NATIONAL HEALTH INVESTORS INC
Form 10-Q
November 06, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2006

Commission file number 001-10822

NATIONAL HEALTH INVESTORS, INC.

(Exact name of registrant as specified in its Charter)

Maryland	62-1470956
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

100 Vine Street
Murfreesboro, TN
37130
(Address of principal executive offices)
(Zip Code)

(615) 890-9100
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 X No

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

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

There were 27,752,239 shares of common stock outstanding as of November 3, 2006.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

NATIONAL HEALTH INVESTORS, INC.
INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)

	Sept. 30,	December 31,

	2006	2005
	(unaudited)	
ASSETS		
Real estate properties:		
Land	$ 30,078	$ 31,647
Buildings and improvements	345,270	362,907
Construction in progress	360	359
	375,708	394,913
Less accumulated depreciation	(138,424)	(131,784)
Real estate properties, net	237,284	263,129
Mortgage and other notes receivable, net	112,936	118,800
Investment in preferred stock	38,132	38,132
Cash and cash equivalents	155,231	132,469
Marketable securities	22,487	19,553
Accounts receivable, net	5,282	5,581
Deferred costs and other assets	13,018	10,268
Total Assets	$584,370	$587,932
LIABILITIES		
Unsecured public notes	$100,000	$100,000
Debt	14,946	17,252
Convertible subordinated debentures	--	201
Accounts payable and other accrued expenses	20,889	26,471
Accrued interest	1,546	3,374
Dividends payable	13,320	12,524
Deferred income	2,968	3,142
Total Liabilities	153,669	162,964
Commitments, Guarantees and Contingencies		
STOCKHOLDERS' EQUITY		
Common stock, $.01 par value; 40,000,000 shares authorized; 27,749,239 and 27,830,439 shares, respectively, issued and outstanding	278	278
Capital in excess of par value	461,431	464,389
Cumulative net income	658,987	613,208
Cumulative dividends	(704,751)	(664,729)
Unrealized gains on marketable securities, net	14,756	11,822
Total Stockholders' Equity	430,701	424,968
Total Liabilities and Stockholders' Equity	$584,370	$587,932

The accompanying notes to interim condensed consolidated financial statements are an integral part of these financial statements. The condensed balance sheet at December 31, 2005 is taken from the audited financial statements at that date.

NATIONAL HEALTH INVESTORS, INC.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

Three Months Ended Nine Months Ended

September 30 September 30

2006

2005

2006

2005

REVENUES:

(in thousands, except share amounts)

Mortgage interest income$ 3,380$ 6,710$ 11,246$ 14,541 Rental income11,37710,85234,56433,018 Facility operating revenue22,45421,296 65,950 63,49337,21138,858111,760111,052EXPENSES: Interest2,0342,1016,1046,500 Depreciation2,9283,0398,7929,072 Amortization of loan costs3434101140 Legal expense16645392367 Franchise, excise and other taxes53102187387 General and administrative1,1591,0343,4763,205 Loan and realty impairment losses--2,852--11,402 Facility operating expense20,62819,74661,60159,34027,00228,95380,65390,413INCOME BEFORE NON-OPERATING INCOME10,2099,90531,10720,639 Non-operating income (investments and other) 3,170 2,287 8,39419,831INCOME FROM CONTINUING OPERATIONS13,37912,19239,50140,470Discontinued Operations Operating income from discontinued operations--323464906 Net gain on sale of real estate -- 25 5,814 773 -- 348 6,278 1,679NET INCOME$13,379$12,540$45,779$42,149Earnings per share: Basic: Income from continuing operations$ .48$ .44$ 1.42$ 1.46 Discontinued operations -- .01 .23 .06 Net income$ .48$ .45$ 1.65$ 1.52 Diluted: Income from continuing operations$ .48$ .44$ 1.42$ 1.46 Discontinued operations -- .01 .23 .06 Net income$ .48$ .45$ 1.65$ 1.52WEIGHTED AVERAGE COMMON SHARES OUTSTANDING: Basic27,699,23927,741,42427,760,24727,676,367 Diluted27,723,57027,860,17727,778,98327,829,214

The accompanying notes to interim condensed consolidated financial statements are an integral part of these financial statements.

NATIONAL HEALTH INVESTORS, INC.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30	
	2006	2005
	(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 45,779	$ 42,149
Depreciation	8,972	9,573
Loan and realty impairment losses	--	8,550
Net gain on sale of real estate	(5,814)	(2,646)
Amortization of loan costs	101	140
Realized gain and recovery on sale of marketable securities	--	(9,072)
Deferred income	--	109
Amortization of deferred income	(174)	(197)
Share based compensation	214	--
Decrease (increase) in accounts receivable	299	(465)
Increase in deferred costs and other assets	(2,852)	(2,585)
Increase (decrease) in accounts payable and other accrued expenses	(5,581)	5,997

Decrease in accrued interest payable	(1,828)	(1,830)
NET CASH PROVIDED BY OPERATING ACTIVITIES	39,116	49,723
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in mortgage and other notes receivable	(10,928)	(22,022)
Collection of mortgage and other notes receivable	5,244	8,635
Prepayment of mortgage notes receivable	11,548	--
Acquisition of property and equipment	(1,527)	(11,772)
Proceeds from disposition of property and equipment	24,214	14,452
Sale of marketable securities	--	10,308
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	28,551	(399)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on debt	(2,306)	(35,987)
Redemption of subordinated convertible debentures	(201)	--
Stock options exercised	357	2,130
Repurchase of common stock	(3,529)	--
Dividends paid to stockholders	(39,226)	(40,767)
NET CASH USED IN FINANCING ACTIVITIES	(44,905)	(74,624)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	22,762	(25,300)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	132,469	161,215
CASH AND CASH EQUIVALENTS, END OF PERIOD	$155,231	$135,915

(continued)

NATIONAL HEALTH INVESTORS, INC.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Nine Months Ended September 30	
	2006	2005
	(in thousands)	
Supplemental Information:		
Cash payments for interest expense	$ 7,351	$ 7,416
During the nine months ended September 30, 2005, $534,000 of Senior Subordinated Convertible Debentures were converted into 76,278 shares of NHI's common stock:		
Senior subordinated convertible debentures	--	$ (534)
Accrued interest	--	(3)
Common stock	--	1
Capital in excess of par value	--	536

The accompanying notes to interim condensed consolidated financial statements are an integral part of these financial statements.

NATIONAL HEALTH INVESTORS, INC.
INTERIM CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005
(in thousands, except share amounts)

	Common Stock		Capital in Excess of Par Value	Cumulative Net Income	Cumulative Dividends	Unrealized Gains (Losses) on Securities	Total Stock-holders' Equity
	Shares	Amount					
BALANCE AT 12/31/05	27,830,439	$278	$464,389	$613,208	$(664,729)	$11,822	$424,968
Net income	--	--	--	45,779	--	--	45,779
Unrealized gains on securities	--	--	--	--	--	2,934	2,934
Total Comprehensive Income							48,713
Stock options exercised	15,000	--	357	--	--	--	357
Shares repurchased	(146,200)	(1)	(3,528)	--	--	--	(3,529)
Restricted stock issued	50,000	1	(1)	--	--	--	--
Share based compensation	--	--	214	--	--	--	214
Dividends to common stockholders	--	--	--	--	(40,022)	--	(40,022)
BALANCE AT 9/30/06	27,749,239	$278	$461,431	$658,987	$(704,751)	$14,756	$430,701
BALANCE AT 12/31/04	27,545,018	$275	$461,119	$558,800	$(614,785)	$20,130	$425,539
Net income	--	--	--	42,149	--	--	42,149
Unrealized losses on securities	--	--	--	--	--	(7,975)	(7,975)
Total Comprehensive Income							34,174
Stock options exercised	139,729	2	2,128	--	--	--	2,130
Shares issued in conversion of convertible debentures to common stock	76,278	1	536	--	--	--	537
Dividends to common stockholders	--	--	--	--	(37,421)	--	(37,421)
BALANCE AT 9/30/05	27,761,025	$278	$463,783	$600,949	$(652,206)	$12,155	$424,959

The accompanying notes to interim condensed consolidated financial statements are an integral part of these financial statements.

Note 1. SIGNIFICANT ACCOUNTING POLICIES:

We, the management of National Health Investors, Inc., believe that the unaudited condensed consolidated financial statements to which these notes are attached include all normal, recurring adjustments which are necessary to fairly present the financial position, results of operations and cash flows of National Health Investors, Inc. ("NHI" or the "Company") in all material respects. We assume that users of these interim financial statements have read or have access to the audited December 31, 2005 consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies, may be determined in that context. Accordingly, footnotes and other disclosures which would substantially duplicate the disclosure contained in our most recent annual report to stockholders on Form 10-K for the year ended December 31, 2005 have been omitted. This interim consolidated financial information is not necessarily indicative of the results that may be expected for a full year for a variety of reasons including, but not limited to, acquisitions and dispositions, changes in interest rates, rents and the timing of debt and equity financings. Our audited December 31, 2005 financial statements are available at our web site: www.nhinvestors.com.

Note 2. NEW ACCOUNTING PRONOUNCEMENTS:

In December 2004, the FASB has issued FASB Statement No. 123 (Revised 2004), *Share-Based Payment* ("Statement 123R"). The new FASB rule requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost is measured based on the fair value of the equity or liability instruments issued. The Company adopted Statement 123R beginning January 1, 2006. The scope of Statement 123R includes a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The adoption of Statement 123R has not had a significant impact on our condensed consolidated financial statements other than the recording of compensation charges for option holders and restricted shares.

In May 2005, the FASB issued FASB Statement No. 154, *Accounting for Changes and Error Corrections* ("Statement 154"). This new standard replaces APB Opinion No. 20, *Accounting Changes* and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. Statement 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle, unless it is impracticable to do so. Statement 154 also provides that (1) a change in method of depreciating or amortizing a long-lived nonfinancial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and (2) correction of errors in previously issued financial statements should be termed a "restatement". The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. The adoption of this pronouncement has not had an impact on the Company's financial statements.

In February 2006, the FASB issued FAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment to FASB Statements No. 133 and 140" (FAS 155). FAS 155 simplifies the accounting for certain hybrid financial instruments containing embedded derivatives. FAS 155 allows fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation under FAS 133. In addition, it amends FAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The Company will adopt the provisions of FAS 155 beginning in fiscal 2007. The implementation of FAS 155 is not expected to have a material impact on the Company's consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140." This Statement amends FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement clarifies when servicing rights should be separately accounted for, requires companies to account for separately recognized servicing rights initially at fair value, and gives companies the option of subsequently accounting for those servicing rights at either fair value or under the amortization method. SFAS 156 is effective for fiscal years beginning after September 15, 2006. The implementation of FAS 156 is not expected to have a material impact on the Company's consolidated financial statements.

In July 2006, the FASB issued Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109." FIN 48 prescribes a recognition threshold and measurement attribute for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. FIN 48 will require that the financial statements reflect expected future tax consequences of such positions presuming the taxing authorities' full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is effective for annual periods beginning after December 15, 2006. We are currently evaluating the impact of adopting FIN 48 on our consolidated financial statements. Upon adoption, the cumulative effect of applying the provision of FIN 48 will be reported as an adjustment to the opening balance of retained earnings for that fiscal year.

Note 3. SHARE-BASED COMPENSATION

Effective January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" ("SFAS 123(R)"), using the modified prospective application transition method. Under this method, compensation cost is recognized, beginning January 1, 2006, based on the requirements of SFAS 123(R) for all share-based payments granted after the effective date, and based on Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), for all awards granted to employees prior to January 1, 2006 that remain unvested on the effective date. Prior to January 1, 2006, we applied Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees"("APB 25") and related interpretations in accounting for our employee stock benefit plans. Accordingly, no compensation cost was recognized for stock options granted under the plans because the exercise prices for options granted were equal to the quoted market prices on the option grant dates and all option grants were to employees or directors. Results for prior periods have not been restated.

<u>Share Based Compensation Plans</u>

The Compensation Committee of the Board of Directors ("the Committee") has the authority to select the participants to be granted options; to designate whether the option granted is an incentive stock option ("ISO"), a non-qualified option, or a stock appreciation right; to establish the number of shares of common stock that may be issued upon exercise of the option; to establish the vesting provision for any award; and to establish the term any award may be outstanding. The exercise price of any ISO's granted will not be less than 100% of the fair market value of the shares of common stock on the date granted and the term of an ISO may not be any more than ten years. The exercise price of any non-qualified options granted will not be less than 100% of the fair market value of the shares of common stock on the date granted unless so determined by the Committee.

In May 2005, our shareholders approved the 2005 Stock Option, Restricted Stock and Stock Appreciation Rights Plan ("the 2005 Plan") pursuant to which 1,500,000 shares of our common stock are available to grant as share-based payments to employees, officers, directors or consultants. Options for 86,000 shares and Restricted Stock for 53,000 shares have been granted under the 2005 Plan during the nine months ended September 30, 2006, leaving 1,361,000 shares available for future grants. The restricted stock granted vests over five years and the options granted vest over three to five years. The term of the options outstanding under the 2005 Plan is five years.

The NHI 1997 Stock Option Plan ("the 1997 Plan") provides for the granting of options to key employees and directors of NHI to purchase shares of common stock at a price no less than the market value of the stock on the date the option is granted. Options for 60,000 shares have been granted under the 1997 Plan during the nine months ended September 30, 2006, leaving 57,800 shares available for future grants. Options to purchase 180,000 shares are currently outstanding to the Board of Directors under the 1997 Stock Option Plan. All of the currently outstanding options under the 1997 stock option plan vested immediately upon grant and may be exercised at any time prior to expiration. The term of the options outstanding under the 1997 stock option plan is five years.

The compensation expense reported for share-based compensation related to the 2005 Plan and the 1997 Plan totaled $214,000 for the nine months ended September 30, 2006, consisting of $61,000 for restricted stock and $153,000 for stock options which is included in general and administrative expense in the condensed consolidated statements of income.

Determining Fair Value Under SFAS No. 123(R)

The fair value of each option award was estimated on the grant date, using the Black-Scholes option valuation model with the weighted average assumptions indicated in the following table. Generally, awards are subject to clift vesting. Each grant is valued as a single award with an expected term based upon expected employee and termination behavior. Compensation cost is recognized on the straight-line attribution method. The straight-line attribution method requires that compensation expense is recognized at least equal to the portion of the grant-date fair value that is vested at that date. The expected volatility is derived using daily historical data for periods preceding the date of grant. The risk-free interest rate is the approximate yield on the United States Treasury Strips having a life equal to the expected option life on the date of grant. The expected life is an estimate of the number of year an option will be held before it is exercised.

The weighted average fair value per share of options granted was $1.95 and $2.51 for 2006 and 2005, respectively. For purposes of pro forma disclosures of net income and earnings per share as required by SFAS 123, as amended, the estimated fair value of the options is amortized to expense over the requisite service period. The fair value of each grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in 2006 and 2005:

	Nine Months Ended September 30,	
	2006	2005
Dividend yield	8.71%	8.80%
Expected volatility	22.93%	21.69%
Expected lives	2.7 years	5 years
Risk-free interest rate	4.83%	3.81%
Expected forfeiture rate	0.00%	0.00%

Stock Option Activity

The following table summarizes option activity:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value

				(in thousands)
Outstanding December 31, 2005	135,000	$23.502		
Options granted under 2005 Plan	86,000	25.318		
Options granted under 1997 Plan	60,000	23.790		
Options exercised under 1997 Plan	(15,000)	23.790		
Outstanding September 30, 2006	266,000	24.138	3.684	$1,115
Exercisable September 30, 2006	180,000	23.574	3.278	857

Grant Date	Options Outstanding	Exercise Price	Remaining Contractual Life in Years
4/24/03	30,000	$16.35	1.583
4/20/04	45,000	23.90	2.583
5/3/05	60,000	26.78	3.667
3/9/06	50,000	26.10	4.417
5/1/06	11,000	23.62	4.583
5/2/06	45,000	23.79	4.583
7/21/06	25,000	24.50	4.750
	266,000		

The weighted average remaining contractual life of all options outstanding at September 30, 2006 is 3.684 years. NHI's Board of Directors has authorized an additional 1,684,800 shares of common stock that may be issued under the share-based payments plans.

Options exercised during the nine months ended September 30, 2006 included 15,000 shares at a weighted average exercise price of $23.79, a quoted market price of the stock of $26.32 on the exercise date and an intrinsic value of $2.53 per share. The closing market price of our common stock at September 30, 2006 was $28.33 per share. The intrinsic value of total options outstanding at September 30, 2006 was $4.19 per share. The intrinsic value of options exercisable at September 30, 2006 was $4.76 per share.

The weighted average fair values of stock options granted during the nine months ended September 30, 2006 and 2005 were $1.95 and $2.51 per share, respectively. At September 30, 2006, we had unvested options to purchase 86,000 shares with a weighted average grant date fair value of $1.53 per share. As of September 30, 2006, we had $132,000 of total unrecognized compensation cost related to unvested options, net of expected forfeitures, which is expected to be recognized over the following periods:

	(in thousands)
2006	$ 21
2007	60
2008	36
2009	11
2010	3
2011	1
	$132

At September 30, 2006, we had $1,244,000 of total unrecognized compensation cost related to unvested restricted stock issued which is expected to be recognized over the following periods:

(in thousands)

2006	$ 26
2007	104
2008	104
2009	104
2010	757
2011	149
	$1,244

Prior Period Pro Forma Presentations

Prior to 2006, our share-based compensation plan was accounted for using the intrinsic value method prescribed in APB No. 25 and related Interpretations. No share-based compensation was reflected in net income in the three month and nine month periods ended September 30, 2005, as all stock options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. Had compensation cost for the plan been determined based on the fair value at the grant dates for awards under the plan consistent with the method of SFAS No. 123R, our net income and basic and diluted net income per share would have been changed to the pro forma amounts indicated below.

	Three Months Ended 9/30/05	Nine Months Ended 9/30/05
(dollars in thousands, except per share amounts)		
Net income - as reported	$12,540	$42,149
Less compensation cost that would be recognized under fair value method	1	153
Net income - pro forma	$12,539	$41,996
Net earnings per share - as reported		
Basic	$ .45	$ 1.52
Diluted	$ .45	$ 1.52
Net earnings per share - pro forma		
Basic	$ .45	$ 1.51
Diluted	$ .45	$ 1.51

Note 4. REAL ESTATE PROPERTIES:

The following table summarizes NHI's real estate properties by facilities that we lease to others and facilities that are operated by others:

(Dollars in thousands)

	September 30, 2006			December 31, 2005		
	Leased	Operating	Total	Leased	Operating	Total
Land	$ 26,502	$ 3,576	$ 30,078	$ 27,598	$ 4,049	$ 31,647
Buildings and improvements	283,638	61,632	345,270	295,416	67,491	362,907
Construction in progress	123	237	360	--	359	359
	310,263	65,445	375,708	323,014	71,899	394,913
Less accumulated depreciation	(111,664)	(26,760)	(138,424)	(106,398)	(25,386)	(131,784)
Real estate properties, net	$198,599	$ 38,685	$237,284	$216,616	$ 46,513	$ 263,129

Foreclosure Properties

New England Properties - During 1999, we took over the operations of seven New England facilities. During 2001, we sold the properties to a not-for-profit entity and provided 100% financing consisting of 6.9% first mortgage proceeds totaling $40,526,000, maturing August, 2011. For financial reporting purposes, we have not recorded the sale of the assets and continue to record the results of operations of these properties each period. For tax reporting purposes, the sale has been recorded with gain on sale to be recorded under the installment method as cash payments are received. For financial reporting purposes, sale proceeds received from the buyer will be reported as a deposit until the down payment and continuing investment criteria of Statement of Financial Accounting Standards No. 66, "Accounting for Sales of Real Estate" ("SFAS 66") are met, at which time we will report the sale under the full accrual method. Management believes that the carrying amount of these real estate properties at September 30, 2006 of $24,735,000 is recoverable.

Amounts included in the condensed consolidated financial statements applicable to the New England facilities are summarized as follows: *(in thousands)*

	Nine Months Ended September 30	
Income Statement:	2006	2005
Facility operating revenue	$41,688	$40,001
Facility operating expenses	38,182	36,604
Interest expense	7	6
Depreciation	1,960	1,864
Total Expenses	40,149	38,474
Net income	$ 1,539	$ 1,527
Balance Sheet:	Sept. 30, 2006	Dec. 31, 2005
Real estate properties, net	$24,735	$25,969
Cash	2,730	3,045
Accounts receivable	3,662	3,241
Other assets	11,074	9,157
Accounts payable and other accrued expenses	6,618	6,689

The operating results of these properties and the asset or liability generated from the cumulative net income (loss) have been considered in our assessment that the carrying amount of these properties at September 30, 2006 is recoverable. The asset or liability generated from the cumulative net income (loss) associated with these properties will be recognized, along with the deferred gain, as a gain or a loss at the time the sale is recorded. Our continuing involvement with these properties is as a creditor.

Kansas and Missouri Properties - In July 2001 we took over the operations of nine nursing homes in Kansas and Missouri and have included the operating results of these facilities in our condensed consolidated financial statements since that date. During 2004, we sold the properties to a not-for-profit entity for $33,585,000 and provided 100% financing. Proceeds consisted of an 8.5% note for $20,585,000 maturing December 31, 2014, and a note for $13,000,000 with interest at 3% through December 31, 2007 and at prime plus 1% thereafter, maturing December 31, 2014. For financial reporting purposes, we have not recorded the sale of the assets and continue to record the results of operations of these properties each period. For tax purposes, the sale has been recorded as an installment sale. For financial reporting purposes, sale proceeds received from the buyer will be reported as a deposit until the down payment and continuing investment criteria of SFAS 66 are met, at which time we will account for the sale under the full accrual method.

During the nine months ended September 30, 2006, we received $5,482,000 in cash from the sale by the not-for-profit entity of the nursing facility in Town & Country, Missouri. The carrying amount of this facility was $5,358,000 composed of net realty of $6,520,000, reduced by net liabilities of $1,162,000. This property was sold in December 2004 to a not-for-profit entity and we provided 100% financing. As a result of having received final proceeds related to this facility, we have recognized the December 2004 sale of this property and recognized a $124,000 gain in the first quarter of 2006.

Management believes that the carrying amount of the remaining Kansas and Missouri properties at September 30, 2006 of $13,950,000 is recoverable.

Amounts included in the condensed consolidated financial statements applicable to the Kansas and Missouri facilities are summarized as follows: *(in thousands)*

	Nine Months Ended September 30	
Income Statement:	2006	2005
Facility operating revenue	$24,263	$23,493
Facility operating expenses	23,421	22,735
Interest (income) expense	(5)	245
Depreciation	558	625
Total expenses	23,974	23,605
Net income (loss)	$ 289	$ (112)
Balance Sheet:	Sept. 30, 2006	Dec. 31, 2005
Real estate properties, net	$13,950	$20,544
Cash	4,366	3,422
Accounts receivable	2,041	2,946
Other assets	576	492
Accounts payable and other accrued expenses	8,343	9,579

The operating results of these properties and the asset or liability generated from the cumulative net income (loss) have been considered in our assessment that the carrying amount of these properties at September 30, 2006 is recoverable. The asset or liability generated from the cumulative net income (loss) associated with these properties will be recognized, along with the deferred gain, as a gain or a loss at the time the sale is recorded. Our continuing involvement with these properties is as a creditor.

Midwest Nursing Home Investors, Inc. ("Midwest") - An $8,735,000 first mortgage loan was secured by two nursing homes in Kansas and one in Wisconsin. Management's analysis of the future expected cash flows consistent with SFAS 114, historical occupancy and operating income of the project resulted in the recording of a $2,000,000 writedown of this mortgage loan value during 2002 and an additional writedown of $2,000,000 during 2003. Payments to NHI were past due and the properties were foreclosed on in October 2004, resulting in our recording of real estate with a carrying value of $4,324,000. The remaining carrying value of $4,025,000 at September 30, 2006, is believed by management to be recoverable. The average recorded investment in these properties was $4,075,000 and $4,242,000 for the nine months ended September 30, 2006 and 2005, respectively. Rental income of $391,000 and $370,000 was recognized on the Midwest Kansas properties for the nine months ended September 30, 2006 and 2005, respectively. Lease Terminations and Sales of Property

Regal and Royal Healthgate - In May 2006, two New Jersey nursing facilities were sold generating net cash proceeds of $17,570,000 and a gain of $5,690,000 which is included in discontinued operations.

Manor House of Charlotte - In January 2005, this facility was sold generating net proceeds of $3,571,000, and a gain of $1,624,000, which is included in discontinued operations as well as the operating results of this facility for all periods presented.

Marriott Senior Living Services - In July 2003, we reached an agreement with Marriott Senior Living Services ("Marriott") to terminate their leases with us on four assisted living facilities, two of which are located in Florida, one in Texas and one in New Jersey. The four facilities were leased to new operators.

Based on our impairment analysis, as a result of further defaults of covenants in the facility leases and continued deferred maintenance of the facilities, we recorded an impairment of $2,550,000 during the first quarter of 2005 on the two Florida facilities. Further maintenance analysis resulted in the recording of an additional $2,852,000 of accrued maintenance expense in the third quarter of 2005 on the two Florida facilities attributable to mold remediation. We had previously recorded an impairment of $5,400,000 during the third quarter of 2003 on one of the Florida facilities.

Lease income of $1,131,000 and $1,256,000 was recognized on these four facilities for the nine months ended September 30, 2006 and 2005, respectively. In February 2005, the facility in Dallas, Texas was sold for cash proceeds of $7,911,000 and a loss of $851,000, which is included in discontinued operations as well as the operating results of this facility for all periods presented. We believe that the carrying amount of these remaining three properties at September 30, 2006 of $24,624,000 is recoverable.

Note 5. MORTGAGE AND OTHER NOTES RECEIVABLE:

American Medical Associates, Inc. ("AMA") - On May 1, 2004, NHI financed the purchase of three Florida-based nursing homes formerly owned by American Medical Associates, Inc. and previously financed by NHI. The amount of the new mortgage loans total $14,500,000 and the notes mature May 14, 2009.

Management's analysis of the future expected cash flows consistent with SFAS 114, historical occupancy and operating income of the project resulted in the recording of a $2,000,000 writedown of these mortgage loans in the second quarter of 2005. The notes were recorded net of the $5,200,000 recorded loss on notes to AMA in 2002. Management believes that the remaining carrying amount of $5,723,000 at September 30, 2006 is realizable. The average recorded investment in the loans was $5,827,000, and $7,106,000 for the nine months ended September 30, 2006 and 2005, respectively. The related amount of interest income recognized on the loans was $1,201,000, and $806,000 for the nine months ended September 30, 2006 and 2005, respectively.

Subsequent to the balance sheet date, on October 2, 2006, the borrower who replaced American Medical Associates, Inc. in May 2004 prepaid the mortgage loans on two of the three facilities. As a result, we received $8,116,000, representing the full principal balances on the notes in cash resulting in a gain of $5,950,000 which will be recognized in the fourth quarter of 2006. The remaining property located in Ocoee, Florida has a principal balance of $5,736,000 and has a carrying amount of $3,557,000 at September 30, 2006.

Miracle Hill Nursing and Convalescent Center ("Miracle Hill") - In September 1996, NHI provided financing to Miracle Hill. Management's analysis of the future expected cash flows consistent with SFAS 114, past, current and anticipated operating income of the project and liquidity of the facility, resulted in the recording of a $2,000,000 writedown of this mortgage loan in the second quarter of 2005. Management believes that the remaining carrying amount of $2,577,000 at September 30, 2006 is supported by the value of the underlying collateral. The average recorded investment in the Miracle Hill loan was $2,646,000, and $3,824,000 for the nine months ended September 30, 2006 and 2005, respectively. The related amount of interest income recognized (representing cash received) on the loan was $371,000, and $381,000 for the nine months ended September 30, 2006 and 2005, respectively.

Allgood HealthCare, Inc. ("Allgood") - We had two loans secured by five Georgia nursing home properties that were operated by Allgood. In January 2003, the borrowers filed for bankruptcy protection. We reported a $2,000,000 writedown of this mortgage loan in the first quarter of 2005 to adjust the loan to its estimated net realizable value. Estate proceeds of $1,247,000 received in August 2006 were applied to the loan.

In December 2005, two of these facilities were sold by the Bankruptcy Trustee pursuant to a plan of liquidation. Prior to the sale, NHI assigned its right to credit bid its mortgages to a third party operator who was the successful purchaser of these facilities. NHI provided the purchaser with $4,000,000 of first mortgage financing and agreed to loan up to a total of $800,000 of working capital. NHI had a first lien on all assets of the borrowers, including accounts receivable.

Effective July 1, 2006, two of the remaining three properties were sold to affiliates of the purchaser of the first two properties. NHI provided the purchaser with long-term first mortgage financing totaling $12,162,000 secured by all four facilities. The Note bears interest at 9% and matures July 1, 2016. The $800,000 commitment to loan working capital remains in place (working capital balance is $122,000 at September 30, 2006) and can be used by any of the four facilities. The carrying amount of this note is $9,921,000 at September 30, 2006, which management believes is supported by the value of the collateral.

On July 1, 2006, the remaining property was sold to a third party operator by the Bankruptcy Trustee with NHI consenting to such sale. NHI provided the purchaser with short-term first mortgage financing totaling $5,692,000. The note bears interest at 9% and matures December 31, 2006. The carrying amount of this note is $3,618,000 at September 30, 2006, which management believes is supported by the value of the collateral.

National Health Realty, Inc. - We purchased by assignment on February 3, 2006, a $10,450,000 bank term loan, owed by National Health Realty, Inc. The assigned loan as amended requires monthly interest payments at the interest rate of 30 days LIBOR plus 1.00% (6.33% at September 30, 2006). Principal of $1,275,000 was paid during the nine months. The unpaid principal ($9,175,000 at September 30, 2006) is due at maturity (January 2, 2008).

Note 6. INVESTMENTS IN MARKETABLE SECURITIES

Our investments in marketable securities include available for sale securities. Unrealized gains and losses on available for sale securities are recorded in stockholders' equity in accordance with SFAS 115 "Accounting for Certain Investments in Debt and Equity Securities". Realized gains and losses from securities sales are determined based upon specific identification of the securities.

Marketable securities consist of the following:

(in thousands)

	9/30/06		12/31/05	
	Cost	Fair Value	Cost	Fair Value
Available for sale	$7,731	$22,487	$7,731	$19,553

Gross unrealized gains and gross unrealized losses related to available for sale securities are as follows:

(in thousands)	9/30/06	12/31/05
Gross unrealized gains	$14,853	$11,941
Gross unrealized losses	(97)	(119)
	$14,756	$11,822

Our available for sale marketable securities consist of the common stock of other publicly traded REITs. None of these available for sale marketable securities have stated maturity dates.

During the nine months ended September 30, 2006 and 2005, we received and recognized $3,459,000 and $3,371,000, respectively, of dividend income from our marketable securities. Such income is included in non-operating income in the condensed consolidated statements of income.

Proceeds from the sale of investments in available for sale securities during the nine months ended September 30, 2005 were $10,308,000. Gross investment gains of $9,072,000 were realized on these sales during the nine months ended September 30, 2005 which is included in non-operating income in the consolidated statements of income described as $5,022,000 of security recoveries and $4,050,000 of realized gains.

Note 7. DEBT

Because of the maturity in one year of the $100,000 million 7.3% unsecured public notes on July 16, 2007, we received a waiver in the covenants related to this debt with the understanding that we will maintain at least $100 million of cash and marketable securities until the debt is paid.

Early payoff of debt in January 2005 included a non-recourse mortgage bank note of $25,637,000 with a weighted average interest rate of 6.0% that was to mature in 2007, and first mortgage notes totaling $8,224,000 with a weighted average interest rate of 5.0% and that were to mature in 2006 and 2021.

Note 8. COMMITMENTS, GUARANTEES AND CONTINGENCIES:

At September 30, 2006, we were committed, subject to due diligence and financial performance goals, to fund approximately $1,674,000 in health care real estate projects, all of which are expected to be funded within the next 12 months. The commitments include additional mortgage investments for three long-term health care centers and one assisted living facility, all at an interest rate of prime plus 2.0%.

As described in Note 5 for Allgood HealthCare, Inc., two of the previous Allgood properties were purchased by new operators using NHI financing. As a part of these transactions, NHI agreed to contingently guarantee up to $113,000 of Utility Deposit Bonds and Resident Trust Fund Bonds.

We believe that we have operated our business so as to qualify as a REIT under Section 856 through 860 of the Internal Revenue Code of 1986, as amended (the "Code") and we intend to continue to operate in such a manner, but no assurance can be given that we will be able to qualify at all times. If we qualify as a REIT, we will generally 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" (at the corporate and stockholder levels) that typically applies to corporate dividends. Our failure to continue to qualify under the applicable REIT qualification rules and regulations would cause us to owe state and federal income taxes and would have a material adverse impact on our financial position, results of operations and cash flows.

Note 9. EARNINGS PER COMMON SHARE:

Basic earnings per share is based on the weighted average number of common shares outstanding during the reporting period.

Diluted earnings per share assumes, if dilutive, the conversion of convertible subordinated debentures (fully retired in 2006) and the exercise of stock options using the treasury stock method. Net income is increased for interest expense on the convertible subordinated debentures, if dilutive.

The following table summarizes the average number of common shares and the net income used in the calculation of basic and diluted earnings per share.

Three Months Ended	Nine Months Ended