

LTC PROPERTIES INC
Form 10-K
February 25, 2009

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

(Mark
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ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
AND EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2008

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

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.)

31365 Oak Crest Drive Suite 200
Westlake Village, California 91361
(Address of principal executive offices)

Registrant's telephone number, including area code: (805) 981-8655

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common stock, \$.01 Par Value	New York Stock Exchange
8.50% Series E Cumulative Convertible Preferred Stock, \$.01 Par Value	New York Stock Exchange
8.00% Series F Cumulative Preferred Stock, \$.01 Par Value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **NONE**

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Indicate by checkmark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by checkmark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the Registrant (1) has filed all reports required 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 the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant was approximately \$481,089,000 as of June 30, 2008 (the last business day of the Registrant's most recently completed second fiscal quarter). For purposes of this calculation, shares of common stock held by officers and directors of the registrant and shares of common stock held by persons who hold more than 5% of the outstanding common stock of the Registrant have been excluded from this calculation because such persons may be deemed to be affiliates.

The number of shares of common stock outstanding as of February 18, 2009 was 23,137,745.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement relating to its 2009 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.

CAUTIONARY STATEMENTS

This annual report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, adopted pursuant to the Private Securities Litigation Reform Act of 1995. Statements that are not purely historical may be forward-looking. You can identify some of the forward-looking statements by their use of forward-looking words, such as "believes," "expects," "may," "will," "should," "seeks," "approximately," "intends," "plans," "estimates" or "anticipates," or the negative of those words or similar words. Forward-looking statements involve inherent risks and uncertainties regarding events, conditions and financial trends that may affect our future plans of operation, business strategy, results of operations and financial position. A number of important factors could cause actual results to differ materially from those included within or contemplated by such forward-looking statements, including, but not limited to, the status of the economy, the status of capital markets including prevailing interest rates, compliance with and changes to regulations and payment policies within the health care industry, changes in financing terms, competition within the health care and senior housing industries, and changes in federal, state and local legislation. For a discussion of these and other factors that could cause actual results to differ from those contemplated in the forward-looking statements, please see the discussion under "Risk Factors" contained in this annual report and in other information contained in this annual report and our publicly available filings with the Securities and Exchange Commission. We do not undertake any responsibility to update or revise any of these factors or to announce publicly any revisions to forward-looking statements, whether as a result of new information, future events or otherwise.

PART I

Item 1. BUSINESS

General

LTC Properties, Inc., a health care real estate investment trust (or REIT), was incorporated on May 12, 1992 in the State of Maryland and commenced operations on August 25, 1992. We invest primarily in long-term care and other health care related properties through mortgage loans, property lease transactions and other investments. 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.

We were organized to qualify, and intend to continue to qualify, as a REIT. So long as we qualify, with limited exceptions, we may deduct distributions, both preferred dividends and common dividends, to our stockholders from our taxable income. We have made distributions, and intend to continue to make distributions to our stockholders, in order to eliminate any federal tax liability.

Owned Properties. As of December 31, 2008, our investment in 23 states are in owned properties consisting of 62 skilled nursing properties with a total of 7,209 beds, 85 assisted living properties with a total of 3,884 units and one school, representing in aggregate a gross investment of approximately \$502.6 million. Here and throughout this Form 10-K wherever we provide details of our properties' bed/unit count the number of beds/units applies to skilled nursing properties and assisted living residences only. This number is based upon unit/bed counts shown on operating licenses provided to us by lessees/borrowers or units/beds as stipulated by lease/mortgage documents. We have found during the years that these numbers often differ, usually not materially, from units/beds in operation at any point in time. The differences are caused by such things as operators converting a patient/resident room for alternative uses, such as offices or storage, or converting a multi-patient room/unit into a

single patient room/unit. We monitor our properties on a routine basis through site visits and reviews of current licenses. In an instance where such change would cause a de-licensing of beds or in our opinion impact the value of the property, we would take action against the lessee/borrower to preserve the value of the property/collateral. See *Item 8. FINANCIAL STATEMENTS Note 6. Real Estate Investments* for further description.

The following operators accounted for more than 10% of our 2008 cash rental revenue:

Lessee	Percent of Rental Revenue
Extendicare REIT and ALC	19.6%
Alterra Healthcare Corporation(1)	18.1%
Preferred Care, Inc.	15.9%

(1)

Subsequent to December 31, 2008, the name Alterra Healthcare Corporation was changed to Brookdale Senior Living Communities, Inc.

Mortgage Loans. As part of our strategy of making long-term investments in properties used in the provision of long-term health care services, we provide mortgage financing on such properties based on our established investment underwriting criteria. See "*Investment and Other Policies*" in this section for further discussion. We have also provided construction loans that by their terms converted into purchase/lease transactions or permanent financing mortgage loans upon completion of construction. See *Item 8. FINANCIAL STATEMENTS Note 6. Real Estate Investments* for further description. At December 31, 2008 we had 43 mortgage loans secured by first mortgages on 39 skilled nursing properties with a total of 4,498 beds, 16 assisted living residences with 714 units and one school. These properties are located in 16 states.

Investment and Other Policies

Objectives and Policies. Our investment policy is to invest primarily in income-producing long-term care properties. Also see "*Government Regulation*" below. Over the past three years (2006 through 2008), we invested approximately \$15.7 million in mortgage loans and we acquired skilled nursing and assisted living properties for approximately \$18.0 million. At December 31, 2008, we had \$21.1 million of cash on hand and \$80.0 million available on our unsecured line of credit with no scheduled maturities other than the maturity date of July 17, 2011. In calendar year 2009, we have debt maturities of \$8.1 million due in October 2009 at an interest rate of 8.43% and \$15.8 million due in December 2009 at an interest rate of 8.81%. The October maturity may be paid 90 days early and the December maturity may be paid six months early. In calendar year 2009, we have mortgage loans receivable of \$7.6 million maturing in November. We believe that our current cash balance, cash flow from operations available for distribution or reinvestment, and our current unsecured line of credit borrowing capacity are sufficient to provide for payment of our current operating costs and debt obligations and to provide funds for distribution to the holders of our preferred stock and pay common dividends at least sufficient to maintain our REIT status. The timing, source and amount of cash flows provided by financing activities and used in investing activities are sensitive to the capital markets environment, especially to changes in interest rates. The current turmoil in the debt and equity markets preclude us from, at this time, being able to determine if there is cost-effective long-term capital available for significant additional capital investments for calendar 2009.

We believe that recent competitive markets had created an environment of very highly priced properties and low yielding mortgages. However, we expect that the recent deterioration in the credit markets should exert downward pressure on prices of long term care properties. During 2007 we hired a vice president of marketing whose focus is to increase our presence at the state and local levels

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through participation in various healthcare associations and trade shows. We believe that this expanded marketing effort will result in increased deal flow and potentially a greater level of new investments in 2009 and 2010. Since the competition from buyers in large transactions consisting of multiple property portfolios generally results in pricing that does not meet our investment criteria, our primary marketing efforts focus on single property transactions or small multiple property portfolios that complement our historic investments and are priced with yields in our historical range.

Historically our investments have consisted of:

mortgage loans secured by long-term care properties;

fee ownership of long-term care properties that are leased to providers; or

participation in such investments indirectly through investments in real estate partnerships or other entities that themselves make direct investments in such loans or properties.

In evaluating potential investments, we consider factors such as:

type of property;

the location;

construction quality, condition and design of the property;

the property's current and anticipated cash flow and its adequacy to meet operational needs and lease obligations or debt service obligations;

the experience, reputation and solvency of the licensee providing services;

the payor mix of private, Medicare and Medicaid patients;

the growth, tax and regulatory environments of the communities in which the properties are located;

the occupancy and demand for similar properties in the area surrounding the property; and

the Medicaid reimbursement policies and plans of the state in which the property is located.

For investments in long-term care properties we favor low cost per bed opportunities, whether in fee simple properties or in mortgages. In addition, with respect to skilled nursing properties, we attempt to invest in properties that do not have to rely on a high percentage of private-pay patients. We seek to invest primarily in properties that are located in suburban and rural areas of states. Prior to every investment, we conduct a property site review to assess the general physical condition of the property and the potential of additional sub-acute services. In addition, we review the environmental reports, state survey and financial statements of the property before the investment is made. We prefer to invest in a property that has a significant market presence in its community and where state certificate of need and/or licensing procedures limit the entry of competing properties.

We believe that assisted living facilities are an important sector in the long-term care market and our investments include direct ownership and mortgages secured by assisted living properties. For assisted living investments we have attempted to diversify our portfolio both geographically and across product levels. Thus, we believe that although the majority of our investments are in affordably priced units, our

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portfolio also includes upscale units in appropriate markets with certain operators.

Borrowing Policies. We may incur additional indebtedness when, in the opinion of our Board of Directors, it is advisable. We may incur such indebtedness to make investments in additional long-term care properties or to meet the distribution requirements imposed upon REITs under the Internal Revenue Code of 1986, as amended. For other short-term purposes, we may, from time to time,

negotiate lines of credit, or arrange for other short-term borrowings from banks or otherwise. We may also arrange for long-term borrowings through public offerings or from institutional investors.

In addition, we may incur mortgage indebtedness on real estate which we have acquired through purchase, foreclosure or otherwise. We may also obtain mortgage financing for unleveraged or underleveraged properties in which we have invested or may refinance properties acquired on a leveraged basis. There is no limitation on the number or amount of mortgages that may be placed on any one property, and we have no policy with respect to limitations on borrowing, whether secured or unsecured.

Prohibited Investments and Activities. Our policies, which are subject to change by our Board of Directors without stockholder approval, impose certain prohibitions and restrictions on our investment practices or activities including prohibitions against:

investing in any junior mortgage loan unless by appraisal or other method, our Board of Directors determine that

- (a) the capital invested in any such loan is adequately secured on the basis of the equity of the borrower in the property underlying such investment and the ability of the borrower to repay the mortgage loan; or
- (b) such loan is a financing device we enter into to establish the priority of our capital investment over the capital invested by others investing with us in a real estate project;

investing in commodities or commodity futures contracts (other than interest rate futures, when used solely for hedging purposes);

investing more than 1% of our total assets in contracts for sale of real estate unless such contracts are recordable in the chain of title;

holding equity investments in unimproved, non-income producing real property, except such properties as are currently undergoing development or are presently intended to be developed within one year, together with mortgage loans on such property (other than first mortgage development loans), aggregating to more than 10% of our assets.

Competition

In the health care industry, we compete for real property investments with health care providers, other health care related REITs, real estate partnerships, banks, private equity funds, venture capital funds and other investors. Many of our competitors are significantly larger and have greater financial resources and lower cost of capital than we have available to us. Our ability to compete successfully for real property investments will be determined by numerous factors, including our ability to identify suitable acquisition targets, our ability to negotiate acceptable terms for any such acquisition and the availability and our cost of capital.

The lessees and borrowers of our properties compete on a local, regional and, in some instances, national basis with other health care providers. The ability of the lessee or borrower to compete successfully for patients or residents at our properties depends upon several factors, including the levels of care and services provided by the lessees or borrowers, the reputation of the providers, physician referral patterns, physical appearances of the properties, family preferences, financial condition of the operator and other competitive systems of health care delivery within the community, population and demographics.

Government Regulation

The health care industry is heavily regulated by the government. Our borrowers and lessees who operate health care facilities are subject to extensive regulation by federal, state and local governments. These laws and regulations are subject to frequent and substantial changes resulting from legislation, adoption of rules and regulations, and administrative and judicial interpretations of existing law. These changes may have a dramatic effect on the definition of permissible or impermissible activities, the relative costs associated with doing business and the amount of reimbursement by both government and other third-party payors. These changes may be applied retroactively. The ultimate timing or effect of these changes cannot be predicted. The failure of any borrower of funds from us or lessee of any of our properties to comply with such laws, requirements and regulations could result in sanctions or remedies such as denials of payment for new Medicare and Medicaid admissions, civil monetary penalties, state oversight and loss of Medicare and Medicaid participation or licensure. Such action could affect our borrower's or lessee's ability to operate its facility or facilities and could adversely affect such borrower's or lessee's ability to make debt or lease payments to us.

The properties owned by us and the manner in which they are operated are affected by changes in the reimbursement, licensing and certification policies of federal, state and local governments. Properties may also be affected by changes in accreditation standards or procedures of accrediting agencies that are recognized by governments in the certification process. In addition, expansion (including the addition of new beds or services or acquisition of medical equipment) and occasionally the discontinuation of services of health care facilities are, in some states, subjected to state and regulatory approval through "certificate of need" laws and regulations.

The ability of our borrowers and lessees to generate revenue and profit determines the underlying value of that property to us. Revenues of our borrowers and lessees of skilled nursing properties are generally derived from payments for patient care. Sources of such payments for skilled nursing facilities include the federal Medicare program, state Medicaid programs, private insurance carriers, health care service plans, health maintenance organizations, preferred provider arrangements, and self-insured employers, as well as the patients themselves.

A significant portion of the revenue of our skilled nursing facility borrowers and lessees is derived from governmentally-funded reimbursement programs, such as Medicare and Medicaid. Because of significant health care costs paid by such government programs, both federal and state governments have adopted and continue to consider various health care reform proposals to control health care costs. There have been fundamental changes in the Medicare program that resulted in reduced levels of payment for a substantial portion of health care services. In many instances, revenues from Medicaid programs are already insufficient to cover the actual costs incurred in providing care to those patients. According to a report issued by the Kaiser Commission on Medicaid and the Uninsured in January 2009, while 47 states adopted budgets for fiscal year 2009 that included provider rate increases, after years of aggressive state Medicaid cost containment efforts, widespread provider rate decreases and program cutbacks are expected in fiscal year 2010. In addition, many states are making changes to their long-term care delivery systems that emphasize home and community-based long-term care services, in some cases coupled with cost controls for institutional providers. Spending on home and community-based services has risen from 13% of total Medicaid long-term care spending in 1990 to 41% of Medicaid long-term care spending in 2006. As states continue to respond to budget pressures, future reduction in state Medicaid payments for skilled nursing facility services could have an adverse effect on the financial condition of our borrowers and lessees which could, in turn, adversely impact the timing or level of their payments to us. On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009, which, among many other things, increases federal Medicaid payments by approximately \$87 billion to help support state Medicaid programs as they face budget shortfalls. Nevertheless, the federal government periodically adopts legislative and/or regulatory policies designed to reduce federal Medicaid spending and to promote community-based alternatives to

institutional services. Moreover, health care facilities continue to experience pressures from private payors attempting to control health care costs, and reimbursement from private payors has in many cases effectively been reduced to levels approaching those of government payors.

Governmental and public concern regarding health care costs may result in significant reductions in payment to health care facilities, and there can be no assurance that future payment rates for either governmental or private payors will be sufficient to cover cost increases in providing services to patients. Any changes in reimbursement policies which reduce reimbursement to levels that are insufficient to cover the cost of providing patient care could adversely affect revenues of our skilled nursing property borrowers and lessees and to a much lesser extent our assisted living property borrowers and lessees and thereby adversely affect those borrowers' and lessees' abilities to make their debt or lease payments to us. Failure of the borrowers or lessees to make their debt or lease payments would have a direct and material adverse impact on us.

The Centers for Medicare & Medicaid Services (or CMS) annually updates Medicare skilled nursing facility prospective payment system rates and other policies. On August 8, 2008, CMS published the final Medicare skilled nursing facility rates for fiscal year 2009, which began October 1, 2008. The final rule provides a 3.4% market basket update, which CMS estimates will increase overall Medicare payments to skilled nursing facilities by \$780 million compared to fiscal year 2008 levels. Notably, CMS did not adopt an earlier provision from its May 7, 2008 proposed rule that would have recalibrated case mix weights to make up for increased Medicare expenditures resulting from certain refinements made in January 2006. The proposed recalibration would have reduced overall Medicare skilled nursing facility payments by 3.3% (\$770 million) in fiscal year 2009. The final rule also addresses a number of other related policy issues, including a continuation of a special adjustment for skilled nursing facility residents with acquired immune deficiency syndrome (or AIDS), consolidated billing, and other policy initiatives that eventually could impact reimbursement for skilled nursing facility services. While the federal government will not decrease Medicare payments to skilled nursing facilities in fiscal year 2009, the loss of revenues associated with potential changes in skilled nursing facility payment rates could, in the future, have an adverse effect on the financial condition of our borrowers and lessees which could, in turn, adversely impact the timing or level of their payments to us.

Various federal and state laws govern financial and other arrangements between health care providers that participate in, receive payments from, or make or receive referrals for work in connection with government funded health care programs, including Medicare and Medicaid. These laws, known as the fraud and abuse laws, include the federal anti-kickback statute, which prohibits, among other things, knowingly and willfully soliciting, receiving, offering or paying any remuneration directly or indirectly in return for, or to induce, the referral of an individual to a person for the furnishing of an item or service for which payment may be made under federal health care programs. In addition, the federal physician self-referral law, commonly known as Stark II (or the Stark Law), prohibits physicians and certain other types of practitioners from making referrals for certain designated health services paid in whole or in part by Medicare and Medicaid to entities with which the practitioner or a member of the practitioner's immediate family has a financial relationship, unless the financial relationship fits within an applicable exception to the Stark Law. The Stark Law also prohibits the entity receiving the referral from seeking payment under the Medicare and Medicaid programs for services rendered pursuant to a prohibited referral. If an entity is paid for services rendered pursuant to a prohibited referral, it may incur civil penalties of up to \$15,000 per prohibited claim and may be excluded from participating in the Medicare and Medicaid programs. Many states have enacted similar fraud and abuse laws which are not necessarily limited to items and services for which payment is made by federal health care programs. Violations of these laws may result in fines, imprisonment, denial of payment for services, and exclusion from federal and/or other state-funded programs. Other federal and state laws authorize the imposition of penalties, including criminal and civil fines and exclusion from participation in federal healthcare programs for submitting false claims, improper billing and other

offenses. Federal and state government agencies have continued rigorous enforcement of criminal and civil fraud and abuse laws in the health care arena. Our borrowers and lessees are subject to many of these laws, and some of them could in the future become the subject of a governmental enforcement action.

Legislative Developments

Congress and the state legislatures regularly consider, and in some cases adopt, legislation that would impact health care providers, including long-term care providers. For instance, the Balanced Budget Act of 1997 enacted significant changes to the Medicare and Medicaid programs designed to modernize payment and health care delivery systems while achieving substantial budgetary savings. Among other things, the law established the prospective payment system for skilled nursing facility services to replace the cost-based reimbursement system, which resulted in significant reductions in Medicare payments to skilled nursing facilities. In recent years, Congress has adopted legislation to somewhat mitigate the impact of the new payment system, including a temporary payment add-on for high-acuity patients, which has subsequently expired, and a temporary payment add-on for residents with AIDS that still is in effect through fiscal year 2009. Other legislation enacted by Congress in recent years has reduced certain Medicare skilled nursing facility bad debt payments, strengthened Medicaid asset transfer restrictions for persons seeking to qualify for Medicaid long-term care coverage, reduced Medicaid provider taxes that are used by many states to finance state health programs, and given states greater flexibility to expand access to home and community based services.

In addition, each year legislation is proposed in Congress and in some state legislatures that would affect broader changes in the health care system, either nationally or at the state level. Among the proposals under consideration are additional cost controls on the Medicare and Medicaid programs, health care provider cost-containment initiatives, health care coverage expansion for the uninsured, measures to prevent medical errors, incentives to promote community-based care as an alternative to institutional long-term care services, and limits on damages that could be claimed in malpractice lawsuits. We cannot predict whether any reform proposals will be adopted or, if adopted, what effect, if any, such proposals would have on our business.

Environmental Matters

Under various federal, state and local environmental laws, ordinances and regulations, an owner of real property or a secured lender (such as us) may be liable for the costs of removal or remediation of hazardous or toxic substances at, under or disposed of in connection with such property, as well as other potential costs relating to hazardous or toxic substances (including government fines and damages for injuries to persons and adjacent property). Such laws often impose such liability without regard to whether the owner or secured lender knew of, or was responsible for, the presence or disposal of such substances and may be imposed on the owner or secured lender in connection with the activities of an operator of the property. The cost of any required remediation, removal, fines or personal or property damages and the owner's or secured lender's liability therefore could exceed the value of the property, and/or the assets of the owner or secured lender. In addition, the presence of such substances, or the failure to properly dispose of or remediate such substances, may adversely affect the owner's ability to sell or rent such property or to borrow using such property as collateral which, in turn, would reduce our revenues.

Although the mortgage loans that we provide and leases covering our properties require the borrower and the lessee to indemnify us for certain environmental liabilities, the scope of such obligations may be limited and we cannot assure that any such borrower or lessee would be able to fulfill its indemnification obligations.

Insurance

It is our current policy, and we intend to continue this policy, that all borrowers of funds from us and lessees of any of our properties secure adequate comprehensive property and general and professional liability insurance that covers us as well as the borrower and/or lessee. Even though that is our policy, certain borrowers and lessees have been unable to obtain general and professional liability insurance in the specific amounts required by our leases or mortgages because the cost of such insurance has increased substantially and some insurers have stopped offering such insurance for long-term care facilities. Additionally, in the past, insurance companies have filed for bankruptcy protection leaving certain of our 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 borrowers, including their ability to make lease or mortgage payments. Although we contend that as a non-possessory landlord we are not generally responsible for what takes place on real estate we do not possess, claims including general and professional liability claims, may still be asserted against us 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 we, a borrower or lessee will have adequate funds to cover all contingencies. If an uninsured loss or a loss in excess of insured limits occurs with respect to one or more of our properties, we could be subject to an adverse claim including claims for general or professional liability, could lose the capital that we have 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 us, we 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.

Employees

We currently employ 13 people. The employees are not members of any labor union, and we consider our relations with our employees to be excellent.

Taxation of our Company

We have elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code (or the Code). We believe that we have been organized and have operated in such a manner as to qualify for taxation as a REIT under the Code commencing with our taxable year ending December 31, 1992. We intend to continue to operate in such a manner, but there is no assurance that we have operated or will continue to operate in a manner so as to qualify or remain qualified.

If we continue to qualify for taxation as a REIT, we generally will not be subject to federal corporate income taxes on our net income that is currently distributed to our stockholders. This treatment substantially eliminates the "double taxation" (once at the corporate level when earned and once at stockholder level when distributed) that generally results from investment in a non-REIT corporation.

However, we will be subject to federal income tax as follows:

First, we will be taxed at regular corporate rates on any undistributed taxable income, including undistributed net capital gains.

Second, under certain circumstances, we may be subject to the alternative minimum tax, if our dividend distributions are less than our alternative minimum taxable income.

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Third, if we have (i) net income from the sale or other disposition of foreclosure property which is held primarily for sale to customers in the ordinary course of business or (ii) other non-qualifying income from foreclosure property, we may elect to be subject to tax at the highest corporate rate on such income, if necessary to maintain our REIT status.

Fourth, if we have net income from "prohibited transactions" (as defined below), such income will be subject to a 100% tax.

Fifth, if we fail to satisfy the 75% gross income test or the 95% gross income test (as discussed below), but nonetheless maintain our qualification as a REIT because certain other requirements have been met, we will be subject to a 100% tax on an amount equal to (a) the gross income attributable to the greater of the amount by which we fail the 75% or 95% test multiplied by (b) a fraction intended to reflect our profitability.

Sixth, if we fail to distribute during each calendar year at least the sum of (i) 85% of our ordinary income for such year, (ii) 95% of our REIT capital gain net income for such year, and (iii) any undistributed taxable income from prior periods, we will be subject to a 4% excise tax on the excess of such required distribution over the amounts actually distributed.

Seventh, if we acquire an asset which meets the definition of a built-in gain asset from a corporation which is or has been a C corporation (i.e., generally a corporation subject to full corporate-level tax) in certain transactions in which the basis of the built-in gain asset in our hands is determined by reference to the basis of the asset in the hands of the C corporation, and if we subsequently recognize gain on the disposition of such asset during the ten-year period, called the recognition period, beginning on the date on which we acquired the asset, then, to the extent of the built-in gain (i.e., the excess of (a) the fair market value of such asset over (b) our adjusted basis in such asset, both determined as of the beginning of the recognition period), such gain will be subject to tax at the highest regular corporate tax rate, pursuant to IRS regulations.

Eighth, if we have taxable REIT subsidiaries, we will also be subject to a tax of 100% on the amount of any rents from real property, deductions or excess interest paid to us by any of our taxable REIT subsidiaries that would be reduced through reapportionment under certain federal income tax principles in order to more clearly reflect income for the taxable REIT subsidiary.

Ninth, if we fail to satisfy any of the REIT asset tests, as described below, by more than a de minimus amount, due to reasonable cause and we nonetheless maintain our REIT qualification because of specified cure provisions, we will be required to pay a tax equal to the greater of \$50,000 or the highest corporate tax rate multiplied by the net income generated by the non-qualifying assets that caused us to fail such test.

Tenth, if we fail to satisfy any provision of the Code that would result in our failure to qualify as a REIT (other than a violation of the REIT gross income tests or certain violations of the asset tests described below) and the violation is due to reasonable cause, we may retain our REIT qualification but we will be required to pay a penalty of \$50,000 for each such failure.

Finally, if we own a residual interest in a real estate mortgage investment conduit (or REMIC), we will be taxed at the highest corporate rate on the portion of any excess inclusion income that we derive from the REMIC residual interests equal to the percentage of our shares that is held in record name by "disqualified organization." A "disqualified organization" includes the United States, any state or political subdivision thereof, any foreign government or international organization, any agency or instrumentality of any of the foregoing, any rural electrical or telephone cooperative and any tax-exempt organization (other than a farmer's cooperative described in Section 521 of the Code) that is exempt from income taxation and from the unrelated business taxable income provisions of the

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Code. However, to the extent that we own a REMIC residual interest through a taxable REIT subsidiary, we will not be subject to this tax.

Requirements for Qualification. The Code defines a REIT as a corporation, trust or association:

- (1) which is managed by one or more trustees or directors;
- (2) the beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest;
- (3) which would be taxable, but for Sections 856 through 860 of the Code, as a domestic corporation;
- (4) which is neither a financial institution nor an insurance company subject to certain provisions of the Code;
- (5) the beneficial ownership of which is held by 100 or more persons;
- (6) during the last half of each taxable year not more than 50% in value of the outstanding stock of which is owned, actually or constructively, by five or fewer individuals (including specified entities); and
- (7) which meets certain other tests, described below, regarding the amount of its distributions and the nature of its income and assets;
- (8) that elects to be a REIT, or has made such election for a previous year, and satisfies the applicable filing and administrative requirements to maintain qualifications as a REIT; and
- (9) that adopts a calendar year accounting period.

The Code provides that conditions (1) to (4), inclusive, must be met during the entire taxable year and that condition (5) must be met during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of less than 12 months. Conditions (5) and (6) do not apply until after the first taxable year for which an election is made to be taxed as a REIT. For purposes of condition (6), pension funds and certain other entities are treated as individuals, subject to a "look-through" exception.

Pursuant to the Code and applicable Treasury Regulations, in order to be able to elect to be taxed as a REIT, we must maintain certain records and request certain information from our stockholders designed to disclose the actual ownership of our stock. Based on publicly available information, we believe we have satisfied the share ownership requirements set forth in conditions (5) and (6). In addition, Sections 9.2 and 9.3 of our Charter provide for restrictions regarding the transfer and ownership of shares. These restrictions are intended to assist us in continuing to satisfy the share ownership requirements described in conditions (5) and (6). These restrictions, however, may not ensure that we will, in all cases, be able to satisfy the share ownership requirements described in conditions (5) and (6).

We have complied with, and will continue to comply with, regulatory rules to send annual letters to certain of our stockholders requesting information regarding the actual ownership of our stock. If despite sending the annual letters, we do not know, or after exercising reasonable diligence would not have known, whether we failed to satisfy the ownership requirement set forth in condition (6) above, we will be treated as having satisfied such condition. If we fail to comply with these regulatory rules, we will be subject to a monetary penalty. If our failure to comply was due to intentional disregard of the requirement, the penalty would be increased. However, if our failure to comply was due to reasonable cause and not willful neglect, no penalty would be imposed.

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Income Tests. There presently are two gross income requirements that we must satisfy to qualify as a REIT:

First, at least 75% of our gross income (excluding gross income from "prohibited transactions," as defined below) for each taxable year must be derived directly or indirectly from investments relating to real property or mortgages on real property, including rents from real property, or from certain types of temporary investment income.

Second, at least 95% of our gross income for each taxable year must be directly or indirectly derived from income that qualifies under the 75% test, and from dividends (including dividends from taxable REIT subsidiaries), interest and gain from the sale or other disposition of stock or securities.

Cancellation of indebtedness income generated by us is not taken into account in applying the 75% and 95% income tests discussed above. A "prohibited transaction" is a sale or other disposition of property (other than foreclosure property) held for sale to customers in the ordinary course of business. Any gain realized from a prohibited transaction is subject to a 100% penalty tax.

Rents received by us will qualify as "rents from real property" for purposes of satisfying the gross income tests for a REIT only if several conditions are met:

The amount of rent must not be based in whole or in part on the income or profits of any person, although rents generally will not be excluded merely because they are based on a fixed percentage or percentages of receipts or sales.

Rents received from a tenant will not qualify as rents from real property if the REIT, or an owner of 10% or more of the REIT, also directly or constructively owns 10% or more of the tenant, unless the tenant is our taxable REIT subsidiary and certain other requirements are met with respect to the real property being rented.

If rent attributable to personal property leased in connection with a lease of real property is greater than 15% of the total rent received under the lease, then the portion of rent attributable to the personal property will not qualify as rents from real property.

We generally must not furnish or render services to tenants, other than through a taxable REIT subsidiary or an "independent contractor" from whom we derive no income, except that we may directly provide services that are "usually or customarily rendered" in the geographic area in which the property is located in connection with the rental of real property for occupancy only, or are not otherwise "rendered to the occupant for his convenience."

For taxable years beginning after August 5, 1997, a REIT has been permitted to render a de minimus amount of impermissible services to tenants and still treat amounts received with respect to that property as rents from real property. The amount received or accrued by the REIT during the taxable year for the impermissible services with respect to a property may not exceed 1% of all amounts received or accrued by the REIT directly or indirectly from the property. If the amount received or accrued by the REIT during the taxable year for impermissible services with respect to a property exceeds 1% of the total amounts received or accrued with respect to such property, then none of the rents received or accrued from such property shall be treated as rents from real property. The amount received for any service or management operation for this purpose shall be deemed to be not less than 150% of the direct cost of the REIT in furnishing or rendering the service or providing the management or operation. Furthermore, impermissible services may be furnished to tenants by a taxable REIT subsidiary subject to certain conditions, and we may still treat rents received with respect to the property as rent from real property.

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The term "interest" generally does not include any amount if the determination of the amount depends in whole or in part on the income or profits of any person, although an amount generally will not be excluded from the term "interest" solely by reason of being based on a fixed percentage of receipts or sales.

If we fail to satisfy one or both of the 75% or 95% gross income tests for any taxable year, we may nevertheless qualify as a REIT for the year if we are eligible for relief. These relief provisions will be generally available if our failure to meet the tests was due to reasonable cause and not due to wilful neglect and following the identification of the failure to satisfy one or both income tests, a description of each item of gross income is filed in accordance with IRS regulations.

It is not now possible to determine the circumstances under which we may be entitled to the benefit of these relief provisions. If these relief provisions apply, a 100% tax is imposed on an amount equal to (a) the gross income attributable to the greater of the amount by which we failed the 75% or 95% test, multiplied by (b) a fraction intended to reflect our profitability.

Asset Tests. At the close of each quarter of our taxable year, we must also satisfy several tests relating to the nature and diversification of our assets. At least 75% of the value of our total assets must be represented by real estate assets, cash, cash items (including receivables arising in the ordinary course of our operations), and government securities and qualified temporary investments. Although the remaining 25% of our assets generally may be invested without restriction, we are prohibited from owning securities representing more than 10% of either the vote or value of the outstanding securities of any issuer other than a qualified REIT subsidiary, another REIT or a taxable REIT subsidiary (the "10% vote and value test"). Further, no more than 20% of our total assets may be represented by securities of one or more taxable REIT subsidiaries (for tax years beginning after July 30, 2008, 25% of the total value of our assets) and no more than 5% of the value of our total assets may be represented by securities of any non-governmental issuer other than a qualified REIT subsidiary, another REIT or a taxable REIT subsidiary (or TRS). Each of the 10% vote and value test and the 20% and 5% asset tests must be satisfied at the end of any quarter. There are special rules which provide relief if the value related tests are not satisfied due to changes in the value of the assets of a REIT.

Investments in Taxable REIT Subsidiaries. For taxable years beginning after December 1, 2000, REITs may own more than 10% of the voting and value of securities in a TRS. A TRS is a corporation other than a REIT in which a REIT directly or indirectly holds stock, and that has made a joint election with the REIT to be treated as a TRS. A TRS also includes any corporation other than a REIT with respect to which a TRS owns securities possessing more than 35% of the total voting power or value of the outstanding securities of such corporation. Other than some activities relating to lodging and health care facilities, a TRS may generally engage in any business, including the provision of customary or non-customary services to tenants of its parent REIT. A TRS is subject to income tax as a regular C corporation. In addition, a TRS may be prevented from deducting interest on debt funded directly or indirectly by its parent REIT if certain tests regarding the TRS's debt to equity ratio and interest expense are not satisfied. A REIT's ownership of a TRS will not be subject to the 10% or 5% asset tests described above, and its operations will be subject to the provisions described above. At this time, we do not have any taxable REIT subsidiaries.

REMIC. A regular or residual interest in a REMIC will be treated as a real estate asset for purposes of the REIT asset tests, and income derived with respect to such interest will be treated as interest on an obligation secured by a mortgage on real property, assuming that at least 95% of the assets of the REMIC are real estate assets. If less than 95% of the assets of the REMIC are real estate assets, only a proportionate share of the assets of and income derived from the REMIC will be treated as qualifying under the REIT asset and income tests. All of our historical REMIC certificates were secured by real estate assets, therefore we believe that our historic REMIC interests fully qualified for purposes of the REIT income and asset tests.

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Ownership of Interests in Partnerships, Limited Liability Companies and qualified REIT Subsidiaries. We own interests in various partnerships and limited liabilities companies. In the case of a REIT which is a partner in a partnership, or a member in a limited liability company treated as a partnership for federal income tax purposes, Treasury Regulations provide that the REIT will be deemed to own its proportionate share of the assets of the partnership or limited liability company, based on its interest in partnership capital, subject to special rules relating to the 10% REIT asset test described above. Also, the REIT will be deemed to be entitled to its proportionate share of income of that entity. The assets and items of gross income of the partnership or limited liability company retain the same character in the hands of the REIT for purposes of Section 856 of the Code, including satisfying the gross income tests and the asset tests. Thus, our proportionate share of the assets and items of income of partnerships and limited liability companies taxed as partnerships, in which we are, directly or indirectly through other partnerships or limited liability companies taxed as partnerships, a partner or member, are treated as our assets and items of income for purposes of applying the REIT qualification requirements described in this Annual Report on Form 10-K (including the income and asset tests previously described).

We also own interests in a number of subsidiaries which are intended to be treated as qualified REIT subsidiaries. The Code provides that such subsidiaries will be ignored for federal income tax purposes and that all assets, liabilities and items of income, deduction and credit of such subsidiaries will be treated as assets, liabilities and such items of our company. If any partnership or qualified real estate investment trust subsidiary in which we own an interest were treated as a regular corporation (and not as a partnership or qualified real estate investment trust subsidiary) for federal income tax purposes, we would likely fail to satisfy the REIT asset test prohibiting a REIT from owning greater than 10% of the voting power of the stock or value of securities of any issuer, as described above, and would therefore fail to qualify as a REIT. We believe that each of the partnerships and subsidiaries in which we own an interest will be treated for tax purposes as a partnership or qualified REIT subsidiary, respectively, although no assurance can be given that the IRS will not successfully challenge the status of any such entity.

Annual Distribution Requirements. In order to qualify as a REIT, we are required to distribute dividends (other than capital gain dividends) to our stockholders annually in an amount at least equal to:

- (1) the sum of:
 - (A) 90% of our "real estate investment trust taxable income" (computed without regard to the dividends paid deduction and our net capital gain); and
 - (B) 90% of the net income, if any (after tax), from foreclosure property; minus
- (2) the excess of certain items of non-cash income over 5% of our real estate investment trust taxable income.

In addition, if we dispose of any asset we acquired from a corporation which is or has been a C corporation in a transaction in which our basis in the asset is determined by reference to the basis of the asset in the hands of that C corporation, within the ten-year period following our acquisition of such asset, we would be required to distribute at least 90% of the after-tax gain, if any, we recognized on the disposition of the asset, to the extent that gain does not exceed the excess of (a) the fair market value of the asset on the date we acquired the asset over (b) our adjusted basis in the asset on the date we acquired the asset.

We must pay these annual distributions (1) in the taxable year to which they relate or (2) in the following year if (i) we pay these distributions during January to stockholders of record in either

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October, November, or December of the prior year or (ii) we elect to declare the dividend before the due date of the tax return (including extensions) and pay on or before the first regular dividend payment date after such declaration.

Amounts distributed must not be preferential; that is, every stockholder of the class of stock with respect to which a distribution is made must be treated the same as every other stockholder of that class, and no class of stock may be treated otherwise than in accordance with its dividend rights as a class.

To the extent that we do not distribute all of our net long-term capital gain or distribute at least 90% but less than 100%, of our "real estate investment trust taxable income," as adjusted, we will be subject to tax on such amounts at regular corporate tax rates. Furthermore, if we should fail to distribute during each calendar year (or, in the case of distributions with declaration and record dates in the last three months of the calendar year, by the end of the following January) at least the sum of:

- (1) 85% of our real estate investment trust ordinary income for such year,
- (2) 95% of our real estate investment trust capital gain net income for such year, and
- (3) 100% of taxable income from prior periods less 100% of distributions from prior periods

we would be subject to a 4% excise tax on the excess of such required distributions over the amounts actually distributed. Any real estate investment trust taxable income and net capital gain on which this excise tax is imposed for any year is treated as an amount distributed during that year for purposes of calculating such tax.

We intend to make timely distributions sufficient to satisfy these annual distribution requirements and to avoid the imposition of the 4% excise tax.

Failure to Qualify. If we fail to qualify for taxation as a REIT in any taxable year, and certain relief provisions do not apply, we will be subject to tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates. Distributions to stockholders in any year in which we fail to qualify as a REIT will not be deductible by us, nor will any distributions be required to be made. Unless entitled to relief under specific statutory provisions, we will also be disqualified from re-electing our REIT status for the four taxable years following the year during which qualification was lost. It is not possible to state whether we would be entitled to the statutory relief in all circumstances. Failure to qualify as a REIT for even one year could substantially reduce distributions to stockholders and could result in our incurring substantial indebtedness (to the extent borrowings are feasible) or liquidating substantial investments in order to pay the resulting taxes.

2008 Act. The Housing and Economic Recovery Act of 2008 made a number of substantial changes to the qualification and tax treatment of REITs. The following is a brief summary of certain significant REIT provisions on the 2008 Act.

- (1) *Modification to "prohibited transactions" provision.* For sales made after July 30, 2008, the "safe harbor" holding period is shortened to two years (from four years) and a 10%-of-aggregate fair market value alternative test is added (in addition to the 10%-of-aggregate basis test) for qualifying for the safe harbor.
- (2) *Extending "qualified lodging facility" rental exception to "qualified health care properties".* The 2008 Act extends the rental exception applicable to qualified lodging facilities to health care facilities. Thus, the rents paid by a taxable REIT subsidiary to its parent REIT for a "qualified health care property" that is operated by an eligible independent contractor will constitute qualifying rental income for purposes of both gross income tests. Also, a taxable

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REIT subsidiary is not considered to be operating or managing a "qualified health care property" solely because it (i) directly or indirectly possesses a license, permit, or similar instrument enabling it to do so, or (ii) employs individuals working at such facility or property located outside the U.S., but only if an eligible independent contractor is responsible for the daily supervision and direction of such individuals on behalf of the taxable REIT subsidiary pursuant to a management agreement or similar service contract.

State and local taxation. We may be subject to state or local taxation in various state or local jurisdictions, including those in which we transact business or reside. The state and local tax treatment of our Company may not conform to the federal income tax consequences discussed above.

Investor Information

We make available to the public free of charge through our internet website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such reports with, or furnish such reports to, the Securities and Exchange Commission. Our internet website address is www.LTCProperties.com. We are not including the information contained on our website as part of, or incorporating it by reference into, this Annual Report on Form 10-K.

Posted on our website and available in print upon request of any stockholder to our Investor Relations Department are the charters for our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee, our Corporate Governance Guidelines and a Code of Business Conduct, Ethics and Corporate Governance governing our directors, officers and employees. Within the time period required by the SEC and the New York Stock Exchange, we will post on our website any amendment to the Code of Business Conduct, Ethics and Corporate Governance and any waiver applicable to our Chief Executive Officer, Principal Financial Officer, Principal Accounting Officer or Directors. In addition, our website includes information concerning purchases and sales of our equity securities by our executive officers and directors. On our website, under the heading "SEC Filings," there is a link to view each Form 4 filing. Our Investor Relations Department can be contacted at:

LTC Properties, Inc.
31365 Oak Crest Drive, Suite 200
Westlake Village, California 91361
Attn: Investor Relations
(805) 981-8655

You may read and copy materials that we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington D.C. 20549. Information on the operation of the Public Reference Room is available by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy statements and other information we file. The address of the SEC website is www.sec.gov.

Our Company is listed on the New York Stock Exchange (or NYSE), ticker symbol LTC. Section 303A.12(a) of the NYSE Listed Company Manual requires that listed companies disclose in their annual report to stockholders that the NYSE Annual CEO Certification has been filed with the NYSE and disclose any qualifications. We filed with the NYSE in 2008 the Annual CEO Certification without any qualifications.

Item 1A. RISK FACTORS

The following discussion of risk factors contains "forward-looking statements" as discussed above. These risk factors may be important to understanding any statement in this Annual Report on Form 10-K or elsewhere. The following information should be read in conjunction with Management's Discussion and Analysis, and the consolidated financial statements and related notes in this Annual Report on Form 10-K.

A Failure to Maintain or Increase our Dividend Could Reduce the Market Price of Our Stock. In January 2009, we declared a \$0.13 per share monthly dividend for the first quarter of calendar 2009. During calendar 2008, we paid a \$0.13 monthly dividend on our common stock. During calendar 2007, we paid a \$0.125 monthly dividend on our common stock. The ability to maintain or raise our common dividend is dependent, to a large part, on growth of funds from operations. This growth in turn depends upon increased revenues from additional investments and loans, rental increases and mortgage rate increases.

At Times, We May Have Limited Access to Capital Which Will Slow Our Growth. A REIT is required to make dividend distributions and retains little cash flow for growth. As a result, growth for a REIT is generally through the steady investment of new capital in real estate assets. Currently, we believe that our low debt levels, \$80.0 million available under our unsecured line of credit and \$21.1 million cash balance at December 31, 2008, will enable us to meet our obligations and continue to make investments. Recently, liquidity in the credit markets has deteriorated and, at this time, we are unable to determine if there is cost effective long-term capital available for significant additional capital investments for calendar 2009. There may be times when we will have limited access to capital from the equity and/or debt markets. During such periods, virtually all of our available capital would be required to meet existing commitments and to reduce existing debt. We may not be able, during such periods, to obtain additional equity or debt capital or dispose of assets on favorable terms, if at all, at the time we require additional capital to acquire health care properties on a competitive basis or meet our obligations.

Income and Returns from Health Care Facilities Can be Volatile. The possibility that the health care properties in which we invest will not generate income sufficient to meet operating expenses, will generate income and capital appreciation, if any, at rates lower than those anticipated or will yield returns lower than those available through investments in comparable real estate or other investments are additional risks of investing in health care related real estate. Income from properties and yields from investments in such properties may be affected by many factors, including changes in governmental regulation (such as zoning laws and government payment), general or local economic conditions (such as fluctuations in interest rates and employment conditions), the available local supply of and demand for improved real estate, a reduction in rental income as the result of an inability to maintain occupancy levels, natural disasters (such as hurricanes, earthquakes and floods) or similar factors.

We Depend on Lease Income and Mortgage Payments from Real Property. Approximately 97% of our revenue for the year ended December 31, 2008, was derived from mortgage payments and lease income from real property. Our revenue would be adversely affected if a significant number of our borrowers or lessees were unable to meet their obligations to us or if we were unable to lease our properties or make mortgage loans on economically favorable terms. There can be no assurance that any lessee will exercise its option to renew its lease upon the expiration of the initial term or that if such failure to renew were to occur, we could lease the property to others on favorable terms.

We Rely on a Few Major Operators. Extencicare REIT and Assisted Living Concepts, Inc (or ALC), collectively lease 37 assisted living properties with a total of 1,427 units owned by us

representing approximately 12.2%, or \$61.8 million, of our total assets at December 31, 2008. Alterra Healthcare Corporation (or Alterra), a wholly owned subsidiary of Brookdale Senior Living, Inc., leases 35 assisted living properties with a total of 1,416 units owned by us representing approximately 12.1%, or \$61.3 million, of our total assets at December 31, 2008. Subsequent to December 31, 2008 the name Alterra Healthcare Corporation was changed to Brookdale Senior Living Communities, Inc. Preferred Care, Inc. (or Preferred Care), through various wholly owned subsidiaries, operates 33 skilled nursing properties with a total of 4,021 beds that we own or on which we hold mortgages secured by first trust deeds. This represents approximately 12.6% or \$63.5 million of our total assets at December 31, 2008. Our financial position and ability to make distributions may be adversely affected by financial difficulties experienced by 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.

Our Borrowers and Lessees Face Competition in the Health Care Industry. The long-term care industry is highly competitive and we expect that it may become more competitive in the future. Our borrowers and lessees are competing with numerous other companies providing similar long-term care services or alternatives such as home health agencies, hospices, life care at home, community-based service programs, retirement communities and convalescent centers. There can be no assurance that our borrowers and lessees will not encounter increased competition in the future which could limit their ability to attract residents or expand their businesses and therefore affect their ability to make their debt or lease payments to us.

The Health Care Industry is Heavily Regulated by the Government. Our borrowers and lessees who operate health care facilities are subject to extensive regulation by federal, state and local governments. These laws and regulations are subject to frequent and substantial changes resulting from legislation, adoption of rules and regulations, and administrative and judicial interpretations of existing law. These changes may have a dramatic effect on the definition of permissible or impermissible activities, the relative costs associated with doing business and the amount of reimbursement by both government and other third-party payors. These changes may be applied retroactively. The ultimate timing or effect of these changes cannot be predicted. The failure of any borrower of funds from us or lessee of any of our properties to comply with such laws, requirements and regulations could affect its ability to operate its facility or facilities and could adversely affect such borrower's or lessee's ability to make debt or lease payments to us.

Congress and the States Have Enacted Health Care Reform and Budget Measures. The health care industry continues to face various challenges, including increased government and private payor pressure on health care providers to control costs. Certain of these initiatives have had the result of limiting Medicare and Medicaid reimbursement for nursing facility services. In particular, the establishment of a Medicare prospective payment system for skilled nursing facility services to replace the cost-based reimbursement system significantly reduced Medicare reimbursement to skilled nursing facility providers. While Congress subsequently took steps to mitigate the impact of the prospective payment system on skilled nursing facilities, other federal legislative policies have been adopted and continue to be proposed that would reduce Medicare and/or Medicaid payments to nursing facilities. Moreover, states are facing increasing budget pressures in light of the current economic downturn, prompting consideration and in some cases adoption of cuts in state Medicaid payments to providers. No assurances can be given that any additional Medicare or Medicaid legislation enacted by Congress or the states would not reduce Medicare or Medicaid reimbursement to nursing facilities or result in additional costs for operators of nursing facilities.

In addition, comprehensive reforms affecting the payment for and availability of health care services have been proposed at the federal and state levels and major reform proposals have been

adopted by certain states. Congress and state legislatures can be expected to continue to review and assess alternative health care delivery systems and payment methodologies. Changes in the law, new interpretations of existing laws, or changes in payment methodology may have a dramatic effect on the definition of permissible or impermissible activities, the relative costs associated with doing business and the amount of reimbursement by the government and other third party payors. Congress also has given states greater flexibility to expand access to home and community based services as an alternative to nursing facility services. These provisions could further increase state funding for home and community based services, while prompting states to cut funding for nursing facilities and homes for persons with disabilities. In light of continuing state Medicaid program reforms, budget cuts, and regulatory initiatives, no assurance can be given that the implementation of such regulations and reforms will not have a material adverse effect on the financial condition or results of operations of our lessees and/or borrowers which, in turn, could effect their ability to meet their contractual obligations to us.

Our Borrowers and Lessees Rely on Government and Third Party Reimbursement. The ability of our borrowers and lessees to generate revenue and profit determines the underlying value of that property to us. Revenues of our borrowers and lessees are generally derived from payments for patient care. Sources of such payments include the federal Medicare program, state Medicaid programs, private insurance carriers, health care service plans, health maintenance organizations, preferred provider arrangements, self-insured employers, as well as the patients themselves.

We Could Incur More Debt. We operate with a policy of incurring debt when, in the opinion of our Board of Directors, it is advisable. We may incur additional debt by borrowing under our unsecured line of credit, mortgaging properties we own and/or issuing debt securities in a public offering or in a private transaction. Accordingly, we could become more highly leveraged. The degree of leverage could have important consequences to stockholders, including affecting our ability to obtain, in the future, additional financing for working capital, capital expenditures, acquisitions, development or other general corporate purposes and making us more vulnerable to a downturn in business or the economy generally.

We Could Fail to Collect Amounts Due Under Our Straight-line Rent Receivable Asset. Straight-line accounting requires us to calculate the total rent we will receive as a fixed amount over the life of the lease and recognize that revenue evenly over that life. In a situation where a lease calls for fixed rental increases during the life of the lease rental income recorded in the early years of a lease is higher than the actual cash rent received, which creates an asset on the balance sheet called straight-line rent receivable. At some point during the lease, depending on the rent levels and terms, this reverses and the cash rent payments received during the later years of the lease are higher than the rental income recognized, which reduces the straight-line rent receivable balance to zero by the end of the lease. We periodically assess the collectibility of the straight-line rent receivable. If during our assessment we determined that we were unlikely to collect a portion or the entire straight-line rent receivable asset, we may provide a reserve against the previously recognized straight-line rent receivable asset for a portion or up to its full value that we estimate may not be recoverable.

Our Assets May be Subject to Impairment Charges. We periodically but not less than quarterly evaluate our real estate investments and other assets for impairment indicators. The judgment regarding the existence of impairment indicators is based on factors such as market conditions, operator performance and legal structure. If we determine that a significant impairment has occurred, we would be required to make an adjustment to the net carrying value of the asset, which could have a material adverse affect on our results of operations and a non-cash impact on funds from operations in the period in which the write-off occurs.

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A Failure to Reinvest Cash Available to Us Could Adversely Affect Our Future Revenues and Our Ability to Increase Dividends to Stockholders; There is Considerable Competition in Our Market for Attractive Investments. From time to time, we will have cash available from (1) proceeds of sales of shares of securities, (2) proceeds from new debt issuances, (3) principal payments on our mortgages and other investments, (4) sale of properties, and (5) funds from operations. We may reinvest this cash in health care investments in accordance with our investment policies, repay outstanding debt or invest in qualified short-term or long-term investments. We compete for real estate investments with a broad variety of potential investors. The competition for attractive investments negatively affects our ability to make timely investments on acceptable terms. Delays in acquiring properties or making loans will negatively impact revenues and perhaps our ability to increase distributions to our stockholders.

Our Failure to Qualify as a REIT Would Have Serious Adverse Consequences to Our Stockholders. We intend to operate so as to qualify as a REIT under the Code. We believe that we have been organized and have operated in a manner which would allow us to qualify as a REIT under the Code beginning with our taxable year ended December 31, 1992. However, it is possible that we have been organized or have operated in a manner which would not allow us to qualify as a REIT, or that our future operations could cause us to fail to qualify. Qualification as a REIT requires us to satisfy numerous requirements (some on an annual and quarterly basis) established under highly technical and complex Code provisions for which there are only limited judicial and administrative interpretations, and involves the determination of various factual matters and circumstances not entirely within our control. For example, in order to qualify as a REIT, at least 95% of our gross income in any year must be derived from qualifying sources, and we must pay dividends to stockholders aggregating annually at least 90% (95% for taxable years ending prior to January 1, 2001) of our REIT taxable income (determined without regard to the dividends paid deduction and by excluding capital gains). Legislation, new regulations, administrative interpretations or court decisions could significantly change the tax laws with respect to qualification as a REIT or the federal income tax consequences of such qualification.

If we fail to qualify as a REIT in any taxable year, we will be subject to federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates. Unless we are entitled to relief under statutory provisions, we would be disqualified from treatment as a REIT for the four taxable years following the year during which we lost qualification. If we lose our REIT status, our net earnings available for investment or distribution to stockholders would be significantly reduced for each of the years involved. In addition, we would no longer be required to make distributions to stockholders.

Provisions in Our Article of Incorporation May Limit Ownership of Shares of Our Capital Stock. In order for us to qualify as a REIT, no more than 50% in value of the outstanding shares of our stock may be beneficially owned, directly or indirectly, by five or fewer individuals at any time during the last half of each taxable year. To ensure qualification under this test, our articles of incorporation provide that, subject to exceptions, no person may beneficially own more than 9.8% of outstanding shares of any class or series of our stock, including our common stock. Our Board of Directors may exempt a person from the 9.8% ownership limit upon such conditions as the Board of Directors may direct. However, our Board of Directors may not grant an exemption from the 9.8% ownership limit if it would result in the termination of our status as a REIT. Shares of capital stock in excess of 9.8% ownership limitation that lack an applicable exemption may lose rights to dividends and voting, and may be subject to redemption. As a result of the limitations on ownership set forth in our Articles of Incorporation, acquisition of any shares of capital stock that would result in our disqualification as a REIT may be limited or void. The 9.8% ownership limitation also may have the effect of delaying, deferring, or preventing a change in control of us, including an extraordinary transaction (such as a merger, tender offer or sale of all or substantially all of our assets) that might provide a premium price for holders of our capital stock.

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Our Real Estate Investments are Relatively Illiquid. Real estate investments are relatively illiquid and, therefore, tend to limit our ability to vary our portfolio promptly in response to changes in economic or other conditions. All of our properties are "special purpose" properties that cannot be readily converted to general residential, retail or office use. Health care facilities that participate in Medicare or Medicaid must meet extensive program requirements, including physical plant and operational requirements, which are revised from time to time. Such requirements may include a duty to admit Medicare and Medicaid patients, limiting the ability of the facility to increase its private pay census beyond certain limits. Medicare and Medicaid facilities are regularly inspected to determine compliance, and may be excluded from the programs in some cases without a prior hearing for failure to meet program requirements. Transfers of operations of nursing homes and other healthcare-related facilities are subject to regulatory approvals not required for transfers of other types of commercial operations and other types of real estate. Thus, if the operation of any of our properties becomes unprofitable due to competition, age of improvements or other factors such that our lessee or borrower becomes unable to meet its obligations on the lease or mortgage loan, the liquidation value of the property may be substantially less than the net book value or the amount owing on any related mortgage loan, than would be the case if the property were readily adaptable to other uses. The receipt of liquidation proceeds or the replacement of an operator that has defaulted on its lease or loan could be delayed by the approval process of any federal, state or local agency necessary for the transfer of the property or the replacement of the operator with a new operator licensed to manage the facility. In addition, certain significant expenditures associated with real estate investment, such as real estate taxes and maintenance costs, are generally not reduced when circumstances cause a reduction in income from the investment. Should such events occur, our income and cash flows from operations would be adversely affected.

Our Remedies May Be Limited When Mortgage Loans Default. To the extent we invest in mortgage loans, such mortgage loans may or may not be recourse obligations of the borrower and generally will not be insured or guaranteed by governmental agencies or otherwise. In the event of a default under such obligations, we may have to foreclose on the property underlying the mortgage or protect our interest by acquiring title to a property and thereafter make substantial improvements or repairs in order to maximize the property's investment potential. Borrowers may contest enforcement of foreclosure or other remedies, seek bankruptcy protection against such enforcement and/or bring claims for lender liability in response to actions to enforce mortgage obligations. If a borrower seeks bankruptcy protection, the Bankruptcy Court may impose an automatic stay that would preclude us from enforcing foreclosure or other remedies against the borrower. Declines in the value of the property may prevent us from realizing an amount equal to our mortgage loan upon foreclosure.

We are Subject to Risks and Liabilities in Connection with Properties Owned Through Limited Liability Companies and Partnerships. We have ownership interests in limited liability companies and/or partnerships. We may make additional investments through these ventures in the future. Partnership or limited liability company investments may involve risks such as the following:

our partners or co-members might become bankrupt (in which event we and any other remaining general partners or members would generally remain liable for the liabilities of the partnership or limited liability company);

our partners or co-members might at any time have economic or other business interests or goals which are inconsistent with our business interests or goals;

our partners or co-members may be in a position to take action contrary to our instructions, requests, policies or objectives, including our policy with respect to maintaining our qualification as a REIT; and

agreements governing limited liability companies and partnerships often contain restrictions on the transfer of a member's or partner's interest or "buy-sell" or other provisions which may result in a purchase or sale of the interest at a disadvantageous time or on disadvantageous terms.

We will, however, generally seek to maintain sufficient control of our partnerships and limited liability companies to permit us to achieve our business objectives. Our organizational documents do not limit the amount of available funds that we may invest in partnerships or limited liability companies. The occurrence of one or more of the events described above could have a direct and adverse impact on us.

Item 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

Item 2. PROPERTIES

Investment Portfolio

At December 31, 2008, our real estate investment portfolio (before accumulated depreciation and amortization) consisted of \$502.6 million invested primarily in owned long-term care properties and mortgage loans of approximately \$78.3 million (prior to deducting a \$0.8 million reserve). Our "direct real estate investment portfolio" (properties that we own or on which we hold promissory notes secured by first mortgages) consisted of investments in 101 skilled nursing properties with 11,707 beds, 101 assisted living properties with 4,598 units and two schools. These properties are located in 30 states.

Skilled nursing facilities provide restorative, rehabilitative and nursing care for people not requiring the more extensive and sophisticated treatment available at acute care hospitals. Many skilled nursing facilities provide ancillary services that include occupational, speech, physical, respiratory and IV therapies, as well as provide sub-acute care services which are paid either by the patient, the patient's family, or through federal Medicare or state Medicaid programs.

Assisted living facilities serve elderly persons who require assistance with activities of daily living, but do not require the constant supervision skilled nursing facilities provide. Services are usually available 24-hours a day and include personal supervision and assistance with eating, bathing, grooming and administering medication. The facilities provide a combination of housing, supportive services, personalized assistance and health care designed to respond to individual needs.

The two schools in our real estate investment portfolio are charter schools. Charter schools provide an alternative to the traditional public school. Charter schools are generally autonomous entities authorized by the state or locality to conduct operations independent from the surrounding public school district. Laws vary by state, but generally charters are granted by state boards of education either directly or in conjunction with local school districts or public universities. Operators are granted charters to establish and operate schools based on the goals and objectives set forth in the charter. Upon receipt of a charter, schools receive an annuity from the state for each student enrolled.

Owned Properties. At December 31, 2008, we owned properties in 23 states consisting of 62 skilled nursing properties with a total of 7,209 beds, 85 assisted living properties with a total of 3,884 units and one school representing a gross investment of approximately \$502.6 million. Owned properties are leased pursuant to non-cancelable operating leases generally with an initial term of 10 to 30 years. Many of the leases contain renewal options and two contain limited period options that permit the operators to purchase the properties. The leases provide for fixed minimum base rent

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during the initial and renewal periods. The majority of our leases contain provisions for specified annual increases over the rents of the prior year and are generally computed in one of four ways depending on specific provisions of each lease: (i) a specified percentage increase over the prior year, generally between 2.0% and 2.5%; (ii) the higher of (i) or a calculation based on the Consumer Price Index; (iii) as a percentage of facility net patient revenues in excess of base amounts or (iv) specific dollar increases. Each lease is a triple net lease which requires the lessee to pay all taxes, insurance, maintenance and repairs, capital and non-capital expenditures and other costs necessary in the operations of the facilities. See *Item 8. FINANCIAL STATEMENTS NOTE 6. Real Estate Investments* for further descriptions.

The following table sets forth certain information regarding our owned properties as of December 31, 2008 (*dollar amounts in thousands*):

Location	No. of SNFs	No. of ALFs	No. of Schools	No. of Beds/Units(1)	Encumbrances	Lease Term(2)	Current Investment
Alabama	3	1		458	\$	93	\$ 16,540
Arizona	5	2		1,029		129	41,212
California	1	2		343	16,054	94	29,305
Colorado	4	6		562	6,019	156	27,706
Florida	3	6		776	2,038	137	33,567
Georgia	2	1		292		34	6,600
Idaho		4		148		72	9,756
Indiana		2		78		72	5,070
Iowa	7	1		645		146	17,422
Kansas	3	4		398		149	17,568
Nebraska		4		156		72	9,332
New Jersey		1	1	39		87	12,195
New Mexico	7			860		138	48,876
N. Carolina		5		210		144	13,096
Ohio	5	11		737		97	56,804
Oklahoma		6		221	4,066	144	12,315
Oregon	1	3		218		77	11,927
Pennsylvania		1		69		112	8,327
S. Carolina		3		128		144	7,610
Tennessee	2			142		118	3,075
Texas	15	14		2,710	3,886	131	74,399
Virginia	3			443		151	13,711
Washington	1	8		431	4,690	74	26,204
TOTAL	62	85	1	11,093	\$ 36,753(3)	119	\$ 502,617(4)

(1) See *Item 1. Business General Owned Properties* for discussion of bed/unit count.

(2) Weighted average remaining months in lease term as of December 31, 2008.

(3) Consists of: i) \$32,063 of non-recourse mortgages payable by us secured by 12 assisted living properties with 642 units and ii) \$4,690 of tax-exempt bonds secured by five assisted living properties in Washington with 188 units. As of December 31, 2008 our gross investment in properties encumbered by mortgage loans, bonds and capital leases was \$62,162.

(4) Of the total, \$239,010 relates to investments in skilled nursing properties, \$254,337 relates to investments in assisted living properties and \$9,270 relates to an investment in a school.

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Mortgage Loans. At December 31, 2008, we had 43 mortgage loans secured by first mortgages on 39 skilled nursing properties with a total of 4,498 beds, 16 assisted living properties with 714 units and one school. These properties are located in 16 states. See *Item 8. FINANCIAL STATEMENTS Note 6. Real Estate Investments* for further description.

The following table sets forth certain information regarding our mortgage loans as of December 31, 2008 (*dollar amounts in thousands*):

Location	No. of SNFs	No. of ALFs	No. of Schools	No. of Beds/ Units(3)	Interest Rate %	Average Months to Maturity	Original Face Amount of Mortgage Loans	Current Carrying Amount of Mortgage Loans	Current Annual Debt Service(1)
California	3	1		489	10.93-12.30	53	\$ 8,100	\$ 5,335	\$ 1,140
Florida	4	1		387	10.50-13.73	13	11,360	10,317	1,437
Georgia	1			152	10.90	27	2,000	1,778	218
Iowa		1		44	13.15	58	2,400	2,252	319
Louisiana	1			127	12.27	95	1,600	1,094	215
Minnesota			1		7.28	126	3,751	3,751	273
Missouri	2			190	10.13-10.60	81	3,000	2,409	344
Montana		1		34	13.41	58	2,346	2,194	316
Nebraska		4		163	11.00-13.15	58	10,911	9,759	1,367
Oklahoma	2			273	12.40	56	2,600	1,243	292
S. Dakota		1		34	13.15	58	2,346	2,203	311
Tennessee	1			120	10.05	84	3,400	2,071	403
Texas	22	7		2,896	9.50-13.15	47	44,705	29,798	5,483
Utah	1			84	10.00	131	1,400	1,400	162
Washington	1			104	13.00	94	1,700	1,151	234
Wisconsin	1			115	11.00	98	2,200	1,546	273
TOTAL	39	16	1	5,212	11.48	53	\$ 103,819	\$ 78,301(2)	\$ 12,787

(1) Includes principal and interest payments.

(2) Of the total current principal balance, \$46,464 relates to investments in skilled nursing properties, \$27,747 relates to investments in assisted living properties and \$3,751 relates to an investment in a school. This balance is gross of a loan loss reserve of \$760 and includes discounts and premiums related to loans acquired in prior years totaling \$339.

(3) See *Item 1. Business General Owned Properties* for discussion of bed/unit count.

In general, the mortgage loans may not be prepaid except in the event of the sale of the collateral property to a third party that is not affiliated with the borrower, although partial prepayments (including the prepayment premium) are often permitted where a mortgage loan is secured by more than one property upon a sale of one or more, but not all, of the collateral properties to a third party which is not an affiliate of the borrower. The terms of the mortgage loans generally impose a premium upon prepayment of the loans depending upon the period in which the prepayment occurs, whether such prepayment was permitted or required, and certain other conditions such as upon the sale of the property under a pre-existing purchase option, destruction or condemnation, or other circumstances as approved by us. On certain loans, such prepayment amount is based upon a percentage of the then outstanding balance of the loan, usually declining ratably each year. For other loans, the prepayment premium is based on a yield maintenance formula. In addition to a lien on the mortgaged property, the loans are generally secured by certain non-real estate assets of the properties and contain certain other

security provisions in the form of letters of credit, pledged collateral accounts, security deposits, cross-default and cross-collateralization features and certain guarantees.

Item 3. LEGAL PROCEEDINGS

We are a party from time to time to various general and professional liability claims and lawsuits asserted against the lessees or borrowers of our properties, which in our opinion are not singularly or in the aggregate material to our results of operations or financial condition. These types of claims and lawsuits may include matters involving general or professional liability, which we believe under applicable legal principles are not our responsibility as a non-possessory landlord or mortgage holder. We believe that these matters are the responsibility of our lessees and borrowers pursuant to general legal principles and pursuant to insurance and indemnification provisions in the applicable leases or mortgages. We intend to continue to vigorously defend such claims.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of our security holders during the fourth quarter of 2008.

PART II

Item 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**Market Information**

Our common stock is listed on the NYSE under the symbol "LTC". Set forth below are the high and low reported sale prices for our common stock as reported on the NYSE for each of the periods indicated.

	2008		2007	
	High	Low	High	Low
First Quarter	\$27.35	\$22.51	\$29.25	\$23.83
Second Quarter	\$28.30	\$25.13	\$27.16	\$22.00
Third Quarter	\$31.16	\$24.57	\$25.69	\$19.03
Fourth Quarter	\$28.87	\$14.70	\$28.00	\$20.89

Holdings of Record

As of December 31, 2008 we had approximately 403 stockholders of record of our common stock.

Dividend Information

We declared and paid total cash distributions on common stock as set forth below:

	Declared		Paid	
	2008	2007	2008	2007
First Quarter	\$0.390	\$0.375	\$0.390	\$0.375
Second Quarter	\$0.390	\$0.375	\$0.390	\$0.375
Third Quarter	\$0.390	\$0.375	\$0.390	\$0.375
Fourth Quarter	\$0.390	\$0.375	\$0.390	\$0.375
	\$1.560	\$1.500	\$1.560	\$1.500

We intend to distribute to our stockholders an amount at least sufficient to satisfy the distribution requirements of a REIT. Cash flows from operating activities available for distribution to stockholders will be derived primarily from interest and rental payments from our real estate investments. All distributions will be made subject to approval of our Board of Directors and will depend on our earnings, our financial condition and such other factors as our Board of Directors deem relevant. In order to qualify for the beneficial tax treatment accorded to REITs by Sections 856 through 860 of the Internal Revenue Code, we are required to make distributions to holders of our shares equal to at least 90% of our REIT taxable income. (See "Annual Distribution Requirements" beginning on page 13.)

Issuer Purchases of Equity Securities

During the fourth fiscal quarter ended December 31, 2008, we did not repurchase any of our outstanding common stock or preferred securities.

Since inception of our existing share repurchase program through December 31, 2008, we had repurchased (i) 893,079 shares of our common stock at an average cost of \$21.01 per share, including commissions, for an aggregate purchase price including commissions paid of \$18,768,000 and (ii) 636,300 shares of our Series F preferred stock at an average cost of \$22.44 per share, including commissions, for an aggregate purchase price including commissions paid of \$14,276,000.

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Our Board of Directors established the existing share repurchase program in June 2007 enabling us to repurchase up to 5,000,000 shares of our common stock on the open market. This authorization does not expire until 5,000,000 shares of our common stock have been repurchased or the Board of Directors terminates its authorization. In January 2008, our Board of Directors amended the share repurchase program to include authorization to repurchase our outstanding preferred securities.

We continue to have authorization to purchase an additional 3,470,621 shares of common stock and/or preferred securities.

Stock Performance Graph

The National Association of Real Estate Investment Trusts (or NAREIT), the representative voice for U.S. REITs and publicly traded real estate companies, classifies a company with less than 25% of its real estate investments in mortgages as an equity REIT. In 2008, our mortgage investments were less than 25% of our total real estate assets.

This graph compares the cumulative total stockholder return on our common stock from December 31, 2003 to December 31, 2008 with the cumulative stockholder total return of (1) the Standard & Poor's 500 Stock Index and (2) the NAREIT Equity REIT Index. The comparison assumes \$100 was invested on December 31, 2003 in our common stock and in each of the foregoing indices and assumes the reinvestment of dividends.

Total Return Stock Performance

The stock performance depicted in the above graph is not necessarily indicative of future performance.

The stock performance graph shall not be deemed incorporated by reference into any filing by us under the Securities Act of 1933 or the Securities Exchange Act of 1934 except to the extent that we specifically incorporate such information by reference, and shall not otherwise be deemed filed under such Acts.

Item 6. SELECTED FINANCIAL DATA

The following table of selected financial information should be read in conjunction with our financial statements and related notes thereto included elsewhere in this Annual Report on Form 10-K.

	2008	2007	2006	2005	2004
	(In thousands, except per share amounts)				
Operating Information:					
Total revenues	\$ 69,357	\$ 74,790	\$ 73,163	\$ 72,408	\$ 62,177
Income from continuing operations	42,885	47,696	45,536	50,688	32,303
Preferred stock dividends	(15,390)	(16,923)	(17,157)	(17,343)	(17,356)
Preferred stock buyback	989				
Preferred stock redemption charge					(4,029)
Net income available to common stockholders	28,576	30,832	61,631(3)	35,366	15,003
Per share Information:					
Net Income (Loss) per Common Share from Continuing Operations Net of Preferred Stock Dividends, Preferred Stock Buyback and Preferred Stock Redemption Charge:					
Basic	\$ 1.24	\$ 1.33	\$ 1.22	\$ 1.49	\$ 0.56
Diluted	\$ 1.24	\$ 1.32	\$ 1.21	\$ 1.48	\$ 0.56
Net Income Per Common Share Available to Common Stockholders:					
Basic	\$ 1.24	\$ 1.33	\$ 2.64	\$ 1.58	\$ 0.77
Diluted	\$ 1.24	\$ 1.32	\$ 2.51	\$ 1.56	\$ 0.77
Common Stock Distributions declared	\$ 1.56	\$ 1.50	\$ 1.08(1)	\$ 1.65(1)	\$ 1.125
Common Stock Distributions paid	\$ 1.56	\$ 1.50	\$ 1.44	\$ 1.29	\$ 1.125
Balance Sheet Information:					
Total assets	\$506,053	\$544,105	\$567,767	\$585,271	\$547,880
Total debt(2)	36,753(4)	52,295	53,811	92,361	96,764

- (1) Dividends for the first quarter of 2006 were declared in the fourth quarter of 2005.
- (2) Includes bank borrowings, mortgage loans payable, bonds payable and capital lease obligations and senior participation payable.
- (3) Higher due to the gain of \$32.6 million relating to the four assisted living properties sold in 2006, as described in *Item 8. FINANCIAL STATEMENTS Note 6. Real Estate Investments* and the \$0.5 million gain recognized in 2006 from the sale of the National Health Investors, Inc. (or NHI) common stock, as described in *Item 8. FINANCIAL STATEMENTS Note 8. Marketable Securities*.
- (4) Lower due to the pay off during 2008 of a mortgage loan in the amount of \$14.2 million secured by four assisted living properties located in Ohio, as described in *Item 8. FINANCIAL STATEMENTS Note 9. Debt Obligations*.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**Executive Overview****Business**

We are a self-administered health care real estate investment trust (or REIT) that invests primarily in long-term care and other health care related properties through mortgage loans, property lease transactions and other investments. In 2008, long-term care properties, which include skilled nursing and assisted living properties, comprised approximately 98% of our investment portfolio.

The following table summarizes our "direct real estate investment portfolio" (properties that we own or on which we hold promissory notes secured by first mortgages) as of December 31, 2008 (*dollar amounts in thousands*):

Type of Property	Gross Investments	Percentage of Investments	For the year ended		Percentage of Revenues (4)	Number of Properties	Number of Beds/ Units (2)	Investment per Bed/Unit	Number of Operators(1)	Number of States(1)
			For the year ended 12/31/08 Rental Income	12/31/08 Interest Income(3)						
Assisted Living Properties	\$ 282,084	48.6%	\$ 28,046	\$ 3,063	46.2%	101	4,598	\$ 61.35	13	22
Skilled Nursing Properties	285,814	49.2%	28,349	6,338	51.6%	101	11,707	\$ 24.41	36	20
Schools	13,020	2.2%	1,167	307	2.2%	2	N/A	N/A	2	2
Totals	\$ 580,918	100.0%	\$ 57,562	\$ 9,708	100.0%	204	16,305			

(1) We have investments in 30 states leased or mortgaged to 46 different operators.

(2) See *Item 1. Business General Owned Properties* for discussion of bed/unit count.

(3) Includes Interest Income from Mortgage Loans.

(4) Includes Rental Income and Interest Income from Mortgage Loans.

As of December 31, 2008 we had \$449.7 million in carrying value of net real estate investment, consisting of \$372.1 million or 83% invested in owned and leased properties and \$77.6 million or 17% invested in mortgage loans secured by first mortgages.

For the year ended December 31, 2008, rental income and interest income from mortgage loans represented 83.0% and 14.0%, respectively, of total gross revenues. In most instances, our lease structure contains fixed annual rental escalations, which are generally recognized on a straight-line basis over the minimum lease period in accordance with SFAS No. 13, "Accounting for Leases." 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. For the years ended December 31, 2008, 2007, and 2006 we recorded \$3.5 million, \$4.8 million, and \$3.1 million, respectively in straight-line rental income. Also during 2008 we recorded \$0.1 million of straight-line rent receivable reserve. Straight-line rental income on a same store basis will increase from \$3.5 million for annual 2008 to \$4.1 million for projected annual 2009 assuming no new leased investments with fixed annual rental escalations are added to our portfolio. During the year ended December 31, 2008 we received \$54.7 million of cash rental revenue and recorded \$0.6 million of lease inducement costs. At December 31, 2008 and 2007, the straight-line rent receivable balance, net of reserves, on the balance sheet was \$13.9 million and \$10.5 million, respectively.

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. We opportunistically consider investments in health care facilities in related businesses where the business model is similar to our existing model and the opportunity provides an attractive expected return. Consistent with this strategy, we pursue, from time to time, opportunities for potential acquisitions and investments, with due diligence and negotiations often at different stages of development at any particular time.

For investments in skilled nursing properties, we favor low cost per bed opportunities, whether in fee simple properties or in mortgages. The average per bed cost of our owned skilled nursing properties is approximately \$33,200 per bed while that of properties subject to our mortgages is approximately \$10,300 per bed.

Additionally with respect to skilled nursing properties, we attempt to invest in properties that do not have to rely on a high percentage of private-pay patients. We seek to invest primarily in properties that are located in suburban and rural areas of states. We prefer to invest in a property that has significant market presence in its community and where state certificate of need and/or licensing procedures limit the entry of competing properties.

For assisted living investments we have attempted to diversify our portfolio both geographically and across product levels. Thus, we believe that although the majority of our investments are in affordably priced units, our portfolio also includes a significant number of upscale units in appropriate markets with certain operators.

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. Historically we have financed up to 90 percent of the stabilized market value of a property. Due to current market uncertainties we most likely will finance lower than our historical percentage. 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.

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 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 secured debt financing. The timing, source and amount of cash flows provided by financing activities and used in investing activities are sensitive to the capital markets environment, especially to changes in interest rates. Changes in capital markets environment may impact the availability of cost-effective capital. 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 during the current period of tightened credit conditions.

Economic Climate

Through 2008, the U.S experienced challenging financial markets, tighter credit conditions, and slower growth. Continued concerns about the systemic impact of inflation, energy costs, declining business and consumer confidence, and a weakened real estate market have contributed to increased market volatility and diminished expectations for the U.S. economy. As a result, the cost and availability of credit has been and may continue to be adversely affected by illiquid credit markets and wider credit spreads. Continued turbulence in the U.S. and international markets and economies may adversely affect our liquidity and financial condition, and the liquidity and financial condition of our operators.

We expect that the deterioration in the credit markets should exert downward pressure on prices of long term care properties, although the lack of recent transaction volume makes it difficult to determine if this is occurring. However, we believe our business model has enabled and will continue to allow us to maintain the integrity of our property investments, including in response to financial difficulties that may be experienced by operators. Traditionally, we have taken a conservative approach to managing our business, choosing to maintain liquidity and exercise patience until favorable investment opportunities arise.

At December 31, 2008, we had \$21.1 million of cash on hand and \$80.0 million available on our unsecured line of credit with no scheduled maturities other than the maturity date of July 17, 2011. In calendar year 2009, we have debt maturities of \$8.1 million due in October 2009 at an interest rate of 8.43% and \$15.8 million due in December 2009 at an interest rate of 8.81%. The October maturity may be paid 90 days early and the December maturity may be paid six months early. In calendar year 2009, we have mortgage receivables of \$7.6 million maturing in November.

As a result, 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 some future investments should we determine such future investments are financially feasible.

Key Transactions

Mortgage Loans. During 2008 we invested we invested \$9.1 million, net of closing fees, in three mortgage loans. One loan secured by an assisted living property in Florida with 41 units in the amount of \$1.0 million has an initial interest rate of 10.5%, increasing 0.125% annually, with a 25-year amortization and matures in November 2009. The second loan secured by six assisted living properties located in Texas with 108 units in the amount of \$6.8 million has an initial interest rate of 9.5%, increasing 0.15% annually, with a 20-year amortization and matures in June 2018. The final loan secured by a skilled nursing property located in Utah with 84 beds in the amount of \$1.4 million has an initial interest rate of 10.0% increasing 0.15% annually, with a 20-year amortization and matures in 11 years. We also invested \$0.6 million under three mortgage loans for capital improvements at an average rate of 11.1%.

Owned Properties. During 2008, we acquired a 30-bed skilled nursing property located in Ohio for an aggregate price of \$1.0 million that was added to an existing master lease at a 10.0% yield and we agreed to provide funding up to \$2.0 million to purchase land, construct and equip a new replacement building which will be a combined skilled nursing and assisted living property. This investment will be at the higher of one-year LIBOR plus 5.3% or 10.0% and construction must be completed by January 18, 2011. Additionally, we invested \$3.0 million under agreements to expand and renovate 13 properties operated by seven different operators. These investments are at an average yield of approximately 10.0%.

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Debt Obligations. We amended and extended our Unsecured Revolving Credit Agreement at an initial commitment amount of \$80.0 million. The Credit Agreement provides for the opportunity to increase the credit amount up to a total of \$120.0 million. The prior agreement did not have an expansion provision. The Credit Agreement provides a revolving line of credit with no scheduled maturities other than the maturity date of July 17, 2011. The interest rates under the Credit Agreement remain the same as under our prior credit agreement, Prime Rate plus 0.50% or LIBOR plus 1.5%. We presently have no outstanding borrowings under the Credit Agreement.

Sunwest Management Inc. On August 19, 2008 we disclosed in a voluntary Current Report on Form 8-K filed with the Securities and Exchange Commission that we had received letters from companies affiliated with Sunwest Management, Inc. (or Sunwest) explaining that Sunwest was experiencing certain negative cash shortfalls which they attributed to properties that had not yet matured in terms of occupancy. Our relationship with Sunwest is limited to only four properties: two mortgage loans secured by properties in Texas and a master lease covering two properties in California. We have acted to preserve our investments with respect to Sunwest as described below.

During the year ended December 31, 2008 we did not receive August or September payments on a \$1.5 million loan at an interest rate of 11.15% and secured by a first mortgage on a 165-unit assisted living property in Mesquite, Texas operated by Sunwest. However, in October we received from non-Sunwest equity investors in this property the payment of all past due interest, property tax impounds, attorney's fees and a \$0.1 million replacement reserve. Interest on the loan, which matures November 19, 2011, represented 1.7% of our interest income from mortgage loans for the year ended December 31, 2008. On October 31, 2008, we completed an assignment and assumption of the loan to an entity formed by the non-Sunwest equity investors. One of the non-Sunwest equity investors is operating the property.

During the year ended December 31, 2008 we did not receive August or September payments on a \$4.7 million loan at an interest rate of 11.15% and secured by a first mortgage on a 140-unit independent living property in Fort Worth, Texas operated by Sunwest. Accordingly we did not record interest income of \$0.1 million in the third quarter of 2008 related to this mortgage loan. Interest on the loan represented 5.0% of our interest income from mortgage loans for the three months ended June 30, 2008. On October 7, 2008 we acquired the property through foreclosure for \$4.7 million, the amount of the debt outstanding and capitalized fees associated with the foreclosure. The property is being operated by a third party under a 10-year lease with two five-year renewal options. The lease provides for a 10-month rent abatement. The annual minimum rent is \$0.1 million for 2009, \$0.5 million for 2010, \$0.6 million for 2011 and increases 3% annually commencing January 1, 2012 and thereafter. Beginning January 1, 2011, total rent payable annually will be equal to 25% of gross revenues but never less than the minimum rent as defined by the lease agreement. We agreed to provide funding up to \$0.9 million for specific capital improvements to the leased property with the yield included in the initial lease rate. The capital improvements deadline is October 7, 2010. See *Item 8. FINANCIAL STATEMENTS Note 11. Commitments and Contingencies* for further discussion about our commitment agreements.

During the year ended December 31, 2008 we did not receive August, September, October or November payments on a master lease covering a 109-unit assisted living property in Vacaville, California and a 113-unit assisted living property in Bakersfield, California operated by Sunwest. The total monthly lease payment under the master lease agreement was approximately \$0.2 million per month or approximately 4.5% of our monthly rental income as of August 2008. Accordingly we did not record rental income of \$0.8 million and wrote-off \$0.1 million of straight-line rent receivable in 2008 related to this lease. Our total gross investment in the properties under the master lease is approximately \$26.2 million or 4.5% of our gross investments in real estate as of December 31, 2008. As of December 31, 2008, single purpose subsidiaries owned by us owed debt obligations totaling \$16.1 million secured by the master lease properties. Specifically, the outstanding principal balance on

the Bakersfield property was \$8.2 million at a rate of 8.43% and is due October 1, 2009, and the outstanding principal balance on the Vacaville property was \$7.9 million at a rate of 8.69% and is due August 1, 2010. On December 1, 2008, we leased these properties to a third party under a 10-year lease with two five-year renewal options. The annual minimum rent will be \$1.8 million for the first lease year, \$2.1 million for the second lease year, \$2.5 million for the third lease year and increases 3% annually commencing on December 1, 2011 and thereafter. We agreed to provide capital improvement funding up to \$1.5 million allocated in two tranches of \$0.8 million each. The yield on the first tranche is included in the initial lease rate and the second tranche is at an 8.5% yield. The capital improvement deadline is December 1, 2010. See *Item 8. FINANCIAL STATEMENTS Note 11. Commitments and Contingencies* for further discussion about our commitment agreements.

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 or mortgage loans. 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				
	12/31/08	9/30/08	6/30/08	3/31/08	12/31/07
	(gross investment, in thousands)				
Asset mix:					
Real property	\$502,617	\$497,656	\$496,114	\$495,202	\$492,880
Loans receivable	78,301	87,581	91,040	91,955	92,168
Investment asset mix:					
Assisted living properties	\$282,084	\$282,304	\$282,406	\$275,313	\$274,333
Skilled nursing properties	285,814	289,913	291,728	298,824	297,695
Schools	13,020	13,020	13,020	13,020	13,020
Operator asset mix:					
Alterra(1)	\$84,210	\$84,210	\$84,210	\$84,210	\$84,210
Preferred Care, Inc.(2)	87,150	87,281	87,490	93,197	92,042
ALC	88,034	88,034	88,034	88,034	88,034
Remaining operators	321,524	325,712	327,420	321,716	320,762

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	Period Ended				
	12/31/08	9/30/08	6/30/08	3/31/08	12/31/07
(gross investment, in thousands)					
Geographic asset mix:					
Colorado	\$ 27,706	\$ 27,581	\$ 27,581	\$ 27,581	\$ 27,518
Florida	43,884	43,930	43,975	47,368	46,385
Ohio	56,804	56,804	55,862	55,121	54,010
Texas	104,197	104,637	106,568	102,245	101,721
Washington	27,355	27,376	27,412	27,504	27,593
Remaining states	320,972	324,909	325,756	327,338	327,821

(1) Subsequent to December 31, 2008, the name Alterra Healthcare Corporation was changed to Brookdale Senior Living Communities, Inc.

(2) Preferred Care, Inc. leases 25 skilled nursing properties under two master leases, one skilled nursing property under a separate lease agreement and operates seven skilled nursing properties securing six mortgage loans receivable we have with unrelated third parties and one mortgage loan receivable we have with Preferred Care. They also operate one skilled nursing facility under a sub-lease with another lessee which is not included in the Preferred Care operator mix.

Credit Strength. We measure our credit strength both in terms of leverage ratios and coverage ratios. Our leverage ratios include debt to book capitalization and debt to market capitalization. The leverage ratios indicate how much of our balance sheet capitalization is related to long-term debt. Our coverage ratios include interest coverage ratio and fixed charge coverage ratio. The coverage ratios indicate our ability to service interest and fixed charges (interest plus preferred dividends). The coverage ratios are based on earnings before interest, taxes, depreciation and amortization. Leverage ratios and coverage ratios are widely used by investors, analysts and rating agencies in the valuation, comparison, rating and investment recommendations of companies. The following table reflects the recent historical trends for our credit strength measures:

	Three Months Ended				
	12/31/08	9/30/08	6/30/08	3/31/08	12/31/07
Debt to book capitalization ratio(5)	7.4%	7.4%	7.4%(4)	10.0%	9.8%
Debt & Preferred Stock to book capitalization ratio(5)	45.8%	45.6%	45.5%(4)	47.0%	49.1%
Debt to market capitalization ratio(5)	5.5%(1)	4.2%	4.6%(4)	6.2%	6.4%
Debt & Preferred Stock to market capitalization ratio(5)	30.2%(1)	23.1%	26.9%(4)	28.7%	30.1%
Interest coverage ratio	15.4x(2)	17.1x(3)	15.0x(3)	13.6x	13.0x
Fixed charge coverage ratio	3.1x	3.2x	3.3x	3.2x	2.9x

(1) Increase primarily due to the decrease in market capitalization.

(2) This decrease is due primarily to non-payment of rental income and mortgage interest income from affiliates of Sunwest Management, Inc., loan pay-offs and lower invested cash balances at lower interest rates, partially offset by lower interest expense due to debt paid off in 2008. Additionally in the fourth quarter of 2008 we incurred \$0.6 million of one-time charges related primarily to lease/loan defaults and terminated transactions. See *Key Transactions* above for further discussion on Sunwest non-payment.

(3) Increase primarily due to decrease in interest expense relating to repayment of a \$14.2 million mortgage loan secured by four assisted living properties located in Ohio.

(4) Decrease due to repayment of a \$14.2 million mortgage loan secured by four assisted living properties located in Ohio.

(5)

Excludes minority interest.

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We evaluate our key performance indicators in conjunction with current expectations to determine if historical trends are indicative of future results. Our expected results may not be achieved and actual results may differ materially from our expectations. This may be a result of various factors, including, but not limited to

The status of the economy;

The status of capital markets, including prevailing interest rates;

Compliance with and changes to regulations and payment policies within the health care industry;

Changes in financing terms;

Competition within the health care and senior housing industries; and

Changes in federal, state and local legislation.

Management regularly monitors the economic and other factors listed above. We develop strategic and tactical plans designed to improve performance and maximize our competitive position. Our ability to achieve our financial objectives is dependent upon our ability to effectively execute these plans and to appropriately respond to emerging economic and company-specific trends.

Operating Results

Year ended December 31, 2008 compared to year ended December 31, 2007

Revenues for the year ended December 31, 2008 decreased to \$69.4 million from \$74.8 million for the same period in 2007 primarily due to decreases resulting from Sunwest non-payment of rental and interest income, decreases in interest income from mortgage loans and decreases in interest and other income, as discussed below. See *Key Transactions* above for further discussion on Sunwest non-payment of rental income and interest income. Rental income decreased \$0.3 million primarily as a result of decreases resulting from non-payment of rental income primarily from Sunwest (\$1.0 million) and lower straight-line rent and amortization of lease costs (\$1.3 million) partially offset by rental increases provided for in existing lease agreements (\$2.0 million). Same store rental income, properties owned for both years ended December 31, 2008 and 2007, and excluding straight-line rental income increased \$2.0 million due to rental increases provided for in existing lease agreements.

Interest income from mortgage loans and notes receivable decreased \$2.8 million primarily as a result of mortgage loan payoffs and Sunwest non-payment of interest income, as described in *Key Transactions* above.

Interest and other income decreased \$2.4 million in 2008 from the prior year primarily due to the early redemption of \$3.5 million face value of the Skilled Healthcare Group, Inc. (or SHG) Senior Subordinated Notes in 2007 and lower interest income from our investments of cash resulting from lower interest rates and lower cash balances. See *Item 8. FINANCIAL STATEMENTS Note 8. Marketable Securities* for further discussion of the SHG Senior Subordinated Notes early redemption.

Interest expense decreased \$0.8 million in 2008 from the prior year primarily due to a decrease in average debt outstanding during the period resulting from the repayment of a \$14.2 million mortgage loan and normal amortization of existing mortgage loans. See *Item 8. FINANCIAL STATEMENTS Note 9. Debt Obligations* for further discussion of the debt payoff.

Depreciation and amortization expense in 2008 increased \$0.7 million from the prior year due to acquisitions and capital improvements made on existing properties. See *Item 8. FINANCIAL STATEMENTS Note 6. Real Estate Investments*.

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Operating and other expenses decreased \$0.4 million primarily due to a decrease in restricted stock vesting, as described in *Item 8. FINANCIAL STATEMENTS Note 10. Stockholders' Equity*, partially offset by an increase in straight-line rent receivable reserve and increase of one-time charges in the fourth quarter of 2008 related primarily to lease/loan defaults and terminated transactions.

Net income available to common stockholders for the year ended December 31, 2008 decreased \$2.3 million from the same period in 2007 due to the changes previously described above and offset by a \$0.1 million gain on sale of a vacant parcel of land adjacent to a skilled nursing property located New Mexico, a \$1.0 million EITF D-42, "*The effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock*," allocation of net income available to common shareholders related to the repurchase of 636,300 shares of our 8.0% Series F Cumulative Preferred Stock (or Series F preferred stock) and a \$1.5 million decrease in preferred stock dividends primarily due to the repurchase of our Series F preferred stock. See *Item 8. FINANCIAL STATEMENTS Note 10. Stockholders' Equity* for further discussion on the Series F preferred stock buyback. During the year ended December 31, 2007, we recognized a \$0.1 million gain related to the sale of a closed, previously impaired, skilled nursing property located in Texas and a 59-bed skilled nursing property located in Tennessee.

Year ended December 31, 2007 compared to year ended December 31, 2006

Revenues for the year ended December 31, 2007, were \$74.8 million compared to \$73.2 million for the same period in 2006. Rental income increased \$5.5 million primarily as a result of properties acquired in 2006 (\$1.1 million), rental increases provided for in existing lease agreements (\$1.5 million), a new master lease entered into during the fourth quarter of 2006 (\$1.7 million) and increase in straight-line rental income net of amortization of lease costs (\$1.2 million). Same store rental income, properties owned for both years ended December 31, 2007 and 2006, and excluding straight-line rental income increased \$3.2 million due to rental increases provided for in existing lease agreements (\$1.5 million) and a new master lease entered into during the fourth quarter of 2006 (\$1.7 million).

Interest income from mortgage loans and notes receivable decreased \$2.9 million primarily as a result of mortgage loan payoffs.

Interest and other income decreased \$0.9 million in 2007 from the prior year primarily as a result of note receivable payoffs (\$0.4 million) and a decrease in other income received in conjunction with early payoff of mortgage loans (\$0.5 million).

Interest expense decreased \$2.1 million in 2007 from the prior year primarily due to a decrease in outstanding borrowings as a result of the payoff of mortgage loans, and bond obligations in 2006.

Depreciation and amortization expense in 2007 increased \$0.5 million from the prior year due to acquisitions in 2006 and capital improvements made on existing properties. See *Item 8. FINANCIAL STATEMENTS Note 6. Real Estate Investments*.

Operating and other expenses increased \$0.5 million primarily due to the vesting of restricted stock and stock options (\$1.2 million), post retirement healthcare benefits vesting during the year (\$0.3 million) partially offset by a \$1.0 million expense related to an IRS settlement in 2006, as described in *Item 8. FINANCIAL STATEMENTS Note 2. Summary of Significant Accounting Policies*.

Non-operating income decreased by \$0.5 million as a result of a gain recognized in 2006 from the sale of the National Health Investors, Inc. (or NHI) common stock, as described in *Item 8. FINANCIAL STATEMENTS Note 8. Marketable Securities*.

For the year ended December 31, 2007, net income from discontinued operations was \$0.1 million. During 2007 we recognized a \$0.1 million gain resulting from the sale of a closed, previously impaired skilled nursing property located in Texas and a 59-bed skilled nursing property located in Tennessee. For the year ended December 31, 2006, net income from discontinued operations was \$33.3 million.

During 2006 we sold four assisted living properties in various states with a total of 431 units and one 174-bed skilled nursing property in Arizona. We recognized a gain of \$32.6 million on the two transactions. During 2006 we realized \$0.7 million in income from discontinued operations related to the properties that were sold in 2006 and 2007. This reclassification was made in accordance with SFAS No. 144 which requires that the financial results of properties meeting certain criteria be reported on a separate line item called "Discontinued Operations."

Net income available to common stockholders for the year ended December 31, 2007, was \$30.8 million compared to \$61.6 million for the year ended December 31, 2006. This decrease is due primarily to a gain on the sale of assets in 2006 and the decrease in mortgage interest income partially offset by increase in rental income and decrease in interest expense as previously discussed.

Critical Accounting Policies

Preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. See *Item 8. FINANCIAL STATEMENTS Note 2. Summary of Significant Accounting Policies* for a description of the significant accounting policies we followed in preparing the consolidated financial statements for all periods presented. We have identified the following significant accounting policies as critical accounting policies in that they require significant judgment and estimates and have the most impact on financial reporting.

Impairments. 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 and impairment losses are calculated as the excess of the carrying amount over the fair value of assets to be held and used, and the carrying amount over the fair value less cost to sell in instances where management has determined that we will dispose of the property as required by SFAS No. 144 "*Accounting for the Impairment or Disposal of Long-Lived Assets.*" In determining fair value, we use current appraisals or other third party opinions of value and other estimates of fair value such as estimated undiscounted future cash flows.

In accordance with SFAS No. 114 "*Accounting by Creditors for Impairment of a Loan*" we evaluate the carrying values of mortgage loans receivable on an individual basis. Management periodically evaluates the realizability of future cash flows from the mortgages when events or circumstances, such as the non-receipt of principal and interest payments and/or significant deterioration of the financial condition of the borrower, indicate that the carrying amount of the mortgage loan receivable may not be recoverable. An impairment charge is recognized in current period earnings and is calculated as the difference between the carrying amount of the mortgage loan receivable and the discounted cash flows expected to be received, or if foreclosure is probable, the fair value of the collateral securing the mortgage.

Mortgage Loans Receivable. Mortgage loans receivable are recorded on an amortized cost basis. We maintain a valuation allowance based upon the expected collectibility of our mortgage loans receivable. Changes in the valuation allowance are included in current period earnings.

Revenue Recognition. Interest income on mortgage loans is recognized using the effective interest method. We follow a policy related to mortgage interest whereby we consider a loan to be non-performing after 60 days of non-payment of amounts due and do not recognize unpaid mortgage interest income from that loan until the past due amounts have been received.

Rental income from operating leases is recognized in accordance with U.S. generally accepted accounting principles, including Statement of Financial Accounting Standards No. 13 "*Accounting for Leases*" (or SFAS No. 13) and SEC Staff Accounting Bulletin No. 101 "*Revenue Recognition*" (or SAB

No.101) as amended by SEC Staff Bulletin No. 104 "*Revenue Recognition in Financial Statements*" (or SAB No. 104). Substantially all of our leases contain provisions for specified annual increases over the rents of the prior year and are generally computed in one of four methods depending on specific provisions of each lease as follows: (i) a specified annual increase over the prior year's rent, generally between 2.0% and 2.5%; (ii) an increase based on the change in the Consumer Price Index from year to year; (iii) an increase derived as a percentage of facility net patient revenues in excess of base revenue amounts or (iv) specific dollar increases over prior years. SAB No. 104 does not provide for the recognition of contingent revenue until all possible contingencies have been eliminated. We consider the operating history of the lessee and the general condition of the industry when evaluating whether all possible contingencies have been eliminated and have historically, and expect in the future, to not include contingent rents as income until received. We follow a policy related to rental income whereby we consider a lease to be non-performing after 60 days of non-payment of past due amounts and do not recognize unpaid rental income from that lease until the amounts have been received.

Rental revenues relating to non-contingent leases that contain specified rental increases over the life of the lease are recognized on the straight-line basis. Recognizing income on a straight-line basis requires us to calculate the total non-contingent rent containing specified rental increases over the life of the lease and to recognize the revenue evenly over that life. This method results in rental income in the early years of a lease being higher than actual cash received, creating a straight-line rent receivable asset included in our balance sheet. At some point during the lease, depending on its terms, the cash rent payments eventually exceed the straight-line rent which results in the straight-line rent receivable asset decreasing to zero over the remainder of the lease term. We assess the collectibility of straight-line rent in accordance with the applicable accounting standards and our reserve policy and defer recognition of straight-line rent if its collectibility is not reasonably assured.

We will defer recognition of the straight-line rental income if the lessee becomes delinquent in rent owed under the terms of the lease. If it is determined that the delinquency is temporary, we will resume booking rent on a straight-line basis once payment is received for past due rents. If it appears that we will not collect future rent under the delinquent lease, we may provide a reserve against the previously recognized straight-line rent receivable asset for a portion, up to its full value, that we estimate may not be recoverable. At December 31, 2008 and 2007 the straight-line rent receivable balance, net of reserves, was \$13.9 million and \$10.5 million on our balance sheet. We evaluate the collectibility of straight-line rent receivable balances on an ongoing basis and provide reserves against receivables we believe may not be fully recoverable. The ultimate amount of straight-line rent we realize could be less than amounts recorded.

Net loan fee income and commitment fee income are amortized over the life of the related loan. Costs associated with leases are deferred and allocated over the lease term in proportion to the recognition of rental income as required by SFAS No. 13 "*Accounting for Leases*."

Liquidity and Capital Resources

Financing Activities:

During 2008, we used \$82.9 million in cash in financing activities. We paid \$15.5 million in principal on mortgage loans and bonds payable including \$14.2 million related to the payoff of a mortgage loan payable secured by four assisted living properties located in Ohio. We also paid cash dividends on our Series C, Series E, and Series F preferred stocks totaling \$3.3 million, \$0.2 million and \$12.3 million respectively. Additionally, we declared and paid cash dividends on our common stock totaling \$36.0 million. Subsequent to December 31, 2008 we declared a monthly cash dividend of \$0.13 per share on our common stock for the months of January, February and March 2009, payable on January 30, February 27 and March 31, 2009, respectively, to stockholders of record on January 22, February 19 and March 23, 2009, respectively.

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In June 2007 our Board of Directors terminated the prior existing share repurchase program and authorized a new share repurchase program enabling us to repurchase up to 5,000,000 shares of our common stock. In January 2008, the Board of Directors amended the share repurchase program to include authorization to repurchase our outstanding preferred securities. During the year ended December 31, 2008, we invested \$14.3 million to repurchase a total of 636,300 shares of our 8.0% Series F Cumulative Preferred Stock (or Series F preferred stock) at an average cost of \$22.44 per share, including commissions. The Series F preferred stock has a liquidation value of \$25.00 per share. As required by EITF D-42, "The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock," the discounted purchase price on these shares, which is the liquidation value over the fair value, is reflected on the income statement netted with the original issue discount and is added to net income in calculating the allocation of net income available to common shareholders. After this purchase, 6,003,700 shares of our Series F preferred stock remained issued and outstanding. We continue to have an open Board authorization to purchase an additional 3,470,621 shares of our outstanding equity securities.

Additionally, we received \$0.4 million in conjunction with the exercise of 17,500 stock options. The total market value as of the dates of exercise was approximately \$0.5 million.

During 2008, holders of 123,419 shares of our 8.5% Series E Cumulative Convertible Preferred Stock (or Series E Preferred Stock) notified us of their election to convert such shares into 246,838 shares of our common stock at the Series E Preferred Stock conversion rate of \$12.50 per share. Subsequent to December 31, 2008, holders of 900 shares of our Series E Preferred Stock notified us of their election to convert such shares into 1,800 shares of common stock. After this most recent conversion, there are 37,816 shares of our Series E Preferred Stock outstanding.

During the year ended December 31, 2008, one of our limited partners redeemed a portion of its interest in the limited partnership. In accordance with the limited partnership agreement, we paid \$0.5 million for the redemption of 22,000 shares owned by the limited partner. Since the market value of the common stock converted was greater than the book value of the partnership interests received, we recognized a \$0.1 million increase in the basis of the properties underlying the limited partnership interest acquired. This conversion had an immaterial effect on minority interest expense. Subsequent to this conversion we have 179,882 shares of our common stock reserved for this partnership agreement. At December 31, 2008 the carrying value (excluding accrued preferred returns) and the market value of the partnership conversion rights are \$3.1 million and \$3.6 million, respectively.

During the year ended December 31, 2008, we amended and extended our Unsecured Revolving Credit Agreement at an initial commitment amount of \$80.0 million. The Credit Agreement provides for the opportunity to increase the credit amount up to a total of \$120.0 million. The prior agreement did not have an expansion provision. The Credit Agreement provides a revolving line of credit with no scheduled maturities other than the maturity date of July 17, 2011. The pricing under the Credit Agreement based on our borrowing election is Prime Rate plus 0.50% or LIBOR plus 1.50% which remained the same as under our prior credit agreement. At the time of borrowing, we may elect the 1, 2, 3 or 6 month LIBOR rate. Under financial covenants contained in the Unsecured Credit Agreement which are measured quarterly we are required to maintain, among other things:

- (i) a ratio, of total indebtedness to total asset value, not greater than .5 to 1.0,
- (ii) a ratio not greater than .35 to 1.0 of secured debt to total asset value
- (iii) a ratio not less than 2.5 to 1.0 of EBITDA to interest expense, and
- (iv) a ratio of not less than 1.50 to 1.0 of EBITDA to fixed charges.

At December 31, 2008, we had no outstanding borrowings under our Unsecured Revolving Credit Agreement and the full amount was available for borrowing. Also, at December 31, 2008 we were in compliance with all covenants.

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As of December 31, 2008, we are obligated to make scheduled principal payments on our mortgage loans and bonds payable. The total scheduled principal payments and debt maturities in 2009 through 2013 and thereafter is approximately \$24.8 million, \$8.2 million, \$0.5 million, \$0.6 million, \$0.6 million and \$2.0 million, respectively.

Available Shelf Registrations:

During 2007, we filed a Form S-3 "shelf" registration statement which became effective August 7, 2007, and provides us with the capacity to offer up to \$300.0 million in our debt and/or equity securities. We currently have \$300.0 million of availability under our effective shelf registration. We may from time to time raise capital under our currently effective shelf registration or a new shelf registration by issuing, in public or private transactions, our equity and debt securities, but the availability and terms of such issuance will depend upon then prevailing market and other conditions.

Operating and Investing Activities:

At December 31, 2008, our real estate investment portfolio (before accumulated depreciation and amortization) consisted of \$502.6 million invested primarily in owned long-term care properties and mortgage loans of approximately \$78.3 million (prior to deducting a \$0.8 million reserve). Our portfolio consists of direct investments (properties that we either own or on which we hold promissory notes secured by first mortgages) in 101 skilled nursing properties, 101 assisted living properties and two schools. These properties are located in 30 states. During the year ended December 31, 2008, net cash provided by operating activities was \$56.4 million.

For the year ended December 31, 2008 we recorded \$3.5 million in straight-line rent in accordance with SFAS No. 13. "Accounting for Leases." Straight-line rental income on a same store basis will increase from \$3.5 million for annual 2008 to \$4.1 million for projected annual 2009 assuming no new leased investments with fixed annual rental escalations are added to our portfolio. Also during the year ended December 31, 2008 we recorded a \$0.1 million straight-line rent receivable reserve. During the year ended December 31, 2008 we received \$54.7 million of cash rental revenue and recorded \$0.6 million of lease inducement costs. At December 31, 2008 and 2007, the straight-line rent receivable balance, net of reserves, on the balance sheet was \$13.9 million and \$10.5 million, respectively.

In 2008 we had net cash provided by investing activities of \$5.0 million. We invested \$3.0 million at an average yield of approximately 10.0% under agreements to renovate 13 properties operated by seven different operators. Additionally, we invested \$1.4 million in capital improvements to existing properties under various lease agreements whose rental rates already reflected this investment.

During 2008 we sold for \$0.6 million a vacant parcel of land adjacent to a skilled nursing property in New Mexico to a third party. We received net cash proceeds of \$0.6 million and recognized a \$0.1 million gain on sale. We also acquired a 30-bed skilled nursing property located in Ohio for an aggregate price of \$1.0 million that was added to an existing master lease at a 10.0% yield and we agreed to provide funding up to \$2.0 million to purchase land, construct and equip a new replacement building which will be a combined skilled nursing and assisted living property. This investment will be at the higher of one-year LIBOR plus 5.3% or 10.0% and construction must be completed by January 18, 2011.

During 2008 we also acquired, via foreclosure sale, a 140-unit independent living property in Fort Worth, Texas for \$4.7 million. The purchase price represented the amount of the debt outstanding on a first mortgage to an affiliate of Sunwest and capitalized fees associated with the foreclosure. See *Key Transactions* above for further discussion on Sunwest non-payment. The property is being operated by a third party under a 10-year lease with two five-year renewal options. The lease provides for a 10-month rent abatement. The annual minimum rent is \$0.1 million for the first lease year, \$0.5 million for the second lease year, \$0.6 million for the third lease year and increases 3% annually commencing January 1, 2012 and thereafter. Beginning January 1, 2011, total rent payable annually will be equal to

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25% of gross revenues but never less than the minimum rent as defined by the lease agreement. We agreed to provide funding up to \$0.9 million for specific capital improvements on the leased property with the yield included in the initial lease rate. The capital improvements deadline is October 7, 2010. See *Item 8. FINANCIAL STATEMENTS Note 11. Commitments and Contingencies* for further discussion about our commitment agreements.

Additionally, during 2008, we invested \$9.1 million, net of closing fees, in three mortgage loans. One loan secured by an assisted living property in Florida with 41 units in the amount of \$1.0 million has an initial interest rate of 10.5%, increasing 0.125% annually, with a 25-year amortization and matures in November 2009. The second loan secured by six assisted living properties located in Texas with 108 units in the amount of \$6.8 million has an initial interest rate of 9.5%, increasing 0.15% annually, with a 20-year amortization and matures in June 2018. The final loan secured by a skilled nursing property located in Utah with 84 beds in the amount of \$1.4 million has an initial interest rate of 10.0% increasing 0.15% annually, with a 20-year amortization and matures in 11 years. We also invested \$0.6 million under three mortgage loans for capital improvements at an average rate of 11.1%. During 2008, we received \$14.2 million plus accrued interest related to the payoff of nine mortgage loans secured by nine skilled nursing properties and received \$4.7 million in regularly scheduled principal payments.

During 2008 we funded \$0.4 million under various loans and line of credit agreements with certain operators. Additionally, we received \$0.8 million in principal payments on notes receivable.

Commitments.

The following table summarizes our capital improvement commitments as of December 31, 2008 (*dollar amounts in thousands*):

Original Commitment(9)	Expiration Date	Investment at 12/31/08	Open Commitment	Estimated Yield	Property Type	Properties	Major Operator
\$ 650	3/31/2009	\$ 124	\$ 526	13.00%(1)	SNF	1	N/A
2,500	12/4/2009		2,500	10.00%(2)	ALF	35	Alterra
500	3/31/2010	273	227	11.00%(2)	SNF	1	Preferred Care
2,000	3/31/2010		2,000	11.00%(1)	SNF	1	Preferred Care
4,000	3/31/2010		4,000	11.00%(1)	SNF	1	Preferred Care
875	10/7/2010	7(8)	868	(6)	ALF	1	N/A
2,500	6/16/2010	2	2,498	10.00%(1)	SNF	1	N/A
1,500	12/1/2010		1,500	(5)	ALF	2	N/A
2,000	1/18/2011		2,000	(4)(1)	SNF	1	N/A
5,000(7)	12/31/2014		5,000(7)	(3)	ALF	37	ALC
\$ 21,525		\$ 406	\$ 21,119				

-
- (1) Minimum rent will increase upon final funding and project completion or in some cases, the improvement deadline as defined in each lease agreement.
- (2) Minimum rent will increase on the 1st of each month by the amount advanced in the previous month.
- (3) 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).
- (4) The higher of one-year LIBOR plus 5.3% or 10%
- (5)

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The commitment is allocated in two tranches of \$0.8 million each. The yield for the first tranche is included in the initial lease rate; the yield for the second tranche is 8.5% with minimum rent increases as per Footnote (2).

- (6) The yield is included in the initial lease rate.
- (7) \$5 million per year for the life of the lease.

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- (8) Subsequent to December 31, 2008, we invested an additional \$0.1 million under this agreement.
- (9) Subsequent to December 31, 2008, we committed to provide a lessee with capital improvement commitment of \$0.1 million for specific capital improvements to the skilled nursing property they lease from us. It is available in two tranches of \$50,000 each. The yield for the first tranche is built in to the lease payments; the yield for the second tranche is 10% with a minimum rent increase upon the earlier of the improvement deadline or final funding and project completion.

The following table summarizes our loan commitments as of December 31, 2008 (*dollar amounts in thousands*):

Original Commitment(1)	Expiration Date	Investment at 12/31/08	Open Commitment at 12/31/08	Yield	Property Type	Properties	Major Operator
\$ 400	1/1/2009(3)	\$ 107	\$ 293	(2)	SNF	1	N/A
200	3/31/2009	20	180	10.00%	SNF	1	N/A
450	6/30/2009	250	200	8.75%	SNF	3	N/A
\$ 1,050		\$ 377	\$ 673				

- (1) Subsequent to December 31, 2008, we committed to provide the following accounts receivable financing: (a) A loan with a credit limit not to exceed \$20,000 with an interest rate of 10% and a maturity date of July 31, 2009 on an assisted living property, and (b) a loan with a credit limit not to exceed \$0.1 million with an interest rate of 10% and a maturity date of December 31, 2009 on a skilled nursing property. To date, no funds have been requested under either of these agreements.
- (2) The principal balance of the loan will increase on the date any funds are disbursed by an amount equal to such funding and shall bear interest at the then current interest rate of the existing loan. The monthly loan payment will increase at each increase to the principal balance. The interest rate at December 31, 2008 is 10.6%
- (3) Subsequent to December 31, 2008, the maturity date was extended to July 1, 2009.

Contractual Obligations:

We monitor our contractual obligations and commitments detailed above to ensure funds are available to meet obligations when due. The following table represents our long-term contractual obligations (scheduled principal payments and amounts due at maturity) as of December 31, 2008, and excludes the effects of interest (*amounts in thousands*):

	Total	2009	2010 2011	2012 2013	Thereafter
Mortgage loans payable	\$32,063	\$24,378	\$ 7,685	\$	\$
Bonds payable	4,690	465	1,025	1,165	2,035
	\$36,753	\$24,843	\$ 8,710	\$ 1,165	\$ 2,035

Off-Balance Sheet Arrangements:

We had no off-balance sheet arrangements as of December 31, 2008.

Liquidity:

We have an Unsecured Credit Agreement in the amount of \$80.0 million and it provides for the opportunity to increase the credit amount up to a total of \$120.0 million. The Credit Agreement provides a revolving line of credit with no scheduled maturities other than the maturity date of July 17, 2011. The pricing under the Credit Agreement based on our borrowing election is Prime Rate plus 0.50% or LIBOR plus 1.50%. At the time of borrowing, we may elect the 1, 2, 3 or 6 month LIBOR rate.

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At December 31, 2008, we had \$21.1 million of cash on hand and \$80.0 million available on our unsecured line of credit. In calendar year 2009, we have debt maturities of \$8.1 million due in October 2009 at an interest rate of 8.43% and \$15.8 million due in December 2009 at an interest rate of 8.81%. The October maturity may be paid 90 days early and the December maturity may be paid six months early. In calendar year 2009, we have mortgage receivables of \$7.6 million maturing in November. We believe that our current cash balance, cash flow from operations available for distribution or reinvestment, and our current unsecured line of credit borrowing capacity are sufficient to provide for payment of our current operating costs and debt obligations and to provide funds for distribution to the holders of our preferred stock and pay common dividends at least sufficient to maintain our REIT status. The timing, source and amount of cash flows provided by financing activities and used in investing activities are sensitive to the capital markets environment, especially to changes in interest rates. The current turmoil in the debt and equity markets preclude us from, at this time, being able to determine if there is availability of cost-effective long-term capital for significant additional capital investments for calendar 2009.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

You are cautioned that statements contained in this section are forward looking and should be read in conjunction with the disclosure under the heading "Cautionary Statements" and the "Risk Factors" set forth above.

We are exposed to market risks associated with changes in interest rates as they relate to our mortgage loans receivable and debt. Interest rate risk is sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors that are beyond our control.

We do not utilize interest rate swaps, forward or option contracts or foreign currencies or commodities, or other types of derivative financial instruments nor do we engage in "off-balance sheet" transactions. The purpose of the following disclosure is to provide a framework to understand our sensitivity to hypothetical changes in interest rates as of December 31, 2008.

Our future earnings, cash flows and estimated fair values relating to financial instruments are dependent upon prevalent market rates of interest, such as LIBOR or term rates of U.S. Treasury Notes. Changes in interest rates generally impact the fair value, but not future earnings or cash flows, of mortgage loans receivable and fixed rate debt. For variable rate debt, such as our revolving line of credit, changes in interest rates generally do not impact the fair value, but do affect future earnings and cash flows.

At December 31, 2008, based on the prevailing interest rates for comparable loans and estimates made by management, the fair value of our mortgage loans receivable using a 7.5% discount rate was approximately \$88.9 million. A 1% increase in such rates would decrease the estimated fair value of our mortgage loans by approximately \$3.2 million while a 1% decrease in such rates would increase their estimated fair value by approximately \$3.4 million. A 1% increase or decrease in applicable interest rates would not have a material impact on the fair value of our fixed rate debt.

The estimated impact of changes in interest rates discussed above are determined by considering the impact of the hypothetical interest rates on our borrowing costs, lending rates and current U.S. Treasury rates from which our financial instruments may be priced. We do not believe that future market rate risks related to our financial instruments will be material to our financial position or results of operations. These analyses do not consider the effects of industry specific events, changes in the real estate markets, or other overall economic activities that could increase or decrease the fair value of our financial instruments. If such events or changes were to occur, we would consider taking actions to mitigate and/or reduce any negative exposure to such changes. However, due to the uncertainty of the specific actions that would be taken and their possible effects, the sensitivity analysis assumes no changes in our capital structure.

Item 8. FINANCIAL STATEMENTS

**Index to Consolidated Financial Statements
and Financial Statement Schedules**

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of LTC Properties, Inc.

We have audited the accompanying consolidated balance sheets of LTC Properties, Inc. (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. Our audits also included the financial statement schedules listed in the Index at Item 15. These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of LTC Properties, Inc. at December 31, 2008 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), LTC Properties, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 24, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California
February 24, 2009

LTC PROPERTIES, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

	December 31,	
	2008	2007
ASSETS		
Real Estate Investments:		
Buildings and improvements, net of accumulated depreciation and amortization: 2008 \$130,475; 2007 \$115,766	\$ 337,171	\$ 342,222
Land	34,971	34,429
Properties held for sale, net of accumulated depreciation and amortization: 2008 \$0; 2007 \$0		463
Mortgage loans receivable, net of allowance for doubtful accounts: 2008 \$760; 2007 \$890	77,541	91,278
Real estate investments, net	449,683	468,392
Other Assets:		
Cash and cash equivalents	21,118	42,631
Debt issue costs, net	831	326
Interest receivable	2,010	2,553
Straight-line rent receivable, net of allowance for doubtful accounts: 2008 \$140; 2007 \$0 (1)	13,900	10,548
Prepaid expenses and other assets	9,148	9,899
Notes receivable	2,895	3,292
Marketable debt securities (2)	6,468	6,464
Total assets	\$ 506,053	\$ 544,105
LIABILITIES AND STOCKHOLDERS' EQUITY		
Bank borrowings	\$	\$
Mortgage loans payable	32,063	47,165
Bonds payable and capital lease obligations	4,690	5,130
Accrued interest	251	349
Accrued expenses and other liabilities	5,015	5,381
Distributions payable	3,022	3,406
Total liabilities	45,041	61,431
Minority interests	3,134	3,518
Stockholders' Equity:		
Preferred stock \$0.01 par value: 15,000 shares authorized; shares issued and outstanding: 2008 8,042; 2007 8,802	189,560	208,553
Common stock: \$0.01 par value; 45,000 shares authorized; shares issued and outstanding: 2008 23,136; 2007 22,872	231	229
Capital in excess of par value	321,979	316,609
Cumulative net income	533,565	490,588
Other	735	956
Cumulative distributions	(588,192)	(537,779)
Total stockholders' equity	457,878	479,156
Total liabilities and stockholders' equity	\$ 506,053	\$ 544,105

(1)

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On December 31, 2008 and 2007, we had \$2,037,000 and \$1,502,000, respectively, in straight-line rent receivable from a lessee that qualifies as a related party because the lessee's Chief Executive Officer is on our Board of Directors. See *Note 12. Transactions with Related Party* for further discussion.

(2)

At December 31, 2008 and 2007, we had a \$6,500,000 face value investment in marketable securities issued by a lessee that qualifies as a related party because the lessee's Chief Executive Officer is on our Board of Directors. See *Note 12. Transactions with Related Party* for further discussion.

See accompanying notes.

LTC PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(In thousands, except per share amounts)

	Years ended December 31,		
	2008	2007	2006
Revenues:			
Rental income (1)	\$57,562	\$57,841	\$52,342
Interest income from mortgage loans			