LTC PROPERTIES INC
Form 10-Q
November 02, 2006

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended September 30, 2006**

**OR**

o **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** | **71-0720518** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**31365 Oak Crest Drive, Suite 200**
**Westlake Village, California 91361**
(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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer o Accelerated filer x Non-accelerated filer o

Indicate by check mark whether the registrant is registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Shares of Registrant s common stock, $.01 par value, outstanding on October 27, 2006 23,554,770

**LTC PROPERTIES, INC.**

**FORM 10-Q**

**September 30, 2006**

**INDEX**

## PART I Financial Information

Item 1. Financial Statements
Consolidated Balance Sheets
Consolidated Statements of Income and Comprehensive Income
Consolidated Statements of Cash Flows
Notes to Consolidated Financial Statements

Item 2. Management s Discussion and
Analysis of Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Item 4. Controls and Procedures

**PART II Other Information**

Item 6. Exhibits

**LTC PROPERTIES, INC.**

**CONSOLIDATED BALANCE SHEETS**

(Amounts in thousands, except per share amounts)

| | **September 30, 2006 (unaudited)** | **December 31, 2005** |
|---|---|---|
| ASSETS | | |
| Real Estate Investments: | | |
| Buildings and improvements, net of accumulated depreciation and amortization: 2006 - $98,672; 2005 - $88,652 | $ 351,740 | $ 342,664 |
| Land | 35,048 | 32,956 |
| Properties held for sale, net of accumulated depreciation and amortization: 2006 - $0; 2005 - $7,119 | | 29,332 |
| Mortgage loans receivable, net of allowance for doubtful accounts: 2006 - $1,280 2005 - $1,280 | 118,243 | 148,052 |
| Real estate investments, net | 505,031 | 553,004 |
| Other Assets: | | |
| Cash and cash equivalents | 45,954 | 3,569 |
| Debt issue costs, net | 749 | 1,268 |
| Interest receivable | 3,048 | 3,436 |
| Prepaid expenses and other assets | 6,424 | 5,130 |
| Notes receivable | 7,570 | 8,931 |
| Marketable securities | 11,637 | 9,933 |
| Total Assets | $ 580,413 | $ 585,271 |
| | | |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Bank borrowings | $ | $ 16,000 |
| Mortgage loans payable | 57,860 | 58,891 |
| Bonds payable and capital lease obligations | 5,545 | 5,935 |
| Senior mortgage participation payable | 2,409 | 11,535 |
| Accrued interest | 426 | 524 |
| Accrued expenses and other liabilities | 5,954 | 8,427 |
| Liabilities related to properties held for sale | | 3,852 |
| Distributions payable | 3,483 | 11,890 |
| Total Liabilities | 75,677 | 117,054 |
| | | |
| Minority interest | 3,518 | 3,524 |
| Stockholders equity: | | |
| Preferred stock $0.01 par value: 15,000 shares authorized; shares issued and outstanding: 2006 8,946; 2005 8,993 | 212,161 | 213,317 |
| Common stock: $0.01 par value; 45,000 shares authorized; shares issued and outstanding: 2006 23,330; 2005 23,276 | 233 | 233 |
| Capital in excess of par value | 328,914 | 331,415 |
| Cumulative net income | 430,885 | 364,045 |
| Other | 2,119 | (941) |
| Cumulative distributions | (473,094) | (443,376) |
| Total Stockholders Equity | 501,218 | 464,693 |
| Total Liabilities and Stockholders Equity | $ 580,413 | $ 585,271 |

*See accompanying notes.*

**LTC PROPERTIES, INC.**

**CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**

(Amounts in thousands, except per share amounts)

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Revenues: | | | | |
| Rental income | $ 13,152 | $ 11,740 | $ 38,536 | $ 37,398 |
| Interest income from mortgage loans and notes receivable | 3,613 | 3,879 | 11,935 | 9,791 |
| Interest income from REMIC Certificates | | 797 | | 3,480 |
| Interest and other income | 1,366 | 550 | 4,317 | 3,713 |
| Total revenues | 18,131 | 16,966 | 54,788 | 54,382 |
| Expenses: | | | | |
| Interest expense | 1,783 | 2,118 | 5,434 | 6,428 |
| Depreciation and amortization | 3,521 | 3,275 | 10,388 | 9,351 |
| Legal expenses | 60 | 39 | 230 | 175 |
| Operating and other expenses | 2,250 | 1,236 | 4,965 | 4,349 |
| Total expenses | 7,614 | 6,668 | 21,017 | 20,303 |
| Income before non-operating income and minority interest | 10,517 | 10,298 | 33,771 | 34,079 |
| Non-operating income | | | | 6,217 |
| Minority interest | (85 ) | (85 ) | (257 ) | (257 ) |
| Income from continuing operations | 10,432 | 10,213 | 33,514 | 40,039 |
| | | | | |
| Discontinued operations: | | | | |
| Income from discontinued operations | 59 | 887 | 769 | 2,669 |
| Gain (loss) on sale of assets, net | 619 | (843 ) | 32,557 | (813 ) |
| Net income from discontinued operations | 678 | 44 | 33,326 | 1,856 |
| Net income | 11,110 | 10,257 | 66,840 | 41,895 |
| Preferred stock dividends | (4,301 ) | (4,330 ) | (12,916 ) | (13,018 ) |
| Net income available to common stockholders | $ 6,809 | $ 5,927 | $ 53,924 | $ 28,877 |
| Net Income per Common Share from Continuing Operations net of Preferred Stock Dividends: | | | | |
| Basic | $ 0.26 | $ 0.26 | $ 0.88 | $ 1.23 |
| Diluted | $ 0.26 | $ 0.26 | $ 0.88 | $ 1.21 |
| Net Income per Common Share from Discontinued Operations: | | | | |
| Basic | $ 0.03 | $ | $ 1.43 | $ 0.08 |
| Diluted | $ 0.03 | $ | $ 1.40 | $ 0.08 |
| Net Income per Common Share Available to Common Stockholders: | | | | |
| Basic | $ 0.29 | $ 0.26 | $ 2.31 | $ 1.31 |
| Diluted | $ 0.29 | $ 0.26 | $ 2.18 | $ 1.28 |
| | | | | |
| Basic weighted average shares outstanding | 23,319 | 22,951 | 23,316 | 22,024 |
| Comprehensive income | | | | |
| Net income | $ 11,110 | $ 10,257 | $ 66,840 | $ 41,895 |
| Unrealized gain on available-for-sale securities | 86 | 3,743 | 260 | 3,743 |
| Reclassification adjustment | (167 ) | (146 ) | (548 ) | (3,756 ) |
| Total comprehensive income | $ 11,029 | $ 13,854 | $ 66,552 | $ 41,882 |

NOTE: Quarterly and year-to-date computations of per share amounts are made independently. Therefore, the sum of per share amounts for the quarters may not agree with the per share amounts for the year. Computations of per share amounts from continuing operations, discontinued operations and net income are made independently. Therefore, the sum of per share amounts from continuing operations and discontinued operations may not agree with the per share amounts from net income available to common stockholders.

*See accompanying notes.*

**LTC PROPERTIES, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Amounts in thousands)

(Unaudited)

| | Nine Months Ended September 30, 2006 | 2005 |
|---|---|---|
| OPERATING ACTIVITIES: | | |
| Net income | $ 66,840 | $ 41,895 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization continuing operations | 10,388 | 9,351 |
| Depreciation and amortization discontinued operations | 52 | 732 |
| Minority interest | 257 | 257 |
| Realization of reserve on note receivable | | (3,905) |
| Realization of deferred gain on note receivable | | (3,610) |
| Income from investments in marketable debt and equity securities | (930) | |
| Straight-line rental income | (1,910) | (1,009) |
| Other non-cash charges | (165) | 2,254 |
| (Gain)/loss on sale of real estate investments, net | (32,557) | 813 |
| (Decrease)increase in accrued interest | (104) | (132) |
| Net change in other assets and liabilities | (278) | 1,017 |
| Net cash provided by operating activities | 41,593 | 47,663 |
| | | |
| INVESTING ACTIVITIES: | | |
| Investment in real estate mortgages | | (38,219) |
| Investment in real estate properties and capital improvements, net | (16,496) | (29,961) |
| Conversion of REMIC Certificates to mortgage loans | | (855) |
| Conversion of mortgage loans into owned properties | | (310) |
| Proceeds from sale of real estate investments | 54,035 | 103 |
| Principal payments received on mortgage loans receivable and REMIC Certificates | 29,769 | 14,443 |
| Investment in marketable equity securities | (1,440) | |
| Income from investments in marketable debt and equity securities | 930 | |
| Advances under notes receivable | (1,375) | (2,116) |
| Principal payments received on notes receivable | 711 | 15,122 |
| Net cash provided by (used in) investing activities | 66,134 | (41,793) |
| | | |
| FINANCING ACTIVITIES: | | |
| Borrowings under the line of credit | 2,000 | 10,700 |
| Repayments of borrowings under the line of credit | (18,000) | (6,000) |
| Mortgage principal payments on the senior mortgage participation | (9,126) | (3,650) |
| Principal payments on mortgage loans payable, bonds and capital lease obligations | (1,427) | (5,555) |
| Net proceeds from issuance of common stock | | 32,636 |
| Repurchase of common stock | (1,476) | (3,296) |
| Distributions paid to minority interests | (263) | (445) |
| Distributions paid to stockholders | (38,125) | (31,874) |
| Other | 1,075 | 1,240 |
| Net cash used in financing activities | (65,342) | (6,244) |
| Increase (decrease) in cash and cash equivalents | 42,385 | (374) |
| Cash and cash equivalents, beginning of period | 3,569 | 4,315 |
| Cash and cash equivalents, end of period | $ 45,954 | $ 3,941 |
| | | |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Interest paid | $ 4,965 | $ 6,306 |
| Non-cash investing and financing transactions: | | |
| Property exchange | 3,410 | |
| Exchange of mortgage loans for owned properties | | 1,690 |

| | | |
|---|---|---|
| Exchange of REMIC Certificates for mortgage loans receivable | | 31,120 |
| Elimination of loans payable resulting from repurchase of REMIC Certificates | | 7,125 |
| Conversion of preferred stock to common stock | 1,156 | 4,997 |
| Restricted stock issued, net of cancellations | | 151 |

*See accompanying notes.*

5

**LTC PROPERTIES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

## 1. General

LTC Properties, Inc., a Maryland corporation, is a real estate investment trust (or REIT) that invests primarily in long term care properties through mortgage loans, property lease transactions and other investments.

In accordance with plain English guidelines provided by the Securities and Exchange Commission, whenever we refer to our company or to us, or use the terms we or our, we are referring to LTC Properties, Inc. and/or its subsidiaries.

We have prepared consolidated financial statements included herein without audit (except for the balance sheet at December 31, 2005 which is audited) and in the opinion of management have included all adjustments necessary for a fair presentation of the results of operations for the three and nine months ended September 30, 2006 and 2005 pursuant to the rules and regulations of the Securities and Exchange Commission. The accompanying consolidated financial statements include the accounts of our company, its wholly-owned subsidiaries and controlled partnership. All significant intercompany accounts and transactions have been eliminated in consolidation. Control over the partnership is based on the provisions of the partnership agreement that provide us with a controlling financial interest in the partnership. Under the terms of the partnership agreement, our company, as general partner, is responsible for the management of the partnership s assets, business and affairs. Certain of our rights and duties in management of the partnership include making all operating decisions, setting the capital budget, executing all contracts, making all employment decisions, and handling the purchase and disposition of assets. The general partner is responsible for the ongoing, major, and central operations of the partnership and makes all management decisions. In addition, the general partner assumes the risk for all operating losses, capital losses, and is entitled to substantially all capital gains (i.e., appreciation).

The limited partners have virtually no rights and are precluded from taking part in the operation, management or control of the partnership. The limited partners are also precluded from transferring their partnership interests without the express permission of the general partner. However, we can transfer our interest without consultation or permission of the limited partners.

Certain information and note 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 rules and regulations governing the presentation of interim financial statements; however, we believe 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 period presentation and as required by Statement of Financial Accounting Standards (or SFAS) 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, 2006 are not necessarily indicative of the results for a full year.

No provision has been made for federal or state income taxes. Our company qualifies as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended. As such, we are not taxed on income that is distributed to our stockholders. See *Note 8. Commitments and Contingencies*.



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## 2. Real Estate Investments

*Owned Properties*. At September 30, 2006, our investment in owned properties consisted of 63 skilled nursing properties with a total of 7,304 beds, 84 assisted living properties with a total of 3,744 units and one school in 23 states.

During the three months ended September 30, 2006, we purchased a 123-bed skilled nursing property located in Washington for $7,124,000. Additionally, we acquired a 100-bed skilled nursing property located in Arizona with a fair market value of approximately $3,410,000 in exchange for a 174-bed skilled nursing property in Arizona. The sale of the 174-bed skilled nursing property resulted in a gain of $619,000. The two new properties were leased to a third party under a ten-year master lease with two five-year renewal options at an initial effective yield of approximately 12.0% or approximately $1,273,000 and increases annually based upon the Consumer Price Index with a maximum annual increase of 2.5%.

During the nine months ended September 30, 2006, we sold four assisted living properties with a total of 431 units located in four states and one 174-bed skilled nursing property located in Arizona. We recognized a gain of $32,557,000 on the two transactions and received total net proceeds of $3,410,000 in property associated with the exchange described above and $54,035,000 in cash, after paying both closing costs and a $3,840,000 8.75% State of Oregon bond obligation related to one of the properties sold. In 2005 we sold an option to purchase these four properties to Sunwest Management Inc. (or Sunwest) for $2,000,000. In exchange for the right to purchase the properties for $58,500,000, we received $500,000 in cash and a note receivable for $1,500,000. The proceeds from the sale of the purchase option have been applied to the proceeds of the sale of the four properties.

During the nine months ended September 30, 2006, we acquired five skilled nursing properties in various states with a total of 373 beds for $13,536,000 in cash and $3,410,000 in property as described above. These properties are leased to two third parties under 10-year master leases, each with two five-year renewal options. The combined initial annual rent is approximately $1,932,000, an 11.4% current yield. Additionally, we have already signed agreements and begun to expand and renovate eight skilled nursing properties and one assisted living property operated by six different operators for a total commitment of $6,160,000, of which $1,564,000 was invested during the third quarter. These investments are at an average yield of approximately 10%.

In accordance with SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* properties held for sale at any reporting period include 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 addition, the operating results of real estate assets designated as held for sale and all gains and losses from real estate sold are included in discontinued operations in the consolidated statement of income.

Set forth in the table below are the components of the net income from discontinued operations *(in thousands)*:

| | Three Months Ended September 30, 2006 | 2005 | Nine Months Ended September 30, 2006 | 2005 |
|---|---|---|---|---|
| Rental income | $ 69 | $ 1,212 | $ 748 | $ 3,663 |
| Interest and other income | | | 97 | |
| Interest expense | | (84 ) | (17 ) | (254 ) |
| Depreciation and amortization | (3 ) | (238 ) | (52 ) | (732 ) |
| Operating and other expenses | (7 ) | (3 ) | (7 ) | (8 ) |
| Income from discontinued operations | $ 59 | $ 887 | $ 769 | $ 2,669 |

*Mortgage Loans*. At September 30, 2006, we had investments in 58 mortgage loans secured by first mortgages on 58 skilled nursing properties with a total of 6,649 beds, 10 assisted living properties with 705 units and one school located in 19 states. At September 30, 2006, the mortgage loans had interest rates ranging from 6.6% to 13.1% and maturities ranging from 2007 to 2019. In addition, some 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 nine months ended September 30, 2006, we received $26,638,000 plus accrued interest related to the payoff of twelve mortgage loans secured by nine skilled nursing properties and three assisted living properties located in various states and a partial principal pay down on one mortgage loan secured by one skilled nursing property located in Georgia. We also received $3,131,000 in regularly scheduled principal payments.

## 3. Notes Receivable

During the three months ended September 30, 2006, we funded $200,000 under a $300,000 line of credit agreement with an operator. This loan matures in July 2007 and bears interest at 10.0%. Also, we amended eleven loans held by one borrower, secured by certain assets including accounts receivable of the borrower, to reduce the outstanding balance by the total capital expenditure holdback of $492,000. The capital expenditure holdback was capitalized to the related properties and the annual rent on the properties increased by 11% of the capital expenditure holdback or $55,000.

During the nine months ended September 30, 2006, we funded $1,375,000 under various loans and line of credit agreements with certain operators and received $711,000 in principal payments.

At December 31, 2005, we held a Promissory Note (or Note) from Sunwest in the amount of $1,500,000. During the fourth quarter of 2005, we sold an option to purchase four of our assisted living properties to Sunwest. The price of the option was $500,000 in cash and the Note. During the first quarter of 2006, the option to purchase the properties was exercised and the proceeds from the payoff of the Note were applied to the purchase price of the four properties (see *Note 2. Real Estate Investments*).

During the first nine months of 2005, we received $22,309,000 in cash as payment in full for a note receivable and a related $500,000 mortgage loan, including accrued and unpaid interest through the payoff date. As a result of the payoff, we recognized $3,667,000 in rental income related to past due rents that were not previously accrued, $2,335,000 of interest income related to past due interest that was not previously accrued, a $477,000 reimbursement for certain expenses paid on behalf of an operator in prior years, a $1,000,000 bonus accrual related to the realization of the value of the note receivable and

non-operating income of $6,217,000 ($3,610,000 of which was classified as Accumulated Comprehensive Income in the equity section of the balance sheet at December 31, 2004). The $6,217,000 of non-operating income is net of $1,298,000 of legal and investment advisory fees related to the transaction that resulted in the note receivable payoff.

## 4. Marketable Securities

Investments in debt and marketable equity securities are accounted for in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (FAS No. 115) which requires that we categorize our investments as trading, available-for-sale or held-to-maturity. At September 30, 2006, we had no trading securities. During the nine months ended September 30, 2006, we purchased 60,000 shares of National Health Investors, Inc. (or NHI) common stock for a total of $1,440,000, or an average purchase price of $24.00 per share. We categorized this investment in marketable equity securities as available-for-sale at the time of purchase. In accordance with FAS No. 115, we record available-for-sale instruments at fair value, with unrealized gains and losses reported as a component of other comprehensive income until realized. At September 30, 2006, the fair market value of our investment in this marketable equity security was $1,700,000. Accordingly, during the third quarter of 2006, we recorded an unrealized gain of $86,000 for a total unrealized gain of $260,000 related to the increase in fair market value of our investment in marketable equity securities. Based upon the current $0.48 per share quarterly dividend, the current yield of our investment in NHI common stock is 8.0%. NHI is a healthcare REIT and as such the dividend income we receive from them is qualified income as defined by the Internal Revenue Code. See page 10 of our Annual Report on Form 10-K for the year ended December 31, 2005, for a description of the income tests required by the Internal Revenue Code.

At September 30, 2006, we had an investment in $10,000,000 face value of Skilled Healthcare Group, Inc. (or SHG) Senior Subordinated Notes with a face rate of 11.0% and an effective yield of 11.1%. Interest on the notes is payable semi-annually in arrears and the notes mature on January 15, 2014. One of our board members is the chief executive officer of SHG. We account for this investment in marketable debt securities as held-to-maturity in accordance with FAS No. 115 at amortized cost, adjusted for any related premiums (discounts) over the estimated remaining period until maturity.

## 5. Debt Obligations

At September 30, 2006, we had no outstanding borrowings under our $90,000,000 Unsecured Revolving Credit Agreement. During the nine months ended September 30, 2006, pricing under the Unsecured Revolving Credit Agreement ranged between LIBOR plus 1.50% and LIBOR plus 2.50%.

During the nine months ended September 30, 2006, the company paid $3,840,000 in principal and accrued interest to fully repay the 8.75% State of Oregon bond obligation related to one of the properties sold as discussed in *Note 2. Real Estate Investments*.

## 6. Senior Mortgage Participation Payable

In 2002, we completed a loan participation transaction whereby we issued a $30,000,000 senior participating interest in 22 of our first mortgage loans that had a total unpaid principal balance of $58,627,000 (the Participation Loan Pool ) to a private bank. The Participation Loan Pool had a weighted average interest rate of 11.6% and a weighted average scheduled term to maturity of 77 months. The senior participation balance is secured by the entire Participation Loan Pool.

The senior participation receives interest at a rate of 9.25% per annum, payable monthly in arrears, on the then outstanding principal balance of the senior participation. In addition, the senior participation receives all mortgage principal collected on the Participation Loan Pool until the senior participation balance has been reduced to zero. We retain interest received on the Participation Loan Pool in excess of the 9.25% paid to the senior participation. The ultimate extinguishments of the senior participation are tied to the underlying maturities of loans in the Participation Loan Pool, which range from 4 to 143 months. We have accounted for the participation transaction as a secured borrowing under SFAS No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

During the nine months ended September 30, 2006, the senior participation received principal payments of $9,126,000, which included loan payoffs of $8,476,000 in the Participation Loan Pool. During the same period last year the senior participation received principal payments of $3,650,000. At September 30, 2006, 16 loans with a total principal balance of $30,567,000 remain in the Participation Loan Pool and $2,409,000 was outstanding under the senior mortgage participation.

## 7. Stockholders Equity

*Preferred Stock.* During the nine months ended September 30, 2006, holders of 46,234 shares of our 8.5% Series E Cumulative Convertible Preferred Stock (Series E preferred stock) notified us of their election to convert such shares into 92,468 shares of our common stock at the Series E preferred stock conversion rate of $12.50 per share. Total shares reserved for issuance of common stock related to the conversion of Series E preferred stock were 612,882 at September 30, 2006. Subsequent to September 30, 2006, holders of 112,398 shares of our Series E preferred stock notified us of their election to convert such shares into 224,796 shares of our common stock. After these conversions, total shares reserved for issuance of common stock related to the conversion of Series E preferred stock were 388,086.

*Common Stock.* During the nine months ended September 30, 2006, a total of 32,600 stock options were exercised at a total option value of $189,000 and a total market value as of the dates of exercise of $713,000. Also during 2006, we repurchased and retired 71,493 shares of common stock for an aggregate purchase price of $1,476,000 or $20.65 per share. The shares were purchased on the open market under a Board authorization to purchase up to 5,000,000 shares. Including these purchases, 2,604,393 shares have been purchased under this authorization. Therefore, we continue to have an open Board authorization to purchase an additional 2,395,607 shares.

*Distributions.* We declared and paid the following cash dividends *(in thousands)*:

| | Nine months ended September 30, 2006 | | | | Nine months ended September 30, 2005 | | | |
|---|---|---|---|---|---|---|---|---|
| | Declared | | Paid | | Declared | | Paid | |
| Preferred Stock | | | | | | | | |
| Series C | $ 2,454 | | $ 2,454 | | $ 2,454 | | $ 2,454 | |
| Series E | 502 | | 526 | | 604 | | 710 | |
| Series F | 9,960 | | 9,960 | | 9,960 | | 9,960 | |
| | 12,916 | | 12,940 | | 13,018 | | 13,124 | |
| Common Stock | 16,802 | (1) | 25,185 | (2) | 21,301 | (3) | 18,750 | (3) |
| Total | $ 29,718 | (4) | $ 38,125 | (4) | $ 34,319 | (4) | $ 31,874 | (4) |

(1) Represents $0.12 per share per month for the third quarter of 2006. Common dividends for the fourth quarter of 2006 were declared subsequent to September 30, 2006.

(2) Represents $0.12 per share per month for the nine months ended September 30, 2006.

(3) Represents $0.30 per share for the first quarter of 2005 and $0.11 per share per month in the second and third quarters of 2005.

(4) The difference between declared and paid is the change in distributions payable on the balance sheet at September 30 and December 31.

In October 2006, we declared a monthly cash dividend of $0.12 per share on our common stock for the months of October, November, and December 2006, payable on October 31, November 30, and December 29, 2006, respectively, to stockholders of record on October 23, November 22, and December 22, 2006, respectively.

*Other Equity.* Other equity consists of the following *(in thousands)*:

| | September 30, 2006 | December 31, 2005 (audited) |
|---|---|---|
| Notes receivable from stockholders | $ | $ (226 ) |
| Deferred compensation | | (3,123 ) |
| Accumulated comprehensive income | 2,119 | 2,408 |
| Total Other Equity | $ 2,119 | $ (941 ) |

During the nine months ended September 30, 2006, we received $226,000 in principal payments on a note receivable from a stockholder which represented payment in full on this loan. At September 30, 2006, we no longer have any notes receivable from stockholders outstanding.

During the nine months ended September 30, 2006, we reclassified $3,123,000 of deferred compensation to capital in excess of par value as required by SFAS No. 123 (revised 2004), *Share-Based Payment*, which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. The deferred compensation was related to unvested restricted stock and unvested stock options previously accounted for under APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and SFAS No. 123, *Accounting for Stock-Based Compensation*.

During the three and nine months ended September 30, 2006, $237,000 and $716,000, respectively, of compensation expense was recognized related to the vesting of restricted stock. During the three and nine months ended September 30, 2005, $140,000 and $368,000, respectively, of compensation expense was recognized related to the vesting of restricted stock.

During the three and nine months ended September 30, 2006 we reclassified $167,000 and $548,000, respectively, of other comprehensive income to mortgage interest income. The reclassification relates to the effective repurchase of mortgage loans underlying REMIC Certificates we owned in 2005. Upon the mortgage loan repurchase, we began amortizing the accumulated comprehensive income as a yield adjustment over the life of the mortgage loans. See *Note 6. Real Estate Investments* to the consolidated financial statements included in our 2005 Annual Report on Form 10-K for further discussion. In addition, during the three and nine months ended September 30, 2006, we recorded $86,000 and $260,000, respectively, of unrealized gain related to the increase in fair market value of our investment in marketable equity securities (see *Note 4. Marketable Securities* for further discussion.)

*Stock-Based Compensation*. On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment*, which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123(R) supersedes APB 25 and amends SFAS No. 95 *Statement of Cash Flows*. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. As required by The Securities and Exchange Commission, we adopted SFAS No. 123(R) on January 1, 2006.

SFAS No. 123(R) permits public companies to adopt its requirements using one of two methods:

1) A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123(R) that remain unvested on the effective date.

2) A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

We adopted SFAS No. 123(R) using the modified-prospective method. We adopted the fair-value-based method of accounting for share-based payments effective January 1, 2003, using the prospective method described in SFAS No. 148 *Accounting for Stock-Based Compensation-Transition and Disclosure* and therefore have recognized compensation expense related to all employee stock-based awards granted, modified or settled after January 1, 2003.

We use the Black-Scholes-Merton formula to estimate the value of stock options granted to employees. This model requires management to make certain estimates including stock volatility, discount rate and the termination discount factor. If management incorrectly estimates these variables, the results of operations could be affected. Because SFAS No. 123(R) must be applied not only to new awards but to previously granted awards that are not fully vested on the effective date, and because we adopted SFAS No. 123 using the prospective transition method (which applied only to awards granted, modified or settled after the adoption date), compensation cost for some previously granted awards that were not recognized under SFAS No. 123 are recognized under SFAS No. 123(R). However, had we adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and earnings per share below. SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized

compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as previously required. Because we qualify as a REIT under the Internal Revenue Code of 1986, as amended, we are not subject to Federal income taxation. Therefore, this new reporting requirement does not have an impact on our statement of cash flows.

Prior to January 1, 2003, we accounted for stock option grants in accordance with APB 25 and related Interpretations. Historically, we granted stock options for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the date of grant. Under APB 25, because the exercise price of our employee stock options equaled the market price of the underlying stock on the date of grant, no compensation expense was recognized. Effective January 1, 2003, we adopted SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, on a prospective basis for all employee awards granted, modified or settled on or after January 1, 2003.

No stock options were issued during the three or nine months ended September 30, 2006. During the nine months ended September 30, 2005, 15,000 options to purchase common stock were granted at an exercise price of $19.62 and vest ratably over a three-year period. Additionally, during the nine months ended September 30, 2005, 4,000 unvested options to purchase common stock were cancelled. At September 30, 2006, the total number of stock options that are scheduled to vest through December 31, 2006, 2007 and 2008 is 6,600, 19,000 and 5,000, respectively. The remaining compensation expense to be recognized related to the future service period of these options is approximately $64,000.

The following table illustrates the effect on net income and earnings per share as if the fair value recognition provision of SFAS No. 123(R) had been applied to options granted under our stock option plans in all periods presented. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes-Merton option-pricing formula and amortized to expense over the options vesting periods *(in thousands)*:

| | **Three Months Ended September 30,** | | **Nine Months Ended September 30,** | |
|---|---|---|---|---|
| | **2006 (actual)** | **2005 (pro forma)** | **2006 (actual)** | **2005 (pro forma)** |
| Net income available to common stockholders, as reported | $ 6,809 | $ 5,927 | $ 53,924 | $ 28,877 |
| Add: Stock-based compensation expense in the period | 13 | 10 | 38 | 29 |
| Deduct: Total stock-based compensation expense determined under fair value method for all awards | (13) | (14) | (38) | (40) |
| Pro forma net income available to common stockholders | $ 6,809 | $ 5,923 | $ 53,924 | $ 28,866 |
| Net income per common share available to common stockholders: | | | | |
| Basic as reported | $ 0.29 | $ 0.26 | $ 2.31 | $ 1.31 |
| Basic pro forma | $ 0.29 | $ 0.26 | $ 2.31 | $ 1.31 |
| Diluted as reported | $ 0.29 | $ 0.26 | $ 2.18 | $ 1.28 |
| Diluted pro forma | $ 0.29 | $ 0.26 | $ 2.18 | $ 1.28 |

*Note: Adjustments to compensation expense related to restricted shares have been excluded from this table since expense for restricted shares is already reflected in net income and is the same under APB No. 25 and SFAS No. 123(R). Above pro forma disclosures are provided for 2005 because employee stock options issued prior to January 1, 2003, the date we adopted SFAS No. 148, were not accounted for using the fair value method during that period. Disclosures are provided for 2006 for comparative purposes since share-based payments have been accounted for under SFAS No. 123(R) s fair value method beginning January 1, 2006.*

## 8. Commitments and Contingencies

At September 30, 2006, we accrued $950,000 related to a proposed closing agreement we have pending with the Internal Revenue Service (or IRS). During the third quarter of 2006, we voluntarily approached the IRS to correct our filing for the year 2000, which is a closed year. In September we submitted a closing agreement for IRS approval to correct a technical violation which occurred in the spring of 2000.

At September 30, 2006, we had the following commitments outstanding:

We committed to provide Alterra Healthcare Corporation (or Alterra) $2,500,000 over three years ending December 4, 2006, to invest in leasehold improvements to properties they lease from us and an additional $2,500,000 over the next succeeding three years ending December 4, 2009 to expand properties they lease from us. Both of these investments would be made at a 10% annual return to us. To date Alterra has not requested any funds under this agreement.

We committed to provide Extendicare Healthcare Services, Inc. (or EHSI) up to $5,000,000 per year, under certain conditions, for expansion of the 37 properties they lease from us. Should we invest such funds, EHSI s minimum rent would increase by an amount equal to (a) 9.5% plus the positive difference, if any, between the average yield on the U.S. Treasury 10-year note for the five days prior to funding, minus 420 basis points (expressed as a percentage), multiplied by (b) the amounts funded. To date EHSI has not requested any funds under this agreement.

We committed to provide Center Healthcare Inc. (or CHC) with a capital allowance of $7,100,000 on five skilled nursing properties. Our commitment provided for CLC s minimum rent to increase by an amount equal to 11.0% of our final funding including capitalized interest during construction. Subsequent to September 30, 2006, we funded $150,000 under this agreement. See *Note 11. Subsequent Events*.

We committed to provide a lessee an accounts receivable financing on a skilled nursing property. The loan has a credit limit not to exceed $150,000, an interest rate of 10.0%, and matures on July 31, 2007. To date $125,000 has been funded under this agreement. Additionally, we have committed to invest $1,150,000 in capital improvements for this property. The minimum rent will increase by an amount equal to 10.5% of our final funding including capitalized interest during construction. This commitment expires June 30, 2007. To date we have funded $411,000 under this agreement.

We committed to make certain capital improvements to be mutually agreed upon by us and the lessee on a skilled nursing property. The lessee s minimum rent will increase by an amount equal to 11.0% of our investment in these capital improvements. To date we have funded $95,000 under this agreement.

We committed to provide a lessee with a capital allowance of $500,000 to improve a skilled nursing property they lease from us. This commitment expires on June 30, 2007. Minimum rent increases by the capital funding multiplied by 10.0%. To date no funds have been requested under this agreement.

We committed to provide a lessee with up to $2,500,000 to invest in capital improvements to renovate an existing closed skilled nursing property they currently lease from us. The renovation is currently scheduled to be completed in May 2007. To date $1,344,000 has been funded under this agreement. As advances are funded the minimum rent increases by 9.5% of the advance.

Contingent upon an outcome of a bankruptcy proceeding, we committed to provide a lessee with the following: (i) up to $260,000 to invest in capital improvements to a skilled nursing property they lease from

us; (ii) up to $735,000 to invest in capital improvements on two skilled nursing properties they lease from us, however, under this commitment, the minimum rent will increase by the amount of the capital funding multiplied by 11.0%; and (iii) up to $3,000,000 to purchase land, construct and equip a new skilled nursing property in the general vicinity of an existing skilled nursing property they lease from us to replace the existing property. The agreement provides us with a corresponding increase in the minimum rent of 11.0% multiplied by the amount funded plus capitalized interest costs associated with the construction of the new property.

We committed to provide a lessee with up to $410,000 to invest in capital improvements on two skilled nursing properties and one assisted living property. The lessee s minimum rent will increase by an amount equal to 10.0% of our funding. To date $238,000 has been funded under this agreement.

We committed to provide a lessee with $1,700,000 to invest in capital improvements to renovate an existing skilled nursing property they currently lease from us. The renovation is currently scheduled to be completed in March 2007. The lessee s minimum rent will increase by an amount equal to 10.0% of our final funding including capitalized interest during construction. To date $489,000 has been funded under this agreement.

We committed to provide a lessee an accounts receivable financing on three skilled nursing properties. The loan has a credit limit not to exceed $300,000, an interest rate of 10.0%, and matures on July 1, 2007. To date $200,000 has been funded under this agreement. Additionally, we have committed to invest $200,000 in capital improvements for these properties which will expire on June 30, 2007. Minimum rent will increase by an amount equal to 10.25% of our final funding including capitalized interest during construction. To date we have funded $88,000 under this agreement.

We committed to provide a lessee with $1,000,000 to invest in capital improvements on an assisted living property. Minimum rent will increase by the total capital funding multiplied by 8.0%. The improvement projects are to be complete by February 21, 2008. To date no funds have been requested under this agreement.

## 9. Major Operators

We have two operators, based on properties subject to lease agreements that each represent between 10% and 20% of our total assets and three operators from each of which we derive over 10% of our rental revenue. EHSI, one of our major operators, is the wholly owned subsidiary of a publicly traded company, Extendicare Inc. In addition, EHSI, although not publicly traded, files quarterly financial information with the Securities and Exchange Commission. Alterra is a wholly owned subsidiary of a publicly traded company, Brookdale Senior Living, Inc. (or Brookdale). Our other operator is privately owned and thus no public financial information is available. The following table summarizes EHSI s and Brookdale s assets, stockholders equity, annual revenue and net income from continuing operations as of or for the three months ended June 30, 2006, per the lessee s public filings:

| | EHSI (in thousands) | Brookdale (in thousands) |
|---|---|---|
| Current assets | $ 199,174 | $ 119,677 |
| Non-current assets | 887,271 | 2,261,509 |
| Current liabilities | 175,362 | 409,428 |
| Non-current liabilities | 599,973 | 1,411,122 |
| Stockholders equity | 311,110 | 560,636 |
| | | |
| Gross revenue | 311,735 | 268,427 |
| Operating expenses | 250,642 | 261,976 |
| Income (loss) from continuing operations | 8,633 | (20,259) |
| Net income (loss) | 7,491 | (20,259) |
| | | |
| Cash provided by operations | 32,749 | 23,239 |
| Cash used in investing activities | (42,399) | (526,732) |
| Cash provided by financing activities | 3,834 | 456,209 |

EHSI, a wholly owned subsidiary of Extendicare Inc. and Assisted Living Concepts, a wholly owned subsidiary of EHSI, collectively lease 37 assisted living properties with a total of 1,427 units owned by us representing approximately 11.5%, or $66,553,000, of our total assets at September 30, 2006 and 19.7% of rental income recognized in 2006 excluding the effects of straight-line rent.

Alterra, a wholly owned subsidiary of Brookdale, leases 35 assisted living properties with a total of 1,416 units we own representing approximately 11.3%, or $65,711,000, of our total assets at September 30, 2006 and 19.1% of rental revenue recognized in 2006 excluding the effects of straight-line rent.

Center Healthcare Inc., (or CHC), through various wholly owned subsidiaries, operates 25 skilled nursing properties with a total of 3,014 beds that we own or on which we hold a mortgage secured by a first trust deed. This represents approximately 9.4%, or $54,686,000, of our total assets at September 30, 2006 and 13.0% of rental revenue recognized in 2006 excluding the effects of straight-line rent. See *Note 11. Subsequent Events*.

Our financial position and our ability to make distributions may be adversely affected by financial difficulties experienced by Alterra, CHC, EHSI or any of our other lessees and borrowers, including 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 us or our borrowers when it expires.

## 10. Earnings per Share

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

| | Three Months Ended September 30, 2006 | 2005 | Nine Months Ended September 30, 2006 | 2005 |
|---|---|---|---|---|
| Net income | $ 11,110 | $ 10,257 | $ 66,840 | $ 41,895 |
| Preferred stock dividends | (4,301 ) | (4,330 ) | (12,916 ) | (13,018 ) |
| Net income for basic net income per share | 6,809 | 5,927 | 53,924 | 28,877 |
| Effect of dilutive securities: | | | | |
| Convertible preferred stock | 163 | | 2,956 | 3,057 |
| Convertible limited partnership units | | | 257 | 257 |
| Net income for diluted net income per share | $ 6,972 | $ 5,927 | $ 57,137 | $ 32,191 |
| | | | | |
| Shares for basic net income per share | 23,319 | 22,951 | 23,316 | 22,024 |
| Effect of dilutive securities: | | | | |
| Stock options | 41 | 88 | 51 | 80 |
| Convertible preferred stock | 613 | | 2,630 | 2,757 |
| Convertible limited partnership units | | | 202 | 202 |
| Shares for diluted net income per share | 23,973 | 23,039 | 26,199 | 25,063 |
| | | | | |
| Basic net income per share | $ 0.29 | $ 0.26 | $ 2.31 | $ 1.31 |
| Diluted net income per share | $ 0.29 | $ 0.26 | $ 2.18 | $ 1.28 |

## 11. Subsequent Events

On October 18, 2006, we entered into an agreement to make available to CLC up to $9,500,000 as a lease termination fee to terminate our master lease with them effective November 1, 2006. Simultaneously, we re-leased the 25 properties to Preferred Care, Inc. (or Preferred Care) under a 15-year master lease with two five-year renewal options. We have agreed with Preferred Care that the monthly rental amounts for November and December 2006 will be at the monthly CLC rate of approximately $551,500. The initial annual minimum rent beginning in January 2007 is $8,188,000 and increases annually by 2.5% on each November 1st thereafter. The initial annual minimum rent we will receive from Preferred Care is $1,570,000 more than we were receiving from CLC. We committed to provide Preferred Care with up to $3,000,000 for capital improvements and will invest this amount, if requested by Preferred Care, at no additional investment return. This commitment expires March 31, 2010. Additionally, we committed to provide Preferred Care with up to $7,100,000 for capital improvements for specific properties. Preferred Care s minimum rent will increase by an amount equal to 11.0% of our final funding of part or all of the $7,100,000 including capitalized interest during any construction project. As part of the new agreement, we agreed to invest $300,000 for inventory and equipment needs at the 25 properties.

At September 30, 2006, the line of credit loan with CLC, which is included in Other Notes Receivable and is collateralized by all of the outstanding receivables of CLC, is $3,797,000. Currently, the net receivables as reported to us by CLC exceed the line of credit loan balance and at this time we believe all amounts are collectible. Certain provisions of the lease termination agreement with CLC provide that under certain conditions some of the $9,500,000 lease termination fee could be applied against the outstanding line of credit balance. Also as part of the lease termination agreement we have made provisions for payment of collateralized CLC receivables to be deposited in our bank account.

We believe that by the time we report 2006 year end results, we will have a more accurate estimation of the total cost, including legal fees and uncollectible amounts under the line of credit, if any, associated with this lease termination and this total amount will be amortized against rental income over the life of the Preferred Care master lease.



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

**Executive Overview**

***Business***

LTC Properties, Inc. a self-administered, health care real estate investment trust (or REIT) commenced operations in 1992. We invest primarily in long-term care and other health care related properties through mortgage loans, property lease transactions and other investments. The following table summarizes our portfolio as of September 30, 2006:

| Type of Property | Gross Investments (in thousands) | Percentage of Investments | For the nine months ended 09/30/06 Revenues (2) (in thousands) | Percentage of Revenues | Number of Properties | Number of Beds/Units | Investment per Bed/Unit (in thousands) | Number of Operators (1) | Number of States (1) |
|---|---|---|---|---|---|---|---|---|---|
| Assisted Living Facilities | $ 273,711 (3) | 45.2 % | $ 23,962 | 46.8 % | 94 | 4,449 | $ 61.52 | 9 | 22 |
| Skilled Nursing Facilities | 318,252 | 52.6 % | 26,186 | 51.1 % | 121 | 13,953 | 22.81 | 46 | 24 |
| Schools | 13,020 | 2.2 % | 1,071 | 2.1 % | 2 | N/A | N/A | 2 | 2 |
| Totals | $ 604,983 | 100.0 % | $ 51,219 | 100.0 % | 217 | 18,402 | | | |

(1) We have leased or mortgage investments in 32 states to 54 different operators.

(2) Revenues exclude interest and other income from non-mortgage loan sources and includes $365,000 of revenue from properties that were sold in the first quarter of 2006.

(3) In January 2006, we sold four assisted living properties operated by Sunwest with a total of 431 units to an entity formed by the principals of Sunwest for $58.5 million. We received $54.5 million in proceeds after paying approximately $3.8 million of 8.75% State of Oregon bond obligations related to one of the properties sold. As a result of the sale, we recognized a gain of $31.9 million.

Our primary objectives are to sustain and enhance stockholder equity value and provide current income for distribution to stockholders through real estate investments in long-term care properties and other health care related properties managed by experienced operators. To meet these objectives, we attempt to invest in properties that provide opportunity for additional value and current returns to our stockholders and diversify our investment portfolio by geographic location, operator and form of investment.

Substantially all of our revenues and sources of cash flows from operations are derived from operating lease rentals and interest earned on outstanding loans receivable. Our investments in mortgage loans and owned properties represent our primary source of liquidity to fund distributions and are dependent upon the performance of the operators on their lease and loan obligations and the rates earned thereon. To the extent that the operators experience operating difficulties and are unable to generate sufficient cash to make payments to us, there could be a material adverse impact on our consolidated results of operations, liquidity and/or financial condition. To mitigate this risk, we monitor our investments through a variety of methods determined by the type of health care facility and operator. Our monitoring process includes periodic review of financial statements for each facility, periodic review of operator credit, scheduled property inspections and review of covenant compliance relating to real estate taxes and insurance.

In addition to our monitoring and research efforts, we also structure our investments to help mitigate payment risk. We typically invest in or finance up to 90 percent of the stabilized appraised value of a property. Some operating leases and loans are credit enhanced by guaranties and/or letters of credit. In addition, operating leases are typically structured as master leases and loans are generally cross-defaulted and cross-collateralized with other loans, operating leases or agreements between us and the operator and its affiliates.

For the nine months ended September 30, 2006, rental income and interest income from mortgage loans and notes receivable represented 71% and 21%, respectively, of total gross revenues. Our lease structure contains fixed annual rental escalations, which are generally recognized on a straight-line basis over the minimum lease period. Certain leases have annual rental escalations that are contingent upon changes in the Consumer Price Index and/or changes in the gross operating revenues of the property. This revenue is not recognized until the appropriate contingencies have been resolved. This lease structure initially generates lower revenues and net income but enables us to generate additional growth and minimize non-cash straight-line rent over time.

Depending upon the availability and cost of external capital, we anticipate making additional investments in health care related properties. New investments are generally funded from invested cash on hand and temporary borrowings under our unsecured line of credit and internally generated cash flows. Our investments generate internal cash from rent and interest receipts and principal payments on mortgage loans receivable. Permanent financing for future investments, which replaces funds drawn under our unsecured line of credit, is expected to be provided through a combination of public and private offerings of debt and equity securities and the incurrence of secured debt. We believe our liquidity and various sources of available capital are sufficient to fund operations, meet debt service obligations (both principal and interest), make dividend distributions and finance future investments.

***Key Transactions***

During the first nine months of 2006 we sold four assisted living properties with a total of 431 units and one 174-bed skilled nursing property. We recognized a gain of $32.6 million on the two transactions and received total net cash proceeds of $54.0 million after paying $3.8 million of 8.75% State of Oregon bond obligations related to one of the properties sold. Also during 2006 we purchased five skilled nursing properties with a total of 373 beds for $13.5 million in cash. One of the properties was acquired in a like-kind exchange transaction with a fair market value of $3.4 million.

***Key Performance Indicators, Trends and Uncertainties***

We utilize several key performance indicators to evaluate the various aspects of our business. These indicators are discussed below and relate to concentration risk and credit strength. Management uses these key performance indicators to facilitate internal and external comparisons to our historical operating results, in making operating decisions and for budget planning purposes.

*Concentration Risk.* We evaluate our concentration risk in terms of asset mix, investment mix, operator mix and geographic mix. Concentration risk is valuable to understand what portion of our investments could be at risk if certain sectors were to experience downturns. Asset mix measures the portion of our investments that are real property. In order to qualify as an equity REIT, at least 75 percent of our total assets must be represented by real estate assets, cash, cash items and government securities. Investment mix measures the portion of our investments that relate to our various property types. Operator mix measures the portion of our investments that relate to our top three operators. Geographic mix measures the portion of our investment that relate to our top five states. The following table reflects our recent historical trends of concentration risk:

| | Period Ended<br>9/30/06<br>(gross investment, in thousands) | 6/30/06 | 3/31/06 | 12/31/05 | 9/30/05 |
|---|---|---|---|---|---|
| Asset mix: | | | | | |
| Real property | $ 485,460 | $ 476,541 | $ 468,435 | $ 500,723 | $ 500,430 |
| Loans receivable | $ 119,523 | 127,192 | 133,264 | 149,332 | 153,740 |
| | | | | | |
| Investment mix: | | | | | |
| Assisted living properties | $ 273,711 | $ 276,720 | $ 280,748 | $ 313,628 | $ 313,742 |
| Skilled nursing properties | 318,252 | 313,993 | 307,931 | 323,407 | 327,408 |
| School | 13,020 | 13,020 | 13,020 | 13,020 | 13,020 |
| | | | | | |
| Operator mix: | | | | | |
| Alterra | $ 84,194 | $ 84,194 | | | |