Transcript of
LTC Properties, Inc.
LTC Properties, Inc. Third Quarter 2023 Earnings Call
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**Participants**

Wendy Simpson - Chairman and CEO, LTC Properties, Inc.
Pam Kessler - Co-President, Chief Financial Officer and Secretary, LTC Properties, Inc.
Clint Malin - Co-President and Chief Investment Officer, LTC Properties, Inc.

**Analysts**

Juan Sanabria - BMO Capital Markets Corp.
Connor Siversky - Wells Fargo Securities, LLC
Michael Carroll - RBC Capital Markets Corp.

**Presentation**

**Operator**

Greetings. Welcome to the LTC Properties, Inc. Third Quarter 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions]. 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 Properties' filings with the 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 turn the conference over to Wendy Simpson.

**Wendy Simpson**

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

On our last call, I spoke about LTC's primary mission of focus for the remainder of 2023. And as a result of that strategy, we have made progress towards those identified goals, including very positive results regarding the Brookdale and Prestige portfolios. We also closed the remaining transactions in the pipeline with funding of that transaction expected early next year. Pam and Clint will talk more about this later.

To recap, since the beginning of the year, we've originated nearly $270 million in transactions and generated over $51 million in sales proceeds resulting in net gains totaling approximately $21 million. Of the $51 million in sales proceeds to date, $14 million was received in the third quarter. We expect to receive additional sales proceeds in the $27 million to $28 million range throughout the remainder of 2023, primarily related to the expected sales of a portion of the Brookdale portfolio.

Additionally, so far in 2023, we have received almost $12 million in mezzanine loan payoffs generating $1.6 million of exit IRR income at a weighted average rate of 12%. LTC's long-term mandate remains focused. First, focus on the portfolio, where we have been working to further reduce its average age while creating additional operator diversity and maintaining a balanced portfolio of private pay and skilled nursing. Second, focus on reducing leverage to more historical levels by using sales proceeds to pay down a portion of our debt; and third, focus on positioning LTC for future growth.

I'd now like to spend a few minutes on some industry wide trends that I'm sure are top of mind, starting with some positive news. The latest NIC MAP data shows that in the third quarter, occupancy grew in both seniors housing and skilled nursing. Recent industry reports have further shown that current indicators point to a return to pre-pandemic occupancy levels by the end of 2024. While we cannot predict specific timing, we agree that the industry is making progress towards that goal.

Additionally, agency usage is trending down in certain cases, and the labor market is strengthening for operators in many areas. These factors, combined with a net Medicare rate increase of 4%, which is slightly higher than the expected increase before the final rate went into effect on October 1st, and additional increases at the state level, but operators, particularly SNF operators in a better position to begin the improving margins.

We are happy to see the positive gains in the industry has made, but are also cognizant that the operators will face some challenges for both seniors housing and skilled nursing including inflation, insurance premiums, litigation and SNF minimum staffing requirements, which pending the release of the final rule will take several years to implement.

Finishing up with some LTC’s specific metrics. The FAD payout ratio for the third quarter was 86%, with the long-term historical goal remaining at 80%. We are currently projecting a FAD payout ratio of 83% for fiscal 2023, down from 85% in fiscal 2022. We also maintain a monthly dividend payout of $0.19 per share. For the fourth quarter, we anticipate that FFO, excluding nonrecurring items, will be in the range of $0.65 to $0.66 per share. As we enter into the last quarter of 2023 and move into 2024, focus remains on needs-based care, coupled with strong demographic demand, positioning us for future growth.

With that, I'll turn the call over to Pam.

**Pam Kessler**

Thank you, Wendy. For the third quarter of 2023, total revenue increased by $5.8 million compared with the third quarter of 2022. The improvement related primarily to $3.5 million more of interest income from acquisitions accounted for as financing receivables and $1.9 million more of interest income from 2023 mortgage loan originations. Additionally, interest and other income increased by $453,000 primarily due to a recent mezzanine loan origination.

Rental revenue and income from unconsolidated joint ventures were comparable to the prior year period. Interest expense increased by $4.7 million from last year's third quarter primarily related to higher interest rates and a higher outstanding balance on our revolving line of credit, partially offset by scheduled principal paydowns on our senior unsecured notes.

During the 2023 third quarter, we recognized a $4.9 million gain on sale related to two assisted living communities in Pennsylvania. I'll provide additional details on property sales shortly. Our provision for credit losses decreased by approximately $600,000, primarily due to the 2022 acquisition of three skilled nursing centers accounted for as a financing receivable partially offset by the origination of the mezzanine loan I mentioned earlier. 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 is paid down.

Net income available to common shareholders increased by $8.9 million primarily due to higher interest income from new investments, the increase in gain on sale of real estate and an impairment charge of $1.3 million reported in the prior year third quarter, partially offset by higher interest expense. Fully diluted FFO per share improved to $0.65 for the third quarter of 2023, up from $0.60 in the third quarter of 2022. Excluding nonrecurring items, FFO per share was $0.65 for the 2023 third quarter compared with $0.63 last year. The increase in FFO, excluding nonrecurring items, was due to higher income from new investments, partially offset by higher interest expense.

Next, I'll discuss recent divestitures. Clint will detail our investment activity later. During the third quarter of 2023, we sold two assisted living communities in Pennsylvania with a combined total of 130 units for $11.1 million with a gain on sale of $4.9 million. We also sold three assisted living communities in Nebraska with a combined total of 117 units at a net book value equal to $3 million. We repaid $33.1 million in regular scheduled principal payments under our senior unsecured notes and also paid $23.6 million in common dividends for the 2023 third quarter.

During the third quarter, we borrowed $35.9 million under our unsecured revolving line of credit. Currently, we have $11.3 million of cash on hand, approximately $38 million available under our line of credit with roughly $362 million outstanding and about $129 million available under our ATM. This gives us total liquidity of almost $178 million.

Additionally, as Wendy mentioned, we anticipate receiving sales proceeds later this year in the range of $27 million to $28 million, which will be used to pay down our line of credit. This sales proceeds amount is lower than our previous assumption based on our decision to sell fewer properties from the Brookdale portfolio, which Clint will describe later. Additionally, we anticipate receiving $30 million in the first quarter of 2024 related to the payoff of a mortgage loan secured by a 189 bed skilled nursing center in Louisiana.

At the end of the 2023 third quarter, our debt to annualized adjusted EBITDA for real estate was 6x, and our annualized adjusted fixed charge coverage ratio was 3.2x. Additionally, regarding Prestige Healthcare, during the third quarter of 2023, we deferred $900,000 in interest payments under our previously disclosed agreement to defer up to $1.5 million or up to $300,000 per month for May through September 2023. Subsequent to the end of the third quarter, we amended the loan.

As part of the amendment, LTC has drawn down $2.8 million of the approximate $5 million letter of credit from Prestige to repay all deferred interest outstanding through October 2023. We will draw down approximately $334,000 in each of November and December 2023 to be applied toward interest due on the loan at that point. As a result, we expect to receive all contractual interest of $19.5 million due from Prestige in 2023.

Beginning on January 1st, 2024, the minimum mortgage interest payment due to LTC will be based on an annual current pay rate of 8.5% on the outstanding loan balance. The contractual interest rate on the loan of 10.84% as of January 1st, 2024, remains unchanged. From retroactive Medicaid funds due to prestige, we expect our letter of credit will be replenished in 2024, and Prestige will be able to pay all contractual interest during 2024 and 2025.

Now I'll turn the call over to Clint.

**Clint Malin**

Thank you, Pam. I'll start with an update on our 35 property Brookdale portfolio, whose lease expires on December 31st. As previously announced, we released 10 of the properties, six in Colorado, and four in Kansas back to Brookdale, under a new six year master lease commencing on January 1, 2024. Recently, we amended the new master lease to add seven additional assisted living communities from the 35 property portfolio, including one in Ohio and six in Texas. The initial rent on the new 17 property master lease will be $9.3 million escalating by approximately 2% annually, and our capital expenditure commitment will be $7.2 million for the first two years of the lease at an initial rate of 8%, escalating by approximately 2% annually thereafter.

Brookdale will have purchase options on these 17 properties in 2029. Brookdale has been a great partner through the years, and we are happy to have reached an outcome that benefits all parties. Additionally, we are on track to transition the remaining 18 properties by year-end. More specifically, we plan to sell seven, while leasing 11 to two different operators. The sales price for the seven properties being sold, four of which are in Florida, and three of which are in South Carolina, will be approximately $27.1 million. We anticipate receiving $20 million to $21 million in proceeds, net of transaction cost and seller financing as a result of these sales.

We are leasing the remaining 11 properties to two operators. Six in Oklahoma with a total of 219 assisted living units will be operated under a new master lease by a current LTC operator which we anticipate will commence on November 1, subject to the issuance of licensure to the new operator. The lease term is for three years with one four-year extension period. Rent in the first year is set at $960,000, increasing to $984,000 in the second year and $1.2 million in the third year. Additionally, the master lease includes a purchase option that can be exercised starting in November 2027 through October of 2029, if the lessee exercises its four year extension option. We are currently working on finalizing a new lease for the remaining five properties located in North Carolina with a total of 210 assisted living units. This new lease is expected to commence on January 1, 2024.

As Wendy detailed in last quarter's call, we remain confident that between the expected sales and the new leases I just mentioned, we should not see a 2024 FFO decline related to the nonrenewal of the original Brookdale leases. Further, using anticipated sales proceeds, we will reduce our outstanding line of credit, which was used to prefund accretive investments made earlier this year. Through this process, we are selling some older buildings and will decrease our Brookdale concentration, reducing the number of buildings operated by Brookdale by 50% and reducing our rental exposure with Brookdale by 40%.

Moving now to our investment activity. During the third quarter, and as previously disclosed, we originated a $17 million mezzanine loan with an affiliate of current operator, Gallery Living. Mezzanine loan was used to recapitalize an existing 130-unit assisted living, memory care and independent living campus in Georgia as well as the construction of 89 additional units. The loan term is five years at an initial yield of 8.75% and an IRR of 12%.

We also committed to fund a $19.5 million mortgage loan with the construction of an 85-unit assisted living and memory care community in Michigan, completing the last transaction in our 2023 pipeline. The borrower contributed $12.1 million of equity, which will initially be used to fund the construction. Once all of the borrower's equity has been drawn, we will begin funding our commitment, which is expected to be in early 2024. The loan term is approximately three years at a rate of 8.75% and includes two one-year extensions, each of which is contingent on the achievement of certain coverage thresholds.

Moving on to our transition portfolios. As expected, we received $1.75 million in rent from HMG in the third quarter and continue to expect $2.75 million in the fourth quarter $750,000 of which relates to the first three quarters of the year, bringing total rent from HMG for 2023 to $8 million. Regarding all of the transition properties with market-based rent resets, projected rent for the 2023 fiscal year is expected to be $561,000 with $60,000 of that in the fourth quarter of this year. This is lower than our prior projection of $720,000 due to the sale of the three Nebraska and two Pennsylvania buildings Pam discussed earlier. We expect rent from the transition properties to equal $360,000 for next year's first quarter.

Next, I'll provide some insight into our portfolio numbers, which exclude properties transitioned on or after January 1, 2022. Q2 trailing 12-month EBITDARM and EBITDAR coverage as reported using a 5% management fee was 1.26x and 1.02x, respectively, for our assisted living portfolio. Excluding stimulus funds received by our operators, coverage was 1.09x and 0.85x, respectively. Because these metrics are given in arrears, this private pay coverage does not include potential future upside related to recent rate and occupancy increases.

For our skilled nursing portfolio, as reported EBITDARM and EBITDAR coverage was 1.92x and 1.44x, respectively. Excluding stimulus funds received by our operators, coverage was 1.62x and 1.14x, respectively. Pro forma for the 4% Medicare market basket rate increase, Skilled EBITDAR coverage, excluding stimulus funds would have been 1.2x coverage.

Now for some recent general occupancy trends, which are as of September 30, and our for our same-store portfolio. These numbers include approximately 96% of our total same-store private pay units and approximately 92% of our same-store skilled nursing beds. Private pay occupancy was 85% at September 30, 2023, 82% at June 30 and 81% at March 31. For our skilled nursing portfolio, average monthly occupancy was 73% in September, 72% in June, and 73% in March. For comparative purposes, our private pay pre-pandemic occupancy in 2019 was approximately 87% and our average skilled nursing occupancy was approximately 80%.

I'll finish with a brief discussion of our pipeline and what we're seeing in the M&A marketplace. As I discussed earlier, we completed the remaining transaction in our 2023 pipeline during the third quarter. We are now in the planning stages of building a new pipeline for 2024 and beyond, but we remain a patient investor. We are watching to see what happens with respect to pricing as current loans come due and owners don't have the resources to refinance. Broadly speaking, we are hearing that banks are being more selective about seniors housing and skilled nursing investments potentially leading to more opportunities for LTC.

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

**Wendy Simpson**

Thank you, Pam and Clint. The third quarter was very productive as we worked through some previously identified challenges and made progress on some of the expectations we set for ourselves and for our shareholders. We're going into the end of the year on a positive note with most signs pointing to continued industry recovery.

As Clint said, bank lending is in flux, maturities are coming due for operators at a brisk pace, and interest rate increases are causing anxiety. We think this environment favors REITs, especially those like LTC who maintain a conservative investment strategy and provide customized solutions geared towards the needs of operators. I believe we are well positioned for growth for next year and into the future. Thank you, everyone, for your continued support. We'll talk to you again next quarter.

Operator, we're now ready to take questions.

**Operator**

Certainly. At this time, we will be conducting a question-and-answer session. [Operator Instructions]. Your first question for today is coming from Juan Sanabria with BMO.

**Q:** Hi, Good morning.
**Pam Kessler**

Good morning, Juan.

**Q:** Good morning. I just wanted to ask a question on Prestige with regards to modeling FAD or cash. How should we think about what they are expected to pay in '24? Should we be modeling kind of the floor on the weight that you set on how that loan was redone? Or should we think about the effective rate. I know there's a difference between FFO and FAD from a GAAP perspective. Curious from a cash perspective, how we should be thinking about that for '24?

**Pam Kessler**

Yes. Sure. Juan, this is Pam. You should model FFO and FAD the same at the effective rate, because we're going to be getting the cash. It's just the timing issue for replenishing the letter of credit. So we'll be drawing down on the letter of credit each month to fund the difference and then they will -- when they get their retroactive Medicaid funds, they'll replenish the letter of credit. So from a cash and GAAP standpoint, it's the same as it has been previously. So same as you probably already have in your model.

**Q:** So that the drawing down, just to confirm the drawing down on the letter of credit will continue in '24 to make up any difference between the cash and effective rate?

**Pam Kessler**

Yes.

**Q:** Okay. Great. And then on Brookdale. So the proceeds from the dispositions of those assets that are teed up or completed. Should we think of those as just repaying the line and any sort of kind of offset to the dilution from asset sales being just the repayment of the line, given you've invested most of your anticipated capital into the '23 pipeline? Is that the right way? Or should we be reinvesting those proceeds at a higher yield?

**Pam Kessler**

Well, as we talked about on the last call, we consider -- we pre-invested the proceeds, right? We're getting $27 million, and we invested this year earlier at 8.5%. So in theory, we've already reinvested those. But logistically, because of timing, we drew down on the line, and that's why debt got higher, and we talked about on the last call that we were comfortable with debt creeping a little higher because there was a difference in the timing of us pre-investing the proceeds and then actually getting the proceeds.

So logistically, you are going to take down the line. But when you're looking at the transaction holistically and saying, are we getting replacement income to be replaced, the $15.4 million from

Brookdale? Yes, we did. And we can walk through that math if you want. But logistically, you are going to just take it, don't assume any more investments this year is what I'm telling you.

**Q:** Okay. And then one -- just one last quick one for me. I think you called out a $30 million loan maturity in the first quarter '24. Is there anything else that we should be modeling for the balance of the year for '24 or put forward?

**Pam Kessler**

Not right now, not with any certainty. I mean, the debt markets are challenging, but for cash flowing properties. Operators are able to find financing for that. So right now, I'm comfortable with the debt maturities or mortgage loan maturities that are coming back to us, not our own mortgage maturities, because we don't really have any -- we don't have mortgages. So we have no maturities. But our debt payments, obviously are -- we feel comfortable with those.

**Q:** Great. Thanks Pam. I appreciate it.

**Operator**

Your next question is your coming from Connor Siversky with Wells Fargo.

**Q:** Good morning, out there. Thanks for the time. Maybe just to zoom in on the minimum staffing requirement. Following the postal ruling we had. I'm curious, are feedback has been from your operators in the SNF portfolio. And then, do you believe there's any potential that we could see a cutback or drawdown in the hours required from the registered nurse part of the room?

**Clint Malin**

Hey, Connor. Good morning. It's Clint. The feedback we're getting from operators were speaking to about this. It's in the comment period right now. There's been a lot of comments that have been submitted and [indiscernible] is doing a good job of organizing that. Generally speaking, I think the consensus is that the impact is not in, obviously, '23 or '24, '25 and really working with CMS, how to phase that in. So that's really where the focus is right now. So as you look into 2024, generally speaking, people aren't concerned about that, but it's just trying to shape what it looks like and how it's phased in beyond that time frame.

**Q:** Okay. Understood. And then transaction activity expectations for next year, I mean, we've seen the 10-year more double and yet in ALS and sale assets yields have only gone up maybe 100 to 150 basis points in certain cases. Do you have any idea what's driving that kind of stickiness on pricing, whether that's just the lack point transaction activity or otherwise paying attention to those assets?

**Clint Malin**

I think it's just a lower transaction volume. And then we see going forward with that rise in rates, and you haven't seen the adjustments yet in the cap rates at with mortgages coming due, as I talked about in the prepared remarks. I mean we see an evolving market with opportunity in front of us we think that REITs would be well positioned to take advantage and capitalizing on deploying additional capital.

**Q:** Got it. Thank you for the time.

**Clint Malin**

Thank you.

**Operator**

Your next question for today is coming from Michael Carroll with RBC Capital Markets.

**Q:** Yes, thanks. And I'm not sure if everybody else is here in that, but I'm getting some feedback on the line two? Anyway, I guess first -- I guess my first question is on Prestige. Clint, can you kind of give us some ideas of what's going on with the Michigan Medicaid throw-up payments. I mean how much additional capital is Prestige going to get in the fourth quarter of '23. And why wasn't that capital used to pay back the deferral?

**Clint Malin**

So on last call, we -- you and I had a conversation in Q&A regarding this. So last quarter, like I mentioned that the estimates of the time was the procedure we received $7 million in or estimated to be $7 million in '23, and then the $8 million to $10 million range in '24. At this point, right now that the rate letters have been issued that estimate is approximately $8 million for 2023, and we're at the higher end of the range of $10 million in 2024. Given the deferral in these rates over the last three years, there will be -- there's AP, there's bed taxes that need to be paid for Prestige. So this basically this initial payment allows them to bring the AP back into current terms pay the deferred bed tax. And on the call last time, I mentioned you shouldn't assume those dollars in 2023 would come to LTC.

**Q:** Okay. And then as you're thinking about into the operations of Prestige going into 2024, are there operating trends improving? And I believe you might have answered this with Juan's question, but do you expect that they're not going to pay the full contractual rent in 2024?

**Clint Malin**

No, we fully expect as Pam just detailed, we fully expect and as Pam mentioned, to Juan's comment to model FAD cash rent from or cash interest from Prestige, the same as FFO. So we fully expect to receive the contractual interest payment, not only in '23, but in '24 in our prepared remarks, you said 2025 as well.

**Q:** Okay. And then why did you change it to allow them to pay less, I guess, what was the reasoning behind that?

**Clint Malin**

I mean, the real story for Prestige is building back census and improving operations. So what we've done is we've afforded them the ability to have a lower current pay, while they're doing that. And in addition to our participation in the retroactive Medicaid payments in exchange for implementing the current rate that LTC will be participating in 50% of the excess cash flow beginning January 1, 2025. And that amount that -- if it materializes, will just be added into our letter of credit to provide more security if there's accrued interest, that will be money available to pay down accrued interest. So that was the -- it was giving them a runway of effectively 2.5 years as we're guiding to getting full contractual interest through that time frame. We're giving them a 2.5 year runway to make improvement in operations and improve margins.

**Q:** Okay. Great. Thank you.

**Clint Malin**

Thank you.

**Operator**

We have reached the end of the question-and-answer session, and I will now turn the call over to Wendy for closing remarks.

**Wendy Simpson**

Thank you, everyone. We really appreciate the time you take to listen to our comments and we appreciate your questions to help us clarify those comments. I look forward to talking to you after the end of the year. Have a great rest of your 2023 and a great weekend. Talk to you soon. Bye-bye.

**Operator**

This concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation.