's the likelihood that you end up taking some type of initial haircut on the rent to get the assets a new operator stabilized and then maybe some type of catch-up plan. What's the current negotiation like in terms of the range of outcomes on the new leases?

Clint Malin

We're going through that process right now. So it's still to be determined. We have definitely had a lot of interest even before we began a process of marketing the portfolio. So we're encouraged by that. We're also encouraged that, as I mentioned in my prepared remarks, what we're seeing in the properties that we own that Brookdale operates, we're seeing similarities to what they've announced publicly in regards to rate growth in occupancy. So as far as going into a transition with the rate growth that took effect on January 1, that's positive to this process.

Austin Wurschmidt

That's helpful. And then just last one for me. I'm just curious, as this process is unfolding, from a people perspective, maybe particular that executive directors I mean what have the conversations been like? Have you seen any increased turnover or concerns within these assets that you intend to keep and re-lease?

Clint Malin

We haven't seen any concerns at this point, but we're in close contact with Brookdale. Brookdale has been very cooperative in this process. So that will be a topic of discussion most likely with them as well as the operators that we select to transition the portfolios or the other ones to sell. So we'll provide updates on a quarterly basis in regard to Brookdale.

Operator

Our next question is from Steven Valiquette with Barclays.

Amin Jacare

This is Amin Jacare on for Steve Valiquette. I was just wondering if you could kindly go in to just add a little bit more color on your kind of upcoming debt maturities. I think 2025 is the next year, you have some, let's say, significant maturities coming due. But just wondering if you could add a little bit more color about how you plan to potentially service these and how you view your liquidity division in relation to 2025?

Pam Kessler

Yes, sure. This is Pam. Yes, 2025 is when our line of credit comes due. We have one term loan, $150 million term loan that comes due and our line of credit. We feel very strong about our financial position right now. We have the asset sales that we've discussed. And we feel we have liquidity to execute on our investment plans and service our debt.

I think you're probably looking everything lumped in and that's why you haven't broken out. We -- in our supplemental, you'll see we break out the line of credit. Most people, when they look at debt maturities, they carve out the line of credit. We don't have any significant long-term debt maturities that are coming due because we finance ourselves through the private placement market, and we match our maturities to our projected cash flow. So we don't have a big -- if you're talking about big refinancing risk, we don't feel we have one.

Wendy Simpson

And on our line of credit, we have the option to renew, right?

Pam Kessler

Yes. We have a one-year renewal option on our line of credit. That's pretty standard.

Amin Jacare

Okay. That's great color, Pam. I appreciate that. And just I was also just wondering that -- just holding on from the asset sales and transactions and acquisitions that you mentioned, I was wondering what kind of cap rates are you guys looking at in the market when you're starting to go ahead with these transactions? Or what kind of cap rates are you targeting? Is it possible for you to add any color on that front as well?

Clint Malin

Well, from a -- this is Clint. From a cap rate standpoint and looking at how we're pricing investments that we're looking at, we've definitely increased our pricing, probably about 75 basis points recently to go and to make an accretive transaction. So that's one current readjustment that we had to make on our pricing.

Pam Kessler

I think you're talking about sales.

Clint Malin

I'm sorry, on sales. On the sales right now, I mean -- I'm sorry, the sales are more on the -- there's some value add, so really applying a cap rate to a value-add sale. I mean it's really hard to do that. It's probably more on a price per unit or price per bed metric.

Amin Jacare

Okay. And just quickly then last question here for me is heading into the -- let's say, looking at the end of the year here, how are you guys looking at your acquisition versus disposition strategy? I mean are you looking at going out there and potentially still making some acquisitions? Or are you looking at just maintaining the portfolio? Just the tiny bit of color on that would be appreciated.

Clint Malin

Absolutely. As I mentioned in my prepared remarks, we have about $100 million in our pipeline right now, and we're being selective. And the investments that we're working on right now, all with existing operating partners that are off-market transactions. So that's really our focus on the investment front right now.

If we completed this additional $100 million of investments that would put us up to almost just under $300 million for the year, which is a very strong volume we feel very good about what we’ve been able to accomplish this year and what we have in the pipeline right now.

On the disposition front, it's really more what we talked about in the prepared remarks. It's -- we've sold some today. We probably do a little bit more to be the average of 30% to 40%, but that could change depending on the sale and timing of the Brookdale property. So that would definitely elevate above our annual average sales.

Operator

Our next question is from Aditi Balachandran from RBC Capital Markets.

Aditi Balachandran

Just a quick question on the Prestige deferment. Is there anything specific that required it? Was the operational issues or an unexpected charge?

Clint Malin

Well, really, the driver on it just been slow recovery in the census and just inflationary pressures, the cost pressures that they've experienced. Michigan is going through a rebasing of their rates right now and the cost reports for 2022 are to be filed by the end of May, which is then to establish the 2023 rates starting in October as well as there is a retroactive settlement for prior years because the last settled cost reported in Michigan is 2019. And they've had just fixed increases of 2.5% on October 1, of 21 and 22. But yet it is a cost-based reimbursement state.

Aditi Balachandran

Okay. Cool. And then do you think there are going to be more in the future? Is the 1.5 there or is that something that you'll probably look back in, in September?

Clint Malin

As Pam mentioned, we're working closely with Prestige right now to try to understand how this is going to work going forward and evaluating information from them. They've been cooperative in the process, and we'll provide additional updates on our next quarterly call regarding Prestige.

Operator

Our next question is from Connor Siversky with Wells Fargo.

Connor Siversky

Jesus on for Connor today. On rent coverage, some improvement in the assisted living portfolio year- over-year. Can you give us a sense on what the watch list looks like at the moment? Or what percentage of the assisted living tenant basis is one times EBITDAR?

Clint Malin

Well, we haven't given specific coverage by individual operator. But from today's call, we're working on a transition and we're speaking about Prestige. But also, we have seen a lot of rate growth on the private pay side. As I mentioned, regarding Brookdale, so that rate growth, as I mentioned in my prepared remarks has in fact been into the trailing coverage so going forward and you should see an improvement. And as Wendy mentioned, we haven't seen a significant decline in occupancy, which is also a positive. So hopefully, that will be reflective of improving coverage on the private pay side.

Operator

There are no additional questions waiting. So I'll pass the conference over to the management team for any additional remarks.

Wendy Simpson

Thank you, and thank you all for joining us for the first quarter results, and we look forward to talking to you regarding our second quarter. Have a great day and weekend.