

NATIONWIDE HEALTH PROPERTIES INC

Form 10-Q

May 04, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2006.

OR

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

For the transition period from to .

Commission file number 1-9028

NATIONWIDE HEALTH PROPERTIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland
(State or Other Jurisdiction of Incorporation

or Organization)

95-3997619
(I.R.S. Employer

Identification Number)

610 Newport Center Drive, Suite 1150

Newport Beach, California 92660

(Address of Principal Executive Offices)

(949) 718-4400

(Registrant's Telephone Number, Including Area Code)

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 whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

Shares of registrant's common stock, \$0.10 par value, outstanding at April 30, 2006: 74,739,376

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NATIONWIDE HEALTH PROPERTIES, INC.

FORM 10-Q

MARCH 31, 2006

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Table of Contents**Part I. Financial Information****Item 1. Financial Statements****NATIONWIDE HEALTH PROPERTIES, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

	March 31, 2006	December 31, 2005
	(Unaudited)	
	(Dollars in thousands)	
ASSETS		
Investments in real estate		
Real estate properties:		
Land	\$ 231,439	\$ 207,563
Buildings and improvements	1,998,752	1,835,183
	<u>2,230,191</u>	<u>2,042,746</u>
Less accumulated depreciation	(354,861)	(344,224)
	<u>1,875,330</u>	<u>1,698,522</u>
Mortgage loans receivable, net	83,729	87,553
	<u>1,959,059</u>	<u>1,786,075</u>
Cash and cash equivalents	12,399	10,005
Receivables	6,440	5,741
Assets held for sale	1,482	9,198
Other assets	84,333	56,201
	<u>\$ 2,063,713</u>	<u>\$ 1,867,220</u>
LIABILITIES AND STOCKHOLDERS EQUITY		
Borrowings under unsecured credit facility	\$ 335,000	\$ 224,000
Senior notes due 2006-2038	570,225	570,225
Notes and bonds payable	293,762	236,278
Accounts payable and accrued liabilities	61,338	55,685
	<u>1,260,325</u>	<u>1,086,188</u>
Minority interest	1,825	
Commitments and contingencies		
Stockholders' equity:		
Preferred stock \$1.00 par value; 5,000,000 shares authorized;		
Series A, 900,485 shares issued and outstanding at March 31, 2006 and December 31, 2005, stated at liquidation preference of \$100 per share	90,049	90,049
Series B, 1,064,500 shares issued and outstanding at March 31, 2006 and December 31, 2005, stated at liquidation preference of \$100 per share	106,450	106,450

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Common stock \$0.10 par value; 100,000,000 shares authorized; 68,889,376 and 67,811,117 issued and outstanding at March 31, 2006 and December 31, 2005, respectively	6,889	6,781
Capital in excess of par value	911,429	889,008
Cumulative net income	906,789	878,716
Cumulative dividends	(1,220,043)	(1,189,972)
	<u>801,563</u>	<u>781,032</u>
Total stockholders equity	<u>\$ 2,063,713</u>	<u>\$ 1,867,220</u>

See accompanying notes.

Table of Contents**NATIONWIDE HEALTH PROPERTIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

	Three Months Ended March 31,	
	2006	2005
	(In thousands, except per share amounts)	
Revenues:		
Rental income		
Triple net lease rent	\$ 55,646	\$ 46,852
Medical office building rent	1,917	
	<u>57,563</u>	<u>46,852</u>
Interest and other income	2,994	2,495
	<u>60,557</u>	<u>49,347</u>
Expenses:		
Interest and amortization of deferred financing costs	19,228	14,586
Depreciation and amortization	16,208	12,603
General and administrative	3,797	3,901
Medical office building operating expenses	999	
Impairment of assets		310
	<u>40,232</u>	<u>31,400</u>
Income before unconsolidated entity and minority interest	20,325	17,947
Income from unconsolidated joint venture		847
Minority interest in losses	(48)	
	<u>20,373</u>	<u>18,794</u>
Income from continuing operations	20,373	18,794
Discontinued operations:		
Gain on sale of facilities, net	7,210	33
Income (loss) from discontinued operations	490	(5,466)
	<u>7,700</u>	<u>(5,433)</u>
Net income	28,073	13,361
Preferred stock dividends	(3,791)	(3,982)
	<u>\$ 24,282</u>	<u>\$ 9,379</u>
Basic/diluted per share amounts:		
Income from continuing operations available to common stockholders	\$ 0.24	\$ 0.22

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Discontinued operations	\$ 0.11	\$ (0.08)
Income available to common stockholders	\$ 0.35	\$ 0.14
Dividends paid per share	\$ 0.38	\$ 0.37
Diluted weighted average shares outstanding	68,449	67,053

See accompanying notes.

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NATIONWIDE HEALTH PROPERTIES, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(Unaudited)

(In thousands)

	Preferred stock		Common stock		Capital in excess of par value	Cumulative net income	Cumulative dividends	Total stockholders equity
	Shares	Amount	Shares	Amount				
Balances at December 31, 2005	1,965	\$ 196,499	67,811	\$ 6,781	\$ 889,008	\$ 878,716	\$ (1,189,972)	\$ 781,032
Issuance of common stock			1,078	108	22,381			22,489
Stock option amortization					40			40
Net income						28,073		28,073
Preferred dividends							(3,791)	(3,791)
Common dividends							(26,280)	(26,280)
Balances at March 31, 2006	1,965	\$ 196,499	68,889	\$ 6,889	\$ 911,429	\$ 906,789	\$ (1,220,043)	\$ 801,563

See accompanying notes.

Table of Contents**NATIONWIDE HEALTH PROPERTIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	Three Months Ended March 31,	
	2006	2005
(In thousands)		
Cash flows from operating activities:		
Net income	\$ 28,073	\$ 13,361
Non-cash adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	16,208	12,603
Depreciation and amortization in discontinued operations	36	743
Gain on sale of facilities	(7,210)	(33)
Impairment of assets		7,169
Amortization of deferred financing costs	554	447
Equity in earnings from unconsolidated joint venture		(754)
Cash distribution from unconsolidated joint venture		550
Changes in operating assets and liabilities:		
Receivables	(699)	995
Other assets	(4,150)	1,605
Accounts payable and accrued liabilities	6,573	2,536
Net cash provided by operating activities	39,385	39,222
Cash flows from investing activities:		
Investment in real estate facilities	(146,278)	(56,545)
Deposit for real estate acquisitions	(8,000)	
Proceeds from sale of real estate facilities	19,194	2,126
Return of investment from unconsolidated joint venture		875
Investment in mortgage loans receivable	(692)	
Principal payments on mortgage loans receivable	5,147	421
Net cash used in investing activities	(130,629)	(53,123)
Cash flows from financing activities:		
Borrowings under unsecured revolving credit facility	180,000	101,000
Repayment of borrowings under unsecured revolving credit facility	(69,000)	(41,000)
Issuance of common stock, net	22,453	4,384
Contributions from minority interests	1,882	
Repayments of senior unsecured debt		(18,000)
Principal payments on notes and bonds payable	(11,385)	(2,755)
Dividends paid	(30,071)	(29,017)
Deferred financing costs	(241)	
Net cash provided by financing activities	93,638	14,612

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Increase in cash and cash equivalents	2,394	711
Cash and cash equivalents, beginning of period	10,005	8,473
	<u> </u>	<u> </u>
Cash and cash equivalents, end of period	\$ 12,399	\$ 9,184
	<u> </u>	<u> </u>

See accompanying notes.

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NATIONWIDE HEALTH PROPERTIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2006

(Unaudited)

1. Organization

Nationwide Health Properties, Inc., a Maryland corporation, is a real estate investment trust (REIT) specializing in investments in health care related senior housing and long-term care properties. Whenever we refer herein to NHP or to us or use the terms we or our, we are referring to Nationwide Health Properties, Inc. and its subsidiaries.

We primarily make our investments by acquiring an ownership interest in facilities and leasing them to unaffiliated tenants under triple-net master leases that pass all facility operating costs (insurance, property taxes, utilities, maintenance, capital improvements, etc.) through to the tenant. In addition, but intentionally to a much lesser extent because we view the risks of this activity to be greater, from time to time we extend mortgage loans and other financing to tenants. Currently, about 96% of our revenues are derived from our leases, with the remaining 4% from our mortgage loans and other financing.

We believe we have operated in such a manner as to qualify as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended. We intend to continue to qualify as such and therefore to distribute at least ninety percent (90%) of our REIT taxable income to our stockholders. If we qualify for taxation as a REIT, and we distribute 100% of our taxable income to our stockholders, we will generally not be subject to federal income taxes on our income that is distributed to stockholders. Accordingly, no provision has been made for federal income taxes.

As of March 31, 2006, we had investments in 448 health care facilities in 39 states, consisting of:

197 skilled nursing facilities;

214 assisted and independent living facilities;

7 continuing care retirement communities;

7 specialty hospitals;

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21 medical office buildings operated by a consolidated joint venture in which we have a 90% interest; and

2 assets held for sale.

Our facilities, other than the medical office buildings, are operated by 74 different tenants, including the following publicly traded companies:

	Number of Facilities Operated
American Retirement Corporation	16
Brookdale Senior Living, Inc.	100
Emeritus Corporation	23
Extendicare, Inc.	5
Genesis Healthcare	4
HEALTHSOUTH Corporation	2
Kindred Healthcare, Inc.	1
Sun Healthcare Group, Inc.	4

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NATIONWIDE HEALTH PROPERTIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

One tenant of our facilities accounted for 10% or more of our revenues at March 31, 2006, as follows:

Brookdale Senior Living, Inc.

15%

2. Summary of Significant Accounting Policies

Basis of Presentation

We have prepared the condensed consolidated financial statements included herein without audit. These financial statements include all adjustments that are, in the opinion of management, necessary for a fair presentation of the results of operations for the three-month periods ended March 31, 2006 and 2005 pursuant to the rules and regulations of the Securities and Exchange Commission. All such adjustments are of a normal recurring nature. Certain items in prior period financial statements have been reclassified to conform to current year presentation, including those required by Statement of Financial Accounting Standards (SFAS) No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS No. 144). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to these rules and regulations. Although we believe that the disclosures in the financial statements included herein are adequate to make the information presented not misleading, these condensed consolidated financial statements should be read in conjunction with our financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission. The results of operations for the three-month periods ending March 31, 2006 and 2005 are not necessarily indicative of the results for a full year.

Principles of Consolidation

The condensed consolidated financial statements include our accounts, the accounts of our wholly owned subsidiaries and the accounts of our majority owned and controlled joint ventures. All material intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Revenue Recognition

Rental income from operating leases is accrued as earned over the life of the lease agreements in accordance with accounting principles generally accepted in the United States. The majority of our leases do not contain step rent provisions. Interest income on real estate mortgages is recognized using the effective interest method based upon the expected payments over the lives of the mortgages. Additional rent, included in the caption Rental income, and additional interest, included in the caption Interest and other income, are generally computed as a percentage of facility net revenues in excess of base amounts or as a percentage of the increase in the Consumer Price Index. Additional rent and interest are generally calculated and payable monthly or quarterly, and the majority of our leases contain provisions such that total rent cannot decrease from one year to the next. While the calculations and payments are generally made on a quarterly basis, SEC Staff Accounting Bulletin No. 101 *Revenue Recognition in Financial Statements* (SAB No. 101) does not allow for the recognition of such revenue

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NATIONWIDE HEALTH PROPERTIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

until all possible contingencies have been eliminated. Most of our leases with additional rent contingent upon facility net patient revenues in excess of base amounts are structured as quarterly calculations so that all contingencies for revenue recognition have been eliminated at each of our quarterly reporting dates.

We have on occasion deferred the payment of rent for the first few months on leases for certain buildings we have constructed. In addition, we have occasionally deferred the payment of a portion or all of the monthly rent for the first few months on leases we have restructured with new tenants. Also, certain leases we entered into, primarily with regard to facilities returned to us by tenants in bankruptcy, have had reduced or free rent in the early months of the lease or fixed increases in future years. These deferred amounts are repaid over the remainder of the lease term. Although the payment of cash rent is deferred, rental income is recorded on a straight-line basis over the life of the lease. We received \$97,000 of cash in excess of revenues recorded during the three months ended March 31, 2006 and received \$325,000 of cash in excess of revenues recorded during the three months ended March 31, 2005. There was \$7,770,000 at March 31, 2006 and \$8,486,000 at December 31, 2005 of deferred rent receivables, net of reserves, recorded under the caption *Other assets* on the balance sheets. We evaluate the collectibility of the deferred rent balances on an ongoing basis and provide reserves against receivables we believe may not be fully recoverable. The ultimate amount of deferred rent we realize could be less than amounts currently recorded.

Gain on Sale of Facilities

We recognize sales of facilities only upon closing. Payments received from purchasers prior to closing are recorded as deposits. Gains on facilities sold are recognized using the full accrual method upon closing when the collectibility of the sales price is reasonably assured, we have received adequate initial investment from the buyer, we are not obligated to perform significant activities after the sale to earn the gain and other profit recognition criteria have been met. Gains may be deferred in whole or in part until the sales meet the requirements of gain recognition on sales of real estate under SFAS No. 66 *Accounting for Sales of Real Estate*.

Asset Impairment

We review our long-lived assets individually on a quarterly basis to determine if there are indicators of impairment in accordance with SFAS No. 144. Indicators may include, among others, the tenant's inability to make rent payments, operating losses or negative operating trends at the facility level, notification by the tenant that it will not renew its lease, a decision to dispose of an asset or changes in the market value of the property. For operating assets, if indicators of impairment exist, we compare the future estimated undiscounted cash flows from the expected use of the property to its net book value to determine if impairment exists. If the sum of the future estimated undiscounted cash flows is higher than the current net book value, in accordance with SFAS No. 144, we conclude no impairment exists. If the sum of the future estimated undiscounted cash flows is lower than the current net book value, we recognize an impairment loss for the difference between the net book value of the asset and its estimated fair market value. To the extent we decide to sell an asset, we recognize an impairment loss if the current net book value of the asset exceeds its fair value less costs to sell. The above analyses require us to determine whether there are indicators of impairment for individual assets, to estimate the most likely stream of cash flows from operating assets and to determine the fair value of assets that are impaired or held for sale. If our assumptions, projections or estimates regarding an asset change in the future, we may have to record an impairment charge to reduce or further reduce the net book value of the asset.

Collectibility of Receivables

We evaluate the collectibility of our mortgage loans and other receivables on a regular basis based on factors including, among others, payment history, the financial strength of the borrower and any guarantors, the

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NATIONWIDE HEALTH PROPERTIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

value of the underlying collateral, the operations and operating trends of the underlying collateral, if any, and current economic conditions. If our evaluation of these factors indicates we may not recover the full value of the receivable, we provide a reserve against the portion of the receivable that we estimate will not be recovered. This analysis requires us to determine whether there are factors indicating a receivable may not be fully collectible and to estimate the amount of the receivable that will not be collected. If our assumptions or estimates regarding the collectibility of a receivable change in the future, we may have to record a reserve to reduce or further reduce the carrying value of the receivable.

Accounting for Stock-Based Compensation

In 1999, we adopted the accounting provisions of SFAS No. 123 *Accounting for Stock-Based Compensation* (SFAS No. 123). In 2005, we adopted SFAS No. 123 (revised 2004) *Share-Based Payment* (SFAS No. 123R). SFAS No. 123 and SFAS No. 123R established a fair value based method of accounting for stock-based compensation. Accounting for stock-based compensation under SFAS No. 123 and SFAS No. 123R causes the fair value of stock options granted to be amortized as an expense over the vesting period and causes any dividend equivalents earned to be treated as dividends for financial reporting purposes. Restricted stock grants are valued at the fair value on the date of grant and amortized as an expense over the vesting period. Net income includes stock-based compensation expense of \$543,000 for the three-month period ended March 31, 2006 and \$330,000 for the three-month period ended March 31, 2005.

Land, Buildings and Improvements

We record properties at cost and use the straight-line method of depreciation for buildings and improvements over their estimated remaining useful lives of up to 40 years, generally 30 to 40 years. We review and adjust useful lives periodically. Depreciation expense was \$15,368,000 for the three months ended March 31, 2006 and \$12,347,000 for the three months ended March 31, 2005. We allocate the purchase price of a property based on management's estimate of its fair value between land, building and, if applicable, equipment as if the property were vacant. Historically, we have generally acquired properties and simultaneously entered into a new market rate lease for the entire property with one tenant. In certain instances we have acquired facilities subject to an in-place lease. Accordingly, in those instances, we may allocate a portion of purchase prices to the value of in-place leases. The costs to execute a lease and the value of above or below market leases at the time of the acquisition of a property are recorded as an intangible asset and amortized over the initial term of the lease to real estate amortization expense or rental revenues, as appropriate.

Impact of New Accounting Pronouncements

In June 2005, the Emerging Issues Task Force released Issue No. 04-5 *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights* (EITF 04-5). EITF 04-5 creates a framework for evaluating whether a general partner or a group of general partners controls a limited partnership or a managing member or a group of managing members controls a limited liability company and therefore should consolidate the entity. EITF 04-5 states that the presumption of general partner or managing member control would be overcome only when the limited partners or non-managing members have

certain specific rights as outlined in EITF 04-5. EITF 04-5 is effective immediately for all newly formed limited partnerships and for existing limited partnership agreements that are modified. EITF 04-5 is not expected to have a material impact on our results of operations or financial position.

3. Real Estate Properties

As of March 31, 2006, we had direct ownership of 184 skilled nursing facilities, 213 assisted and independent living facilities, six continuing care retirement communities and seven specialty hospitals. We lease

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NATIONWIDE HEALTH PROPERTIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

our owned facilities to single tenants under triple-net leases that are accounted for as operating leases. The leases generally have initial terms ranging from five to 21 years, and generally have two or more multiple-year renewal options. Approximately 84% of our facilities are leased under master leases. In addition, the majority of our leases contain cross-collateralization and cross-default provisions tied to other leases with the same tenant, as well as grouped lease renewals and grouped purchase options. Leases covering 340 facilities are backed by security deposits consisting of irrevocable letters of credit or cash totaling approximately \$62,000,000. Under the terms of the leases, the tenant is responsible for all maintenance, repairs, taxes, insurance and capital expenditures on the leased properties. No individual property held by us is material to us as a whole.

During the three months ended March 31, 2006, we acquired twelve skilled nursing facilities and two assisted and independent living facilities in three separate transactions for an aggregate investment of \$156,168,000, including the assumption of \$62,441,000 of mortgage financing. We also funded \$3,225,000 in expansions, construction and capital improvements at certain facilities in accordance with existing lease provisions. Such expansions, construction and capital improvements generally result in an increase in the minimum rents earned by us on these facilities either at the time of funding or upon completion of the project. At March 31, 2006, we have committed to fund additional expansions, construction and capital improvements of approximately \$31,000,000.

During the three-month period ended March 31, 2006, we sold four skilled nursing facilities to the tenants of the facilities pursuant to purchase options, none of which were previously transferred to assets held for sale, for net cash proceeds of \$9,954,000. We provided a mortgage loan related to the sale of two facilities to the former tenant in the amount of \$1,148,000, partially offset by a deferred gain of \$517,000 that will be recognized in proportion to principal payments received. The other sales resulted in a total gain of \$5,823,000 that is included in gain on sale of facilities in discontinued operations.

4. Mortgage Loans Receivable

As of March 31, 2006, we held 13 mortgage loans receivable secured by 13 skilled nursing facilities, one assisted living facility, one continuing care retirement community and one land parcel. In addition, we held one mortgage loan receivable secured by the skilled nursing portion of a continuing care retirement community that for facility count purposes is accounted for in the real estate properties above as a continuing care retirement community and therefore is not counted as a separate facility here. As of March 31, 2006, the mortgage loans receivable had a net book value of \$83,729,000 with individual outstanding balances ranging from \$631,000 to \$10,685,000 and maturities ranging from 2007 to 2024.

During the three months ended March 31, 2006, we funded one mortgage loan secured by two skilled nursing facilities we sold to the former tenant totaling \$1,148,000 and one mortgage loan secured by land for \$692,000. In addition, one mortgage loan was prepaid in the amount of \$5,003,000.

5. Medical Office Building Joint Venture

On December 6, 2005, we entered into a joint venture, NHP/Broe, LLC, with The Broe Companies to invest in medical office buildings. We hold a 90% equity interest in the venture and Broe holds 10%. Broe is the managing member, however the joint venture is consolidated by us. The accounting policies of the joint venture are consistent with those of the Company. No investments were made by or into this joint venture prior to 2006.

For the first 36 months of the joint venture, we will receive 100% of the proceeds of the joint venture until we have received a cumulative annual return of 8.5%, at which point Broe will receive 100% of the proceeds until it has received a cumulative annual return of 8.5%. If we have not received a cumulative annual return of

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8.5% after the first 36 months, distributions will go to the members in accordance with their ownership percentages until such time as we earn a cumulative annual return of 8.5% and then 100% to Broe until it has also achieved a cumulative annual return of 8.5%. Then distributions shall be made 65% to us and 35% to Broe until we have achieved a cumulative annual return of 10.5%. Thereafter distributions will be made 50% to each party.

During the three months ended March 31, 2006, the joint venture acquired 21 medical office buildings in six states. The purchase price totaled \$55,985,000, of which \$38,475,000 was allocated to real estate, \$14,502,000 was allocated to in-place leases related assets and \$3,008,000 was allocated to other assets and liabilities. The joint venture was financed with a bridge loan from us of approximately \$30,729,000, capital contributions from us of approximately \$16,981,000, capital contributions from Broe of approximately \$1,887,000 and assumed mortgages on three facilities totaling \$6,438,000. The bridge loan from us was replaced on April 13, 2006 by third party mortgage financing. All intercompany balances with the joint venture have been eliminated for purposes of our consolidated financial statements.

The balance sheet and income statement for the joint venture below present its financial position as of March 31, 2006 and its results of operations for the three-month period ended March 31, 2006 in thousands. Intercompany balances have not been eliminated in preparing the financial statements included below.

BALANCE SHEET

	March 31, 2006
	(Unaudited)
Assets	
Real estate:	
Land	\$ 3,296
Buildings and improvements	35,179
	<u>38,475</u>
Less accumulated depreciation	(227)
	<u>38,248</u>
Cash and cash equivalents	462
Other assets	17,688
	<u>\$ 56,398</u>
Liabilities and Equity	
Notes and bonds payable	\$ 37,157
Accounts payable and accrued liabilities	993

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Equity:	
NHP	16,423
Broe	1,825
	<hr/>
Total equity	18,248
	<hr/>
	\$ 56,398
	<hr/>

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	Three Months Ended March 31, 2006
Rental income	\$ 1,917
Expenses:	
Interest and amortization of deferred financing costs	546
Depreciation and amortization	847
Operating expenses	999
	<u>2,392</u>
Net loss	<u>\$ (475)</u>

6. Assets Held for Sale

During 2006, we sold three assets held for sale for \$9,130,000 resulting in a gain of \$1,387,000 included in discontinued operations. At March 31, 2006 two buildings and one land parcel remained in assets held for sale. At December 31, 2005 five buildings and one land parcel remained in assets held for sale. We intend to dispose of the assets classified as assets held for sale at March 31, 2006 within one year.

7. Unsecured Credit Facility

At March 31, 2006, we had \$335,000,000 outstanding on our \$700,000,000 credit facility, which is comprised of a \$600,000,000 revolving facility with a three year term and an option on our part to extend for one year and a \$100,000,000 five year term loan. At our option, borrowings under the agreement bear interest at prime (7.75% at March 31, 2006) or LIBOR plus 0.90% (5.73% at March 31, 2006). We pay a facility fee of 0.2% per annum on the total commitment under the agreement. The revolving facility matures October 20, 2008 and the term loan matures October 20, 2010.

8. Common Stock

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On January 17, 2006 we entered into a sales agreement with Cantor Fitzgerald & Co. to sell up to 5,000,000 shares of our common stock from time to time through a controlled equity offering program. During the quarter ended March 31, 2006, we sold 809,600 shares of common stock at a weighted average price of \$22.90 resulting in net proceeds of \$18,080,000 after underwriting fees.

On March 30, 2006, we priced an offering of 9,000,000 shares of common stock at \$21.50 per share with a closing date of April 5, 2006. The underwriters also exercised an option to purchase 1,350,000 additional shares of common stock to cover over-allotments. Of the 10,350,000 shares to be issued, 5,850,000 were issued directly by us and 4,500,000 were sold by affiliates of certain underwriters in connection with the forward sale agreements between such affiliates and us. The net proceeds from the 5,850,000 shares issued directly by us on the closing date of approximately \$119,000,000 after underwriters' discounts and estimated expenses will be used to repay borrowings under our credit facility and eventually to fund a portion of our acquisition and master leaseback of the real estate holdings of Hearthstone Assisted Living, Inc., which was announced on March 22, 2006 and is expected to close by May 31, 2006. We have the option of settling the 4,500,000 forward shares in shares of common stock or cash at any time during the twelve months following the closing date. We intend to issue new shares at a price of \$20.54 per share (net of the underwriters' discount) to settle the forward sale resulting in net proceeds of \$92,430,000, however we could elect to cash settle which would result in either the company or the underwriters paying the other party a sum of money that would be determined based on changes in our stock price between the closing date and the settlement date.

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We sponsor a dividend reinvestment and stock purchase plan that enables existing stockholders to purchase additional shares of common stock by automatically reinvesting all or part of the cash dividends paid on their shares of common stock. The plan also allows investors to acquire shares of our common stock, subject to certain limitations, including a maximum monthly investment of \$10,000, at a discount ranging from 0% to 5%, determined by us from time to time in accordance with the plan. The discount at March 31, 2006 was 2%. During the three months ended March 31, 2006, we issued approximately 176,000 shares of common stock resulting in net proceeds of \$3,825,000.

9. Earnings Per Share (EPS)

Basic EPS is computed by dividing income from continuing operations available to common stockholders by the weighted average common shares outstanding. Income from continuing operations available to common stockholders is calculated by deducting dividends declared on preferred stock from income from continuing operations. Diluted EPS includes the effect of any potential shares outstanding, which for us is only comprised of dilutive stock options. The calculation below excludes the Series B Convertible Preferred stock which is not dilutive for any period presented and 110,000 stock options with option prices that would not be dilutive for the three months ended March 31, 2006 and 288,000 stock options with option prices that would not be dilutive for the three months ended March 31, 2005. The table below details the components of the basic and diluted EPS from continuing operations available to common stockholders calculations:

	Three months ended March 31,			
	2006		2005	
	Income	Shares	Income	Shares
	(In thousands)			
Income from continuing operations	\$ 20,373		\$ 18,794	
Less: preferred stock dividends	(3,791)		(3,982)	
Amounts used to calculate Basic EPS	16,582	68,332	14,812	66,934
Effect of dilutive securities:				
Stock options		117		119
Amounts used to calculate Diluted EPS	\$ 16,582	68,449	\$ 14,812	67,053

10. Impairment of Assets

There were no asset impairments during the three months ended March 31, 2006.

During the three months ended March 31, 2005, we recognized an impairment of assets charge of \$7,019,000 related to one facility that would no longer be operated as a skilled nursing facility. The impairment included the write-down of the facility to its estimated fair value less costs to sell, a reserve against a receivable from the tenant of the facility and the write off of certain capitalized lease costs. In addition, we had an impairment of \$150,000 against one land parcel in assets held for sale to write it down to its estimated fair value less costs to sell.

11. Pension Plan

During 1991, we adopted an unfunded pension plan covering the current non-employee members of our Board of Directors. The benefits, limited to the number of years of service on the Board, are based upon the then current annual retainer in effect. The plan was frozen at December 31, 2005 and no additional years of service will be earned subsequent to that date. All years of benefits previously accrued will be paid in accordance with the plan. There was no service cost for the plan for the three months ended March 31, 2006. Service cost was \$27,000 for the three months ended March 31, 2005. The interest cost for the plan was \$22,000 for the three

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months ended March 31, 2006 and \$17,000 for the three months ended March 31, 2005. We made \$25,000 of contributions to the plan for the three months ended March 31, 2006 and \$50,000 for the three months ended March 31, 2005 and we expect to make \$56,000 of contributions during the remainder of 2006.

12. Discontinued Operations

SFAS No. 144 requires the operating results of any assets with their own identifiable cash flows that are disposed of or held for sale be removed from income from continuing operations and reported as discontinued operations. The operating results for any such assets for any prior periods presented must also be reclassified as discontinued operations. See Note 3, Note 6 and Note 10 for more detail regarding the facilities sold and classified as held for sale during 2006. The following table details the amounts reclassified to discontinued operations for the periods presented:

	Three months ended March 31,	
	2006	2005
	(In thousands)	
Rental income	\$ 569	\$ 2,163
Expenses:		
Depreciation and amortization	36	743
General and administrative	43	27
Impairment of assets		6,859
	<u>79</u>	<u>7,629</u>
Income (loss) from discontinued operations	<u>\$ 490</u>	<u>\$ (5,466)</u>

13. Litigation

In late 2004 and early 2005, we were served several lawsuits in connection with a fire at the Greenwood Healthcare Center that occurred on February 26, 2003. At the time of the fire, the Greenwood Healthcare Center was owned by us and leased to and operated by Lexington Healthcare Group. There are a total of 13 lawsuits arising from the fire. Those suits have been filed by representatives of patients who were either killed or injured in the fire. The lawsuits seek unspecified monetary damages. The complaints allege that the fire was set by a resident who had previously been diagnosed with depression. The complaints allege theories of negligent operation and premises liability against Lexington Healthcare, as operator, and the Company as owner. Lexington Healthcare has filed for bankruptcy. The matters have been consolidated into one action and are in the early stages of discovery and pleading.

We are being defended in the matter by our commercial general liability carrier. We believe that we have substantial defenses to the claims and that we have adequate insurance to cover the risks, should liability nonetheless be imposed. However, because the litigation is in the early stages of discovery and pleading, it is not possible to predict the ultimate outcome of these claims.

14. Subsequent Events

On April 5, 2006, we closed on the sale of 5,850,000 shares of common stock (including the underwriters' over-allotment option of 1,350,000 shares) at \$21.50 per share. The net proceeds from the sale of these shares of approximately \$119,000,000 after underwriters' discounts and estimated expenses will be used to repay borrowings under our credit facility and eventually to fund a portion of our acquisition and master leaseback of the real estate holdings of Hearthstone Assisted Living, Inc., which was announced on March 22, 2006 and is expected to close by May 31, 2006.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Critical Accounting Policies**

Our financial statements have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates and assumptions, including those that impact our most critical accounting policies. We base our estimates and assumptions on historical experience and on various other factors that we believe are reasonable under the circumstances. Actual results may differ from these estimates. We believe the following are our most critical accounting policies.

Revenue Recognition

Our rental revenue is accounted for in accordance with Statement of Financial Accounting Standards (SFAS) No. 13 *Accounting for Leases* (SFAS No. 13) and SEC Staff Accounting Bulletin No. 101 *Revenue Recognition in Financial Statements* (SAB No. 101) among other authoritative pronouncements. These pronouncements require us to account for the rental income on a straight-line basis unless a more appropriate method exists. We believe that the method most reflective of the use of a healthcare facility with fixed rate increases is the straight-line method. Straight-line accounting requires us to calculate the total fixed rent to be paid 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 a lease or there is a period of free rent at the beginning of a 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 deferred 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 deferred rent receivable balance to zero by the end of the lease. The majority of our leases do not contain fixed increases or provide for free or reduced rent at the beginning of the lease term. However, certain leases for facilities we have constructed have had free rent for the first three to six months and certain leases we entered into, primarily with regard to facilities returned to us by tenants in bankruptcy have had reduced or free rent in the early months of the lease or fixed increases in future years. We record the rent for these facilities on a straight-line basis in accordance with SFAS No. 13. However, we also assess the collectibility of the deferred portion of the rent that is to be collected in a future period in accordance with SAB No. 101. This assessment is based on several factors, including the financial strength of the lessee and any guarantors, the historical operations and operating trends of the facility, the historical payment pattern of the facility and whether we intend to continue to lease the facility to the current tenant, among others. If our evaluation of these factors indicates we may not receive the rent payments due in the future, we provide a reserve against the current rental income as an offset to revenue, and depending on the circumstances, we may provide a reserve against the existing deferred rent balance for the portion, up to its full value, that we estimate will not be recovered. This assessment requires us to determine whether there are factors indicating the future rent payments may not be fully collectible and to estimate the amount of the rent that will not be collected. If our assumptions or estimates regarding a lease change in the future, we may have to record a reserve to reduce or further reduce the rental revenue recognized and/or deferred rent receivable balance. We received \$97,000 of cash in excess of revenues recorded during the three months ended March 31, 2006 and received \$325,000 of cash in excess of revenues recorded during the three months ended March 31, 2005. There is \$7,770,000 at March 31, 2006 and \$8,486,000 at December 31, 2005 of deferred rent receivables, net of reserves, recorded under the caption "Other assets" on the balance sheet. We evaluate the collectibility of the deferred rent balances on an ongoing basis and provide reserves against receivables we believe may not be fully recoverable. The ultimate amount of deferred rent we realize could be less than amounts recorded.

Additional rents are generally computed as a percentage of facility revenues in excess of base amounts or as a percentage of the increase in the Consumer Price Index. We do not straight-line rent contingent on revenue increases or increases in the Consumer Price Index. Additional rents are generally calculated and payable

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monthly or quarterly, and most of our leases contain provisions such that total rent cannot decrease from one year to the next. While the calculations and payments of additional rents contingent upon revenue are generally made on a quarterly basis, SAB No. 101 does not allow for the recognition of this revenue until all possible contingencies have been eliminated. Most of our leases with additional rents contingent upon revenue are structured as quarterly calculations so that all contingencies for revenue recognition have been eliminated at each of our quarterly reporting dates.

Depreciation and Useful Lives of Assets

We calculate depreciation on our buildings and improvements using the straight-line method based on estimated useful lives ranging up to 40 years, generally from 30 to 40 years. A significant portion of the cost of each property is allocated to building (generally approximately 90%). The allocation of the cost between land and building, and the determination of the useful life of a property, are based on management's estimates. We calculate depreciation and amortization on equipment and lease costs using the straight-line method based on estimated useful lives of up to five years or the lease term, whichever is appropriate. We review and adjust useful lives periodically. If we do not allocate appropriately between land and building or we incorrectly estimate the useful lives of our assets, our computation of depreciation and amortization will not appropriately reflect the usage of the assets over future periods. If we overestimate the useful life of an asset, the depreciation expense related to the asset will be understated, which could result in a loss if the asset is sold in the future.

Asset Impairment

We review our long-lived assets individually on a quarterly basis to determine if there are indicators of impairment in accordance with SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS No. 144). Indicators may include, among others, the tenant's inability to make rent payments, operating losses or negative operating trends at the facility level, notification by the tenant that it will not renew its lease, a decision to dispose of an asset or changes in the market value of the property. For operating assets, if indicators of impairment exist, we compare the undiscounted cash flows from the expected use of the property to its net book value to determine if impairment exists. If the sum of the future estimated undiscounted cash flows is higher than the current net book value, in accordance with SFAS No. 144, we conclude no impairment exists. If the sum of the future estimated undiscounted cash flows is lower than the current net book value, we recognize an impairment loss for the difference between the net book value of the asset and its estimated fair market value. To the extent we decide to sell an asset, we recognize an impairment loss if the current net book value of the asset exceeds its fair value less costs to sell. The above analyses require us to determine whether there are indicators of impairment for individual assets, to estimate the most likely stream of cash flows from operating assets and to determine the fair value of assets that are impaired or held for sale. If our assumptions, projections or estimates regarding an asset change in the future, we may have to record an impairment charge to reduce or further reduce the net book value of such asset. There were no asset impairments during the three months ended March 31, 2006. During the three months ended March 31, 2005, we recognized an impairment of assets charge of \$7,169,000, \$7,019,000 of which related to the write-down of one facility that would no longer be operated as a skilled nursing facility and a reserve against a receivable from the tenant of the facility and \$150,000 of which related to the write-down of one land parcel in assets held for sale to its estimated fair value less costs to sell.

Collectibility of Receivables

We evaluate the collectibility of our mortgage loans and other receivables on a regular basis. We evaluate the collectibility of receivables based on factors including, among others, payment history, the financial strength of the borrower and any guarantors, the value of the underlying collateral, the operations and operating trends of the underlying collateral, if any, and current economic conditions. If our evaluation of these factors indicates we may not recover the full value of the receivable, we provide a reserve against the portion of the receivable that we estimate will not be recovered. This analysis requires us to determine whether there are factors indicating a

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receivable may not be fully collectible and to estimate the amount of the receivable that will not be collected. If our assumptions or estimates regarding the collectibility of a receivable change in the future, we may have to record a reserve to reduce or further reduce the carrying value of the receivable.

Impact of New Accounting Pronouncements

In June 2005, the Emerging Issues Task Force released Issue No. 04-5 *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights* (EITF 04-5). EITF 04-5 creates a framework for evaluating whether a general partner or a group of general partners controls a limited partnership or a managing member or a group of managing members controls a limited liability company and therefore should consolidate the entity. EITF 04-5 states that the presumption of general partner or managing member control would be overcome only when the limited partners or non-managing members have certain specific rights as outlined in EITF 04-5. EITF 04-5 is effective immediately for all newly formed limited partnerships and for existing limited partnership agreements that are modified. EITF 04-5 is not expected to have a material impact on our results of operations or financial position.

Operating Results

Three-Month Period Ended March 31, 2006 vs. Three-Month Period Ended March 31, 2005

Rental income increased \$8,794,000, or 19%, in 2006 as compared to 2005. The increase was primarily due to rental income from 14 facilities acquired in 2006, 64 facilities acquired during 2005 and rent increases at existing facilities totaling \$1,479,000. Interest and other income increased \$499,000, or 20%, over 2005. The increase was primarily due to two loans funded during 2005 and two loans funded during 2006 partially offset by loan repayments. Medical office building revenue is generated by the medical office buildings we acquired through our joint venture with The Broe Companies during the first quarter of 2006.

Interest and amortization of deferred financing costs increased \$4,642,000, or 32%, over 2005. The increase was primarily due to increased borrowings to fund acquisitions in 2005 and 2006, an increase in the interest rates on our floating rate debt and the assumption of \$68,878,000 of secured debt during the first quarter of 2006 and \$70,506,000 during 2005, partially offset by interest savings from the extinguishment of \$131,775,000 of senior notes in August 2005. Depreciation and amortization increased \$3,605,000, or 29%, over 2005. The increase was primarily due to the acquisition of 14 facilities in 2006 and 64 facilities during 2005 as well as the amortization of lease related intangible assets in the medical office building joint venture. General and administrative expenses decreased \$104,000, or 3%, over 2005. The decrease was primarily due to a \$585,000 charge in 2005 related to the separation of our former chief financial officer, partially offset by increases in other general corporate expenses. Medical office building joint venture operating expenses relate to the operations of the non-triple-net leased medical office building portfolio that was acquired during the first quarter of 2006.

SFAS No. 144 requires the operating results of any assets with their own identifiable cash flows that are disposed of or held for sale be removed from income from continuing operations and reported as discontinued operations. The operating results for any such assets for any prior periods presented must also be reclassified as discontinued operations. Income from discontinued operations increased \$13,133,000 versus 2005. The income from discontinued operations of \$7,700,000 for the three months ended March 31, 2006 is comprised of a gain on sale of \$7,210,000 and rent revenue of \$569,000, partially offset by general and administrative expenses of \$43,000 and depreciation of \$36,000. The loss from discontinued operations for the three months ended March 31, 2005 was comprised of an asset impairment of \$6,859,000, depreciation and amortization of \$743,000 and general and administrative expenses of \$27,000, offset by rental income of \$2,163,000 and a gain on sale of

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\$33,000. The difference in the composition of the income from discontinued operations (excluding the gains and impairments) was primarily caused by the fact that the facilities sold in 2005 had income in 2005, but do not have income in 2006, while the assets held for sale generate expenses, but generally do not produce income. Any future income or loss in discontinued operations would result from future sales of facilities or reclassifications of facilities to assets held for sale.

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We expect to receive increased rent and interest at individual facilities because our leases and mortgages generally contain provisions under which rents or interest income increase with increases in facility revenues and/or increases in the Consumer Price Index. If revenues at our facilities and/or the Consumer Price Index do not increase, our revenues may not continue to increase. Sales of facilities or repayments of mortgage loans receivable would serve to offset revenue increases, and if sales and repayments exceed additional investments this could actually reduce revenues. Our leases could renew below or above the aggregate existing rent level, so the impact of lease renewals may cause a decrease or an increase in the total rent we receive. We currently have leases on ten facilities expiring in 2006. The exercise of purchase options by tenants would also cause a decrease in the total rent we receive. We believe our tenants may exercise purchase options on assets totaling between \$23,000,000 to \$51,000,000 during the remainder of 2006. However, we do not have any control over whether our tenants will choose to exercise any available purchase options. Additional investments in healthcare facilities would increase rental and/or interest income. At this time we expect to make additional acquisitions during 2006, although the quantity and timing of any such acquisitions cannot be accurately forecast. As additional investments in facilities are made, depreciation and/or interest expense will also increase. We expect any such increases to be at least partially offset by rent or interest income associated with the investments.

Investment in Consolidated Medical Office Building Joint Venture

On December 6, 2005, we entered into a joint venture, NHP/Broe, LLC, with The Broe Companies to invest in medical office buildings. We hold a 90% equity interest in the venture and Broe holds 10%. Broe is the managing member, however the joint venture is consolidated by us. The accounting policies of the joint venture are consistent with those of the Company. No investments were made by or into this joint venture prior to 2006.

For the first 36 months of the joint venture, we will receive 100% of the proceeds of the joint venture until we have received a cumulative annual return of 8.5%, at which point Broe will receive 100% of the proceeds until it has received a cumulative annual return of 8.5%. If we have not received a cumulative annual return of 8.5% after the first 36 months, distributions will go to the members in accordance with their ownership percentages until such time as we earn a cumulative annual return of 8.5% and then 100% to Broe until it has also achieved a cumulative annual return of 8.5%. Then distributions shall be made 65% to us and 35% to Broe until we have achieved a cumulative annual return of 10.5%. Thereafter distributions will be made 50% to each party.

During the three months ended March 31, 2006, the joint venture acquired 21 medical office buildings in six states. The purchase price totaled \$55,985,000, of which \$38,475,000 was allocated to real estate, \$14,502,000 was allocated to in-place leases related assets and \$3,008,000 was allocated to other assets and liabilities. The joint venture was financed with a bridge loan from us of approximately \$30,729,000, capital contributions from us of approximately \$16,936,000, capital contributions from Broe of approximately \$1,882,000 and assumed mortgages on three facilities totaling \$6,438,000. The bridge loan from us was replaced on April 13, 2006 by third party mortgage financing. All intercompany balances with the joint venture have been eliminated for pur