

NATIONAL HEALTH INVESTORS INC
Form 10-K
March 23, 2007

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006

OR

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

For the transition period from _____ to _____

Commission File Number 001-10822

National Health Investors, Inc.

(Exact name of registrant as specified in its charter)

MARYLAND

(State or other jurisdiction of incorporation or organization)

62-1470956

(I.R.S. Employer Identification Number)

100 Vine Street, Suite 1202, Murfreesboro, Tennessee 37130

(Address of principal executive offices)

37130

(Zip Code)

Company's telephone number, including area code: **(615) 890-9100**

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

| <u>Title of each Class</u> | <u>Name of each exchange on which registered</u> |
|-------------------------------|--|
| Shares of Common Stock | New York Stock Exchange |
| 7.30% Notes Due 2007 | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: **Same**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes: No:

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes: No:

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes: No:

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Act). Large accelerated filer Accelerated filer 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 :

The aggregate market value of voting stock held by nonaffiliates on June 30, 2006 (based on the closing price of such shares on the New York Stock Exchange) was approximately \$561 million. For purposes of the foregoing calculation only, all directors, named executive officers and persons known to the Registrant to be holders of 5% or more of the Registrant's Common Stock have been deemed affiliates of the Registrant. The number of shares of Common Stock outstanding as of March 22, 2007 was 27,756,091.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement for its 2007 annual meeting of stockholders are incorporated by reference into Part III, Items 10, 11, 12, 13, and 14 of this Form 10-K.

PART I

ITEM 1. BUSINESS.

General

National Health Investors, Inc. (NHI or the Company) is a real estate investment trust ("REIT") which invests in income-producing health care properties primarily in the long-term care industry. As of December 31, 2006, we had ownership interests in real estate, mortgage and notes receivable investments totaling approximately \$334,731,000 and other investments in preferred stock and marketable securities of \$63,645,000 resulting in total invested assets of \$398,376,000. Our mission is to invest in health care real estate which generates current income that will be distributed to stockholders. We have pursued this mission by making mortgage loans and acquiring properties to lease nationwide, primarily in the long-term health care industry. These investments include long-term care facilities, acute care hospitals, medical office buildings, retirement centers and assisted living facilities, all of which are collectively referred to herein as "Health Care Facilities". We have funded these investments through three sources of capital: (1) current cash flow, including principal prepayments from our borrowers, (2) the sale of equity in the form of common and preferred stock, and (3) debt offerings, including bank lines of credit, the issuance of convertible debt instruments, and the issuance of straight debt. At December 31, 2006, we had no outstanding bank lines of credit or convertible debt instruments.

As of December 31, 2006, we had approximately \$334,731,000 in real estate, mortgage and notes receivable investments in 139 health care facilities located in 18 states consisting of 97 long-term care facilities, 1 acute care hospital, 4 medical office buildings, 14 assisted living facilities, 6 retirement centers and 17 residential projects for the developmentally disabled. These investments consisted of approximately \$99,532,000 aggregate carrying amount of loans to 15 borrowers and \$235,199,000 of purchase-leaseback agreements with 17 lessees. Of these 139 facilities, 41 are leased to National HealthCare Corporation (NHC), a publicly-held company and our largest customer. These 41 facilities include 4 centers subleased to and operated by other companies, the lease payments to us being guaranteed by NHC. Of the 139 facilities, 17 were previously acquired through foreclosure and have been sold to third-parties, though we have not met the accounting criteria under Statement of Financial Accounting Standards No. 66 to record the sales for financial statement purposes. Our investment in notes receivable at December 31, 2006 included \$8,750,000 from National Health Realty (NHR), a publicly-held real estate investment trust.

We will continue to review our investment opportunities as we generate cash from our operating, investing and financing activities. At December 31, 2006, we were committed, subject to due diligence and financial performance goals, to fund approximately \$815,000 in health care real estate projects. The commitments include investments for 3 long-term health care facilities at rates of prime plus 2% (10.25% at December 31, 2006).

Effective November 1, 2004, we assigned our Advisory, Administrative Services and Facilities Agreement (the "Advisory Agreement") with NHC to Management Advisory Source, LLC, (MAS) formed by NHI's President and

Board Chairman W. Andrew Adams. NHI has no ownership in MAS. Pursuant to this Advisory Agreement, services related to investment activities and day-to-day management and operations are provided to NHI by MAS. Accordingly, MAS is subject to the supervision of and policies established by NHI's Board of Directors. Prior to November 1, 2004, NHC had provided advisory services to us since our inception.

Unless the context indicates otherwise, references herein to the Company , we and our include all of our subsidiaries.

Types of Health Care Facilities

Long-term care facilities. As of December 31, 2006, we owned and leased 66 licensed long-term care facilities, 34 of which were operated by NHC. All of the 32 remaining licensed long-term care facilities are leased to other long-term care companies. We also had outstanding first mortgage loans on 31 additional licensed long-term care facilities. All of these facilities provide some combination of skilled and intermediate nursing and rehabilitative care, including speech, physical and occupational therapy. The operators of the long-term care facilities receive payment from a combination of private pay sources and government programs such as Medicaid and Medicare. Long-term care facilities are required to obtain state licenses and are highly regulated at the federal, state and local level. Most long-term care facilities must obtain certificates of need from the state before opening or expanding such facilities.

Acute and long term care hospitals. As of December 31, 2006, we owned and leased 1 acute care hospital. Acute care hospitals provide a wide range of inpatient and outpatient services and are subject to extensive federal, state and local legislation and regulation. Acute and long term care hospitals undergo periodic inspections regarding standards of medical care, equipment and hygiene as a condition of licensure. Services provided by acute and long term care hospitals are generally paid for by a combination of private pay sources and governmental programs.

Medical office buildings. As of December 31, 2006, we owned and leased 4 medical office buildings. Medical office buildings are specifically configured office buildings whose tenants are primarily physicians and other medical practitioners. Medical office buildings differ from conventional office buildings due to the special requirements of the tenants and their patients. Each of our owned medical office buildings is leased to one lessee, and is either physically attached to or located on an acute care hospital campus. The lessee then leases individual office space to the physicians or other medical practitioners. The lessee is responsible to us for the lease obligations of the entire building, regardless of its ability to lease the individual office space.

Assisted Living Facilities. We own 14 assisted living facilities which are leased to individual operators. Assisted living facilities are either free-standing or are attached to long-term care or retirement facilities and provide basic room and board functions for the elderly. Some assisted living projects include licensed long-term care (nursing home) beds. On-site staff personnel are available to assist in minor medical needs on an as needed basis.

Retirement Centers. We own 5 retirement centers, three of which are leased to NHC, one to Sun Healthcare, and one to ElderTrust and have a first mortgage on one other center. Retirement centers offer specially designed residential units for the active and ambulatory elderly and provide various ancillary services for their residents including restaurants, activity rooms and social areas. Charges for services are paid from private sources without assistance from government programs. Retirement centers may be licensed and regulated in some states, but do not require the issuance of a certificate of need such as is required for long-term care facilities.

Residences for the developmentally disabled. As of December 31, 2006, we had outstanding first mortgage notes on 17 residences for the developmentally disabled. Residences for the developmentally disabled are generally small home-like environments which accommodate six to eight mentally and developmentally disabled persons. These persons obtain custodial care which includes food, lodging, education and transportation services. These community based services are replacing the large state institutions which have historically provided care to the developmentally disabled. Services to the developmentally disabled are primarily paid for by state Medicaid programs.

Nature of Investments

Our investments are typically structured as either purchase-leaseback transactions or mortgage loans. We also provide construction loans for facilities for which we have already committed to provide long-term financing or which the operator agrees to enter into a lease with us upon completion of the construction. The lease rates of our leases and the interest rates on the mortgage loans and construction loans have historically ranged between 9% and 12% per annum. We typically charge a commitment fee of 1% based on the purchase price of the property of a purchase-leaseback or the total principal loan amount of a mortgage loan. In instances where construction financing has also been supplied, there is generally an additional 1% commitment fee for the construction financing. We believe our lease terms, mortgage loan and construction loan terms are competitive in the market place. Except for certain properties, as described under Real Estate and Mortgage Write-downs (Recoveries) in Item 7, all of the operating Health Care Facilities are currently performing under their mortgage loans or leases. Typical characteristics

of these transactions are as follows:

Mortgage Loans. In general, the term of our mortgage loans is 10 years with the principal amortized over 20 to 25 years and a balloon payment due at the end of the 10 year term. Substantially all mortgage loans have an additional interest component which is based on the escalation of gross revenues at the project level or fixed rate increases. In certain of our mortgage loans, we have received an equity participation which allows us to share in a portion of any appreciation of the equity value of the underlying property. We do not expect the equity participations to constitute a significant or frequent source of income. In most cases, the owner of the property has committed to make minimum annual capital improvements for the purpose of maintenance or upgrading their respective facilities.

Leases. Our leases generally have an initial leasehold term of 10 to 15 years with one or more five-year renewal options. The leases are "triple net leases" under which the tenant is responsible to pay all taxes, utilities, insurance premium costs, repairs and other charges relating to the ownership and operation of the Health Care Facilities. The tenant is generally obligated at its expense to keep all improvements and fixtures and other components of the Health Care Facilities covered by "all risk" insurance in an amount equal to at least the full replacement costs thereof and to maintain specified minimal personal injury and property damage insurance, protecting us as well as the tenant at such Health Care Facility. The leases also require the tenant to indemnify and hold harmless NHI from all claims resulting from the use and occupancy of each Health Care Facility by the tenant and related activities, as well as to indemnify NHI against all costs related to any release, discovery, clean-up and removal of hazardous substances or materials on, or other environmental responsibility with respect to, each Health Care Facility.

Some of our existing leases contain annual escalators in rent payments. All of the acute care and medical office building properties which we own and lease give the lessee an option to purchase the underlying property at the greater of i) our acquisition costs; ii) the then fair market value as established by independent appraisers or iii) the sum of the land costs, construction costs and any additional capital improvements made to the property by us. In addition, the acute care and medical office building leases contain a right of first refusal for the lessee if we receive an offer to buy the underlying leased property.

Most of the obligations under the leases are guaranteed by the parent corporation of the lessee, if any, or affiliates or individual principals of the lessee. In some leases, the third party operator will also guarantee some portion of the lease obligations, usually for a fixed period such as six months or one year. Some obligations are further backed by other collateral such as machinery, equipment, furnishings and other personal property.

Construction loans. From time to time, although none are currently outstanding, we also provide construction loans that by their terms convert either into purchase leaseback transactions or mortgage loans upon the completion of the construction of the facility. The term of such construction loans are for a period which commences upon the closing of such loan and terminates upon the earlier of (a) the completion of the construction of the applicable facility or (b) a specific date. During the term of the construction loan, funds are usually advanced pursuant to draw requests made by the borrower in accordance with the terms and conditions of the loan. In addition to the security of the lien against the property, we will generally require additional security and collateral in the form of either payment and performance completion bonds or completion guarantees by the borrower's parent, affiliates of the borrower or one or more of the individuals who control the borrower. No such loans are currently outstanding.

Operating Facilities. We owned and operated 17 long-term health care facilities (the Foreclosure Properties) that we acquired through foreclosure or through the acceptance of deeds in lieu of foreclosure and subsequently sold the facilities to an unrelated not-for-profit entity, providing 100% financing. The operating revenues and expenses of these facilities continue to be recorded in the consolidated statements of income until such time as 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 account for the sale under the full accrual method.

Competition and Market Conditions

We compete with real estate partnerships, other REITs and other investors (including, but not limited to, banks, insurance companies, and investment bankers who market securities in mortgage funds) in the acquisition, leasing and financing of health care-related entities, primarily on the basis of price, available capital, knowledge of the industry and flexibility of financing structure.

The operators of the Health Care Facilities compete on a local and regional basis with operators of facilities that provide comparable services. Operators compete for patients and staff based on quality of care, reputation, physical appearance of facilities, services offered, family preference, physicians, staff and price. They compete with independent operators as well as companies managing multiple facilities, some of which are substantially larger and have greater resources than the operators of the Health Care Facilities. Some of these facilities are operated for profit while others are owned by governmental agencies or tax-exempt non-profit organizations.

The long-term care facilities to which we provide mortgage loans and which we lease to others receive the majority of their revenues from Medicare, Medicaid and other government programs. From time to time, these facilities have experienced Medicare and Medicaid revenue reductions brought about by the enactment of legislation to reduce government costs. Beginning January 1, 2006, CMS (Centers for Medicare and Medicaid Services) implemented major changes to the SNF PPS payment methodology (See Sources of Revenue) that reduced payments to facilities by about 5%. State Medicaid funding is not expected to keep pace with inflation according to industry studies.

Additionally, the assisted living industry experienced slower fill up rates on new projects and more competition for their mature projects as overbuilding occurred in certain markets. Any changes in reimbursement methodology that reduces reimbursement to levels that are insufficient to cover the operating costs of our borrowers, lessees and the facilities we operate could adversely impact us.

Operators

The majority of the Health Care Facilities are operated by the owner or lessee. As a percent of total investments, 26.7% of the Health Care Facilities are operated by publicly-owned companies, while 61.8% are operated by regional health care operators and 11.5% are operated by smaller operators. We consider the operator to be an important factor in determining the creditworthiness of the investment, and we generally have the right to approve any changes in operators. Operators who collectively operate more than 3% of our total real estate investments are as follows: NHC, Health Services Management of

Texas, LLC, THI of Baltimore, Inc., Sunrise Senior Living Services, Inc., Health Services Management, Inc., Community Health Systems, Inc., ElderTrust of Florida, RGL Development, LLC, Senior Living Management, American HealthCare, LLC and SeniorTrust of Florida, Inc.

NHC Master Agreement to Lease

On December 27, 2005, under an amendment to the Master Lease, NHC exercised its option to extend the existing lease on 41 properties for the second renewal term. These 41 properties include 38 skilled nursing homes, (four of which are subleased to other parties for whom the lease payments are guaranteed to us by NHC under the Master Lease), and three retirement centers. The 15-year lease extension begins January 1, 2007, and includes three additional five-year renewal options, each at fair market value. Under the terms of the lease, total rent for 2007 will total \$33,700,000 (compared to \$31,309,000; \$33,328,000; and \$32,836,000 in 2006, 2005, and 2004, respectively) with rent thereafter escalating by 4% of the increase in facility revenue over a 2007 base year. The master lease was scheduled to expire on December 31, 2006 unless extended by NHC. The terms of the existing lease remained in place for 2006 as discussed below.

Before amendment on December 27, 2005, and before termination of one lease each in 2004 and 2005, the Master Agreement To Lease (the "Master Lease") with NHC covered 40 nursing homes and three retirement centers and contained terms and conditions applicable to all leases entered into by and between NHC and the Company (the "Leases"). The Leases were for an initial term expiring on December 31, 2001 with two five year renewal options at the election of NHC which allow for the renewal of the leases on an omnibus basis only. During 2000, NHC exercised its option to extend the lease term for the first five-year renewal term under the same terms and conditions as the initial term. During 2000, individual facility leases for four centers, all in Florida, were terminated and NHC re-leased the properties to third parties. Although NHC's rent obligations pursuant to the Master Lease are unchanged, NHC receives a credit for rents paid to NHC by the new operators of the four Florida centers.

During the initial term and the first renewal term ending on December 31, 2006 (which renewal term has been exercised by NHC), NHC is obligated to pay three types of rent for the respective Health Care Facilities: (1) base rent, (2) debt service rent, and (3) percentage rent. Base rent (which includes rent on property additions since inception) totaled \$19,027,000 in 2006. Debt service rent varies from year to year and is the amount of interest and principal on the mortgages to which the Health Care Facilities were subject when they were transferred to us in 1991. Debt service rent has been adjusted for refinancings from time to time and totaled \$7,453,000 in 2006.

In addition to base rent and debt service rent, NHC must pay percentage rent to us equal to 3% of the increase in the gross revenue of each facility. Effective January 1, 2000, we amended our lease agreements with NHC to provide for the calculation of percentage rent based on quarterly revenue increases rather than annual revenue increases. NHC paid \$4,829,000 as percentage rent for 2006.

The Master Agreement is a "triple net lease", under which NHC is responsible for all taxes, utilities, insurance premium costs, repairs (including structural portions of the buildings, constituting a part of the Health Care Facilities) and other charges relating to the ownership and operation of the Health Care Facilities. NHC is obligated at its expense to keep all improvements and fixtures and other components of the Health Care Facilities covered by "all risk" insurance in an amount equal to the full replacement costs thereof, insurance against boiler explosion and similar insurance, flood insurance if the land constituting the Health Care Facility is located within a designated flood plain area and to maintain specified property damage insurance, protecting us as well as NHC at such Health Care Facility. NHC is also obligated to indemnify and hold us harmless from all claims resulting from the use and occupancy of each Health Care Facility by NHC or persons claiming under NHC and related activities, as well as to indemnify us against all costs related to any release, discovery, cleanup and removal of hazardous substances or materials on, or other environmental responsibility with respect to, each Health Care Facility leased by NHC.

Commitments

As of December 31, 2006, we have commitments to third parties to make loans to fund projects totaling \$815,000 as follows:

| Facility Type | Facilities | Commitments | | Total |
|-----------------|------------|-----------------------|-------------------|------------|
| | | Less Than One Year | After One Year | |
| Long-term Care | 3 | \$ 815,000 | \$ | \$ 815,000 |
| Assisted Living | | | | |
| Totals | 3 | \$ 815,000 | \$ | \$ 815,000 |

Sources of Revenues

General. Our revenues are derived primarily from mortgage interest income, rental income and the operation of the Foreclosure Properties. During 2006, mortgage interest income equaled \$14,981,000 of which \$217,000 was from NHC. Rental income totaled \$46,281,000 of which \$31,309,000 was from properties leased by NHC. The interest and rental payments are primarily derived from the operations of the Health Care Facilities. The source and amount of revenues from such operations are determined by (i) the licensed bed or other capacity of the Health Care Facilities, (ii) the occupancy rate of the Health Care Facilities, (iii) the extent to which the services provided at each Health Care Facility are utilized by the patients, (iv) the mix of private pay, Medicare and Medicaid patients at the Health Care Facilities, and (v) the rates paid by private paying patients and by the Medicare and Medicaid programs. Facility operating revenues are derived from the operations of the Foreclosure Properties and are determined by similar factors.

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

Medicare and Medicaid. A significant portion of the revenue of our Foreclosure Properties and our lessees and borrowers is derived from governmental-funded reimbursement programs, such as Medicare and Medicaid.

Medicare is uniform nationwide and reimburses nursing centers under a fixed payment methodology named the Prospective Payment System (SNF PPS). PPS was instituted as mandated by the Balanced Budget Act of 1997. PPS became effective July 1, 1998. PPS is an acuity based classification system that uses nursing and therapy indexes adjusted by geographical wage indexes to calculate per diem rates for each Medicare patient. Payment rates are updated annually and are generally increased each October when the federal fiscal year begins. The acuity classification system is named Resource Utilization Groups III (RUGs). SNF PPS as implemented had an adverse impact on the healthcare industry and our lessees and borrowers business by decreasing payments materially, which has adversely impacted our business. Refinements in the form of temporary add-ons provided some relief until October 1, 2002. Annual market basket (inflationary) increases have continued to improve payments.

On July 28, 2005, the Centers for Medicare and Medicaid Services (CMS) issued a final rule updating SNF PPS and consolidated billing provisions. The rule updates the per diem payment rates under the SNF PPS for federal fiscal year (FY) 2006.

Effective October 1, 2006, PPS rates were increased by a 3.1% annual inflation update factor. Payments to facilities for the fourth quarter of 2006 reflect the continuation of the temporary add-on payments.

Including inflation, total projected payments to providers in FY 2006 were the same as total payments made to providers in FY 2005. However, the final rule caused a redistribution of payments among providers. This was accomplished by expanding the RUGs from 44 RUG groups to 53 RUG groups, and eliminating temporary rate add-ons. The elimination of temporary add-ons has always been tied to the long awaited RUG refinement. RUG refinement modifies case mix weights and indexes. This is a permanent change in the PPS methodology. Excluding the 3.1% annual inflation update factor, RUG refinement reduced Medicare payment rates beginning January 1, 2006 by 5%, thereby reducing 2006 revenues for operators of long-term care facilities.

Medicaid is a joint federal and state program designed to provide medical assistance to medically indigent persons. These programs are operated by state agencies that adopt their own medical reimbursement methodology and standards. Payment rates and covered services vary from state to state. In many instances, revenues from Medicaid programs are insufficient to cover the actual costs incurred in providing care to those patients. State Medicaid plans subject to budget constraints are of particular concern to us given the repeal of the Boren Amendment by the Balance Budget Act of 1997. The Boren Amendment provided fair reimbursement protection to nursing facilities. Changes in federal funding and pressure on certain provider taxes coupled with state budget problems have produced an uncertain environment. Industry studies predict the Medicaid crisis will continue with states required contribution to Medicare Part D and anticipated budget deficits. States will more than likely be unable to keep pace with nursing center inflation. States are under pressure to pursue other alternatives to long term care such as community and home based services. Furthermore, several of the states in which we have investments have actively sought to reduce or slow the increase of Medicaid spending for nursing home care.

Medicare and Medicaid programs are highly regulated and subject to frequent and substantial changes resulting from legislation, adoption of rules and regulations, and administrative and judicial interpretations of existing law. Moreover, as health care facilities have experienced increasing pressure from private payors attempting to control health care costs, reimbursement from private payors has in many cases effectively been reduced to levels approaching those of government payors.

Licensure and Certification. The health care industry is highly regulated by federal, state and local law, and is directly affected by state and local licensing requirements, facility inspections, state and federal reimbursement policies, regulations concerning capital and other expenditures, certification requirements and other such laws, regulations and rules. Sanctions for failure to comply with these regulations and laws include (but are not limited to) loss of licensure, fines and loss of certification to participate in the Medicare and Medicaid programs, as well as potential criminal penalties. The failure of any lessee or borrower to comply with such laws, requirements and regulations could affect its ability to operate the facility or facilities and could adversely affect such lessee's or borrower's ability to make lease or debt payments to us.

In the past several years, due to rising health care costs, there has been an increased emphasis on detecting and eliminating fraud and abuse in the Medicare and Medicaid programs. Payment of any consideration in exchange for referral of Medicare and Medicaid patients is generally prohibited by federal statute, which subjects violators to severe penalties, including exclusion from the Medicare and Medicaid programs, fines and even prison sentences. In recent years, both federal and state governments have significantly increased investigation and enforcement activity to detect and punish wrongdoers. In addition, legislation has been adopted at both state and federal levels which severely restricts the ability of physicians to refer patients to entities in which they have a financial interest.

It is anticipated that the trend toward increased investigation and enforcement activity in the area of fraud and abuse, as well as self-referral, will continue in future years. Certain of our investments are with lessees or borrowers which are partially or wholly owned by physicians. In the event that any lessee or borrower were to be found in violation of laws regarding fraud and abuse or self-referral, that lessee's or borrower's ability to operate the facility as a health care facility could be jeopardized, which could adversely affect the lessee's or borrower's ability to make lease or debt payments to us and thereby adversely affect us.

Certificates of Need. Certain Health Care Facilities in which we invest are also generally subject to state statutes which may require regulatory approval in the form of a certificate of need ("CON") prior to the addition or construction of new beds, the addition of services or certain capital expenditures. CON requirements are not uniform throughout the United States and are subject to change. We cannot predict the impact of regulatory changes with respect to CON's on the operations of our lessees and mortgagees; however, in our primary market areas, a significant reduction in new construction of long term care beds has occurred.

Investment Policies

Our investment objectives are (i) to provide current income for distribution to our stockholders through investments primarily in health care related facilities, (ii) to provide the opportunity to realize capital growth resulting from appreciation, if any, in the residual value of our portfolio properties, and (iii) to preserve and protect stockholders' capital. There can be no assurance that these objectives will be realized.

We anticipate making new investments in 2007. In making new investments, we would consider such factors as (i) the geographic area and type of property, (ii) the location, construction quality, condition and design of the property, (iii) the current and anticipated cash flow and its adequacy to meet operational needs and lease or mortgage obligations and to provide a competitive market return on equity to our investors, (iv) the growth, tax and regulatory environments of the communities in which the properties are located, (v) occupancy and demand for similar health care facilities in the same or nearby communities, (vi) the quality, experience and creditworthiness of the management operating the facilities located on the property; and (vii) the

mix of private and government sponsored patients. There can be no assurances that investments containing these attributes will be found or closed.

We will not, without the approval of a majority of the Board of Directors, enter into any joint venture relationships with or acquire from or sell to any director, officer, or employee of NHC or NHI, or any affiliate thereof, as the case may be, any of our assets or other property.

The Board of Directors, without the approval of the stockholders, may alter our investment policies if they determine that such a change is in our best interests and our stockholders' best interests. The methods of implementing our investment policies may vary as new investment and financing techniques are developed or for other reasons.

We may incur additional indebtedness in the future to make investments in health care related facilities or business when it is advisable in the opinion of the Board of Directors. We may negotiate other lines of credit, or arrange for other short or long-term borrowings from banks, NHC or otherwise. We have and may arrange for long term borrowings from institutional investors or through public offerings. We have invested and may in the future invest in properties subject to existing loans or secured by mortgages, deeds of trust or similar liens with favorable terms or REMIC investments.

Advisory Agreement

Management Advisory Source, LLC - Effective November 1, 2004, we assigned our Advisory Agreement with NHC to a new company, Management Advisory Source, LLC (MAS), formed by NHI's President and Board Chairman, W. Andrew Adams. NHI has no ownership in MAS. Pursuant to this agreement, services related to investment activities and day-to-day management and operations are provided to NHI by MAS. Accordingly, MAS is subject to the supervision of and policies established by NHI's Board of Directors. In 2006, the expense recorded under the Advisory Agreement was \$3,499,000. We believe it to be in the best interest of NHI to accentuate its independence from NHC, its largest tenant. Therefore, Mr. Adams, through his company MAS, assumed the responsibilities of the Advisory Agreement. To assure independence from NHC, Mr. Adams resigned as CEO of NHC and terminated his managerial responsibilities with NHC in 2004. From November 1, 2004 to October 1, 2006, Mr. Adams outsourced non-managerial functions of the Advisory Agreement such as payroll processing, accounting, financing and the like to NHC. Effective October 1, 2006, MAS began to provide these services. Mr. Adams has remained as NHC Board Chairman, focusing on strategic planning, but has no management involvement with NHC.

NHC - We entered into the Advisory Agreement on October 17, 1991 with NHC as "Advisor" under which NHC provided management and advisory services to us through November 1, 2004. Under the Advisory Agreement, we engaged NHC to use its best efforts (a) to present to us a continuing and suitable investment program consistent with our investment policies adopted by the Board of Directors from time to time; (b) to manage our day-to-day affairs and operations; and (c) to provide administrative services and facilities appropriate for such management. In performing its obligations under the Advisory Agreement, NHC was subject to the supervision of and policies established by our

Board of Directors.

The Advisory Agreement was initially for a stated term which expired December 31, 1997. Since then, the Agreement was on a year-to-year term, but terminable on 90 days notice, and terminable for cause at any time. For 1993 and later years, the Advisor was entitled to annual compensation which was calculated on a formula related to the increase in funds from operations per common share (as defined in the Advisory Agreement).

Pursuant to the Advisory Agreement, the advisor managed all of our day-to-day affairs and provided all such services through its personnel or contractual agreements. The Advisory Agreement provided that without regard to the amount of compensation received by the Advisor under the Advisory Agreement, the Advisor pay all expenses in performing its obligations including the employment expenses of the personnel providing services to us. The Advisory Agreement further provided that NHI pay the expenses incurred with respect to and allocable to the prudent operation and business of NHI including any fees, salaries, and other employment costs, taxes and expenses paid to our directors, officers and employees who are not also employees of the Advisor.

Investor Information

We maintain a worldwide web site at www.nhinvestors.com. We publish to this web site our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and press releases. We do not necessarily have these filed the same day as they are filed with the SEC or released to the public, but rather have a policy of placing these on the web site within two (2) business days of public release or SEC filing.

We also maintain the following documents on the web site:

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The NHI Code of Ethics and Standards of Conduct. This has been adopted for all employees of our Administrative Services Contractor, officers and directors of the Company. The website will also disclose whether there have been any amendments or waivers to the Code of Ethics and Standards of Conduct. To date there have been none.

*

Information on our NHI Valuesline , which allows our staff and investors unrestricted access to our Corporate Compliance Officer, executive officers and directors. The toll free number is 800-526-4064 and the communications may be made anonymously, if desired.

*

The NHI Restated Audit Committee Charter.

*

The NHI Compensation Committee Charter.

*

The NHI Nomination and Corporate Governance Committee Charter

We will furnish, free of charge, a copy of any of the above documents to any interested investor upon receipt of a written request.

ITEM 1A. RISK FACTORS.

We depend on the operating success of our tenants, who operate in the skilled nursing and assisted living industry for collection of our rent revenues. Our skilled nursing, hospital and projects for the developmentally disabled facility operators' revenues are primarily driven by occupancy, Medicare and Medicaid reimbursement and private pay rates. Our assisted living facility operators' revenues are primarily driven by occupancy and private pay rates. Expenses for these facility types are driven by the costs of labor, food, utilities, taxes, insurance and rent or debt service. Revenues from government reimbursement have, and may continue, to come under pressure due to reimbursement cuts and from federal and state budget shortfalls. Liability insurance and staffing costs continue to increase for our operators. To the extent that any decrease in revenues and/or any increase in operating expenses result in a facility not generating enough cash to make payments to us, the credit of our operator and the value of other collateral would have to be relied upon.

We are exposed to the risk that our operators may not be able to meet the rent, principal and interest or other payments due us, which may result in an operator bankruptcy or insolvency, or that an operator might become subject to bankruptcy or insolvency proceedings for other reasons. Although our operating lease agreements provide us the right to evict an operator, demand immediate payment of rent and exercise other remedies, and our mortgage loans provide us the right to terminate any funding obligations, demand immediate repayment of principal and unpaid interest, foreclose on the collateral and exercise other remedies, the bankruptcy laws afford certain rights to a party that has filed for bankruptcy or reorganization. An operator in bankruptcy may be able to limit or delay our ability to collect unpaid rent in the case of a lease or to receive unpaid principal and/or interest in the case of a mortgage loan, and to exercise other rights and remedies.

We may be required to fund certain expenses (e.g., real estate taxes, maintenance and capital improvements) to preserve the value of a facility, avoid the imposition of liens on a facility and/or transition a facility to a new operator. In some instances, we have terminated our lease with an operator and released the facility to another operator. In some of those situations, we provided working capital loans to and limited indemnification of the new operator. If we cannot transition a leased facility to a new operator, we may take possession of that facility, which may expose us to certain successor liabilities. Should such events occur, our revenue and operating cash flow may be adversely affected.

We are exposed to risks related to government regulations and the effect they have on our operators' business. Our operators' businesses are affected by government reimbursement and private payor rates. To the extent that any skilled nursing, hospital or project for the developmentally disabled facility receives a significant portion of its revenues from governmental payors, primarily Medicare and Medicaid, such revenues may be subject to statutory and regulatory changes, retroactive rate adjustments, recovery of program overpayments or set-offs, administrative rulings, policy interpretations, payment or other delays by fiscal intermediaries, government funding restrictions (at a program level or with respect to specific facilities) and

interruption or delays in payments due to any ongoing governmental investigations and audits at such facility. In recent years, governmental payors have frozen or reduced payments to health care providers due to budgetary pressures. Changes in health care reimbursement will likely continue to be of paramount importance to federal and state authorities. We cannot make any assessment as to the ultimate timing or effect any future legislative reforms may have on the financial condition of the health care industry. There can be no assurance that adequate reimbursement levels will continue to be available for services provided by any facility operator, whether the facility receives reimbursement from Medicare, Medicaid or private payors. Significant limits on the scope of services reimbursed and on reimbursement rates and fees could have a material adverse effect on an operator's liquidity, financial condition and results of operations, which could adversely affect the ability of an operator to meet its obligations to us. In addition, the replacement of an operator that has defaulted on its lease or loan could be delayed by the approval process of any federal, state or local agency necessary for the transfer of the facility or the replacement of the operator licensed to manage the facility.

We are exposed to the risk that the cash flows of our tenants and mortgages will be affected by increased liability claims and increased general and professional liability insurance costs. Long-term care facility operators (assisted living and skilled nursing facilities) have experienced substantial increases in both the number and size of patient care liability claims in recent years, particularly in the states of Texas and Florida. As a result, general and professional liability costs have increased and may continue to increase. Nationwide, long-term care liability insurance rates are increasing because of large jury awards in states like Texas and Florida. In 2004 and 2005, both Texas and Florida adopted skilled nursing facility liability laws that modify or limit tort damages. Despite some of these reforms, the long-term care industry overall continues to experience very high general and professional liability costs. Insurance companies have responded to this claims crisis by severely restricting their capacity to write long-term care general and professional liability policies. No assurance can be given that the climate for long-term care general and professional liability insurance will improve in any of the foregoing states or any other states where the facility operators conduct business. Insurance companies may continue to reduce or stop writing general and professional liability policies for assisted living and skilled nursing facilities. Thus, general and professional liability insurance coverage may be restricted, very costly or not available, which may adversely affect the facility operators' future operations, cash flows and financial condition, and may have a material adverse effect on the facility operators' ability to meet their obligations to us.

We depend on the success of future acquisitions. We are exposed to the risk that our future acquisitions may not prove to be successful. We could encounter unanticipated difficulties and expenditures relating to any acquired properties, including contingent liabilities, and newly acquired properties might require significant management attention that would otherwise be devoted to our ongoing business. If we agree to provide construction funding to an operator and the project is not completed, we may need to take steps to ensure completion of the project or we could lose the property. Moreover, if we issue equity securities or incur additional debt, or both, to finance future acquisitions, it may reduce our per share financial results. These costs may negatively affect our results of operations.

We are exposed to risks related to environmental laws and the costs associated with the liability related to hazardous substances. Under various federal and state laws, owners or operators of real property may be required to respond to the release of hazardous substances on the property and may be held liable for property damage, personal injuries or penalties that result from environmental contamination. These laws also expose us to the possibility that we may become liable to reimburse the government for damages and costs it incurs in connection with the contamination. Generally, such liability attaches to a person based on the person's relationship to the property. Our

tenants or borrowers are primarily responsible for the condition of the property and since we are a passive landlord, we do not participate in the management of any property in which we have an interest. Moreover, we review environmental site assessment of the properties that we own or encumber prior to taking an interest in them. Those assessments are designed to meet the all appropriate inquiry standard, which qualifies us for the innocent purchaser defense if environmental liabilities arise. Based upon such assessments, we do not believe that any of our properties are subject to material environmental contamination. However, environmental liabilities, including mold, may be present in our properties and we may incur costs to remediate contamination, which could have a material adverse effect on our business or financial condition.

We depend on the ability to reinvest cash from our operating, investing and financing activities in a timely manner and on acceptable terms. From time to time, we will have cash available from (1) the proceeds of sales of our securities, (2) principal payments on our loans receivable, and (3) the sale of properties, including non-elective dispositions, under the terms of master leases or similar financial support arrangements. We must re-invest these proceeds, on a timely basis, in health care investments or in qualified short-term investments. We compete for real estate investments with a broad variety of potential investors. This competition for attractive investments may negatively affect our ability to make timely investments on terms acceptable to us. Delays in acquiring properties may negatively impact revenues and perhaps our ability to make distributions to stockholders.

We depend on the ability to continue to qualify as a REIT. We intend to operate as a REIT under the Internal Revenue Code and believe we have and will continue to operate in such a manner. Since REIT qualification requires us to meet a number of complex requirements, it is possible that we may fail to fulfill them, and if we do, our earnings will be reduced by the amount of

federal taxes owed. A reduction in our earnings would affect the amount we could distribute to our stockholders. Also, if we were not a REIT, we would not be required to make distributions to stockholders since a non-REIT is not required to pay dividends to stockholders amounting to at least 90% of its annual taxable income.

We are dependent upon Management Advisory Source, LLC (MAS) for services related to investment activities and day-to-day management to include accounting, monitoring of investments, finance activities, etc. MAS, which was formed by our President and Board Chairman W. Andrew Adams, outsourced most functions of the Advisory Agreement such as accounting, monitoring of investments, finance activities, etc. to NHC from November 1, 2004 to October 1, 2006. Our advisory agreement with MAS may be cancelled upon 90 days notice or upon demand in some circumstances. The cancellation of this agreement could, at least temporarily, have a material adverse impact on our business and upon our ability to comply with government regulations.

See the notes to the annual financial statements, and Business under Item 1 herein for a discussion of various governmental regulations and other operating factors relating to the health care industry and the risk factors inherent in them. You should carefully consider these risks before making any investment decisions in the Company. These risks and uncertainties are not the only ones facing the Company. There may be additional risks that we do not presently know of or that we currently deem immaterial. If any of the risks actually occur, our business, financial condition or results of operations could be materially adversely affected. In that case, the trading price of our shares of stock could decline, and you may lose all or part of your investment. Given these risks and uncertainties, we can give no assurance that these forward-looking statements will, in fact, occur and, therefore, caution investors not to place undue reliance on them.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None

ITEM 2. PROPERTIES.

NHI PROPERTIES

| LONG TERM CARE | | Licensed |
|--------------------------|----------|----------|
| Center | City | Beds |
| ALABAMA | | |
| NHC HealthCare, Anniston | Anniston | 151 |
| NHC HealthCare, Moulton | Moulton | 136 |

ARIZONA

| | | |
|---|----------------|-----|
| Sunbridge Estrella Care and Rehabilitation | Avondale | 161 |
| FLORIDA | | |
| Ayers Health and Rehabilitation Center | Trenton | 120 |
| Bayonet Point Health & Rehabilitation Center | Hudson | 180 |
| Bear Creek Nursing Center | Hudson | 120 |
| Brooksville Healthcare Center | Brooksville | 180 |
| Cypress Cove Care Center | Crystal River | 120 |
| Heather Hill HealthCare Center | New Port | |
| | Richey | 120 |
| Osceola Health Care Center | St. Cloud | 120 |
| Parkway Health and Rehabilitation Center | Stuart | 177 |
| Lake Bennett Health and Rehabilitation Center | Ocoee | 120 |
| Royal Oak Nursing Center | Dade City | 120 |
| The Health Center of Merritt Island | Merritt Island | 180 |
| The Health Center of Plant City | Plant City | 180 |

| LONG TERM CARE (continued) | | Licensed |
|--|-----------------|----------|
| Center | City | Beds |
| FLORIDA (continued) | | |
| Savannah Cove of Maitland* | Maitland | 39 |
| Savannah Cove of the Palm Beaches* | West Palm Beach | 30 |
| GEORGIA | | |
| Ashton Woods Rehabilitation Center | Rossville | 157 |
| The Place at Martinez | Augusta | 100 |
| The Place at Deans Bridge | Augusta | 100 |
| The Place at Pooler | Pooler | 122 |
| NHC HealthCare, Rossville | Rossville | 112 |
| The Place at Augusta | Augusta | 100 |
| IDAHO | | |
| Grangeville Health and Rehabilitation Center | Grangeville | 60 |
| Sunbridge Retirement and Rehabilitation for Nampa* | Nampa | 46 |
| KANSAS | | |
| Chanute HealthCare Center | Chanute | 77 |
| Council Grove HealthCare Center | Council Grove | 80 |
| Emporia Rehabilitation Center | Emporia | 79 |
| Haysville HealthCare Center | Haysville | 119 |
| Cheyenne Meadows Living Center | Hoisington | 56 |
| Larned HealthCare Center | Larned | 73 |
| Sedgwick HealthCare Center | Sedgwick | 62 |
| KENTUCKY | | |
| NHC HealthCare, Glasgow* | Glasgow | 194 |
| NHC HealthCare, Madisonville | Madisonville | 94 |
| MASSACHUSETTS | | |
| John Adams HealthCare Center | Quincy | 71 |
| Buckley HealthCare Center | Greenfield | 120 |
| Holyoke HealthCare Center | Holyoke | 102 |
| Longmeadow of Taunton | Taunton | 100 |
| MISSOURI | | |
| Charleviox HealthCare Center | St. Charles | 142 |

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| | | |
|----------------------------------|------------------|-----|
| Columbia HealthCare Center | Columbia | 97 |
| Joplin HealthCare Center | Joplin | 92 |
| NHC HealthCare, Desloge | Desloge | 120 |
| NHC HealthCare, Joplin | Joplin | 126 |
| NHC HealthCare, Kennett | Kennett | 170 |
| NHC HealthCare, Maryland Heights | Maryland Heights | 220 |
| NHC HealthCare, St. Charles | St. Charles | 120 |
| NEW HAMPSHIRE | | |
| Epsom HealthCare Center | Epsom | 108 |
| Maple Leaf HealthCare Center | Manchester | 114 |
| Villa Crest HealthCare Center | Manchester | 165 |
| NEW JERSEY | | |
| Brighton Gardens of Edison* | Edison | 30 |

| LONG TERM CARE (continued) | | Licensed |
|-------------------------------------|----------------|----------|
| Center | City | Beds |
| SOUTH CAROLINA | | |
| NHC HealthCare, Anderson | Anderson | 290 |
| NHC HealthCare, Greenwood | Greenwood | 152 |
| NHC HealthCare, Laurens | Laurens | 176 |
| TENNESSEE | | |
| NHC HealthCare, Athens | Athens | 98 |
| NHC HealthCare, Chattanooga | Chattanooga | 207 |
| NHC HealthCare, Columbia | Columbia | 106 |
| NHC HealthCare, Dickson* | Dickson | 191 |
| NHC HealthCare, Franklin | Franklin | 80 |
| NHC HealthCare, Hendersonville | Hendersonville | 122 |
| NHC HealthCare, Hillview | Columbia | 92 |
| NHC HealthCare, Knoxville | Knoxville | 139 |
| NHC HealthCare, Lewisburg | Lewisburg | 102 |
| NHC HealthCare, McMinnville | McMinnville | 150 |
| NHC HealthCare, Milan | Milan | 122 |
| NHC HealthCare, Oakwood | Lewisburg | 60 |
| NHC HealthCare, Pulaski | Pulaski | 102 |
| NHC HealthCare, Scott | Lawrenceburg | 62 |
| NHC HealthCare, Sequatchie | Dunlap | 120 |
| NHC HealthCare, Smithville* | Smithville | 114 |
| NHC HealthCare, Somerville* | Somerville | 72 |
| NHC HealthCare, Sparta | Sparta | 120 |
| NHC HealthCare, Springfield | Springfield | 107 |
| TEXAS | | |
| Beaumont Health Care Center | Beaumont | 82 |
| Cleveland Health Care Center | Cleveland | 148 |
| College Street Health Care Center | Beaumont | 50 |
| Columbus Nursing and Rehabilitation | Columbus | 129 |
| Conroe Health Care Center | Conroe | 108 |
| Friendswood Health Care Center | Friendswood | 102 |
| Forest Lane Healthcare Center | Dallas | 120 |
| Heritage Manor - Canton | Canton | 110 |
| Heritage Place | Dallas | 149 |
| Heritage Oaks | Arlington | 204 |

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| | | |
|------------------------------------|------------------|-----|
| Hill Country Care Center | Dripping Springs | 60 |
| Huntsville Health Care Center | Huntsville | 92 |
| Lawrence Street Health Care Center | Tomball | 150 |
| Liberty Health Care Center | Liberty | 118 |
| Pecan Tree Manor | Gainesville | 122 |
| Richmond Health Care Center | Richmond | 92 |
| Sugar Land Health Care Center | Sugarland | 150 |
| The Village at Richardson | Dallas | 280 |
| West Janisch Health Care Center | Houston | 116 |
| Winterhaven Healthcare Center | Houston | 160 |

VIRGINIA

| | | |
|--------------------------------|-----------------|-----|
| NHC HealthCare, Bristol | Bristol | 120 |
| Heritage Hall- Charlottesville | Charlottesville | 120 |
| Heritage Hall- Brookneal | Brookneal | 60 |

| LONG TERM CARE (continued) | | Licensed Beds |
|---|----------------|------------------|
| | City | |
| VIRGINIA (continued) | | |
| Heritage Hall- Lexington | Lexington | 60 |
| Heritage Hall- Virginia Beach | Virginia Beach | 90 |
| Heritage Hall- Front Royal | Front Royal | 60 |
| Heritage Hall- Grundy | Grundy | 120 |
| Heritage Hall- Laurel Meadows | Laurel Fork | 60 |
| WISCONSIN | | |
| Milwaukee South HealthCare Center | Milwaukee | 191 |
| ACUTE CARE PROPERTIES | | |
| KENTUCKY | | |
| Kentucky River Hospital | Jackson | 55 |
| MEDICAL OFFICE BUILDINGS | | |
| | | Sq. Ft. |
| FLORIDA | | |
| North Okaloosa | Crestview | 27,017 |
| ILLINOIS | | |
| Crossroads | Mt. Vernon | 12,910 |
| TEXAS | | |
| Hill Regional | Hillsboro | 23,000 |
| Pasadena | Pasadena | 61,500 |
| RETIREMENT CENTERS | | |
| | | Licensed Beds |
| IDAHO | | |
| Sunbridge Retirement and Rehab for Nampa* | Nampa | 117 |
| NEW HAMPSHIRE | | |
| Heartland Place | Epsom | 78 |
| TENNESSEE | | |
| Colonial Hill Retirement Center | Johnson City | 63 |

| | | |
|--------------------------------|-------------|----|
| Parkwood Retirement Apartments | Chattanooga | 30 |
|--------------------------------|-------------|----|

TEXAS

| | | |
|---------------------------|---------|----|
| Tomball Retirement Center | Tomball | 60 |
|---------------------------|---------|----|

**ASSISTED LIVING AND
DEVELOPMENTALLY DISABLED**

Licensed
Beds

ARIZONA

| | | |
|----------------------|---------|----|
| The Place at Gilbert | Gilbert | 59 |
|----------------------|---------|----|

| | | |
|-----------------------|----------|----|
| The Place at Glendale | Glendale | 40 |
|-----------------------|----------|----|

| | | |
|---------------------------|--------|----|
| The Place at Tanque Verde | Tucson | 42 |
|---------------------------|--------|----|

| | | |
|---------------------|--------|----|
| The Place at Tucson | Tucson | 60 |
|---------------------|--------|----|

FLORIDA

| | | |
|------------------------|-------------|---|
| 19th Street Group Home | Gainesville | 6 |
|------------------------|-------------|---|

| | | |
|------------------------|-----------|---|
| 107th Place Group Home | Belleview | 6 |
|------------------------|-----------|---|

| LONG TERM CARE (continued) | | Licensed Beds |
|---|-----------------|------------------|
| | City | |
| FLORIDA (continued) | | |
| Bessent Road Group Home | Starke | 6 |
| Claudia Drive Group Home | Jacksonville | 6 |
| Coletta Drive Group Home | Orlando | 6 |
| Frederick Avenue Group Home | Daytona Beach | 6 |
| High Desert Court Group Home | Jacksonville | 6 |
| Plaza Oval Group Home | Casselberry | 6 |
| Rosewood Group Home | Ormond Beach | 6 |
| Second Street Group Home | Ocala | 6 |
| Spring Street Group Home | Lake City | 6 |
| Suffridge Drive Group Home | Bonita Springs | 6 |
| Savannah Court of Maitland* | Maitland | 112 |
| The Place at Daytona Beach | Daytona Beach | 60 |
| The Place at Maitland | Maitland | 116 |
| Savannah Court of Palm Beaches* | West Palm Beach | 114 |
| Tunis Street Group Home | Jacksonville | 6 |
| Walnut Street Group Home | Starke | 6 |
| IDAHO | | |
| Sunbridge Retirement and Rehab for Nampa* | Nampa | 20 |
| KENTUCKY | | |
| NHC HealthCare, Glasgow | Glasgow | 12 |
| NEW JERSEY | | |
| Brighton Gardens of Edison* | Edison | 118 |
| PENNSYLVANIA | | |
| Heritage Hill Senior Community | Weatherly | 142 |
| SOUTH CAROLINA | | |
| The Place at Conway | Conway | 52 |
| TENNESSEE | | |
| 717 Cheatam Street | Springfield | 8 |
| 305 West Hillcrest Drive | Springfield | 8 |
| 307 West Hillcrest Drive | Springfield | 8 |

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| | | |
|-----------------------------|------------|----|
| NHC HealthCare, Dickson* | Dickson | 20 |
| NHC HealthCare, Somerville* | Somerville | 9 |
| NHC HealthCare, Smithville* | Smithville | 6 |
| The Place at Gallatin | Gallatin | 49 |
| The Place at Kingsport | Kingsport | 49 |
| The Place at Tullahoma | Tullahoma | 49 |

*These facilities are listed in multiple categories (numbers of beds are not duplicated elsewhere in this table).

ITEM 3. LEGAL PROCEEDINGS.

One of our owned nursing home properties, leased to a subsidiary of NHC and located in Nashville, Tennessee, was damaged by a tragic fire on September 25, 2003 which resulted in the loss of life or critical injury to a number of patients. The lease requires NHC to indemnify and hold harmless NHI from any and all demands and claims arising from its use of the property. Although NHI had been named as a defendant in 32 lawsuits, all of these lawsuits have been settled at no cost to NHI.

A provision of the lease allowed that if substantial damage occurs during the lease term, NHC may terminate the lease with respect to the damaged property. During October 2004, NHC exercised its right to terminate the lease on the Nashville facility. As a result, NHI was entitled to receive all property insurance proceeds paid as a result of the fire. NHI retained the right to the bed license following lease termination. Prior to the fire, NHI received annualized rent of \$250,000 per year on the Nashville facility. NHI received \$2,654,000 in insurance proceeds which was included in non-operating income for the year ended December 31, 2005. NHI sold the Nashville facility in May 2005 (See Note 3 to the financial statements).

On October 13, 2006, a lawsuit was filed in Chancery Court for the State of Tennessee, Rutherford County, against us and the individual directors serving on the Special Committee alleging breach of fiduciary duty and improper action in connection with the offer by Mr. Adams as described under "Acquisition Offer" in Item 7. We filed a motion to dismiss the complaint and on January 26, 2007 an amended lawsuit was filed against NHI and the members of the Special Committee. We intend to vigorously defend the allegations in the complaint. NHI has previously indemnified all members of the Board of Directors for all actions related to NHI, including serving on the Special Committee. NHI expects that indemnification to cover the expenses incurred by the directors in the defense of this action.

The Health Care Facilities are subject to claims and suits in the ordinary course of business. Our lessees and mortgagees have indemnified and will continue to indemnify us against all liabilities arising from the operation of the Health Care Facilities, and will indemnify us against environmental or title problems affecting the real estate underlying such facilities. While there are lawsuits pending against certain of the owners and/or lessees of the Health Care Facilities, management believes that the ultimate resolution of all pending proceedings will have no material adverse effect on our financial position, operations and cash flows.

Through the operation of our 17 foreclosure properties, we are subject to general and professional liability litigation for the provision of patient care. The entire long-term care industry has seen a dramatic increase in personal injury/wrongful death claims based on alleged negligence by nursing homes and their employees in providing care to residents. We have maintained or caused the majority of our lessees or mortgagees to maintain insurance coverage for this type of litigation. In Florida, however, coverage is limited. We are subject to certain claims, none of which, in management's opinion, would be material to our financial position or results of operations.

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

The Annual Meeting of the Shareholders was held on May 2, 2006, the results of which were included in the March 31, 2006, Form 10-Q filed with the SEC on May 4, 2006.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

On October 16, 1996, the NHI Board of Directors, pursuant to powers granted by NHI's charter, changed the limit on the percentage of ownership which any person may have in the outstanding common stock of NHI from a limit of 7.0% (as passed on October 17, 1995) to a limit of 9.9%. The limit on ownership of any other class of stock (including issues convertible into common stock) remains at 9.9% of the outstanding stock.

In order to qualify for the beneficial tax treatment accorded to a REIT, we must make quarterly distributions to holders of our Common Stock equal on an annual basis to at least 90% of our REIT taxable income (excluding net capital gains), as defined in the Internal Revenue Code. Cash available for distribution to our stockholders is primarily derived from interest payments received on our mortgages and from rental payments received under our leases. All distributions will be made by us at the discretion of the Board of Directors and will depend on our cash flow and earnings, our financial condition, bank covenants contained in our financing documents and such other factors as the Board of Directors deems relevant. Our REIT taxable income is calculated without reference to our cash flow. Therefore, under certain circumstances, we may not have received cash sufficient to pay our required distributions.

Common Stock Market Prices and Dividends

Our common stock is traded on the New York Stock Exchange under the symbol NHI. The closing price for NHI stock on February 28, 2007 was \$30.40. As of December 31, 2006, there were approximately 1,000 holders of record of shares and we estimate that as of such date there were in addition in excess of 11,900 beneficial owners of the shares.

High and low stock prices and dividends for the last two years were:

| Quarter Ended | 2006 | | | 2005 | | |
|---------------|-------------|---------|--------------------|-------------|---------|--------------------|
| | Sales Price | | Cash | Sales Price | | Cash |
| | High | Low | Dividends Declared | High | Low | Dividends Declared |
| March 31 | \$27.54 | \$25.25 | \$.480 | \$29.05 | \$25.20 | \$.450 |
| June 30 | 27.64 | 23.03 | .480 | 28.95 | 25.05 | .450 |
| September 30 | 28.97 | 24.31 | .480 | 30.95 | 26.56 | .450 |
| December 31 | 33.75 | 28.00 | .930 | 28.45 | 25.20 | .450 |

We purchased and retired shares of our common stock during 2006 as follows:

| Period | Total number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs |
|-----------|----------------------------------|------------------------------|--|--|
| May, 2006 | 146,200 | \$24.14 | 146,200 | N/A |

We currently maintain two equity compensation plans: the NHI 1997 Stock Option Plan and the 2005 Stock Option, Restricted Stock and Stock Appreciation Rights Plans. Each of these plans has been approved by our stockholders. The following table provides information as of December 31, 2006 about the Company's common stock that may be

issued upon grants of restricted stock and the exercise of options under the Company existing equity compensation plans.

| | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column) |
|---|---|--|---|
| Equity compensation plans approved by security holders | 266,000 | \$24.14 | 1,418,800 ^(a) |
| Equity compensation plans not approved by security holders | | | |

^(a) There are 57,800 shares and 1,361,000 shares available for grant under the 1997 and 2005 Plans, respectively.

ITEM 6. SELECTED FINANCIAL DATA.

The following table represents our financial information for the five years ended December 31, 2006. This financial information has been derived from our historical financial statements including those for the most recent three years included elsewhere in this Annual Report on Form 10-K and should be read in conjunction with those consolidated financial statements and accompanying footnotes.

NATIONAL HEALTH INVESTORS, INC.

SELECTED FINANCIAL DATA

(dollars in thousands, except share and per share amounts)

| As of and for the Year Ended December 31 | 2006 | 2005 ^(a) | 2004 ^(a) | 2003 ^(a) | 2002 ^(a) |
|--|------------|---------------------|---------------------|---------------------|---------------------|
| Net revenues | \$ 150,724 | \$ 146,924 | \$ 145,065 | \$ 144,205 | \$ 142,930 |
| Non-operating income | 12,721 | 22,331 | 12,381 | 5,931 | 1,110 |
| Income from continuing operations | 62,947 | 52,535 | 53,567 | 39,936 | 25,310 |
| Discontinued operations: | | | | | |
| Operating income - discontinued operations | 467 | 1,100 | 1,269 | 2,337 | 394 |
| Net gain on sales of real estate | 5,814 | 773 | 1,543 | 1,535 | 5,083 |
| Net income | 69,228 | 54,408 | 56,379 | 43,808 | 30,787 |
| Earnings per share: | | | | | |
| Basic: | | | | | |
| Income from continuing operations | \$ 2.27 | \$ 1.89 | \$ 1.95 | \$ 1.44 | \$.89 |
| Discontinued operations | .23 | .07 | .10 | .14 | .21 |
| Net income per common share | 2.50 | 1.96 | 2.05 | 1.58 | 1.10 |
| Diluted: | | | | | |
| Income from continuing operations | \$ 2.26 | \$ 1.89 | \$ 1.93 | \$ 1.43 | \$.89 |
| Discontinued operations | .23 | .07 | .10 | .14 | .21 |
| Net income per common share | 2.49 | 1.96 | 2.03 | 1.57 | 1.10 |
| BALANCE SHEET DATA: | | | | | |
| Mortgages and other notes receivable, net | \$ 99,532 | \$ 118,800 | \$ 112,072 | \$ 149,892 | \$ 201,236 |
| Real estate properties, net | 235,199 | 263,129 | 278,170 | 289,465 | 304,394 |
| Total assets | 595,464 | 587,932 | 631,371 | 624,366 | 651,064 |
| Debt | 113,492 | 117,252 | 154,432 | 162,100 | 161,763 |
| Convertible subordinated debentures | | 201 | 1,116 | 1,351 | 41,633 |
| Total stockholders' equity | 431,671 | 424,968 | 425,539 | 409,644 | 400,429 |
| OTHER DATA: | | | | | |
| Common shares outstanding | 27,752,239 | 27,830,439 | 27,545,018 | 26,770,123 | 26,682,994 |
| Weighted average common shares: | | | | | |
| Basic | 27,744,868 | 27,699,887 | 27,257,826 | 26,727,814 | 26,453,053 |
| Diluted | 27,778,764 | 27,830,886 | 27,531,084 | 26,985,571 | 26,853,420 |
| Common dividends declared per share | \$ 2.37 | \$ 1.80 | \$ 1.85 | \$ 1.70 | \$ 1.40 |

^(a) Prior period financial information has been reclassified for presentation of operations discontinued during 2006.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion and analysis is based primarily on the consolidated financial statements of National Health Investors, Inc. for the periods presented and should be read together with the notes thereto contained in this Annual Report on Form 10-K. Other important factors are identified in Item 1. Business above.

Executive Overview

National Health Investors, Inc. ("NHI" or the "Company"), a Maryland corporation, is a real estate investment trust (REIT) that invests primarily in income producing health care properties with emphasis on the long-term health care sector. As of December 31, 2006, we had interests in real estate owned, and investments in mortgages, preferred stock and marketable securities resulting in total invested assets of \$398,376,000. Founded in 1991, our mission is to invest in health care real estate which generates current income that will be distributed to stockholders. We have pursued this mission by making mortgage loans and acquiring properties to lease nationwide, primarily in the long-term health care industry.

Portfolio

As of December 31, 2006, we had investments in real estate and mortgage notes receivable in 139 health care facilities located in 18 states consisting of 97 long-term care facilities, 1 acute care hospital, 4 medical office buildings, 14 assisted living facilities, 6 retirement centers and 17 residential projects for the developmentally disabled. These investments consisted of approximately \$90,782,000 aggregate carrying value amount of loans to 14 borrowers and \$235,199,000 of real estate investments with 17 lessees.

Of these 139 facilities, 41 are leased to National HealthCare Corporation (NHC), a publicly-held company and our largest customer. These 41 facilities include four centers subleased to and operated by other companies, the lease payments of which are guaranteed to us by NHC. Our investment advisor was NHC until November 1, 2004. Of these 139 facilities, 17 were acquired through foreclosure. The 17 facilities have been sold, but we have not yet met the accounting criteria described in Statement of Financial Accounting Standards No. 66 to record the sales for financial statement purposes. The facilities are managed by subsidiaries of NHC.

Consistent with our strategy of diversification, we have increased our portfolio so that the portion of our portfolio leased by NHC has been reduced from 100% of our total portfolio on October 17, 1991 (the date we began operations) to 27.7% of total real estate portfolio on December 31, 2006, based on the net book value of these properties. In 1991, these assets were transferred by NHC to NHI at their then current net book value, in a non-taxable exchange. Many of these assets were substantially depreciated as a result of having been carried on NHC's books for as many as 20 years.

As a result, we believe that the fair market value of these assets is significantly in excess of their net book value. To illustrate, rental income in 2006 from NHC was \$31,309,000 or approximately 48% of our net book value of the facilities leased to NHC. Subsequent additions to the portfolio related to non-NHC investments reflect their higher value based on existing costs at the date the investment was made.

As with all assets in our portfolio, we monitor the financial and operating results of each of these properties on a quarterly basis. In addition to reviewing the consolidated financial results of NHC, the individual center financial results are reviewed including their occupancy, patient mix, state survey results and other relevant information.

At December 31, 2006, 26.7% of the total invested assets of the health care facilities were operated by publicly-traded operators, 61.8% by regional operators, and 11.5% by small operators.

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The following tables summarize our portfolio as of December 31, 2006:

| Portfolio Statistics | Properties | Investment | |
|--------------------------------|------------|------------|---------------|
| | | Percentage | Investment |
| Real Estate Properties | 90 | 72% | \$235,199,000 |
| Mortgages and Notes Receivable | 49 | 28% | 90,782,000 |
| Total Real Estate Portfolio | 139 | 100% | \$325,981,000 |

| Real Estate Properties | Properties | Beds | Investments |
|-------------------------------|------------|-----------------|---------------|
| Long-term Care Centers | 66 | 8,555 | \$149,537,000 |
| Assisted Living | 14 | 1,161 | 59,080,000 |
| Medical Office Buildings | 4 | 124,427 sq. ft. | 9,983,000 |
| Retirement Centers | 5 | 534 | 9,700,000 |
| Hospitals | 1 | 55 | 6,899,000 |
| Total Real Estate Properties | 90 | | 235,199,000 |

| Mortgages and Notes Receivable | Properties | Beds | Investments |
|---------------------------------------|------------|-------|---------------|
| Long-term Care Centers | 31 | 3,377 | \$84,716,000 |
| Retirement Centers | 1 | 60 | 1,936,000 |
| Developmentally Disabled | 17 | 108 | 4,130,000 |
| Total Mortgages and Notes Receivable | 49 | | 90,782,000 |
| Total Real Estate Portfolio | 139 | | \$325,981,000 |

| Summary of Facilities by Type | Properties | Percentage of | |
|--------------------------------------|------------|---------------|---------------|
| | | Total Dollars | Total Dollars |
| Long-term Care Centers | 97 | 71.86% | \$234,253,000 |
| Assisted Living | 14 | 18.12% | 59,080,000 |
| Medical Office Buildings | 4 | 3.06% | 9,983,000 |
| Retirement Centers | 6 | 3.57% | 11,636,000 |
| Hospitals | 1 | 2.12% | 6,899,000 |
| Developmentally Disabled | 17 | 1.27% | 4,130,000 |
| Total Real Estate Portfolio | 139 | 100.00% | \$325,981,000 |

| Portfolio by Operator Type: | Properties | Percentage | Dollar Amount |
|------------------------------------|------------|------------|---------------|
| Public | 62 | 26.68% | \$ 86,981,000 |
| Regional | 65 | 61.82% | 201,521,000 |
| Small Operator | 12 | 11.50% | 37,479,000 |
| Total Real Estate Portfolio | 139 | 100.00% | \$325,981,000 |

| Public Operators | Percentage of Total Portfolio | Dollar Amount |
|---------------------------|-------------------------------|---------------|
| National HealthCare Corp. | 13.65% | \$44,510,000 |

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| | | |
|--------------------------------|--------|--------------|
| Community Health Systems, Inc. | 3.95% | 12,861,000 |
| Sunrise Senior Living Services | 3.96% | 12,918,000 |
| Sun Healthcare | 2.62% | 8,540,000 |
| Res-Care, Inc. | 1.27% | 4,130,000 |
| HCA - The Healthcare Company | 1.23% | 4,022,000 |
| Total Public Operators | 26.68% | \$86,981,000 |

Operators who operate more than 3% of our total real estate investments are as follows: NHC, Health Services Management of Texas, LLC, THI of Baltimore, Inc., Sunrise Senior Living Services, Inc., Health Services Management, Inc., Community Health Systems, Inc., ElderTrust of Florida, Inc., RGL Development, LLC Senior Living Management Corporation, LLC, American HealthCare, LLC, and SeniorTrust of Florida, Inc.

Areas of Focus

We anticipate making new investments in 2007 while continuing to monitor and improve our existing properties. Even as we make new investments, however, we expect to maintain a relatively low level of debt vs. equity compared to our historical levels. New investments may be funded by our liquid investments and, if needed, by external financing. We will make new investments where we believe the spreads over our cost of capital will generate returns to our investors.

We have focused on increasing our liquidity and lowering our debt. Our debt to capitalization ratio on December 31, 2006 was 20.8%, the lowest level in our 15 year history. Our liquidity is also strong with cash and marketable securities of \$203,278,000 at December 31, 2006 compared to \$152,022,000 at December 31, 2005. Our total debt outstanding was \$113,492,000 and \$117,252,000 at December 31, 2006 and 2005 respectively.

On December 27, 2005, we reached an agreement with NHC to extend through December 31, 2021, our current lease on 41 of our real estate properties. These 41 facilities include four centers leased to other parties and three retirement centers. This extension assures an ongoing relationship with our largest customer.

As a result of our strong liquidity, we anticipated making new portfolio investments during 2006. Although we evaluated a number of potential new investments during the year, none were closed. At this time, we are continuing to cautiously evaluate new portfolio investments and monitor the current prices being offered for health care assets.

Acquisition Offer

On October 5, 2006, we received an offer from W. Andrew Adams, our Chairman and CEO, a significant shareholder and President of Management Advisory Source, LLC, NHI's management advisor, to acquire all of our outstanding shares of common stock for \$30.00 per share. The offer was subject to certain conditions and contingencies. The Board of Directors formed a Special Committee of independent directors for the purpose of evaluating strategic alternatives to enhance shareholder value. Additionally, the Special Committee hired The Blackstone Group L.P. as its financial advisor to assist in evaluating this or any other proposed transactions. The Special Committee subsequently informed Mr. Adams that it considered his proposal inadequate.

On January 2, 2007, we received a revised offer from Mr. Adams to acquire all of our outstanding shares of common stock for \$33.00 per share payable through a \$15 dividend and \$18 common stock purchase price. On February 1, 2007 the Special Committee of National Health Investors, informed Mr. Adams that it considered the revised offer not to be in the best interests of NHI's public stockholders and requested that management further develop and implement a wide-ranging strategic plan to enhance the business and shareholder value of NHI. Since that date, Mr. Adams has continued to express to the Special Committee his interest in a transaction; however, no agreement has been reached

with respect to an acquisition offer from Mr. Adams or his related entities, and management continues to work on the plan requested by the Special Committee. NHI does not intend to update the status of any negotiations with respect to a potential transaction unless required by law to make such disclosure.

On October 13, 2006, a lawsuit was filed in Chancery Court for the State of Tennessee, Rutherford County, against us and the individual directors serving on the Special Committee alleging breach of fiduciary duty and improper action in connection with the offer by Mr. Adams. We filed a motion to dismiss the complaint and on January 26, 2007, an amended lawsuit was filed against NHI and the members of the Special Committee. The amended complaint rendered the motion to dismiss moot. The plaintiff has indicated that he intends to amend the complaint a second time by the end of March. We have responded to discovery and intend to vigorously defend the plaintiff's allegations. NHI has previously indemnified all members of the Board of Directors for all actions related to NHI, including serving on the Special Committee. NHI expects that indemnification to cover the expenses incurred by the directors in the defense of this action.

Critical Accounting Policies

We prepare our financial statements in conformity with accounting principles generally accepted in the United States of America. These accounting principles require us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and cause our reported net income to vary significantly from period to period. If actual experience differs from the assumptions and other considerations used in estimating amounts reflected in our consolidated financial statements, the resulting changes could have a material adverse effect on our consolidated results of operations, liquidity and/or financial condition. We consider an accounting estimate or assumption critical if:

- the nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and

- the impact of the estimates and assumptions on financial condition or operating performance is material.

Refer to Note 2 to our audited consolidated financial statements for further information on significant accounting policies that impact us. There have been no material changes to these policies in 2006.

Our significant accounting policies and the associated estimates, judgments and the issues which impact these estimates are as follows:

1) Valuations and impairments to our investments - The majority of our tenants and borrowers are in the long-term health care industry and derive their revenues primarily from Medicare, Medicaid and other government programs. Amounts paid under these government programs are subject to legislative and government budget constraints. From time to time, there may be material changes in government reimbursement. In the past, the long-term health care industry has at times experienced material reductions in government reimbursement.

The long-term health care industry has also experienced a dramatic increase in professional liability claims and in the cost of insurance to cover such claims. These factors have combined to cause a number of bankruptcy filings, bankruptcy court rulings and court judgments about refinancing for our lessees and mortgagees. Prior to 2006, we had determined that impairment of certain of our investments had occurred as the result of these events.

Decisions about valuations and impairments of our investments require significant judgments and estimates on the part of management. For real estate properties, the need to recognize an impairment is evaluated on a property-by-property basis in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment and Disposal of Long-Lived Assets* (SFAS 144"). The determination and recording of an impairment is based upon estimated future undiscounted cash flows from a property compared to the carrying amount of the property and may be affected by management's plans, if any, to dispose of the property.

For notes receivable, impairment recognition is based upon an evaluation of the estimated collectibility of loan payments and general economic conditions on a specific loan basis in accordance with Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan - An Amendment of FASB Statements No. 5 and 15* (SFAS 114"). On a quarterly basis, NHI reviews its notes receivable for recoverability

when events or circumstances, including the non-receipt of principal and interest payments, significant deteriorations of the financial condition of the borrower and significant adverse changes in general economic conditions, indicate that the carrying amount of the note receivable may not be recoverable. If necessary, an impairment is measured as the amount by which the carrying amount exceeds the discounted cash flows expected to be received under the note receivable or, if foreclosure is probable, the fair value of the collateral securing the note receivable.

We evaluate our marketable securities for other-than-temporary impairments consistent with the provisions of Statement of Financial Accountant Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115) as amended by EITF 03-01 *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments* . An impairment of a marketable security would be considered other-than-temporary unless we have the ability and intent to hold the investment for a period of time sufficient for a forecasted market price recovery up to (or beyond) the cost of the investment and evidence indicates the cost of the investment is recoverable within a reasonable period of time.

While we believe that the carrying amounts of our properties, notes receivable, marketable securities and other investments are realizable and/or recoverable, it is possible that future events could require us to make significant adjustments or revisions to these estimates.

2) Revenue recognition - mortgage interest and rental income - We collect interest and rent from our customers. Generally our policy is to recognize revenues on an accrual basis as earned. However, there are certain of our customers for which we have determined, based on insufficient historical collections and the lack of expected future collections, that revenue for interest or rent may not be realizable. For these nonperforming investments, our policy is to recognize interest or rental income when assured, which we consider to be the period the amounts are collected. We identify investments as nonperforming if a required payment is not received within 30 days of the date it is due. This policy could cause our revenues to vary significantly from period to period. Revenue from minimum lease payments under our leases is recognized on a straight-line basis as required under Statement of Financial Accounting Standard No. 13 *Accounting For Leases* (SFAS 13) to the extent that future lease payments are considered collectible. Lease payments that depend on a factor directly related to future use of the property, such as an increase in annual revenues over a base year revenues, are considered to be contingent rentals and are excluded from minimum lease payments in accordance with SFAS 13.

3) REIT status and taxes - We believe that we have operated our business so as to qualify as a REIT under Sections 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.

4) Revenue recognition - third party payors - Approximately two-thirds of our facility operating revenues are derived from Medicare, Medicaid, and other government programs. Amounts earned under these programs are subject to review by the third party payors. In our opinion, adequate provision has been made for any adjustments that may result from these reviews. Any differences between our estimates of settlements and final determinations are reflected in operations in the year finalized.

Liquidity and Capital Resources

Sources and Uses of Funds

Our primary sources of cash include rent and interest receipts, the revenues of facilities we operate, proceeds from the sales of real property and principal payments on loans receivable. Our primary uses of cash include dividend distributions, the expenses of facilities we operate, debt service payments (including principal and interest), real property acquisitions and general and administrative expenses. These sources and uses of cash are reflected in our Consolidated Statements of Cash Flows and are discussed in further detail below. The following is a summary of our sources and uses of cash flows (*dollars in thousands*):

| | Year Ended | | One Year Change | | Year | One Year Change | | Two Year Change | |
|--|------------|------------|-----------------|------------|-------------------|-----------------|------------|-----------------|------------|
| | 12/31/04 | 12/31/05 | Dollars | Percentage | Ended 12/31/06 | Dollars | Percentage | Dollars | Percentage |
| Cash and cash equivalents at beginning of period | \$ 93,687 | \$ 161,215 | \$ 67,528 | 72% | \$ 132,469 | (\$ 28,746) | (18%) | \$ 38,782 | 41% |

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| | | | | | | | | | |
|---|-----------|-----------|------------|------|-----------|----------|---------|----------|-------|
| C a s h provided from (used i n) operating activities | 57,092 | 59,010 | 1,918 | 3% | 57,805 | (1,205) | (2%) | 713 | 1% |
| C a s h provided from (used i n) investing activities | 65,742 | 333 | (65,409) | -99% | 47,170 | 46,837 | 14,065% | (18,572) | (28%) |
| C a s h provided from (used i n) financing activities | (55,306) | (88,089) | (32,783) | 59% | (59,679) | 28,410 | (32%) | (4,373) | 8% |
| Cash and c a s h equivalents | | | | | | | | | |
| at end of period | \$161,215 | \$132,469 | \$(28,746) | -18% | \$177,765 | \$45,296 | 34% | 16,550 | 10% |

The notes to the consolidated financial statements describe the significant transactions that impact our cash flows from operating, investing and financing activities.

Operating Activities - We have generated net cash from operating activities during 2006 totaling \$57,805,000, a decrease of \$1,205,000 compared to \$59,010,000 in the prior year. Net cash from operating activities generally includes net income adjusted for non-cash items, such as depreciation and amortization, working capital changes, investment write-downs and recoveries, gains on asset disposals and share-based compensation. The components of net cash provided from operating activities in 2006 includes net income of \$69,228,000, depreciation of \$12,026,000 and net loan and realty recoveries of \$7,934,000. The net loan and realty recoveries are related to mortgage loan payoffs. There was a net gain on the sale of real estate of \$5,814,000 comprised of \$5,690,000 related to the sale of two New Jersey facilities and \$124,000 related to the sale of one Missouri facility. There was a gain on the payoff of a note receivable of \$1,015,000. Cash used in other operating activities is primarily due to the timing of payments of accounts payable and the increase in capital improvement reserves of the foreclosure properties.

Net cash provided by operating activities during 2005 of \$59,010,000 included net income of \$54,408,000, depreciation of \$12,855,000 and net loan and realty write-downs of \$7,985,000. The net loan and realty write-downs consisted of \$2,550,000

related to real estate and \$5,435,000 related to mortgage loans. Gains and recoveries on the sale of marketable securities and real estate were \$9,072,000 and \$2,552,000, respectively. Cash used in other operating activities was primarily due to the timing of payments of accounts payable and the increase in capital improvement reserves of the foreclosed facilities.

The \$57,092,000 net cash provided from operating activities for 2004 is composed primarily of increases due to net income of \$56,379,000 and depreciation of \$14,453,000.

Investing Activities - Net cash provided by investing activities during 2006 totaled \$47,170,000, an increase of \$46,837,000 compared to the prior year of \$333,000. Cash flows provided from investing activities during 2006 included collections on mortgage and other notes receivable of \$16,853,000 of which \$11,516,000 were related to scheduled maturities and settlements of existing loans. Prepayments of mortgage notes receivable were \$19,664,000 in 2006 due to early payoffs of loans to four borrowers. Dispositions of property and equipment provided \$24,215,000 of cash flow in 2006 related to the sale of two New Jersey facilities for \$17,570,000 and a Missouri facility for \$6,645,000. Investments in mortgage and other notes receivable increased by \$11,063,000 due primarily to the funding of a note receivable from National Health Realty, a real estate investment trust, in the original amount of \$10,450,000.

Cash flows used in investing activities in 2005 and 2004 included investments in real estate properties of \$12,264,000 and \$1,678,000, respectively, while funding of mortgage and other notes receivable in 2005 and 2004 were \$22,079,000 and \$2,419,000, respectively.

Financing Activities - Net cash used in financing activities during 2006 totaled \$59,679,000, a decrease of \$28,410,000 from the prior year of \$88,089,000. Cash flows used in financing activities for 2006 included principal payments on debt of \$3,760,000 and dividends paid to stockholders of \$52,545,000. An amount of \$3,530,000 was used to repurchase and retire 146,200 shares of common stock.

Cash flows used in financing activities in 2005 and 2004 included principal payment on debt of \$37,180,000 and \$7,670,000, respectively, while dividends paid to stockholders in 2005 and 2004 were \$53,259,000 and \$48,650,000, respectively.

Liquidity

At December 31, 2006, our liquidity is strong, with cash and marketable securities of \$203,278,000 exceeding \$113,492,000 of total debt outstanding. Further, our debt to book capitalization ratio declined to 20.8%, the lowest level in our 15 year history. Our next significant debt maturity is our \$100 million 7.3% unsecured public notes due on July 16, 2007. We currently have the liquidity to retire the debt; we currently are evaluating our option to either

retire or extend the debt.

We declared and paid total annual dividends of \$1.85 to shareholders of record in 2004, \$1.80 to shareholders of record in 2005, and \$2.37 to shareholders of record in 2006. The 2004 fourth quarter dividend of \$.5750 per share was paid on January 10, 2005 and included a \$.15 per share special dividend. The 2005 fourth quarter dividend of \$.45 per share was paid on January 10, 2006. The 2006 fourth quarter dividend of \$.93 per share was paid on January 10, 2007 and included a special dividend of \$.45 per share.

Contractual Obligations and Contingent Liabilities

As of December 31, 2006, our contractual payment obligations and commitments were as follows:

| Contractual Obligations (in thousands) | Total | Less than | | | After |
|---|------------|------------|-----------|-----------|---------|
| | | 1 Year | 2-3 Years | 4-5 Years | 5 Years |
| Debt principal | \$ 113,492 | \$ 103,980 | \$ 6,713 | \$ 2,049 | \$ 750 |
| Debt interest ^(a) | 5,389 | 4,393 | 757 | 200 | 39 |
| Loan commitments | 815 | 815 | | | |
| Facility management fees to NHC | 8,425 | 8,425 | | | |
| Advisory fees to MAS | 1,179 | 1,179 | | | |
| | \$ 129,300 | \$ 118,792 | \$ 7,470 | \$ 2,249 | \$ 789 |

^(a) For variable rate debt, future interest commitments were calculated using interest rates existing at December 31, 2006.

Off Balance Sheet Arrangements

We currently have no outstanding guarantees or letters of credit except for those disclosed in Note 11 of the notes to our consolidated financial statements. We may or may not elect to use financial derivative instruments to hedge interest rate exposure. At December 31, 2006, we did not participate in any such financial instruments.

Commitments

At December 31, 2006, we were committed, subject to due diligence and financial performance goals, to fund approximately \$815,000 in health care real estate projects, all of which is expected to be funded within the next 12 months. The commitments include additional mortgage investments for three long-term health care centers, at an interest rate of prime plus 2.0%. We currently have sufficient liquidity to finance current investments for which we are committed to repay or refinance borrowings at or prior to their maturity, and to pay dividends required to maintain our REIT status.

Real Estate, Mortgage and Notes Receivable Write-downs (Recoveries)

Our borrowers, tenants and the properties we operate as foreclosure properties have experienced financial pressures and difficulties similar to those experienced by the health care industry in general since 1997. Governments at both the federal and state levels have enacted legislation to lower or at least slow the growth in payments to health care providers. Furthermore, the costs of professional liability insurance have increased significantly during this same period.

Prior to 2006, a number of our real estate property operators and mortgage loan borrowers experienced bankruptcy. Others were forced to surrender properties to us in lieu of foreclosure. Still others failed to make timely payments on their obligations to us.

The following table summarizes our write-downs and recoveries for the last three years, recorded in accordance with the provisions of SFAS 114 and SFAS 144:

| Write-downs (Recoveries) | | | |
|------------------------------------|----------------|----------|---------|
| <i>(in thousands)</i> | 2006 | 2005 | 2004 |
| Real estate | \$ | \$ 2,550 | \$ |
| Mortgages & Notes Receivable (net) | (7,934) | 5,435 | (2,209) |

\$ (7,934) \$ 7,985 \$ (2,209)

During 2006, three mortgage notes receivable were paid off, resulting in recoveries of amounts previously written down of \$9,008,000. One working capital note with an outstanding balance of \$1,074,000 was written down due to non-payment.

Further maintenance analysis resulted in the recording of an additional \$2,852,000 of accrued maintenance expense in the third quarter of 2005 on two Florida assisted living facilities as discussed in Note 3 to our consolidated financial statements.

See Note 4 to our financial statements for details of the properties identified as impaired real estate investments and non-performing loans. We believe that the carrying amounts of our real estate properties and notes receivable, including those identified as impaired or non-performing, are recoverable and supported by the value of the underlying collateral. However, it is possible that future events could require us to make significant adjustments to these carrying amounts.

Security Recoveries

The following table summarizes our security recoveries for the last three years, recorded in accordance with the provisions of SFAS 115:

| Recoveries | | | |
|-----------------------|-------------|----------|--------|
| <i>(in thousands)</i> | 2006 | 2005 | 2004 |
| Securities | \$ | \$ 5,022 | \$ 687 |

Assisted Living Concepts, Inc. (ALC) common stock was called in January 2005 resulting in a gain of \$9,072,000 which is included in non-operating income in the consolidated statements of income for 2005 described as \$5,022,000 of security recoveries and \$4,050,000 of realized gains. These securities were previously identified as impaired in 2001.

ALC convertible debentures were called in January 2004 resulting in a gain of \$687,000 which we included in non-operating income described as security recoveries. These securities were previously identified as impaired in 2001.

Results of Operations

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Certain 2005 financial information has been reclassified for the presentation of operations discontinued during 2006. Such changes had no impact on the Company's net income.

Net income for the year ended December 31, 2006 is \$69,228,000 versus net income of \$54,408,000 for the same period in 2005, an increase of 27.2%. Diluted earnings per common share increased \$.53 or 27.0% to \$2.49 in 2006 from \$1.96 in 2005.

Total revenues for the year ended December 31, 2006 increased \$3,800,000 or 2.6% to \$150,724,000 from \$146,924,000 for the year ended December 31, 2005. Revenues from mortgage interest income decreased \$3,245,000 or 17.8% when compared to the same period in 2005 due to scheduled maturities, settlements and prepayments of our mortgage loan portfolio. Revenues from rental income increased \$2,276,000 or 5.2% in 2006 as compared to 2005 due primarily to the significant improvement in the operations of our owned facilities with one lessee who is now making lease payments of \$225,000 per month. Facility operating revenue increased \$4,769,000 or 5.6% in 2006 compared to 2005. The increase in facility operating revenues is due primarily to the improved government payment rates and census at our foreclosure properties in Massachusetts and New Hampshire for the year ended December 31, 2006. The increase in facility operating revenues is related to a \$3,087,000 increase in our Massachusetts and New Hampshire operating facilities and a \$1,759,000 increase in our Kansas and Missouri operating facilities.

Total expenses for the year ended December 31, 2006 decreased \$16,222,000 or 13.9% to \$100,498,000 from \$116,720,000 for 2005. Interest expense decreased \$425,000 or 5.0% in 2006 as compared to 2005 primarily due to the payment of debt of \$37,180,000 in 2005. Net loan and realty recoveries are reported as a decrease in expenses and amounted to \$7,934,000 in 2006 as compared to net loan and realty losses of \$10,837,000 in 2005. Loan recoveries in 2006 were \$9,008,000, less loan write-downs of \$1,074,000.

Non-Operating Income -

Non-operating income of \$12,721,000 in 2006 and \$22,331,000 in 2005 includes dividends, interest income, and gains and losses on the sale of marketable securities. In 2005, \$4,525,000 of fire insurance proceeds and gains from the sale of real estate damaged in a fire is also included in non-operating income. Furthermore, a gain of \$9,072,000 on the sale (as a result of merger) of ALC common stock for cash (described as \$5,022,000 of security recoveries and \$4,050,000 of realized gains) is included in non-operating income in 2005.

Discontinued Operations -

In March 2006, we received proceeds from the sale by the current owner of a 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 recognized the December 2004 sale of this property and recognized a \$124,000 gain. In May 2006, two New Jersey nursing facilities were sold generating net proceeds in cash of \$17,570,000 and a gain of \$5,690,000 which is included in discontinued operations.

During the year ended December 31, 2005, we sold two assisted living facilities with carrying amounts totaling \$10,709,000 for proceeds of \$11,482,000. We recognized a \$773,000 gain on the sale of these facilities. The net gain on the sale of real estate of \$773,000 is composed of a \$1,624,000 gain from a Charlotte, North Carolina assisted living facility sale and an \$851,000 loss from a Dallas, Texas assisted living facility sale. Both of these assisted living facilities were sold as a result of never achieving their expected profitability, discussed in Note 4 of the notes to our consolidated financial statements.

For 2006 and 2005, we have reclassified the operations, including the net gain on the sale of these facilities, as discontinued operations in accordance with SFAS 144.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Certain 2004 financial information has been reclassified for the presentation of operations discontinued during 2005. Such changes had no impact on the Company's reported net income.

Net income for the year ended December 31, 2005 is \$54,408,000 versus net income of \$56,379,000 for the same period in 2004, a decrease of 3.5%. Diluted earnings per common share decreased \$.07 or 3.4% to \$1.96 in 2005 from \$2.03 in 2004.

Total revenues for the year ended December 31, 2005 increased \$1,859,000 or 1.3% to \$146,924,000 from \$145,065,000 for the year ended December 31, 2004. Revenues from mortgage interest income increased \$110,000, or 0.6%, when compared to the same period in 2004. Revenues from rental income decreased \$1,707,000, or 3.7% in 2005 as compared to 2004. Facility operating revenue increased \$3,456,000 or 4.3% in 2005 compared to 2004.

Of the \$110,000 net increase in mortgage interest income, increases totaling \$5,862,000 are related to the following: (1) \$1,856,000 increased income from new loans, (2) \$1,855,000 income from legal and bankruptcy settlements attributable to interest income unrecorded in earlier years, and (3) \$2,151,000 increase in income from other mortgage loans due to improved performance of the operations of our mortgagors. Decreases in mortgage interest income totaling \$5,752,000 relate primarily to prior period payoffs of mortgage and REMIC investments.

The \$1,707,000 decrease in rental income in 2005 resulted primarily from decreases of \$840,000 because of terminated leases and \$2,962,000 because of delinquent leases, offset in part by increases of \$788,000 from new leases and \$1,307,000 from improved paying leases and increased percentage rent from fully paying leases.

The \$3,456,000 increase in facility operating revenues is due primarily to the improved government payment rates and census at our foreclosure properties in Massachusetts, New Hampshire, Kansas and Missouri for the year ended December 31, 2005. The increase in facility operating revenues is attributable to a \$1,514,000 increase in our Massachusetts and New Hampshire operating facilities and a \$1,942,000 increase in our Kansas and Missouri operating facilities. The New Hampshire facilities experienced a one-time \$4,228,000 state Medicaid retroactive rate adjustment in 2004 applicable to 2004 and 2003, which increased 2004 revenue as compared to 2005.

Total expenses for the year ended December 31, 2005 increased \$12,841,000 or 12.4% to \$116,720,000 from \$103,879,000 for 2004. Interest expense decreased \$3,883,000 or 31.2% in 2005 as compared to 2004. Loan, REMIC and realty losses increased \$13,046,000. Facility operating expense increased by \$4,443,000 or 5.9% in 2005 compared to 2004.

Interest expense for the year ended December 31, 2005 decreased primarily due to the payment of debt of \$37,180,000 since December 2004. This debt was repaid with cash that was earning less than the cost of the repaid debt and as a result, was immediately accretive to earnings.

Loan, REMIC, realty and security losses netted \$5,815,000 in 2005. Security recoveries of \$5,022,000 were recorded in 2005 related to the sale of Assisted Living Concepts, Inc. common stock as a result of the acquisition of all the outstanding shares of ALC by Extendicare, Inc. by merger, discussed in Note 6 of the notes to our financial statements. Realty impairments of \$2,550,000 were recorded during the first quarter of 2005 on two Florida assisted living facilities previously leased to Marriott Senior Living Services as a result of further defaults of covenants in the facility leases and continued maintenance of the facilities, discussed in Note 3 of the notes to our financial statements. Further maintenance analysis resulted in the recording of an additional \$2,852,000 of accrued maintenance expense in the third quarter of 2005 on these two Florida assisted living facilities attributable to mold remediation.

Loan write-downs of \$6,000,000 were recorded during 2005 as follows: (1) \$2,000,000 on two loans held by Algood HealthCare, Inc., (2) \$2,000,000 on mortgage loans with purchasers of three Florida-based nursing homes formerly owned by American Medical Associates, Inc., and (3) \$2,000,000 on a Miracle Hill nursing home loan. All these impairments are as a result of declines in past, current and anticipated cash flow from the facilities collateralizing the loans, discussed in Note 5 of the notes to our financial statements. Loan recoveries of \$565,000 were recorded in 2005.

The \$5,120,000 increase in facility operating expense relates primarily to the improved facility census in Massachusetts, New Hampshire, Kansas and Missouri facilities. The increase in facility operating expense is attributable to an increase of \$2,846,000 in our Massachusetts and New Hampshire operating facilities and in increase of \$2,274,000 in our Kansas and Missouri operating facilities. The New Hampshire facilities experienced a one-time \$1,811,000 state Medicaid retroactive bed tax fee in 2004 applicable to 2004 and 2003 which increased 2004 expenses as compared to 2005. Expenses at these facilities increased also because of inflation and service improvements to enhance census.

Non-Operating Income -

Non-operating income of \$22,331,000 in 2005 and \$12,381,000 in 2004 includes dividends, interest income, and gains and losses on the sale of marketable securities. In 2005, \$4,525,000 of fire insurance proceeds and gains from the sale of real estate damaged in a fire is also included in non-operating income. Furthermore, a gain of \$4,050,000 on the sale, as a result of merger, of ALC common stock for cash (after \$5,022,000 of the ALC common sale proceeds is treated as a recovery) is included in non-operating income in 2005.

Discontinued Operations -

During the year ended December 31, 2005, we sold two assisted living facilities with carrying amounts totaling \$10,709,000 for cash proceeds of \$11,482,000. We recognized a \$773,000 gain on the sale of these facilities. The net gain on the sale of real estate of \$773,000 is composed of a \$1,624,000 gain from a Charlotte, North Carolina assisted living facility sale and an \$851,000 loss from a Dallas, Texas assisted living facility sale. Both of these assisted living facilities were sold as a result of never achieving their expected profitability as discussed in Note 4 of the notes to our financial statements.

During the prior year ended December 31, 2004, we sold three nursing facilities (one previously designated as held for sale) with carrying amounts totaling \$2,846,000 for cash proceeds of \$4,389,000. We recognized a gain of \$1,543,000 on the sale of these facilities.

For 2005 and 2004, we have reclassified the operations, including the net gain on the sale of these facilities, as discontinued operations in accordance with SFAS 144.

Funds From Operations

Our funds from operations (FFO) for the year ended December 31, 2006, on a diluted basis was \$74,221,000, an increase of \$10,768,000 as compared to \$63,453,000 for the same period in 2005. FFO represents net earnings available to common stockholders, excluding the effects of asset dispositions, plus depreciation associated with real estate investments. Diluted FFO assumes, if dilutive, the conversion of convertible subordinated debentures, the conversion of cumulative convertible preferred stock and the exercise of stock options using the treasury stock method.

We believe that FFO is an important supplemental measure of operating performance for a real estate investment trust. Because the historical cost accounting convention used for real estate assets requires straight-line depreciation

(except on land), such accounting presentation implies that the value of real estate assets diminishes predictably over time. Since real estate values instead have historically risen and fallen with market conditions, presentation of operating results for a real estate investment trust that uses historical cost accounting for depreciation could be less informative, and should be supplemented with a measure such as FFO. The term FFO was designed by the real estate investment trust industry to address this issue. Our measure may not be comparable to similarly titled measures used by other REITs. Consequently, our funds from operations may not provide a meaningful measure of our performance as compared to that of other REITs. Since other REITs may not use our definition of FFO, caution should be exercised when comparing our Company's FFO to that of other REITs. Funds from operations in and of itself does not represent cash generated from operating activities in accordance with GAAP (funds from operations does not include changes in operating assets and liabilities) and therefore should not be considered an alternative to net earnings as an indication of operating performance, or to net cash flow from operating activities as determined by GAAP in the United States, as a measure of liquidity and is not necessarily indicative of cash available to fund cash needs.

We have complied with the SEC's interpretation that recurring impairments taken on real property may not be added back to net income in the calculation of FFO. The SEC's position is that recurring impairments on real property are not an appropriate adjustment.

The following table reconciles net income to funds from operations:

| Year Ended December 31, <i>(dollar amounts in thousands, except per share amounts)</i> | 2006 | 2005 | 2004 |
|---|------------|------------|------------|
| Net income | \$ 69,228 | \$ 54,408 | \$ 56,379 |
| Dividends to preferred stockholders | | — | (514) |
| Net income available to common stockholders | 69,228 | 54,408 | 55,865 |
| Elimination of non-cash items in net income: | | | |
| Real estate depreciation | 10,668 | 11,049 | 11,540 |
| Real estate depreciation in discontinued operations | 139 | 469 | 753 |
| Gain on sale of real estate | (5,814) | (2,554) | (1,543) |
| Basic funds from operations available to common stockholders | 74,221 | 63,372 | 66,615 |
| Interest on convertible subordinated debentures | | 81 | 120 |
| Diluted funds from operations available to common stockholders | \$ 74,221 | \$ 63,453 | \$ 66,735 |
| Basic funds from operations per share | \$ 2.68 | \$ 2.29 | \$ 2.44 |
| Diluted funds from operations per share | 2.67 | 2.28 | 2.42 |
| Shares for basic funds from operations per share | 27,744,868 | 27,699,887 | 27,257,826 |
| Shares for diluted funds from operations per share | 27,778,764 | 27,830,886 | 27,531,084 |

Impact of Inflation

During the past three years, inflation has not significantly affected our earnings because of relatively moderate inflation rates. Inflation may affect us in the future by changing the underlying value of our real estate or by impacting our cost of financing its operations.

Our revenues are generated primarily from long-term investments with fixed rates of return. These investments are financed through a combination of equity, long-term borrowings, and, as needed, line of credit arrangements. During periods of rising interest rates, our ability to grow may be adversely affected because yields on new investments may increase more slowly than new borrowing costs. Certain of our leases offer some degree of inflation protection by requiring increases in rental income based upon increases in the revenues of the tenants.

New Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123 (Revised 2004), *Share-Based Payment* (SFAS 123R). The new standard requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. The Company adopted SFAS 123R beginning January 1, 2006. The scope of SFAS 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 SFAS 123R has resulted in the recording of compensation charges of \$174,000 for options and restricted shares granted.

In May 2005, the FASB issued Statement No. 154, *Accounting for Changes and Error Corrections* (SFAS 154). This new standard replaces APB Opinion No. 20, *Accounting Changes* and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. SFAS 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. SFAS 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 a significant impact on the Company s consolidated financial statements.

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

In March 2006, the FASB issued Statement No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140* (SFAS 156). This statement amends SFAS 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 SFAS 156 is not expected to have material impact on the Company's consolidated financial statements.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109* (FIN 48). 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 assuming 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. The implementation of FIN 48 is not expected to have a material impact on the Company's consolidated financial statements.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (SFAS 157). This standard defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The new standard does not supersede all applications of fair value in other pronouncements, but creates a fair value hierarchy and prioritizes the inputs to valuation techniques for use in most pronouncements. It requires companies to assess the significance of an input to the fair value measurement in its entirety. SFAS 157 also requires companies to disclose information to enable users of financial statements to assess the inputs used to develop the fair value measurements. SFAS 157 is effective for fiscal periods beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS 157 on its consolidated financial statements.

In September 2006, the FASB issued Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – An amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158). This Statement enhances disclosure regarding the funded status of an employer's defined benefit postretirement plan by (a) requiring companies to include the funding status in comprehensive income and (b) recognize transactions and events that affect the funded status in the financial statements in the year in which they occur (c) at a measurement date of the employer's fiscal year-end. Statement No. 158 is not expected to apply to the Company.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). This standard amends SFAS No. 115, *Accounting for Certain Investment in Debt and Equity Securities*, with respect to accounting for a transfer to the trading category for all entities with available-for-sale and trading securities electing the fair value option. This standard allows companies to elect fair value accounting for many financial instruments and other items that currently are not required to be accounted as such, allows different applications for electing the option for a single item or groups of items, and requires disclosures to facilitate comparisons of similar assets and liabilities that are accounted for differently in relation to the fair value option. SFAS 159 is effective for fiscal years beginning after November 15, 2007. If elected, the implementation of SFAS 159 is not expected to have a material impact on the Company's consolidated financial statements.

Forward Looking Statements

References throughout this document to the Company include National Health Investors, Inc. and its wholly-owned subsidiaries. In accordance with the Securities and Exchange Commission's Plain English guidelines, this Annual Report on Form 10-K has been written in the first person. In this document, the words we, our, ours and us refer to National Health Investors, Inc. and its wholly-owned subsidiaries and not any other person.

This Annual Report on Form 10-K and other information we provide from time to time, contains certain forward-looking statements as that term is defined by the Private Securities Litigation Reform Act of 1995. All statements regarding our expected future financial position, results of operations, cash flows, funds from operations, continued performance improvements, ability to service and refinance our debt obligations, ability to finance growth opportunities, and similar statements including, without limitations, those containing words such as believes, anticipates, expects, intends, estimates, plans, and other similar expressions are forward-looking statements.

Forward-looking statements involve known and unknown risks and uncertainties that may cause our actual results in future periods to differ materially from those projected or contemplated in the forward-looking statements as a result of, but not limited to, the following factors:

*

national and local economic conditions, including their effect on the availability and cost of labor, utilities and materials;

*

the effect of government regulations and changes in regulations governing the healthcare industry, including compliance with such regulations by us and our borrowers and/or lessees;

*

changes in Medicare and Medicaid payment levels and methodologies and the application of such methodologies by the government and its fiscal intermediaries to our borrowers and/or lessees;

*

the ability to pay when due or refinance certain debt obligations maturing within the next 12 months;

*

the availability and terms of capital to fund investments;

*

the competitive environment in which we operate.

See the notes to the Annual Financial Statements, and Business and Risk Factors under Item 1 and Item 1A herein for a discussion of various governmental regulations and other operating factors relating to the healthcare industry and the risk factors inherent in them. You should carefully consider these risks before making any investment decisions in the Company. These risks and uncertainties are not the only ones facing the Company. There may be additional risks that we do not presently know of or that we currently deem immaterial. If any of the risks actually occur, our business, financial condition or results of operations could be materially adversely affected. In that case, the trading price of our shares of stock could decline and you may lose all or part of your investment. Given these risks and uncertainties, we can give no assurance that these forward-looking statements will, in fact, occur and, therefore, caution investors not to place undue reliance on them.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Interest Rate Risk

Our cash and cash equivalents consist of highly liquid investments with a maturity of less than three months when purchased. All of our mortgage and other notes receivable bear interest at fixed interest rates. Our investment in preferred stock represents an investment in the preferred stock of another real estate investment trust and bears interest at a fixed rate of 8.5%. As a result of the short-term nature of our cash instruments and because the interest rates on our investments in notes receivable and preferred stock are fixed, a hypothetical 10% change in interest rates has no impact on our future earnings and cash flows related to these instruments.

As of December 31, 2006, \$100 million of our debt bears interest at a fixed interest rate of 7.3%. Because the interest rate of this debt instrument is fixed, a hypothetical 10% change in interest rates has no impact on our future earnings and cash flows related to this debt instrument. The remaining \$13,492,000 of our debt bears interest at variable rates. A hypothetical 10% increase in interest rates would reduce our future earnings and cash flows related to these debt instruments by \$74,000. A hypothetical 10% decrease in interest rates would increase our future earnings and cash flows related to these debt instruments by \$74,000.

We are subject to risks associated with debt financing, including the risk that our existing indebtedness may not be refinanced or that the terms of refinancing may not be as favorable as the terms of existing indebtedness. Certain of our loan agreements require the maintenance of specified financial ratios. Accordingly, in the event that we are unable to raise additional equity or borrow money because of those limitations, our ability to make additional investments may be limited.

We do not use derivative instruments to hedge interest rate risks. The future use of such instruments will be subject to strict approvals by our senior officers.

Equity Price Risk

We consider our investments in marketable securities of \$25,513,000 at December 31, 2006 as available-for-sale securities and unrealized gains and losses are recorded in stockholders' equity in accordance with SFAS 115. The investments in marketable securities are recorded at their fair market value based on quoted market prices. Thus, there is exposure to equity price risk, which is the potential change in fair value due to a change in quoted market prices. Hypothetically, a 10% change in quoted market prices would result in a related \$2,551,000 change in the fair value of our investments in marketable securities.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

National Health Investors, Inc.

Murfreesboro, Tennessee

We have audited the accompanying consolidated balance sheets of National Health Investors, Inc. as of December 31, 2006 and 2005 and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of National Health Investors, Inc. at December 31, 2006 and 2005, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the Consolidated Financial Statements, effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment*.

We were also engaged to audit, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of National Health Investors, Inc.'s internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 23, 2007 expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP

Memphis, Tennessee

March 23, 2007

NATIONAL HEALTH INVESTORS, INC.**Consolidated Balance Sheets***(In thousands, except share and per share amounts)*

| December 31, | 2006 | 2005 |
|--|-------------------|------------|
| Assets | | |
| Real estate properties: | | |
| Land | \$ 30,067 | \$ 31,647 |
| Buildings and improvements | 346,033 | 362,907 |
| Construction in progress | 307 | 359 |
| | 376,407 | 394,913 |
| Less accumulated depreciation | (141,208) | (131,784) |
| Real estate properties, net | 235,199 | 263,129 |
| Mortgage and other notes receivable, net | 99,532 | 118,800 |
| Investment in preferred stock | 38,132 | 38,132 |
| Cash and cash equivalents | 177,765 | 132,469 |
| Marketable securities | 25,513 | 19,553 |
| Accounts receivable, net | 6,133 | 5,581 |
| Deferred costs and other assets | 13,190 | 10,268 |
| Total Assets | \$ 595,464 | \$ 587,932 |
| Liabilities | | |
| Unsecured public notes | \$ 100,000 | \$ 100,000 |
| Debt | 13,492 | 17,252 |
| Convertible subordinated debentures | | 201 |
| Accounts payable and other accrued expenses | 20,951 | 26,471 |
| Accrued interest | 3,378 | 3,374 |
| Dividends payable | 25,809 | 12,524 |
| Deferred income | 163 | 3,142 |
| Total Liabilities | 163,793 | 162,964 |
| Commitments and contingencies | | |
| Stockholders Equity | | |
| Common stock, \$.01 par value; 40,000,000 shares authorized; 27,752,239 and 27,830,439 shares, respectively, issued and outstanding | 278 | 278 |
| Capital in excess of par value | 461,735 | 464,389 |
| Cumulative net income | 682,437 | 613,209 |

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| | | |
|--|-------------------|------------|
| Cumulative dividends | (730,562) | (664,730) |
| Unrealized gains on marketable securities | 17,783 | 11,822 |
| Total Stockholders' Equity | 431,671 | 424,968 |
| Total Liabilities and Stockholders' Equity | \$ 595,464 | \$ 587,932 |

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

NATIONAL HEALTH INVESTORS, INC.**Consolidated Statements of Income***(In thousands, except share and per share amounts)*

| Year Ended December 31 | 2006 | 2005 | 2004 |
|--|-------------------|------------|------------|
| Revenues: | | | |
| Mortgage interest income | \$ 14,981 | \$ 18,226 | \$ 18,116 |
| Rental income | 46,281 | 44,005 | 45,712 |
| Facility operating revenue | 89,462 | 84,693 | 81,237 |
| | 150,724 | 146,924 | 145,065 |
| Expenses: | | | |
| Interest expense | 8,131 | 8,556 | 12,439 |
| Depreciation | 11,845 | 12,199 | 13,424 |
| Amortization of loan costs | 135 | 174 | 148 |
| Legal expense | 592 | 570 | 1,292 |
| Franchise, excise, and other taxes | 204 | 622 | 284 |
| General and administrative | 5,344 | 4,310 | 3,492 |
| Loan, remic, and realty losses (recoveries) | (7,934) | 10,837 | (2,209) |
| Facility operating expenses | 82,181 | 79,452 | 75,009 |
| | 100,498 | 116,720 | 103,879 |
| Income before non-operating income | 50,226 | 30,204 | 41,186 |
| Non-operating income (investment interest and other) | 12,721 | 22,331 | 12,381 |
| Income from continuing operations | 62,947 | 52,535 | 53,567 |
| Discontinued operations | | | |
| Operating income - discontinued | 467 | 1,100 | 1,269 |
| Net gain on sales of real estate | 5,814 | 773 | 1,543 |
| | 6,281 | 1,873 | 2,812 |
| Net income | 69,228 | 54,408 | 56,379 |
| Dividends to preferred stockholders | | | (514) |
| Net income available to common stockholders | \$ 69,228 | \$ 54,408 | \$ 55,865 |
| Weighted average common shares outstanding: | | | |
| Basic | 27,744,868 | 27,699,887 | 27,257,826 |
| Diluted | 27,778,764 | 27,830,886 | 27,531,084 |
| Earnings per share: | | | |
| Basic: | | | |
| Income from continuing operations | \$ 2.27 | \$ 1.89 | \$ 1.95 |
| Discontinued operations | .23 | .07 | .10 |
| Net income available to common stockholders | \$ 2.50 | \$ 1.96 | \$ 2.05 |
| Diluted: | | | |

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| | | | | | | |
|---|----|-------------|----|------|----|------|
| Income from continuing operations | \$ | 2.26 | \$ | 1.89 | \$ | 1.93 |
| Discontinued operations | | .23 | | .07 | | .10 |
| Net income available to common stockholders | \$ | 2.49 | \$ | 1.96 | \$ | 2.03 |

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

NATIONAL HEALTH INVESTORS, INC.**Consolidated Statements of Cash Flows***(In thousands)*

| Year Ended December 31 | 2006 | 2005 | 2004 |
|---|-----------|-----------|-----------|
| Cash flows from operating activities: | | | |
| Net income | \$ 69,228 | \$ 54,408 | \$ 56,379 |
| Adjustments to reconcile net income to net cash provided from operating activities: | | | |
| Depreciation | 12,026 | 12,855 | 14,453 |
| Provision for loan, remic and realty losses (recoveries) | (7,934) | 7,985 | (2,209) |
| Net gain on sales of real estate | (5,814) | (2,552) | (1,543) |
| Gain on notes receivable | (1,015) | | (3,308) |
| Share-based compensation | 519 | | |
| Realized gain and recovery on sales of marketable securities | | (9,072) | (2,682) |
| Amortization of loan costs | 135 | 174 | 148 |
| Interest on debenture conversions | | 10 | |
| Amortization of discount on held-to-maturity securities and real estate mortgage investment conduit | | | (1,191) |
| Deferred income | | 109 | 10 |
| Amortization of deferred income | (217) | (252) | (320) |
| Changes in operating assets and liabilities: | | | |
| (Increase) decrease in accounts receivable | (552) | 803 | (2,075) |
| Increase in deferred costs and other assets | (3,057) | (4,142) | (446) |
| (Decrease) increase in accounts payable and other accrued expenses | (5,518) | (1,298) | (107) |
| Decrease in accrued interest | 4 | (18) | (17) |
| Net cash provided by operating activities | 57,805 | 59,010 | 57,092 |
| Cash flows from investing activities: | | | |
| Investment in mortgage and other notes receivable | (11,063) | (22,079) | (2,419) |
| Collection of mortgage and other notes receivable | 16,853 | 4,492 | 13,944 |
| Prepayment of mortgage notes receivable | 19,664 | 5,424 | 4,461 |
| Sale of mortgage notes receivable | | | 24,120 |
| Collection of real estate mortgage investment conduits | | | 13,126 |
| Acquisition of and construction of real estate properties | (2,499) | (12,264) | (1,678) |
| Disposition of property and equipment | 24,215 | 14,452 | 4,389 |
| Acquisition of marketable securities | | | (1,024) |
| Sales of marketable securities | | 10,308 | 10,823 |
| Net cash provided by investing activities: | 47,170 | 333 | 65,742 |
| Cash flows from financing activities: | | | |
| Payments on debt | (3,760) | (37,180) | (7,670) |

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| | | | |
|---|-------------------|------------|------------|
| Redemption of convertible subordinated debentures | (201) | - | - |
| Dividends paid to stockholders | (52,545) | (53,259) | (48,650) |
| Repurchase of common stock | (3,530) | | (578) |
| Sale of common stock | 357 | 2,350 | 1,592 |
| Net cash used in financing activities | (59,679) | (88,089) | (55,306) |
| Increase (decrease) in cash and cash equivalents | 45,296 | (28,746) | 67,528 |
| Cash and cash equivalents, beginning of period | 132,469 | 161,215 | 93,687 |
| Cash and cash equivalents, end of period | \$ 177,765 | \$ 132,469 | \$ 161,215 |

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

NATIONAL HEALTH INVESTORS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(In thousands, except share and per share amounts)

| | Cumulative Convertible | | Common Stock | | Capital in Excess of Par | Cumulative Net Income | Cumulative Dividends | Unrealized (Losses) Gains on Marketable Securities | Total Stockholders Equity |
|---|--------------------------------------|----------|-----------------|--------|--------------------------------------|-----------------------------|-------------------------|---|---------------------------------|
| | Preferred Stock at \$25 per share | Shares | Amount | Shares | Amount | Value | Income | Dividends | Equity |
| | | | \$ | | \$ | \$ | \$ | \$ | \$ |
| Balances at December 31, 2003 | 747,994 | 18,700 | 770,123 | 267 | 41,178 | 502,438 | (563,682) | \$10,758 | \$409,644 |
| Comprehensive income: | | | | | | | | | |
| Net income | | | | | | 56,379 | | | 56,379 |
| Unrealized gains on marketable securities | | | | | | | | 9,371 | 9,371 |
| Total comprehensive income | | | | | | | | | 65,750 |
| Shares repurchased and retired | | | (23,860) | | (578) | | | | (578) |
| Shares issued: | | | | | | | | | |
| Stock options exercised | | | 88,271 | 1 | 1,591 | | | | 1,592 |
| Shares issued in conversion of preferred stock | (747,994) | (18,700) | 676,922 | | 718,693 | | | | |
| Shares issued in conversion of convertible debentures to common stock | | | 33,562 | | 235 | | | | 235 |
| Cash dividends: | | | | | | | | | |
| Dividends to common stockholders, \$1.85 per share | | | | | | | (50,590) | | (50,590) |
| Dividends to preferred stockholders, \$.6876 per share | | | | | | | (514) | | (514) |
| Balances at December 31, 2004 | | | 27,545,018 | 274 | 61,119 | 558,804 | (614,786) | 20,130 | 425,539 |
| Comprehensive income: | | | | | | | | | |
| Net income | | | | | | 54,408 | | | 54,408 |
| Unrealized losses on marketable securities | | | | | | | | (8,308) | (8,308) |

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| | | | | |
|---|---------------|-------|------------------|--------------------------------|
| Total comprehensive income | | | | 46,100 |
| Shares issued: | | | | |
| Stock options exercised | 154,729 | 2 | 2,348 | 2,350 |
| Shares issued in conversion of convertible debentures to common stock | 130,692 | 1 | 922 | 923 |
| Cash dividends: | | | | |
| Dividends to common stockholders, \$1.80 per share | | | (49,944) | (49,944) |
| Balances at December 31, 2005 | 27,830,439 | 27 | 164,389 | 13,200,664,730) 11,822,424,968 |
| Comprehensive income: | | | | |
| Net income | | | 69,228 | 69,228 |
| Unrealized gain on marketable securities | | | | 5,961 5,961 |
| Total comprehensive income | | | | 75,189 |
| Shares repurchased and retired | (146,200) | (1) | (3,529) | (3,530) |
| Shares issued: | | | | |
| Stock options exercised | 15,000 | | 357 | 357 |
| Restricted stock | 53,000 | 1 | (1) | - |
| Compensation related items: | | | | |
| Share-based compensation | | | 519 | 519 |
| Cash Dividends: | | | | |
| Dividends to common stockholders, \$2.37 per share | | | (65,832) | (65,832) |
| Balances at December 31, 2006 | \$ 27,752,239 | \$ 27 | \$ 161,735,682,4 | \$ 17,783,431,671 |

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

NATIONAL HEALTH INVESTORS, INC.

Notes to Consolidated Financial Statements

Years Ended December 31, 2006, 2005, and 2004

NOTE 1. ORGANIZATION

National Health Investors, Inc. ("NHI" or the "Company") is a Maryland real estate investment trust (REIT) that was incorporated on July 24, 1991. NHI's revenue is derived primarily from interest income on mortgage loans, rent generated on leased properties, income on other investments and the operations of long-term health care facilities on which NHI has foreclosed or has accepted deeds in lieu of foreclosure. NHI invests in health care properties including long-term care centers, acute care hospitals, medical office buildings, assisted living facilities and retirement centers. These properties are located throughout the United States and are operated by qualified health care providers.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation - The consolidated financial statements include the accounts of NHI and its wholly-owned subsidiaries. Significant intercompany accounts and transactions have been eliminated.

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

Real Estate Properties - NHI records properties at cost, including capitalized interest during construction periods. NHI uses the straight-line method of depreciation for buildings and improvements over their estimated remaining useful lives as follows:

| | |
|--------------|---------------|
| Buildings | 40 years |
| Improvements | 5 to 25 years |

In accordance with Financial Accounting Standards Board (FASB) Statement No. 144, "*Accounting for the Impairment or Disposal of Long-Lived Assets*" ("SFAS 144"), NHI evaluates the recoverability of the carrying values of its properties on a property-by-property basis. On a quarterly basis, NHI reviews its properties for recoverability when events or circumstances, including significant physical changes in the property, significant adverse changes in general economic conditions, and significant deteriorations of the underlying cash flows of the property, indicate that the carrying amount of the property may not be recoverable. The need to recognize an impairment is based on estimated undiscounted future cash flows from a property compared to the carrying value of that property. If recognition of an impairment is necessary, it is measured as the amount by which the carrying amount of the property exceeds the fair value of the property.

Mortgage and Other Notes Receivable - In accordance with FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan - An Amendment of FASB Statements No. 5 and 15* (SFAS 114), NHI evaluates the carrying values of its mortgage and other notes receivable on an instrument-by-instrument basis. On a quarterly basis, NHI reviews its notes receivable for recoverability when events or circumstances, including the non-receipt of principal and interest payments, significant deteriorations of the financial condition of the borrower and significant adverse changes in general economic conditions, indicate that the carrying amount of the note receivable may not be recoverable. If necessary, an impairment is measured as the amount by which the carrying amount exceeds the discounted cash flows expected to be received under the note receivable or, if foreclosure is probable, the fair value of the collateral securing the note receivable.

Cash Equivalents - Cash equivalents consist of all highly liquid investments with an original maturity of three months or less.

Federal Income Taxes - NHI intends at all times to qualify as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended. Therefore, NHI will not be subject to federal income tax provided it distributes at least 90% of its REIT taxable income to its stockholders and meets other requirements to continue to qualify as a REIT. Accordingly, no provision for federal income taxes has been made in the consolidated financial statements. NHI's failure to continue to qualify under the applicable REIT qualification rules and regulations would have a material adverse impact on the financial position, results of operations and cash flows of NHI.

At December 31, 2006, the primary difference between NHI's tax basis and the reported amounts of NHI's assets and liabilities is a higher book basis than tax basis in its real estate properties by approximately \$26,049,000. Of the amount, \$38,149,000 is attributable to operating facilities sold in Massachusetts, New Hampshire, Kansas and Missouri not recorded for financial

statement purposes (accounted for under the deposit method under Statement of Financial Accounting Standard No. 66 *Accounting for Sales of Real Estate* (SFAS 66), while accounted for under the installment sale method for tax purposes). This is offset by a \$12,100,000 higher tax basis than book basis on other real estate properties.

Earnings and profits, which determine the taxability of dividends to stockholders, differ from net income reported for financial reporting purposes due primarily to differences in the basis of assets, recognition of commitment fees, estimated useful lives used to compute depreciation expense and in the treatment of accrued interest expense that existed at the time debentures were converted to common stock.

Concentration of Credit Risks - NHI's credit risks primarily relate to cash and cash equivalents, investments in preferred stock, real estate mortgage investment conduits and mortgage and other notes receivable. Cash and cash equivalents are primarily held in bank accounts and overnight investments. The company maintains its bank deposit accounts with large financial institutions that exceed federally-insured limits. The Company has not experienced any losses in such accounts. Mortgage and other notes receivable consists primarily of secured loans with health care facilities as discussed in Note 4. The investment in preferred stock is in one entity as discussed in Note 6.

NHI's financial instruments, principally its investments in preferred stock and notes receivable, are subject to the possibility of loss of the carrying values as a result of either the failure of other parties to perform according to their contractual obligations or changes in market prices which may make the instruments less valuable. NHI obtains various collateral and other protective rights and continually monitors these rights in order to reduce such possibilities of loss. NHI evaluates the need to provide for reserves for potential losses on its financial instruments based on management's periodic review of its portfolio on an instrument-by-instrument basis. See Notes 4 and 6 for additional information on the notes receivable and investment in preferred stock.

Marketable Securities - NHI's 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 Statement of Financial Accounting Standards No. 115, "*Accounting for Certain Investments in Debt and Equity Securities*" ("SFAS 115"). NHI evaluates its marketable securities for other-than-temporary impairments consistent with the provisions of SFAS 115.

Deferred Costs - Costs incurred to acquire financings are amortized by the effective interest method over the term of the related debt.

Deferred Income - Deferred income primarily includes non-refundable loan commitment fees received by NHI, which are amortized into income by the effective interest method over the expected period of the related loans. In the

event that a potential borrower chooses not to borrow funds from NHI, the related commitment fees are recognized into income when the commitment expires.

In management's opinion, these loan commitment fees approximate the loan commitment fees that NHI would currently charge to enter into similar agreements based on the terms of the agreements and the creditworthiness of the parties, and the committed interest rates are approximately the same as current levels of interest rates.

Rental Income - Rental income is recognized by NHI based on the terms of NHI's leases, which is generally on a straight-line basis over the term of the lease. Under certain of its leases, NHI receives additional contingent rent, which is based on the increase in revenues of a lessee over a base year or base quarter. NHI recognizes contingent rent annually or quarterly, as applicable, when, based on the actual revenues of the lessee, receipt of such income is assured since the target threshold has been received. Revenue from minimum lease payments under our leases is recognized on a straight-line basis as required under FASB Statement No. 13 *Accounting For Leases* (SFAS 13) to the extent that future lease payments are considered collectible. Lease payments that depend on a factor directly related to future use of the property, such as an increase in annual revenues over a base year revenues, are considered to be contingent rentals and are excluded from minimum lease payments in accordance with SFAS 13.

NHI identifies leases as non-performing if a required payment is not received within 30 days of the date it is due. The Company's policy related to rental income on non-performing leased real estate properties is to recognize rental income in the period when the income is received.

Mortgage Interest Income - Mortgage interest income is recognized by NHI based on the interest rates and principal amounts outstanding of the mortgage notes receivable. Under certain of its mortgages, NHI receives additional contingent interest, which is based on the increase in the current year revenues of a borrower over a base year. NHI recognizes contingent interest income annually when, based on the actual revenues of the borrower, receipt of such income is assured since the target threshold has been achieved. Mortgage interest income includes prepayment penalties, which are recognized into income upon prepayment of

notes receivable. NHI identifies loans as non-performing if a required payment is not received within 30 days of the date it is due. The Company's policy related to mortgage interest income on non-performing mortgage loans is to recognize mortgage interest income in the period when the income is received.

Investment Interest and Other Income - Investment interest and other income includes dividends and interest received from investments in preferred stock and marketable securities, realized gains and losses on sales of marketable securities, interest on cash and cash equivalents and amortization of deferred income.

Facility Operating Revenue - Facility operating revenue is generated from the long-term health care facilities on which NHI became the licensed operator. With certain elections, unqualified income generated by these properties is expected to be treated as qualified income for up to six years from the purchase date for purpose of the income-source tests that must be satisfied by REITs to maintain their tax status. Approximately 75% of NHI's facility operating revenue in 2006, 2005 and 2004 is derived from participation in Medicare and Medicaid programs. Amounts earned under Medicare, Medicaid and other governmental programs are subject to review by the third party payors. In the opinion of management, adequate provision has been made for any adjustments that may result from such reviews. Any differences between estimated settlements and final determinations are reflected in facility operating revenue in the year finalized.

Foreclosures - NHI records the assets received and liabilities assumed during foreclosures at their estimated fair value in accordance with the provisions of FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings* (SFAS 15).

Stock-Based Compensation - NHI accounts for stock-based compensation arrangements under FASB Statement 123 (Revised 2004) *Share-Based payments* (SFAS 123R). See Note 14 for additional disclosures about NHI's stock-based compensation.

Comprehensive Income - FASB Statement No. 130, "*Reporting Comprehensive Income*" requires that changes in the amounts of certain items, including unrealized gains and losses on certain securities, be shown in the consolidated financial statements. NHI reports its comprehensive income in the consolidated statements of stockholders' equity.

Segment Disclosures - FASB Statement No. 131, *Disclosures About Segments of an Enterprise and Related Information* establishes standards for the manner in which public business enterprises report information about operating segments. Management believes that substantially all of NHI's operations comprise one operating segment.

New Accounting Pronouncements - In December 2004, the issued FASB Statement No. 123 (Revised 2004), *Share-Based Payments* (SFAS 123R). The new standard 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 SFAS 123R beginning January 1, 2006. The scope of SFAS 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 SFAS 123R has resulted in the recording of compensation charges of \$174,000 for options and restricted shares granted.

In May 2005, the FASB issued Statement No. 154, *Accounting for Changes and Error Corrections*. (SFAS 154) This new standard replaces APB Opinion No. 20, *Accounting Changes* and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. SFAS 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. SFAS 154 also provides that (1) a change in method of depreciating or amortizing a long-lived non-financial 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 a significant impact on the Company s financial statements.

In February 2006, the FASB issued Statement No. 155, *Accounting for Certain Hybrid Financial Instruments An amendment to FASB Statements No. 133 and 140* (SFAS 155). SFAS 155 simplifies the accounting for certain hybrid financial instruments containing embedded derivatives. SFAS 155 allows fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation under SFAS 133. In addition, it amends SFAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to beneficial interest other than another derivative financial instrument. The new standard is effective to new or modified financial instruments in fiscal years beginning after September 15, 2006. The implementation of SFAS 155 is not expected to have material impact on the Company s consolidated financial statements.

In March 2006, the FASB issued Statement No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140* (SFAS 156). 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 standard 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 SFAS 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 *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109*. (FIN 48), 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. The implementation of FIN 48 is not expected to have a material impact on the Company's consolidated financial statements.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (SFAS 157). This standard defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The new FASB rule does not supersede all applications of fair value in other pronouncements, but creates a fair value hierarchy and prioritizes the inputs to valuation techniques for use in most pronouncements. It requires companies to assess the significance of an input to the fair value measurement in its entirety. SFAS 157 also requires companies to disclose information to enable users of financial statements to assess the inputs used to develop the fair value measurements. SFAS 157 is effective for fiscal periods beginning after November 15, 2007. The Company is currently evaluating the impact on its consolidated financial statements.

In September 2006, the FASB issued Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – An amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158). This standard enhances disclosure regarding the funded status of an employer's defined benefit postretirement plan by (a) requiring companies to include the funding status in comprehensive income and (b) recognize transactions and events that affect the funded status in the financial statements in the year in which they occur (c) at a measurement date of the employer's fiscal year-end. SFAS 158 is not expected to apply to the Company.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115* (SFAS 159). This standard amends FASB Statement No. 115, *Accounting for Certain Investment in Debt and Equity Securities*, with respect to accounting for a transfer to the trading category for all entities with available-for-sale and trading securities electing the fair value option. This standard allows companies to elect fair value accounting for many financial instruments and other items that currently

are not required to be accounted as such, allows different applications for electing the option for a single item or groups of items, and requires disclosures to facilitate comparisons of similar assets and liabilities that are accounted for differently in relation to the fair value option. SFAS 159 is effective for fiscal years beginning after November 15, 2007. If elected, the implementation of FAS 159 is not expected to have a material impact on the Company's consolidated financial statements.

Note 3. Real Estate

The following table summarizes NHI's real estate properties by type of facility and by state as of December 31, 2006 and 2005:

(Dollar amounts in thousands)

2006

| Facility Type and State | Number of Facilities | Land | Buildings, Improvements & Construction in Progress | Accumulated Depreciation | Mortgage Notes Payable |
|----------------------------------|----------------------------|--------|---|-----------------------------|------------------------------|
| <i>Long-Term Care:</i> | | | | | |
| Alabama | 2 | \$ 95 | \$ 5,165 | \$ 3,197 | \$ |
| Arizona | 1 | 453 | 6,678 | 1,862 | 1,780 |
| Florida | 4 | 2,306 | 37,437 | 19,143 | 837 |
| Georgia | 1 | 52 | 865 | 754 | |
| Idaho | 1 | 122 | 2,491 | 702 | |
| Kansas | 7 | 658 | 12,931 | 2,446 | |
| Kentucky | 2 | 231 | 2,182 | 1,387 | |
| Massachusetts | 4 | 1,189 | 18,873 | 9,810 | |
| Missouri | 8 | 1,515 | 29,224 | 13,860 | 2,225 |
| New Hampshire | 3 | 1,473 | 23,398 | 12,385 | |
| South Carolina | 3 | 572 | 11,527 | 7,418 | |
| Tennessee | 20 | 1,835 | 41,297 | 24,516 | |
| Texas | 8 | 2,280 | 47,409 | 8,156 | |
| Virginia | 1 | 176 | 2,510 | 1,407 | 2,100 |
| Wisconsin | 1 | 170 | 1,604 | 138 | |
| Total Long-Term Care | 66 | 13,127 | 243,591 | 107,181 | 6,942 |
| <i>Acute Care:</i> | | | | | |
| Kentucky | 1 | 540 | 10,163 | 3,804 | |
| Total Acute Care | 1 | 540 | 10,163 | 3,804 | |
| <i>Medical Office Buildings:</i> | | | | | |
| Florida | 1 | 165 | 3,349 | 1,576 | |

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| | | | | | | |
|--------------------------------|----|-----------|------------|------------|----------|--|
| Illinois | 1 | | 1,925 | 451 | | |
| Texas | 2 | 631 | 9,677 | 3,737 | | |
| Total Medical Office Buildings | 4 | 796 | 14,951 | 5,764 | | |
| <i>Assisted Living:</i> | | | | | | |
| Arizona | 4 | 1,757 | 13,622 | 2,695 | | |
| Florida | 4 | 7,095 | 21,232 | 8,312 | | |
| New Jersey | 1 | 4,229 | 13,030 | 4,340 | | |
| Pennsylvania | 1 | 439 | 3,960 | 132 | | |
| South Carolina | 1 | 344 | 2,877 | 572 | | |
| Tennessee | 3 | 871 | 7,062 | 1,387 | | |
| Total Assisted Living | 14 | 14,735 | 61,783 | 17,438 | | |
| <i>Retirement Centers:</i> | | | | | | |
| Idaho | 1 | 243 | 4,182 | 1,154 | | |
| Missouri | 1 | 344 | 3,181 | 1,683 | | |
| New Hampshire | 1 | 218 | 2,846 | 1,618 | | |
| Tennessee | 2 | 64 | 5,643 | 2,566 | | |
| Total Retirement Centers | 5 | 869 | 15,852 | 7,021 | | |
| Total | 90 | \$ 30,067 | \$ 346,340 | \$ 141,208 | \$ 6,942 | |

2005

| Facility Type and State | Number Of Facilities | Land | Buildings, Improvements & Construction in Progress | Accumulated Depreciation | Mortgage Notes Payable |
|-------------------------|----------------------------|--------|---|-----------------------------|------------------------------|
| <i>Long-Term Care:</i> | | | | | |
| Alabama | 2 | \$ 95 | \$ 5,165 | \$ 3,086 | \$ 1 |
| Arizona | 1 | 453 | 6,678 | 1,668 | 1,950 |
| Florida | 4 | 2,306 | 37,511 | 17,929 | 1,097 |
| Georgia | 1 | 52 | 865 | 721 | |
| Idaho | 1 | 122 | 2,491 | 637 | |
| Kansas | 7 | 658 | 12,512 | 1,980 | |
| Kentucky | 2 | 231 | 2,182 | 1,301 | |
| Massachusetts | 4 | 1,189 | 18,665 | 8,832 | |
| Missouri | 9 | 1,988 | 36,203 | 13,984 | 2,725 |
| New Hampshire | 3 | 1,473 | 22,870 | 10,997 | |
| New Jersey | 2 | 1,096 | 11,973 | 1,070 | |
| South Carolina | 3 | 572 | 11,544 | 7,092 | |
| Tennessee | 20 | 1,835 | 41,312 | 23,199 | 13 |
| Texas | 8 | 2,280 | 47,409 | 6,741 | |
| Virginia | 1 | 176 | 2,510 | 1,333 | 2,400 |
| Wisconsin | 1 | 170 | 1,604 | 83 | |
| Total Long-Term Care | 69 | 14,696 | 261,494 | 100,653 | 8,186 |

Acute Care:

| | | | | | |
|------------------|---|-----|--------|-------|--|
| Kentucky | 1 | 540 | 10,163 | 3,455 | |
| Total Acute Care | 1 | 540 | 10,163 | 3,455 | |

Medical Office Buildings:

| | | | | | |
|--------------------------------|---|-----|--------|-------|--|
| Florida | 1 | 165 | 3,349 | 1,483 | |
| Illinois | 1 | | 1,925 | 397 | |
| Texas | 2 | 631 | 9,677 | 3,450 | |
| Total Medical Office Buildings | 4 | 796 | 14,951 | 5,330 | |

Assisted Living:

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| | | | | | |
|----------------------------|----|----------|-----------|-----------|----------|
| Arizona | 4 | 1,757 | 13,622 | 2,354 | |
| Florida | 5 | 7,096 | 20,194 | 7,724 | |
| New Jersey | 1 | 4,229 | 13,030 | 3,970 | |
| Pennsylvania | 1 | 440 | 3,960 | 33 | |
| South Carolina | 1 | 344 | 2,877 | 500 | |
| Tennessee | 3 | 871 | 7,061 | 1,210 | |
| Total Assisted Living | 15 | 14,737 | 60,744 | 15,791 | |
| <i>Retirement Centers:</i> | | | | | |
| Idaho | 1 | 243 | 4,182 | 1,043 | |
| Missouri | 1 | 353 | 3,171 | 1,590 | |
| New Hampshire | 1 | 218 | 2,917 | 1,533 | |
| Tennessee | 2 | 64 | 5,644 | 2,389 | |
| Total Retirement Centers | 5 | 878 | 15,914 | 6,555 | |
| Total | 94 | \$31,647 | \$363,266 | \$131,784 | \$ 8,186 |

Certain of NHI's real estate properties are pledged as collateral on individual mortgage notes payable, as noted in the tables above.

The following table summarizes NHI's real estate properties by leased facilities and operating facilities at December 31, 2006 and 2005, respectively (*in thousands*):

| | 2006 | | | 2005 | | |
|-------------------------------|----------------|---------------|----------------|-----------|-----------|-----------|
| | Leased | Operating | Total | Leased | Operating | Total |
| Land | \$ 26,491 | \$ 3,576 | \$ 30,067 | \$ 27,598 | \$ 4,049 | \$ 31,647 |
| Buildings and improvements | 284,382 | 61,651 | 346,033 | 295,416 | 67,491 | 362,907 |
| Construction in progress | 2 | 305 | 307 | | 359 | 359 |
| | 310,875 | 65,532 | 376,407 | 323,014 | 71,899 | 394,913 |
| Less accumulated depreciation | (113,825) | (27,383) | (141,208) | (106,398) | (25,386) | (131,784) |
| Real estate properties, net | \$ 197,050 | \$ 38,149 | \$ 235,199 | \$216,616 | \$46,513 | \$263,129 |

Foreclosure Properties

We have previously treated the Washington State, New England, Kansas and Missouri properties described below as foreclosure properties for federal income tax purposes. With certain elections, unqualified income generated by the properties is expected to be treated as qualified income for up to six years from the purchase date for purpose of the income-source tests that must be satisfied by REITs to maintain their tax status. All of the properties have been recognized as sold or disposed of for tax purposes. However, as described below, the operations of the New England, Kansas and Missouri properties continue to be included in our consolidated financial statements for financial reporting purposes.

Washington State Properties - During 1998, we assumed the operations of four long-term care properties in Washington State. The operating results of these facilities were included in our financial statements from 1998 until the operations were disposed of during 2003 and 2004.

New England Properties - During 1999, we assumed 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 in 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 recognized 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 December 31, 2006 of \$ 24,184,000 is recoverable.

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

| | Year Ended December 31 | | |
|---|------------------------|-----------|-----------|
| | 2006 | 2005 | 2004 |
| Income Statement: | | | |
| Facility operating revenue | \$ 56,391 | \$ 53,304 | \$ 51,790 |
| Facility operating expenses | 51,125 | 49,080 | 46,234 |
| Interest expense | 9 | 8 | 335 |
| Depreciation | 2,682 | 2,551 | 3,414 |
| Total Expenses | 53,816 | 51,639 | 49,983 |
| Net income | \$ 2,575 | \$ 1,665 | \$ 1,807 |
| | | | |
| | December 31 | | |
| Balance Sheet | 2006 | 2005 | |
| Real estate properties, net | \$ 24,184 | \$ 25,969 | |
| Cash and cash equivalents | 2,752 | 3,045 | |
| Accounts receivable, net | 4,491 | 3,241 | |
| Other assets | 12,083 | 9,157 | |
| Accounts payable and other accrued expenses | 6,212 | 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 December 31, 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 qualifies for recognition under generally accepted accounting principles. Our continuing involvement with these properties is as a creditor.

Kansas and Missouri Properties - In July 2001, we assumed the operations of nine nursing homes in Kansas and Missouri and have included the operating results of these facilities in our 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 recognized 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 SFAS 66 are met, at which time we will account for the sale under the full accrual method.

During 2006, we received \$5,482,000 in cash as full payment for sale of the nursing facility known as 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. We originally sold the property in December 2004 to a not-for-profit entity and 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 2006.

Management believes that the carrying amount of the remaining Kansas and Missouri properties at December 31, 2006 of

\$13,965,000 is recoverable.

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

| Income Statement: | Year Ended December 31 | | |
|-----------------------------|------------------------|-----------|-----------|
| | 2006 | 2005 | 2004 |
| Facility operating revenue | \$ 35,331 | \$ 31,389 | \$ 29,448 |
| Facility operating expenses | 33,498 | 30,373 | 28,774 |

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| | | | |
|---------------------------|---------|--------|------------|
| Interest (income) expense | (4) | 172 | 1,806 |
| Depreciation | 727 | 622 | 755 |
| Total expenses | 34,221 | 31,167 | 31,335 |
| Net income (loss) | \$1,110 | \$ 222 | \$ (1,887) |

| | December 31 | |
|---|-------------|-----------|
| Balance sheet | 2006 | 2005 |
| Real estate properties, net | \$ 13,965 | \$ 20,544 |
| Cash and Cash equivalents | 5,403 | 3,422 |
| Accounts receivable, net | 2,543 | 2,946 |
| Other assets | 371 | 492 |
| Accounts payable and other accrued expenses | 8,819 | 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 December 31, 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 qualifies for recognition under generally accepted accounting principles. Our continuing involvement with these properties is as a creditor.

Midwest Nursing Home Investors, Inc. (Midwest) In past years, a \$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 write-down of this mortgage loan value during 2002 and an additional write-down of \$2,000,000 during 2003. Payments to NHI were past due and the properties were foreclosed on in October 2004, resulting in real estate with a carrying value of \$4,324,000. After the recognition of the aforementioned impairment charges, the remaining real estate carrying value of \$3,992,000 at December 31,

2006, is believed by management to be recoverable. Rental income of \$492,000, \$452,000 and \$136,000 was recognized on the Kansas properties for the years ended December 31, 2006, 2005 and 2004, respectively. The average recorded investment in the Midwest loan, before foreclosure in October 2004, was \$4,324,000 and \$5,465,000 for the years ended December 31, 2004 and 2003 respectively. The related amount of interest income recognized on the loan was \$304,000 for the year ended December 31, 2004.

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. The operating results of these facilities were reclassified to discontinued operations for all periods presented.

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 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.

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 2005 on the two Florida facilities. We had previously recorded an impairment of \$5,400,000 during 2003 on one of the Florida facilities. Further maintenance analysis resulted in the recording of an additional \$2,852,000 of accrued maintenance expense in 2005 on the two Florida facilities attributable to mold remediation.

Lease income of \$1,603,000, \$1,582,000, and \$2,236,000 was recognized on these facilities for the years ended December 31, 2006, 2005 and 2004, respectively. In February 2005, a facility in Dallas, Texas was sold for proceeds of \$7,911,000 and a loss of \$851,000. The results of operations are included in discontinued operations for all periods presented. We believe that the carrying amount of these remaining three properties at December 31, 2006 of \$24,657,000 is recoverable.

Nashville Facility - During October 2004, a subsidiary of NHC exercised its right to terminate the lease on one of our owned nursing home properties located in Nashville, Tennessee that was damaged by a fire on September 25,

2003. The lease termination entitled NHI to receive all property insurance proceeds paid as a result of the fire. NHI retains the right to the bed license following lease termination. Prior to the fire, NHI received annualized rent of \$250,000 per year on the Nashville facility. NHI received \$2,654,000 in insurance proceeds which was included in non-operating income for the year ended December 31, 2005. NHI sold the Nashville facility in May 2005 for net proceeds of \$2,971,000, resulting in a gain of \$1,871,000 which was included in non-operating income for the year ended December 31, 2005.

NOTE 4. MORTGAGE AND OTHER NOTES RECEIVABLE

The following is a summary of mortgage and other notes receivable by type:

| | December 31, | |
|----------------|----------------------|----------------|
| | 2006 | 2005 |
| Mortgage loans | \$ 90,782,000 | \$ 115,901,000 |
| Term loans | | 2,899,000 |
| Other loans | 8,750,000 | |
| | \$ 99,532,000 | \$ 118,800,000 |

The following is a summary of the terms and amounts of mortgage and other notes receivable (*dollar amounts in thousands*):

| Final Payment Date | Number of Loans | Payment Terms in 2006 | Original Face Amount of Mortgage | December 31, | |
|--------------------------|-----------------------|---|--|------------------|-----------|
| | | | | 2006 | 2005 |
| 2007 | 1 | Monthly payment of \$274, including interest at 11.5% Balloon payment due at maturity. | \$ 25,900 | \$ 21,972 | \$ 22,673 |
| 2007 | 1 | Monthly payment of interest only at Prime plus 2.0% | 800 | 119 | 135 |
| 2008 | 1 | Monthly payment of \$50, including interest at 10%. Balloon payment due at maturity. | 5,196 | 4,130 | 4,294 |
| 2009 | 1 | Monthly payment of \$70, including interest at 9.5% Balloon payment due at maturity. | 7,900 | 6,991 | 7,150 |
| 2009 | 1 | Monthly payment of \$46, including interest at 8%. Note B accrues interest at 6% with balance due at Maturity. | 6,000 | 3,526 | 3,650 |
| 2009, 2014 | 2 | Monthly payment of \$353, including interest at 10.5% on Note A and Prime Rate on Note B. Balloon payments due at maturity. | 50,000 | 23,228 | 24,071 |
| 2013 | 1 | Monthly payment of \$22, including interest at 6.5% Balloon payment at maturity. | 5,158 | 933 | 994 |
| 2016 | 1 | Monthly payment of \$109, including interest at 9.0% Balloon payment due at maturity. | 12,162 | 8,784 | 7,201 |
| 2019 | 1 | Monthly payment of interest only 9.0% | 2,500 | 2,500 | 2,500 |
| 2027-2032 | 7 | Monthly payments of \$19 to \$32, which include Interest ranging from 8.0 to 9.6% | 20,774 | 18,599 | 18,777 |
| 2006 | 1 | Monthly payments of \$186, including interest at the | 18,000 | | 8,028 |

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Greater of 12.25% or 5-year U.S security yield plus 4.5%. Original maturity. 2010, paid in full in 2006.

| | | | | | |
|------------|---|--|------------|------------------|------------|
| 2006 | 2 | Monthly payments from \$19 to \$47, which include Interest at 6%-8%. Original maturity 2009, paid in full in 2006 | 8,500 | | 2,280 |
| 2006 | 1 | Monthly payment of \$57, including interest at 10.5%. Loan matured and paid in full in 2006. | 6,205 | | 2,716 |
| 2006 | 1 | Monthly payment of interest only at 9.0%. Loan matured and paid in full in 2006 | 5,692 | | 3,618 |
| 2006 | 3 | Monthly payments from \$4 to \$23, including Interest at 6%-9.5%. Original maturity 2007-2008, paid in full in 2006. | 4,500 | | 4,071 |
| 2006 | 1 | Monthly payment of interest only 11.0%. This loan was refinanced with NHI in 2006. | 4,000 | | 2,897 |
| 2006 | 1 | Monthly payment of interest only at Prime plus 2.0%. This loan was written off in 2006 | 1,750 | | 512 |
| Term Loans | | | | | |
| 2008 | 1 | Monthly payment of interest only at LIBOR plus 1% in addition to quarterly principle payments of \$425. | 10,450 | 8,750 | - |
| 2006 | 3 | Monthly payments of \$29, including interest at 7.5%. | 4,239 | | 3,233 |
| | | | \$ 199,726 | \$ 99,532 | \$ 118,800 |

The mortgage notes receivable are generally first mortgage notes secured by the real estate of long-term health care centers, medical office buildings, assisted living facilities and retirement centers in the states of Arizona, Colorado, Florida, Georgia, Kentucky, Pennsylvania, Tennessee, Texas, Virginia and Wisconsin.

The mortgage notes receivable are secured by first mortgages on the real property and UCC liens on the personal property of the facilities. Certain of the notes receivable are also secured by guarantees of significant parties and by cross-collateralization on properties with the same respective owner.

National Health Realty, Inc. (NHR) We purchased by assignment on February 3, 2006, a \$10,450,000 bank term loan owed by National Health Realty, Inc., a publicly-held real estate investment trust. The assigned loan as amended requires monthly interest payments at the interest rate of 30-days LIBOR plus 1.00% (6.32% at December 31, 2006) and quarterly principal payments of \$425,000. The unpaid balance at December 31, 2006 was \$8,750,000. On December 21, 2006, NHC announced an offer to purchase the outstanding stock of NHR.

Loan Write-downs

American Medical Associates, Inc. (AMA) On May 1, 2004, NHI provided financing to purchasers of three Florida-based nursing homes formerly owned by American Medical Associates, Inc. (AMA) and previously financed by NHI. The amount of the new mortgage loans totaled \$14,450,000 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 write-down 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. Loans secured by two of the properties were paid during 2006 and are discussed in the *Loan Recoveries* section below.

Management believes that the remaining carrying amount of \$3,526,000 at December 31, 2006 is supported by the value of the underlying collateral. The average recorded investment in the AMA loan was \$3,584,000, \$7,114,000, and \$8,297,000 for the years ended December 31, 2006, 2005, 2004, respectively. The related amount of interest income recognized (representing cash received) on the loan was \$1,377,000, \$1,118,000, and \$306,000 for the years ended December 31, 2006, 2005, and 2004, 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 write-down of one of the loans in the first quarter of 2005 to adjust the loan to its estimated net realizable value. The loan was paid during 2006 and is discussed in the *Loan Recoveries* section below. Estate proceeds of \$1,247,000 received in 2006 were applied to one of the loans.

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 properties were sold by the Bankruptcy Trustee to affiliates of the purchaser of the first two properties. NHI provided the purchaser with long-term first mortgage financing totaling \$12,162,000 collateralized by all four facilities, and NHI received an option to purchase the 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 of \$119,000 at December 31, 2006) and can be used by any of the four facilities. Prior to December 31, 2006, NHI gave notice to the purchasers of the four facilities to exercise its purchase option for the four facilities in the amount of \$12,162,000. Subsequent to December 31, 2006, the intent to purchase the four facilities was rescinded.

Management believes that the remaining carrying amount of \$8,903,000 at December 31, 2006 is supported by the value of the underlying collateral. The average recorded investment in the Allgood loans was \$13,013,000, \$14,783,000, and \$15,716,000 for the years ended December 31, 2006, 2005, and 2004, respectively. The related amount of interest income recognized (representing cash received) on the loans was \$788,000, \$955,000, and \$1,040,000 for the years ended December 31, 2006, 2005, and 2004, respectively.

Milwaukee South Healthcare, LLC Management's analysis of the future expected cash flows consistent with SFAS 114, payment history, historical occupancy and operating income of the facility resulted in a write-down in 2006 of \$1,074,000 related to our working capital loan with the company. The carrying amount of this loan at December 31, 2006 was zero.

Loan Recoveries

American Medical Associates, Inc. (AMA) In October 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 in cash, representing the full principal balances on the notes which resulted in a recovery of the carrying amount of the loan in the amount of \$4,935,000 and a gain of \$1,015,000.

In March 2007, the remaining AMA mortgage loans (as referenced above in *Loan Write-downs*) secured by the last of three AMA properties were paid. As a result, we received \$5,721,000 in cash, representing the full principal balances on the notes and will record a loan recovery of \$2,168,000 in the first quarter.

Miracle Hill Nursing and Convalescent Center (Miracle Hill) In September 1996, NHI provided financing to Miracle Hill. Management's past 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 write-down of this mortgage loan in the second quarter of 2005. In November 2006, the Miracle Hill note matured and was fully paid off, at which time NHI recorded a loan recovery of \$2,000,000.

The average recorded investment in the Miracle Hill loan was \$2,194,000, \$3,802,000, and \$4,963,000 for the years ended December 31, 2006, 2005 and 2004, respectively. The related amount of interest income recognized (representing cash received) on the loan was \$504,000, \$508,000, and \$536,000 for the years ended December 31, 2006, 2005, and 2004, respectively.

Allgood HealthCare, Inc. (Allgood) On July 1, 2006, one of the five original properties was sold to a third party operator by the Bankruptcy Trustee with NHI consenting to such sale. NHI provided the purchaser with short-term mortgage financing totaling \$5,692,000. The note matured and was paid in full on December 31, 2006, at which time NHI recorded a loan recovery of \$2,073,000.

Colonial Care - The \$25,000,000 Colonial Care promissory note dated January 1996 with a carrying value of \$17,062,000 was sold in December 2004 for cash proceeds of \$22,370,000, resulting in a gain of \$5,308,000. A total of \$2,000,000 of this gain is included in loan loss recoveries and \$3,308,000 is included in non-operating income for the year ended December 31, 2004.

Somerset on Lake Saunders - Management's analysis of the future cash flows consistent with SFAS 114, historical occupancy and operating income of the project resulted in the recording of a \$1,500,000 write-down of this mortgage loan value during the first quarter of 2003. This loan was sold in January 2004 for cash proceeds of \$1,750,000 resulting in a gain of \$1,302,000, which is included in loan recoveries for 2004.

NOTE 5. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to their short-term nature. We calculate the fair values of other financial instruments using quoted market prices and discounted cash flow techniques. At December 31, 2006 and 2005, there were no material differences between the carrying amounts and fair values of NHI's financial instruments.

NOTE 6. INVESTMENT IN PREFERRED STOCK

In September 1998, NHI purchased two million shares of the cumulative preferred stock of LTC Properties, Inc. (LTC), a publicly-held REIT. The nonvoting preferred stock is convertible into common stock at a 1:1 ratio. The preferred stock has an annual cumulative coupon rate of 8.5% payable quarterly and a liquidation preference of \$19.25 per share. The preferred stock is not redeemable by NHI or LTC. The preferred stock, which is not listed on a stock exchange, is considered a non-marketable security accounted for under Accounting Principles Board Opinion No. 18 *The Equity Method of Accounting for Investments in Common Stock*, and is recorded at cost in the consolidated balance sheets. Amounts to be received from the 8.5% coupon rate are recorded as investment income when the dividend is declared. The carrying value of the preferred stock was \$38,132,000 at December 31, 2006 and 2005, respectively.

In addition to its investment in the preferred stock of LTC, NHI holds 774,800 shares of common stock of LTC (with a fair value and carrying value of \$21,160,000 at December 31, 2006), which is included in marketable securities. (See Note 7).

NOTE 7. INVESTMENT 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. Realized gains and losses from securities sales are determined on the specific identification of the securities.

Marketable securities consist of the following (*in thousands*):

| December 31, | 2006 | | 2005 | |
|--------------------|-----------|----------|-----------|----------|
| | Amortized | Fair | Amortized | Fair |
| | Cost | Value | Cost | Value |
| Available for sale | \$7,731 | \$25,513 | \$7,731 | \$19,553 |

Gross unrealized gains and gross unrealized losses related to available-for-sale securities are as follows (*in thousands*):

| | 12/31/06 | 12/31/05 |
|-------------------------|-----------|-----------|
| Gross unrealized gains | \$ 17,856 | \$ 11,941 |
| Gross unrealized losses | (73) | (119) |
| Total | \$ 17,783 | \$ 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 2006, 2005 and 2004, we received and recognized \$4,626,000, \$4,669,000, and \$4,408,000, respectively, of dividend and interest income from our marketable securities. Such income is included in non-operating income in the

consolidated statements of income.

Proceeds from the sale of investments in available-for-sale marketable securities during the year ended December 31, 2005 were \$10,308,000. Gross investment gains of \$9,072,000 were realized on these sales during the year ended December 31, 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.

Proceeds from the sale of investments in available-for-sale marketable securities during the year ended December 31, 2004 were \$10,823,000. Gross investment gains of \$2,682,000 were realized on these sales during the year ended December 31, 2004 which is included in non-operating income in the consolidated statements of income described as \$687,000 of security recoveries and \$1,995,000 of realized gains.

Assisted Living Concepts, Inc. (ALC) Convertible Debentures - During 2002, in order to protect our status as a REIT, we sold a portion of our investments in Assisted Living Concepts, Inc. convertible debentures to an employee of our former investment advisor, NHC. The note was collected in February 2004 for proceeds of \$4,593,000, resulting in no gain or loss. ALC debentures owned by us with a face amount of \$4,655,000 and a carrying value of \$4,013,000 were called during January 2004 for proceeds of \$4,700,000 resulting in a gain of \$687,000 which is included in non-operating income described as security recoveries for 2004.

NOTE 8. INVESTMENT IN REAL ESTATE MORTGAGE INVESTMENT CONDUITS

We had no carrying balances on REMIC investments at December 31, 2006, 2005 and 2004, respectively.

During 2004, we collected \$13,126,000 of our original investment in a REMIC purchased in 1993, of which \$2,246,000 (the amount recognized as a write-down in 2000) was included in REMIC recoveries in the statement of income. During 2004, we recorded a write-down of \$3,339,000 of the remaining uncollected balance of our investment in a REMIC purchased in 1995.

NOTE 9. DEBT

Debt consists of the following:

| December 31, | Weighted Average Interest Rate | Final Maturities | Principal Amount | |
|--|--------------------------------------|---------------------|-----------------------|----------------|
| | | | 2006 | 2005 |
| Unsecured public notes, interest payable semi-annually, principal due at maturity | Fixed, 7.3% | 2007 | \$ 100,000,000 | \$ 100,000,000 |
| First mortgage revenue bonds, principal payable in periodic installments, interest payable monthly | Variable, 5.4% | 2008 to 2014 | 6,942,000 | 8,143,000 |
| Senior notes, principal and interest payable quarterly | Variable, 5.6% | 2009 | 6,550,000 | 9,109,000 |
| | | | \$ 113,492,000 | \$ 117,252,000 |

The 7.3% unsecured notes (the "Notes"), which mature on July 16, 2007, have no sinking fund provisions. We currently have the liquidity to retire the debt; we currently are evaluating our options to either retire or extend the debt. The Notes are senior unsecured obligations of NHI and rank equally with NHI's other unsecured senior debt. NHI agrees in the note indenture that it will limit liens on assets to certain percentages of tangible assets and that it will limit the issuance of new debt to certain multiples of capital or net worth.

We received a waiver in the covenants related to the first mortgage revenue bonds with the understanding that we will maintain at least \$100 million of cash and marketable securities until the bonds are 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.

Certain loan agreements require maintenance of specified financial ratios. We have met all such covenants as of December 31, 2006. Our failure to meet the required covenants could have a material adverse effect on our financial position and cash flows.

Principal Maturities of All Debt - The aggregate principal maturities of all debt as of December 31, 2006 are as follows:

| | |
|------------|----------------|
| 2007 | \$ 103,980,000 |
| 2008 | 5,097,000 |
| 2009 | 1,616,000 |
| 2010 | 1,819,000 |
| 2011 | 230,000 |
| Thereafter | 750,000 |
| | \$ 113,492,000 |

NOTE 10. CONVERTIBLE SUBORDINATED DEBENTURES

2000 Senior Debentures - Through a rights offering to its common stockholders on December 29, 2000, NHI issued \$20,000,000 of senior subordinated convertible debentures (the 2000 senior debentures) due on January 1, 2006. The 2000 senior debentures paid interest at the greater of the prime rate plus 1% or 9%. All outstanding debentures were redeemed on January 1, 2006.

NOTE 11. COMMITMENTS AND CONTINGENCIES

At December 31, 2006, we were committed, subject to due diligence and financial performance goals, to fund approximately

\$815,000 in health care real estate projects, all of which is expected to be funded within the next 12 months. The commitments include additional mortgage investments for three long-term health care centers, at interest rates of prime plus 2.0%.

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 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.

One of our owned nursing home properties, leased to a subsidiary of NHC and located in Nashville, Tennessee, was damaged by a tragic fire on September 25, 2003 which resulted in the loss of life or critical injury to a number of patients. The lease required NHC to indemnify and hold harmless NHI from any and all demands and claims arising from its use of the property. Although NHI had been named as a defendant in 32 lawsuits, all of these lawsuits have been settled at no cost to NHI. A provision of the lease allowed that if substantial damage occurs during the lease term, NHC could terminate the lease with respect to the damaged property. During October 2004, NHC exercised its right to terminate the lease on the Nashville facility. As a result, NHI was entitled to receive all property insurance proceeds paid as a result of the fire. NHI retained the right to the bed license following lease termination. Prior to the fire, NHI received annualized rent of \$250,000 per year on the Nashville facility. NHI has received \$2,654,000 in insurance proceeds which is included in non-operating income for the year ended December 31, 2005. NHI sold the real estate of the Nashville facility in May 2005 (See Note 3).

On October 5, 2006, we received an offer from W. Andrew Adams, our Chairman and CEO, a significant shareholder and President of Management Advisory Source, LLC, NHI's management advisor, to acquire all of our outstanding shares of common stock for \$30.00 per share. The offer was subject to certain conditions and contingencies. The Board of Directors formed a Special Committee of independent directors for the purpose of evaluating strategic alternatives to enhance shareholder value. Additionally, the Special Committee hired The Blackstone Group L.P. as its financial advisor to assist in evaluating this or any other proposed transactions. The Special Committee subsequently informed Mr. Adams that it considered his proposal inadequate.

On January 2, 2007, we received a revised offer from Mr. Adams to acquire all of our outstanding shares of common stock for \$33.00 per share payable through a \$15 dividend and \$18 common stock purchase price. On February 1, 2007 the Special Committee of National Health Investors, informed Mr. Adams that it considered the revised offer not to be in the best interests of NHI's public stockholders and requested that management further develop and implement a wide-ranging strategic plan to enhance the business and shareholder value of NHI. Since that date, Mr. Adams has continued to express to the Special Committee his interest in a transaction; however, no agreement has been reached with respect to an acquisition offer from Mr. Adams or his related entities, and management continues to work on the plan requested by the Special Committee. NHI does not intend to update the status of any negotiations with respect to a potential transaction unless required by law to make such disclosure.

On October 13, 2006, a lawsuit was filed in Chancery Court for the State of Tennessee, Rutherford County, against us and the individual directors serving on the Special Committee alleging breach of fiduciary duty and improper action in connection with the offer by Mr. Adams. We filed a motion to dismiss the complaint and on January 26, 2007, an amended lawsuit was filed against NHI and the members of the Special Committee. The amended complaint rendered the motion to dismiss moot. The plaintiff has indicated that he intends to amend the complaint a second time by the end of March. We have responded to discovery and intend to vigorously defend the plaintiff's allegations. NHI has previously indemnified all members of the Board of Directors for all actions related to NHI, including serving on the Special Committee. NHI expects that indemnification to cover the expenses incurred by the directors in the defense of this action.

The Health Care Facilities are subject to claims and suits in the ordinary course of business. Our lessees and mortgagees have indemnified and will continue to indemnify us against all liabilities arising from the operation of the Health Care Facilities, and will indemnify us against environmental or title problems affecting the real estate underlying such facilities. While there are lawsuits pending against certain of the owners and/or lessees of the Health Care Facilities, management believes that the ultimate resolution of all pending proceedings will have no material adverse effect on our financial position, operations and cash flows.

Through the operation of our 17 foreclosure properties, we are subject to professional and general liability litigation for the provision of patient care. The entire long-term care industry has seen a dramatic increase in personal injury/wrongful death claims based on alleged negligence by nursing homes and their employees in providing care to residents. We have maintained or caused the majority of our lessees or mortgagees to maintain insurance coverage for this type of litigation. In Florida, however, coverage is limited. We are subject to certain claims, none of which, in management's opinion, would be material to our financial position or results of operations.

NOTE 12. CUMULATIVE CONVERTIBLE PREFERRED STOCK

We have no cumulative convertible preferred stock outstanding at either December 31, 2006 or 2005. Previous transactions are described in the paragraphs that follow.

8.5% Preferred Stock - In February and March 1994, NHI issued \$109,558,000 of non-voting, 8.5% cumulative convertible preferred stock ("8.5% Preferred Stock") with a liquidation preference of \$25.00 per share. Dividends at an annual rate of \$2.125 were cumulative from the date of issuance and were paid quarterly.

On April 30, 2004, 100% of NHI's 8.5% cumulative convertible preferred stock, with a balance of 747,994 shares or \$18,700,000, was called by NHI for conversion into common stock of NHI at a conversion rate of .905 shares of common stock for each share of preferred stock. This resulted in an additional 676,922 shares of common stock issued and outstanding. Dividends on the preferred stock were accrued and paid through April 30, 2004.

NOTE 13. LIMITS ON COMMON STOCK OWNERSHIP

The Company's charter limits the percentage of ownership that any person may have in the outstanding securities of the Company to 9.9% of the total outstanding securities. This limit is a provision of the Company's charter and is necessary in order to reduce the possibility of the Company's failing to meet the stock ownership requirements for qualification as a REIT under the Internal Revenue Code of 1986, as amended.

NOTE 14. STOCK-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 remained 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.

Share-Based Compensation Plans

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 year ended December 31, 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 from the date of grant.

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 year ended December 31, 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 from the date of the grant. The compensation expense reported for share-based compensation related to the 2005 Plan and the 1997 Plan totaled \$519,000 for the year ended December 31, 2006, consisting of \$345,000 for restricted stock and \$174,000 for stock options which is included in general and administrative expense in the 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 cliff 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 graded vesting method over the requisite service period for each separately vesting tranche of the award as though the award were, in substance, multiple awards. 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 years an option will be held before it is exercised.

Stock Options

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(R), 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:

| | 2006 | 2005 | 2004 |
|-------------------------|-----------|---------|---------|
| Dividend yield | 8.71% | 8.80% | 8.66% |
| Expected volatility | 22.93% | 21.69% | 28.86% |
| Expected lives | 2.7 years | 5 years | 5 years |
| Risk-free interest rate | 4.83% | 3.81% | 3.58% |

Expected forfeiture rate 0.00% 0.00% 0.00%

Stock Option Activity

The following table summarizes option activity:

| December 31, 2003 | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (Years) | Aggregate Intrinsic Value <i>(in thousands)</i> |
|-----------------------------------|---------------------|------------------------------------|---|---|
| Outstanding December 31, 2003 | 257,500 | \$ 15.79 | | |
| Options granted under 1997 Plan | 60,000 | 23.90 | | |
| Options expired under 1997 Plan | (2,500) | 14.50 | | |
| Options exercised under 1997 Plan | (88,271) | 18.02 | | |
| Outstanding December 31, 2004 | 226,729 | 17.08 | | |
| Options granted under 1997 Plan | 63,000 | 26.20 | | |
| Options exercised under 1997 Plan | (154,729) | 15.19 | | |
| Outstanding December 31, 2005 | 135,000 | 23.50 | | |
| Options granted under 2005 Plan | 86,000 | 25.32 | | |
| Options granted under 1997 Plan | 60,000 | 23.79 | | |
| Options exercised under 1997 Plan | (15,000) | 23.79 | | |
| Outstanding December 31, 2006 | 266,000 | \$ 24.14 | 3.434 | \$ 2,357 |
| Exercisable December 31, 2006 | 180,000 | \$ 23.57 | 3.028 | \$ 1,697 |

| Grant Date | Options Outstanding | Exercise Price | Remaining Contractual Life in Years |
|------------|---------------------|----------------|-------------------------------------|
| 4/24/03 | 30,000 | \$16.35 | 1.333 |
| 4/20/04 | 45,000 | \$23.90 | 2.333 |
| 5/3/05 | 60,000 | \$26.78 | 3.417 |
| 3/9/06 | 50,000 | \$26.10 | 4.167 |
| 5/1/06 | 11,000 | \$23.62 | 4.333 |
| 5/2/06 | 45,000 | \$23.79 | 4.333 |
| 7/21/06 | 25,000 | \$24.50 | 4.500 |
| | 266,000 | | |

The weighted average remaining contractual life of all options outstanding at December 31, 2006 is 3.434 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 year ended December 31, 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 December 31, 2006 was \$33.00 per share. The intrinsic value of total options outstanding at December 31, 2006 was \$8.86 per share. The intrinsic value of options exercisable at December 31, 2006 was \$9.43 per share.

The weighted average fair values of stock options granted during the year ended December 31, 2006 and 2005 were \$1.95 and \$2.51 per share, respectively. At December 31, 2006, we had unvested options to purchase 86,000 shares with a weighted average grant date fair value of \$2.00 per share. As of December 31, 2006, we had \$116,000 of total unrecognized compensation cost related to unvested options, net of expected forfeitures, which is expected to be recognized over the following periods: 2007-\$62,000; 2008-\$37,000; 2009-\$12,000; 2010-\$4,000; and 2011-\$1,000.

Restricted Stock Activity

The following table summarizes restricted stock activity:

| | Number of Shares | Weighted Average Grant Price | Weighted Average Remaining Contractual Life (Years) | Aggregate Intrinsic Value <i>(in thousands)</i> |
|---------------------------------|---------------------|---------------------------------|---|---|
| Non-vested at December 31, 2005 | | \$ | | |
| Restricted Stock granted under | | | | |
| 2005 Plan | 53,000 | 25.96 | | |
| Non-vested at December 31, 2006 | 53,000 | \$ 25.96 | 4.176 | \$ 1,749 |
| Vested December 31, 2006 | | | | |

| Grant Date | Shares Outstanding | Grant Price | Remaining Contractual Life in Years |
|---------------|-----------------------|----------------|---|
| 3/9/06 | 50,000 | \$26.10 | 4.167 |
| 5/2/06 | 3,000 | \$23.62 | 4.333 |
| | 53,000 | | |

The weighted average remaining contractual life of all restricted shares outstanding at December 31, 2006 is 4.176 years. None of the restricted shares had vested as of December 31, 2006. The closing market price of our common stock at December 31, 2006 was \$33.00 per share, which is the implied intrinsic value of the restricted stock.

At December 31, 2006, we had \$1,031,000 of total unrecognized compensation cost related to unvested restricted stock issued which is expected to be recognized over the following periods: 2007-\$327,000; 2008-\$261,000; 2009-\$220,000; 2010-\$191,000; and 2011-\$32,000.

Prior Period 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 for the years ended December 31, 2005 and 2004. 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. There were no restricted stock grants issued prior to this year.

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. 123(R), our net income and basic and diluted net income per share would have been changed to amounts indicated below:

| | 2005 | 2004 |
|--|----------|----------|
| <i>(dollars in thousands, except per share amounts)</i> | | |
| Net income - as reported | \$54,408 | \$55,865 |
| Less compensation cost that would be recognized under fair value method | (112) | (136) |
| Net income - pro forma | \$54,296 | \$55,729 |
| Net earnings per share - as reported | | |
| Basic | \$ 1.96 | \$ 2.05 |
| Diluted | \$ 1.96 | \$ 2.03 |
| Net earnings per share - pro forma | | |
| Basic | \$ 1.96 | \$ 2.04 |
| Diluted | \$ 1.95 | \$ 2.03 |

NOTE 15. SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental disclosure of cash flow information is as follows:

(in thousands, except share amounts)

| Years Ended December 31, | 2006 | 2005 | 2004 |
|------------------------------------|-----------------|----------|----------|
| Cash payments for interest expense | \$ 7,368 | \$ 7,444 | \$ 7,784 |

Cash payments for income taxes

During 2005, and 2004, \$915, and \$235, respectively, of convertible subordinated debentures were converted into 130,692, and 33,562 shares respectively, of NHI's common stock

| | | | | | |
|-------------------------------------|----|----|-------|----|-------|
| Convertible subordinated debentures | \$ | \$ | (915) | \$ | (235) |
| Financing costs | | | 2 | | |
| Accrued interest | | | (10) | | |
| Common stock | | | 1 | | |
| Capital in excess of par value | | | 922 | | 235 |

During 2004, \$18,700,000 or 747,994 shares of 8.5%

Cumulative Convertible Preferred stock was called by NHI for redemption into 676,922 shares of NHI's common stock

| | | | | | |
|--|----|----|--|----|----------|
| Cumulative convertible preferred stock | \$ | \$ | | \$ | (18,700) |
| Common stock | | | | | 7 |
| Capital in excess of par | | | | | 18,693 |

During 2004, NHI acquired property in exchange for its rights under mortgage notes receivable

| | | | | | |
|----------------------------|----|----|--|----|---------|
| Mortgage notes receivable | \$ | \$ | | \$ | 4,324 |
| Land | | | | | (339) |
| Buildings and improvements | | | | | (3,985) |

NOTE 16. EARNINGS PER SHARE

Basic earnings per share is based on the weighted average number of common shares outstanding during the year. Net income is reduced by dividends to holders of cumulative convertible preferred stock.

Diluted earnings per share assumes, if dilutive, the conversion of convertible subordinated debentures, the conversion of cumulative convertible preferred stock 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:

| Year Ended December 31, | 2006 | 2005 | 2004 |
|--|----------------------|---------------|---------------|
| <u>BASIC:</u> | | | |
| Weighted average common shares | 27,744,868 | 27,699,887 | 27,257,826 |
| Income from continuing operations | \$ 62,947,000 | \$ 52,535,000 | \$ 53,567,000 |
| Dividends paid to preferred stockholders | | | (514,000) |
| Income from continuing operations available to common shareholders | 62,947,000 | 52,535,000 | 53,053,000 |
| Discontinued operations | 6,281,000 | 1,873,000 | 2,812,000 |
| Net income available to common stockholders | \$ 69,228,000 | \$ 54,408,000 | \$ 55,865,000 |
| Income from continuing operations per common share | \$ 2.27 | \$ 1.89 | \$ 1.95 |
| Discontinued operations per common share | .23 | .07 | .10 |
| Net income per common share | \$ 2.50 | \$ 1.96 | \$ 2.05 |
| <u>DILUTED:</u> | | | |
| Weighted average common shares | 27,744,868 | 27,699,887 | 27,257,826 |
| Stock options | 28,415 | 29,604 | 102,423 |
| Restricted stock shares | 5,481 | | |
| Convertible subordinated debentures | | 101,395 | 170,835 |
| Average common shares outstanding | 27,778,764 | 27,830,886 | 27,531,084 |

| | | | |
|--|----------------------|---------------|---------------|
| Income from continuing operations | \$ 62,947,000 | \$ 52,535,000 | \$ 53,567,000 |
| Dividends paid to preferred stockholders | | | (514,000) |
| Interest on convertible subordinated debentures | | 81,000 | 120,000 |
| Income from continuing operations available to common stockholders | 62,947,000 | 52,616,000 | 53,173,000 |
| Discontinued operations | 6,281,000 | 1,873,000 | 2,812,000 |
| Net income available to common stockholders assuming conversion of convertible subordinated debentures to common stock, if dilutive | \$ 69,228,000 | \$ 54,489,000 | \$ 55,985,000 |
| Income from continuing operations per common share | \$ 2.26 | \$ 1.89 | \$ 1.93 |
| Discontinued operations per common share | .23 | .07 | .10 |
| Net income per common share | \$ 2.49 | \$ 1.96 | \$ 2.03 |
| Incremental shares excluded since anti-dilutive: | | | |
| 8.5% Preferred Stock | | | 169,230 |
| Stock options | 50,000 | | |

In accordance with Statement of Financial Accounting Standards No. 128, *Earnings per Share*, the above incremental shares were excluded from the computation of diluted earnings per share, since inclusion of these incremental shares in the calculation would have been anti-dilutive.

NOTE 17. COMMON STOCK DIVIDENDS *(Unaudited)*

Dividend payments per share to common stockholders are characterized in the following manner for tax purposes in 2006:

| Dividend Payment Date | Taxable as Ordinary Income | Taxable as Capital Gain | Unrecaptured Section 1250 Gain ⁽¹⁾ | Non-Taxable Return of Capital | Totals |
|-----------------------------|----------------------------------|-------------------------------|---|-------------------------------------|---------|
| May 10, 2006 | \$.365 | \$.112 | \$.009 | \$.003 | \$.480 |
| August 10, 2006 | .365 | .112 | .009 | .003 | .480 |
| November 10, 2006 | .365 | .112 | .009 | .003 | .480 |
| January 31, 2007 | .815 | .112 | .009 | .003 | .930 |
| | \$ 1.910 | \$.448 | \$.036 | \$.012 | \$ 2.37 |

⁽¹⁾ These amounts are included in the capital gain.

NOTE 18. RELATIONSHIP WITH NATIONAL HEALTHCARE CORPORATION*Leases*

Lease extension - On December 27, 2005, under an amendment to the master lease, NHC exercised its option to extend the existing lease on 41 properties for the second renewal term. The 41 properties include four centers leased to other parties, the lease payments of which are guaranteed to us by NHC under the Master Lease. The 15-year lease extension begins January 1, 2007, and includes three additional five-year renewal options, each at fair market value. Under the terms of the lease, base rent for 2007 will total \$33,700,000 with rent thereafter escalating by 4% of the increase in facility revenue over a 2007 base year. The lease was scheduled to expire on December 31, 2006 unless extended by NHC. The terms of the existing lease remain in place for 2006, as discussed below.

Initial lease - On October 17, 1991, concurrent with NHC's conveyance of real property to NHI, NHI leased to NHC 40 long-term care facilities and three retirement centers. Each lease was for an initial term expiring December 31,

2001, with two additional five-year renewal terms at the option of NHC, assuming no defaults. During 2000, NHC exercised its option to extend the lease term for the first five-year renewal term under the same terms and conditions as the initial term. NHI accounts for its leases as operating leases.

During the initial term and the first renewal term ended on December 31, 2006, NHC was obligated to pay annual base rent on all 43 facilities of \$15,238,000. The leases also obligated NHC to pay as debt service rent all payments of interest and principal due under each mortgage to which the conveyance of the facilities was subject. Payments for debt previously serviced were required for the shorter of the remaining life of the mortgage or lease term.

In addition to base rent and debt service rent, NHC paid percentage rent to NHI equal to 3% of the increase in the gross revenue of each facility through December 31, 2006. Effective January 1, 2000, NHI amended its lease agreements with NHC to provide for the calculation of percentage rent based on quarterly revenue increases rather than annual revenue increases. NHI recognized \$4,829,000, \$4,525,000, and \$4,124,000 of percentage rent from NHC during 2006, 2005, and 2004, respectively.

Each lease with NHC is a "triple net lease" under which NHC is responsible for paying all taxes, utilities, insurance premium costs, repairs and other charges relating to the ownership of the facilities. NHC is obligated at its expense to maintain adequate insurance on the facilities' assets.

One of our owned nursing home properties, leased to a subsidiary of NHC and located in Nashville, Tennessee, was damaged by a tragic fire on September 25, 2003 which resulted in the loss of life or critical injury to a number of patients. The lease required NHC to indemnify and hold harmless NHI from any and all demands and claims arising from its use of the property.

A provision of the lease allowed that if substantial damage occurred during the lease term, NHC could terminate the lease with respect to the damaged property. During October 2004, NHC exercised its right to terminate the lease on the Nashville facility. The lease termination entitled NHI to receive all property insurance proceeds paid as a result of the fire. NHI retained the right to the bed license following lease termination. Prior to the fire, NHI received annualized rent of \$250,000 per year on the

Nashville facility. NHI has received \$2,654,000 in insurance proceeds. NHI sold the Nashville facility in May 2005. (See Note 3).

Rental income was \$46,281,000 (\$31,309,000 from NHC) in 2006; \$45,971,000 (\$33,328,000 from NHC) in 2005; and \$48,004,000 (\$32,836,000 from NHC) in 2004.

During 2000, NHC subleased four Florida facilities to unrelated third parties. Although NHC's rent obligations pursuant to the master lease were unchanged, NHC received a credit for rents paid to NHI on the four subleased Florida centers by the current lessees.

Future minimum lease payments - At December 31, 2006, the future minimum lease payments (excluding percentage rent) to be received by NHI under its operating leases (including debt service payments for 2007 which are based on interest rates in effect at December 31, 2006 and including obligations related to the four Florida leases) are as follows:

| | NHC | Others | Total |
|------------|---------------|--------------|---------------|
| 2007 | \$33,700,000 | \$10,002,000 | \$43,702,000 |
| 2008 | \$33,700,000 | \$6,208,000 | \$39,908,000 |
| 2009 | \$33,700,000 | \$5,961,000 | \$39,661,000 |
| 2010 | \$33,700,000 | \$5,794,000 | \$39,494,000 |
| 2011 | \$33,700,000 | \$4,921,000 | \$38,621,000 |
| Thereafter | \$337,000,000 | \$14,226,000 | \$351,226,000 |

Advisory Agreements

Management Advisory Source, LLC - Effective November 1, 2004, NHI assigned its Advisory Agreement with NHC to a new company, Management Advisory Source, LLC (MAS), formed by NHI's President and Board Chairman W. Andrew Adams. Pursuant to this agreement, services related to investment activities and day-to-day management and operations are provided to NHI by MAS. Accordingly, MAS is subject to the supervision of and policies established by NHI's Board of Directors. NHI has no ownership in MAS. The expense recorded under the Advisory Agreement was approximately \$3,499,000 and \$3,599,000 in 2006 and 2005, respectively. NHI believes it to be in the best interest of NHI to accentuate its independence from NHC, its largest tenant. Therefore, Mr. Adams has assumed the responsibilities of the Advisory Agreement. To assure independence from NHC, Mr. Adams resigned as CEO of NHC and terminated his managerial responsibilities with NHC in 2004. From November 1, 2004 to October 1, 2006,

Mr. Adams outsourced non-managerial functions of the Advisory Agreement such as payroll processing, accounting, financing and the like to NHC. Effective October 1, 2006, MAS began to provide these services. Mr. Adams has remained as NHC Board Chairman, focusing on strategic planning, but has no management involvement with NHC.

NHC Since its inception until November 1, 2004, NHI had an Advisory Agreement with NHC whereby services related to investment activities and day-to-day management and operations were provided to NHI by NHC. As Advisor, NHC was subject to the supervision of and policies established by NHI's Board of Directors. For its services under the Advisory Agreement, NHC was entitled to annual compensation of \$2,383,000 in 2004. The annual compensation was reduced by any compensation paid by NHI to its executive officers, if any, and could be deferred under certain circumstances.

Facility Management Services - Subsidiaries of NHC manage foreclosure properties for management fees equal to a weighted average of 5.35% of net revenues of the foreclosure properties, which management fees totaled \$4,903,000, \$5,045,000, and \$4,340,000 for the years ended December 31, 2006, 2005 and 2004, respectively. Accrued but unpaid management fees to NHC were \$8,425,000 and \$7,355,000 at December 31, 2006 and 2005, respectively, and are included in the caption *Accounts payable and other accrued expenses* on the consolidated balance sheets.

Ownership of Common Stock - At December 31, 2006, NHC owned 1,405,642 shares of our common stock.

NOTE 19. DISCONTINUED OPERATIONS

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.

In March 2006, we received \$5,482,000 from the sale by the current owner of a 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 during 2006, we have recognized the December 2004 sale of this property and recognized a \$124,000 gain.

During the year ended December 31, 2005, we sold two assisted living facilities with carrying amounts totaling \$10,709,000 for cash proceeds of \$11,482,000. We recognized a \$773,000 gain on the sale of these facilities.

During the year ended December 31, 2004, we sold three nursing facilities (one previously designated as held for sale) with carrying amounts totaling \$2,846,000 for cash proceeds of \$4,389,000. We recognized a gain of \$1,543,000 on the sale of these facilities.

For 2006, 2005 and 2004, we have reclassified the operations, including the net gain on the sale of these facilities, as discontinued operations in accordance with SFAS 144.

Income from discontinued operations related to these facilities are as follows:

| <i>(in thousands, except per share amounts)</i> | Year Ended December 31, | | |
|---|-------------------------|----------|--------|
| | 2006 | 2005 | 2004 |
| Revenues: | | | |
| Rental income | | | \$ |
| | \$ 662 | \$ 1,786 | 2,521 |
| Facility operating revenue | 2,067 | 8,717 | 9,005 |
| | 2,729 | 10,503 | 11,526 |
| Expenses: | | | |
| Depreciation | 181 | 656 | 1,029 |
| Facility operating expenses | 2,081 | 8,747 | 9,228 |
| | 2,262 | 9,403 | 10,257 |
| Operating income | 467 | 1,100 | 1,269 |
| Gain on sale of assets | 5,814 | 773 | 1,543 |
| Total discontinued operations | \$ 6,281 | \$ 1,873 | 2,812 |
| Discontinued operations per common share: | | | |
| Basic | \$.23 | \$.07 | |

| | | | | |
|---------|----|-----|----|-----|
| | | | | \$ |
| | | | | .10 |
| Diluted | | | | \$ |
| | \$ | .23 | \$ | .07 |
| | | | | .10 |

NOTE 20. NON-OPERATING INCOME

Non-operating income is outlined in the table below:

| | Year Ended December | | |
|------------------------------|-----------------------|----------|----------|
| | 31 | | |
| | 2006 | 2005 | 2004 |
| | <i>(in thousands)</i> | | |
| Dividends | \$ 4,626 | \$ 4,521 | \$ 4,377 |
| Equity income - investees | 26 | | |
| Realized gains on securities | | 4,050 | 1,995 |
| Recovery of securities | | 5,022 | 687 |
| Interest income | 6,889 | 4,049 | 1,686 |
| Gain on note sold | | | 3,308 |
| Gain on disposal of assets | 1,015 | 1,779 | |
| Insurance proceeds | | 2,654 | |
| Other | 165 | 256 | 328 |
| | \$12,721 | \$22,331 | \$12,381 |

NOTE 21. SELECTED QUARTERLY FINANCIAL DATA*(Unaudited, in thousands, except per share amounts)*

The following table sets forth selected quarterly financial data for the two most recent fiscal years.

| | 1 st | 2 nd | 3 rd | 4 th |
|--|------------------|------------------|------------------|------------------|
| | Quarter | Quarter | Quarter | Quarter |
| 2006 | | | | |
| Net Revenues | \$ 36,458 | \$ 38,091 | \$ 37,211 | \$ 38,964 |
| Non-operating income | 2,402 | 2,822 | 3,170 | 4,327 |
| Income from continuing operations | 12,219 | 13,903 | 13,379 | 23,446 |
| Discontinued operations - | | | | |
| Operating income- discontinued | 277 | 187 | | 3 |
| Net gain on sale of real estate | 124 | 5,690 | | |
| Net income | 12,620 | 19,780 | 13,379 | 23,449 |
| Earnings per share: | | | | |
| Basic: | | | | |
| Income from continuing operations | .44 | .50 | .48 | .84 |
| Discontinued operations | .01 | .21 | | .01 |
| Net income | .45 | .71 | .48 | .85 |
| Diluted: | | | | |
| Income from continuing operations | .44 | .50 | .48 | .83 |
| Discontinued operations | .01 | .21 | | .01 |
| Net income | .45 | .71 | .48 | .84 |
| 2005 | | | | |
| Net Revenues | \$ 35,559 | \$ 36,635 | \$ 38,858 | \$ 35,872 |
| Non-operating income | 10,976 | 6,568 | 2,287 | 2,500 |

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| | | | | |
|-----------------------------------|--------|--------|--------|--------|
| Income from continuing operations | 15,748 | 12,529 | 12,192 | 12,066 |
| Discontinued operations - | | | | |
| Operating income- discontinued | 298 | 286 | 323 | 193 |
| Net gain on sale of real estate | 748 | | 25 | |
| Net income | 16,794 | 12,815 | 12,540 | 12,259 |
| Earnings per share: | | | | |
| Basic: | | | | |
| Income from continuing operations | .57 | .45 | .44 | .43 |
| Discontinued operations | .04 | .01 | .01 | .01 |
| Net income | .61 | .46 | .45 | .44 |
| Diluted: | | | | |
| Income from continuing operations | .57 | .45 | .44 | .43 |
| Discontinued operations | .04 | .01 | .01 | .01 |
| Net income | .61 | .46 | .45 | .44 |

2006 - Non-operating income and income from continuing operations for the fourth quarter of 2006 include loan recovery transactions of \$4,935,000, \$2,073,000 and \$2,000,000 (totaling \$9,008,000) and a gain of \$1,015,000, as discussed in Note 4. Income in that same quarter was reduced by a loan impairment of \$1,074,000.

2005 - Non-operating income and income from continuing operations for the first quarter of 2005 included a \$4,050,000 gain and \$5,022,000 recovery on security sales as discussed in Note 7. Non-operating income and income from continuing operations for the second quarter of 2005 included \$4,525,000 attributable to realty insurance proceeds and gain as discussed in Note 3. Income from continuing operations for the second quarter of 2005 has been reduced by loan impairments of \$4,000,000.

Certain quarterly financial information shown above for the first quarter of 2006 and each quarter of 2005 differs from amounts previously reported in the Forms 10-Q for those periods due to reclassifications to reflect the dispositions of certain facilities as discontinued operations, as well as the operating results of these facilities for all periods presented.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures - Based on their evaluation as of December 31, 2006, the CEO and principal accounting officer of the Company have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective to ensure that the information required to be disclosed by us in this Annual Report on Form 10-K was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and instructions for Form 10-K.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of National Health Investors, Inc. (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 (the Assessment) using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on that assessment, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2006. The Company's independent auditors, BDO Seidman, LLP, have issued an attestation report on management's assessment of the Company's internal control over financial reporting included herein.

Management has excluded from its Assessment the internal control over financial reporting of the foreclosure properties described in Note 3 to the consolidated financial statements which have been sold for tax purposes to third parties under installment sales. For financial reporting purposes, we have not recorded the sale of the assets, and continue to record the results of operations of these properties in our consolidated financial statements. Sale proceeds received from the purchasers of these foreclosed properties 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* are met, at which time we will report the sale under the full accrual method. Since the Company does not have the contractual right, authority or ability, in practice, to assess the internal controls over financial reporting of these properties that have been sold, nor does the Company have the ability to dictate or modify those controls, management has concluded it is unable to assess the effectiveness of the internal control over financial reporting of such properties. As of and for the year ended December 31, 2006, 11%, 59%, 85%, and 6% of the Company's consolidated assets, operating revenues, operating expenses and net income, respectively, related to these properties.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

National Health Investors, Inc.

Murfreesboro, Tennessee

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that National Health Investors, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). National Health Investors, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Management's Annual Report on Internal Control Over Financial Reporting, management has excluded from its assessment the internal control over financial reporting of the foreclosure properties described in Note 3 to the consolidated financial statements which have been sold for tax purposes to third parties under installment sales. For financial reporting purposes, we have not recorded the sale of the assets, and continue to record the results of operations of these properties in our consolidated financial statements. Sale proceeds received from the purchasers of these foreclosed properties 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* are met, at which time we will report the sale under the full accrual method. Since the Company does not have the contractual right, authority or ability, in practice, to assess the internal controls over financial reporting of these properties that have been sold, nor does the Company have the ability to dictate or modify those controls, management has concluded it is unable to assess the effectiveness of the internal control over financial reporting of such properties. As of and for the year ended December 31, 2006, 11%, 59%, 85%, and 6% of the Company's consolidated assets, operating revenues, operating expenses and net income, respectively, related to these properties. Our audit of internal control over financial reporting of National Health Investors, Inc. also did not include an evaluation of the internal control over financial reporting of the foreclosure properties described in Note 3 to the consolidated financial statements.

In our opinion, management's assessment that National Health Investors, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, National Health Investors, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006 based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated balance sheets of National Health Investors, Inc. as of December 31, 2006 and 2005 and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006 and our report dated March 23, 2007 expressed an unqualified opinion.

/s/ BDO Seidman, LLP

Memphis, Tennessee

March 23, 2007

Changes in Internal Controls - There were material changes in our internal controls over financial reporting during the fourth quarter ended December 31, 2006 as we transitioned from such controls being provided by NHC to being provided by Management Advisory Source, LLC. While these changes have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting, the changes were not based on issues identified in the evaluation described above. In addition, we believe that internal controls over financial reporting both prior to the change and after the change were effective based on our assessment.

Our management, including our CEO and principal accounting officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefit of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, with NHI have been detected.

ITEM 9B. OTHER INFORMATION

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The information in our definitive 2007 proxy statement set forth under the caption *Directors and Executive Officers of Registrant* is hereby incorporated by reference.

We have filed with the New York Stock Exchange (NYSE) the Annual CEO Certification regarding the Company s compliance with the NYSE s Corporate Governance listing standards as required by Section 303A-12(a) of the NYSE Listed Company Manual. Additionally, we have filed as exhibits to this annual report on Form 10-K for the year ended December 31, 2006, the applicable certifications of our Chief Executive Officer and our Chief Financial Officer as required under Section 302 of the Sarbanes-Oxley Act of 2002.

Item 11. Executive Compensation.

The information in our definitive 2007 proxy statement set forth under the caption *Compensation of Directors and Executive Officers, Equity Compensation Plan Information, and Certain Transactions* is hereby incorporated by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholders Matters.

The information in our definitive 2007 proxy statement set forth under the caption *Compensation of Directors and Executive Officers, Equity Compensation Plan Information, and Certain Transactions* is hereby incorporated by reference.

Item 13. Certain Relationships and Related Transactions and Director Independence.

The information in our definitive 2007 proxy statement set forth under the caption *Certain Relationships and Related Transactions* is hereby incorporated by reference.

Item 14. Principal Accountant Fees and Services.

The information in our definitive 2007 proxy statement set forth under the caption *Committee Reports* is hereby incorporated by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) (1) Financial Statements

The Consolidated Financial Statements are included in Item 8 and are filed as part of this report.

(2) Financial Statement Schedules

The Financial Statement Schedules and Report of Independent Registered Public Accounting Firms on Financial Statement Schedules listed in Exhibit 13.

(3) Exhibits

Exhibits required as part of this report are listed in the Exhibit Index.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NATIONAL HEALTH INVESTORS, INC.

BY: /s/ W. Andrew Adams

W. Andrew Adams
Chief Executive Officer

Date: March 23, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|--------------------------|----------------|
| <u>/s/ W. Andrew Adams</u> W. Andrew Adams | Chief Executive Officer | March 23, 2007 |
| <u>/s/ Roger R. Hopkins</u> Roger R. Hopkins | Chief Accounting Officer | March 23, 2007 |
| <u>/s/ Richard F. LaRoche, Jr.</u> Richard F. LaRoche, Jr. | Director | March 23, 2007 |
| <u>/s/ Robert A. McCabe, Jr.</u> Robert A. McCabe, Jr. | Director | March 23, 2007 |

/s/ Robert T. Webb Director March 23, 2007
Robert T. Webb

/s/ Ted H. Welch Director March 23, 2007
Ted H. Welch

NATIONAL HEALTH INVESTORS, INC.

FORM 10-K FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

EXHIBIT INDEX

| Exhibit No. | Description | Page No. or Location |
|-------------|---|---|
| 3.1 | Articles of Incorporation | Incorporated by reference to Exhibit 3.1 to Form S-11 Registration Statement No. 33-41863 |
| 3.2 | Bylaws | Incorporated by reference to Exhibit 3.2 to Form S-11 Registration Statement No. 33-41863 |
| 4.1 | Form of Common Stock Certificate | Incorporated by reference to Exhibit 39 to Form S-11 Registration Statement No. 33-41863 |
| 4.2 | Form of Preferred Convertible Stock Certificate | Incorporated by reference to Exhibit 60 to Form S-3 Registration Statement No. 33-72370 |
| 4.3 | Form of Debenture due 2006 (10%) | Incorporated by reference to Exhibit 38 to Form S-11 Registration Statement No. 33-41863 |
| 4.4 | Form of Indenture Governing the Debentures | Incorporated by reference to Exhibit 4.3 to Form S-4 |

Registration Statement No.
33-41863

4.6 Form of Debenture due 2006
(7%)

Incorporated by reference
to Exhibit 1 to Form S-3
Registration Statement
No. 33-72370

4.7 First Supplemental Indenture
Dated December 15, 1995

Incorporated by reference
to Exhibit 4.7 to Form 10-K
dated February 26, 1996

| | |
|--|---|
| 10.1 Materials Contracts | Incorporated by reference from Exhibits 10.1 thru 10.9 to Form S-4 Registration Statement No. 33-41863 |
| 10.2 Amendment No. 5 to Master Agreement to Lease dated December 27, 2005, effective January 1, 2007. | Incorporated by reference to Exhibit 10.2 to Form 10-K dated March 10, 2006 |
| 10.3 Advisory, Administrative Services and Facilities Agreement between National Health Investors, Inc. and Management Advisory Source, LLC dated November 1, 2004 | Incorporated by reference to Exhibit 10.3 to Form 10-K dated March 10, 2006 |
| 10.4 1991 Stock Option Plan | Incorporated by reference from Exhibit 10.12 to Form S-4 Registration No. 33-41863 |
| 10.5 1997 Stock Option Plan | Incorporated by reference from the 1997 Proxy Statement as filed |
| 10.6 2005 Stock Option Plan | Incorporated by reference from Exhibit 4.10 to the Company's registration statement on Form S-8 filed August 4, 2005. |
| 13 Financial Statement Schedules | Filed herewith |
| 23.1 Consent of Independent Registered Public Accounting Firm | Filed herewith |

- | | |
|---|----------------|
| 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer | Filed Herewith |
| 31.2 Rule 13a-14(a)/15d-14(a) Certification of Principal Accounting Officer | Filed Herewith |
| 32 Certification pursuant to 18 U.S.C. Section 1350 by Chief Executive Officer and Principal Accounting Officer | Filed Herewith |