

OMEGA HEALTHCARE INVESTORS INC

Form 10-Q

November 07, 2012

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-11316

OMEGA HEALTHCARE  
INVESTORS, INC.

(Exact name of Registrant as specified in its charter)

Maryland

(State of incorporation)

38-3041398

(IRS Employer  
Identification No.)

200 International Circle, Suite 3500, Hunt Valley, MD 21030

(Address of principal executive offices)

(410) 427-1700

(Telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒

No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒

No ☐

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐

No ☒

Indicate the number of shares outstanding of each of the issuer’s classes of common stock as of October 31, 2012.

Common Stock, \$.10 par value	112,049,247
(Class)	(Number of shares)

OMEGA HEALTHCARE INVESTORS, INC.  
FORM 10-Q  
September 30, 2012

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## PART I – FINANCIAL INFORMATION

## Item 1 - Financial Statements

OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except per share amounts)

	September 30, 2012 (Unaudited)	December 31, 2011
<b>ASSETS</b>		
Real estate properties		
Land and buildings	\$ 2,786,213	\$ 2,537,039
Less accumulated depreciation	(550,381 )	(470,420 )
Real estate properties – net	2,235,832	2,066,619
Mortgage notes receivable – net	245,550	238,675
	2,481,382	2,305,294
Other investments – net	45,807	52,957
	2,527,189	2,358,251
Assets held for sale – net	1,620	2,461
Total investments	2,528,809	2,360,712
Cash and cash equivalents	6,951	351
Restricted cash	32,923	34,112
Accounts receivable – net	119,361	100,664
Other assets	71,396	61,473
Total assets	\$ 2,759,440	\$ 2,557,312
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Revolving line of credit	\$ 102,000	\$ 272,500
Secured borrowings	286,016	303,610
Unsecured borrowings – net	1,200,523	975,290
Accrued expenses and other liabilities	149,981	127,428
Total liabilities	1,738,520	1,678,828
Stockholders' equity:		
Common stock \$.10 par value 200,000 shares authorized — 112,046 shares as of September 30, 2012 and 103,410 as of December 31, 2011 issued and outstanding	11,205	10,341
Common stock – additional paid-in-capital	1,658,882	1,471,381
Cumulative net earnings	720,205	633,430
Cumulative dividends paid	(1,369,372)	(1,236,668)
Total stockholders' equity	1,020,920	878,484
Total liabilities and stockholders' equity	\$ 2,759,440	\$ 2,557,312

See notes to consolidated financial statements.



OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
Unaudited  
(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenue				
Rental income	\$78,170	\$68,622	\$229,373	\$203,446
Mortgage interest income	7,677	3,617	22,417	10,548
Other investment income – net	1,238	383	3,533	1,641
Miscellaneous	23	196	125	265
Total operating revenues	87,108	72,818	255,448	215,900
Expenses				
Depreciation and amortization	28,305	24,871	82,651	74,848
General and administrative	5,173	4,393	15,653	14,549
Acquisition costs	483	-	686	45
Impairment loss on real estate properties	-	-	272	24,971
Provisions for uncollectible mortgages, notes and accounts receivable	-	-	-	4,139
Nursing home expenses of owned and operated assets	-	148	-	603
Total operating expenses	33,961	29,412	99,262	119,155
Income before other income and expense	53,147	43,406	156,186	96,745
Other income (expense)				
Interest income	6	12	22	35
Interest expense	(24,050 )	(20,101 )	(71,026 )	(60,173 )
Interest – amortization of deferred financing costs	(673 )	(629 )	(1,970 )	(2,026 )
Interest – loss on extinguishment of debt	-	(3,055 )	(5,410 )	(3,071 )
Total other expense	(24,717 )	(23,773 )	(78,384 )	(65,235 )
Income before gain on assets sold	28,430	19,633	77,802	31,510
Gain on assets sold – net	1,689	1,803	8,973	1,803
Net income	30,119	21,436	86,775	33,313
Preferred stock dividends	-	-	-	(1,691 )
Preferred stock redemption	-	-	-	(3,456 )
Net income available to common stockholders	\$30,119	\$21,436	\$86,775	\$28,166
Income per common share available to common shareholders:				
Basic:				
Net income	\$0.28	\$0.21	\$0.82	\$0.28
Diluted:				
Net income	\$0.27	\$0.21	\$0.81	\$0.28
Dividends declared and paid per common share	\$0.42	\$0.40	\$1.25	\$1.15

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Weighted-average shares outstanding, basic	109,135	103,180	106,202	101,722
Weighted-average shares outstanding, diluted	109,667	103,231	106,570	101,772

See notes to consolidated financial statements.



OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
Unaudited  
(in thousands, except per share amounts)

	Common Stock Par Value	Additional Paid-in Capital	Cumulative Net Earnings	Cumulative Dividends	Total
Balance at December 31, 2011 (103,410 common shares)	\$ 10,341	\$ 1,471,381	\$ 633,430	\$ (1,236,668)	\$ 878,484
Issuance of common stock:					
Grant of restricted stock to company executives (428 shares)	43	(43 )	—	—	—
Grant of restricted stock to company directors (13 shares at \$20.29 per share)	1	(1 )	—	—	—
Amortization of restricted stock	—	4,410	—	—	4,410
Dividend reinvestment plan (4,791 shares at \$22.16 per share)	479	105,653	—	—	106,132
Grant of stock as payment of directors fees (7 shares at an average of \$22.40 per share)	1	149	—	—	150
Equity Shelf Program (3,398 shares at \$23.47 per share, net of issuance costs)	340	77,333	—	—	77,673
Net income	—	—	86,775	—	86,775
Common dividends (\$1.25 per share)	—	—	—	(132,704 )	(132,704 )
Balance at September 30, 2012 (112,046 common shares)	\$ 11,205	\$ 1,658,882	\$ 720,205	\$ (1,369,372)	\$ 1,020,920

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
Unaudited (in thousands)

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities		
Net income	\$86,775	\$33,313
Adjustment to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	82,651	74,848
Impairment on real estate properties	272	24,971
Provisions for uncollectible accounts receivable	—	4,139
Amortization of deferred financing and debt extinguishment costs	7,380	5,097
Restricted stock amortization expense	4,456	4,518
Gain on assets sold – net	(8,973 )	(1,803 )
Amortization of acquired in-place leases - net	(4,088 )	(4,640 )
Other	(113 )	(112 )
Change in operating assets and liabilities – net of amounts assumed/acquired:		
Accounts receivable, net	195	355
Straight-line rent	(19,745 )	(9,896 )
Lease inducement	2,527	2,538
Effective yield receivable on mortgage notes	(1,674 )	(932 )
Other operating assets and liabilities	7,304	(3,331 )
Operating assets and liabilities for owned and operated properties	—	(47 )
Net cash provided by operating activities	156,967	129,018
Cash flows from investing activities		
Acquisition of real estate – net of liabilities assumed and escrows acquired	(232,661 )	(98 )
Placement of mortgage loans	(7,126 )	(10,461 )
Proceeds from sale of real estate investments	24,194	4,150
Capital improvements and funding of other investments	(20,106 )	(12,012 )
Proceeds from other investments	11,821	3,186
Investments in other investments	(4,671 )	(4,845 )
Collection of mortgage principal – net	362	54
Net cash used in investing activities	(228,187 )	(20,026 )
Cash flows from financing activities		
Proceeds from credit facility borrowings	272,000	289,000
Payments on credit facility borrowings	(442,500 )	(244,000 )
Receipts of other long-term borrowings	400,000	—
Payments of other long-term borrowings	(189,657 )	(1,836 )
Payments of financing related costs	(13,150 )	(4,236 )
Receipts from dividend reinvestment plan	106,132	54,917
Net proceeds from issuance of common stock	77,673	31,237
Payments from exercised options and restricted stock – net	—	(1,254 )
Dividends paid	(132,678 )	(120,455 )
Redemption of preferred stock	—	(108,556 )
Net cash provided by (used in) financing activities	77,820	(105,183 )
Increase in cash and cash equivalents	6,600	3,809

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Cash and cash equivalents at beginning of period	351	6,921
Cash and cash equivalents at end of period	\$6,951	\$10,730
Interest paid during the period, net of amounts capitalized	\$70,123	\$55,882

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Unaudited  
September 30, 2012

NOTE 1 – BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Business Overview

Omega Healthcare Investors, Inc. (“Omega” or the “Company”) has one reportable segment consisting of investments in healthcare-related real estate properties. Our core business is to provide financing and capital to the long-term healthcare industry with a particular focus on skilled nursing facilities (“SNFs”) located in the United States. Our core portfolio consists of long-term leases and mortgage agreements. All of our leases are “triple-net” leases, which require the tenants to pay all property-related expenses. Our mortgage revenue derives from fixed-rate mortgage loans, which are secured by first mortgage liens on the underlying real estate and personal property of the mortgagor.

Basis of Presentation

The accompanying unaudited consolidated financial statements for Omega have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements. In our opinion, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. We have evaluated all subsequent events through the date of the filing of this Form 10-Q. These unaudited consolidated financial statements should be read in conjunction with the financial statements and the footnotes thereto included in our latest Annual Report on Form 10-K.

Our consolidated financial statements include the accounts of (i) Omega, (ii) all direct and indirect wholly owned subsidiaries of Omega, and (iii) TC Healthcare (“TC Healthcare”), an entity and interim operator created in 2008 to temporarily operate the 15 facilities we assumed as a result of the bankruptcy of one of our former tenants/operators. Thirteen of these facilities were transitioned from TC Healthcare to a new tenant/operator on September 1, 2008. The two remaining facilities were transitioned to the new tenant/operator on June 1, 2010 upon approval by state regulators of the operating license transfer, and as of such date, TC Healthcare no longer operated these facilities (see Note 3 – Owned and Operated Assets). All inter-company accounts and transactions have been eliminated in consolidation of the financial statements.

Accounts Receivable

Accounts receivable includes: contractual receivables, effective yield interest receivables, straight-line rent receivables and lease inducements, net of an estimated provision for losses related to uncollectible and disputed accounts. Contractual receivables relate to the amounts currently owed to us under the terms of our lease and loan agreements. Effective yield interest receivables relate to the difference between the interest income recognized on an effective yield basis over the term of the loan agreement and the interest currently due to us according to the contractual agreement. Straight-line receivables relate to the difference between the rental revenue recognized on a straight-line basis and the amounts currently due to us according to the contractual agreement. Lease inducements result from value provided by us to the lessee at the inception or renewal of the lease and will be amortized as a reduction of rental revenue over the non cancellable lease term.



On a quarterly basis, we review our accounts receivable to determine their collectability. The determination of collectability of these assets requires significant judgment and is affected by several factors relating to the credit quality of our operators that we regularly monitor, including (i) payment history, (ii) the age of the contractual receivables, (iii) the current economic conditions and reimbursement environment, (iv) the ability of the tenant to perform under the terms of their lease and/or contractual loan agreements and (v) the value of the underlying collateral of the agreement. If we determine collectability of any of our contractual receivables is at risk, we estimate the potential uncollectible amounts and provide an allowance. In the case of a lease recognized on a straight-line basis or existence of lease inducements, we generally provide an allowance for straight-line accounts receivable and/or the lease inducements when certain conditions or indicators of adverse collectability are present.

A summary of our net receivables by type is as follows:

	September 30, 2012	December 31, 2011
	(in thousands)	
Contractual receivables	\$ 6,261	\$ 4,683
Effective yield interest receivables	3,015	1,341
Straight-line receivables	93,312	73,604
Lease inducements	20,150	22,677
Allowance	(3,377 )	(1,641 )
Accounts receivable – net	\$ 119,361	\$ 100,664

We continuously evaluate the payment history and financial strength of our operators and have historically established allowance reserves for straight-line rent adjustments for operators that do not meet our requirements. We consider factors such as payment history and the operator's financial condition as well as current and future anticipated operating trends when evaluating whether to establish allowance reserves.

## NOTE 2 – PROPERTIES AND INVESTMENTS

In the ordinary course of our business activities, we periodically evaluate investment opportunities and extend credit to customers. We also regularly engage in lease and/or loan extensions and modifications. Additionally, we actively monitor and manage our investment portfolio with the objectives of improving credit quality and increasing investment returns. In connection with our portfolio management, we may engage in various collection and foreclosure activities.

If we acquire real estate pursuant to a foreclosure or bankruptcy proceeding, the assets will initially be included on the consolidated balance sheet at the lower of cost or estimated fair value (see Note 3 – Owned and Operated Assets).

### Leased Property

Our leased real estate properties, represented by 403 SNFs, 14 assisted living facilities (“ALFs”) and 11 specialty facilities at September 30, 2012, are leased under provisions of single or master leases with initial terms typically ranging from 5 to 15 years, plus renewal options. Substantially all of our leases contain provisions for specified annual increases over the rents of the prior year and are generally computed in one of three methods depending on specific provisions of each lease as follows: (i) a specific annual percentage increase over the prior year's rent, generally 2.5%; (ii) an increase based on the change in pre-determined formulas from year to year (i.e., such as increases in the Consumer Price Index (“CPI”)); or (iii) specific dollar increases over prior years. Under the terms of the leases, the lessee is responsible for all maintenance, repairs, taxes and insurance on the leased properties.



## 2012 Acquisitions

### Health and Hospital Corporation

On August 31, 2012, we purchased 27 facilities (17 SNFs, four ALFs and six independent living facilities) totaling 2,892 licensed beds in Indiana from an unrelated third party for approximately \$203 million in cash and assumed a liability associated with the lease of approximately \$13.9 million. Simultaneous with the transaction, we also purchased one parcel of land for \$2.8 million. The purchase price of both (i) 27 facilities and (ii) the parcel of land were funded from cash on hand and borrowings from our credit facility. The 27 facilities and land parcel were added to an existing master lease with Health and Hospital Corporation of Marion County, Indiana (“Health and Hospital Corporation”).

We are in the process of obtaining information necessary to complete the process of allocating the fair value of the assets purchased and liabilities assumed. Our preliminary allocation as of September 30, 2012, consists of land of \$16.1 million, building and site improvements of \$189.2 million and furniture and fixtures of \$14.4 million. We allocated approximately \$13.9 million to a liability associated with the lease. For the three months ended September 30, 2012, we incurred approximately \$0.5 million in acquisition related costs.

On June 29, 2012, we purchased four facilities encompassing 383 licensed beds in Indiana for approximately \$21.7 million and leased the facilities to an existing operator. We recorded approximately \$1.9 million for land, \$18.4 million for buildings and site improvements and \$1.4 million for furniture and fixtures.

### Mark Ide Limited Liability Company

On June 29, 2012, we purchased one facility encompassing 80 licensed beds in Indiana for approximately \$3.4 million and leased the facility to an existing operator. We recorded approximately \$0.2 million for land, \$2.9 million for buildings and site improvements and \$0.3 million for furniture and fixtures.

## 2011 Acquisitions

### Capital Funding Group, Inc.

On December 23, 2011, we purchased 17 SNFs from affiliates of Capital Funding Group, Inc. (“CFG”), a new operator to Omega, for an aggregate purchase price of \$128 million. The acquisition consisted of the assumption of \$71 million of indebtedness guaranteed by the Department of Housing and Urban Development (“HUD”) and \$57 million in cash.

The \$71 million of assumed HUD debt was comprised of 15 HUD mortgage loans with a blended interest rate of 5.70% and maturities between October 2029 and July 2044.

The 17 SNFs, representing 1,820 available beds, are located in Arkansas (12), Colorado (1), Florida (1), Michigan (2) and Wisconsin (1). The transaction involved two separate master lease agreements covering all 17 SNFs.

We recorded approximately \$129.9 million consisting of land (\$9.0 million), buildings and site improvements (\$111.5 million) and furniture and fixtures (\$9.4 million). We recorded approximately \$1.9 million of fair value adjustment related to the above market debt assumed based on the terms of comparable debt. On June 29, 2012, we retired four HUD mortgage notes in the amount of \$11.7 million and wrote-off the unamortized premium associated with the mortgages. We did not record goodwill in connection with this transaction.





Persimmon Ventures, LLC and White Pine Holdings, LLC

During the fourth quarter of 2011, we completed \$86 million of combined new investments with affiliates of Persimmon Ventures, LLC and White Pine Holding, LLC (“White Pine”), both new operators to Omega. The investments involved a purchase / lease back transaction and a mortgage transaction. The combined transaction consists of 7 facilities and 938 beds.

Purchase / Lease Back Transaction

We purchased four SNFs located in Maryland (3) and West Virginia (1), totaling 586 beds for a total investment of \$61 million, including approximately \$1 million to complete renovations at one facility. The consideration consisted of \$31 million in cash and the assumption of \$30 million in HUD – guaranteed indebtedness, which bears an interest rate of 4.87% (weighted-average) and matures between March 2036 and September 2040.

Acquisition costs related to the acquisitions from affiliates of CFG and from White Pine were approximately \$1.2 million in 2011.

Mortgage Transaction

We entered into a first mortgage loan with White Pine in the amount of \$25 million secured by a lien on three SNFs, totaling 352 beds, all located in Maryland.

The overall combined transaction totaled \$86 million, consisting of \$56 million in cash and \$30 million in assumed HUD indebtedness, with a combined initial annual yield of approximately 10%.

We recorded approximately \$62.7 million consisting of land (\$4.4 million), buildings and site improvements (\$55.0 million) and furniture and fixtures (\$3.3 million). We funded approximately \$1.3 million in renovation costs for one of the facilities acquired in connection with this transaction and completed the renovation during the third quarter of 2012. We recorded approximately \$3.0 million of fair value adjustment related to the above market debt assumed based on the terms of comparable debt. We estimate amortization will be approximately \$0.2 million per year over the next five years. We did not record goodwill in connection with this transaction.

The facilities acquired (i) from White Pine and affiliates of CFG during the fourth quarter of 2011, (ii) from Health and Hospital Corporation and Mark Ide during the second quarter of 2012 and (iii) from Health and Hospital Corporation during the third quarter of 2012 are included in our results of operations from the respective date of acquisition. The following unaudited pro forma results of operations reflect each of the transactions with White Pine, affiliates of CFG, Health and Hospital Corporation and Mark Ide transactions as if they occurred on January 1, 2011. In the opinion of management, all significant necessary adjustments to reflect the effect of the acquisitions have been made. The following pro forma information is not indicative of future operations.

	Pro Forma			
	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	2011		2011	
	(in thousands, except per share amount, unaudited)			
Revenues	\$91,157	\$84,897	\$273,039	\$252,137
Net income available to common stockholders	\$31,756	\$25,386	\$93,730	\$40,016
Earnings per share – diluted:				
Net income available to common stockholders – as reported	\$0.27	\$0.21	\$0.81	\$0.28
Net income available to common stockholders – pro forma	\$0.29	\$0.25	\$0.88	\$0.39

#### Connecticut Properties

In January 2011, at our request, a complaint was filed by the State of Connecticut, Commissioner of Social Services (the “State”) against the licensees/operators of four Connecticut SNFs, seeking the appointment of a receiver. The facilities were leased and operated by affiliates of FC/SCH Capital, LLC (“FC/SCH”) and were managed by Genesis Healthcare (“Genesis”), and had approximately 472 licensed beds as of March 31, 2011. The Superior Court, Judicial District of Hartford, Connecticut (the “Court”) appointed a receiver.

The receiver was responsible for (i) operating the facilities and funding all operational expenses incurred after the appointment of the receiver and (ii) for providing the Court with recommendations regarding the facilities. In March 2011, the receiver moved to close all four SNFs and we objected. At the hearing held on April 21, 2011, we stated our position that the receiver failed to comply with the statutory requirements prior to recommending the facilities’ closure. In addition, alternative operators expressed interest in operating several of the facilities. On April 27, 2011, the Court granted the receiver’s motion and ordered the facilities closed.

We timely filed our notice of appeal, taking the position that the Court’s Order was final and appealable, and erroneous. Following our notice of appeal, we negotiated a stipulation with the State and the receiver which afforded us significant concessions. Those concessions included: (a) an agreed recognition of us as a secured lienholder with a priority claim, (b) an accelerated timeframe for the (i) allocation by the receiver of collected funds between pre- and post- receivership periods, and (ii) disbursement to us of pre-receivership funds collected, and (c) an agreement by the State that it would forego its right to seek recoupment of pre-receivership funds as reimbursement for post-receivership advances. In exchange for these concessions (among others), we withdrew our appeal.

As a result of these developments, during the three month period ended March 31, 2011, we recorded an impairment charge of \$24.4 million to reduce the carrying values of the Connecticut SNFs to their estimated fair values. We estimated the fair value of these facilities based on the facilities’ potential sales value assuming that the facilities would not be used as SNFs. As of November 1, 2011, all of the residents of the four facilities had been relocated and the receiver surrendered possession of all of the facilities to us. We are actively marketing the facilities for sale (for

purposes other than the provision of skilled nursing care). See “Assets Sold or Held for Sale” below for more detail.

## FC/SCH Facilities

During the second quarter of 2011, we entered into a master transition agreement (“2011 MTA”) with one of our current lessee/operators and a third party lessee/operator to transition the facilities from the current operator to the new operator. The 2011 MTA closing was subject to receipt of healthcare regulatory approvals from several states for the operating license transfer from the current operator to the new operator. On January 1, 2012, regulatory approval was provided and the former lease was terminated and a new operator entered into a new twelve-year master lease for the facilities. As a result of the 2011 MTA, during the second quarter of 2011, we evaluated the recoverability of the straight-line rent and lease inducements associated with the current lease and recorded a \$4.1 million provision for uncollectible accounts associated with straight-line receivables and lease inducements.

## Assets Sold or Held for Sale

### Assets Sold

On January 13, 2012, we sold a SNF in Indiana for approximately \$3.1 million resulting in a gain of approximately \$0.3 million.

On March 23, 2012, an operator in Alaska exercised its purchase option and purchased a SNF for approximately \$11.0 million. We recognized a gain of approximately \$5.1 million in this transaction.

On April 2, 2012, we sold a held-for-sale SNF in Arkansas for approximately \$1.7 million. No gain or loss was recognized in this transaction.

On May 18, 2012, we sold a held-for-sale SNF in Alabama for \$4.5 million resulting in a gain of approximately \$0.4 million.

On June 15, 2012, we sold a held-for-sale SNF in Connecticut for \$1.8 million resulting in a gain of approximately \$1.6 million.

On August 21, 2012, we sold a held-for-sale SNF in Connecticut for \$2.3 million resulting in a gain of approximately \$1.6 million.

### Held for Sale

During the first quarter of 2012, we recorded a \$0.1 million impairment charge to reduce the carrying value of a SNF in Arkansas to its estimated fair value less cost to sell and simultaneously classified the facility as held-for-sale. Also during the first quarter of 2012, we recorded a \$0.1 million impairment charge to reduce the carrying value of a held-for-sale facility that was sold during the quarter.

At September 30, 2012, we had three SNFs and one parcel of land classified as held-for-sale with an aggregate net book value of approximately \$1.6 million.

## Mortgage Notes Receivables

Our mortgage notes receivables relate to 13 fixed-rate mortgages on 32 long-term care facilities and two construction mortgages on two facilities currently under construction. The mortgage notes are secured by first mortgage liens on the borrowers’ underlying real estate and personal property. The mortgage notes receivable relate to facilities located in five (5) states, which are operated by six (6) independent healthcare operating companies. We monitor compliance

with mortgages and when necessary have initiated collection, foreclosure and other proceedings with respect to certain outstanding loans. As of September 30, 2012, none of our mortgages were in default or in foreclosure proceedings. Where appropriate, the mortgage properties are generally cross-collateralized with the master lease agreement.

Mortgage interest income is recognized as earned over the terms of the related mortgage notes, using the effective yield method. Allowances are provided against earned revenues from mortgage interest when collection of amounts due becomes questionable or when negotiations for restructurings of troubled operators lead to lower expectations regarding ultimate collection. When collection is uncertain, mortgage interest income on impaired mortgage loans is recognized as received after taking into account application of security deposits.

### NOTE 3 – OWNED AND OPERATED ASSETS

In November 2007, affiliates of Haven Healthcare (“Haven”), one of our former operators/lessees/mortgagors, operated under Chapter 11 bankruptcy protection. Commencing in February 2008, the assets of the Haven facilities were marketed for sale via an auction process to be conducted through proceedings established by the bankruptcy court. The auction process failed to produce a qualified buyer. As a result, and pursuant to our rights as ordered by the bankruptcy court, Haven moved the bankruptcy court to authorize us to credit bid certain of the indebtedness that it owed to us in exchange for taking ownership of and transitioning certain of its assets to a new entity in which we have a substantial ownership interest, all of which was approved by the bankruptcy court on July 4, 2008. Effective July 7, 2008, we took ownership and/or possession of 15 facilities previously operated by Haven. TC Healthcare, a new entity and an interim operator, in which we have a substantial economic interest, began operating these facilities on our behalf through an independent contractor.

On August 6, 2008, we entered into a Master Transaction Agreement (“2008 MTA”) with affiliates of FC/SCH whereby FC/SCH agreed (subject to certain closing conditions, including the receipt of licensure) to lease 14 SNFs and one ALF facility under a master lease. These facilities were formerly leased to Haven.

Effective September 1, 2008, we completed the operational transfer of 12 SNFs and one ALF to affiliates of FC/SCH, in accordance with the terms of the 2008 MTA. These 13 facilities were located in Connecticut (5), Rhode Island (4), New Hampshire (3) and Massachusetts (1). As part of the transaction, Genesis has entered into a long-term management agreement with FC/SCH to oversee the day-to-day operations of each of these facilities. The two remaining facilities in Vermont, which were operated by TC Healthcare until May 31, 2010, were transferred to FC/SCH upon licensure from the state of Vermont. As a result of the transition of the operations to FC/SCH, we no longer operate any owned and operated facilities, effective June 1, 2010. Our consolidated financial statements include the results of operations of the two Vermont facilities from July 7, 2008 to May 31, 2010.

Nursing home revenues and expenses, included in our consolidated financial statements that relate to such owned and operated assets are set forth in the tables below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Nursing home revenues	\$—	\$—	\$—	\$—
Nursing home expenses	—	148	—	603
Loss from nursing home operations	\$—	\$(148)	\$—	\$(603)

#### NOTE 4 – CONCENTRATION OF RISK

As of September 30, 2012, our portfolio of real estate investments consisted of 463 healthcare facilities, located in 34 states and operated by 47 third-party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately \$3.0 billion at September 30, 2012, with approximately 99% of our real estate investments related to long-term care facilities. This portfolio is made up of 403 SNFs, 14 ALFs, 11 specialty facilities, fixed rate mortgages on 32 SNFs, and three SNFs that are held-for-sale. At September 30, 2012, we also held miscellaneous investments of approximately \$45.8 million, consisting primarily of secured loans to third-party operators of our facilities.

At September 30, 2012, we had investments with one operator that exceeded 10% of our total investment: affiliates and/or subsidiaries of CommuniCare Health Services (“CommuniCare”) (11%). The three states in which we had our highest concentration of investments were Florida (20%), Ohio (12%) and Indiana (10%) at September 30, 2012.

For the three-month period ended September 30, 2012, our revenues from operations totaled \$87.1 million, of which approximately \$11.1 million was from CommuniCare (13%) and \$8.5 million was from Sun Healthcare (“Sun”) (10%). No other operator generated more than 9% of our revenues from operations for the three-month period ended September 30, 2012.

For the nine-month period ended September 30, 2012, our revenues from operations totaled \$255.4 million, of which approximately \$33.0 million was from CommuniCare (13%) and \$25.6 million was from Sun (10%). No other operator generated more than 9% of our revenues from operations for the nine-month period ended September 30, 2012.

Sun is subject to the reporting requirements of the SEC and is required to file with the SEC annual reports containing audited financial information and quarterly reports containing unaudited interim financial information. Sun’s filings with the SEC can be found at the SEC’s website at [www.sec.gov](http://www.sec.gov). We are providing this data for information purposes only, and we undertake no responsibility for Sun’s filings.

#### NOTE 5 – DIVIDENDS

##### Common Dividends

On October 17, 2012, the Board of Directors declared a common stock dividend of \$0.44 per share, increasing the quarterly common dividend by \$0.02 per share, or 4.8 % over the previous quarter, to be paid November 15, 2012 to common stockholders of record on October 31, 2012.

On July 17, 2012, the Board of Directors declared a common stock dividend of \$0.42 per share, which was paid August 15, 2012 to common stockholders of record on July 31, 2012.

On April 17, 2012, the Board of Directors declared a common stock dividend of \$0.42 per share, increasing the quarterly common dividend by \$0.01 per share over the prior quarter, which was paid May 15, 2012 to common stockholders of record on April 30, 2012.

On January 13, 2012, the Board of Directors declared a common stock dividend of \$0.41 per share, increasing the quarterly common dividend by \$0.01 per share over the prior quarter, which was paid February 15, 2012 to common stockholders of record on January 31, 2012.





## NOTE 6 – TAXES

So long as we qualify as a real estate investment trust (“REIT”) under the Internal Revenue Code (the “Code”), we generally will not be subject to federal income taxes on the REIT taxable income that we distribute to stockholders, subject to certain exceptions. On a quarterly and annual basis, we test our compliance within the REIT taxation rules to ensure that we were in compliance with the rules.

Subject to the limitation under the REIT asset test rules, we are permitted to own up to 100% of the stock of one or more taxable REIT subsidiaries (“TRSs”). Currently, we have one TRS that is taxable as a corporation and that pays federal, state and local income tax on its net income at the applicable corporate rates. As of September 30, 2012, the TRS had a net operating loss carry-forward of \$1.1 million. The loss carry-forward is fully reserved with a valuation allowance as we concluded it was more-likely-than-not that the deferred tax asset would not be realized.

## NOTE 7 – STOCK-BASED COMPENSATION

The following is a summary of our stock-based compensation expense for the three- and nine- month periods ended September 30, 2012 and 2011, respectively:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
	(in thousands)			
Stock-based compensation expense	\$1,485	\$1,520	\$4,456	\$4,518

## 2011 and 2012 Stock Awards

Effective January 2011, we granted 428,503 shares of restricted stock and 496,977 performance restricted stock units (“PRSUs”) to six employees. Effective January 2012, we granted 124,244 PRSUs to six employees.

## Restricted Stock Awards

The restricted stock awards vest 100% on December 31, 2013, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company. As of September 30, 2012, no shares of restricted stock have vested under these restricted stock awards.

## Performance Restricted Stock Units

Effective January 1, 2011, we awarded three types of PRSUs to the six employees: (i) 124,244 annual total shareholder return (“TSR”) PRSUs for the year ended December 31, 2011 (“2011 Annual TSR PRSUs”); (ii) 279,550 multi-year absolute TSR PRSUs and (iii) 93,183 multi-year relative TSR PRSUs. On January 1, 2012, we awarded to the six employees 124,244 annual TSR PRSUs for the year ended December 31, 2012 (“2012 Annual TSR PRSUs”).

## Annual TSR PRSUs

The number of shares earned under the annual TSR PRSUs depends generally on the level of achievement of TSR for the year. The annual TSR PRSUs vest on December 31 of the year, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company. The 2011 Annual TSR PRSUs were forfeited because the required TSR for 2011 was not achieved.



## Multi-year Absolute TSR PRSUs

The number of shares earned under the multi-year absolute TSR PRSUs depends generally on the level of achievement of TSR for the three-years ending December 31, 2013. The multi-year absolute TSR PRSUs vest 25% on the last day of each calendar quarter in 2014, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

## Multi-year Relative TSR PRSUs

The number of shares earned under the multi-year relative TSR PRSUs depends generally on the level of achievement of TSR relative to other real estate investment trusts in the MSCI U.S. REIT Index for the three-years ending December 31, 2013. The multi-year relative TSR PRSUs vest 25% on the last day of each calendar quarter in 2014, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

The PRSU awards have varying degrees of performance requirements to achieve vesting, and each PRSU award represents the right to a variable number of shares of common stock and related dividend equivalents based on dividends paid to stockholders during the applicable performance period.

As of September 30, 2012, none of the PRSUs are vested or earned.

The following table summarizes our total unrecognized compensation cost as of September 30, 2012 associated with outstanding restricted stock and PRSU awards to employees:

	Shares/ Units	Grant Date Average Fair Value Per Unit/ Share	Total Compensation Cost (in millions)	Weighted Average Period of Expense Recognition (in months)	Unrecognized Compensation Cost (in millions)
Restricted stock	428,503	\$22.44	\$ 9.6	36	\$ 4.0
2012 Annual PRSUs	124,244	\$9.61	1.2	12	0.3
Multi-year absolute TSR PRSUs	279,550	\$11.06	3.1	44	1.6
Multi-year relative TSR PRSUs	93,183	\$12.26	1.1	44	0.6
Total	925,480	\$15.64	\$ 15.0		\$ 6.5

We used a Monte Carlo model to estimate the fair value for PRSUs granted to the employees in January 2011 and January 2012.

## Director Restricted Stock Grants

As of September 30, 2012, we had 30,999 shares of restricted stock outstanding to directors. The directors' restricted shares are scheduled to vest over the next three years. As of September 30, 2012, the unrecognized compensation cost associated with outstanding director restricted stock grants is approximately \$0.3 million.



## NOTE 8 – FINANCING ACTIVITIES AND BORROWING ARRANGEMENTS

## Secured and Unsecured Borrowings

The following is a summary of our long-term borrowings:

	Maturity	Current Rate	September 30, 2012 (in thousands)	December 31, 2011
Secured borrowings:				
HUD Berkadia mortgages (1)	2036 - 2040	6.61	% \$63,326	\$64,533
HUD Capital Funding mortgages	2040 - 2045	4.85	% 131,437	133,061
HUD White Pine mortgages (1)	2036 - 2040	4.87	% 32,199	32,813
HUD Affiliates of CFG mortgages(1)	2044	5.55	% 59,054	73,203
Total secured borrowings			286,016	303,610
Unsecured borrowings:				
Revolving line of credit	2015	1.93	% \$102,000	\$272,500
2016 Notes	2016	7.0	% —	175,000
2020 Notes	2020	7.5	% 200,000	200,000
2022 Notes	2022	6.75	% 575,000	575,000
2024 Notes	2024	5.875	% 400,000	—
Subordinated debt	2021	9.0	% 21,090	21,219
			1,196,090	971,219
Premium - net			4,433	4,071
Total unsecured borrowings			1,302,523	1,247,790
Totals – net			\$1,588,539	\$1,551,400

(1) Reflects the weighted average interest rate on the mortgages.

## Bank Credit Agreements

At September 30, 2012, we had \$102.0 million outstanding under our \$475 million unsecured revolving credit facility (the “2011 Credit Facility”), and no letters of credit outstanding, leaving availability of \$373.0 million.

The 2011 Credit Facility matures on August 17, 2015. The 2011 Credit Facility includes an “accordion feature” that permits us to expand our borrowing capacity to \$600 million, under certain conditions.

The 2011 Credit Facility agreement includes an alternative pricing grid for us if we achieved investment grade ratings from at least two of the following rating agencies: (i) Standard & Poor’s, (ii) Moody’s, and/or (iii) Fitch Ratings. In July, Fitch Ratings initiated coverage of our bonds at an investment grade, thereby achieving investment grade rating from two of the three named rating agencies. As a result, for so long as we maintain two investment grade ratings, our borrowing cost under 2011 Credit Facility will be based on this alternative pricing grid, which reduces the borrowing cost under the 2011 Credit Facility to LIBOR plus an applicable percentage ranging from 150 basis points to 210 basis points (including a facility fee). As of September 30, 2012, our applicable percentage above LIBOR was 170 basis

points. The 2011 Credit Facility is used for acquisitions and general corporate purposes.

The 2011 Credit Facility contains customary affirmative and negative covenants, including, without limitation, limitations on indebtedness; limitations on investments; limitations on liens; limitations on mergers and consolidations; limitations on sales of assets; limitations on transactions with affiliates; limitations on negative pledges; limitations on prepayment of debt; limitations on use of proceeds; limitations on changes in lines of business; limitations on repurchases of the Company's capital stock if a default or event of default occurs; and maintenance of REIT status. In addition, the 2011 Credit Facility contains financial covenants including, without limitation, those relating to maximum total leverage, maximum secured leverage, maximum unsecured leverage, minimum fixed charge coverage, minimum consolidated tangible net worth, minimum unsecured debt yield, minimum unsecured interest coverage and maximum distributions. As of September 30, 2012, we were in compliance with all affirmative and negative covenants, including financial covenants.

#### Issuance of \$400 Million 5.875% Senior Notes due 2024

On March 19, 2012, we issued \$400 million aggregate principal amount of our 5.875% Senior Notes due 2024, or the 2024 Notes. The 2024 Notes mature on March 15, 2024 and pay interest semi-annually on March 15 and September 15 of each year, commencing on September 15, 2012.

We may redeem the 2024 Notes, in whole at any time or in part from time to time, at redemption prices of 102.938%, 101.958% and 100.979% of the principal amount thereof if the redemption occurs during the 12-month periods beginning on March 15 of the years 2017, 2018 and 2019, respectively, and at a redemption price of 100% of the principal amount thereof on and after March 15, 2020, in each case, plus any accrued and unpaid interest to the redemption date. In addition, until March 15, 2015 we may redeem up to 35% of the 2024 Notes with the net cash proceeds of one or more public equity offerings at a redemption price of 105.875% of the principal amount of the 2024 Notes to be so redeemed, plus any accrued and unpaid interest to the redemption date. If we undergo a change of control, we may be required to offer to purchase the notes from holders at a purchase price equal to 101% of the principal amount plus accrued interest.

The 2024 Notes were sold at an issue price of 100% of the principal amount. We used the net proceeds of the offering to fund the tender offer and consent solicitation for the 2016 Notes (described below), to fund the redemption of the untendered 2016 Notes (described below) and to repay a portion of our indebtedness outstanding under our \$475 million senior unsecured revolving credit facility. As of September 30, 2012, our subsidiaries that are not guarantors of the 2024 Notes accounted for approximately \$465 million of our total assets.

#### \$175 Million 7% Senior Notes due 2016 Tender Offer and Redemption

On March 5, 2012, we commenced a tender offer to purchase for cash any and all of our outstanding \$175 million aggregate principal amount of 7% Senior Notes due 2016, or the 2016 Notes. Pursuant to the terms of the tender offer, on March 19, 2012, we purchased \$168.9 million aggregate principal amount of the 2016 Notes.

On March 27, 2012, pursuant to the terms of the indenture governing the 2016 Notes, we redeemed the remaining \$6.1 million aggregate principal amount of the 2016 Notes at a redemption price of 102.333% of their principal amount, plus accrued and unpaid interest up to the redemption date. Following redemption, the 2016 Notes, the indenture governing the 2016 Notes and the related guarantees were terminated.

The redemption resulted in approximately \$7.1 million of redemption related cost and write-offs, including \$4.5 million in payments made to bondholders for early redemption, \$2.2 million of write-offs associated with deferred costs and \$0.4 million of expenses associated with the tender and redemption.





### \$245 Million Equity Shelf Program

On June 19, 2012, we entered into separate Equity Distribution Agreements (collectively, the “2012 Agreements”) to sell shares of our common stock having an aggregate gross sales price of up to \$245 million (the “2012 ESP”) with each of BB&T Capital Markets, a division of Scott & Stringfellow, LLC, Credit Agricole Securities (USA) Inc., Deutsche Bank Securities Inc., Jefferies & Company, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, RBC Capital Markets, LLC, RBS Securities Inc., Stifel, Nicolaus & Company, Incorporated, SunTrust Robinson Humphrey, Inc. and UBS Securities LLC, each as a sales agent and/or principal (collectively, the “Managers”). Under the terms of the 2012 Agreements, we may sell shares of our common stock, from time to time, through or to the Managers having an aggregate gross sales price of up to \$245 million. Sales of the shares, if any, will be made by means of ordinary brokers’ transactions on the New York Stock Exchange at market prices, or as otherwise agreed with the applicable Manager. We will pay each Manager compensation for sales of the shares equal to 2% of the gross sales price per share of shares sold through such Manager under the applicable 2012 Agreement.

We are not obligated to sell and the Managers are not obligated to buy or sell any shares under the 2012 Agreements. No assurance can be given that we will sell any shares under the 2012 Agreements, or, if we do, as to the price or amount of shares that we sell, or the dates when such sales will take place. As of September 30, 2012, 2.6 million shares were issued under the 2012 ESP, at an average price of \$24.10 per share, generating gross proceeds of approximately \$63.6 million, before \$1.3 million of commissions.

### Termination of \$140 Million Equity Shelf Program

On June 19, 2012, we terminated our \$140 million Equity Shelf Program (the “2010 ESP”). For the three months ended June 30, 2012, we issued 510,000 shares of our common stock under the 2010 ESP generating gross proceeds of approximately \$10.8 million, before \$0.2 million of commissions. For the six months ended June 30, 2012, we issued approximately 759,000 shares of our common stock under the 2010 ESP at an average price per share of \$21.27, generating gross proceeds of approximately \$16.1 million, before \$0.3 million of commissions. The proceeds of the sale of our common stock were used for working capital and for general corporate purposes, including funding the recent investments described above.

Since inception of the 2010 ESP, we have sold a total of 5.3 million shares of common stock generating total gross proceeds of \$114.9 million under the program, before \$2.3 million of commissions. As a result of the termination of the 2010 ESP, no additional shares were issued under the 2010 ESP.

### HUD Mortgage Payoffs

On June 29, 2012, we paid approximately \$11.8 million to retire four HUD mortgages that were assumed as part of the acquisition of SNFs from affiliates of CFG. The retirement of the four HUD mortgages resulted in a net gain of approximately \$1.7 million. The net gain included the write-off of approximately \$1.8 million related to marking the debt to market at the time of the acquisition of SNFs from affiliates of CFG as well as a prepayment fee of approximately \$0.1 million.

### \$400 Million 5.875% Senior Notes Exchange Offer

On August 15, 2012, we commenced an offer to exchange \$400 million of our 5.875% Senior Notes due 2024 that have been registered under the Securities Act of 1933 for \$400 million of our outstanding 5.875% Senior Notes due 2024, which were issued on March 19, 2012 in a private placement.

All \$400 million outstanding aggregate principal amount of the initial notes were validly tendered and not withdrawn prior to the expiration of the exchange offer, and were exchanged for exchange notes as of September 20, 2012, pursuant to the terms of the exchange offer. The Exchange Notes are identical in all material respects to the Initial Notes, except that the Exchange Notes were registered under the Securities Act of 1933 and the provisions of the Initial Notes relating to transfer restrictions, registration rights and additional interest will not apply to the Exchange Notes.

## Dividend Reinvestment and Common Stock Purchase Plan

For the nine-month period ended September 30, 2012, approximately 4.8 million shares of our common stock were issued through our Dividend Reinvestment and Common Stock Purchase Program for net proceeds of approximately \$106.1 million.

## NOTE 9 – FINANCIAL INSTRUMENTS

At September 30, 2012 and December 31, 2011, the carrying amounts and fair values of our financial instruments were as follows:

	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
	(in thousands)			
Cash and cash equivalents	\$ 6,951	\$ 6,951	\$ 351	\$ 351
Restricted cash	32,923	32,923	34,112	34,112
Mortgage notes receivable – net	245,550	249,292	238,675	241,494
Other investments – net	45,807	42,758	52,957	48,903
Totals	\$ 331,231	\$ 331,924	\$ 326,095	\$ 324,860
Liabilities:				
Revolving line of credit	\$ 102,000	\$ 102,000	\$ 272,500	\$ 272,500
7.00% Notes due 2016 – net	—	—	174,376	186,398
7.50% Notes due 2020 – net	197,460	238,726	197,202	216,114
6.75% Notes due 2022 – net	581,973	733,718	582,493	582,684
5.875% Notes due 2024 – net	400,000	435,092	—	—
HUD debt	286,016	358,436	303,610	321,949
Subordinated debt	21,090	27,968	21,219	23,198
Totals	\$ 1,588,539	\$ 1,895,940	\$ 1,551,400	\$ 1,602,843

Fair value estimates are subjective in nature and are dependent on a number of important assumptions, including estimates of future cash flows, risks, discount rates and relevant comparable market information associated with each financial instrument (see Note 2 – Summary of Significant Accounting Policies in our 2011 Annual Report on Form 10-K). The use of different market assumptions and estimation methodologies may have a material effect on the reported estimated fair value amounts.

The following methods and assumptions were used in estimating fair value disclosures for financial instruments.

**Cash and cash equivalents and restricted cash:** The carrying amount of cash and cash equivalents and restricted cash reported in the balance sheet approximates fair value because of the short maturity of these instruments (i.e., less than 90 days).

**Mortgage notes receivable:** The fair values of the mortgage notes receivables are estimated using a discounted cash flow analysis, using interest rates being offered for similar loans to borrowers with similar credit ratings (Level 2).

**Other investments:** Other investments are primarily comprised of: (i) notes receivable and (ii) an investment in redeemable non-convertible preferred security of an unconsolidated business accounted for using the cost method of accounting. The fair values of notes receivable are estimated using a discounted cash flow analysis, using interest rates being offered for similar loans to borrowers with similar credit ratings (Level 2). The fair value of the

investment in the unconsolidated business is estimated using quoted market value and considers the terms of the underlying arrangement (Level 2).

Revolving line of credit: The fair value of our borrowings under variable rate agreements are estimated using an expected present value technique based on expected cash flows discounted using the current market rates (Level 2).

Senior notes and other long-term borrowings: The fair value of our borrowings under fixed rate agreements are estimated based on open market trading activity provided by a third party (Level 2).

#### NOTE 10 – LITIGATION

We are subject to various legal proceedings, claims and other actions arising out of the normal course of business. While any legal proceeding or claim has an element of uncertainty, management believes that the outcome of each lawsuit, claim or legal proceeding that is pending or threatened, or all of them combined, will not have a material adverse effect on our consolidated financial position or results of operations.

#### NOTE 11 – EARNINGS PER SHARE

The computation of basic earnings per share (“EPS”) is computed by dividing net income available to common stockholders by the weighted-average number of shares of common stock outstanding during the relevant period. Diluted EPS is computed using the treasury stock method, which is net income available to common stockholders divided by the total weighted-average number of common outstanding shares plus the effect of dilutive common equivalent shares during the respective period. Dilutive common shares reflect the assumed issuance of additional common shares pursuant to certain of our share-based compensation plans, including stock options, restricted stock and performance restricted stock units.

The following tables set forth the computation of basic and diluted earnings per share:

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	2011		2011	
	(in thousands, except per share amounts)			
Numerator:				
Net income	\$30,119	\$21,436	\$86,775	\$33,313
Preferred stock dividends	—	—	—	(1,691 )
Preferred stock redemption	—	—	—	(3,456 )
Numerator for net income available to common per share - basic and diluted	\$30,119	\$21,436	\$86,775	\$28,166
Denominator:				
Denominator for basic earnings per share	109,135	103,180	106,202	101,722
Effect of dilutive securities:				
Restricted stock	511	38	350	38
Deferred stock	21	13	18	12
Denominator for diluted earnings per share	109,667	103,231	106,570	101,772
Earnings per share – basic:				
Net income – basic	\$0.28	\$0.21	\$0.82	\$0.28
Earnings per share – diluted:				
Net income – diluted	\$0.27	\$0.21	\$0.81	\$0.28



## NOTE 12 – CONSOLIDATING FINANCIAL STATEMENTS

As of September 30, 2012, we had outstanding (i) \$200 million 7.5% Senior Notes due 2020, (ii) \$575 million 6.75% Senior Notes due 2022 and (iii) \$400 million 5.875% Senior Notes due 2024, which we collectively refer to as the Senior Notes. The Senior Notes are fully and unconditionally guaranteed, jointly and severally, by each of our subsidiaries that guarantee other indebtedness of Omega or any of the subsidiary guarantors. Any subsidiary that we properly designate as an “unrestricted subsidiary” under the indentures governing the Senior Notes will not provide guarantees of the Senior Notes. As of and prior to March 31, 2010, the non-subsidiary guarantors were minor and insignificant. On June 29, 2010, we designated as “unrestricted subsidiaries” the 39 subsidiaries acquired from CapitalSource on such date. During the fourth quarter of 2011, we designated as “unrestricted subsidiaries” three subsidiaries acquired from White Pine and 17 of the subsidiaries acquired from affiliates of CFG. On July 17, 2012, our Board of Directors approved removing the unrestricted subsidiary designation from five of the CFG subsidiaries due to the retirement of the HUD related mortgages. The total assets related to these five “unrestricted subsidiaries” at June 30, 2012 was approximately \$47.9 million. As a result, the December 31, 2011 consolidating balance sheet reflects the removal of the restriction from these five subsidiaries.

For the nine months ended September 30, 2012 and 2011, the operating cash flow of the non-guarantor subsidiaries approximated net income of the non-guarantor subsidiaries, adjusted for depreciation and amortization expense. For the nine months ended September 30, 2012 and 2011, the non-guarantor subsidiaries have not engaged in investing or financing activities other than routine principal payments on its HUD mortgage debt of \$2.9 million and \$1.8 million, respectively. All of the subsidiary and non-subsidiary guarantors of our outstanding senior notes are 100 percent owned by Omega.

The following summarized condensed consolidating financial information segregates the financial information of the non-guarantor subsidiaries from the financial information of Omega Healthcare Investors, Inc. and the subsidiary guarantors under the Senior Notes. The results and financial position of acquired entities are included from the dates of their respective acquisitions.



OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATING BALANCE SHEETS  
Unaudited  
(in thousands, except per share amounts)

	September 30, 2012			
	Issuer & Subsidiary Guarantors	Non-Guarantor Subsidiaries	Elimination Company	Consolidated
Real estate properties				
Land and buildings	\$2,344,862	\$ 441,351	\$—	\$ 2,786,213
Less accumulated depreciation	(510,675 )	(39,706 )	—	(550,381 )
Real estate properties – net	1,834,187	401,645	—	2,235,832
Mortgage notes receivable – net	245,550	—	—	245,550
	2,079,737	401,645	—	2,481,382
Other investments – net	45,807	—	—	45,807
	2,125,544	401,645	—	2,527,189
Assets held for sale – net	1,620	—	—	1,620
Total investments	2,127,164	401,645	—	2,528,809
Cash and cash equivalents	6,951	—	—	6,951
Restricted cash	6,629	26,294	—	32,923
Accounts receivable – net	113,533	5,828	—	119,361
Investment in affiliates	109,767	—	(109,767 )	—
Other assets	40,116	31,280	—	71,396
Total assets	\$2,404,160	\$ 465,047	\$(109,767 )	\$ 2,759,440

LIABILITIES AND STOCKHOLDERS' EQUITY

Revolving line of credit	\$ 102,000	\$ —	\$—	\$ 102,000
Secured borrowings	—	286,016	—	286,016
Unsecured borrowings – net	1,179,433	21,090	—	1,200,523
Accrued expenses and other liabilities	101,807	48,174	—	149,981
Intercompany payable	—	92,242	(92,242 )	—
Total liabilities	1,383,240	447,522	\$(92,242 )	\$ 1,738,520

Stockholders' equity:

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Common stock	11,205	—	—	11,205
Common stock – additional paid-in-capital	1,658,882	—	—	1,658,882
Cumulative net earnings	720,205	17,525	(17,525 )	720,205
Cumulative dividends paid	(1,369,372)	—	—	(1,369,372 )
Total stockholders' equity	1,020,920	17,525	\$(17,525 )	1,020,920
Total liabilities and stockholders' equity	\$2,404,160	\$ 465,047	\$(109,767 )	2,759,440

OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATING BALANCE SHEETS  
(in thousands, except per share amounts)

	December 31, 2011			
	Issuer & Subsidiary Guarantors	Non – Guarantor Subsidiaries	Elimination Company	Consolidated
<b>ASSETS</b>				
Real estate properties				
Land and buildings	\$ 2,095,441	\$ 441,598	\$ —	\$ 2,537,039
Less accumulated depreciation	(446,581 )	(23,839 )	—	(470,420 )
Real estate properties – net	1,648,860	417,759	—	2,066,619
Mortgage notes receivable – net	238,675	—	—	238,675
	1,887,535	417,759	—	2,305,294
Other investments – net	52,957	—	—	52,957
	1,940,492	417,759	—	2,358,251
Assets held for sale – net	2,461	—	—	2,461
Total investments	1,942,953	417,759	—	2,360,712
Cash and cash equivalents	351	—	—	351
Restricted				
cash	6,511	27,601	—	34,112
Accounts receivable – net	97,407	3,257	—	100,664
Investment in affiliates	119,564	—	(119,564 )	—
Other assets	32,798	28,675	—	61,473
Total assets	\$ 2,199,584	\$ 477,292	(119,564 )	\$ 2,557,312
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>				
Revolving line of credit	\$ 272,500	\$ —	\$ —	\$ 272,500
Secured borrowings	13,652	289,958	—	303,610
Unsecured borrowings – net	954,071	21,219	—	975,290
Accrued expenses and other liabilities	80,877	46,551	—	127,428
Intercompany payable	—	109,907	(109,907 )	—
Total liabilities	1,321,100	467,635	(109,907 )	1,678,828
Stockholders' equity:				
Common stock	10,341	—	—	10,341
Common stock – additional paid-in-capital	1,471,381	—	—	1,471,381
Cumulative net earnings	633,430	9,657	(9,657 )	633,430
Cumulative dividends paid	(1,236,668 )	—	—	(1,236,668 )
Total stockholders' equity	878,484	9,657	(9,657 )	878,484
Total liabilities and stockholders' equity	\$ 2,199,584	\$ 477,292	\$ (119,564 )	\$ 2,557,312

OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATING STATEMENTS OF OPERATIONS  
Unaudited  
(in thousands, except per share amounts)

	Three Months Ended September 30, 2012				Nine Months Ended September 30, 2012			
	Issuer & Subsidiary Guarantor	Non – Subsidiary Guarantor	Elimination	Consolidated	Issuer & Subsidiary Guarantor	Non – Subsidiary Guarantor	Elimination	Consolidated
Revenue								
Rental income	\$66,231	\$11,939	\$-	\$78,170	\$193,411	\$35,962	\$-	\$229,373
Mortgage interest income	7,677	-	-	7,677	22,417	-	-	22,417
Other investment income – net	1,238	-	-	1,238	3,533	-	-	3,533
Miscellaneous	23	-	-	23	125	-	-	125
Total operating revenues	75,169	11,939	-	87,108	219,486	35,962	-	255,448
Expenses								
Depreciation and amortization	22,996	5,309	-	28,305	66,784	15,867	-	82,651
General and administrative	5,062	111	-	5,173	15,305	348	-	15,653
Acquisition costs	483	-	-	483	686	-	-	686
Impairment loss on real estate properties	-	-	-	-	272	-	-	272
Total operating expenses	28,541	5,420	-	33,961	83,047	16,215	-	99,262
Income before other income and expense	46,628	6,519	-	53,147	136,439	19,747	-	156,186
Other income (expense):								
Interest income	-	6	-	6	2	20	-	22
Interest expense	(19,883)	(4,167)	-	(24,050)	(59,127)	(11,899)	-	(71,026)
Interest – amortization of deferred financing costs	(673)	-	-	(673)	(1,970)	-	-	(1,970)
Interest – loss on extinguishment of debt	-	-	-	-	(5,410)	-	-	(5,410)
Equity in earnings	2,358	-	(2,358)	-	7,868	-	(7,868)	-
Total other expense	(18,198)	(4,161)	(2,358)	(24,717)	(58,637)	(11,879)	(7,868)	(78,384)
Income before gain on assets sold	28,430	2,358	(2,358)	28,430	77,802	7,868	(7,868)	77,802
Gain on assets sold – net	1,689	-	-	1,689	8,973	-	-	8,973
Net income available to common stockholders	\$30,119	\$2,358	\$(2,358)	\$30,119	\$86,775	\$7,868	\$(7,868)	\$86,775

OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATING STATEMENTS OF OPERATIONS  
Unaudited  
(in thousands, except per share amounts)

	Three Months Ended September 30, 2011				Nine Months Ended September 30, 2011			
	Issuer & Subsidiary Guarantor	Non – Guarantor	Elimination Company	Consolidated	Issuer & Subsidiary Guarantor	Non – Guarantor	Elimination Company	Consolidated
Revenue								
Rental income	\$60,333	\$8,289	\$-	\$68,622	\$178,289	\$25,157	\$-	\$203,446
Mortgage interest income	3,617	-	-	3,617	10,548	-	-	10,548
Other investment income – net	383	-	-	383	1,641	-	-	1,641
Miscellaneous	196	-	-	196	265	-	-	265
Total operating revenues	64,529	8,289	-	72,818	190,743	25,157	-	215,900
Expenses								
Depreciation and amortization	21,000	3,871	-	24,871	63,421	11,427	-	74,848
General and administrative	4,329	64	-	4,393	14,324	225	-	14,549
Acquisition costs	-	-	-	-	45	-	-	45
Impairment loss on real estate properties	-	-	-	-	24,971	-	-	24,971
Provisions for uncollectible accounts receivable	-	-	-	-	4,139	-	-	4,139
Nursing home expenses of owned and operated assets	148	-	-	148	603	-	-	603
Total operating expenses	25,477	3,935	-	29,412	107,503	11,652	-	119,155
Income before other income and expense	39,052	4,354	-	43,406	83,240	13,505	-	96,745
Other income (expense):								
Interest income	6	6	-	12	15	20	-	35
Interest expense	(17,374)	(2,727)	-	(20,101)	(51,922)	(8,251)	-	(60,173)
Interest – amortization of deferred financing costs	(629)	-	-	(629)	(2,026)	-	-	(2,026)
Interest – refinancing costs	(3,055)	-	-	(3,055)	(3,071)	-	-	(3,071)
Equity in earnings	1,633	-	(1,633)	-	5,274	-	(5,274)	-
Total other expense	(19,419)	(2,721)	(1,633)	(23,773)	(51,730)	(8,231)	(5,274)	(65,235)
Income before gain on assets sold	19,633	1,633	(1,633)	19,633	31,510	5,274	(5,274)	31,510
Gain on assets sold - net	1,803	-	-	1,803	1,803	-	-	1,803
Net income	21,436	1,633	(1,633)	21,436	33,313	5,274	(5,274)	33,313
Preferred stock dividends	-	-	-	-	(1,691)	-	-	(1,691)
Preferred stock redemption	-	-	-	-	(3,456)	-	-	(3,456)
	\$21,436	\$1,633	\$(1,633)	\$21,436	\$28,166	\$5,274	\$(5,274)	\$28,166

Net income available to  
common stockholders

25

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## Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations

### Forward-looking Statements, Reimbursement Issues and Other Factors Affecting Future Results

The following discussion should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this document, including statements regarding potential future changes in reimbursement. This document contains forward-looking statements within the meaning of the federal securities laws. These statements relate to our expectations, beliefs, intentions, plans, objectives, goals, strategies, future events, performance and underlying assumptions and other statements other than statements of historical facts. In some cases, you can identify forward-looking statements by the use of forward-looking terminology including, but not limited to, terms such as “may,” “will,” “anticipates,” “expects,” “believes,” “intends,” “should” or comparable terms or the negative thereof. statements are based on information available on the date of this filing and only speak as to the date hereof and no obligation to update such forward-looking statements should be assumed. Our actual results may differ materially from those reflected in the forward-looking statements contained herein as a result of a variety of factors, including, among other things:

- (i) those items discussed under “Risk Factors” in Item 1A to our annual report on Form 10-K for the year ended December 31, 2011, in Part II, Item 1A of our Quarterly Report on Form 10-Q for the three months ended March 31, 2012 and June 30, 2012, and in Part II, Item 1A of this report;
- (ii) uncertainties relating to the business operations of the operators of our assets, including those relating to reimbursement by third-party payors, regulatory matters and occupancy levels;
- (iii) the ability of any operators in bankruptcy to reject unexpired lease obligations, modify the terms of our mortgages and impede our ability to collect unpaid rent or interest during the process of a bankruptcy proceeding and retain security deposits for the debtors’ obligations;
- (iv) our ability to sell closed or foreclosed assets on a timely basis and on terms that allow us to realize the carrying value of these assets;
  - (v) our ability to negotiate appropriate modifications to the terms of our credit facilities;
  - (vi) our ability to manage, re-lease or sell any owned and operated facilities;
  - (vii) the availability and cost of capital;
  - (viii) changes in our credit ratings and the ratings of our debt securities;
  - (ix) competition in the financing of healthcare facilities;
  - (x) regulatory and other changes in the healthcare sector;
  - (xi) the effect of economic and market conditions generally and, particularly, in the healthcare industry;
  - (xii) changes in the financial position of our operators;
  - (xiii) changes in interest rates;
  - (xiv) the amount and yield of any additional investments;
  - (xv) changes in tax laws and regulations affecting real estate investment trusts; and
  - (xvi) our ability to maintain our status as a real estate investment trust.

### Overview

We have one reportable segment consisting of investments in healthcare related real estate properties. Our core business is to provide financing and capital to the long-term healthcare industry with a particular focus on skilled nursing facilities (“SNFs”) located in the United States. Our core portfolio consists of long-term leases and mortgage agreements. All of our leases are “triple-net” leases, which require the tenants to pay all property-related expenses. Our mortgage revenue derives from fixed-rate mortgage loans, which are secured by first mortgage liens on the underlying real estate and personal property of the mortgagor.





Our portfolio of investments at September 30, 2012, consisted of 463 healthcare facilities (including three facilities classified as held for sale), located in 34 states and operated by 47 third-party operators. Our gross investment in these facilities totaled approximately \$3.0 billion at September 30, 2012, with 99% of our real estate investments related to long-term healthcare facilities. This portfolio is made up of (i) 403 SNFs, (ii) 14 assisted living facilities (“ALFs”), (iii) 11 specialty facilities, (iv) fixed rate mortgages on 32 SNFs and (v) three SNFs that are held for sale. At September 30, 2012, we also held other investments of approximately \$45.8 million, consisting primarily of secured loans to third-party operators of our facilities.

Our consolidated financial statements include the accounts of (i) Omega, (ii) all direct and indirect wholly owned subsidiaries of Omega and (iii) TC Healthcare, an entity and interim operator created in 2008 to temporarily operate the 15 facilities we assumed as a result of the bankruptcy of one of our former tenants/operators. We consolidate the financial results of TC Healthcare into our financial statements based on the applicable consolidation accounting literature. We include the operating results, assets and liabilities of these facilities for the period of time that TC Healthcare was responsible for the operations of the facilities. Thirteen of these facilities were transitioned from TC Healthcare to a new tenant/operator on September 1, 2008. The two remaining facilities were transitioned to the new tenant/operator on June 1, 2010 upon approval by state regulators of the operating license transfer. The operating revenues and expenses and related operating assets and liabilities of the two facilities are shown on a gross basis in our Consolidated Statements of Operations and Consolidated Balance Sheets, respectively. TC Healthcare is responsible for the collection of the accounts receivable earned and the liabilities incurred prior to the date of the transition to the new tenant/operator. All inter-company accounts and transactions have been eliminated in consolidation of the financial statements.

#### Taxation

We have elected to be taxed as a Real Estate Investment Trust (“REIT”), under Sections 856 through 860 of the Internal Revenue Code (the “Code”), beginning with our taxable year ended December 31, 1992. We believe that we have been organized and operated in such a manner as to qualify for taxation as a REIT. We intend to continue to operate in a manner that will maintain our qualification as a REIT, but no assurance can be given that we have operated or will be able to continue to operate in a manner so as to qualify or remain qualified as a REIT. Under the Code, we generally are not subject to federal income tax on taxable income distributed to stockholders if certain distribution, income, asset and stockholder tests are met, including a requirement that we must generally distribute at least 90% of our annual taxable income, excluding any net capital gain, to stockholders. If we fail to qualify as a REIT in any taxable year, we may be subject to federal income taxes on our taxable income for that year and for the four years following the year during which qualification is lost, unless the Internal Revenue Service grants us relief under certain statutory provisions. Such an event could materially adversely affect our net income and net cash available for distribution to our stockholders. For further information, see “Taxation” in Item 1 of our annual report on Form 10-K for the year ended December 31, 2011.

#### Government Regulation and Reimbursement

The following is a description of certain of the laws and regulations and reimbursement policies and programs affecting our business and the businesses conducted by our operators. The following description should be read in conjunction with the risk factors described under “Item 1A – Risk Factors.”

**Healthcare Reform.** The Patient Protection and Affordable Care Act and accompanying Healthcare and Education Affordability and Reconciliation Act of 2010 (the “Healthcare Reform Law”) were signed into law in March 2010. This legislation represents the most comprehensive change to healthcare benefits since the inception of the Medicare program in 1965 and will affect reimbursement for governmental programs, private insurance and employee welfare benefit plans in various ways. Some changes under the Healthcare Reform Law have already occurred, such as

changes to pre-existing condition requirements and coverage of dependents. Other changes, including taxes on so-called “Cadillac” health plans, will be implemented over time. There has already been significant rule making and regulation promulgation under the Healthcare Reform Law, and we expect significant additional rules and regulations.

The attorneys general for several states, as well as other individuals and organizations, challenged the constitutionality of certain provisions of the Healthcare Reform Law, including the requirement that each individual carry health insurance. On June 28, 2012, the U.S. Supreme Court upheld all of the Healthcare Reform Law except for the requirement that states expand Medicaid beginning in 2014. However, various Congressional leaders have indicated a desire to revisit some or all of the Healthcare Reform Law and the U.S. House of Representatives voted to repeal the Healthcare Reform Law following the Supreme Court's decision. While the U.S. Senate voted against repealing the entire Healthcare Reform Law prior to the Supreme Court's decision, a number of bills and budget proposals seek to repeal, change or defund certain provisions of the law. For example, the 2011 budget eliminated two programs funded under the Healthcare Reform Law: the Consumer Operated and Oriented Plan (CO-OP) and the Free Choice Voucher programs. Further, a number of states have passed legislation intended to block various requirements of the Healthcare Reform Law. Because of these challenges, we cannot predict whether any or all of the legislation will be implemented as enacted, overturned, repealed or modified.

Given the multitude of factors involved in the Healthcare Reform Law and the substantial requirements for regulation thereunder, we cannot predict the impact of the Healthcare Reform Law on our operators or their ability to meet their obligations to us. The Healthcare Reform Law could result in decreases in payments to our operators or otherwise adversely affect the financial condition of our operators, thereby negatively impacting our financial condition. We cannot predict whether our operators will have the ability to modify certain aspects of their operations to lessen the impact of any increased costs or other adverse effects resulting from changes in governmental programs, private insurance and/or employee welfare benefit plans. The impact of the Healthcare Reform Law on each of our operators will vary depending on payor mix, resident conditions and a variety of other factors. In addition to the provisions relating to reimbursement, other provisions of the Healthcare Reform Law may impact our operators as employers (e.g., requirements related to providing health insurance for employees), which could negatively impact the financial condition of our operators. We anticipate that many of the provisions in the Healthcare Reform Law may be subject to further clarification and modification during the rule making process.

The Healthcare Reform Law requires private health insurers that sell policies to individuals and small businesses to provide, starting in 2014, a set of "essential health benefits" in 10 categories, including prescription drugs, rehabilitative and habilitative services, and chronic disease management. As required under the law, states define the essential health benefits. States are now submitting their essential health benefit packages to the Department of Health and Human Services (HHS). How these benefits are established will affect payments for long term care facilities.

The Healthcare Reform Law requires SNFs to implement, by March 23, 2013, a compliance and ethics program that is effective in preventing and detecting criminal, civil and administrative violations and in promoting quality of care. HHS has not yet issued the proposed regulations to implement this law that were due in March 2012. It is unclear whether this provision of the law will be enforced until the regulations are issued.

SNFs will be required to provide additional information for the Centers for Medicare and Medicaid Services (CMS) Nursing Home Compare website regarding staffing as well as summary information regarding the number of criminal violations by a facility or its employees committed within the facility, and specification of those that were crimes of abuse, neglect, criminal sexual abuse or other violations or crimes resulting in serious bodily injury, and, in addition, the number of civil monetary penalties imposed on the facility, its employees, contractors and other agents, to further the ability of consumers to compare nursing homes.

Reimbursement. A significant portion of our operators' revenue is derived from governmentally-funded reimbursement programs, primarily Medicare and Medicaid. The federal government and many state governments are currently focusing on reducing expenditures under Medicare and Medicaid programs, resulting in significant cost-cutting at both the federal and state levels. These cost-cutting measures, together with the implementation of changes in reimbursement rates under the Healthcare Reform Law, could result in a significant reduction of reimbursement rates to our operators under both the Medicare and Medicaid programs. We currently believe that our operator coverage ratios are adequate and that our operators can absorb moderate reimbursement rate reductions and still meet their obligations to us. However, significant limits on the scopes of services reimbursed and on reimbursement rates could have a material adverse effect on our operators' results of operations and financial condition, which could adversely affect our operators' ability to meet their obligations to us.

For the federal fiscal year 2013, CMS has announced that it will increase SNF payment rates by 1.8% (2.5% market basket update minus 0.7% productivity adjustment), which amounts to an estimated \$670 million increase in payments to SNFs beginning October 1, 2012.

The Sequestration Transparency Act of 2012 requires President Obama to submit to Congress a report on the potential sequestration triggered by the failure of the Joint Selective Committee on Deficit Reduction to propose, and Congress to enact, a plan to reduce the deficit by \$1.2 trillion, as required by the Budget Control Act of 2011. Under the sequestration, automatic spending cuts would become effective beginning January 2, 2013. This would result in cuts of 2% (\$11.1 billion) to Medicare. However, Medicaid is exempt from the automatic spending cuts.

We cannot predict whether Congress will take any action to change the automatic spending cuts. Further, we cannot predict how states will react to any changes that occur at the federal level.

Medicaid. State budgetary concerns, coupled with the implementation of rules under the Healthcare Reform Law, may result in significant changes in healthcare spending at the state level.

Many states are currently focusing on the reduction of expenditures under their state Medicaid programs, which may result in a reduction in reimbursement rates for our operators. The need to control Medicaid expenditures may be exacerbated by the potential for increased enrollment in Medicaid due to unemployment and declines in family incomes. Since our operators' profit margins on Medicaid patients are generally relatively low, more than modest reductions in Medicaid reimbursement or an increase in the number of Medicaid patients could adversely affect our operators' results of operations and financial conditions, which in turn could negatively impact us.

Under the Healthcare Reform Law, Medicaid coverage will be expanded to all individuals under age 65 with incomes up to 133% of the federal poverty level, beginning January 1, 2014. The federal government will pay the entire cost for Medicaid coverage for newly eligible beneficiaries for 3 years (2014 through 2016). In 2017, the federal share declines to 95%; in 2018, to 94%; in 2019, to 93%; and in 2020 and subsequent years, to 90%. States may delay Medicaid expansion after 2014 but the federal payment rates will be less. However, on June 28, 2012, the Supreme Court issued its opinion in *National Federation of Independent Business v. Sebellius*, which stated that states could not be required to expand Medicaid or risk losing federal funding of their existing Medicaid programs. Thus, it is unknown which states will expand their Medicaid programs.

Although states are currently required by law to maintain current Medicaid eligibility standards until at least 2014, at least one state has filed a lawsuit challenging the constitutionality of the "maintenance of effort" (MOE) provision based on the Supreme Court's decision.

Medicare. In 2009, the CMS finalized a revised case-mix classification system, the RUG-IV, and planned implementation for fiscal year 2010. However, the Healthcare Reform Law delayed implementation of RUG-IV to

October 1, 2011. The Medicare and Medicaid Extenders Act of 2010 repealed the delay in implementation under the Healthcare Reform Law and provided that RUG-IV would be implemented immediately and applied retroactively to October 1, 2010. According to the CMS, this change in case-mix classification methodology resulted in a significant increase in Medicare expenditures for fiscal year 2011.

In response to this increase, on July 29, 2011, the CMS announced the final rule for SNF funding for fiscal year 2012. The final rule includes a recalibration of the case-mix indexes that form the RUG-IV and will result in a reduction of aggregate Medicare reimbursement to SNFs of \$4.47 billion or 12.6%. However, the reduction is partially offset by an update that reflects a 2.7% increase in the prices of a “market basket” of goods and services reduced by a 1.0% multi-factor productivity adjustment mandated by the Healthcare Reform Law. The combination of the recalibration and the update will yield a net reduction of aggregate Medicare reimbursement to SNFs of \$3.87 billion or 11.1%. We believe that the implementation of RUG-IV in 2010 had a positive effect on the cash flow and rent coverage ratios of our operators. This funding cut has reduced operator coverage ratios; however, we currently believe that our operator coverage ratios are adequate and that our operators can absorb the fiscal year 2012 reimbursement rate reductions and still meet their obligations to us.

The Medicare Improvements for Patients and Providers Act of 2008 (“MIPPA”) became law on July 15, 2008, and made a variety of changes to Medicare, some of which affected SNFs. For instance, MIPPA extended the therapy cap exceptions process through December 31, 2009. A number of other laws have further extended the therapy cap exceptions process, with the current expiration set to occur on December 31, 2012. The therapy caps limit the physical therapy, speech-language therapy and occupational therapy services that a Medicare beneficiary can receive during a calendar year. These caps do not apply to therapy services covered under Medicare Part A for SNFs, although the caps apply in most other instances involving patients in SNFs or long-term care facilities who receive therapy services covered under Medicare Part B. Congress implemented a temporary therapy cap exceptions process, which permits medically necessary therapy services to exceed the payment limits. Expiration of the therapy cap exceptions process in the future could have a material adverse effect on our operators’ financial condition and operations, which could adversely impact their ability to meet their obligations to us.

Quality of Care Initiatives. The CMS has implemented a number of initiatives focused on the quality of care provided by nursing homes that could affect our operators. For instance, in December 2008, the CMS released quality ratings for all of the nursing homes that participate in Medicare or Medicaid. Facility rankings, ranging from five stars (“much above average”) to one star (“much below average”) are updated on a monthly basis. In March 2012, the Government Accountability Office released a report that recommended that the CMS use strategic planning in its efforts to evaluate and improve the rating system. While CMS agreed with the GAO’s recommendations, we cannot predict what changes, if any, it will make to the rating system. It is possible that this or any other ranking system could lead to future reimbursement policies that reward or penalize facilities on the basis of the reported quality of care parameters.

CMS has incorporated hospital readmissions review into the Quality Indicators Survey. Under Medicare’s Inpatient Prospective Payment System, CMS began adjusting payments to hospitals for excessive readmissions of patients for heart attacks, heart failure, and pneumonia during fiscal years beginning on and after October 1, 2012. Long term care facilities will be under increased scrutiny to prevent residents from being readmitted to hospitals for these conditions in particular, and have an opportunity to demonstrate their quality of care by reducing their hospital readmission rates. It is anticipated that hospital readmissions will be a consideration in the (CMS) Five Star ratings.

Office of the Inspector General Activities. The Office of Inspector General’s (OIG) Work Plan for fiscal year 2013, which describes projects that the OIG plans to address during the fiscal year, includes a number of projects related to nursing homes. Reviews of Medicare Part A and Part B payments and services for SNFs will focus on the following: (1) adverse events in post-acute care; (2) Medicare requirements for quality of care; (3) verification of state agency identified deficiencies’ corrections; (4) oversight of poorly performing SNFs; (5) use of atypical antipsychotic drugs; (6) hospitalizations of SNF residents; (7) questionable billing practices for Part B services; and (8) oversight of the accuracy and completeness of MDS data. Medicaid reviews will focus on communicable diseases and MDS data. The OIG plans to continue its efforts in addressing fraud and abuse. While we cannot predict the results of the OIG’s activities, the projects could result in further scrutiny and/or oversight of nursing homes.



**Fraud and Abuse.** There are various federal and state civil and criminal laws and regulations governing a wide array of healthcare provider referrals, relationships and arrangements, including laws and regulations prohibiting fraud by healthcare providers. Many of these complex laws raise issues that have not been clearly interpreted by the relevant governmental authorities and courts. In addition, federal and state governments are devoting increasing attention and resources to anti-fraud initiatives against healthcare providers.

The federal anti-kickback statute is a criminal statute that prohibits the knowing and willful offer, payment, solicitation or receipt of any remuneration in return for, to induce or to arrange for the referral of individuals for any item or service payable by a federal or state healthcare program. There is also a civil analogue. States also have enacted similar statutes covering Medicaid payments, and some states have broader statutes. Some enforcement efforts have targeted relationships between SNFs and ancillary providers, relationships between SNFs and referral sources for SNFs and relationships between SNFs and facilities for which the SNFs serve as referral sources. The federal self-referral law, commonly known as the “Stark Law,” is a civil statute that prohibits a physician from making referrals to an entity for “designated health services” if the physician has a financial relationship with the entity. Some of the services provided in SNFs are classified as designated health services. There are also criminal provisions that prohibit filing false claims or making false statements to receive payment or certification under Medicare and Medicaid, as well as failing to refund overpayments or improper payments. Violation of the anti-kickback statute or Stark Law may form the basis for a federal False Claims Act violation. In addition, the federal False Claims Act allows a private individual with knowledge of fraud to bring a claim on behalf of the federal government and earn a percentage of the federal government’s recovery. Because of these incentives, these so-called “whistleblower” suits have become more frequent. The violation of any of these laws or regulations by an operator may result in the imposition of fines or other penalties, including exclusion from Medicare, Medicaid and all other federal and state healthcare programs.

**Privacy.** Our operators are subject to various federal, state and local laws and regulations designed to protect the confidentiality and security of patient health information, including the federal Health Insurance Portability and Accountability Act of 1996 and the corresponding regulations promulgated thereunder (“HIPAA”). HIPAA was amended by the Health Information Technology For Economic and Clinical Health (“HITECH”) Act, which was part of the American Recovery and Reinvestment Act of 2009, known as the Stimulus Bill. The HITECH Act increases penalties for HIPAA violations, imposes stricter requirements on healthcare providers, expands the scope of enforcement and, in most cases, requires notification if there is a breach of unsecured individual protected health information, including notification to the affected individual(s), the Secretary of the Department of Human Services and, in some cases, the media. Various states have similar laws and regulations that govern the maintenance and safeguarding of patient records, charts and other information generated in connection with the provision of professional medical services. These laws and regulations require our operators to expend the requisite resources to secure protected health information, including the funding of costs associated with technology upgrades. Operators found in violation of HIPAA or any other privacy law or regulation may face large penalties. In addition, compliance with an operator’s notification requirements in the event of a breach of unsecured protected health information could cause reputational harm to an operator’s business.

**Licensing and Certification.** Our operators and facilities are subject to various federal, state and local licensing and certification laws and regulations, including laws and regulations under Medicare and Medicaid requiring operators of SNFs and ALFs to comply with extensive standards governing operations. Governmental agencies administering these laws and regulations regularly inspect our operators’ facilities and investigate complaints. Our operators and their managers receive notices of observed violations and deficiencies from time to time, and sanctions have been imposed from time to time on facilities operated by them.

**Other Laws and Regulations.** Additional federal, state and local laws and regulations affect how our operators conduct their operations, including laws and regulations protecting consumers against deceptive practices and



otherwise generally affecting our operators' management of their property and equipment and the conduct of their operations (including laws and regulations involving fire, health and safety; quality of services, including care and food service; residents' rights, including abuse and neglect laws; and the health standards set by the federal Occupational Safety and Health Administration).

General and Professional Liability. Although arbitration agreements have been effective in limiting general and professional liabilities for long term care providers, there have been national efforts to outlaw the use of pre-dispute arbitration agreements in long term care settings. All of these factors have a potential impact on liability costs of our operators, which could adversely affect our operators' ability to meet their obligations to us.

#### Critical Accounting Policies and Estimates

Our financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP"), and a summary of our significant accounting policies is included in Note 2 – Summary of Significant Accounting Policies to our Annual Report on Form 10-K for the year ended December 31, 2011. Our preparation of the financial statements requires us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and accompanying footnotes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such difference may be material to the consolidated financial statements. We have described our most critical accounting policies in our 2011 Annual Report on Form 10-K in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

On a quarterly basis, we review our accounts receivable as well as our straight-line rents receivable and lease inducement assets to determine their collectability. The determination of collectability of these assets requires significant judgment and is affected by several factors relating to the credit quality of our operators that we regularly monitor, including (i) payment history, (ii) the age of the contractual receivables, (iii) the current economic conditions and reimbursement environment, (iv) the ability of the tenant to perform under the terms of their lease and/or contractual loan agreements and (v) the value of the underlying collateral of the agreement. If we determine collectability of any of our contractual receivables is at risk, we estimate the potential uncollectible amounts and provide an allowance. In the case of a lease recognized on a straight-line basis or existence of lease inducements, we generally provide an allowance for straight-line accounts receivable and/or the lease inducements when certain conditions or indicators of adverse collectability are present.

#### Results of Operations

The following is our discussion of the consolidated results of operations, financial position and liquidity and capital resources, which should be read in conjunction with our unaudited consolidated financial statements and accompanying notes.

#### Three Months Ended September 30, 2012 and 2011

##### Operating Revenues

Our operating revenues for the three months ended September 30, 2012, totaled \$87.1 million, an increase of \$14.3 million over the same period in 2011. The \$14.3 million increase was primarily the result of additional rental income due to (i) new acquisitions in the fourth quarter of 2011 and in the second and third quarter of 2012, (ii) additional mortgage interest income primarily due to (a) the \$92.0 million mortgage loan that we entered into with Ciena in November 2011 and (b) the \$25.0 million mortgage loan that we entered into with White Pine in October 2011, (iii) lease amendments and extensions with existing operators and (iv) additional other investment income primarily due to the December 2011 \$28.0 million note with Signature.

## Operating Expenses

Operating expenses for the three months ended September 30, 2012, totaled \$34.0 million, an increase of approximately \$4.5 million over the same period in 2011. The increase was primarily due to (i) an increase of \$3.4 million of depreciation and amortization due to the (a) fourth quarter 2011 acquisitions of affiliates from CFG and from White Pine, (b) second quarter 2012 acquisitions from Health and Hospital Corporation and from Mark Ide and (c) third quarter 2012 acquisition from Health and Hospital Corporation and (ii) an increase of \$0.5 million in acquisition costs.

## Other Income (Expense)

For the three months ended September 30, 2012, total other expenses were \$24.7 million, an increase of approximately \$0.9 million over the same period in 2011. The increase in interest expense of approximately \$4.0 million was primarily due to an increase in borrowings outstanding, including debt assumed or incurred to finance (i) fourth quarter 2011 acquisitions of affiliates from CFG and from White Pine, (ii) second quarter 2012 acquisitions from Health and Hospital Corporation and from Mark Ide, (iii) third quarter 2012 acquisitions of land and facilities from Health and Hospital Corporation and (iv) the funding of mortgage investments during the fourth quarter of 2011 for Ciena and White Pine, offset by a \$3.1 million write-off of deferred costs associated with the termination of the \$320 million revolving senior secured credit facility (the "2010 Credit Facility") in the third quarter of 2011.

## Nine Months Ended September 30, 2012 and 2011

## Operating Revenues

Our operating revenues for the nine months ended September 30, 2012, totaled \$255.4 million, an increase of \$39.5 million over the same period in 2011. The \$39.5 million increase was primarily the result of additional rental income due to (i) new acquisitions in the fourth quarter of 2011 and second and third quarter of 2012; (ii) lease amendments and extensions, (iii) the transition of FC/SCH facilities to the new operator, (iv) additional mortgage interest income primarily due to (a) the \$92.0 million mortgage loan that we entered into with Ciena in November 2011 and (b) new \$25.0 million mortgage loan that we entered into with White Pine in October 2011 and (v) additional other investment income primarily due to the December 2011 \$28.0 million note with Signature.

## Operating Expenses

Operating expenses for the nine months ended September 30, 2012, totaled \$99.3 million, a decrease of approximately \$19.9 million over the same period in 2011. The decrease was primarily due to (i) a decrease of \$24.7 million associated with the provision for real estate impairment (of which approximately \$24.4 million related to the first quarter 2011 write-down of the Connecticut properties to their estimated fair value as non SNF facilities); (ii) a decrease of \$4.1 million provision for uncollectible accounts associated with FC/SCH's straight-line receivables and lease inducements and (iii) a decrease of \$0.6 million related to expense related to our owned and operated assets, offset by (iv) an increase of \$7.8 million of depreciation and amortization due to (a) the fourth quarter 2011 acquisitions of affiliates from CFG and from White Pine; (b) the second quarter 2012 acquisitions from Health and Hospital Corporation and from Mark Ide and (c) the third quarter 2012 acquisition from Health and Hospital Corporation; (v) an increase of \$1.1 million in general and administrative expenses due to (a) the closed facilities in Connecticut and (b) increased costs associated with the new facilities and (vi) an increase of \$0.6 million in acquisition cost primarily related to the Health and Hospital Corporation acquisition in 2012.



## Other Income (Expense)

For the nine months ended September 30, 2012, total other expenses were \$78.4 million, an increase of approximately \$13.1 million over the same period in 2011. The increase in interest expense of approximately \$10.8 million was primarily due to an increase in borrowings outstanding, including debt assumed or incurred to finance (i) fourth quarter 2011 acquisitions of affiliates from CFG and from White Pine, (ii) second quarter 2012 acquisitions from Health and Hospital Corporation and from Mark Ide, (iii) third quarter 2012 acquisition from Health and Hospital Corporation and (iv) the funding of mortgage investments during the fourth quarter of 2011 for Ciena and White Pine. During the first quarter of 2012, we incurred \$7.1 million in interest refinancing cost including prepayment penalties of approximately \$4.5 million, write-off of deferred costs of \$2.2 million and \$0.4 million of expenses associated with the tender offer and redemption of our outstanding \$175 million 7% 2016 Notes. This was partially offset by a \$1.7 million write-off of the unamortized premium on the four HUD loans that were paid off early during the second quarter of 2012. During the third quarter of 2011, we wrote-off \$3.1 million of deferred costs associated with the termination of the \$320 million 2010 Credit Facility.

## Funds From Operations

Our funds from operations available to common stockholders ("FFO"), for the three months ended September 30, 2012, was \$56.7 million, compared to \$44.5 million, for the same period in 2011. Our funds from operations available to common stockholders ("FFO"), for the nine months ended September 30, 2012, was \$160.7 million, compared to \$126.2 million, for the same period in 2011.

We calculate and report FFO in accordance with the definition and interpretive guidelines issued by the National Association of Real Estate Investment Trusts ("NAREIT"), and, consequently, FFO is defined as net income available to common stockholders, adjusted for the effects of asset dispositions and certain non-cash items, primarily depreciation and amortization and impairment on real estate assets. We believe that FFO is an important supplemental measure of our operating performance. Because the historical cost accounting convention used for real estate assets requires depreciation (except on land), such accounting presentation implies that the value of real estate assets diminishes predictably over time, while real estate values instead have historically risen or fallen with market conditions. The term FFO was designed by the real estate industry to address this issue. FFO herein is not necessarily comparable to FFO of other REITs that do not use the same definition or implementation guidelines or interpret the standards differently from us.

FFO is a non-GAAP financial measure. We use FFO as one of several criteria to measure operating performance of our business. We further believe that by excluding the effect of depreciation, amortization, impairment on real estate assets and gains or losses from sales of real estate, all of which are based on historical costs and which may be of limited relevance in evaluating current performance, FFO can facilitate comparisons of operating performance between periods and between other REITs. We offer this measure to assist the users of our financial statements in evaluating our financial performance under GAAP, and FFO should not be considered a measure of liquidity, an alternative to net income or an indicator of any other performance measure determined in accordance with GAAP. Investors and potential investors in our securities should not rely on this measure as a substitute for any GAAP measure, including net income.

The following table presents our FFO results for the three- and nine- months ended September 30, 2012 and 2011:

	Three Months Ended September 30, 2012		September 30, 2011		Nine Months Ended September 30, 2012		2011	
							(in thousands)	
Net income available to common stockholders	\$30,119		\$21,436		\$86,775		\$28,166	
Deduct gain from real estate dispositions	(1,689)	)	(1,803)	)	(8,973)	)	(1,803)	)
Sub-total	28,430		19,633		77,802		26,363	
Elimination of non-cash items included in net income:								
Depreciation and amortization	28,305		24,871		82,651		74,848	
Add back impairments on real estate properties	—		—		272		24,971	
Funds from operations available to common stockholders	\$56,735		\$44,504		\$160,725		\$126,182	

## Portfolio and Recent Developments

### 2012 Acquisitions

#### Health and Hospital Corporation

On August 31, 2012, we purchased 27 facilities (17 SNFs, four ALFs and six independent living facilities) totaling 2,892 licensed beds in Indiana from an unrelated third party for approximately \$203 million in cash and assumed a liability associated with the lease of approximately \$13.9 million. Simultaneous with the transaction, we also purchased one parcel of land for \$2.8 million. The purchase price of both (i) 27 facilities and (ii) the parcel of land were funded from cash on hand and borrowings from our credit facility. The 27 facilities and land parcel were added to an existing master lease with Health and Hospital Corporation of Marion County, Indiana (“Health and Hospital Corporation”).

We are in the process of obtaining information necessary to complete the process of allocating the fair value of the assets purchased and liabilities assumed. Our preliminary allocation as of September 30, 2012, consists of land of \$16.1 million, building and site improvements of \$189.2 million and furniture and fixtures of \$14.4 million. We allocated approximately \$13.9 million to a liability associated with the lease. For the three months ended September 30, 2012, we incurred approximately \$0.5 million in acquisition related costs.

On June 29, 2012, we purchased four facilities encompassing 383 licensed beds in Indiana for approximately \$21.7 million and leased the facilities to an existing operator. We recorded approximately \$1.9 million for land, \$18.4 million for buildings and site improvements and \$1.4 million for furniture and fixtures.

#### Mark Ide Limited Liability Company

On June 29, 2012, we purchased one facility encompassing 80 licensed beds in Indiana for approximately \$3.4 million and leased the facility to an existing operator. We recorded approximately \$0.2 million for land, \$2.9 million for buildings and site improvements and \$0.3 million for furniture and fixtures.

## 2011 Acquisitions

### Capital Funding Group, Inc.

On December 23, 2011, we purchased 17 SNFs from affiliates of CFG, a new operator to Omega, for an aggregate purchase price of \$128 million. The acquisition consisted of the assumption of \$71 million of indebtedness guaranteed by the Department of Housing and Urban Development (“HUD”) and \$57 million in cash.

The \$71 million of assumed HUD debt was comprised of 15 HUD mortgage loans with a blended interest rate of 5.70% and maturities between October 2029 and July 2044.

The 17 SNFs, representing 1,820 available beds, are located in Arkansas (12), Colorado (1), Florida (1), Michigan (2) and Wisconsin (1). The transaction involved two separate master lease agreements covering all 17 SNFs.

We recorded approximately \$129.9 million consisting of land (\$9.0 million), buildings and site improvements (\$111.5 million) and furniture and fixtures (\$9.4 million). We recorded approximately \$1.9 million of fair value adjustment related to the above market debt assumed based on the terms of comparable debt. On June 29, 2012, we retired four mortgage notes in the amount of \$11.7 million and wrote-off the unamortized premium associated with the mortgages. We did not record goodwill in connection with this transaction.

### Persimmon Ventures, LLC and White Pine Holdings, LLC

During the fourth quarter of 2011, we completed \$86 million of combined new investments with affiliates of Persimmon Ventures, LLC and White Pine, both new operators to Omega. The investments involved a purchase / lease back transaction and a mortgage transaction. The combined transaction consists of 7 facilities and 938 beds.

#### Purchase / Lease Back Transaction

We purchased four SNFs located in Maryland (3) and West Virginia (1), totaling 586 beds for a total investment of \$61 million, including approximately \$1 million to complete renovations at one facility. The consideration consisted of \$31 million in cash and the assumption of \$30 million in HUD – guaranteed indebtedness, which bears an interest rate of 4.87% (weighted-average) and matures between March 2036 and September 2040.

Acquisition costs related to the acquisitions from affiliates of CFG and from White Pine were approximately \$1.2 million in 2011.

#### Mortgage Transaction

We entered into a first mortgage loan with White Pine in the amount of \$25 million secured by a lien on three SNFs, totaling 352 beds, all located in Maryland.

The overall combined transaction totaled \$86 million, consisting of \$56 million in cash and \$30 million in assumed HUD indebtedness, with a combined initial annual yield of approximately 10%.

We recorded approximately \$62.7 million consisting of land (\$4.4 million), buildings and site improvements (\$55.0 million) and furniture and fixtures (\$3.3 million). We funded approximately \$1.3 million in renovation costs for one of the facilities acquired in connection with this transaction and completed the renovation during the third quarter of 2012. We recorded approximately \$3.0 million of fair value adjustment related to the above market debt assumed based on the terms of comparable debt. We estimate amortization will be approximately \$0.2 million per year over

the next five years. We did not record goodwill in connection with this transaction.



## Assets Sold or Held for Sale

### Assets Sold

On January 13, 2012, we sold a SNF in Indiana for approximately \$3.1 million resulting in a gain of approximately \$0.3 million.

On March 23, 2012, an operator in Alaska exercised its purchase option and purchased a SNF for approximately \$11.0 million. We recognized a gain of approximately \$5.1 million in this transaction.

On April 2, 2012, we sold a held-for-sale SNF in Arkansas for approximately \$1.7 million. No gain or loss was recognized in this transaction.

On May 18, 2012, we sold a held-for-sale SNF in Alabama for \$4.5 million resulting in a gain of approximately \$0.4 million.

On June 15, 2012, we sold a held-for-sale SNF in Connecticut for \$1.8 million resulting in a gain of approximately \$1.6 million.

On August 21, 2012, we sold a held-for-sale SNF in Connecticut for \$2.3 million resulting in a gain of approximately \$1.6 million.

### Held for Sale

During the first quarter of 2012, we recorded a \$0.1 million impairment charge to reduce the carrying value of a SNF in Arkansas to its estimated fair value less cost to sell and simultaneously classified the facility as held-for-sale. Also during the first quarter of 2012, we recorded a \$0.1 million impairment charge to reduce the carrying value of a held-for-sale facility that was sold during the quarter.

At September 30, 2012, we had three SNFs and one parcel of land classified as held-for-sale with an aggregate net book value of approximately \$1.6 million.

### Connecticut Properties

In January 2011, upon our request, a complaint was filed by the State of Connecticut, Commissioner of Social Services (the "State") against the licensees/operators of four Connecticut SNFs, seeking the appointment of a receiver. The Superior Court, Judicial District of Hartford, Connecticut (the "Court") appointed a receiver.

The receiver was responsible for (i) operating the facilities and funding all operational expenses incurred after the appointment of the receiver and (ii) for providing the Court with recommendations regarding the facilities. In March 2011, the receiver moved to close all four SNFs and we objected. At the hearing held on April 21, 2011, we stated our position that the receiver failed to comply with the statutory requirements prior to recommending the facilities' closure. In addition, alternative operators expressed interest in operating several of the facilities. On April 27, 2011, the Court granted the receiver's motion and ordered the facilities closed.

We timely filed our notice of appeal, taking the position that the Court's Order was final and appealable, and erroneous. Following our notice of appeal, we negotiated a stipulation with the State and the receiver which afforded us significant concessions. Those concessions included: (a) an agreed recognition of us as a secured lienholder with a priority claim, (b) an accelerated timeframe for the (i) allocation by the receiver of collected funds between pre- and

post-receivership periods, and (ii) disbursement to us of pre-receivership funds collected, and (c) an agreement by the State that it would forego its right to seek recoupment of pre-receivership funds as reimbursement for post-receivership advances. In exchange for these concessions (among others), we withdrew our appeal.

As a result of these developments, during the three month period ended March 31, 2011, we recorded an impairment charge of \$24.4 million to reduce the carrying values of the Connecticut SNFs to their estimated fair values. We estimated the fair value of these facilities based on the facilities' potential sales value assuming that the facilities would not be used as SNFs. As of November 1, 2011, all of the residents of the four facilities had been relocated, and the receiver surrendered possession of all of the facilities to us. We are actively marketing the facilities for sale (for purposes other than the provision of skilled nursing care). See "Assets Sold or Held for Sale" above for more detail.

#### FC/SCH Facilities

During the second quarter of 2011, we entered into a master transition agreement ("2011 MTA") with one of our current lessee/operators and a third party lessee/operator to transition the facilities from the current operator to the new operator. The 2011 MTA closing was subject to receipt of healthcare regulatory approvals from several states for the operating license transfer from the current operator to the new operator. On January 1, 2012, regulatory approval was provided and the former lease was terminated and a new operator entered into a new twelve-year master lease for the facilities. As a result of the 2011 MTA, during the second quarter of 2011, we evaluated the recoverability of the straight-line rent and lease inducements associated with the current lease and recorded a \$4.1 million provision for uncollectible accounts associated with straight-line receivables and lease inducements.

#### Liquidity and Capital Resources

At September 30, 2012, we had total assets of \$2.8 billion, stockholders' equity of \$1.0 billion and debt of \$1.6 billion, representing approximately 60.9% of total capitalization.

#### Financing Activities and Borrowing Arrangements

##### Bank Credit Agreements

At September 30, 2012, we had \$102.0 million outstanding under our \$475 million unsecured revolving credit facility (the "2011 Credit Facility"), and no letters of credit outstanding, leaving availability of \$373.0 million.

The 2011 Credit Facility matures in four years, on August 17, 2015. The 2011 Credit Facility includes an "accordion feature" that permits us to expand our borrowing capacity to \$600 million, under certain conditions.

The 2011 Credit Facility agreement includes an alternative pricing grid for us if we achieve investment grade ratings from at least two of the following rating agencies: (i) Standard & Poor's, (ii) Moody's, and/or (iii) Fitch Ratings. In July, Fitch Ratings initiated coverage of our bonds at an investment grade, thereby achieving investment grade rating from two of the three named rating agencies. As a result, for so long as we maintain two investment grade ratings, our borrowing under the 2011 Credit Facility will be based on this alternative pricing grid, which reduces the borrowing cost under the 2011 Credit Facility to LIBOR plus an applicable percentage ranging from 150 basis points to 210 basis points (including a facility fee). As of September 30, 2012, our applicable percentage above LIBOR was 170 basis points. The 2011 Credit Facility is used for acquisitions and general corporate purposes.

The 2011 Credit Facility contains customary affirmative and negative covenants, including, without limitation, limitations on indebtedness; limitations on investments; limitations on liens; limitations on mergers and consolidations; limitations on sales of assets; limitations on transactions with affiliates; limitations on negative pledges; limitations on prepayment of debt; limitations on use of proceeds; limitations on changes in lines of business; limitations on repurchases of the Company's capital stock if a default or event of default occurs; and maintenance of REIT status. In addition, the 2011 Credit Facility contains financial covenants including, without limitation, those relating to maximum total leverage, maximum secured leverage, maximum unsecured leverage, minimum fixed charge coverage, minimum consolidated tangible net worth, minimum unsecured debt yield, minimum unsecured interest coverage and maximum distributions. As of September 30, 2012, we were in compliance with all affirmative and negative covenants, including financial covenants.

#### \$400 Million 5.875% Senior Notes Exchange Offer

On August 15, 2012, we commenced an offer to exchange \$400 million of our 5.875% Senior Notes due 2024 that have been registered under the Securities Act of 1933 for \$400 million of our outstanding 5.875% Senior Notes due 2024, which were issued on March 19, 2012 in a private placement.

All \$400 million outstanding aggregate principal amount of the initial notes were validly tendered and not withdrawn prior to the expiration of the exchange offer, and were exchanged for exchange notes as of September 20, 2012, pursuant to the terms of the exchange offer. The Exchange Notes are identical in all material respects to the Initial Notes, except that the Exchange Notes were registered under the Securities Act of 1933 and the provisions of the Initial Notes relating to transfer restrictions, registration rights and additional interest will not apply to the Exchange Notes.

#### \$245 Million Equity Shelf Program

On June 19, 2012, we entered into separate Equity Distribution Agreements (collectively, the "2012 Agreements") to sell shares of our common stock having an aggregate gross sales price of up to \$245 million (the "2012 ESP") with each of BB&T Capital Markets, a division of Scott & Stringfellow, LLC, Credit Agricole Securities (USA) Inc., Deutsche Bank Securities Inc., Jefferies & Company, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, RBC Capital Markets, LLC, RBS Securities Inc., Stifel, Nicolaus & Company, Incorporated, SunTrust Robinson Humphrey, Inc. and UBS Securities LLC, each as a sales agent and/or principal (collectively, the "Managers"). Under the terms of the 2012 Agreements, we may sell shares of our common stock, from time to time, through or to the Managers having an aggregate gross sales price of up to \$245 million. Sales of the shares, if any, will be made by means of ordinary brokers' transactions on the New York Stock Exchange at market prices, or as otherwise agreed with the applicable Manager. We will pay each Manager compensation for sales of the shares equal to 2% of the gross sales price per share of shares sold through such Manager under the applicable 2012 Agreement.

We are not obligated to sell and the Managers are not obligated to buy or sell any shares under the 2012 Agreements. No assurance can be given that we will sell any shares under the 2012 Agreements, or, if we do, as to the price or amount of shares that we sell, or the dates when such sales will take place. As of September 30, 2012, 2.6 million shares were issued under the 2012 ESP, at an average price of \$24.10 per share, generating gross proceeds of approximately \$63.6 million, before \$1.3 million of commissions.

#### Termination of \$140 Million Equity Shelf Program

On June 19, 2012, we terminated our \$140 million Equity Shelf Program (the "2010 ESP"). For the three months ended June 30, 2012, we issued 510,000 shares of our common stock under the 2010 ESP generating gross proceeds of approximately \$10.8 million, before \$0.2 million of commissions. For the six months ended June 30, 2012, we issued

approximately 759,000 shares of our common stock under the 2010 ESP at an average price per share of \$21.27, generating gross proceeds of approximately \$16.1 million, before \$0.3 million of commissions. The proceeds of the sale of our common stock were used for working capital and for general corporate purposes, including funding the recent investments described above.

Since inception of the 2010 ESP, we have sold a total of 5.3 million shares of common stock generating total gross proceeds of \$114.9 million under the program, before \$2.3 million of commissions. As a result of the termination of the 2010 ESP, no additional shares were issued under the 2010 ESP.

#### HUD Mortgage Payoffs

On June 29, 2012, we paid approximately \$11.8 million to retire four HUD mortgages that were assumed as part of the acquisition of SNFs from affiliates of CFG. The retirement of the four HUD mortgages resulted in a net gain of approximately \$1.7 million. The net gain included the write-off of approximately \$1.8 million related to marking the debt to market at the time of acquisition of SNFs from affiliates of CFG as well as a prepayment fee of approximately \$0.1 million.

#### Issuance of \$400 Million 5.875% Senior Notes due 2024

On March 19, 2012, we issued \$400 million aggregate principal amount of our 5.875% Senior Notes due 2024, or the 2024 Notes. The 2024 Notes mature on March 15, 2024 and pay interest semi-annually on March 15 and September 15 of each year, commencing on September 15, 2012.

We may redeem the 2024 Notes, in whole at any time or in part from time to time, at redemption prices of 102.938%, 101.958% and 100.979% of the principal amount thereof if the redemption occurs during the 12-month periods beginning on March 15 of the years 2017, 2018 and 2019, respectively, and at a redemption price of 100% of the principal amount thereof on and after March 15, 2020, in each case, plus any accrued and unpaid interest to the redemption date. In addition, until March 15, 2015 we may redeem up to 35% of the 2024 Notes with the net cash proceeds of one or more public equity offerings at a redemption price of 105.875% of the principal amount of the 2024 Notes to be so redeemed, plus any accrued and unpaid interest to the redemption date. If we undergo a change of control, we may be required to offer to purchase the notes from holders at a purchase price equal to 101% of the principal amount plus accrued interest.

The 2024 Notes were sold at an issue price of 100% of the principal amount. We used the net proceeds of the offering to fund the tender offer and consent solicitation for the 2016 Notes (described below), to fund the redemption of the untendered 2016 Notes (described below) and to repay a portion of our indebtedness outstanding under our 2011 Credit Facility. As of September 30, 2012, our subsidiaries that are not guarantors of the 2024 Notes accounted for approximately \$465 million of our total assets.

#### \$175 Million 7% Senior Notes due 2016 Tender Offer and Redemption

On March 5, 2012, we commenced a tender offer to purchase for cash any and all of our outstanding \$175 million aggregate principal amount of 7% Senior Notes due 2016, or the 2016 Notes. Pursuant to the terms of the tender offer, on March 19, 2012, we purchased \$168.9 million aggregate principal amount of the 2016 Notes.

On March 27, 2012, pursuant to the terms of the indenture governing the 2016 Notes, we redeemed the remaining \$6.1 million aggregate principal amount of the 2016 Notes at a redemption price of 102.333% of their principal amount, plus accrued and unpaid interest up to the redemption date. Following redemption, the 2016 Notes, the indenture governing the 2016 Notes and the related guarantees were terminated.

The redemption resulted in approximately \$7.1 million of expenses, including \$4.5 million in payments made to bondholders for early redemption, \$2.2 million of write offs associated with deferred costs and \$0.4 million of expenses associated with the tender and redemption.



## Dividend Reinvestment and Common Stock Purchase Plan

For the nine-month period ended September 30, 2012, approximately 4.8 million shares of our common stock were issued through our Dividend Reinvestment and Common Stock Purchase Program for net proceeds of approximately \$106.1 million.

## Dividends

In order to qualify as a REIT, we are required to distribute dividends (other than capital gain dividends) to our stockholders in an amount at least equal to (A) the sum of (i) 90% of our "REIT taxable income" (computed without regard to the dividends paid deduction and our net capital gain), and (ii) 90% of the net income (after tax), if any, from foreclosure property, minus (B) the sum of certain items of non-cash income. In addition, if we dispose of any built-in gain asset during a recognition period, we will be required to distribute at least 90% of the built-in gain (after tax), if any, recognized on the disposition of such asset. Such distributions must be paid in the taxable year to which they relate, or in the following taxable year if declared before we timely file our tax return for such year and paid on or before the first regular dividend payment after such declaration. In addition, such distributions are required to be made pro rata, with no preference to any share of stock as compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that such class is entitled to such a preference. To the extent that we do not distribute all of our net capital gain or do distribute at least 90%, but less than 100% of our "REIT taxable income" as adjusted, we will be subject to tax thereon at regular ordinary and capital gain corporate tax rates.

In addition, our 2011 Credit Facility has certain financial covenants that limit the distribution of dividends paid during a fiscal quarter to no more than 95% of our aggregate cumulative FFO as defined in the credit agreement, unless a greater distribution is required to maintain REIT status. Solely for purposes of the credit agreement, FFO is defined as net income (or loss) plus depreciation and amortization, adjusted to exclude gains or losses resulting from: (i) restructuring our debt; (ii) sales of property; (iii) sales or redemptions of preferred stock; (iv) revenue or expenses related to owned and operated assets; (v) cash litigation charges up to \$10.0 million over the term of the credit agreement; (vi) non-cash charges associated with the write-down of accounts due to straight-line rent; (vii) other non-cash charges for accounts and notes receivable up to \$20.0 million over the term of the credit agreement; (viii) certain non-cash compensation related expenses; (ix) non-cash real property impairment charges; (x) non-cash charges associated with the sale or settlement of derivative instruments; and (xi) charges related to acquisition deal-related costs.

For the three- and nine- months ended September 30, 2012, we paid total dividends of \$45.7 million and \$132.7 million, respectively.

On October 17, 2012, the Board of Directors declared a common stock dividend of \$0.44 per share, increasing the quarterly dividend by \$0.02 per share, or 4.8% over the previous quarter, to be paid November 15, 2012 to common stockholders of record on October 31, 2012.

## Liquidity

We believe our liquidity and various sources of available capital, including cash from operations, our existing availability under our 2011 Credit Facility and expected proceeds from mortgage payoffs are adequate to finance operations, meet recurring debt service requirements and fund future investments through the next twelve months.





We regularly review our liquidity needs, the adequacy of cash flow from operations, and other expected liquidity sources to meet these needs. We believe our principal short-term liquidity needs are to fund:

- normal recurring expenses;
- debt service payments;
- common stock dividends; and
- growth through acquisitions of additional properties.

The primary source of liquidity is our cash flows from operations. Operating cash flows have historically been determined by: (i) the number of facilities we lease or have mortgages on; (ii) rental and mortgage rates; (iii) our debt service obligations; and (iv) general and administrative expenses. The timing, source and amount of cash flows provided by financing activities and used in investing activities are sensitive to the capital markets environment, especially to changes in interest rates. Changes in the capital markets environment may impact the availability of cost-effective capital and affect our plans for acquisition and disposition activity.

Cash and cash equivalents totaled \$7.0 million as of September 30, 2012, an increase of \$6.6 million as compared to the balance at December 31, 2011. The following is a discussion of changes in cash and cash equivalents due to operating, investing and financing activities, which are presented in our Consolidated Statements of Cash Flows.

**Operating Activities** – Net cash flow from operating activities generated \$157.0 million for the nine months ended September 30, 2012, as compared to \$129.0 million for the same period in 2011, an increase of \$28.0 million. The increase is primarily due to: (i) the rental revenue from the fourth quarter 2011 acquisitions of White Pine and affiliates of CFG and 2012 acquisitions of Health and Hospital Corporation and Mark Ide and (ii) the placement of additional mortgages, offset by additional interest associated with financing the acquisitions and new mortgages.

**Investing Activities** – Net cash flow from investing activities was an outflow of \$228.2 million for the nine months ended September 30, 2012, as compared to an outflow of \$20.0 million for the same period in 2011. The \$208.2 million increase in cash outflow from investing activities relates primarily to (i) a \$1.9 million purchase of land in the first quarter of 2012, a \$25.1 million purchase of five SNFs in the second quarter of 2012 and a \$205.7 million purchase of 27 facilities in the third quarter of 2012 and (ii) an additional \$8.1 million investment in capital improvement projects compared to the same period in 2011. Offsetting increases of the cash outflow were: (i) \$24.2 million in proceeds from the sale of real estate in 2012, as compared to \$4.2 million for the same period in 2011 and (ii) an increase in net proceeds of \$8.8 million from other investments – net compared to the same period in 2011.

**Financing Activities** – Net cash flow from financing activities was an inflow of \$77.8 million for the nine months ended September 30, 2012 as compared to an outflow of \$105.2 million for the same period in 2011. The \$183.0 million change in financing activities was primarily a result of: (i) a net payment of \$170.5 million on the 2011 Credit Facility during the nine months of 2012 compared to \$45.0 million of net proceeds for the same period in 2011; (ii) net proceeds of \$400 million from our 5.875% Senior Notes due 2024 issued in March 2012; (iii) a \$187.8 million change in payments of long term borrowings including (a) \$175.0 million tender offer and redemption payments for our outstanding \$175 million 2016 Notes in March 2012, (b) \$11.7 million early retirement of four HUD mortgages in June 2012 and (c) \$2.9 million in routine HUD debt principal payments during the nine months of 2012 as compared to \$1.8 million for the same period in 2011; (iv) an increase in payment of \$8.9 million related to deferred financing costs and refinancing costs primarily associated with (a) the issuance of our \$400 million 5.875% Senior Notes due 2024 in March 2012, (b) the tender offer and redemption of our outstanding \$175 million 2016 Notes in March 2012 and (c) a prepayment penalty related to the early retirement of four HUD mortgages in June 2012; (v) an increase in net proceeds of \$51.2 million from our dividend reinvestment plan during the nine months of 2012 compared to the same period in 2011; (vi) an increase in net proceeds of \$46.4 million from our common stock issued through our Equity Shelf Program during the nine months of 2012 as compared to the same period in 2011; (vii) an increase in

dividend payments of \$12.2 million related to an increase in number of shares outstanding and an increase of \$0.10 per share in the dividends and (viii) the impact of the \$108.6 million preferred stock redemption in the first quarter of 2011.

### Item 3 – Quantitative and Qualitative Disclosures about Market Risk

We are exposed to various market risks, including the potential loss arising from adverse changes in interest rates. We do not enter into derivatives or other financial instruments for trading or speculative purposes, but we seek to mitigate the effects of fluctuations in interest rates by matching the term of new investments with new long-term fixed rate borrowing to the extent possible.

The interest rate charged on our 2011 Credit Facility can vary based on the interest rate option we choose to utilize. The interest rates per annum applicable to the 2011 Credit Facility are the reserve adjusted LIBOR Rate (the “Eurodollar Rate” or “Eurodollar”), plus the applicable margin (as defined below) or, at our option, the base rate, which will be the highest of (i) the rate of interest publicly announced by the administrative agent as its prime rate in effect, (ii) the federal funds effective rate from time to time plus 0.50% and (iii) the Eurodollar Rate determined on such day for a Eurodollar Loan with an interest period of one month plus 1.0%, in each case, plus the applicable margin (as defined below). In July 2012 we received an investment grade rating for our senior unsecured debt from a second rating agency (Fitch). So long as we maintain at least two investment grade ratings for our senior unsecured debt from S&P, Moody’s or Fitch, the applicable margin with respect to the 2011 Credit Facility is determined in accordance with a grid based on such debt ratings. The applicable margin may range from 1.70% to 1.25% in the case of Eurodollar advances, and from 0.70% to 0.25% in the case of base rate advances. Letter of credit fees may range from 1.70% to 1.25% per annum, based on the same debt ratings grid. As of September 30, 2012, the total amount of debt outstanding on the 2011 Credit Facility was \$102.0 million, which is subject to interest rate fluctuations.

For additional information, refer to Item 7A as presented in our annual report on Form 10-K for the year ended December 31, 2011.

### Item 4 – Controls and Procedures

Disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) are controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

In connection with the preparation of this Form 10-Q, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2012. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at a reasonable assurance level as of September 30, 2012.

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the period covered by this report identified in connection with the evaluation of our disclosure controls and procedures described above that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1 – Legal Proceedings

See Note 10 – Litigation to the Consolidated Financial Statements in Part I, Item 1 hereto, which is hereby incorporated by reference in response to this item.

### Item 1A – Risk Factors

We filed our Annual Report on Form 10-K for the year ended December 31, 2011, with the Securities and Exchange Commission on February 27, 2012, which sets forth our risk factors in Item 1A therein, as supplemented in Part II, Item 1A to our Quarterly Report on Form 10-Q for the three months ended March 31, 2012 and June 30, 2012. We have not experienced any material changes from the risk factors previously described therein.

Item 6 – Exhibits

Exhibit No.

10.1	Amended and Restated Deferred Stock Plan, dated October 16, 2012, and forms of related agreements.+*
31.1	Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.
32.1	Section 1350 Certification of the Chief Executive Officer.
32.2	Section 1350 Certification of the Chief Financial Officer.
101.INS	XBRL Instance Document.**
101.SCH	XBRL Taxonomy Extension Schema Document.**
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.**
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.**
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.**
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.**

\* Exhibits that are filed herewith.

+ Management contract or compensatory plan, contract or arrangement.

\*\*In accordance with Rule 406T of Regulation S-T, this XBRL-related information shall be deemed to be “furnished” and not “filed.”

SIGNATURES

Pursuant to the requirements 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.

OMEGA HEALTHCARE INVESTORS, INC.

Registrant

Date: November 7, 2012

By: /S/ C. TAYLOR PICKETT  
C. Taylor Pickett  
Chief Executive Officer

Date: November 7, 2012

By: /S/ ROBERT O. STEPHENSON  
Robert O. Stephenson  
Chief Financial Officer