
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20459

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2002

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition period from ____ to ____

Commission file number 1-11314

LTC PROPERTIES, INC.

(Exact name of Registrant as specified in its charter)

Maryland

(State or other jurisdiction of incorporation or organization)

71-0720518

(I.R.S. Employer Identification No)

**300 Esplanade Drive, Suite 1860
Oxnard, California 93030**

(Address of principal executive offices)

(805) 981-8655

(Registrant's telephone number, including area code)

Indicate by check mark whether Registrant (1) has filed all reports to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Shares of Registrant's common stock, \$.01 par value, outstanding at November 8, 2002 – 18,393,322

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LTC PROPERTIES, INC.

FORM 10-Q

September 30, 2002

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LTC PROPERTIES, INC.
CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except per share amounts)

	September 30, 2002	December 31, 2001
	(Unaudited)	
ASSETS		
Real Estate Investments:		
Buildings and improvements, net of accumulated depreciation and amortization: 2002 - \$64,289; 2001 - \$56,844	\$ 390,933	\$ 409,611
Land	27,164	26,393
Properties held for sale, net of accumulated depreciation and amortization: 2002 - \$0; 2001 - \$1,739	—	1,537
Mortgage loans receivable, net of allowance for doubtful accounts: 2002 - \$1,280; 2001 - \$1,250	83,011	93,611
REMIC Certificates	68,545	73,154
	<u>569,653</u>	<u>604,306</u>
Real estate investments, net	569,653	604,306
Other Assets:		
Cash and cash equivalents	22,968	6,322
Debt issue costs, net	2,932	3,578
Interest receivable	3,543	3,258
Prepaid expenses and other assets	2,672	2,423
Notes receivable (includes \$3,095 due from CLC Healthcare, Inc. in 2002 and 2001)	15,358	14,584
Marketable debt securities	8,871	8,755
Line of credit due from CLC Healthcare, Inc.	5,341	5,342
	<u>61,685</u>	<u>44,262</u>
Total Assets	<u>\$ 631,338</u>	<u>\$ 648,568</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Convertible subordinated debentures	\$ —	\$ 2,408
Bank borrowings	74,390	104,000
Mortgage loans and notes payable	137,527	162,232
Bonds payable and capital lease obligations	15,446	15,994
Senior mortgage participation payable	29,873	—
Accrued interest	1,421	1,210
Accrued expenses and other liabilities	7,024	7,024
Liabilities related to properties held for sale	—	114
Distributions payable	981	1,803
	<u>266,662</u>	<u>294,785</u>
Total Liabilities	266,662	294,785
Minority interest	13,155	13,404
Stockholders' equity:		
Preferred stock \$0.01 par value: 10,000 shares authorized; shares issued and outstanding: 2002 - 7,062; 2001 - 7,062	165,183	165,183
Common stock: \$0.01 par value; 40,000 shares authorized; shares issued and outstanding: 2002 - 18,393; 2001 - 18,393	184	185
Capital in excess of par value	255,311	254,930
Cumulative net income	245,923	218,826
Notes receivable from stockholders	(7,712)	(8,042)
Deferred compensation	(163)	—
Accumulated comprehensive income	2,741	2,437
Cumulative distributions	(309,946)	(293,140)
	<u>351,521</u>	<u>340,379</u>
Total Stockholders' Equity	351,521	340,379
Total Liabilities and Stockholders' Equity	<u>\$ 631,338</u>	<u>\$ 648,568</u>

See accompanying notes.

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LTC PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Revenues:				
Rental income	\$ 10,716	\$ 9,768	\$ 32,314	\$ 30,081
Interest income from mortgage loans and notes receivable	2,928	3,022	8,046	9,630
Interest income from REMIC Certificates	3,137	3,620	9,623	11,656
Interest and other income	951	647	2,462	2,049
Total revenues	17,732	17,057	52,445	53,416
Expenses:				
Interest expense	5,417	5,116	16,153	16,631
Depreciation and amortization	3,535	3,404	10,904	10,344
Minority interest	322	254	978	724
Impairment charge	925	—	5,807	18,829
Operating and other expenses	1,652	1,761	5,168	5,375
Total expenses	11,851	10,535	39,010	51,903
Income from continuing operations	5,881	6,522	13,435	1,513
Discontinued Operations:				
Net loss from discontinued operations	(146)	(176)	(277)	(4,577)
Gain (loss) on sale of assets, net	819	(279)	13,939	1,565
Net income (loss) from discontinued operations	673	(455)	13,662	(3,012)
Net income (loss)	6,554	6,067	27,097	(1,499)
Less: Preferred dividends	3,762	3,772	11,281	11,315
Net income (loss) available to common stockholders	\$ 2,792	\$ 2,295	\$ 15,816	\$ (12,814)
Net Income (Loss) per Common Share from Continuing Operations Net of Preferred Dividends:				
Basic	\$ 0.11	\$ 0.11	\$ 0.12	\$ (0.39)
Diluted	\$ 0.11	\$ 0.11	\$ 0.11	\$ (0.39)
Net Income (Loss) per Common Share from Discontinued Operations:				
Basic	\$ 0.04	\$ (0.02)	\$ 0.74	\$ (0.12)
Diluted	\$ 0.04	\$ (0.02)	\$ 0.74	\$ (0.12)
Net Income (Loss) per Common Share Available to Common Stockholders:				
Basic	\$ 0.15	\$ 0.09	\$ 0.86	\$ (0.51)
Diluted	\$ 0.15	\$ 0.09	\$ 0.85	\$ (0.51)
Comprehensive Income (Loss)				
Net income (loss) available to common stockholders	\$ 2,792	\$ 2,295	\$ 15,816	\$ (12,814)
Unrealized gain (loss) on available for-sale securities	—	—	28	(332)
Reclassification adjustment	276	1,010	276	1,376
Total comprehensive income (loss)	\$ 3,068	\$ 3,305	\$ 16,120	\$ (11,770)

See accompanying notes.

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LTC PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2002	2001
OPERATING ACTIVITIES:		
Net income (loss)	\$ 27,097	\$ (1,499)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	10,938	10,622
Impairment charge	5,807	22,866
Other non-cash charges	3,253	3,442
Loss on the sale of other assets	—	456
Gain on sale of real estate investments, net	(13,939)	(2,021)
Decrease in accrued interest	247	(1,372)
Net change in other assets and liabilities	(1,221)	(799)
Net cash provided by operating activities	32,182	31,695
INVESTING ACTIVITIES:		
Investment in real estate properties and capital improvements, net	(1,265)	(1,227)
Proceeds from sale of real estate investments and other assets, net	12,057	43,196
Principal payments on mortgage loans receivable	5,686	3,643
Advances under line of credit to CLC Healthcare, Inc.	(792)	(3,845)
Payments from CLC Healthcare, Inc. on line of credit	793	—
Investment in debt securities	(26)	(2,784)
Other	1,372	2,937
Net cash provided by investing activities	17,825	41,920
FINANCING ACTIVITIES:		
Borrowings under the line of credit	10,000	17,000
Repayments of bank borrowings under line of credit	(39,610)	(56,000)
Proceeds from issuance of senior mortgage participation, net of repayments	29,873	—
Mortgage loan borrowings	—	11,252
Principal payments on mortgage loans payable and capital lease obligations	(13,896)	(3,469)
Redemption of convertible subordinated debentures	(2,408)	(22,230)
Repurchase of common and preferred stock	—	(6,559)
Distributions paid	(17,628)	(11,315)
Other	308	(835)
Net cash used in financing activities	(33,361)	(72,156)
Increase in cash and cash equivalents	16,646	1,459
Cash and cash equivalents, beginning of period	6,322	1,870
Cash and cash equivalents, end of period	\$ 22,968	\$ 3,329
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$ 15,012	\$ 17,454
Non-cash investing and financing transactions:		
Conversion of mortgage loans into owned properties	\$ 3,832	\$ 3,502
Increase in short term notes receivable related to the disposition of real estate assets	\$ 2,631	\$ 8,483
Assumption of mortgage loans payable for acquisitions of real estate assets	\$ 1,357	\$ —

See accompanying notes.

LLC PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. General

LTC Properties, Inc. (the “Company”), a Maryland corporation, is a real estate investment trust (“REIT”) that invests primarily in long term care facilities through mortgage loans, facility lease transactions and other investments.

The consolidated financial statements included herein have been prepared by the Company without audit and in the opinion of management include all adjustments necessary for a fair presentation of the results of operations for the three and nine months ended September 30, 2002 and 2001 pursuant to the rules and regulations of the Securities and Exchange Commission. The accompanying consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and controlled partnerships. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations; however, the Company believes that the disclosures in the accompanying financial statements are adequate to make the information presented not misleading. Certain reclassifications have been made to the prior period financial statements to conform to the current year presentation as proscribed by Statement of Financial Accounting Standards (“FASB”) No. 144 “*Accounting for the Impairment or Disposal of Long-Lived Assets*”. The results of operations for the three and nine months ended September 30, 2002 are not necessarily indicative of the results for a full year.

No provision has been made for federal or state income taxes. The Company qualifies as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended. As such, the Company is not taxed on its income that is distributed to its stockholders.

2. Real Estate Investments

Owned Properties. At September 30, 2002, the Company owned 64 skilled nursing facilities with a total of 7,374 beds, 89 assisted living facilities with 4,222 units and one school located in 24 states. During the third quarter of 2002, the Company sold, in three separate transactions, two skilled nursing facilities in Texas and one skilled nursing facility in Arizona for a total combined gain of \$819,000. The Company received approximately \$2,538,000 in cash from these transactions. All of the cash received from these transactions was used to repay debt. Additionally, \$930,000 of commitments under the Senior Secured Revolving Line of Credit were reduced as a result of these sales. During the second quarter of 2002, the Company sold five skilled nursing facilities in Alabama for approximately \$9,824,000 in cash, a 10-year \$3,550,000 note with a face rate of 7.0% which the Company discounted to \$2,631,000 for an effective rate of 13.0% and a reduction of \$10,247,000 in mortgage debt due to a REMIC pool originated by the Company. The Company recognized a gain of approximately \$13,192,000. Net proceeds from the sale were used to meet debt maturities in the third quarter of 2002. Annual rental revenue to the Company from these five properties was approximately \$2,100,000 before net interest expense of approximately \$800,000. In the first quarter of 2002, the Company sold, in one transaction, two skilled nursing facilities in Illinois for approximately \$2,100,000 in cash and used the proceeds and available cash to pay off \$2,562,000 in mortgage debt due to REMIC pools originated by the Company. The Company recognized a loss of approximately \$72,000 from this sale.

During the nine months ended September 30, 2002, the Company purchased one skilled nursing facility in Grapevine, Texas for a total cost of \$1,862,000. The Company paid approximately \$505,000 in cash and

LTC PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued
(Unaudited)

assumed \$1,357,000 in mortgage debt due to a REMIC pool originated by the Company. This facility was leased to CLC Healthcare, Inc.

During the third quarter of 2002, one mortgage loan on a closed skilled nursing facility in Florida was reclassified to an owned property as a result of a foreclosure sale. The Company is currently under contract to sell this facility for approximately \$1,925,000, however no assurances can be given that this sale will close. During the first quarter of 2002, one mortgage loan on a skilled nursing facility in Florida was reclassified to an owned property as a result of a deed-in-lieu of foreclosure transaction. A new operator began operating this facility in May 2002.

In October 2001, the Financial Accounting Standards Board issued FASB No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets", which was required to be adopted in fiscal years beginning after December 15, 2001. FASB No. 144 on asset impairment supercedes FASB No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", and provides a single accounting model for long-lived assets to disposed of. Subsequent to January 1, 2002, and in accordance with FASB No. 144, properties held for sale on the balance sheet includes only those properties available for immediate sale in their present condition and for which management believes that it is probable that a sale of the property will be completed within one year. Properties held for sale are carried at the lower of cost or fair value less estimated selling costs. No depreciation expense is recognized on properties held for sale once they have been classified as such. In accordance with the implementation provisions of FASB No. 144, the operating results of real estate assets designated as held for sale subsequent to January 1, 2002 are included in discontinued operations in the consolidated statement of operations. In addition, all gains and losses from real estate sold are also included in discontinued operations.

Set forth in the table below are the components of the net loss from discontinued operations for the three and nine months ended September 30, 2002 and 2001 (unaudited, in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Interest expense	\$ —	\$ 64	\$ —	\$ 185
Depreciation amortization	19	103	34	278
Impairment charge	—	—	—	4,037
Operating and other expenses	127	9	243	77
Net loss from discontinued operators	\$ 146	\$ 176	\$ 277	\$ 4,577

Mortgage Loans. At September 30, 2002 the Company had 39 mortgage loans secured by first mortgages on 36 skilled nursing facilities with a total of 4,095 beds and eight assisted living facilities with a total of 369 units located in 20 states. At September 30, 2002, the mortgage loans had interest rates ranging from 9.3% to 13.7% and maturities ranging from 2003 to 2018. In addition, the loans contain certain guarantees, provide for certain facility fees and generally have 25-year amortization schedules. The majority of the mortgage loans provide for annual increases in the interest rate based upon a specified increase of 10 to 25 basis points.

During the third quarter of 2002 the Company sold, to a private bank, a non-recourse senior participation interest in 22 of the Company's first mortgages with a total balance outstanding of approximately \$58,627,000. The sales agreement provides that the private bank will receive 9.25% per annum interest and all principal payments from these mortgages until the senior participation is retired. There is no specific principal maturity date for the senior participation other than the principal maturity dates of the underlying

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued
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mortgages. The Company will continue to receive interest from these mortgages above the 9.25% paid to the private bank and will resume collecting principal once the senior participation is repaid in full. The weighted average interest rate of these mortgages is approximately 11.6%. The Company sold the senior participation interest for \$30,000,000 and received \$29,750,000 in net proceeds, which it used to reduce commitments and amounts outstanding under the Senior Secured Revolving Line of Credit. This transaction does not meet all of the requirements of FASB No. 140 *"Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities"* and as such, the Company has recorded this transaction as a secured borrowing rather than a sale.

REMIC Certificates. As of September 30, 2002, the outstanding certificate principal balance and the weighted average pass-through rate for the senior REMIC Certificates (all held by outside third parties) was \$224,620,000 and 7.33%. As of September 30, 2002, the carrying value of the subordinated REMIC Certificates held by the Company was \$68,545,000. The effective yield on the subordinated REMIC Certificates held by the Company, based on expected future cash flows discounted to give effect to potential risks associated with prepayments and unanticipated credit losses was 17.28% at September 30, 2002.

Interest only certificates and certificates with an investment rating of "BB" or higher are classified as available-for-sale and unrated certificates and certificates with an investment rating of "B" or lower are classified as held-to-maturity. As of September 30, 2002, available-for-sale certificates were recorded at their fair value of approximately \$15,664,000. An unrealized holding gain on available-for-sale certificates of \$28,000 was included in comprehensive income for the nine months ended September 30, 2002. An unrealized holding loss of \$332,000 was included in comprehensive loss for the same period in 2001. For the three and nine months ended September 30, 2002, \$276,000 of unrealized losses recognized in prior years on available-for-sale certificates were reclassified to impairment charge. For the nine months ended September 30, 2002, the Company recognized a total impairment charge (including the \$276,000 reclass for comprehensive income) of \$2,497,000 on REMIC Certificates held by the Company.

At September 30, 2002 held-to-maturity certificates had a book value of \$52,881,000 and a fair value of \$35,183,000. As of September 30, 2002, the effective yield on the available-for-sale certificates and the held-to-maturity certificates, based on expected future cash flows discounted to give effect to potential risks associated with prepayments and unanticipated credit losses, was 34.70% and 11.94%, respectively.

3. Impairment Charge

The Company periodically performs an evaluation of its real estate investment portfolio. Impairment losses are recorded when events or changes in circumstances indicate the asset is impaired and the estimated undiscounted cash flows to be generated by the asset are less than its carrying amount. Management assesses the impairment of properties individually, or in groups of properties if under a master lease agreement, and impairment losses are calculated as the excess of the carrying amount of the real estate over its fair value less cost to sell as per FASB No. 144 *"Accounting for the Impairment or Disposal of Long-Lived Assets."* In determining fair value, the Company uses current appraisals or other third party opinions of value and other estimates of fair value such as estimated undiscounted future cash flows. During the three months ended September 30, 2002, the Company recorded an impairment charge of \$925,000. Of this charge, \$710,000 related to a valuation adjustment on one skilled nursing facility and \$215,000 related to a valuation adjustment of the subordinated REMIC Certificates held by the Company. During the nine months ended September 30, 2002, the Company recorded an impairment charge of \$5,807,000. Of this charge, \$1,600,000 related to loans on two skilled nursing facilities,

LTC PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued
(Unaudited)

\$1,710,000 related to valuation adjustments on two skilled nursing facilities and \$2,497,000 related to a valuation adjustment of the subordinated REMIC Certificates held by the Company. Relative to the \$215,000 and \$2,497,000 charge and as more fully described in *Note 2 - Summary of Significant Accounting Policies* of the Company's 10-K for the year ending December 31, 2001, to the extent there are defaults, unrecoverable losses or prepayments of principal on the underlying mortgages resulting in reduced cash flows, the subordinated REMIC Certificates held by the Company would bear the first risk of loss. During management's periodic evaluation of the realizability of expected future cash flows from the mortgages underlying the Company's REMIC Certificates, there were indications that a portion of the underlying mortgage collateral would not be realized by the REMIC Trust. Accordingly, the Company recorded a permanent impairment in current period earnings related to the valuation adjustment of the subordinated REMIC Certificates held by the Company.

The Company believes it has recorded valuation adjustments on all assets for which there are permanent impairments. However, the long-term care industry has experienced significant adverse changes which have resulted in continued operating losses by certain of the Company's operators and in some instances the filing by certain operators for bankruptcy protection. Thus, the Company cannot predict what, if any, impairment charge may be needed in the future.

During the three and nine months ended September 30, 2001 the Company recorded impairment charges totaling \$0 and \$22,866,000 (\$4,037,000 of which is included in net loss from discontinued operations as required by FASB No. 144 and is more fully explained in *Note 2 — Real Estate Investments*). The impairment charges consisted of the following: a \$11,537,000 valuation adjustment on 10 skilled nursing facilities and a \$9,829,000 valuation adjustment on the Company's investment in the convertible subordinated debentures of Assisted Living Concepts, Inc. ("ALC") and a \$1,500,000 write down of a note receivable.

4. CLC Healthcare, Inc.

As of September 30, 2002, 23 skilled nursing facilities with 2,617 beds and a gross carrying value of \$57,916,000 or 10.2% of the Company's direct real estate investment portfolio were operated by CLC Healthcare, Inc. ("CLC"). These facilities are leased to CLC under individual six-year leases that provide for total rents of \$3,000,000; \$4,000,000; \$4,750,000; \$5,350,000; \$5,900,000 and \$6,500,000 respectively, in years 2002 through 2007. The leases contain two five-year renewal options with increases of 2% annually. These leases have cross default provisions and a provision for acceleration should there be a change of control of CLC, as defined in the leases. Additionally, CLC owns and operates two skilled nursing facilities in New Mexico, discussed more fully below, that are financed with mortgage loans payable to a REMIC pool originated by the Company. During the three and nine months ended September 30, 2002, the Company was due rental income of approximately \$825,000 and \$2,100,000, respectively, from CLC as compared to \$720,000 and \$2,334,000 during the same periods in 2001. For the three and nine months ended September 30, 2002 and 2001, the Company classified the rents due from CLC as non-accrual rents. The Company has waived default under the lease provisions through November 30, 2002 as to unpaid rents.

During the nine months ended September 30, 2002, the Company sold a wholly owned subsidiary, LTC-Fort Tucum, Inc. to CLC for a \$500,000 note bearing no interest for one year and thereafter interest at 8% annually for two years. CLC has certain rights to extend the note at its maturity. The \$500,000 note is a full recourse obligation of LTC-Fort Tucum, Inc. and is secured by all the assets owned now or in the future by LTC-Fort Tucum, Inc. and contains a provision for acceleration should there be a change of control of LTC-Fort Tucum, Inc. LTC-Fort Tucum, now owned by CLC, has acquired two skilled

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued
(Unaudited)

nursing facilities in New Mexico, previously financed with debt from a REMIC pool originated by the Company. CLC began operating the two facilities during the second quarter of 2002.

During the nine months ended September 30, 2001, the Company sold all 180,000 shares of CLC common stock it owned at December 31, 2000. The shares were sold to CLC for \$225,000, not including selling commissions, which was the fair market value as of the date of sale. The Company recognized a loss of \$386,000 on the sale of these shares. The Company sold these shares because the Tax Relief Extension Act of 1999 ("Act") provides that, subject to certain exceptions for taxable years commencing after December 31, 2000, a REIT may not own more than 10% of the total value of the securities of any corporation. Without qualifying as safe harbor debt, securities under the Act include the line of credit provided by the Company to CLC. In order to qualify as safe harbor debt and retain its REIT status, the Company was required to hold only such debt or the shares.

Effective October 1, 2002, the Company and CLC amended the secured line of credit extended by the Company to CLC. The amendment reduced the line from \$20,000,000 to \$10,000,000 and added certain restrictions as to the use of funds drawn under the agreement. The line of credit continues to bear interest at 10%, mature on April 1, 2008 and contains a provision for acceleration should there be a change of control of CLC. In consideration of this amendment, the Company waived until November 30, 2002, defaults under its leases with CLC for non-payment of rent. The independent Board members of each company's board approved this amendment. At September 30, 2002 and December 31, 2001, there was \$5,341,000 and \$5,342,000, respectively, outstanding under the line of credit. During the nine months ended September 30, 2002, the Company advanced CLC \$792,000 under the line of credit and CLC repaid \$793,000 on the line of credit. During the three and nine months ended September 30, 2002 the Company recorded interest income of \$362,000 on the average outstanding principal balance under the line of credit as compared to \$0 and \$437,000, during the same periods in 2001.

CLC has advised the Company that it no longer has general and professional liability insurance in Texas and Florida. CLC no longer operates in Florida; however, it has claims arising from operations prior to its exit from the Florida market. CLC does provide for a reserve for potential insurance losses based on an estimate of incurred but not reported losses; however, should CLC incur a significant uninsured loss, it may not have the resources to pay the loss. At this time, CLC has stated that given the current litigation environment and unpredictability of jury trials, the existing claims could develop in a way which may present a material adverse affect on CLC's financial position, results of operations or liquidity.

CLC further stated that its insurance for those claims for which insurance exists and CLC's allowance for general and professional liability risk in an amount determined for reported claims and the incurred but not reported claims, at this time, in CLC's management's belief, do not present a material adverse affect on CLC's financial position or results of operations, however, such claims could have a material adverse effect on liquidity.

Additionally, the Company holds a Promissory Note ("Note") issued by Healthcare Holdings, Inc. ("Holdings"), a wholly owned subsidiary of CLC, in the face amount of \$7,000,000. The Note was received in December 2001 in exchange for the Company's right to receive 1,238,076 shares of Assisted Living Concepts, Inc. ("ALC") common stock distributed concurrently with ALC's emergence from bankruptcy on December 31, 2001. The Note is for a term of five years and bears interest at 5.0% compounded annually and accruing to the principal balance plus interest at 2.0% on the original principal of \$7,000,000 payable in cash annually. The Company did not accrue any interest income on the Note during the first nine months of 2002. The Note is a full recourse obligation of Holdings and is secured by

LTC PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued
(Unaudited)

all the assets owned now or in the future by Holdings and contains a provision for acceleration should there be a change of control of Holdings or CLC. At September 30, 2002 Holdings owned 1,452,794 shares of ALC common stock with a fair market value based on the closing price of the stock on September 30, 2002 of \$4,431,000 and \$1,382,000 face value of ALC Senior Subordinated Debentures and \$544,000 face value of Junior Subordinated Debentures. At September 30, 2002, the book value of the Note was \$3,095,000 which represented the fair market value of the 1,238,076 shares acquired by Holdings on December 31, 2001.

In February 2002, the independent members of CLC's Board of Directors approved, in principle, an Administrative Services Agreement between CLC and the Company. However the independent members of CLC's Board of directors have not as yet been able to confer with an independent advisor on this Agreement. As a result, the Company and CLC have agreed to defer until January 1, 2003, the effective date of the Agreement. It is still anticipated that this agreement would terminate on June 30, 2007, and provide that during its term the Company will provide office space and certain management and administrative services to CLC for a fee of approximately \$1,000,000 per year beginning as of January 1, 2003. Additionally, the Company has an indemnification agreement covering four of the Company's officers who also serve as officers of CLC and one current CLC outside director.

5. Debt Obligations

At September 30, 2002, \$74,390,000 was outstanding under the Company's Senior Secured Revolving Line of Credit (the "Secured Revolving Credit") and commitments were \$75,000,000. During the three and nine months ended September 30, 2002, pricing under the Secured Revolving Credit ranged from LIBOR plus 2.50% to LIBOR plus 3.00% and LIBOR plus 2.25% LIBOR plus 3.00%, respectively. At September 30, 2002, the Company's weighted average interest rate was 4.33%.

In accordance with provisions of the Secured Revolving Credit, on October 2, 2002, the Company paid a fee of \$3,000,000 (4% of the commitment balance of \$75,000,000) to extend the Secured Revolving Credit to October 2, 2004. This fee is being amortized over the remaining term of the Secured Revolving Credit as additional interest expense.

In addition, on October 2, 2002, the Company issued 1,500,000 book value units ("BVUs") to the lenders under the Secured Revolving Credit. The number of BVUs issued represented 20,000 BVUs for each \$1,000,000 of outstanding commitment (\$75,000,000) as October 2, 2002. The BVUs entitle the lenders to participate in any increase in the Company's book value per common share (measured at September 30, 2004) in excess of the Company's book value per common share at September 30, 2000, less \$2.00 per share from such excess. The Company's book value per common share at September 30, 2000 was \$8.92, thus the book value per common share at September 30, 2004 would have to be in excess of \$10.92 in order for the Company to be obligated to pay any money to the lenders for their BVUs. At September 30, 2002, the Company's book value per common share was \$10.13. The Company is obligated to pay the lenders any amounts due them relating to the BVUs as of September 30, 2004, even if the Company repays in full and terminates the Secured Revolving Credit prior to its maturity.

During the nine months ended September 30, 2002 the Company paid off \$24,416,000 in mortgage notes payable to REMIC pools originated by the Company. Approximately \$13,354,000 of the pay-offs related to property sales as discussed in *Note 2 – Real Estate Investments* and \$11,062,000 related to five loans that were repaid prior to maturity.

LTC PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued
(Unaudited)

At maturity, January 2, 2002, the Company redeemed \$2,408,000 of convertible subordinated debentures.

6. Senior Mortgage Participation Payable

On August 1, 2002, the Company sold, to a private bank, a non-recourse senior participation interest in 22 of the Company's first mortgages with a total balance outstanding of approximately \$58,627,000. The sales agreement provides that the private bank will receive 9.25% per annum interest and all principal payments from these mortgages until the senior participation is retired. There is no specific principal maturity date for the senior participation other than the principal maturity dates of the underlying mortgages. The Company will continue to receive interest from these mortgages above the 9.25% paid to the private bank and will resume collecting principal once the senior participation is repaid in full. The weighted average interest rate of these mortgages is approximately 11.6%. The Company sold the senior participation interest for \$30,000,000 and received \$29,750,000 in net proceeds, which it used to reduce commitments and amounts outstanding under the Secured Revolving Credit. This transaction does not meet all of the requirements of FASB No. 140 *"Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities"* and as such, the Company has recorded this transaction as a secured borrowing rather than as a sale.

7. Stockholders' Equity

During the nine months ended September 30, 2002, the Company declared and paid cash dividends on its Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock totaling \$5,464,000, \$3,362,000 and \$3,273,000 (\$818,000 of which was accrued at December 31, 2001), respectively. During the first three quarters of 2002 the Company declared and paid cash dividends of \$0.10 per share on its common stock totaling \$5,529,000.

Subsequent to September 30, 2002 the Company declared a cash dividend of \$0.10 per share on its common stock payable on December 31, 2002 to stockholders of record on December 21, 2002.

During the nine months ended September 30, 2002, the Company granted 30,000 stock options at an exercise price of \$7.63. The options vest over five years and expire the earlier of seven years from the date of vesting and ten years from the date of grant.

On September 19, 2002, the Company announced a tender offer to purchase up to 1,500,000 shares of its common stock at a purchase price of \$8.50 per share. On October 18, 2002, the Company announced the termination of the tender offer because after discussions with various operators it became clear that as a result of the failure of Congress to extend certain Medicare skilled nursing facility "add-ons" that expired October 1, 2002, most operators of skilled nursing facilities may experience a deterioration in their financial condition. The Company cannot, at this time, determine the total impact of the continuing Medicare payment reductions on all of its leasees and mortgagors who have exposure to the Medicare program and as a result cannot evaluate the potential impact on the Company's revenues.

8. Major Operators

At September 30, 2002, Sun Healthcare Group, Inc. ("Sun") operated 14 facilities (13 leases and one loan to a party who in turn leased the facility to Sun) with 1,714 beds/units representing approximately 11.6%, or \$65,965,000, of the Company's "direct real estate investment portfolio" (properties that the Company owns or on which the Company holds promissory notes, secured by first mortgages). Additionally, at September 30, 2002 Sun operated nine skilled nursing facilities securing seven mortgage

LTC PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued
(Unaudited)

loans payable to REMIC pools originated by the Company. During 1999, Sun filed for reorganization under Chapter 11 of the Bankruptcy Code and operated its business as a debtor-in-possession subject to the jurisdiction of the Bankruptcy Court until it emerged from bankruptcy in February 2002. Concurrently, 13 leases the Company had directly with Sun were affirmed; additionally the lease related to the loan was affirmed.

In Sun's June 30, 2002 Form 10-Q filing, Sun estimated that if the Medicare "add-ons" expired, Sun's estimated Medicare revenues would decrease by approximately \$32,400,000 for the period of October 1, 2002 to September 30, 2003. The Company believes that a material amount of this decrease, if it were to happen, would also reduce Sun's operating income unless Sun was able to reduce costs by a commensurate amount. Sun also disclosed in its June 30, 2002 Form 10-Q that it was not in compliance with certain financial covenants contained in its loan agreements. Sun obtained certain waivers but disclosed that if it were unable to either enter into an amendment of the financial covenants or to fulfill the existing covenants and obtain a permanent waiver of the default with respect to the Revolving Loan Agreement for the period ending June 30, 2002 prior to September 30, 2002 and June 29, 2003 with respect to the Term Loan Agreement, then Sun would be in default under the loan agreements. Sun disclosed that it had initiated negotiations with the lenders to revise the covenants but gave no assurances that it would be able to amend the covenants. If it were unable to do so, Sun disclosed that the lenders could exercise their remedies including but not limited to declaring amounts outstanding to be immediately due and payable and denying Sun the right to further borrowings under the revolving loan agreement.

In addition, Sun disclosed it was in default of two financial covenants contained in leases of 38 skilled nursing facilities. None of these leases are with the Company. Sun stated that it had instituted negotiations with the landlord, however, if it was unable to amend the covenants it would be likely that Sun would continue to be in default and the landlord could exercise remedies including the potential termination of the leases which would result in the loss of Sun's ability to operate the facilities and the landlord could assess leasehold damages against Sun.

As of the filing of this Form 10-Q by the Company, the Company does not have access to any subsequent disclosure from Sun regarding these issues.

At September 30, 2002, ALC operated 37 assisted living facilities with 1,434 units representing approximately 15.6%, or \$88,105,000, of the Company's direct real estate investment portfolio. ALC filed for reorganization under Chapter 11 of the Bankruptcy Code in October 2001 and emerged from bankruptcy on December 31, 2001. The Company also has an investment in ALC's senior and junior subordinated debentures with a net book value of \$8,844,000 at September 30, 2002. Additionally, as more fully described in *Note 4 – CLC Healthcare, Inc.*, the Company has a \$7,000,000 note (recorded at a value of \$3,095,000) from CLC that is secured by 1,452,794 shares of ALC common stock and \$1,926,000 face value ALC senior and junior debentures.

At September 30, 2002, Alterra Healthcare Corporation ("Alterra") operated 35 assisted living facilities with 1,416 units representing 14.9%, or \$84,194,000 of the Company's direct real estate investment portfolio. Alterra has announced that it has engaged financial advisors to assist Alterra in a restructuring of its debt and equity.

In Alterra's June 30, 2002 Form 10-Q filing, Alterra disclosed that it was not in compliance with certain debt covenants and lease agreements though it had negotiated limited time waivers with certain lenders and lessors. Alterra disclosed that it had \$5,600,000 of delinquent outstanding scheduled debt service

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued
(Unaudited)

relating to certain mortgages and that it had received written notice of acceleration from lenders with respect to indebtedness aggregating \$149,100,000. In addition indebtedness of approximately \$96,900,000 was due and past due as of June 30, 2002. As a result of several cross default provisions, certain lenders and lessors had taken various actions such as applying deposits and reserve funds against amounts owed. Alterra also disclosed it was in litigation with a former lessor with respect to a damage claim associated with the early termination of 11 leases. Alterra's disclosure further describes other obligations and agreements under which it is in default and discussions with lenders and lessors.

Alterra disclosed that it would require significant additional capital resources in order to fund its operations and restructuring plan. Alterra's disclosure further describes actions it is taking to restructure its business including negotiations with various REITs to amend certain covenants and terms.

As of the filing of this Form 10-Q by the Company, the Company does not have access to any subsequent disclosure from Alterra regarding these issues.

At this time the Company has not called a default of any provisions of its leases with Alterra and is negotiating four new master leases with Alterra that would cover the 35 facilities currently leased to Alterra.

The Company cannot, at this time predict or quantify what, if any, impact any ultimate restructuring could have on the Company. As of November 2002, Alterra was current on all rent due the Company.

At September 30, 2002, Sunwest Management, Inc. ("Sunwest") operated 7 assisted living facilities with 693 units representing 10.9%, or \$61,584,000, of the Company's direct real estate investment portfolio.

CLC Healthcare, Inc. (See *Note 4 — CLC Healthcare, Inc.*)

All of these companies, except Sunwest, are publicly traded companies, and as such are subject to the filing requirements of the Securities and Exchange Commission. The Company's financial position and its ability to make distributions may be adversely affected by further financial difficulties experienced by ALC, Alterra, CLC and Sun, or financial difficulties experienced by Sunwest, or any of the Company's other major operators, including additional bankruptcies, inability to emerge from bankruptcy, insolvency or general downturn in business of any such operator, or in the event any such operator does not renew and/or extend its relationship with the Company or the Company's borrowers when it expires.

9. Contingencies

It is the Company's policy to require, all borrowers of funds from the Company and lessees of any of the Company's properties to secure comprehensive property and general and professional liability insurance that covers the Company, as well as the borrower and/or lessee. Even though that is the policy of the Company, certain borrowers and lessees have been unable to obtain general and professional liability insurance because the cost of such insurance has increased substantially and some insurers have stopped offering such insurance for long term care facilities. Additionally, insurance companies have filed for bankruptcy protection leaving certain of the Company's borrowers and/or lessees without coverage for periods that were believed to be covered prior to such bankruptcies. The unavailability and associated exposure as well as increased cost of such insurance could have a material adverse effect on the lessees and operators, including their ability to make lease or mortgage payments. Although the Company contends that as a non-possessory landlord it is not generally responsible for what takes place on real estate it does not possess, claims including general and professional liability claims, may still be asserted

LTC PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued
(Unaudited)

against it which may result in costs and exposure for which insurance is not available. Certain risks may be uninsurable, not economically insurable or insurance may not be available and there can be no assurance that the Company, a borrower or lessee will have adequate funds to cover all contingencies. At renewal in August of 2001, the Company's insurer elected to not renew its policy for general and professional liability coverage. The Company has been unable to replace coverage for this type of contingent liability insurance. If an uninsured loss or a loss in excess of insured limits occurs with respect to one or more of the Company's properties, the Company could be subject to an adverse claim including claims for general or professional liability, could lose the capital that it has invested in the properties, as well as the anticipated future revenue for the properties and, in the case of debt which is with recourse to the Company, the Company would remain obligated for any mortgage debt or other financial obligations related to the properties. Certain losses such as losses due to floods or seismic activity if insurance is available may be insured subject to certain limitations including large deductibles or co-payments and policy limits.

The Company and one of its subsidiaries were parties to an action which attempted to present a legal basis to hold the Company and its subsidiaries responsible for an incident occurring in February 2001 in connection with resident care at a facility where the subsidiary was the non-possessory landlord and had a long term lease to a third party operator. Subsequent to September 30, 2002, all parties to this action entered into a contingent settlement agreement and release which contingency will expire on February 7, 2003. The terms and conditions of this agreement are strictly confidential, however, the Company is allowed to state upon the expiration of the contingency that the parties have resolved their differences and that the lawsuit has been dismissed. The Company will continue to vigorously defend itself against claims that a non-possessory landlord has liability for the actions of the operators in other similar asserted claims.

10. Earnings per Share

The following table sets forth the computation of basic and diluted net income per share (unaudited, in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Net income (loss)	\$ 6,554	\$ 6,067	\$ 27,097	\$ (1,499)
Preferred dividends	(3,762)	(3,772)	(11,281)	(11,315)
Net income (loss) for basic net income per share	2,792	2,295	15,816	(12,814)
Effect of dilutive securities	—	—	—	—
Net income (loss) for diluted net income per share	\$ 2,792	\$ 2,295	\$ 15,816	\$ (12,814)
Shares for basic net income per share	18,393	24,571	18,393	25,312
Effect of dilutive securities:				
Stock options	148	—	151	—
Shares for diluted net income per share	18,541	24,571	18,544	25,312
Basic net income (loss) per share	\$ 0.15	\$ 0.09	\$ 0.86	\$ (0.51)
Diluted net income (loss) per share	\$ 0.15	\$ 0.09	\$ 0.85	\$ (0.51)

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Operating Results

Three months ended September 30, 2002 compared to three months ended September 30, 2001

Revenues for the three months ended September 30, 2002 increased to \$17.7 million from \$17.1 million for the same period in 2001. Rental income for the three months ended September 30, 2002 increased \$0.9 million compared to the same period of 2001 primarily as a result of the acquisition of properties in December 2001, new leases and rental increases provided for in existing lease agreements, partially offset by the elimination of rents from sold properties, closed facilities and reduction of rents due from ALC. Same store rental income, properties owned for the three months ended September 30, 2002 and the three months ended September 30, 2001, was unchanged due a reduction of rents due from ALC offset by normal rental rate increases, as set forth in the lease agreements. Interest income from mortgage loans and notes receivable decreased \$0.1 million primarily as a result of the early payoff of three mortgage loans, the conversion of one mortgage loan to an owned property, lower default interest, and the effect of not accruing interest on one mortgage loan, partially offset by the receipt of interest income on the Company's line of credit with CLC. Interest income from REMIC Certificates for the three months ended September 30, 2002 decreased \$0.5 million compared to the same period of 2001 due to the amortization of the related asset, the early payoff of certain mortgage loans underlying the Company's REMIC Certificates and the sale of REMIC Certificates in the third quarter of 2001. Interest and other income for the three months ended September 30, 2002 increased \$0.3 million from the same period in 2001 due to the receipt of interest on the Company's investment in ALC bonds.

Interest expense increased by \$0.3 million to \$5.4 million for the three months ended September 30, 2002 from \$5.1 million during the same period in 2001, due to an increase in the Company's overall weighted average interest rate resulting from the sale of the Senior Mortgage Participation as discussed in *Note 6. – Senior Mortgage Participation Payable* partially offset by lower debt outstanding along with a decrease in interest rates on the Company's Senior Secured Revolving Line of Credit. Depreciation and amortization expense for the third quarter of 2002 increased \$0.1 million from the second quarter of 2001 due to the conversion of mortgage loans into owned properties and the acquisition of properties in December 2001 partially offset by properties sold and a lower basis of certain assets due to impairment charges taken in 2001 and 2002. The Company recorded a \$0.9 million impairment charge during the third quarter of 2002 (as discussed in *Note 3. – Impairment Charge*). No impairment charge was taken in the same quarter of the prior year.

During the quarter ended September 30, 2002, the Company reported a net loss from discontinued operations of \$0.1 million as compared to a \$0.2 million net loss in the same period in the prior year. This reclassification was made in accordance with FASB No. 144 "*Accounting for the Impairment or Disposal of Long-Lived Assets*" which requires that the financial results of properties meeting certain criteria be reported on a separate line item called "Discontinued Operations". During the three months ended September 30, 2002, the Company sold, in three separate transactions, two skilled nursing facilities in Texas and one skilled nursing facility in Arizona for a total combined gain of approximately \$0.8 million. The Company received approximately \$2.5 million in cash from these transactions. All of the cash received from these transactions was used to repay debt. Additionally, \$0.9 million of commitments under the Senior Secured Revolving Line of Credit were reduced as result of these sales. In the third quarter of 2001, the Company recognized a \$0.3 million loss on sale of assets.

Net income available to common stockholders increased to \$2.8 million for the three months ended September 30, 2002 from \$2.3 million for the same period in 2001 due to the gain on sale of assets in 2002 as discussed above.

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Nine months ended September 30, 2002 compared to nine months ended September 30, 2001

Revenues for the nine months ended September 30, 2002 decreased to \$52.4 million from \$53.4 million for the same period in 2001. Rental income for the nine months ended September 30, 2002 increased \$2.2 million compared to the same period of 2001 primarily as a result of the acquisition of properties in December 2001, new leases and rental increases provided for in existing lease agreements, partially offset by the elimination of rents from sold properties and closed facilities and a reduction in rents due from ALC. Same store rental income, properties owned for the nine months ended September 30, 2002 and the nine months ended September 30, 2001, was comparable due to rental rate increases provided for in the leases offset by decreases in rents due from ALC. Interest income from mortgage loans and notes receivable decreased \$1.6 million primarily as a result of the early payoff of five mortgage loans (three in 2002 and two in the second half of 2001), the conversion of one mortgage loan to an owned property, a receipt of delinquent interest related to a bankruptcy order in the prior year and the effect of not accruing interest on one mortgage loan. Interest income from REMIC Certificates for the nine months ended September 30, 2002 decreased \$2.0 million compared to the same period of 2001 due to the amortization of the related asset, the early payoff of certain mortgage loans underlying the Company's REMIC Certificates and the sale of REMIC Certificates in the third quarter of 2001. Interest and other income increased \$0.4 million for the nine months ended September 30, 2002 due primarily to the receipt of interest income from the Company's investment in ALC bonds.

Interest expense decreased by \$0.4 million to \$16.2 million for the nine months ended September 30, 2002 from \$16.6 million during the same period in 2001, due to lower debt outstanding along with a decrease in the interest rate on the Company's Senior Secured Revolving Line of Credit, partially offset by a higher interest rate on the Company's Senior Mortgage Participation (see *Note 6. – Senior Mortgage Participation Payable*). Depreciation and amortization expense increased \$0.6 million due to the conversion of mortgage loans into owned properties and the acquisition of properties in December 2001 partially offset by properties sold and a lower basis of certain assets due to impairment charges taken in 2001 and 2002. The Company recorded a \$5.8 million impairment charge during the nine months ended September 30, 2002 (as discussed in *Note 3. – Impairment Charge*) compared to an \$22.8 million impairment charge (\$4.0 million of which is included in net loss from discontinued operations as required by FASB No. 144 and is more fully explained in *Note 2. — Real Estate Investments*) taken in the nine months ended September 30, 2001.

During the nine months ended September 30, 2002, the Company reported a net loss from discontinued operations of \$0.3 million as compared to a \$4.6 million net loss in the same period in the prior year. This reclassification was made in accordance with FASB No. 144 "*Accounting for the Impairment or Disposal of Long-Lived Assets*" which requires that the financial results of properties meeting certain criteria be reported on a separate line item called "Discontinued Operations". During the nine months ended September 30, 2002, the Company sold two skilled nursing facilities in Texas, one skilled nursing facility in Arizona, two skilled nursing facilities in Illinois and five skilled nursing facilities in Alabama resulting in a net gain of approximately \$13.9 million. During the same period in 2001, the Company recorded a net gain of \$1.6 million related the sale of three schools, three skilled nursing facilities, an office building, certain REMIC Certificates, its investment in the common stock of CLC and the funding of the operating losses of two skilled nursing facilities being closed.

Net income available to common stockholders increased to \$15.8 million for the nine months ended September 30, 2002 from a net loss to common stockholders of \$12.8 million for the same period in 2001, due largely to the impairment in 2001 and the gain on sale of assets in 2002 as discussed above.

Liquidity and Capital Resources

At September 30, 2002 the Company's real estate investment portfolio (before accumulated depreciation and amortization) consisted of \$482.4 million invested primarily in owned long-term care facilities, mortgage loans of approximately \$83.0 million (net of a \$1.3 million reserve) and subordinated REMIC Certificates of approximately \$68.5 million with a weighted average effective yield of 17.3%. At September 30, 2002 the outstanding certificate principal balance and the weighted average pass-through rate for the senior REMIC Certificates (all held by

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outside third parties) was \$224.6 million and 7.3%. The Company's portfolio consists of direct investments (properties that the Company either owns or on which the Company holds promissory notes secured by first mortgages) in 100 skilled nursing facilities, 97 assisted living facilities and one school in 30 states.

For the nine months ended September 30, 2002, the Company had net cash provided by operating activities of \$32.2 million. The Company acquired one skilled nursing facility in Texas for \$0.5 million cash and the assumption of \$1.4 million in mortgage debt payable to a REMIC pool originated by the Company. Additionally, the Company invested \$0.8 million for renovation of owned properties. The Company sold nine skilled nursing facilities resulting in a net gain of \$13.9 million. The sales resulted in net cash proceeds of \$12.1 million, a ten-year \$3.6 million note with a face rate of 7.0% which the Company discounted to \$2.6 million for an effective rate of 13.0% and the pay off of \$12.8 million of mortgage debt payable to REMIC pools originated by the Company. The Company received \$5.7 million in principal payments on mortgage loans receivable including \$4.3 million in prepayments of three loans on skilled nursing facilities. The Company also received \$1.7 million in repayments of three notes receivable related to properties sold in 2001 and advanced \$0.5 million to an operator under a line of credit. The Company provided CLC with an additional \$0.8 million in borrowings, and CLC repaid \$0.8 million, under the \$10.0 million secured line of credit that bears interest at 10% and matures in April 1, 2008 (see *Note 4. CLC Healthcare, Inc.*). In addition, two mortgage loans on two skilled nursing facilities in Florida with a combined principal balance of \$3.8 million were reclassified to owned properties as a result of a deed-in-lieu of foreclosure transaction and a foreclosure sale.

During the nine months ended September 30, 2002, the Company borrowed \$10.0 million and repaid \$39.6 million of bank borrowings and redeemed \$2.4 million of convertible subordinated debentures at maturity and has on hand, as of September 30, 2002, cash and cash equivalents of \$23.0 million. At September 30, 2002, in addition, to the \$12.8 million pay off of mortgage debt related to asset sales, the Company also repaid five loans payable to REMIC pools originated by the Company totaling \$11.1 million. On August 1, 2002, the Company sold, to a private bank, a non-recourse senior participation interest in 22 of the Company's first mortgages with a total balance outstanding of approximately \$58.6 million. The sales agreement provides that the private bank will receive 9.25% per annum interest and all principal payments from these mortgages until the senior participation is retired. There is no specific principal maturity date for the senior participation other than the principal maturity dates of the underlying mortgages. The Company will continue to receive interest from these mortgages above the 9.25% paid to the private bank and will resume collecting principal once the senior participation is repaid in full. The weighted average interest rate of these mortgages is approximately 11.6%. The Company sold the senior participation interest for \$30.0 million and received approximately \$29.8 million in net proceeds, which it used to reduce commitments and amounts outstanding under the Secured Revolving Credit. This transaction does not meet all of the requirements of FASB No. 140 "*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*" and as such, the Company has recorded this transaction as a secured borrowing rather than as a sale.

During the nine months ended September 30, 2002, the Company paid cash dividends on its Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock totaling \$5.5 million, \$3.4 million, and \$3.2 million (\$0.8 million of which was accrued at December 31, 2001), respectively. Additionally, the Company paid a cash dividend on its common stock totaling \$5.5 million. The Company has declared a \$0.10 dividend per share on its common stock payable on December 30, 2002; however, the Company is giving no assurances that this amount or any amount will be a continuing common dividend in the near future.

As of November 4, 2002, the Company had reduced the amounts outstanding and commitment amount under its Senior Secured Revolving Line of Credit to the levels required as of October 1, 2003. In aggregate, the Company is required to make payments of at least \$25.4 million to reduce various debt obligations in 2002. As of September 30, 2002, the Company had made approximately \$24.8 million of these payments. Additionally, the Company paid \$13.2 million in principal that was scheduled to mature in 2003 and 2004.

At December 31, 2001, the Company had three contracts to sell four skilled nursing homes and three assisted living facilities for a total aggregate sales price of \$35.1 million including the assumption of approximately

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\$4.1 million of debt. One of these contracts to sell a skilled nursing facility was completed in the third quarter of 2002 and generated \$1.9 million in net cash proceeds. The contract covering the other three skilled nursing facilities is being renegotiated and at this time, the Company cannot predict if the transaction will be completed or what proceeds, if any, would be generated. The contract is with the operator of the facilities who remains the operator and is obligated to continue paying rent on the facilities. The contract for the three assisted living facilities expired as a result of the purchaser's inability to obtain the necessary financing. The purchaser is the operator of the facilities and has agreed to an extended lease on these facilities.

Alterra Healthcare Corporation ("Alterra") operates 35 assisted living facilities with a total of 1,416 units owned by the Company representing approximately 14.9%, or \$84.2 million, of the Company's "direct real estate investment portfolio" (properties that the Company owns or on which the Company holds promissory notes secured by first mortgages). Alterra has announced that it has engaged financial advisors to assist Alterra in a restructuring of its debt and equity.

In Alterra's June 30, 2002 Form 10-Q filing, Alterra disclosed that it was not in compliance with certain debt covenants and lease agreements though it had negotiated limited time waivers with certain lenders and lessors. Alterra disclosed that it had \$5.6 million of delinquent outstanding scheduled debt service relating to certain mortgages and that it had received written notice of acceleration from lenders with respect to indebtedness aggregating \$149.1 million. In addition indebtedness of approximately \$96.9 million was due and past due as of June 30, 2002. As a result of several cross default provisions, certain lenders and lessors had taken various actions such as applying deposits and reserve funds against amounts owed. Alterra also disclosed it was in litigation with a former lessor with respect to a damage claim associated with the early termination of 11 leases. Alterra's disclosure further describes other obligations and agreements under which it is in default and discussions with lenders and lessors.

Alterra disclosed that it would require significant additional capital resources in order to fund its operations and restructuring plan. Alterra's disclosure further describes actions it is taking to restructure its business including negotiations with various REITs to amend certain covenants and terms.

At this time the Company has not called a default of any provisions of its leases with Alterra and is negotiating four new master leases with Alterra that would cover the 35 facilities currently leased to Alterra.

The Company cannot, at this time, predict or quantify what, if any, impact any ultimate restructuring could have on the Company. As of November 2002, Alterra was current on all rent due the Company.

As of the filing of this Form 10-Q by the Company, the Company does not have access to any subsequent disclosure from Alterra regarding these issues.

At September 30, 2002, Sun Healthcare Group, Inc. ("Sun") operated 14 facilities (13 leases and one loan to a party who in turn leased the facility to Sun) with 1,714 beds/units representing approximately 11.6%, or \$66.0 million of the Company's "direct real estate investment portfolio" (properties that the Company owns or on which the Company holds promissory notes, secured by first mortgages). Additionally, at September 30, 2002 Sun operated nine skilled nursing facilities securing seven mortgage loans payable to REMIC pools originated by the Company. During 1999, Sun filed for reorganization under Chapter 11 of the Bankruptcy Code and operated its business as a debtor-in-possession subject to the jurisdiction of the Bankruptcy Court until it emerged from bankruptcy in February 2002. Concurrently, 13 leases the Company had directly with Sun were affirmed; additionally the lease related to the loan was affirmed.

In Sun's June 30, 2002 Form 10-Q filing, Sun estimated that if the Medicare "add-ons" expired, Sun's estimated Medicare revenues would decrease by approximately \$32.4 million for the period of October 1, 2002 to September 30, 2003. The Company believes that a material amount of this decrease, if it were to happen, would also reduce Sun's operating income unless Sun was able to reduce costs other than direct patient care costs by a commensurate amount. Sun also disclosed in its June 30, 2002 Form 10-Q that it was not in compliance with

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certain financial covenants contained in its loan agreements. Sun obtained certain waivers but disclosed that if it were unable to either enter into an amendment of the financial covenants or to fulfill the existing covenants and obtain a permanent waiver of the default with respect to the Revolving Loan Agreement for the period ending June 30, 2002 prior to September 30, 2002 and June 29, 2003 with respect to the Term Loan Agreement, then Sun would be in default under the loan agreements. Sun disclosed that it had initiated negotiations with the lenders to revise the covenants but gave no assurances that it would be able to amend the covenants. If it were unable to do so, Sun disclosed that the lenders could exercise their remedies including but not limited to declaring amounts outstanding to be immediately due and payable and denying Sun the right to further borrowings under the revolving loan agreement.

In addition, Sun disclosed it was in default of two financial covenants contained in leases of 38 skilled nursing facilities. None of these leases are with the Company. Sun stated that it had instituted negotiations with the landlord, however, if it was unable to amend the covenants it would be likely that Sun would continue to be in default and the landlord could exercise remedies including the potential termination of the leases which would result in the loss of Sun's ability to operate the facilities and the landlord could assess leasehold damages against Sun.

As of the filing of this Form 10-Q by the Company, the Company does not have access to any subsequent disclosure from Sun regarding these issues.

The Company expects its future income and ability to make distributions from cash flows from operations to depend on the collectibility of its mortgage loans receivable, REMIC Certificates and rents. The collection of these loans, certificates and rents will be dependent, in large part, upon the successful operation by the operators of the skilled nursing facilities and assisted living facilities owned by or pledged to the Company and the school owned by the Company. The operating results of the facilities will be impacted by various factors over which the operators/owners may have no control. Those factors include, without limitation, the status of the economy, changes in supply of or demand for competing long-term care facilities, ability to control rising operating costs, and the potential for significant reforms in the long-term care industry. In addition, the Company's future growth in net income and cash flow may be adversely impacted by various proposals for changes in the governmental regulations and financing of the long-term care industry. The Company cannot presently predict what impact these proposals may have, if any. The Company believes that an adequate provision has been made for the possibility of loans proving uncollectible but will continually evaluate the status of the operations of the skilled nursing facilities, assisted living facilities and the school. In addition, the Company will monitor its borrowers and the underlying collateral for mortgage loans and will make future revisions to the provision, if considered necessary.

Should an insufficient amount be raised to meet the Company's debt obligations through asset sales or financings, the Company would need to again suspend paying a common dividend and perhaps some of the preferred dividends in order to apply funds from operations to debt reductions.

The Company's investments, principally its investments in mortgage loans, REMIC Certificates, and owned properties, are subject to the possibility of loss of their carrying values as a result of changes in market prices, interest rates and inflationary expectations. The effects on interest rates may affect the Company's costs of financing its operations and the fair market value of its financial assets. The Company generally made loans that have predetermined increases in interest rates and leases that have agreed upon annual increases. Inasmuch as the Company initially funded its investments with its Senior Secured Revolving Line of Credit, the Company is at risk of net interest margin deterioration if medium and long-term rates were to increase.

The REMIC Certificates retained by the Company are subordinate in rank and right of payment to the certificates sold to third-party investors and as such would, in most cases, bear the first risk of loss in the event of impairment to any of the underlying mortgages. The returns on the Company's investment in REMIC Certificates are subject to certain uncertainties and contingencies including, without limitation, the level of prepayments, estimated future credit losses, prevailing interest rates, and the timing and magnitude of credit losses on the underlying mortgages collateralizing the securities that are a result of the general condition of the real estate market or long-term care

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industry. As these uncertainties and contingencies are difficult to predict and are subject to future events that may alter management's estimations and assumptions, no assurance can be given that current yields will not vary significantly in future periods. To minimize the impact of prepayments, the mortgage loans underlying the REMIC Certificates generally prohibit prepayment unless the property is sold to an unaffiliated third party (with respect to the borrower).

The Company believes that its current cash flow from operations available for distribution or reinvestment and its current borrowing capacity are sufficient to provide for payment of its operating costs, meet debt obligations and provide funds for distribution to the holders of the Company's preferred stock. As a result of the Company's current inability to refinance its Senior Secured Revolving Line of Credit, the Company has continued to limit its investment activity in 2002. If prevailing interest rates or other factors at the time of refinancing, if any, (such as the reluctance of lenders to make commercial real estate loans) result in higher rates upon refinancing the interest expense relating to the refinanced indebtedness would increase and therefore adversely affect the Company's financial condition and results of operations.

Critical Accounting Policies

In October 2001, the Financial Accounting Standards Board issued FASB No. 144 *"Accounting for the Impairment or Disposal of Long-Lived Assets"*, which is required to be adopted in fiscal years beginning after December 15, 2001. FASB No. 144 on asset impairment supercedes FASB No. 121, *"Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of"*, and provides a single accounting model for long-lived assets to be disposed of. Subsequent to January 1, 2002, and in accordance with FASB No. 144, properties held for sale on the balance sheet includes only those properties available for immediate sale in their present condition and for which management believes that it is probable that a sale of the property will be completed within one year. Properties held for sale are carried at the lower of cost or fair value less estimated selling costs. No depreciation expense is recognized on properties held for sale. In accordance with the implementation provisions of FASB No. 144, the operating results of real estate assets designated as held-for-sale subsequent to January 1, 2002 are included in discontinued operations in the consolidated statement of operations. In addition, all gains and losses from real estate sold are also included in discontinued operations.

For further discussion of the Company's critical accounting policies, see the Company's Annual Report filed on Form 10-K for the year ended December 31, 2001.

Funds From Operations

Industry analysts generally consider funds from operations ("FFO") to be an alternative measure of performance of a REIT. The National Association of Real Estate Investment Trusts ("NAREIT") has defined FFO as net income applicable to common stockholders (computed in accordance with GAAP) excluding gain (or losses) from debt restructuring, sales of property and impairment charges, plus depreciation of real property and after adjustments for unconsolidated entities in which a REIT holds an interest.

The Company believes that FFO is an important supplemental measure of operating performance. FFO should not be considered as a alternative to net income or any other GAAP measurement of performance as an indicator of operating performance or as an alternative to cash flows from operations, investing or financing activities as a measure of liquidity. The Company believes that FFO is helpful in evaluating a REIT portfolio's overall performance considering the fact that historical cost accounting implicitly assumes that the value of real estate assets diminishes predictably over time. FFO provides an alternative measurement criteria, exclusive of certain non-cash charges included in GAAP income, by which to evaluate the performance of such investments. FFO as used by the Company may not be comparable to similarly entitled items reported by other REITs.

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The following table reconciles net income available to common stockholders to FFO available to common stockholders (unaudited, in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Net income (loss) available to common stockholders	\$ 2,792	\$ 2,295	\$ 15,816	\$ (12,814)
(Gain) loss on sale of assets, net	(819)	279	(13,939)	(1,565)
Impairment charge discontinued operations	—	—	—	4,037
Impairment charge continuing operations	925	—	5,807	18,829
Real estate depreciation from discontinued operations	19	103	34	278
Real estate depreciation from continuing operations	3,535	3,404	10,904	10,344
FFO available to common stockholders	\$ 6,452	\$ 6,081	\$ 18,622	\$ 19,109
Basic FFO per share	\$ 0.35	\$ 0.25	\$ 1.01	\$ 0.75
Diluted FFO per share	\$ 0.35	\$ 0.25	\$ 1.00	\$ 0.75

Statement Regarding Forward Looking Disclosure

Certain information contained in this report includes forward looking statements, which can be identified by the use of forward looking terminology such as “may”, “will”, “expect”, “should” or comparable terms or negatives thereof. These statements involve risks and uncertainties that could cause actual results to differ materially from those described in the statements. These risks and uncertainties include (without limitation) the following: the effect of economic and market conditions and changes in interest rates, government policy changes relating to the health care industry including changes in reimbursement levels under the Medicare and Medicaid programs, changes in reimbursement by other third party payors, the financial strength of the operators of the Company’s facilities as it affects the continuing ability of such operators to meet their obligations to the Company under the terms of the Company’s agreements with its borrowers and operators, the amount and the timing of additional investments, access to capital markets and changes in tax laws and regulations.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable.

Item 4. CONTROLS AND PROCEDURES

The Chief Executive Officer and the Chief Financial Officer of the Company (its principal executive officer and principal financial officer, respectively) have concluded, based on their evaluation as of a date within 90 days prior to the date of the filing of this report, that the Company’s disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports filed or submitted by it under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company’s management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no significant changes in the Company’s internal controls or in other factors that could significantly affect these controls subsequent to the date of such evaluation.

PART II
LTC PROPERTIES, INC.
OTHER INFORMATION

Item 5. Other Information

- (a) **Section 302 Certification of Chief Executive Officer**
- (b) **Section 302 Certification of Chief Financial Officer**

Item 6. Exhibits and Reports on Form 8-K

(a) **Exhibits**

In accordance with Item 601(b)(4)(iii) of Regulation S-K, certain instruments pertaining to Registrant's long-term debt have not been filed; copies thereof will be furnished to the Securities and Exchange Commission upon request.

10.1 First Amendment to Second Amended and Restated Promissory Note between LTC Properties, Inc. and CLC Healthcare, Inc. dated October 1, 2002.

10.2 Purchase, Warranties, Participation and Servicing Agreement between Beal Bank, SSB and LTC BBCO, Inc. dated August 1, 2002.

(b) **Reports on Form 8-K**

On August 14, 2002, the Company filed a Current Report on Form 8-K dated August 14, 2002 reporting its certifications as required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LTC PROPERTIES, INC.
Registrant

Dated: November 14, 2002

By: /s/ WENDY L. SIMPSON

Wendy L. Simpson
Vice Chairman and Chief Financial Officer

Form 10-Q Section 302 Certification

CERTIFICATION

I, Andre C. Dimitriadis, certify that:

1. I have reviewed this quarterly report on Form 10-Q of LTC Properties, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ ANDRE C. DIMITRIADIS

Andre C. Dimitriadis
Chairman & Chief Executive Officer

Form 10-Q Section 302 Certification

CERTIFICATION

I, Wendy L. Simpson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of LTC Properties, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ WENDY L. SIMPSON

Wendy L. Simpson
Vice Chairman & Chief Financial Officer

**FIRST AMENDMENT TO
SECOND AMENDED AND RESTATED PROMISSORY NOTE**

THIS FIRST AMENDMENT (THE "AMENDMENT") TO THE SECOND AMENDED AND RESTATED PROMISSORY NOTE (THE "NOTE") IS MADE AS OF THE 1ST DAY OF OCTOBER 2002, BY CLC HEALTHCARE, INC., A NEVADA CORPORATION (FORMERLY KNOWN AS LTC HEALTHCARE, INC., FORMERLY KNOWN AS LTC EQUITY HOLDING COMPANY, INC.), AS MAKER ("MAKER"), IN FAVOR OF LTC PROPERTIES, INC., A MARYLAND CORPORATION, AS PAYEE ("PAYEE") WHICH NOTE FOR \$20,000,000.00 DATED JUNE 8, 2001 SUPERSEDED AND REPLACED THAT CERTAIN AMENDED AND RESTATED PROMISSORY NOTE DATED MARCH 30, 1998 MADE BY MAKER IN FAVOR OF PAYEE, WITH REFERENCE TO THE FOLLOWING FACTS:

RECITALS

A. As of the date hereof, Maker certifies, acknowledges and agrees the outstanding principal balance of the Note is \$5,340,660.07 as of September 30, 2002.

B. Payee and certain of its wholly-owned subsidiaries, as landlord, and certain wholly owned subsidiaries of Maker (hereinafter "Subsidiaries"), as lessee, are parties to certain leases. Maker's Subsidiaries have failed to make rental payments as and when due up through September 30, 2002 under such leases in the total amount of \$2,250,000.00, and has requested, and Payee has agreed, to forbear from exercising Payee's rights and remedies under such leases with respect to such rental payments. For good and valuable consideration, including without limitation, Payee's agreement to forbear through November 30, 2002, from exercising its rights and remedies under such leases, Maker is executing and delivering this Amendment to Payee.

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which is acknowledged, Maker and Payee agree as follows:

1. *Recitals and Definitions.* The above recitals are incorporated herein by reference. All capitalized terms not otherwise defined herein shall have the same meaning as set forth in the Note and/or Security Documents.

2. *Amount Reduction.* The Note is hereby amended to reduce the amount of such Note from Twenty Million Dollars (\$20,000,000.00) to Ten Million Dollars (\$10,000,000.00). In installments as herein stated, for value received, Maker hereby promises to pay to the order of Payee, at Payee's principal place of business in Oxnard, California, or such other place as Payee may from time to time designate, the principal sum of Ten Million Dollars (\$10,000,000.00), or so much thereof as may have been advanced, with interest accruing on the principal amount from time to time outstanding from the date hereof to and including the Maturity Date (as defined below) at a rate equal to the lesser of (i) Ten Percent (10%) per annum, or (ii) the Highest Lawful Rate (as defined in Section 14 of the Note). Principal and interest shall be payable as more particularly set forth below. All principal and accrued but unpaid interest shall be due on or before April 1, 2008 (the "Maturity Date"). Principal, interest and all other sums due hereunder shall be payable in lawful money of the United States.

3. Subject to the limitations described in Section 5 of this Amendment and any other provisions set forth in the Note, Maker desires to obtain a secured line of credit from Payee to enable Maker to borrow, from time to time, sums up to, but not exceeding, in the aggregate the principal sum of Ten Million Dollars (\$10,000,000.00). Accordingly, such sum represents funds that have been or will, subject to the terms hereof, be advanced to Maker in a series of disbursements that will be made, from time to time, up to, but not exceeding, in the aggregate the principal amount of Ten Million Dollars (\$10,000,000.00). As a condition to Payee's obligation to make each and every disbursement hereunder, Payee shall receive a request for advance setting forth the desired amount of the advance and specifying the wiring instructions to which the advance should be sent (or other method of delivery) not later than ten (10) business days prior to the date on which Maker wishes to receive the funds. No request for any such advance shall be for an amount less than One Hundred Thousand Dollars (\$100,000.00).

4. *Payments.*

(a) *Payments of Interest.* Payments of interest only under the Note shall be made in arrears in monthly installments, without set-off, deduction, demand or notice of any kind or nature whatsoever, on the 1st day of each calendar month commencing on November 1, 2002 (each, a "Payment Date"), in an amount equal to the accrued but unpaid interest for the immediately preceding one-month period on the principal amount outstanding from time to time.

(b) *Payments on Maturity Date.* Assuming no acceleration by Payee and no prepayment in full of the Loan by Maker, on the Maturity Date, Maker shall pay to Payee the entire outstanding principal balance, accrued and unpaid interest and any and all other outstanding charges, fees or amounts owing to Payee by Maker under the Note.

Paragraph 4 of the Note, entitled "*Restrictive Covenants*," is hereby deleted and replaced by the language as set forth in this Paragraph 5:

5. *Restrictive Covenants.* Maker hereby covenants and agrees with Payee that, for so long as the obligations of Maker under the Note remain outstanding, or Payee has any obligation to make advances under the Note, Maker will comply with all of the following:

(a) Maker will not, and will not permit any subsidiary of Maker to, create, assume, incur or suffer to exist any lien or encumbrance of any kind, upon all or any portion of the Collateral (as defined in the Security Documents).

(b) Maker will not use the proceeds to pay any claim arising from an uninsured loss arising as a result of a claim for general or professional liability. At the time of requesting any advance, Maker will submit to Payee a statement certified by an officer of Maker that the requested advance does not violate this provision.

(c) Maker will not use the proceeds available under the Note for any purposes other than: (i) working capital, other than amounts referred to in 4(b) above, or (ii) for such other purposes Payee, in its sole and absolute discretion, approves in writing.

(d) Maker will not, and will not permit any subsidiary to, directly or indirectly, incur, create, issue, assume, purchase or suffer to exist any debt, other than debt under the Note.

(e) Maker will not, and will not permit any subsidiary to (i) lease, assign or sell all or substantially all of its property or business to any other Person (as hereinafter defined), (ii) merge or consolidate with or into any other Person, (iii) purchase or lease or otherwise acquire all or substantially all of the assets of any other Person, (iv) sell, transfer, pledge or otherwise dispose of capital stock in any of its subsidiaries, (v) liquidate, suspend or dissolve its business operations, (vi) change its name, identity or corporate, partnership or other structure, or (vii) change the current principal place of business or chief executive office, in each case without the prior written consent of Payee.

6. *No Further Changes.* Except as expressly set forth in this Amendment, the Note remains unchanged and in full force and effect and is hereby ratified and affirmed. If there is any inconsistency between the provisions, terms and conditions of this Amendment and the provisions, terms and conditions of the Note, the provisions, terms and conditions of this Amendment shall prevail in each and every instance.

7. *Counterparts.* This Amendment may be executed in counterparts, each of which shall be an original, but such counterparts shall together constitute one and the same instrument. Signatures on this Amendment conveyed via facsimile transmission shall be binding upon the parties who signed the Amendment.

8. *No Waiver of Default(s).* To the extent any Event of Default exists under the Note as of the date hereof (or any event has occurred, which with the giving of notice or the passage of time would constitute an Event of Default), the making and entering into this Amendment shall not be deemed to be a waiver by Payee of any such Event of Default (or any event which, with the giving of notice or the passage of time, would constitute an Event of Default). Payee reserves all of its rights and remedies pertaining to any such Event(s) of Default and/or default(s).

9. *Governing Law.* This Amendment shall be governed by the laws of the state of California.

IN WITNESS WHEREOF, the parties have executed this Amendment as of the date first above written.

MAKER:

**CLC HEALTHCARE, INC.,
a Nevada corporation**

By:

/s/

**Christopher Ishikawa
President**

BEAL BANK, SSB

PURCHASER

AND

LTC BBCO , INC.

COMPANY

AND

LTC PROPERTIES, INC.

SERVICER

PURCHASE, WARRANTIES, PARTICIPATION AND SERVICING AGREEMENT

Dated as of August 1, 2002

22 mortgage loans secured by 27 long-term care facilities

This is a Purchase, Warranties, Participation and Servicing Agreement for first mortgages on long-term care facilities, dated and effective as of August 1, 2002, and is executed among Beal Bank, S.S.B., as purchaser (the "Purchaser"), LTC BBCO, Inc., as seller (the "Company.") and LTC Properties, Inc., as servicer (the "Servicer").

WITNESSETH:

WHEREAS, the Purchaser has agreed to purchase from the Company and the Company has agreed to sell to the Purchaser (subject to a subordinated participation interest therein retained by the Company as provided herein) certain Mortgage Loans listed on the Mortgage Loan Schedule that is annexed hereto as Exhibit A which have an aggregate outstanding principal balance as of the close of business on the Cut-off Date after deduction of payments due on or before such date of not less than \$58,174,462.02;

WHEREAS, each of the Mortgage Loans is secured by a mortgage, deed of trust or other security instrument with respect to a longterm care facility located in the jurisdiction indicated on the Mortgage Loan Schedule;

WHEREAS, the Purchaser and the Company wish to prescribe the manner of purchase of the Mortgage Loans;

WHEREAS, the Purchaser, the Company and the Servicer wish to prescribe the management, servicing and control of the Mortgage Loans.

NOW, THEREFORE, in consideration of the mutual agreements hereinafter set forth and for other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, the Purchaser, the Servicer and the Company agree as follows:

ARTICLE I

DEFINITIONS

Whenever used herein, the following words and phrases, unless the context otherwise requires, shall have the following meanings:

Accepted Servicing Practices: With respect to any Mortgage Loan, those mortgage servicing practices of prudent mortgage lending institutions which service mortgage loans of the same type as such Mortgage Loan in the jurisdiction where the related Mortgaged Property is located.

Agreement: This Purchase, Warranties, Participation and Servicing Agreement and all amendments hereof and supplements hereto.

Assignment of Mortgage: An assignment of the Mortgage and the other Mortgage Loan Documents, notice of transfer or equivalent instrument in recordable form, sufficient under the laws of the jurisdiction wherein the related Mortgaged Property is located to reflect the sale of the Mortgage and the other Mortgage Loan Documents to the Purchaser.

Available Funds: means, collectively, all Available Interest plus all Available Principal deposited in the Custodial Account as of the close of the business on the Remittance

Date (net of charges against or withdrawals from the Custodial Account pursuant to Section 4.05).

Available Interest: means all amounts deposited in the Custodial Account as of the close of the business on the Remittance Date from the payment of interest on the Mortgage Loans.

Available Principal: means all amounts deposited in the Custodial Account as of the close of the business on the Remittance Date from the payment of scheduled principal on the Mortgage Loans.

Business Day: Any day other than (i) a Saturday or Sunday, or (ii) a day on which banking and savings and loan institutions in the State of Texas, Illinois or California are authorized or obligated by law or executive order to be closed.

Closing: The consummation of the sale described herein.

Closing Date: August 1, 2002.

Code: The Internal Revenue Code of 1986, as it may be amended from time to time or any successor statute thereto, and applicable U.S. Department of the Treasury regulations issued pursuant thereto.

Company: LTC BBCO, Inc., or its successor in interest, or any successor to the Company under this Agreement appointed as herein provided.

Condemnation Proceeds: All awards or settlements in respect of a Mortgaged Property, whether permanent or temporary, partial or entire, by exercise of the power of eminent domain or condemnation, to the extent not required to be released to a Mortgagor in accordance with the terms of the related Mortgage Loan Documents.

Custodial Account: The separate account or accounts created and maintained pursuant to Section 4.04.

Cut-off Date: July 31, 2002.

Deleted Mortgage Loan: A Mortgage Loan which is repurchased by the Company in accordance with the terms of this Agreement.

Determination Date: The last day (or if such last day is not a Business Day, the Business Day immediately following such last day) of the month immediately preceding the month of the related Remittance Date.

Due Date: The day of the month on which the Monthly Payment is due on a Mortgage Loan, exclusive of any days of grace.

Due Period: With respect to each Remittance Date, the period commencing on the second day of the month preceding the month of the Remittance Date and ending on the first day of the month of the Remittance Date.

Estoppel Certificate: The certificate referred to in Exhibit F.

First Remittance Date: August 15, 2002.

Initial Principal Amount: As of the Closing Date, the aggregate unpaid principal balances of the Mortgage Loans sold hereunder.

Insurance Proceeds: With respect to each Mortgage Loan, proceeds of insurance policies insuring such Mortgage Loan or the related Mortgaged Property.

Junior Participation: A subordinated interest in the Mortgage Loans initially retained by the Company pursuant to this Agreement.

Junior Participation Holder: The Company, its successors or permitted assigns who holds the Junior Participation.

Junior Participation Principal Amount: With respect to the Junior Participation, as determined at any time, the then aggregate unpaid principal balances of the Mortgage Loans minus the then Senior Participation Principal Amount .

Liquidation Proceeds: Cash received in connection with the liquidation of a defaulted Mortgage Loan, whether through the sale or assignment of such Mortgage Loan, trustee's sale, foreclosure or repossession sale or otherwise, or the sale of the related Mortgaged Property if the Mortgaged Property is acquired in satisfaction of the Mortgage Loan.

Monthly Payment: The scheduled monthly payment of principal and interest on a Mortgage Loan.

Mortgage: The mortgage, deed of trust or other instrument securing a Mortgage Note.

Mortgage File: The items pertaining to a particular Mortgage Loan referred to in Exhibit D annexed hereto, as applicable, and any additional documents required to be added to the Mortgage File pursuant to this Agreement including, without limitation, the original Mortgage Note.

Mortgage Insurance Policy: A mortgage blanket hazard insurance policy.

Mortgage Interest Rate: The annual rate of interest borne from time to time on a Mortgage Note as set forth therein (which may increase, in the case of a "step-up rate" Mortgage Note, at the times and in the amount specified in the Mortgage Note and which may increase as a result of a default in regard thereto as specified in the Mortgage Note).

Mortgage Loan: An individual Mortgage Loan, which is the subject of this Agreement, each Mortgage Loan originally sold and subject to this Agreement being identified on the Mortgage Loan Schedule, which Mortgage Loan includes without limitation the Mortgage File, the Monthly Payments, Principal Prepayments, Liquidation Proceeds, Condemnation Proceeds, Insurance Proceeds, REO Disposition Proceeds and all other rights, benefits, proceeds and obligations arising from or in connection with such Mortgage Loan.

Mortgage Loans: All of the Mortgage Loans listed on the Mortgage Loan Schedule and sold pursuant to this Agreement.

Mortgage Loan Documents: The documents listed in Exhibit E hereto.

Mortgage Loan Schedule: The Schedule of Mortgage Loans annexed hereto as Exhibit A (which, with the prior written consent of Company and Purchaser, may be amended from time to time) such Mortgage Loans Schedule setting forth the following information with respect to each Mortgage Loan, as applicable: (1) the Company's Mortgage Loan identifying number; (2) the Mortgagor's name; (3) the effective Mortgage Interest Rate and if the Mortgage Loan is a "step-up" rate loan, the step-up expressed in basis points; (4) the stated maturity date; (5) the due date of the Mortgage Loan; (6) the original principal amount of the Mortgage Loan; and (7) the principal balance of the Mortgage Loan as of the close of business on the Cut-off Date, after deduction of payments of principal actually collected on or before the Cut-off Date.

Mortgage Note: The mortgage note or other evidence of the indebtedness of a Mortgagor secured by a Mortgage.

Mortgaged Property: With respect to a Mortgage Loan, means the real and personal property securing repayment of the debt evidenced by a Mortgage Note.

Mortgagor: The obligor on a Mortgage Loan.

Non-performing Loan: Any Mortgage Loan for which a scheduled payment is delinquent and remains outstanding for a period in excess of sixty (60) days from when such payment is due for so long as any such scheduled payment remains so delinquent.

Officer's Certificate: A certificate signed by the Chairman of the Board or the Vice Chairman of the Board or the President or a Vice President or an assistant Vice President and by the Treasurer or the Secretary or one of the Assistant Treasurers or Assistant Secretaries of the Company and/or the Servicer, as applicable, and delivered to the Purchaser as required by this Agreement.

Opinion of Counsel: A written opinion of counsel who (i) is in fact independent of the Company, the Servicer and any master servicer of the Mortgage Loans, (ii) does not have any material direct or indirect financial interest in the Company, the Servicer or an affiliate of either and (iii) is not connected with the Company, the Servicer or an affiliate of either as an officer, employee, director or person performing similar functions.

Original Seller: LTC Properties, Inc. pursuant to the terms and conditions as set forth in the Purchase Agreement between it and the Company.

Person: Any individual, corporation, partnership, limited liability company, joint venture, association, joint-stock company, trust, unincorporated organization, government or any agency or political subdivision thereof.

Prepayment Premium: Any premium or charge required to be paid by a Mortgagor with respect to a Principal Prepayment.

Principal Prepayment: Any payment or other recovery of principal on a Mortgage Loan which is received in advance of its scheduled Due Date.

Property Protection Amounts: With respect to any Mortgage Loan, the amounts constituting ground rents, taxes, assessments, water rates, sewer rents, municipal charges, fire and hazard insurance premiums, condominium charges, and any other similar charges or other charges that could result in the imposition of a lien senior to that of a Mortgage Loan on any Mortgaged Property.

Purchase Agreement: The Agreement of even date herewith pursuant to which the Company acquired the Mortgage Loans from the Original Seller.

Purchase Price: \$30,000,000.00.

Purchaser: Beal Bank, S.S.B., or its successor in interest or any successor to the Purchaser under this Agreement as herein provided.

Qualified Depository: A depository the accounts of which are insured by the Federal Deposit Insurance Corporation through the Bank Insurance Fund, or any successor thereto, or the Savings Association Insurance Fund, or any successor thereto, and the debt obligations of which are rated A or better by Standard & Poor's, a division of The McGraw Hill Companies, Inc.

Qualified Insurer: An insurance company duly authorized and licensed where required by law to transact insurance business.

Remittance Date: The 15th day (or if such 15th day is not a Business Day, the first Business Day immediately following) of any month, beginning with the First Remittance Date.

REO Disposition: The final sale by the Company or the Servicer of any REO Property.

REO Disposition Proceeds: All amounts received with respect to an REO Disposition pursuant to Section 4.10.

REO Property: A Mortgaged Property acquired by the Company or the Servicer on behalf of the Purchaser through foreclosure or repossession or by deed in lieu of foreclosure or similar document, as described in Section 4.10.

Repurchase: The repurchase of a Mortgage Loan by the Company.

Repurchase Price: With respect to any Repurchased Mortgage Loan, a price equal to the sum of (i) the outstanding principal balance of the Repurchased Mortgage Loan plus (ii) interest on such outstanding principal balance at the Mortgage Interest Rate from the date on which interest on such Repurchased Mortgage Loan has last been paid and distributed to Purchaser to the date of Repurchase plus (iii) reasonable amounts paid to third parties to collect principal, interest and other amounts due under the Repurchased Mortgage Loan(s), plus (iv) all advances made for Property Protection Amounts in regard to the Repurchased Mortgage Loan from the Closing Date to the date the Repurchased Mortgage Loan is repurchased less (v) amounts received in respect of such Repurchased Mortgage Loan which are being held in the Custodial Account for distribution in the month of repurchase and which will be disbursed pursuant to Section 5.01 hereof.

Repurchased Mortgage Loan: A Mortgage Loan which is repurchased by the Company pursuant to Section 3.04.

Scheduled Payments: The monthly payments of principal, excluding balloon payments, on the Mortgage Loans scheduled to occur during the Due Period immediately preceding a Remittance Date.

Senior Participation: An amortizing interest in the Mortgage Loans, held by the Purchaser, or any of its successors or assigns, pursuant to this Agreement.

Senior Participation Interest Amount: With respect to each Remittance Date and the Senior Participation, an amount payable from Available Funds equal to one month's accrued interest calculated with reference to the Senior Participation Principal Amount on the Determination Date at the Senior Participation Rate.

Senior Participation Principal Amount: With respect to the Senior Participation, as determined at any time, THIRTY MILLION AND NO/100 DOLLARS (\$30,000,000), minus amounts in respect of principal received by the Purchaser pursuant to this Agreement.

Senior Participation Rate: 9.25% per annum. The Senior Participation Rate is net of all Servicing Fees.

Servicer: LTC Properties, Inc., or its successor in interest or permitted assigns, or any successor to the Servicer under this Agreement appointed as herein provided.

Servicer Event of Default: Any one of the conditions or circumstances enumerated in Section 10.01.

Servicing Advances: All customary, reasonable and necessary "out of pocket" costs and expenses (including reasonable attorneys' fees and disbursements) incurred in the performance by the Servicer of its servicing obligations, and, if to be paid with funds other than funds that would otherwise be paid to the Junior Participant pursuant hereto, approved by Purchaser in writing, including, but not limited to, the cost of (a) the preservation, restoration, protection and inspection of the Mortgaged Property or the Mortgage Loans, (b) any enforcement or judicial proceedings, including foreclosures, (c) the management and liquidation of any REO Property and (d) compliance with the obligations under Section 4.06; provided however, that to

the extent the Servicer is obligated to make such advances under this subsection (d) the Purchaser's approval shall not be required.

Servicing Fee: For a period of one full month, one-twelfth of the product of (a) the applicable Servicing Fee Rate and (b) the collective unpaid principal balance of the Mortgage Loans as of the beginning of the related Due Period. The Servicing Fee in all cases (i) is subordinate and inferior to the Senior Participation and (ii) is to be paid from funds that would otherwise be paid to the Company in regard to the Junior Participation.

Servicing Fee Rate: (a) for Non-performing Loans: 2.0% per annum, and (b) for Mortgage Loans which are not Non-performing Loans: .5% per annum.

Servicing File: With respect to each Mortgage Loan, the file retained by the Servicer consisting of copies of all Mortgage Loan Documents and other documents contained in the Mortgage File listed in Exhibit E, the originals of which are delivered to the Purchaser pursuant to Section 2.02.

Servicing Officer: Any officer of the Servicer involved in or responsible for, the administration and servicing of the Mortgage Loans whose name appears on a list of servicing officers furnished by the Servicer to the Purchaser upon request, as such list may from time to time be amended.

Share Percentage: With respect to the Purchaser, such percentage shall be determined by dividing: (1) the Senior Participation Principal Amount as of the time in question but before application of any prepayment as to which a prepayment premium or fee is being paid; by (2) the aggregate outstanding principal balances of all Mortgage Loans as of the time in question but before application of any prepayment as to which a prepayment premium or fee is being paid ("Purchaser Share Percentage"). With respect to the Company, such percentage shall be determined by deducting: (Y) the Purchaser Share Percentage from (Z) 100% ("Company Share Percentage").

Subservicer: Any Subservicer which is subservicing the Mortgage Loans pursuant to a Subservicing Agreement meeting the qualifications set forth in Section 4.01.

Subservicing Agreement: An agreement between the Servicer and a Subservicer for the servicing of the Mortgage Loans.

UCC: The Uniform Commercial Code, as in effect from time to time in the relevant jurisdiction.

ARTICLE II

PURCHASE PRICE; CONVEYANCE OF MORTGAGE LOANS; POSSESSION OF MORTGAGE FILES; BOOKS AND RECORDS; CUSTODIAL AGREEMENT; DELIVERY OF DOCUMENTS

Section 2.01 Purchase Price.

- (a) As consideration for the acquisition of the Mortgage Loans (other than the Company's retained Junior Participation), Purchaser shall pay to Company, an amount equal to the Purchase Price.
- (b) Subject to the satisfaction, or waiver, of the conditions set forth in Section 3.01 hereof, on the Closing Date, the Purchaser shall remit by wire transfer of immediately available funds to the Company the Purchase Price .
- (c) As otherwise provided in this Agreement, the Company is retaining the Junior Participation in the Mortgage Loans.

Section 2.02 Conveyance of Mortgage Loans; Possession of Mortgage Files; Maintenance of Servicing Files.

The Company, effective as of the Closing Date, does hereby sell, transfer, assign, set over and convey to the Purchaser, without recourse, but subject to the terms of this Agreement, (i) all the right, title and interest of the Company (other than the Junior Participation) in and to the Mortgage Loans as of the Closing Date, and (ii) the Company's rights under the Purchase Agreement (including, without limitation, the Company's rights in regard to or as a result of any breach of any representation, warranty or covenant by the Servicer, as the Original Seller). The Original Seller is joining herein to evidence its consent to the assignment to Purchaser of the Company's rights under the Purchase Agreement and its agreement that the Purchaser may enforce such rights. On the Closing Date, the Company will deliver or cause to be delivered the Mortgage Loan Documents set forth in Exhibit E to the Purchaser and the Purchaser within 15 business days following the Closing Date will certify to the Company the Purchaser's receipt of all such Mortgage Documents so received by Purchaser by delivering to the Company a written receipt thereof, in a form satisfactory to the Company.

The Servicer shall maintain a Servicing File consisting of a copy of the contents of each Mortgage File. The possession of each Servicing File by the Servicer is for the sole purpose of servicing the related Mortgage Loan. Upon the Closing the ownership of each Mortgage Note, the related Mortgage, the related Mortgage File and the related Servicing File shall vest immediately in the Purchaser, and the ownership of all records and documents with respect to the related Mortgage Loan prepared by or which come into the possession of the Company or the Servicer, as applicable, shall vest immediately in the Purchaser and shall be retained and maintained by the Company or the Servicer, as applicable, in trust. Each Servicing File shall be marked appropriately on the Servicer's servicing system to reflect clearly the sale of the related Mortgage Loan to the Purchaser. The Servicer shall not release its custody of the contents of any Servicing File unless such release is required as incidental to the Servicer's servicing of the Mortgage Loans or to Purchaser or its designee or assignee under the terms of this Agreement.

Section 2.03 Books and Records; Transfers of Mortgage Loans.

From and after the Closing all rights arising out of the Mortgage Loans including but not limited to all funds received on or in connection with the Mortgage Loans after the Cut-off Date, shall be received and held by the Servicer in trust for the benefit of the Purchaser as owner of the Mortgage Loans, and the Company, as owner of the Junior Participation and record title of the related Mortgages shall be transferred to Purchaser.

The Servicer shall be responsible for maintaining, and shall maintain, a complete set of books and records for each Mortgage Loan which shall be marked clearly to reflect the ownership of each Mortgage Loan by the Purchaser.

The Servicer shall maintain with respect to each Mortgage Loan and shall make available for inspection and use by Purchaser or its designee the related Servicing File during the time the Purchaser retains ownership of a Mortgage Loan in accordance with applicable laws and regulations. On or before January 15 of each year during the term hereof and at such other times as Purchaser may request, Servicer will use its best efforts to provide to Purchaser copies of all correspondence issued or received in the preceding year with regards to the Mortgage Loans and which has not previously been delivered to Purchaser. In addition, at all times during normal business hours upon reasonable notice from Purchaser, Servicer will make available to Purchaser and its agents, accountants, attorneys or other representatives access to all files maintained by Servicer in regard to the Mortgage Loans and Purchaser shall have the right to make copies of any and all such files and the materials therein.

Neither party shall divulge or otherwise make available any of the Mortgage Loan Documents or the contents of any Servicing File in contravention of the applicable loan documents or applicable law.

Section 2.04 Conditions to Closing.

The respective obligations of the Purchaser, the Company and the Servicer under this Agreement shall be subject to the satisfaction, on the Closing Date, of the following conditions:

(a) The respective obligations of each of the Purchaser, the Company and the Servicer required to be performed by them at or prior to the Closing Date pursuant to the terms of this Agreement shall have been duly performed and complied with and all of the representations and warranties of each of the Purchaser, the Company and the Servicer under this Agreement or incorporated herein by reference shall be true and correct as of the date hereof and as of the Closing Date, and no event shall have occurred which, with notice or the passage of time, or both, would constitute a default under this Agreement.

(b) The Purchaser shall have received, or the Purchaser's attorney shall have received in escrow, all of the following closing documents, in such forms as are agreed upon and acceptable to the Purchaser:

- (i) The Mortgage Loan Schedule;

(ii) The Mortgage Loan Documents (including, without limitation, each original Mortgage Note) as enumerated on Exhibit E attached hereto, properly endorsed, without recourse, to the Purchaser;

(iii) The Mortgage File for each Mortgage Loan as enumerated on Exhibit E attached hereto

(iv) The Assignment of Mortgage for each Mortgage Loan. The Servicer shall prepare and record an Assignment of Mortgage with respect to each Mortgage Loan as of the Closing Date in the public recording office for the jurisdiction in which the related Mortgaged Property is located. A copy of each file marked Assignment of Mortgage shall be retained in the appropriate Mortgage File and an original of each such Assignment of Mortgage shall be delivered to the Purchaser. The Servicer shall be obligated for the cost of preparing and recording the initial Assignment of Mortgage with respect to each Mortgage Loan; provided however, at the Purchaser's option and if so instructed by the Purchaser, the Servicer shall prepare and deliver each original Assignment of Mortgage in recordable form at the Servicer's expense directly to the Purchaser and Purchaser shall be responsible for recording such Assignment of Mortgage, and for the costs of such recording;

(v) A favorable Opinion of Counsel addressed to the Purchaser, in substantially the form attached hereto as Exhibit O-1, regarding the corporate existence and authority of the Company and the validity and enforceability of this Agreement against the Company;

(vi) A favorable Opinion of Counsel addressed to the Purchaser, in substantially the form attached hereto as Exhibit O-1, regarding the corporate existence and authority of the Servicer and the validity and enforceability of this Agreement against the Servicer;

(vii) A favorable Opinion of Counsel addressed to the Purchaser, in substantially the form attached hereto as Exhibit O-2, regarding the priority and perfection of the Purchaser's interest in the Mortgage Loans and that the sale of the Mortgage Loans effected pursuant to this Agreement will be honored and treated as a true sale;

(viii) Such other certificates of its officers or others and such other documents to evidence fulfillment of the conditions set forth in this Agreement as the Purchaser may reasonably request; and

(c) Purchaser shall have delivered to the Company each of (i) the Purchase Price and (ii) such other documents, certificates and opinions to evidence fulfillment of the conditions set forth in this Agreement as the Company may reasonably request.

Section 2.05 No Recourse.

The Mortgage Loans are acquired by the Purchaser without recourse to the Company (except as set forth in this Agreement) and for the Purchaser's own account and risk.

Except as otherwise provided in this Agreement, the Company makes no representation or warranty, express or implied, and assumes no responsibility, with respect to the genuineness, authorization, execution, delivery, validity, legality, value, sufficiency, perfection, priority, enforceability or collectability of any of the Mortgage Loan Documents or the Mortgage Loan File. The Company assumes no responsibility for (i) any representation or warranty made by, or the accuracy, completeness, correctness or sufficiency of any information (or the validity, completeness or adequate disclosure of assumptions underlying any estimates, forecasts or projections contained in such information) provided directly or indirectly by, any Mortgagor or any other Person (other than the Servicer, the Company or their respective agents or representatives), (ii) the performance or observance by any Mortgagor or any other Person (other than the Servicer, the Company or their respective agents or representatives) of any of the provisions of the Mortgage Loan Documents (whether on, before or after the Closing Date), (iii) the financial condition of the Mortgagor or any other Person or (iv) (except as otherwise expressly provided herein) any other matter whatsoever relating to the Mortgagor, any other Person or the Mortgage Loans.

Section 2.06 Grant of Security Interest.

It is the express intent of the parties hereto that the conveyance of the Mortgage Loans by the Company to the Purchaser be, and be construed as, a sale of the Mortgage Loans by the Company and not a pledge of the Mortgage Loans by the Company to secure a debt or other obligation of the Company. However, in the event that, notwithstanding the aforementioned intent of the parties, the Mortgage Loans are determined by a court of law to be property of the Company, then (a) it is the express intent of the parties that such conveyance be deemed a pledge of the Mortgage Loans by the Company to the Purchaser to secure a debt or other obligation of the Company and (b) (1) this Agreement shall also be deemed to be a security agreement within the meaning of Articles 8 and 9 of the Uniform Commercial Code as in effect from time to time in the State of Texas; (2) the conveyance provided for in Section 2.02 hereof shall be deemed to be a grant by the Company to the Purchaser of a security interest in all of the Company's right, title and interest in and to the Mortgage Loans and all amounts payable to the holders of the Mortgage Loans in accordance with the terms thereof and all proceeds of the conversion, voluntary or involuntary, of the foregoing (including, without limitation, any collateral securing any Mortgage Loan) into cash, instruments, securities or other property, including, without limitation, all Available Funds, Condemnation Proceeds, Liquidation Proceeds and REO Disposition Proceeds, whether in the form of cash, instruments, securities or other property; (3) the obligations secured by such security agreement shall be deemed to be all of the Company's and the Servicer's respective obligations under this Agreement; and (4) notifications to persons holding such property, and acknowledgments, receipts or confirmations from persons holding such property, shall be deemed notifications to, or acknowledgments, receipts or confirmations from, financial intermediaries, bailees or agents (as applicable) of the Purchaser for the purpose of perfecting such security interest under applicable law. Accordingly, the Company hereby grants to the Purchaser a security interest in the Mortgage Loans and all other property described in clause (2) of the preceding sentence, for the purpose of securing to the Purchaser the performance by the Company and the Servicer of the obligations described in clause (3) of the preceding sentence. Notwithstanding the foregoing, the parties hereto intend the conveyance pursuant to Section 2.02 hereof to be a true, absolute and unconditional sale of the Mortgage Loans by the Company to the Purchaser. The Company authorizes the Purchaser to file one or more financing or continuation statements, and

amendments thereto, relating to all or any part of the Mortgage Loans (and any and all rights and interests relating thereto) without the signature of the Company where permitted by law.

ARTICLE III

REPRESENTATIONS AND WARRANTIES; REMEDIES AND BREACH

Section 3.01 Company and/or Servicer Representation and Warranties.

The Company and the Servicer, each for itself, represent and warrant to, and covenant with the Purchaser that as of the Closing Date:

(a) (i) The Company is a corporation duly formed, validly existing and in good standing under the laws of the State of Delaware, with all requisite power and authority to carry on its business as now conducted; and (ii) the Servicer is a corporation duly formed, validly existing and in good standing under the laws of the State of Maryland, with all requisite power and authority to carry on its business as now conducted.

(b) (i) The Company and the Servicer have all requisite power and authority to enter into and perform their respective obligations under this Agreement and all other agreements and documents to be executed and delivered by the Company and/or the Servicer in connection with transactions contemplated hereby. This Agreement and all documents to be executed by the Company and/or Servicer pursuant hereto and thereto are, or when executed, will be, the valid, binding and enforceable agreement of the Company and the Servicer; and (ii) the Company and the Servicer have all requisite power and authority to enter into and perform their respective obligations under this Agreement and all other agreements and documents to be executed and delivered by the Company and/or the Servicer in connection with transactions contemplated hereby.

(c) The execution and delivery of this Agreement and any other agreement or document executed and/or delivered pursuant to this Agreement and each of the Company's and Servicer's performance thereunder will not violate or conflict with, or constitute a default or breach (either alone or with the giving of notice and/or the passage of time) under either the Company's or the Servicer's organizational documents.

(d) Neither the Company nor the Servicer has (i) made a general assignment for the benefit of its creditors, (ii) filed any voluntary petition in bankruptcy or suffered the filing of an involuntary petition in bankruptcy by its creditors, (iii) suffered the appointment of a receiver to take possession of all or substantially all of its assets, (iv) suffered the attachment or other judicial seizure of all or substantially all of its assets, or (v) admitted in writing its inability to pay its debts as they become due.

(e) The Servicer acknowledges and agrees that the Servicing Fee, as calculated at the Servicing Fee Rate, represents reasonable compensation for performing such services.

(f) The Servicer has the facilities, procedures, and experienced personnel necessary for the servicing of mortgage loans of the same type as the Mortgage Loans.

Section 3.02 Representations and Warranties Regarding Individual Mortgage Loans.

With respect to each Mortgage Loan, the Company represents and warrants to, and covenants with the Purchaser as follows as of the Closing Date:

(a) The Company is the sole owner of each Mortgage Loan, has good and marketable title thereto, has full right and authority to sell, assign and transfer each Mortgage Loan and is transferring each Mortgage Loan (other than the Junior Participation) free and clear of any and all liens, pledges, charges or security interests of any nature encumbering any Mortgage Loan, and no provision of the Mortgage Note, Mortgage or other Mortgage Loan Document relating to each Mortgage Loan prohibits or restricts Company's right to assign or transfer such Mortgage Loan pursuant to this Agreement.

(b) Except pursuant to documents (none of which has been entered into within the last two (2) months) which are included in the Mortgage Files previously provided to Purchaser for review, no Mortgage or Mortgage Note has been satisfied, modified (except for the loans to Los Gatos Associates, L.P., Pet-Cal Associates, L.P., Charleston Associates, L.P. and Bartle Ok Associates, L.P., all of which, as reflected on Exhibit "B", may or may not have been modified solely to have their payment maturities extended such that they become fully-amortizing Mortgage Loans), canceled, rescinded, or amended in whole or in part, and no Mortgaged Property has been released from the lien of the related Mortgage, in whole or in part, nor has any instrument been executed that would effect any such satisfaction, modification, cancellation, rescission, or amendment. Neither the Company nor any prior owner or holder of the Mortgage Loan has previously waived any monetary obligation or default of the borrower or any other obligor for all or any part of such Mortgage Loan which relates to any obligation due subsequent to the Closing Date and which is not disclosed by documents previously provided to Purchaser or as described above, or waived in writing any other default or obligation that would materially prejudice the ability of the owner of the Mortgage Loans to pursue any remedy that may be available to it under the Mortgage Loans.

(c) The Mortgage Loans have been closed and the proceeds of each Mortgage Loan have been fully disbursed and there is no requirement for future advances thereunder.

(d) All of the Mortgage Loans are current with respect to regularly scheduled principal and interest payments and none of the Mortgage Loans is a Non-performing Loan.

(e) With respect to each Mortgage Loan purchased pursuant to this Agreement, the Mortgage File and any other documents required to be delivered under this Agreement shall be delivered to the Purchaser. The Company or its designee, is in possession of a Mortgage File with respect to the Mortgage Loans purchased pursuant to this Agreement, except for such documents the originals of which have been delivered to the Purchaser;

(f) The Mortgage Loan Schedule is complete and accurate in all material respects.

Section 3.03 Purchaser Representations and Warranties.

As of the Closing Date, Purchaser represents and warrants to, and covenants with the Company and Servicer as follows:

(a) Purchaser is a savings bank duly organized, validly existing, and in good standing under the laws of the State of Texas with all requisite power and authority to own and operate its properties and to carry on its business as now conducted.

(b) Purchaser has all requisite corporate power and authority to enter into and perform its obligations under this Agreement and all other agreements and instruments to be delivered by Purchaser in connection with the transactions contemplated hereby. This Agreement has been, and will on the Closing Date be, duly executed and delivered by Purchaser. This Agreement and all documents to be executed by Purchaser pursuant hereto are, or when executed, will be, the valid, binding and enforceable agreement of Purchaser.

(c) Pursuant to this Agreement Purchaser acknowledges that in connection with its purchase of the Mortgage Loans that it is to receive at or prior to the Closing Date the Mortgage Files and any other documents required to be delivered under this Agreement. Purchaser represents and warrants that its retention of such Mortgage Files shall be in accordance with all applicable policies and procedures promulgated by the Federal Deposit Insurance Corporation. Neither Purchaser nor any of its affiliates, assignees, successors or any other related party will in any way attempt to, now or in the future, finance or refinance any of the Mortgage Loans.

(e) The execution and delivery of this Agreement by Purchaser, and the performance by Purchaser of its obligations hereunder, will not violate or conflict with or constitute a default or breach (either alone or with the giving of notice and/or the passage of time) under Purchaser's organizational documents.

(f) Purchaser has not (i) made a general assignment for the benefit of its creditors, (ii) filed any voluntary petition in bankruptcy or suffered the filing of an involuntary petition in bankruptcy by Purchaser's creditors, (iii) suffered the appointment of a receiver to take possession of all or substantially all of Seller's assets, (iv) suffered the attachment or other judicial seizure of all or substantially all of Purchaser's assets, or (v) admitted in writing its inability to pay its debts as they become due.

(g) The Purchaser represents to and agrees with the Company that the Purchaser is a sophisticated buyer and has made, independently and without reliance on the Company, its own analysis of the Mortgagors and the Mortgage Loan Documents, and it has received such additional documents and information (including any confidential information) as it has deemed necessary for such purpose, and it shall continue to make its own decisions with respect to the purchase of the Mortgage Loans without such reliance.

Section 3.04 Remedies for Breach of Representations and Warranties.

It is understood and agreed that the representations and warranties set forth in Sections 3.01, 3.02 and 3.03 shall survive the Closing Date. Upon discovery by any of the Servicer, the Company or the Purchaser of a breach of any of the foregoing representations and warranties (in the case of any of the foregoing, a "Breach"), the party discovering such Breach shall give prompt written notice to the others.

Within 60 days of the earlier of either discovery by or notice to the Company of any Breach by the Company, the Company shall use its best efforts promptly to cure such Breach

in all material respects to the satisfaction of Purchaser, provided such Breach can be cured within the constraints of the Mortgage Loan Documents, and, if such Breach is not so cured, the Servicer and the Company shall, at the Purchaser's option, repurchase Mortgage Loan(s) which are the subject of or affected by such Breach (and each such Mortgage Loan will be considered a Repurchased Mortgage Loan) at the Repurchase Price, which will be paid to and retained as the sole property of Purchaser, but not in excess of the Senior Participation Principal Balance plus any accrued and unpaid interest thereon and unreimbursed advances for Property Protection Amounts made by Purchaser. Any Repurchase pursuant to the foregoing provisions of this Section 3.04 shall be accomplished by direct payment from the Servicer and the Company to Purchaser of the Repurchase Price.

At the time of any Repurchase, the Purchaser, the Servicer and the Company shall arrange for the reassignment of all of Purchaser's right, title and interest in and to the Repurchased Mortgage Loan to the Servicer and the Company and the delivery to the Servicer and the Company of any documents held by the Purchaser relating to the Repurchased Mortgage Loan. In connection with such a Repurchase, Purchaser will represent and warrant to the Servicer and the Company the following in regard to Mortgage Loan in question: (i) Purchaser has not previously assigned any interest it received in such Mortgage Loan and such interest is not subject to any encumbrance granted by Purchaser and (ii) Purchaser has not taken any action in regard to such Mortgage Loan or amended or modified such Mortgage Loan unless such action, amendment or modification is in accordance with the terms and provisions of this Agreement or has been effected with the consent of the Company (the foregoing are referred to herein as "Purchaser Repurchase Representations"). In the event of a Repurchase, Purchaser, the Company and the Servicer shall amend the Mortgage Loan Schedule to reflect the withdrawal of the Repurchased Mortgage Loan from this Agreement. The Repurchase Price shall be applied by Purchaser first to reimburse Purchaser for amounts described in clauses (iii) and (iv) of the definition of Repurchase Price which have been paid by Purchaser and then to the Senior Participation Principal Amount.

In addition to the foregoing, if the Breach in question concerns the outstanding principal balances of the Mortgage Loans as of the Cut-Off Date and if the aggregate principal balances of the Mortgage Loans as of the Cut-Off Date is less than \$58,174,462.02, upon demand from Purchaser, Servicer and the Company will pay to Purchaser for application to the Senior Participation Principal Amount an amount (not in excess of the Senior Participation Principal Amount plus accrued and unpaid interest thereon and all other sums due to Purchaser hereunder) equal to the product of (i) a fraction, the numerator of which is the Senior Participation Principal Amount and the denominator of which is the aggregate principal balances of the Mortgage Loans as of the Cut-Off Date times (ii) the difference between (i) the aggregate principal balances of the Mortgage Loans as of the Cut-Off Date as represented herein less (ii) the actual aggregate principal balances of the Mortgage Loans as of the Cut-Off Date.

ARTICLE IV

ADMINISTRATION AND SERVICING OF MORTGAGE LOANS

Section 4.01 Servicer to Act as Servicer.

The Servicer, as an independent contractor, shall service and administer the Mortgage Loans from the Closing Date and shall, subject to the limitations below, have the power and authority, acting alone, to take such action as is specified in or permitted by this Section 4.01.

Servicer shall, consistent with Accepted Servicing Practices: (i) (x) use good faith, reasonable efforts to collect, and (y) process and account for payments on Mortgage Loans, including past due payments; (ii) avoid the imposition of any lien upon any Mortgaged Property, including making reimbursable Servicing Advances in accordance with Section 4.06 of this Agreement due to the nonpayment by the Mortgagor, to the extent such payment is required under the Mortgage Loan Documents, of any real or personal property tax, or any other assessment or charge that may be required by a municipal agency in which the Mortgaged Property is located; (iii) avoid the lapse of insurance coverage on any Mortgaged Property required under the Mortgage Loan documents including making reimbursable Servicing Advances in accordance with Section 4.06 of this Agreement, provided, however, so long as the Mortgage Loan in question is not a Non-performing Loan, if liability insurance is not commercially available to the Mortgagor of such Mortgage Loan (or its tenant or manager of the Mortgaged Property) at a reasonable price, the Servicer will not be required by the Purchaser to either obtain and pay for (as a Servicing Advance) such liability insurance or declare the Mortgagor of such Mortgage Loan in default for failing to obtain and maintain such liability insurance and commence foreclosure action as a result of such default; (iv) remit all payments on Mortgage Loans actually collected by Servicer to the Custodial Account as provided in Section 4.04, (v) make on a timely basis all payments due hereunder to Purchaser and the Junior Participation Holder; (vi) cause to be maintained to the extent required under the Mortgage Loan Documents (a) any required flood insurance policy with respect to each Mortgaged Property and (b) a required hazard insurance policy with respect to each Mortgaged Property, in an amount equal to the lesser of (1) outstanding principal balance of the related Mortgage Loan plus accrued but unpaid interest and the Servicer's estimate of liquidation expenses to be incurred in connection with such property or (2) the maximum insurable value of such Mortgaged Property (unless the Mortgage Documents or applicable law requires a different calculation); (vii) enforce the terms and provisions of each Mortgage Note or Mortgage Loan except as otherwise provided in this Agreement; (viii) prepare, and, with specific written authorization from Purchaser hereafter granted, use good faith, reasonable efforts to execute and deliver, any and all instruments of satisfaction or cancellation or of partial or full release or discharge and all other comparable instruments with respect to the Mortgage Loans that are paid in full; (ix) submit claims for insurance benefits payable; (x) make interest rate and payment adjustments in accordance with the terms of the Mortgage Note and Mortgage Loan Documents; and (xi) pay, or cause to be paid, to Mortgagors any interest required to be paid on their escrow accounts.

Except as provided below in this paragraph, the Servicer may not, without the prior written consent of Purchaser and the Company, waive, modify or vary any term of any Mortgage Loan or consent to the postponement of strict compliance with any such term or release any collateral for or obligor on any Mortgage Loan. Without limiting the generality of the foregoing, the Servicer shall not, modify the amortization schedule of any Mortgage Loan or increase the interest rate applicable to any Mortgage Loan without the prior written consent of

the Purchaser and the Company, which consents may be granted or withheld in the sole discretion of Purchaser and the Company. Provided (a) the Servicer gives to the Purchaser and the Company written notice of the following as to any Mortgage Loan prior to the date any of the following transactions is effected, (b) neither Servicer nor the Company is affiliated in any way with any obligor for the Mortgage Loan in question, and (c) the modification in question is effected in accordance with Accepted Servicer Practices, the Servicer may, without the prior written consent of the Purchaser and the Company, (i) extend the term of any Mortgage Loan for a cumulative total of no more than five (5) years, (ii) reduce the interest rate applicable to any Mortgage Loan to a rate not less than the sum of the Senior Participation Rate plus the Servicing Fee Rate, (iii) grant a payment moratorium (but not forgiveness) of not more than a cumulative total of six (6) months for any Mortgage Loan (however, each Mortgage Loan subject to any such moratorium will be considered a Non-performing Loan for so long as such moratorium is in effect unless during the term of such moratorium Available Interest is sufficient to pay (and there is paid to Purchaser pursuant to this Agreement) interest on the Senior Participation Principal Amount at the Senior Participation Rate, plus the Servicing Fee) and (iv) change the date on which the regular monthly payment is due on a Mortgage Loan one (1) time.

In servicing and administering the Mortgage Loans, the Servicer shall employ procedures (including collection procedures) and exercise the same care that it customarily employs and exercises in servicing and administering mortgage loans for its own account, giving due consideration to Accepted Servicing Practices where such practices do not conflict with the requirements of this Agreement, and the Purchaser's reliance on the Servicer.

The Mortgage Loans may be subserviced by a Subservicer on behalf of the Servicer approved in writing by the Purchaser. The Servicer may perform any of its servicing responsibilities hereunder or may cause the Subservicer to perform any such servicing responsibilities on its behalf, but the use by the Servicer of the Subservicer shall not release the Servicer from any of its obligations hereunder and the Servicer shall remain responsible hereunder for all acts and omissions of the Subservicer as fully as if such acts and omissions were those of the Servicer. The Servicer shall pay all fees and expenses of any Subservicer from its own funds.

Any Subservicing Agreement and any other transactions or services relating to the Mortgage Loans involving the Subservicer shall be deemed to be between the Subservicer and Servicer alone, and the Purchaser shall have no obligations, duties or liabilities with respect to the Subservicer including no obligation, duty or liability of Purchaser to pay the Subservicer's fees and expenses.

Section 4.02 Liquidation of Mortgage Loans.

In the event that any payment due under any Mortgage Loan is not paid when the same becomes due and payable, or in the event the Mortgagor fails to perform any other covenant or obligation under the Mortgage Loan and such failure continues beyond any applicable grace period, the Servicer shall promptly notify Purchaser and the Company in writing of such default or failure to perform and, subject to the limitations set forth in this Agreement, and (subject to the rights of Servicer under Section 4.01 above) take such action as (1) the Servicer would take under similar circumstances with respect to a similar mortgage loan held for

its own account for investment and (2) shall be consistent with Accepted Servicing Practices. The Servicer shall not, without the prior written consent of Purchaser, which consent will not be unreasonably withheld, commence litigation or foreclosure proceedings in regard to any Mortgage Loan. The Servicer shall from its own funds make all necessary and proper Servicing Advances, provided, however, that the Servicer shall not be required to expend its own funds in connection with any foreclosure of any Mortgaged Property, unless in its good faith business judgment, the Servicer reasonably believes (a) that such foreclosure will increase the proceeds of liquidation of the Mortgage Loan after reimbursement to itself for such expenses and (b) that such expenses will be recoverable by it either through Liquidation Proceeds related to such Mortgage Loan (respecting which it shall have priority for purposes of withdrawals from the Custodial Account pursuant to Section 4.05) or through Insurance or Condemnation Proceeds related thereto (respecting which it shall have similar priority).

Section 4.03 Collection of Mortgage Loan Payments.

During the term of this Agreement, the Servicer shall proceed diligently to collect all payments due under each of the Mortgage Loans when the same shall become due and payable.

Section 4.04 Establishment of and Deposits to Custodial Accounts.

(a) The Servicer shall segregate and hold all funds collected and received on or in the Mortgage Loans separate and apart from any of its own funds and general assets and shall establish and maintain one or more Custodial Accounts, in the form of time deposit or demand accounts, titled "LTC Properties, Inc. in trust for Beal Bank, S.S.B. ". Each Custodial Account shall be established with a Qualified Depository acceptable to the Purchaser. Funds deposited in the Custodial Account may be drawn on by the Servicer in accordance with Section 4.05.

Within five Business Days of the Closing Date, the Servicer shall cause to be delivered to each Mortgagor (i) a letter, substantially in the form of Exhibit G attached hereto, informing the Mortgagor of the sale of the Mortgage to Purchaser and instructing the Mortgagor to deliver all future payments under the Mortgage Loan to the Custodial Account, and (ii) an Estoppel Certificate, substantially in the form of Exhibit F attached hereto, with a request that the Mortgagor sign and return it.

In the event that, notwithstanding such instructions, the Servicer shall receive any of the following collections, it shall deposit the same in the Custodial Account not later than 5 Business Days following receipt thereof:

- (i) all payments on account of principal on the Mortgage Loans, including all Principal Prepayments;
- (ii) any Prepayment Premiums received in connection with the Mortgage Loans;
- (iii) all payments on account of interest on the Mortgage Loans;
- (iv) all Liquidation Proceeds;

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- (v) all Insurance Proceeds (other than proceeds to be applied to the restoration or repair of the Mortgaged Property or released to the Mortgagor in accordance with Section 4.09);
 - (vi) all Condemnation Proceeds which are not applied to the restoration or repair of the Mortgaged Property or released to the Mortgagor in accordance with Section 4.09;
 - (vii) any amount required to be deposited in the Custodial Account pursuant to Sections 6.01 or 6.02;
 - (viii) Any and all other payments and amounts received by Servicer in connection with the Mortgage Loans, including, without limitation, escrow payments, late payment charges, insufficient funds charges and other similar charges; and
 - (ix) any amounts received with respect to or related to any REO Property and all REO Disposition Proceeds pursuant to Section 4.10.

(b) The foregoing payments and amounts described in subsections (i) through (ix) constitute all payments and amounts that Servicer must deposit into the Custodial Account upon its receipt of same. To the extent not prohibited by the Mortgage Loan Documents, Servicer may retain the interest on the Custodial Account. In addition, so long as all payments due to Purchaser pursuant to this Agreement are fully and timely paid to and received by Purchaser, Servicer may retain all late payment fees it receives on the Mortgage Loans. If any such payments due to Purchaser have not been so fully and timely paid, such late payment fees will be paid to Purchaser and the Company in the Purchaser Share Percentage and the Company Share Percentage, respectively.

Section 4.05 Permitted Withdrawals From Custodial Account.

The Servicer shall, from time to time, withdraw funds from the Custodial Account for the following purposes and in the following priority:

- (i) to reimburse itself for unreimbursed Servicing Advances, it being understood that, in the case of any such reimbursement, the Servicer's right thereto shall be prior to the rights of Purchaser except (i) if any payment due hereunder to Purchaser has not been fully and timely received by Purchaser and (ii) where the Company is required to repurchase a Mortgage Loan pursuant to Section 3.04 or 6.02, and in either such case the Servicer's right to such reimbursement shall be subsequent to the payment to the Purchaser of all amounts then due to the Purchaser pursuant hereto and the Repurchase Price pursuant to such Sections and all other amounts required to be paid to the Purchaser;
- (ii) to pay itself the interest earned on the funds deposited in the Custodial Account, if permitted as provided in Section 4.04 (b) above;
- (iii) to pay any amount required to be paid pursuant to Section 4.10 related to any REO Property;

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- (iv) to make payments in the amounts and in the manner provided for in Section 5.01;
 - (v) to clear and terminate the Custodial Account upon the termination of this Agreement; and
 - (vi) to withdraw funds deposited in error.

The Servicer may use such withdrawn funds only for the purposes described in this Section 4.05. except for funds received in (vi) above.

Section 4.06 Payment of Taxes, Insurance and Other Charges.

With respect to each Mortgage Loan, the Servicer shall monitor the status of taxes and other impositions, nonpayment of which may result in a lien upon any of the Mortgaged Property. The Servicer shall obtain evidence that fire and hazard insurance coverage is in place on each Mortgaged Property and shall use commercially reasonable efforts consistent with Accepted Servicing Practices to determine that any such insurance policies are renewed timely by the Mortgagor. The Servicer shall make Servicing Advances from its own funds to effect payments for taxes and insurance (subject to Servicer's rights under Section 4.01 above), provided however, that nothing in this Agreement shall be deemed to require the Servicer to perform or cause the performance of any act or the delivery of any item that is not required to be performed or delivered by the Mortgagor pursuant to the related Mortgage Loan Documents; provided, however, that the Servicer shall: (i) "force place" fire and hazard insurance for each Mortgaged Property if the Servicer cannot confirm the continuation of such insurance policies for the benefit of Purchaser in accordance with the provisions of the applicable Mortgage Loan Documents and (ii) pay taxes to the extent required to avoid a foreclosure sale by the taxing authorities of any of the Mortgaged Property.

Section 4.07 Protection of Accounts.

The Servicer may transfer the Custodial Account to a different Qualified Depository from time to time. Such transfer shall be made only upon obtaining the consent of the Purchaser, which consent shall not be withheld unreasonably.

The Servicer shall bear any expenses, losses or damages sustained by the Purchaser because the Custodial Account are not demand deposit accounts.

Amounts on deposit in the Custodial Account may at the option of the Servicer be invested pursuant to an overnight sweep or similar arrangement in bank money market funds or similar investments. All income on or gain realized from any such investment shall be for the benefit of the Servicer and may be withdrawn at any time by the Servicer. Any losses incurred in respect of any such investment shall be deposited in the Custodial Account, by the Servicer out of its own funds immediately as realized.

Section 4.08 Administration of Non-performing Loans.

In the event that any Mortgage Loan becomes a Non-performing Loan, the Servicer shall administer and manage each Non-performing Loan for the Purchaser and the Company solely for the purpose of its prompt resumption of payment of principal, interest and any fees attendant to its non-performing status. The Servicer, either itself or through an agent selected by the Servicer, shall administer and manage the Non-performing Loan in the manner directed in this Agreement or by Purchaser, and in the event no such direction is provided by Purchaser, then in accordance with Accepted Servicing Practices in the same manner that Servicer administers and manages other similar non-performing loans for its own account, and in the same manner that similar non-performing loans are administered and managed. Purchaser will use reasonable business efforts to respond to requests for direction from Servicer within ten (10) days following Purchaser's receipt of written request from Servicer for direction concerning how to proceed in regard to a Non-performing Loan.

To the extent that a Mortgagor pays fees in consideration of modification of the terms of a Mortgage Loan, which has been approved by the Purchaser and the Company, or other work-out related fees in connection with the administration of the Mortgage Loan, such fees (other than reimbursements from such fees of reasonable internal and external expenses incurred in regard to the transaction in question due the Servicer) shall be paid to the Purchaser and the Company, with the Purchaser obtaining the Purchaser Share Percentage and the Company obtaining the Company Share Percentage of such fees.

In the event that (a) any Non-performing Loan is delinquent in payments of principal and interest thereon for any ten-month period and (b) the aggregate outstanding principal balances of Mortgage Loans (other than Non-performing Loans) is less than 194% of the Senior Participation Principal Amount, the Purchaser, in its sole discretion, shall have the right, so long as such Non-performing Loan remains delinquent, to: (i) assume the servicing of the Non-performing Loan, and be entitled to the Servicing Fee related to that Non-performing Loan; provided however, that failure to collect such principal and interest and such assumption of the servicing rights with respect to such Non-performing Loan by the Purchaser shall not be a Servicer Event of Default, and/or (ii) require that the Purchaser and the Company (or the Servicer) each provide, simultaneously to the other, a Non-performing Loan purchase price which shall be any cash amount up to, but not in excess of, the then outstanding principal balance of and accrued but unpaid interest on the Non-performing Loan in question ("Call Price"). The Call Price is to be provided by each party to the other party on or before the first Business Day 30 days after the notice of such election by Purchaser. The Party offering the highest Call Price shall purchase the Non-performing Loan from the Purchaser free and clear of this Agreement and all liens, claims, and encumbrances of Purchaser, Servicer or Company. In the event that the Call Price provided by Purchaser and the Company (or the Servicer) is equal, the Company (or the Servicer) shall have the right to purchase the Non-performing Loan in question. The amount of the Call Price received shall be applied first to the accrued but unpaid interest owed to Purchaser in regard to the Senior Participation Principal Amount, then to the Senior Participation Principal Amount and then disbursed in accordance with Section 5.01.

In addition, provided the Company and/or Servicer provide to Purchaser written notice of the following election prior to the date Purchaser notifies the Company of Purchaser's election under clause (ii) of the preceding paragraph, the Company and/or the Servicer may purchase any Non-performing Loan for an amount ("Par") equal to the principal balance thereof,

all accrued and unpaid interest thereon and all other amounts due in regard to such Non-performing Loan. Such purchase must be completed within thirty (30) days following the date Purchaser receives notice of such election by the Company and/or the Servicer.

In the event that the aggregate unpaid principal balances of the Mortgage Loans (not including Non-performing Loans) is less than one hundred thirty five percent (135%) of the Senior Participation Principal Amount, the Purchaser shall have the right, in its sole discretion, to assume the servicing of the Mortgage Loans and be paid the Servicing Fee. For so long as the Purchaser has not relinquished the servicing rights, the Servicer shall not be liable for the discharge of its duties or fulfillment of its obligations as Servicer. For so long as the Purchaser is servicing the Mortgage Loans and REO Property, the Purchaser shall not be liable to Servicer or Company for the discharge of its duties or fulfillment of its obligations as servicer of the Mortgage Loans or the REO Property in accordance with Accepted Servicing Practices and the Purchaser shall proceed to collect or otherwise realize upon the Mortgage Loans and REO Property in its sole discretion; provided however, that the Purchaser, in its capacity as Servicer shall be required to make Remittances in accordance with Section 5.01 of this Agreement. Notwithstanding the foregoing, the Purchaser shall relinquish all servicing to Servicer (and Servicer will assume all such obligations) when the unpaid principal balances of the Senior Participation Principal Amount together with all other amounts owed to Purchaser under this Agreement becomes zero. In the event that the aggregate unpaid principal balances of the Mortgage Loans (not including Non-performing Loans) is less than one hundred percent (100%) of the Senior Participation Principal Amount, the Purchaser may notify the Company and the Servicer in writing of such fact and the Company or the Servicer shall have thirty (30) days following their receipt of such notice to notify the Purchaser that the Company or the Servicer is electing to purchase a sufficient number of the Non-performing Loans to reduce the Senior Participation Principal Amount to an amount less than 100% of the unpaid principal balance of all Mortgage Loans (not including Non-performing Loans). The purchase price for such Non-performing Loans will be Par for all such Non-performing Loans so purchased. If the Company or the Servicer elects to so purchase all such Non-performing Loans for Par, at the time the Company or the Servicer gives such notice to Purchaser, the Purchaser must also be paid a non-refundable earnest money deposit equal to twenty percent (20%) of the total Par purchase price for all such Non-performing Loans, which deposit will be applicable to the purchase price for such Non-performing Loans. The closing of the sale of such Non-performing Loans to the Company or Servicer will take place on the date designated by the Company or the Servicer in its notice of its election to so purchase such Non-performing Loans, which date will be not less than ten (10) days, and not more than sixty (60) days, following the date of such notice. If the Company or the Servicer fails to so complete the purchase of such Non-performing Loans, the Purchaser shall have available all remedies at law or in equity (including, without limitation, enforcing specific performance of the Company's or the Servicer's obligation to so purchase such Non-performing Loans and/or retaining the earnest money deposit). If (i) the Company fails to timely elect to so purchase such Non-performing Loans or (ii) at the option of Purchaser, the Company so elects to purchase such Non-performing Loans but thereafter fails to timely close such purchase, the Purchaser, the Company and the Servicer agree that as liquidated damages for the failure to purchase such Non-performing Loans as described in this paragraph, the rights of the Junior Participation shall inure to the Senior Participation and the Company shall have no right, title or interest in the Junior Participation or to the Mortgage Loans or any part thereof, and the Servicer will have no further right to service any Mortgage Loans until the Senior

Participation Principal Balance has been repaid in full. In such case, the Purchaser may deal with the Mortgage Loans as it sees fit, so long as the Purchaser does not sell or transfer any Mortgage Loan to itself or any person or entity which either has an ownership interest in Purchaser or in which Purchaser has an ownership interest, and except for willful misconduct or gross negligence, Purchaser shall have no liability or obligation to the Company, the Servicer or the Junion Participation Holder hereunder or otherwise in regard to the servicing and handling of the Mortgage Loans.

Section 4.09 Restoration of Mortgaged Property.

Unless required by the applicable Mortgage Loan Documents to do so, the Servicer must obtain the approval of the Purchaser prior to releasing any Insurance Proceeds or Condemnation Proceeds to the Mortgagor to be applied to the restoration or repair of the Mortgaged Property whether or not such release is in accordance with Accepted Servicing Practices.

Section 4.10 Title, Management and Disposition of REO Property.

In the event that title to any Mortgaged Property is acquired in foreclosure or repossession, or by deed in lieu of foreclosure or similar document, the deed, title, certificate of sale or similar document shall be taken in the name of the Purchaser or its designee. Each REO Property shall be treated as a Non-performing Loan for the purposes of this Agreement.

The Servicer shall use its best efforts to arrange for the conservation and protection of each REO Property for the Purchaser and the Company solely for the purpose of its prompt disposition and sale. The Servicer, either itself or through an agent selected by the Servicer, shall conserve and protect the REO Property in the same manner that it conserves and protects other foreclosed property for its own account, and in the same manner that similar property in the same locality as the REO Property is conserved and protected. The Servicer shall attempt to sell the same (and may temporarily rent the same for a period not greater than one year, except as otherwise provided below) on such terms and conditions as the Servicer deems to be the best available commercial terms.

The disposition of REO Property shall: (i) not be made by Servicer to any related or affiliated party; and (ii) be subject to Purchaser's written consent, as to all terms thereof, which consent may be granted or withheld at the sole discretion of Purchaser; and (iii) otherwise carried out by the Servicer at such price, and upon such terms and conditions, as the Purchaser may approve. The Purchaser shall be provided with 15 days written notice of any proposed REO Property sale and opportunity to purchase the REO Property on substantially the same terms as the proposed sale. The proceeds of sale of the REO Property shall be promptly deposited in the Custodial Account. As soon as practical thereafter the expenses of such sale shall be paid, and on the Remittance Date immediately following the date on which such sale proceeds are received the net cash proceeds of such sale remaining in the Custodial Account shall be distributed to the Purchaser.

If the Purchaser does not consent to a sale of any REO Property proposed by the Servicer in good faith to a person or entity not affiliated with or related to the Servicer, within

ten (10) days following the date Purchaser notifies the Servicer that Purchaser is not consenting to such proposed sale, the Servicer may notify Purchaser in writing that Servicer is electing to have the REO Property in question appraised by a disinterested, qualified appraiser reasonably acceptable to both Purchaser and Servicer. In such case, Purchaser may also have the REO Property in question appraised by such an appraiser. Such appraisals must be received within 45 days (or as soon thereafter as practicable) after the date Servicer so notifies Purchaser that Servicer is having the REO Property in question so appraised. The appraised values of the REO Property in question determined by such two appraisals received shall be averaged. Thereafter, for a period of 180 days following the end of such 45 day period or the date such two appraisals are so averaged, whichever first occurs, Servicer may seek to sell the REO Property in question to a person or entity not affiliated with or related to Servicer and if the purchase price therefor is not less than 80% of the average of the appraisal values established by such appraisals of the REO Property in question and the price is to be paid all in cash, Servicer may effect such sale pursuant to an agreement of sale acceptable to Purchaser in the exercise of its reasonable business judgment, subject to Purchaser's prior right to elect to purchase such REO Property on the terms so offered to the third party.

The management fee, if any, payable to the Servicer or a third party manager for managing REO Property shall be an amount that is (i) a market rate if such management fee is to be paid to a person or entity unaffiliated in any way with the Servicer or the Company and (ii) in all other cases approved by Purchaser in writing and is reasonable and customary in the area where the Mortgaged Property is located. In no event will any such management fee exceed seven percent (7%) of the monthly revenue generated by the REO Property in question. The Servicer shall make monthly distributions on each Remittance Date to the Purchaser of the collected net cash flow from the REO Property (which shall equal the revenues from such REO Property net of expenses and of any reserves reasonably acceptable to Purchaser from time to time to be maintained to satisfy anticipated liabilities for such expenses).

Section 4.11 Liquidation Reports.

Upon the foreclosure or other sale of any Mortgaged Property or the acquisition thereof by the Purchaser pursuant to a deed in lieu of foreclosure or similar document, the Servicer shall submit to the Purchaser upon request a liquidation report with respect to such Mortgaged Property.

Section 4.12 Advances by Servicer.

Except as expressly provided in this Agreement, the Servicer shall have no obligation to make any Servicing Advances or to advance any amounts constituting delinquent principal and interest payments with respect to the Mortgage Loans, but may at its option make such advances.

ARTICLE V

PAYMENTS

Section 5.01 Remittances.

On each Remittance Date, and except as otherwise specifically provided elsewhere in this Agreement, the Servicer shall remit by wire transfer the Available Funds in the Custodial Account in the following order of priority:

- (a) first, from Available Interest, to the Purchaser in or towards satisfaction, of the Senior Participation Interest Amount (including, without limitation, any due, but unpaid from prior Due Periods);
- (b) second, from Available Principal, to the Purchaser in or towards satisfaction of the Senior Participation Principal Amount until the same is reduced to \$0;
- (c) third, Principal Prepayments and REO Disposition Proceeds, net of any unreimbursed Servicing Advances as permitted under Section 4.05(i) of this Agreement, to the extent not previously remitted to the Purchaser in or towards satisfaction of the Senior Participation Principal Amount until the same is reduced to \$0;
- (d) fourth, from Available Interest, to the Servicer, in respect of the Servicer Fee and any other expenses reimbursable pursuant to Section 4.05 (including any amounts remaining unpaid from any prior Remittance Date, and any interest required to be paid thereon);
- (e) fifth, any and all remaining Available Interest to the holder of the Junior Participation;
- (f) sixth, from Available Principal, to the holder of the Junior Participation in or towards satisfaction of the Junior Participation Principal Amount.

Section 5.02 Prepayments.

Distributions of prepaid principal shall first be paid to the Purchaser to the extent that the Senior Participation Principal Amount is greater than zero. Such distributions applied to the Senior Participation Principal Amount shall be accompanied by interest thereon calculated at the Senior Participation Rate for the number of days from the most recent Determination Date up to the date of such prepayment. Any interest (subject to the provisions of Section 5.01 (a) above) or principal in excess of amounts so distributed to the Purchaser shall be distributed to the Junior Participation.

Section 5.03 Statements to Purchaser.

On or prior to each Remittance Date, the Servicer shall furnish to the Purchaser and the Company a monthly statement, with a trial balance report attached thereto, in the form of Exhibit H annexed hereto in electronic medium mutually acceptable to the parties as to the preceding remittance and the period ending on the preceding Determination Date. A hard copy

of the latest Monthly Remittance shall be delivered to the Purchaser and the Company upon the written request of either. In addition, not more than 95 days after the end of each calendar year, the Servicer shall furnish to the Purchaser and the Company an annual statement in accordance with the requirements of applicable federal income tax law as to the aggregate of remittances for the applicable portion of such year. Such obligation of the Servicer shall be deemed to have been satisfied to the extent that substantially comparable information shall be provided by the Servicer pursuant to any requirements of the Internal Revenue Code as from time to time are in force.

In addition, the Servicer shall provide the Purchaser and the Company with such information concerning the Mortgage Loans as is necessary for the Purchaser and the Company to prepare their federal income tax returns as the Purchaser and the Company may reasonably request from time to time.

Servicer shall also provide to Purchaser, as soon as practicable following its creation, those standard reports (in the form attached as Exhibit I annexed hereto) as are typically created by Servicer related to the Mortgage Property and its performance and operation including, without limitation, the financial statement analysis of each Mortgagor and each Mortgage Loan and any appraisal or valuation of any Mortgage Property.

ARTICLE VI

GENERAL SERVICING PROCEDURES

Section 6.01 Transfers of Mortgaged Property.

Unless otherwise directed by Purchaser in writing or unless otherwise permitted by this Agreement or otherwise required by applicable law, the Servicer shall enforce any “due-on-sale” provision contained in any Mortgage or Mortgage Note, and deny assumption by the person to whom the Mortgaged Property has been or is about to be sold whether by absolute conveyance or by contract of sale, and whether or not the Mortgagor remains liable on the Mortgage and the Mortgage Note. If the Servicer reasonably believes it is unable under applicable law to enforce such “due-on-sale” clause or if the Purchaser approves such assumption, the Servicer on behalf of the Purchaser and the Company shall enter into an assumption and modification agreement (in form approved by Purchaser) with the person to whom such property has been conveyed, pursuant to which such person becomes liable under the Mortgage Note. If an assumption fee is collected by the Servicer for entering into an assumption agreement, the Purchaser shall be provided the Purchaser Share Percentage of such fee and the Company shall be provided the Company Share Percentage of such fee. In connection with any such assumption, neither the Mortgage Interest Rate borne by the related Mortgage Note, the term of the Mortgage Loan, the amortization schedule of the Mortgage Loan, the outstanding principal amount of the Mortgage Loan nor any other term of the Mortgage Loan shall be changed, unless such change is permitted pursuant to Section 4.01 above or is consented to by Purchaser and the Company in writing, which consent may be granted or withheld at the sole discretion of the Purchaser and the Company. Notwithstanding the foregoing, no Mortgage Loan

shall be assumed by the Servicer or any affiliate thereof without the Purchaser's prior written consent.

Section 6.02 Satisfaction of Mortgages and Release of Mortgage Files.

Upon the payment in full of any Mortgage Loan, or the receipt by the Servicer of a notification that payment in full will be escrowed in a manner customary for such purposes, the Servicer shall timely notify the Purchaser by a certification of a Servicing Officer which certification shall include a statement to the effect that all amounts received or to be received in connection with such payment which are required to be deposited in the Custodial Account pursuant to Section 4.04 have been or will be so deposited prior to the delivery of the release of such Mortgage Loan, and shall request execution of any document necessary to satisfy the Mortgage Loan and delivery to it of any portion of the Mortgage Loan held by the Purchaser or the Purchaser's designee. Upon receipt of such certification and request, the Purchaser shall, within five (5) Business Days, release and send by overnight mail the related Mortgage documents to the Servicer and the Servicer shall prepare and provide to Purchaser for execution any satisfaction or release. No expenses incurred in connection with any instrument of satisfaction or deed of reconveyance shall be chargeable to the Custodial Account. Servicer has no authority to grant or execute any documents of satisfaction or release relating to any Mortgage Loan.

If the Servicer releases a Mortgage without first having obtained payment in full of the indebtedness secured by the Mortgage, or in the case of a Non-performing Loan an amount agreed to by the Purchaser, upon written demand of the Purchaser, without limitation of other rights and remedies available to Purchaser and without limitation of Servicer's liability up to the amount of indebtedness under the released Mortgage, the Servicer shall repurchase the related Mortgage Loan at the Repurchase Price by deposit thereof in the Custodial Account within five (5) Business Days of receipt of such demand by the Purchaser.

Section 6.03 Servicing Compensation.

As compensation for its services hereunder, payable to Servicer from the Junior Participation Interest in the Mortgage Loans held by the Company only and only after all amounts required to be paid to Purchaser under Section 5.01 have been paid as of the date such Servicing Fee is to be paid, the Servicer shall be entitled to withdraw from the Custodial Account the amount of its Servicing Fee. The Servicing Fee shall be payable monthly in arrears and shall be computed on the first day of the month on the basis of the aggregate unpaid principal balance of the Mortgage Loans as of the first day of the related Due Period and shall be paid on the day following the Remittance Date in such month.

The Servicer shall be required to pay all expenses incurred by it in connection with its servicing activities hereunder and shall not be entitled to reimbursement thereof except as specifically provided for herein.

Section 6.04 Right to Examine Servicer Records.

The Purchaser shall have the right to examine any and all of the books, records, or other information of the Servicer, whether held by the Servicer or by another on its behalf, with

respect to or concerning this Agreement or the Mortgage Loans, during business hours or at such other times as may be reasonable under applicable circumstances, upon reasonable advance notice. Upon request by Purchaser in connection with any proposed sale of a Mortgage Loan or REO Property, Servicer will promptly provide to Purchaser a complete copy of the Servicing File related to the Mortgage Loan or REO Property in question, including, without limitation, all correspondence in Servicer's possession or control.

Section 6.05 Prepayment Premiums.

Prepayment Premiums, to the extent received, shall be allocated with the Purchaser receiving the Purchaser Share Percentage and the Company receiving the Company Share Percentage of such Prepayment Premiums within five (5) Business Days of receipt thereof by Servicer; provided, however, if a prepayment of a Mortgage Loan results in the payment to Purchaser of the entire Senior Participation Principal Amount and all other amounts to which Purchaser is entitled to be paid pursuant to this Agreement, the Prepayment Premium received in regard to such prepayment will be retained by the Company.

ARTICLE VII

COMPANY AND SELLER TO COOPERATE

Section 7.01 Provision of Information.

During the term of this Agreement, the Servicer shall furnish to the Purchaser such periodic, special, or other reports or information and copies or originals of any documents contained in the Servicing File for each Mortgage Loan, whether or not provided for herein, as shall be reasonably requested by Purchaser. All such reports, documents or information shall be provided by and in accordance with all reasonable instructions and directions which the Purchaser may give.

The Servicer and the Company shall execute and deliver all such instruments and take all such action as the Purchaser may reasonably request from time to time, in order to effectuate the purposes and to carry out the terms of this Agreement.

ARTICLE VIII

THE COMPANY AND THE SERVICER

Section 8.01 Indemnification.

(a) Company and the Servicer shall jointly and severally defend, indemnify and hold Purchaser and each of its members, shareholders, partners, managers, officers, employees, directors, agents and representatives, as applicable (the "Purchaser Indemnitees") harmless from and against any and all demands, claims, actions, suits, fines, forfeitures, lawsuits, court costs, proceedings, penalties, losses, damages, liabilities, costs and expenses, including, without limitation, reasonable attorneys' fees and expenses asserted against, imposed

upon, or incurred by any Purchaser Indemnitee, directly or indirectly, arising out of or resulting from:

- (i) any inaccuracy in or breach of any of the representations or warranties of the Company or the Servicer contained in this Agreement; or
- (ii) any breach of any of the covenants or other agreements of the Company or the Servicer set forth in this Agreement.

(b) Purchaser shall defend, indemnify and hold the Company, the Servicer, and each of their officers, employees, directors, shareholders, partners, agents and representatives, as applicable (the "Company and/or Servicer Indemnitees") harmless from and against any and all demands, claims, actions, suits, fines, forfeitures, lawsuits, court costs, proceedings, penalties, losses, damages, liabilities, costs and expenses, including, without limitation, reasonable attorneys fees and expenses asserted against, imposed upon, or incurred by any Company and/or Servicer Indemnitee, directly or indirectly, arising out of or resulting from:

- (i) any inaccuracy in or breach of any of the representations or warranties of Purchaser contained in this Agreement; and
- (ii) any breach of any of the covenants or other agreements of Purchaser set forth in this Agreement.

Section 8.02 Merger or Consolidation of the Company and Servicer.

Each of the Company and the Servicer shall keep in full effect its existence, rights and franchises as a corporation, and shall obtain and preserve its qualification to do business as a foreign corporation in each jurisdiction in which such qualification is or shall be necessary to protect the validity and enforceability of this Agreement or any of the Mortgage Loans and to perform its duties under this Agreement.

Any person into which each of the Company or the Servicer, as the case may be, may be merged or consolidated, or any corporation resulting from any merger, conversion or consolidation to which the Company or the Servicer, as the case may be, shall be a party, or any Person succeeding to the business of the Company or the Servicer, as the case may be, shall be the successor of the Company or the Servicer, as the case may be, hereunder, without the execution or filing of any paper or any further act on the part of any of the parties hereto, anything herein to the contrary notwithstanding.

Section 8.03 Limitation on Liability of Purchaser, Company, Servicer and Others.

In no event will any party hereto be liable hereunder for a breach of any representation, warranty or covenant of such party for any punitive, special or consequential damages or for any other damages other than actual damages suffered or incurred as a result of such breach. No Servicing Officer shall be personally liable to the Purchaser for any action taken or for refraining from taking any action in good faith pursuant to this Agreement.

Section 8.04 Limitation on Resignation and Assignment by Servicer.

The Servicer shall neither assign this Agreement or the servicing hereunder nor delegate its rights or duties hereunder or any portion hereof (to other than a Subservicer or to a third party in the case of outsourcing routine tasks such as taxes, insurance and property inspection, in which case the Servicer shall be fully liable for such tasks as if the Servicer performed them itself) without the prior written consent of the Purchaser, which consent shall be granted or withheld in the reasonable discretion of the Purchaser.

ARTICLE IX

TERM OF AGREEMENT

Section 9.01 Term of Agreement.

This Agreement shall terminate on the date the Senior Participation Principal Amount is reduced to zero and all amounts due under this Agreement to the Purchaser are fully, finally and unconditionally paid to and received by Purchaser. If this Agreement is terminated as provided above, and if as of the date of such termination any Mortgage Loan or REO Property remains owned by Purchaser subject to the terms of this Agreement, Purchaser shall transfer, assign, set-over and convey to Company or its designee all of Purchaser's then right, title and interest in and to such Mortgage Loan(s) and/or REO Property, and the Purchaser shall promptly deliver the Mortgage Files to the Company or its designee together with such endorsements and assignments (in form acceptable to Purchaser) as shall reasonably be requested by the Company or its designee. In connection therewith, Purchaser will make the Purchaser's Repurchase Representations in regard to such Mortgage Loans and/or REO Property. No such termination shall affect any duties, obligations, rights or remedies which have accrued or arisen prior to such termination but which have not been fully performed as of the date of termination.

ARTICLE X

SERVICER EVENTS OF DEFAULT

Section 10.01 Servicer Events of Default.

Each of the following shall constitute a "Servicer Event of Default" on the part of the Servicer:

(a) any failure by the Servicer to remit to the Purchaser or the Junior Participation Holder any payment required to be made under the terms of this Agreement which continues unremedied for a period of five (5) Business Days after the date upon which written notice of such failure, requiring the same to be remedied, shall have been given to the Servicer by the Purchaser and/or the Junior Participation Holder; or

(b) any failure to materially perform any of its other duties under this Agreement for a period in excess of thirty (30) days following the date of Servicer's receipt of written notice from Purchaser or the Junior Participation Holder, notifying Servicer of the existence of and specifying in reasonable detail the nature of the default; provided however, if the default is of a nature that cannot reasonably be cured within thirty (30) days, Servicer shall have such additional time as may be reasonable and necessary within which to cure such default (provided however, such additional time shall in no event extend beyond thirty (60) days); or

(c) the second occurrence, during any twelve (12) month period, of Servicer's failure to (1) remit any payment required under Section 10.01(a) or (2) materially perform any of its duties under this Agreement as to which notice has previously during such twelve (12) month period been given to Servicer under Section 10.01 (b); or

(d) a decree or order of a court or agency or supervisory authority having jurisdiction for the appointment of a conservator or receiver or liquidator in any insolvency, readjustment of debt, including bankruptcy, marshaling of assets and liabilities or similar proceedings, or for the winding-up or liquidation of its affairs, shall have been entered against the Servicer and such decree or order shall have remained in force undischarged or unstayed for a period of sixty (60) days; or

(e) the Servicer shall consent to the appointment of a conservator or receiver or liquidator in any insolvency, readjustment of debt, marshaling of assets and liabilities or similar proceedings of or relating to the Servicer or of or relating to all or substantially all of the property of the Servicer; or

(f) the Servicer shall fail to pay, or shall admit in writing its inability to pay, its debts generally as they become due, file a petition to take advantage of any applicable insolvency, bankruptcy or reorganization statute or make an assignment for the benefit of its creditors.

In each and every such case, so long as a Servicer Event of Default shall not have been remedied, in addition to whatsoever rights the Purchaser or the Junior Participation Holder may have at law or equity, including, without limitation, seeking damages, including injunctive relief and specific performance, the Purchaser (or the Junior Participation Holder only in the event that the Senior Participation Principal Balance has been reduced to zero), by five (5) Business Days' prior notice in writing to the Servicer and without the payment of any termination fee, may assume the servicing of the Mortgage Loans pursuant to this Agreement.

Upon receipt by the Servicer of such written notice that Purchaser or the Junior Participation Holder is assuming the servicing of the Mortgage Loans pursuant to this Agreement, all authority and power of the Servicer under this Agreement, whether with respect to the Mortgage Loans or otherwise, shall pass to and be vested in the Purchaser or the Junior Participation Holder, as the case may be, thereafter. In such case, upon written request from the Purchaser or the Junior Participation Holder, the Servicer shall prepare, execute and deliver to the new servicer any and all documents and other instruments, place in such new servicer's possession all Mortgage Files, and do or cause to be done all other acts or things necessary or appropriate to effect the purposes of such notice of termination, including but not limited to the

transfer and endorsement or assignment of the Mortgage Loans and related documents, at the Servicer's sole expense to the Purchaser or Junior Participation Holder, as the case may be. The Servicer shall cooperate with the Purchaser or the Junior Participation Holder, as the case may be, in effecting the termination of the Servicer's rights hereunder, including without limitation, the immediate transfer for administration of all cash amounts which shall at the time be credited by the Servicer to the Custodial Account thereafter received with respect to the Mortgage Loans.

Notwithstanding the foregoing, if the Purchaser, its Affiliate or assign becomes the Servicer through an occurrence described in Section 4.08, so long as any thereof remain the Servicer, Sections 10.01(b),(c),(d),(e) and (f) shall no longer constitute a Servicer Event of Default. If Purchaser, its Affiliate or assignee takes over the servicing of the Mortgage Loans and while any thereof continues to service the Mortgage Loans pursuant hereto, if a Servicer Event of Default shall occur as to Purchaser, its Affiliate or assignee, the Junior Participation Holder may designate a reputable institutional loan servicer to act as Servicer thereafter.

Section 10.02 Waiver of Defaults.

By a written notice, the Purchaser may waive any default by the Servicer in the performance of its obligations hereunder and its consequences. Upon any waiver of a past default, such default shall cease to exist, and any Servicer Event of Default arising therefrom shall be deemed to have been remedied for every purpose of this Agreement. No such waiver shall extend to any subsequent or other default or impair any right consequent thereon except to the extent expressly so waived.

ARTICLE XI

PARTICIPATION

Section 11.01 The Participation. Subject to the terms and conditions set forth in this Agreement, the Company hereby retains a subordinated Junior Participation in the Mortgage Loans. Such Junior Participation is and in all cases shall be subordinate to the rights of the Purchaser in the Mortgage Loans to the extent provided in this Agreement.

Section 11.02 Non-Recourse; No Liability:

(a) The Junior Participation is retained by the Company without recourse to the Purchaser and for the Company's own account and risk. The Purchaser makes no representation or warranty, express or implied, and assumes no responsibility, with respect to the genuineness, authorization, execution, delivery, validity, legality, value, sufficiency, perfection, priority, enforceability or collectability of any of the Mortgage Loan Documents. The Purchaser assumes no responsibility for (i) any representation or warranty made by, or the accuracy, completeness, correctness or sufficiency of any information (or the validity, completeness or adequate disclosure of assumptions underlying any estimates, forecasts or projections contained in such information) provided directly or indirectly by, the Mortgagor or any other Person, (ii) the performance or observance by the Mortgagor or any other Person of any of the provisions of the Mortgage Loan Documents (whether on, before or after the date of this Agreement), (iii) the

filing, recording, or taking of the Mortgagor or any other Person or (v) any other matter whatsoever relating to the Mortgagors, any other Person, the Mortgage Loans or the Junior Participation.

(b) The Company represents to and agrees with the Purchaser that the Company is a sophisticated entity and has made, independently and without reliance on the Purchaser, its own analysis of the Mortgagors and the Mortgage Loan Documents for the purpose of retaining the Junior Participation, and it has received such additional documents and information as it has deemed necessary for such purpose, and it shall continue to make its own decisions with respect to the Junior Participation without such reliance.

Section 11.03 Nature of Interest. The Company shall not, by reason of this Agreement and the transactions contemplated hereby, be deemed to have an interest in any other extension of credit by the Purchaser, or in any property now or hereafter in the Purchaser's possession or control (other than an undivided junior participation interest hereunder in the Mortgage Loans).

Section 11.04 No Fiduciary Duty. In no event will the Purchaser be deemed to be a fiduciary of, or have any fiduciary duty to, the Company in regard to the Mortgage Loans or any REO Property.

ARTICLE XII

MISCELLANEOUS PROVISIONS

Section 12.01 Successor to Servicer.

Prior to termination of the Servicer's responsibilities and duties under this Agreement pursuant to Sections 8.04 and 10.01 the Purchaser shall (i) succeed to Servicer's rights, and duties under this Agreement, or (ii) appoint a successor which shall succeed to all rights and duties of the Servicer under this Agreement. Servicer shall take no action whatsoever that might impair or prejudice the rights of its successor with respect to its assumption of the same. The resignation or removal of the Servicer pursuant to the aforementioned sections shall not become effective until a successor shall be appointed pursuant to this Section 12.01.

Any termination or resignation of the Servicer or termination of this Agreement pursuant to Sections 8.04, 9.01 or 10.01 shall not affect claims that Purchaser may have against the Servicer arising out of the Servicer's actions or failure to act prior to any such termination or resignation.

The Servicer shall deliver promptly to the successor servicer control over the Custodial Account and all Mortgage Files and related documents and statements held by it hereunder and the Servicer shall account for all funds and shall execute and deliver such instruments and do such other things as may reasonably be required to more fully and definitively vest in the successor all such rights, powers, duties, responsibilities, obligations and liabilities of the Servicer.

Section 12.02 Amendment.

This Agreement may only be amended from time to time by the Company, the Servicer and the Purchaser by written agreement signed by the Company, the Servicer and the Purchaser.

Section 12.03 Governing Law.

This Agreement shall be construed in accordance with the laws of the State of Texas and the obligations, rights and remedies of the parties hereunder shall be determined in accordance with such laws.

Section 12.04 Jurisdiction.

Each of the parties hereto irrevocably and unconditionally submits to and accepts the nonexclusive jurisdiction of any Texas State or United States Federal court of the Northern District of Texas for any action, suit, or proceeding arising out of or based upon this Agreement or any matter relating to it, and waives any objection that it may have to the laying of venue in any such court or that such court is an inconvenient forum or does not have personal jurisdiction over it. The parties irrevocably agree that, should any party institute any legal action or proceeding in any jurisdiction (whether for an injunction, specific performance, damages or otherwise) in relation to this Agreement, no immunity (to the extent that it may at any time exist, whether on the grounds of sovereignty or otherwise) from such action or proceeding shall be claimed by it or on its behalf, any such immunity being hereby irrevocably waived, and each party irrevocably agrees that it and its assets are, and shall be, subject to such legal action or proceeding in respect of its obligations under this Agreement.

Section 12.05 Notices.

All communications between the parties or notices or other information sent under this Agreement shall be in writing, hand delivered or sent by overnight courier or telecopier, addressed to the relevant party at its address or facsimile number specified in Exhibit J or at such other address or facsimile number as such Party may request in writing. All such communications and notices shall be effective upon proof of receipt or refusal of the addressee to accept such delivery.

Section 12.06 Severability of Provisions.

If any one or more of the covenants, agreements, provisions or terms of this Agreement shall be held invalid for any reason whatsoever, then such covenants, agreements, provisions or terms shall be deemed severable from the remaining covenants, agreements, provisions or terms of this Agreement and shall in no way affect the validity or enforceability of the other provisions of this Agreement.

Section 12.07 Relationship of Parties.

Nothing herein contained shall be deemed or construed to create a partnership or joint venture between the parties hereto and the services of the Servicer shall be rendered as an independent contractor and not as agent for the Purchaser.

Section 12.08 Execution; Successors and Assigns.

This Agreement may be executed in one or more counterparts and by the different parties hereto on separate counterparts, each of which, when so executed, shall be deemed to be an original; such counterparts, together, shall constitute one and the same agreement. This Agreement shall inure to the benefit of and be binding upon the Company, the Servicer and the Purchaser and their respective successors and assigns. No assignment or transfer of any rights or obligations of a party hereunder will act to relieve or release such party from any liabilities or obligations hereunder, no matter when accruing or arising. In addition, and notwithstanding the foregoing, Servicer may not assign or transfer any rights or interests hereunder as Servicer or be merged into any other entity (or otherwise effect a similar transaction), unless the existing management of Servicer continues to manage the assignee or surviving entity.

Section 12.09 Recordation of Assignments of Mortgage.

To the extent permitted by applicable law, each of the Assignments of Mortgage is subject to recordation in all appropriate public offices for real property records in all the counties or other comparable jurisdictions in which any or all of the Mortgaged Properties are situated, and in any other appropriate public recording office or elsewhere, such recordation to be effected at the Purchaser's expense in the event recordation is either necessary under applicable law or requested by the Purchaser at its sole option.

Section 12.10 Assignment by Purchaser.

The Purchaser shall have the right, with notice to the Company and Servicer but without the consent of the Company or Servicer to assign to any Person affiliated with the Purchaser or to any entity which is regulated by any agency of the federal government or if required to do so by regulatory authority (provided, if the assignee of Purchaser is not affiliated with Purchaser or so regulated, if the Company does not consent to such assignee, which consent will not be unreasonably withheld, before effecting such assignment, Purchaser will transfer ownership of the Mortgage Loans to the Company subject to the Senior Participation, which will be assigned to such assignee), in whole but not in part, its interest under this Agreement with respect to any or all of the Mortgage Loans, and designate any person to exercise any rights of the Purchaser hereunder. Upon such assignment of rights and assumption of obligations, the assignee or designee shall accede to the rights and obligations hereunder of the Purchaser with respect to such Mortgage Loans so assigned. All references to the Purchaser in this Agreement shall be deemed to include its assignee or designee.

Section 12.11 Waiver of Jury Trial.

THE PARTIES HEREBY IRREVOCABLY AND UNCONDITIONALLY WAIVE, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY RIGHT

THAT THEY MAY HAVE TO TRIAL BY JURY OF ANY CLAIM OR CAUSE OF ACTION, OR IN ANY LEGAL PROCEEDING DIRECTLY OR INDIRECTLY BASED UPON OR ARISING OUT OF THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED BY THIS AGREEMENT (WHETHER BASED ON CONTRACT, TORT OR ANY OTHER THEORY). EACH PARTY (A) CERTIFIES THAT NO REPRESENTATIVE, AGENT OR ATTORNEY OF THE OTHER PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT SUCH OTHER PARTY WOULD NOT, IN THE EVENT OF LITIGATION, SEEK TO ENFORCE THE FOREGOING WAIVER AND (B) ACKNOWLEDGES THAT IT AND THE OTHER PARTY HAVE BEEN INDUCED TO ENTER INTO THIS AGREEMENT BY, AMONG OTHER THINGS, THE MUTUAL WAIVERS AND CERTIFICATIONS IN THIS SECTION 12.11.

Section 12.12 Counterparts.

This Agreement may be executed in counterparts (and by different parties hereto on different counterparts), each of which shall constitute an original, but all of which when taken together shall constitute a single contract. Delivery of an executed counterpart of a signature page to this Agreement by telecopy shall be effective as delivery of a manually executed counterpart of this Agreement.

Section 12.13 Further Assurances. The Company and the Servicer agree, as and when required by the Purchaser, (i) to execute and deliver, or to cause to be executed and delivered, all such documents and (ii) to take all such actions as the Purchaser may reasonably request to effectuate the intent and purposes, and to carry out the terms, of this Agreement, including, without limitation, the procurement of any third-party consents and missing intervening assignments. IN WITNESS WHEREOF, the Company, the Purchaser and the Servicer have caused their names to be signed hereto by their respective officers thereunto duly authorized as of the day and year first above written.

BEAL BANK, S.S.B., as Purchaser

By: _____
Name: _____
Title: _____

LTC BBCO, INC., as Company

By: _____
Name: _____
Title: _____

LTC PROPERTIES, INC., as Servicer

By:

Name:

Title:

LTC PROPERTIES, INC., as Original Seller is joining herein as provided in Section 2.02

By:

Name:

Title: