NATIONAL HEALTH INVESTORS INC
Form 10-Q
August 04, 2014
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q
(Mark One)
[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2014

[ ] 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 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.)
222 Robert Rose Drive, Murfreesboro, Tennessee	37129
(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes [x] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	[x]	Accelerated filer	[ ]
Non-accelerated filer	[ ]	Smaller reporting company	[ ]

(Do not check if a smaller reporting company)

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

There were 33,054,599 shares of common stock outstanding of the registrant as of July 31, 2014.

Table of Contents

	Page
Part I. Financial Information	
Item 1. Financial Statements	3
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.	21
Item 3. Quantitative and Qualitative Disclosures About Market Risk.	41
Item 4. Controls and Procedures.	42
Part II. Other Information	
Item 1. Legal Proceedings.	43
Item 1A. Risk Factors.	43
Item 6. Exhibits.	44
Signatures.	45

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	June 30, 2014 (unaudited)	December 31, 2013
Assets:		
Real estate properties:		
Land	$93,950	$91,770
Buildings and improvements	1,374,727	1,320,567
Construction in progress	13,973	9,665
	1,482,650	1,422,002
Less accumulated depreciation	(193,018)	(174,262)
Real estate properties, net	1,289,632	1,247,740
Mortgage and other notes receivable, net	60,854	60,639
Investment in preferred stock, at cost	38,132	38,132
Cash and cash equivalents	7,157	11,312
Marketable securities	13,991	12,650
Straight-line rent receivable	27,181	18,691
Equity-method investment and other assets	46,180	66,656
Total Assets	$1,483,127	$1,455,820
Liabilities and Equity:		
Debt	$638,019	$617,080
Real estate purchase liabilities	4,000	2,600
Accounts payable and accrued expenses	11,084	8,011
Dividends payable	25,452	24,293
Lease deposit liabilities	22,775	22,775
Deferred income	1,415	3,901
Total Liabilities	702,745	678,660
Commitments and Contingencies		
National Health Investors Stockholders' Equity:		
Common stock, $.01 par value; 60,000,000 and 40,000,000 shares authorized; 33,054,599 and 33,051,176 shares issued and outstanding, respectively	331	330
Capital in excess of par value	762,703	753,635
Cumulative dividends in excess of net income	969	3,043
Accumulated other comprehensive income	6,024	9,538
Total National Health Investors Stockholders' Equity	770,027	766,546
Noncontrolling interest	10,355	10,614
Total Equity	780,382	777,160
Total Liabilities and Equity	$1,483,127	$1,455,820

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated financial statements. The Condensed Consolidated Balance Sheet at December 31, 2013 was derived from the audited consolidated financial statements at that date.

Table of Contents

NATIONAL HEALTH INVESTORS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except share and per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(unaudited)		(unaudited)	
Revenues:				
Rental income	$41,353	$24,067	$81,666	$48,172
Interest income from mortgage and other notes	1,748	1,972	3,504	3,941
Investment income and other	1,059	1,063	2,126	2,115
	44,160	27,102	87,296	54,228
Expenses:				
Depreciation	9,540	4,391	18,777	8,639
Interest, including amortization of debt discount and issuance costs	6,829	1,597	13,715	2,721
Legal	10	290	83	566
Franchise, excise and other taxes	406	93	712	237
General and administrative	1,850	2,325	4,785	5,414
Loan and realty losses	—	—	—	4,037
	18,635	8,696	38,072	21,614
Income before equity-method investee, discontinued operations and noncontrolling interest	25,525	18,406	49,224	32,614
Income from equity-method investee	52	70	210	91
Income from continuing operations	25,577	18,476	49,434	32,705
Income from discontinued operations	—	1,622	—	3,316
Net income	25,577	20,098	49,434	36,021
Less: net income attributable to noncontrolling interest	(283)	(178)	(606)	(358)
Net income attributable to common stockholders	$25,294	$19,920	$48,828	$35,663
Weighted average common shares outstanding:				
Basic	33,052,750	27,876,176	33,052,083	27,871,120
Diluted	33,087,283	27,913,727	33,086,258	27,907,600
Earnings per common share:				
Basic:				
Income from continuing operations attributable to common stockholders	$.77	$.66	$1.48	$1.16
Discontinued operations	—	.05	—	.12
Net income per common share attributable to common stockholders	$.77	$.71	$1.48	$1.28
Diluted:				
Income from continuing operations attributable to common stockholders	$.76	$.66	$1.48	$1.15
Discontinued operations	—	.05	—	.12
Net income per common share attributable to common stockholders	$.76	$.71	$1.48	$1.27

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

Table of Contents

NATIONAL HEALTH INVESTORS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(unaudited)		(unaudited)	
Net income	$25,577	$20,098	$49,434	$36,021
Other comprehensive income:				
Change in unrealized gains (losses) on securities	553	(641)	1,341	1,320
Increase (decrease) in fair value of cash flow hedge	(2,079)	974	(3,137)	1,373
Less: reclassification adjustment for amounts recognized in net income	(1,190)	(137)	(1,718)	(266)
Total other comprehensive income (loss)	(2,716)	196	(3,514)	2,427
Comprehensive income	22,861	20,294	45,920	38,448
Less: comprehensive income attributable to noncontrolling interest	(283)	(178)	(606)	(358)
Comprehensive income attributable to common stockholders	$22,578	$20,116	$45,314	$38,090

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

Table of Contents

NATIONAL HEALTH INVESTORS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Six Months Ended June 30,	
	2014	2013
	(unaudited)	
Cash flows from operating activities:		
Net income	$49,434	$36,021
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	18,777	8,973
Amortization	1,081	506
Straight-line rental income	(8,490)	(2,695)
Write-off of debt issuance costs	2,145	353
Loan and realty losses	—	4,037
Share-based compensation	1,573	1,833
Income from equity-method investee	(210)	(91)
Change in operating assets and liabilities:		
Equity-method investment and other assets	(381)	(1,234)
Accounts payable and accrued expenses	177	326
Deferred income	(2,486)	(104)
Net cash provided by operating activities	61,620	47,925
Cash flows from investing activities:		
Investment in mortgage and other notes receivable	(1,214)	(500)
Collection of mortgage and other notes receivable	999	15,484
Investment in real estate	(29,423)	(83,179)
Investment in real estate development	(3,320)	(3,905)
Investment in renovations of existing real estate	(2,076)	(3,336)
Payment of earnest money deposit	—	(2,500)
Payment of real estate purchase liability	(1,600)	—
Net cash used in investing activities	(36,634)	(77,936)
Cash flows from financing activities:		
Net change in borrowings under revolving credit facilities	(51,000)	103,000
Proceeds from convertible senior notes	200,000	—
Borrowings on term loan	130,000	80,000
Payments on term loans	(250,526)	(80,000)
Debt issuance costs	(7,007)	(1,231)
Proceeds from exercise of stock options	—	146
Distributions to noncontrolling interest	(865)	(441)
Dividends paid to stockholders	(49,743)	(44,166)
Net cash (used in) provided by financing activities	(29,141)	57,308
(Decrease) increase in cash and cash equivalents	(4,155)	27,297
Cash and cash equivalents, beginning of period	11,312	9,172
Cash and cash equivalents, end of period	$7,157	$36,469

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

Table of Contents

NATIONAL HEALTH INVESTORS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(in thousands)

	Six Months Ended June 30,	
	2014	2013
	(unaudited)	
Supplemental disclosure of cash flow information:		
Interest paid	$8,886	$2,201
Supplemental disclosure of non-cash investing and financing activities:		
Tax deferred exchange funds applied to investment in real estate	$23,813	$—
Conditional consideration in asset acquisition	$3,000	$1,600
Accounts payable related to investments in real estate	$2,103	$—
Assumption of debt in real estate acquisition	$—	$80,528
Increase (decrease) in fair value of cash flow hedge	$(3,137)	$1,373
Assignment of net assets in equity-method investee	$—	$817

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

Table of Contents

NATIONAL HEALTH INVESTORS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY
(unaudited, in thousands except share and per share amounts)

	Common Stock		Capital in Excess of Par Value	Cumulative Net Income in Excess of Dividends	Accumulated Other Comprehensive Income	Total National Health Investors Stockholders' Equity	Noncontrolling Interest	Total Equity
	Shares	Amount						
Balances at December 31, 2013	33,051,176	$ 330	$ 753,635	$ 3,043	$ 9,538	$ 766,546	$ 10,614	$ 777,160
Total comprehensive income	—	—	—	48,828	(3,514)	45,314	606	45,920
Distributions to noncontrolling interest	—	—	—	—	—	—	(865)	(865)
Shares issued on stock options exercised	3,423	1	—	—	—	1	—	1
Share-based compensation	—	—	1,573	—	—	1,573	—	1,573
Equity component of convertible debt	—	—	7,495	—	—	7,495	—	7,495
Dividends declared, $1.54 per common share	—	—	—	(50,902)	—	(50,902)	—	(50,902)
Balances at June 30, 2014	33,054,599	$ 331	$ 762,703	$ 969	$ 6,024	$ 770,027	$ 10,355	$ 780,382

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

Table of Contents

NATIONAL HEALTH INVESTORS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2014
(unaudited)

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

We, the management of National Health Investors, Inc., ("NHI" or the "Company") believe that the unaudited condensed consolidated financial statements of which these notes are an integral part include all normal, recurring adjustments which are necessary to fairly present the condensed consolidated financial position, results of operations and cash flows of NHI in all material respects. The Condensed Consolidated Balance Sheet at December 31, 2013 has been derived from the audited consolidated financial statements at that date. We assume that users of these condensed consolidated financial statements have read or have access to the audited December 31, 2013 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 those contained in our most recent Annual Report on Form 10-K for the year ended December 31, 2013 have been omitted. This condensed 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. For a better understanding of NHI and its condensed consolidated financial statements, we recommend reading these condensed consolidated financial statements in conjunction with the audited consolidated financial statements for the year ended December 31, 2013, which are included in our 2013 Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission, a copy of which is available at our web site: www.nhireit.com.

Principles of Consolidation - The accompanying consolidated financial statements include our accounts and the accounts of our wholly-owned subsidiaries and the joint venture entity over which we exercise control. All inter-company transactions and balances have been eliminated in consolidation. Net income is reduced by the portion of net income attributable to noncontrolling interests.

We apply Financial Accounting Standards Board ("FASB") guidance for our arrangements with variable interest entities ("VIEs") which requires us to identify entities for which control is achieved through means other than voting rights and to determine which business enterprise is the primary beneficiary of the VIE. A VIE is broadly defined as an entity with one or more of the following characteristics: (a) the total equity investment at risk is insufficient to finance the entity's activities without additional subordinated financial support; (b) as a group, the holders of the equity investment at risk lack (i) the ability to make decisions about the entity's activities through voting or similar rights, (ii) the obligation to absorb the expected losses of the entity, or (iii) the right to receive the expected residual returns of the entity; or (c) the equity investors have voting rights that are not proportional to their economic interests, and substantially all of the entity's activities either involve, or are conducted on behalf of, an investor that has disproportionately few voting rights. We consolidate investments in VIEs when we are determined to be the primary beneficiary of the VIE. We may change our assessment of a VIE due to events such as modifications of contractual arrangements that affect the characteristics or adequacy of the entity's equity investments at risk and the disposal of all or a portion of an interest held by the primary beneficiary.

We identify the primary beneficiary of a VIE as the enterprise that has both: (i) the power to direct the activities of the VIE that most significantly impact the entity's economic performance; and (ii) the obligation to absorb losses or the right to receive benefits of the VIE that could be significant to the entity. We perform this analysis on an ongoing basis. At June 30, 2014, we held an interest in one unconsolidated VIE, of which we were not the primary beneficiary.

We also apply FASB guidance related to investments in joint ventures based on the type of controlling rights held by the members' interests in limited liability companies that may preclude consolidation by the majority equity owner in certain circumstances in which the majority equity owner would otherwise consolidate the joint venture.

We structure our joint ventures to be compliant with the provisions of the REIT Investment Diversification and Empowerment Act of 2007 ("RIDEA") which permits NHI to receive rent payments through a triple-net lease between a property company and an operating company and is designed to give NHI the opportunity to capture additional value on the improving performance of the operating company through distributions to a taxable REIT subsidiary ("TRS"). Accordingly, the TRS holds our equity interest in an unconsolidated operating company, which we do not control, and provides an organizational structure that will allow the TRS to engage in a broad range of activities and share in revenues that would otherwise be non-qualifying income under the REIT gross income tests.

Table of Contents

Equity-Method Investment - We report our TRS' investment in an unconsolidated entity, over whose operating and financial policies we have the ability to exercise significant influence but not control, under the equity method of accounting. Under this method of accounting, our pro rata share of the entity's earnings or losses is included in our Condensed Consolidated Statements of Income. Additionally, we adjust our investment carrying amount to reflect our share of changes in an equity-method investee's capital resulting from its capital transactions.

The initial carrying value of our equity-method investment is based on the fair value of the net assets of the entity at the time we acquired our interest. We estimate fair values of the net assets of our equity-method investee based on discounted cash flow models. The inputs we use in these models are based on assumptions that we believe to be within a reasonable range of current market rates for the respective investments.

We evaluate our equity-method investment for impairment whenever events or changes in circumstances indicate that the carrying value of our investment may exceed the fair value. If it is determined that a decline in the fair value of our investment is not temporary, and if such reduced fair value is below its carrying value, an impairment is recorded. The determination of the fair value of our equity-method investments involves significant judgment. Our estimates consider all available evidence including the present value of the expected future cash flows discounted at market rates, general economic conditions and other relevant factors.

Noncontrolling Interest - We present the portion of any equity that we do not own in entities that we control (and thus consolidate) as noncontrolling interest and classify such interest as a component of consolidated equity, separate from total NHI stockholders' equity, in our Condensed Consolidated Balance Sheets. In addition, we include net income attributable to the noncontrolling interest in net income in our Condensed Consolidated Statements of Income.

Use of Estimates - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Earnings Per Share - The weighted average number of common shares outstanding during the reporting period is used to calculate basic earnings per common share. Diluted earnings per common share assume the exercise of stock options using the treasury stock method, to the extent dilutive. Diluted earnings per share incorporate the potential dilutive impact of our 3.25% convertible senior notes due 2021, and stock options outstanding during the periods presented, unless their effect is anti-dilutive. In addition, we apply the if-converted method to our convertible debt instruments, the effect of which is that conversion will not be assumed for purposes of computing diluted earnings (loss) per share if the effect would be anti-dilutive.

Reclassifications - We have reclassified for 2013 the operations of facilities meeting the accounting criteria as either being sold or held for sale as discontinued operations in the Condensed Consolidated Statements of Income. There is no change to reported net income for the prior periods as a result of this reclassification.

New Accounting Pronouncements - In the first quarter of 2014, we adopted ASU 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. Under ASU 2014-08, disposals will be reported as discontinued operations only when the disposal represents a strategic shift that will have a major effect on our operations and financial results. Previously, we reported the disposition of components that were either reporting units, subsidiaries, or asset groups as discontinued operations. ASU 2014-08 is effective for all disposals (or classifications as held for sale) of components that occur on or after December 15, 2014. We have elected early adoption, under which terms we will prospectively apply ASU 2014-08 and report as discontinued operations only those disposals (or classifications as held for sale) that have not been previously reported.

In May 2014 the FASB issued ASU 2014-09, Revenue from Contracts with Customers. ASU 2014-09 provides a principles-based approach for a broad range of revenue generating transactions, including the sale of real estate, which will generally require more estimates and more judgment and more disclosures than under current guidance. Because this ASU specifically excludes lease contracts from its scope, its application is not expected to impact our recognition of rental income on a straight-line basis. ASU 2014-09 is effective for public entities for annual periods beginning after December 15, 2016, including interim periods therein. Early adoption is prohibited. We are continuing to study the effect that our eventual adoption of ASU 2014-09 will have on our reported financial position and results of operation, the extent of which cannot be reasonably estimable, at this time.

In June 2014 the FASB issued ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. Current FASB guidance does not state whether instruments within the scope of ASU 2014-12 should be treated as a performance condition that affects vesting or as a nonvesting condition that affects the grant-date fair value of an award. Among its provisions, this ASU clarifies that the performance target

Table of Contents

should not be reflected in estimating the grant-date fair value of the award. Rather, compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. ASU 2014-12 is effective for interim and annual periods beginning after December 15, 2015. Early adoption is permitted. We are studying the effects of the ASU prior to adoption. We have not previously issued instruments within its scope, and, accordingly, our eventual adoption of the new standard is expected to have no effect on our financial position, results of operation or cash flows.

NOTE 2. REAL ESTATE

As of June 30, 2014, we owned 162 health care real estate properties located in 30 states and consisting of 93 senior housing communities, 64 skilled nursing facilities, 3 hospitals and 2 medical office buildings. Our senior housing properties include assisted living facilities, independent living facilities, and senior living campuses. These investments (excluding our corporate office of $894,000) consisted of properties with an original cost of approximately $1,481,756,000, rented under triple-net leases to 24 lessees.

Acquisition and New Lease of Real Estate

Chancellor

On June 1, 2014, we acquired a 56-unit assisted living/memory care facility in Sacramento, California for $11,500,000 and leased the facility to Chancellor Health Care, LLC for an initial term of 15 years, plus renewal options. The initial lease rate is 8.0% with fixed annual escalators. Because the facility was owner-occupied, we accounted for the acquisition as an asset purchase.

Prestige

In March 2014 we completed the purchase of 3 skilled nursing facilities in Oregon totaling 196 beds and a 105-unit assisted living facility in Idaho from Prestige Senior Living ("Prestige"). The purchase price includes $40,115,000 in cash and a commitment to fund contingent earn out payments up to a maximum of $6,390,000 based on the achievement of certain financial metrics as measured periodically through December 31, 2015. Because the facilities were owner-occupied, we accounted for the acquisition as an asset purchase. At acquisition, we estimated probable contingent payments of $3,000,000 to be likely and have, accordingly, reflected that amount in the Condensed Consolidated Balance Sheet. Contingent payments earned will be an addition to our investment in the properties when funded and will be included in the lease base.

We have leased the 4 facilities to Prestige with a 15-year term at an initial rate of 8.4% plus fixed annual escalators. In addition, at 2 of the Oregon facilities we have committed to invest $2,000,000 for capital improvements which are expected to be completed by June 30, 2015. This investment will be added to the basis on which the lease amount is calculated.

Holiday

In December 2013 we acquired 25 independent living facilities from Holiday Acquisition Holdings LLC (“Holiday”), an affiliate of Holiday Retirement. We have leased this portfolio to NH Master Tenant, LLC, a subsidiary of Holiday. Our tenant continues to operate the facilities pursuant to a management agreement with a Holiday-affiliated manager. The master lease term of 17 years began in December 2013 and provides for initial base rent of $31,915,000 plus annual escalators of 4.5% in the first 3 years and a minimum of 3.5% each year thereafter.

Of our total revenue from continuing operations, $10,954,000 (25%) and $21,908,000 (25%) was derived from Holiday for the three and six months ended June 30, 2014, respectively. Lease revenue from Holiday for the three and six months ended June 30, 2014 includes straight-line rent of $2,975,000 and $5,951,000, respectively.

NHC

As of June 30, 2014, we leased 42 health care facilities under two master leases to National HealthCare Corporation (“NHC”), a publicly-held company and the lessee of our legacy properties. The facilities leased to NHC consist of 3 independent living facilities and 39 skilled nursing facilities (4 of which are subleased to other parties for whom the lease payments are guaranteed to us by NHC). These facilities are leased to NHC under the terms of an amended master lease agreement originally dated October 17, 1991 ("the 1991 lease") which includes our 35 remaining legacy properties and a master lease agreement dated August 30, 2013 ("the 2013 lease") which includes 7 skilled nursing facilities acquired from ElderTrust of Florida, Inc. on August 31, 2013.

Table of Contents

The 1991 lease has been amended to extend the lease expiration to December 31, 2026. There are two additional 5-year renewal options, each at fair rental value of such leased property as negotiated between the parties and determined without including the value attributable to any improvements to the leased property voluntarily made by NHC at its expense. Under the terms of the lease, the base annual rental is $30,750,000 and rent escalates by 4% of the increase, if any, in each facility's revenue over a 2007 base year. The 2013 lease provides for a base annual rental of $3,450,000 and has a lease expiration of August 2028. Under the terms of the lease, rent escalates 4% of the increase in each facility's revenue over the 2014 base year. For both the 1991 lease and the 2013 lease, we refer to this additional rent component as “percentage rent.” During the last three years of the 2013 lease, NHC will have the option to purchase the facilities for $49,000,000.

The following table summarizes the percentage rent income from NHC (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Current year	$573	$568	$1,139	$1,136
Prior year final certification[1]	—	—	15	746
Total percentage rent income	$573	$568	$1,154	$1,882

[1] For purposes of the percentage rent calculation described in the master lease Agreement, NHC’s annual revenue by facility for a given year is certified to NHI by March 31st of the following year.

Of our total revenue from continuing operations, $9,109,000 (21%) and $8,201,000 (30%) were derived from NHC for the three months ended June 30, 2014 and 2013, respectively, and $18,227,000 (21%) and $17,148,000 (32%) for the six months ended June 30, 2014 and 2013, respectively.

Bickford

As of June 30, 2014, we owned an 85% equity interest and an affiliate of Bickford Senior Living ("Bickford") owned a 15% equity interest in our consolidated subsidiary ("PropCo") which owns 29 assisted living/memory care facilities and also has 1 facility under construction. The facilities are leased to an operating company, ("OpCo"), in which we also retain an 85/15 ownership interest with an affiliate of Bickford, who controls the entity. This joint venture is structured to comply with the provisions of RIDEA.

For the stabilized portfolio of 27 properties, the current annual contractual rent from OpCo to PropCo is $19,108,000, plus fixed annual escalators. OpCo is continuing the lease-up of 2 assisted living facilities which opened in the fourth quarter of 2013. Under the terms of the current development lease agreement, PropCo receives rent from OpCo on the total amount of development costs, including land, which totaled $20,937,000 at June 30, 2014. Of these costs, $15,548,000 relate to the 2 facilities currently in lease-up. As of June 30, 2014, PropCo had purchased land and begun construction on one assisted living/memory care facility having a maximum cost of $9,000,000. Our costs incurred to date, including land, were $5,389,000. Once the facilities stabilize, an annual rental amount will be determined between the parties. Rent income received from the development projects was $671,000 and $295,000 for the six months ended June 30, 2014 and 2013, respectively. NHI has an exclusive right to Bickford's future acquisitions, development projects and refinancing transactions.

Of our total revenues from continuing operations, $5,202,000 (12%) and $2,093,000 (8%) were recognized as rental income from Bickford for the three months ended June 30, 2014 and 2013, respectively, and $10,465,000 (12%) and $4,174,000 (8%) for the six months ended June 30, 2014 and 2013, respectively.

In June 2013 PropCo acquired 14 properties from Care Investment Trust in a transaction we accounted for as a business combination. The unaudited pro forma revenue, net income and net income available to common

stockholders of the combined entity are provided below had the acquisition date been January 1, 2012 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenue	$44,160	$29,690	$87,296	$59,404
Net income	$25,605	$20,506	$49,489	$36,847
Net income available to common stockholders	$25,306	$20,267	$48,863	$36,365
Basic earnings per common share	$.77	$.73	$1.48	$1.30
Diluted earnings per common share	$.76	$.73	$1.48	$1.30

Table of Contents

Supplemental pro forma information above includes revenues from the Care lease with OpCo, recognized on a straight-line basis, depreciation, and appropriate interest costs.

Our revenue from continuing operations includes $2,588,000 and $5,176,000 from the 14 Care properties for the three months and six months ended June 30, 2014, respectively. Our net income includes $409,000 and $807,000 for the three months and six months ended June 30, 2014, respectively.

NOTE 3. EQUITY-METHOD INVESTMENT AND OTHER ASSETS

Our equity-method investment in OpCo and other assets consist of the following (in thousands):

	June 30, 2014	December 31, 2013
Equity-method investment in OpCo	$9,704	$9,494
Debt issuance costs	11,386	7,366
Accounts receivable and other assets	1,519	2,502
Replacement reserve and tax escrows - Fannie Mae	796	706
Lease escrow deposits	22,775	22,775
Escrow deposit for tax deferred exchange	—	23,813
	$46,180	$66,656

Upon the acquisition of our equity method investment in OpCo in 2012, our purchase price was allocated to the assets acquired based upon their estimated relative fair values. Accounting guidance for equity method investments requires that we account for the difference between the cost basis of our investment in OpCo and our pro rata share of the amount of underlying equity in the net assets of OpCo as though OpCo were a consolidated subsidiary. Accordingly, the excess of the original purchase price over the fair value of identified tangible assets at acquisition of $8,986,000 is treated as implied goodwill and is subject to periodic review for impairment in conjunction with our equity method investment. When we acquired 17 properties leased or managed by Bickford in June 2013, an assignment was entered into whereby the operations of the related facilities were conveyed by an affiliate of Bickford to OpCo. The transaction mandated the effective cut-off of operating revenues and expenses and the settlement of operating assets and liabilities as of the acquisition date. Specified remaining net tangible assets were assigned to OpCo at the transferor's carryover basis resulting in an adjustment, through NHI's capital in excess of par value to our equity method investment in OpCo, of $817,000. We monitor and periodically review our equity method investment in OpCo for impairment to determine whether a decline, if any, in the value of the investment is other-than temporary. We noted no decline in value as of June 30, 2014.

OpCo is intended to be self-financing, and aside from initial investments therein, no direct support has been provided by NHI to OpCo since the original investment on September 30, 2012. While PropCo's rental revenues associated with the related properties are sourced from OpCo, a decision to furnish additional direct support would be at our discretion and not obligatory. As a result, we believe our maximum exposure to loss at June 30, 2014, due to our investment in OpCo, would be limited to our equity interest. We have concluded that OpCo meets the accounting criteria to be considered a VIE. However, because we do not control the entity, nor do we have any role in the day-to-day management, we are not the primary beneficiary of the entity, and we account for our investment using the equity method. There were no distributions declared during the six months ended June 30, 2014 and 2013.

At June 30, 2014, we held lease escrow deposits of $22,775,000 in regard to our lease with Holiday. The Holiday deposits include $21,275,000 as a lease security deposit which remains for the term of the 17-year lease commencing in December 2013 and is payable to Holiday at the end of the lease term. The remaining $1,500,000 is reserved for specified capital improvements.

In March 2014 we utilized $23,813,000 held with a qualified intermediary to provide a portion of the funding for the Prestige acquisition discussed in Note 2.

NOTE 4. MORTGAGE AND OTHER NOTES RECEIVABLE

At June 30, 2014, we had investments in mortgage notes receivable with a carrying value of $35,057,000 secured by real estate and UCC liens on the personal property of 11 health care properties and other notes receivable with a carrying value of $25,797,000 guaranteed by significant parties to the notes or by cross-collateralization of properties with the same owner. No allowance for doubtful accounts was considered necessary at June 30, 2014.

Table of Contents

Due to non-receipt of contractual payments, in March 2013 we evaluated the recoverability of the SeniorTrust notes and recognized an impairment to the carrying value in the total amount of $4,037,000.

In June 2014 we entered into a $500,000 revolving loan with our joint venture partner, an affiliate of Bickford, to fund pre-development expenses related to potential future projects. Interest is payable monthly at 10% and the note matures in August 2015. The outstanding balance at June 30, 2014 was $84,000.

NOTE 5. INVESTMENT IN PREFERRED STOCK, AT COST

We recognized $818,000 and $1,636,000 in preferred dividend income from LTC (a publicly-traded REIT) for the three and six months ended June 30, 2014 and 2013 on our investment in 2,000,000 shares of their cumulative preferred stock carried at its original cost of $38,132,000. The preferred stock, which was purchased in September 1998, is not listed on a stock exchange, is considered a non-marketable security and is recorded at cost in our Condensed Consolidated Balance Sheets. The non-voting preferred stock is convertible into 2,000,000 shares of LTC common stock whose closing price at June 30, 2014 was $39.04 per share. The preferred stock has an annual cumulative coupon rate of 8.5% payable quarterly and a liquidation preference of $19.25 per share. While not the fair value of our preferred stock investment, we provide the above information as pertinent to the reader's estimation of the fair value of our investment. In accordance with ASC Topic 825 Financial Instruments, paragraph 10-50 Disclosure-Overall, we have determined that due to excessive costs, it is not practicable to estimate the fair value of our cost basis investment in preferred stock because of inherent subjectivities in refining the estimate to a degree that is likely to materially augment the information provided above. Further, we have identified no events that may have had an adverse effect on its fair value which would have required revisiting the instrument's carrying value.

NOTE 6. INVESTMENTS IN MARKETABLE SECURITIES

Our investments in marketable securities include available-for-sale securities which are reported at fair value. Unrealized gains and losses on available-for-sale securities are presented as a component of accumulated other comprehensive income. Realized gains and losses from securities sales are determined based upon specific identification of the securities.

Marketable securities consist of the following (in thousands):

	June 30, 2014		December 31, 2013	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Common stock of other healthcare REITs	$4,088	$13,991	$4,088	$12,650

Gross unrealized gains related to available-for-sale securities were $9,903,000 at June 30, 2014 and $8,562,000 at December 31, 2013.

NOTE 7. DEBT

Debt consists of the following (in thousands):

	June 30, 2014	December 31, 2013
Convertible senior notes - unsecured (net of discount of $7,484)	$192,516	$—
Revolving credit facility - unsecured	116,000	167,000
Bank term loans - unsecured	250,000	370,000
Fannie Mae term loans - secured (including a premium of $1,705)	79,503	80,080
	$638,019	$617,080

In March 2014 we issued $200,000,000 of 3.25% senior unsecured convertible notes due April 2021 (the "Notes"). Interest is payable April 1st and October 1st of each year. The Notes are convertible at an initial conversion rate of 13.926 shares of common stock per $1,000 principal amount, representing a conversion price of approximately $71.81 per share for a total of approximately 2,785,200 underlying shares. The conversion rate is subject to adjustment upon the occurrence of certain events, as defined in the indenture governing the Notes, but will not be adjusted for any accrued and unpaid interest except in limited circumstances. Upon conversion, NHI's conversion obligation may be satisfied, at our option, in cash, shares of common stock or a combination of cash and shares of common stock. Because the conversion price is in excess of the average stock price for the quarter, the impact of the conversion option is currently anti-dilutive to the earnings per share calculation and as such has no effect on our earnings per share.

Table of Contents

The Notes are split into a debt component and an equity component since they may be settled in cash upon conversion. The value of the debt component is based upon the estimated fair value of a similar debt instrument without the conversion feature at the time of issuance and was estimated to be approximately $192,238,000. The $7,762,000 difference between the contractual principal on the debt and the value allocated to the debt was recorded as an equity component and represents the estimated value of the conversion feature of the instrument. The excess of the contractual principal amount of the debt over its estimated fair value, the original issue discount, is amortized to interest expense using the effective interest method over the estimated term of the Notes. The effective interest rate used to amortize the debt discount and the liability component of the debt issue costs was approximately 3.9% based on our estimated non-convertible borrowing rate at the date the Notes were issued.

The total cost of issuing the Notes was $6,055,000, of which $267,000 was allocated to the equity component and $5,789,000 to the debt component and is amortized over the estimated term of the notes.

On March 27, 2014, we entered into an amended $700,000,000 senior unsecured credit facility. The facility can be expanded, subject to certain conditions, up to an additional $130,000,000. At closing, the new facility amended a smaller credit facility that provided for $620,000,000 of total commitments.

The amended credit facility provides for: (1) a $450,000,000 unsecured, revolving credit facility that matures in March 2019 (inclusive of an embedded 1-year extension option) with interest at 150 basis points over LIBOR; (2) a $130,000,000 unsecured term loan that matures in June 2020 with interest at 175 basis points over LIBOR of which interest of 3.91% is fixed with an interest rate swap agreement; and (3) two existing term loans which remain in place totaling $120,000,000, maturing in June 2020 and bearing interest at 175 basis points over LIBOR, a notional amount of $40,000,000 being fixed at 3.29% until 2019 and $80,000,000 being fixed at 3.86% until 2020.

At June 30, 2014, we had $334,000,000 available to draw on the revolving portion of the credit facility. The unused commitment fee is 40 basis points per annum. The unsecured credit facility requires that we maintain certain financial ratios within limits set by our creditors. To date, these ratios, which are calculated quarterly, have been within the limits required by the credit facility agreements.

As part of the Care acquisition, we assumed Fannie Mae mortgage loans, with principal balances of $70,613,000 and $7,185,000 on June 30, 2014, which have interest at rates of 6.85% and 7.17%, respectively, and mature on July 1, 2015 (prepayable without penalty after December 31, 2014).

The following table summarizes interest expense (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Interest expense at contractual rates	$6,065	$1,193	$10,438	$2,235
Amortization of debt issuance costs and bond discount	764	404	1,132	133
Debt issuance costs expensed due to credit facility modifications	—	—	2,145	353
Total interest expense	$6,829	$1,597	$13,715	$2,721

Interest Rate Swap Agreements

To mitigate our exposure to interest rate risk, we have entered into the following interest rate swap contracts on our bank term loans as of June 30, 2014 (dollars in thousands):

Date Entered	Maturity Date	Fixed Rate	Rate Index	Notional Amount	Fair Value
May 2012	April 2019	3.29%	1-month LIBOR	$40,000	$(39)

June 2013	June 2020	3.86%	1-month LIBOR	$80,000	$(1,333)
March 2014	June 2020	3.91%	1-month LIBOR	$130,000	$(2,508)

See Note 12 for fair value disclosures about our Fannie Mae mortgage loan and interest rate swap agreements.

In July 2014 we obtained $29,199,000 of mortgage debt from the U.S. Department of Housing and Urban Development ("HUD") secured by seven properties in our joint venture with an affiliate of Bickford. The mortgage notes require monthly payments of

principal and interest at 4.3% and mature in August 2049. Two additional mortgages are currently in process and will bring the total proceeds from HUD debt to approximately $38,000,000. We are using these proceeds to retire borrowings under our revolving credit facility.

NOTE 8. COMMITMENTS AND CONTINGENCIES

Bickford

As of June 30, 2014, our subsidiary PropCo had purchased land and begun construction on one assisted living/memory care facility having a maximum cost of $9,000,000. Our costs incurred to date, including land, were $5,389,000. The facility is expected to open by the end of the third quarter of 2014. In February 2014 NHI entered into a commitment of $2,785,000 on a letter of credit for the benefit of our joint venture partner, an affiliate of Bickford, which holds a minority interest in PropCo. See Note 4 for a discussion of our outstanding revolving loan commitment with an affiliate of Bickford.

Chancellor

In October 2013, we entered into a $7,500,000 commitment to build a 46-unit free-standing assisted living and memory care community, expanding our Linda Valley senior living campus in Loma Linda, California. We began construction during the first quarter of 2014 and had funded $1,029,000 as of June 30, 2014. The initial lease term is for 15 years at an annual rate of 9% plus a fixed annual escalator. NHI purchased the Linda Valley campus in 2012 and leased it to Chancellor Health Care, who has been operating the campus since 1993. We also committed to provide up to $500,000 for renovations and improvements related to our recent acquisition of a 63-unit senior housing community in Baltimore, Maryland which we have leased to Chancellor Health Care. We began renovations during the first quarter of 2014 and had funded $161,000 as of June 30, 2014. We receive rent income on funds advanced for both construction projects.

Discovery

As a lease inducement, we have a contingent commitment to fund a series of payments up to $2,500,000 in connection with our September 2013 lease to Discovery Senior Living ("Discovery") of a senior living campus in Rainbow City, Alabama. Discovery would earn the contingent payments upon obtaining and maintaining a specified lease coverage ratio. As earned, the payments would be due in installments of $750,000 in each of years two and three of the lease with the residual due in year four. As of June 30, 2014, the likelihood that we would incur the contingent payments was not considered probable. Accordingly, no provision for these payments is reflected in the condensed consolidated financial statements.

Fundamental

In April 2013, we completed the purchase of two skilled nursing facilities located in Canton and Corinth, Texas for a purchase price of $26,150,000 in cash, plus consideration related to the Corinth facility of $1,600,000 conditional upon the achievement of certain operating metrics. In March 2014 upon satisfactory achievement of the required operating metrics, we made the full $1,600,000 payment to Fundamental.

Kentucky River

In March 2012, we entered into a long-term lease extension and construction commitment to Jackson Hospital Corporation, an affiliate of Community Health Systems, to provide up to $8,000,000 for extensive renovations and additions to our Kentucky River Medical Center, a general acute care hospital in Jackson, Kentucky. This investment

will be added to the basis on which the lease amount is calculated. The construction project commenced during the first quarter of 2013 and is expected to continue over two years. Total construction costs incurred as of June 30, 2014 were $7,094,000. The 10-year lease extension began July 1, 2012, with an additional 5-year renewal option.

Prestige

We have agreed to fund capital improvements of up to $2,000,000 in connection with our lease of facilities to Prestige. The capital improvements will be an addition to our investment in the properties when funded and will be included in the lease base. As of June 30, 2014, we had funded $13,000 of this commitment. Additionally, we have committed to fund contingent earn out payments up to a maximum of $6,390,000 based on the achievement of certain financial metrics as measured periodically through December 31, 2015. At acquisition, we estimated probable contingent payments of $3,000,000 to be likely and have reflected that amount in the condensed consolidated financial statements. Contingent payments earned will be an addition to our investment in the properties when funded and will be included in the lease base.

Table of Contents

Santé

We have a $2,000,000 supplemental construction commitment to our borrower, Santé Partners, LLC (“Santé”). This additional loan amount becomes available to the borrower when the 70-bed transitional rehabilitation hospital, completed in March 2011, achieves certain operating metrics. NHI also has the option to purchase and lease back the hospital when it achieves a predetermined level of stabilized net operating income.

In connection with our Silverdale, Washington senior living campus, we have a contingent commitment to fund two lease inducement payments of $1,000,000 each. Santé would earn the payments upon obtaining and maintaining a specified lease coverage ratio. If earned, the first payment would be due after the second lease year and the second payment would be due after the third lease year. At acquisition, the likelihood that we would incur the contingent payments was not considered probable. Accordingly, no provision for these payments is reflected in the condensed consolidated financial statements.

Helix Healthcare

In March 2010, we completed a purchase/leaseback transaction with Helix Healthcare (“Helix”) for $12,500,000. The purchase price includes a conditional payment of $1,000,000, which is recorded as a purchase liability.

Litigation