

OMEGA HEALTHCARE INVESTORS INC  
Form 10-Q  
November 07, 2014

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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, 2014

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

38-3041398

(State of incorporation)

(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 website, 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, 2014.

|                               |                    |
|-------------------------------|--------------------|
| Common Stock, \$.10 par value | <b>127,427,232</b> |
| (Class)                       | (Number of shares) |

OMEGA HEALTHCARE INVESTORS, INC.

FORM 10-Q

September 30, 2014

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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<br>30,<br>2014<br>(Unaudited) | December<br>31,<br>2013 |
|---|---|-------------------------|
| <b>ASSETS</b>   |   |                         |
| Real estate properties  |   |                         |
| Land and buildings  | \$3,143,356                             | \$3,099,547             |
| Less accumulated depreciation   | (794,105 )                              | (707,410 )              |
| Real estate properties – net  | 2,349,251                               | 2,392,137               |
| Investment in direct financing leases   | 536,687                                 | 529,445                 |
| Mortgage notes receivable – net   | 647,590                                 | 241,515                 |
|   | 3,533,528                               | 3,163,097               |
| Other investments – net   | 51,852                                  | 53,054                  |
|   | 3,585,380                               | 3,216,151               |
| Assets held for sale  | 6,670                                   | 1,356                   |
| Total investments   | 3,592,050                               | 3,217,507               |
| Cash and cash equivalents   | 452                                     | 2,616                   |
| Restricted cash   | 31,821                                  | 31,759                  |
| Accounts receivable – net   | 162,628                                 | 147,504                 |
| Other assets  | 70,551                                  | 62,830                  |
| Total assets  | \$3,857,502                             | \$3,462,216             |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |   |                         |
| Revolving line of credit  | \$3,000                                 | \$326,000               |
| Term loan   | 200,000                                 | 200,000                 |
| Secured borrowings  | 256,403                                 | 298,531                 |
| Unsecured borrowings – net  | 1,841,977                               | 1,199,887               |
| Accrued expenses and other liabilities  | 149,745                                 | 137,695                 |
| Total liabilities   | 2,451,125                               | 2,162,113               |
| Stockholders' equity:   |   |                         |
| Common stock \$.10 par value authorized – 200,000 shares issued and outstanding – 127,408 shares as of September 30, 2014 and 123,530 as of December 31, 2013 | 12,741                                  | 12,353                  |
| Common stock – additional paid-in capital   | 2,131,033                               | 1,998,169               |
| Cumulative net earnings   | 1,091,008                               | 926,649                 |
| Cumulative dividends paid   | (1,828,405)                             | (1,637,068)             |
| Total stockholders' equity  | 1,406,377                               | 1,300,103               |
| Total liabilities and stockholders' equity  | \$3,857,502                             | \$3,462,216             |

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited

(in thousands, except per share amounts)

|   | Three Months Ended |           | Nine Months Ended |           |
|---|--------------------|-----------|-------------------|-----------|
|   | September 30,      |           | September 30,     |           |
|   | 2014               | 2013      | 2014              | 2013      |
| <b>Revenue</b>  |                    |           |                   |           |
| Rental income   | \$97,536           | \$93,837  | \$289,696         | \$280,015 |
| Income from direct financing leases                                   | 14,211             | -         | 42,441            | -         |
| Mortgage interest income  | 16,883             | 7,289     | 36,132            | 22,070    |
| Other investment income – net   | 2,035              | 2,175     | 5,197             | 5,492     |
| Total operating revenues  | 130,665            | 103,301   | 373,466           | 307,577   |
| <b>Expenses</b>   |                    |           |                   |           |
| Depreciation and amortization   | 30,111             | 32,202    | 92,856            | 96,386    |
| General and administrative  | 5,987              | 5,462     | 18,781            | 16,142    |
| Acquisition costs   | 259                | (9 )      | 399               | 134       |
| Impairment loss on real estate properties                             | 2,102              | -         | 3,660             | -         |
| Provisions for uncollectible mortgages, notes and accounts receivable | (15 )              | 2,321     | 2,730             | 2,386     |
| Total operating expenses  | 38,444             | 39,976    | 118,426           | 115,048   |
| Income before other income and expense                                | 92,221             | 63,325    | 255,040           | 192,529   |
| <b>Other income (expense)</b>   |                    |           |                   |           |
| Interest income   | 11                 | 3         | 36                | 20        |
| Interest expense  | (30,873 )          | (24,492 ) | (87,401 )         | (75,116 ) |
| Interest – amortization of deferred financing costs                   | (1,243 )           | (699 )    | (3,111 )          | (2,079 )  |
| Interest – refinancing gain (costs)                                   | 1,617              | -         | (3,068 )          | 11,112    |
| Total other expense   | (30,488 )          | (25,188 ) | (93,544 )         | (66,063 ) |
| Income before gain (loss) on assets sold                              | 61,733             | 38,137    | 161,496           | 126,466   |
| (Loss) gain on assets sold – net                                      | (20 )              | -         | 2,863             | (1,151 )  |
| Net income available to common stockholders                           | \$61,713           | \$38,137  | \$164,359         | \$125,315 |
| <b>Income per common share available to common shareholders:</b>      |                    |           |                   |           |
| <b>Basic:</b>   |                    |           |                   |           |
| Net income  | \$0.48             | \$0.32    | \$1.30            | \$1.08    |
| <b>Diluted:</b>   |                    |           |                   |           |
| Net income  | \$0.48             | \$0.32    | \$1.30            | \$1.08    |
| Dividends declared and paid per common share                          | \$0.51             | \$0.47    | \$1.50            | \$1.38    |
| Weighted-average shares outstanding, basic                            | 127,464            | 117,600   | 126,132           | 115,527   |
| Weighted-average shares outstanding, diluted                          | 128,428            | 118,462   | 126,895           | 116,335   |

See notes to consolidated financial statements.

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

|   | Common<br>Stock Par<br>Value | Additional<br>Paid-in<br>Capital | Cumulative<br>Net<br>Earnings | Cumulative<br>Dividends | Total        |
|---|------------------------------|----------------------------------|-------------------------------|-------------------------|--------------|
| Balance at December 31, 2013 (123,530 common shares)                                      | \$ 12,353                    | \$ 1,998,169                     | \$ 926,649                    | \$(1,637,068)           | \$ 1,300,103 |
| Grant of restricted stock to company directors (12 shares at \$35.79 per share)           | 1                            | (1 )                             | —                             | —                       | —            |
| Amortization of restricted stock  | —                            | 6,424                            | —                             | —                       | 6,424        |
| Vesting of restricted stock to company executives, net of tax withholdings (70 shares)    | 7                            | (1,589 )                         | —                             | —                       | (1,582 )     |
| Dividend reinvestment plan (1,944 shares at \$34.09 per share)                            | 195                          | 66,068                           | —                             | —                       | 66,263       |
| Grant of stock as payment of directors fees (4 shares at an average of \$34.85 per share) | —                            | 150                              | —                             | —                       | 150          |
| Equity Shelf Program (1,848 shares at \$34.33 per share, net of issuance costs)           | 185                          | 61,812                           | —                             | —                       | 61,997       |
| Net income  | —                            | —                                | 164,359                       | —                       | 164,359      |
| Common dividends (\$1.50 per share)   | —                            | —                                | —                             | (191,337 )              | (191,337 )   |
| Balance at September 30, 2014 (127,408 common shares)                                     | \$ 12,741                    | \$ 2,131,033                     | \$ 1,091,008                  | \$(1,828,405)           | \$ 1,406,377 |

See notes to consolidated financial statements.



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

|   | Nine months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2014                               | 2013       |
| Cash flows from operating activities  |                                    |            |
| Net income  | \$164,359                          | \$125,315  |
| Adjustment to reconcile net income to cash provided by operating activities:  |                                    |            |
| Depreciation and amortization   | 92,856                             | 96,386     |
| Provision for impairment on real estate properties                            | 3,660                              | —          |
| Provision for uncollectible mortgages, notes and accounts receivable          | 2,730                              | 2,386      |
| Amortization of deferred financing and debt extinguishment costs (gain)       | 6,179                              | (9,033 )   |
| Accretion of direct financing leases  | (7,242 )                           | —          |
| Restricted stock amortization expense   | 6,570                              | 4,433      |
| (Gain) loss on assets sold – net  | (2,863 )                           | 1,151      |
| Amortization of acquired in-place leases - net                                | (3,779 )                           | (3,821 )   |
| Change in operating assets and liabilities – net of amounts assumed/acquired: |                                    |            |
| Accounts receivable, net  | (2,252 )                           | (61 )      |
| Straight-line rent receivables  | (15,919 )                          | (20,385 )  |
| Lease inducements   | 2,009                              | 2,230      |
| Effective yield receivable on mortgage notes                                  | (1,731 )                           | (1,416 )   |
| Other operating assets and liabilities  | 15,017                             | 2,865      |
| Net cash provided by operating activities                                     | 259,594                            | 200,050    |
| Cash flows from investing activities  |                                    |            |
| Acquisition of real estate – net of liabilities assumed and escrows acquired  | (47,500 )                          | (2,400 )   |
| Deposit for proposed capital lease  | —                                  | (15,000 )  |
| Placement of mortgage loans   | (528,780 )                         | (3,227 )   |
| Proceeds from sale of real estate investments – net                           | 4,054                              | 2,288      |
| Capital improvements to real estate investments                               | (12,684 )                          | (23,732 )  |
| Proceeds from other investments   | 7,952                              | 4,113      |
| Investments in other investments  | (6,711 )                           | (32,195 )  |
| Collection of mortgage principal  | 122,705                            | 358        |
| Net cash used in investing activities   | (460,964 )                         | (69,795 )  |
| Cash flows from financing activities  |                                    |            |
| Proceeds from credit facility borrowings                                      | 756,000                            | 201,000    |
| Payments on credit facility borrowings  | (1,079,000)                        | (259,000 ) |
| Receipts of other long-term borrowings  | 842,148                            | 59,355     |
| Payments of other long-term borrowings  | (238,032 )                         | (113,418 ) |
| Payments of financing related costs   | (17,319 )                          | (1,053 )   |
| Receipts from dividend reinvestment plan                                      | 66,263                             | 47,821     |
| Payments for exercised options and restricted stock – net                     | (1,582 )                           | —          |
| Net proceeds from issuance of common stock                                    | 61,997                             | 160,159    |
| Dividends paid  | (191,269 )                         | (159,073 ) |
| Net cash provided by (used in) financing activities                           | 199,206                            | (64,209 )  |

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|   |          |   |          |
|---|----------|---|----------|
| (Decrease) increase in cash and cash equivalents            | (2,164   | ) | 66,046   |
| Cash and cash equivalents at beginning of period            | 2,616    |   | 1,711    |
| Cash and cash equivalents at end of period                  | \$452    |   | \$67,757 |
| Interest paid during the period, net of amounts capitalized | \$76,276 |   | \$75,848 |

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Unaudited  
September 30, 2014

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. The results of operations for the interim periods reported herein are not necessarily indicative of results to be expected for the full year. 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 and (ii) all direct and indirect wholly owned subsidiaries of Omega. All inter-company accounts and transactions have been eliminated in consolidation of the financial statements.

Recent Accounting Pronouncements

Discontinued Operations

In April 2014, we adopted the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Update No 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity (ASU 2014-08). ASU 2014-08 changes the criteria for determining which disposals can be presented as discontinued operations and modified related disclosure requirements. Under the new guidance, a discontinued operation is defined as: (i) a disposal of a component or group of components that is disposed of or is classified as held for sale that represents a strategic shift that has or will have a major effect on an entity’s operations and financial results or (ii) an acquired business or nonprofit activity that is classified as held for sale on the date of acquisition. The standard states that a strategic shift could include a disposal of (i) a major geographical area of operations, (ii) a major line of business, (iii) a major equity method investment, or (iv) other major parts of an entity.

The standard expands the disclosures for discontinued operations and requires new disclosures related to individually material disposals that do not meet the definition of a discontinued operation, an entity's continuing involvement with a discontinued operation following the disposal date and retained equity method investments in a discontinued operation. The guidance is effective for annual periods beginning on or after December 15, 2014 and interim periods within that year. Early adoption is permitted, and calendar year-end companies may early adopt the guidance in the first quarter of 2014, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issue. We have chosen to adopt the guidance effective January 1, 2014 and determined that the adoption had no impact on our consolidated financial statements.

## Revenue Recognition

In May 2014, the FASB issued a comprehensive new revenue recognition standard that will supersede nearly all existing revenue recognition guidance under GAAP. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. We will be required to apply the new standard in the first quarter of 2017 and are assessing whether the new standard will have a material effect on our financial position or results of operations.

## 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,<br>2014 | December 31,<br>2013 |
|--------------------------------------|-----------------------|----------------------|
|                                      | (in thousands)        |                      |
| Contractual receivables              | \$ 5,132              | \$ 2,941             |
| Effective yield interest receivables | 5,085                 | 5,333                |
| Straight-line receivables            | 138,615               | 123,486              |
| Lease inducements                    | 14,219                | 16,228               |
| Allowance                            | (423 )                | (484 )               |
| Accounts receivable – net            | \$ 162,628            | \$ 147,504           |

During the nine-months ended September 30, 2014, we wrote-off (i) \$0.8 million of straight-line rent receivables associated with a lease amendment to an existing operator for two facilities that were transitioned to a new operator and (ii) \$2.0 million of effective yield interest receivables associated with the termination of our mortgage note that

was due November 2021. See Note 2 – Properties and Investments for additional information related to the early termination of the November 2021 mortgage note.

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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.

#### Leased Property

Our leased real estate properties, represented by 423 SNFs, 18 assisted living facilities (“ALFs”) and 11 specialty facilities at September 30, 2014, 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.

#### \$8 Million New Investment in Q3 2014

On July 1, 2014, we purchased one SNF located in Texas from an unrelated third party for approximately \$8.2 million and leased it to an existing operator of Omega. The 125 bed SNF was added to the operator's existing master lease with an initial annual cash yield of 9.5%. We allocated approximately \$8.2 million consisting of land (\$0.4 million), building and site improvements (\$7.4 million), and furniture and fixtures (\$0.4 million). We have not recorded goodwill in connection with this transaction.

#### Transition of Two West Virginia Facilities to a New Operator in Q3 2014

On July 1, 2014, we transitioned two West Virginia SNFs that we previously leased to Diversicare Healthcare Services (“Diversicare” and formerly known as Advocat) to a new unrelated third party operator. The two facilities represent 150 operating beds. We amended our Diversicare master lease to reflect the transition of the two facilities to the new operator and for the nine-months ended September 30, 2014 recorded a \$0.8 million provision for uncollectible straight-line accounts receivable. Simultaneous with the Diversicare master lease amendment, we entered into a 12-year master lease with a new third party operator.

#### \$34.6 Million of New Investments in Q2 and Q3 2014

On June 27, 2014, we purchased two SNFs from an unrelated third party for approximately \$17.3 million and leased them to an existing operator of Omega. The SNFs, located in Georgia and South Carolina with a total of 213 beds, were combined into a 12 year master lease with an initial annual cash yield of 9.5%.



In the third quarter of 2014, we purchased a third SNF in South Carolina with 132 beds that was added to the master lease. The combined purchase price, including the third SNF was \$34.6 million. We allocated approximately \$34.6 million consisting of land (\$0.9 million), building and site improvements (\$32.1 million), and furniture and fixtures (\$1.6 million). We have not recorded goodwill in connection with this transaction.

#### \$4.7 Million of New Investment in Q1 2014

On January 30, 2014, we acquired an ALF in Arizona from an unrelated third party for approximately \$4.7 million. The operations of the 90 bed facility were transitioned to an existing operator of Omega. We allocated approximately \$4.7 million consisting of land (\$0.4 million), building and site improvements (\$3.9 million), and furniture and fixtures (\$0.4 million). We have not recorded goodwill in connection with this transaction.

#### Pro Forma Acquisition Results

The facilities acquired in 2014 and 2013 are included in our results of operations from the date of acquisition. The following unaudited pro forma results of operations reflect the impact of the transactions as if they occurred on January 1, 2013. For a list of the 2013 transactions, refer to Note 3 – Properties in our 2013 Form 10-K. 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<br>September 30,<br>2014         |           | Nine Months Ended<br>September 30,<br>2014 |           |
|   | 2014  | 2013      | 2014                                       | 2013      |
|   | (in thousands, except per share amounts, unaudited) |           |  |           |
| Revenues  | \$130,823   | \$105,358 | \$376,015                                  | \$313,748 |
| Net income available to common stockholders               | \$61,788  | \$38,949  | \$165,373                                  | \$127,751 |
| Earnings per share – diluted:                             |   |           |  |           |
| Net income available to common stockholders – as reported | \$0.48  | \$0.32    | \$1.30                                     | \$1.08    |
| Net income available to common stockholders – pro forma   | \$0.48  | \$0.33    | \$1.30                                     | \$1.10    |

#### Assets Sold or Assets Held for Sale

##### Assets Sold and Closures

During the three-month period ended September 30, 2014, we sold a closed held-for-sale SNF in Indiana for approximately \$0.1 million, resulting in a \$20 thousand loss. We closed one SNF in Texas, and recorded a \$2.1 million impairment charge to reduce the carrying value of the facility to its estimated fair value. We also reclassified one SNF in Vermont with a carrying value of approximately \$6.0 million to assets held-for-sale and recorded a \$23 thousand impairment charge to reduce the carrying value of the facility to its estimated fair value.

In the second quarter of 2014, we sold a parcel of undeveloped land in Texas to a third party for approximately \$0.3 million. We also closed a 75 bed developmental disability facility in Indiana and recorded a \$1.6 million impairment charge to reduce the carrying value of the facility to its estimated fair value based upon estimated future cash flows less cost to sell (Level 3).

In the first quarter of 2014, we sold one SNF in Louisiana for approximately \$1.0 million, resulting in a \$0.8 million gain. We also sold two closed held-for-sale SNFs for total cash proceeds of \$2.6 million, generating a \$2.1 million gain.

#### Assets Held for Sale

At September 30, 2014, we had one SNF and one parcel of land classified as held-for-sale with an aggregate net book value of approximately \$6.7 million.

#### Mortgage Notes Receivables

Our mortgage notes receivables relate to 13 fixed-rate mortgages on 53 SNFs and two ALFs. 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 states, which are operated by five 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, 2014, none of our mortgages were in default or in foreclosure proceedings. Where appropriate, the mortgaged properties are generally cross-collateralized with the master lease agreement with the same operator.

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.

#### \$415 Million of New Investment in Q2 2014

On June 30, 2014, we entered into an agreement to refinance/consolidate \$117 million in existing mortgages on 17 facilities into one mortgage and simultaneously provide mortgage financing for an additional 14 facilities. The new \$415 million mortgage is secured by 31 facilities totaling 3,430 licensed beds all located in the state of Michigan. The new loan bears an initial annual cash interest rate of 9.0% and increases by 0.225% per year (e.g., beginning in year 2 the interest rate will be 9.225%, in year 3 the rate will be 9.45%, etc.).

One of the existing mortgages that was refinanced/consolidated into the new \$415 million mortgage included annual interest rate escalators and required the mortgagee to pay a prepayment penalty in the event the mortgage was retired early which resulted in us recording an effective yield interest receivable. In connection with the refinancing/consolidating transaction which was entered into at market terms, the old mortgage was considered to be retired early since the modifications made to the terms of the mortgage were more than minor. As of the date of the refinancing/consolidation transaction, the effective yield interest receivable was approximately \$2.0 million. We forgave the prepayment penalty associated with the retired mortgage and recorded a \$2.0 million provision to write-off the effective yield interest receivable related to the retired mortgage.

\$113 Million of New Investment in Q1 2014

On January 17, 2014, we entered into a \$112.5 million first mortgage loan with an existing operator of Omega. The loan is secured by 7 SNFs and 2 ALFs totaling 798 operating beds located in Pennsylvania (7) and Ohio (2). The loan is cross-defaulted and cross-collateralized with our existing master lease with the operator. The loan bears an initial annual cash interest rate of 9.5% and matures in January 2024.

## NOTE 3 – DIRECT FINANCING LEASES

The components of investment in direct financing leases consist of the following:

|   | September 30,<br>2014 | December 31,<br>2013 |
|---|-----------------------|----------------------|
|   | (in thousands)        |                      |
| Minimum lease payments receivable             | \$ 4,255,817          | \$ 4,291,067         |
| Estimated residual values                     | —                     | —                    |
| Less unearned income                          | (3,719,130)           | (3,761,622)          |
| Investment in direct financing leases         | \$ 536,687            | \$ 529,445           |
| <br>  |                       |                      |
| Properties subject to direct financing leases | 56                    | 56                   |

On November 27, 2013, we closed on an aggregate \$529 million purchase/leaseback transaction in connection with the acquisition of Ark Holding Company, Inc. (“Ark Holding”) by 4 West Holdings Inc. At closing, we acquired 55 SNFs and 1 ALF operated by Ark Holding and leased the facilities back to Ark Holding, now known as New Ark Investment Inc. (“New Ark”), pursuant to four 50-year master leases, with rental payments yielding 10.6% per annum over the term of the leases. The purchase/leaseback transaction is being accounted for as a direct financing lease.

The lease agreements allow the tenant the right to purchase the facilities for a bargain purchase price plus closing costs at the end of term. In addition, commencing in the 41st year of each lease, the tenant will have the right to prepay the remainder of its obligations thereunder for an amount equal to the sum of the unamortized portion of the original aggregate \$529 million investment plus the net present value of the remaining payments under the lease, and closing costs. In the event the tenant exercises either of these options, we have the right to purchase the properties for fair market value at the time.

The 56 facilities represent 5,623 licensed beds located in 12 states, predominantly in the southeastern United States. The 56 facilities are separated by region and divided amongst four cross-defaulted master leases. The four regions include the Southeast (39 facilities), the Northwest (7 facilities), Texas (9 facilities) and Indiana (1 facility). As of September 30, 2014, the following minimum rents are due under our direct financing leases for the next five years (in thousands):

| Year 1   | Year 2   | Year 3   | Year 4   | Year 5   |
|----------|----------|----------|----------|----------|
| \$47,000 | \$47,000 | \$47,319 | \$48,370 | \$49,580 |

## NOTE 4 – OTHER INVESTMENTS

A summary of our other investments is as follows:

|   | September 30,<br>2014 | December 31,<br>2013 |
|---|-----------------------|----------------------|
|   | (in thousands)        |                      |
| Other investment note due 2015                | \$ 2,168              | \$ 2,318             |
| Other investment notes due 2021 - 2023        | 14,926                | 13,427               |
| Other investment note due 2014                | -                     | 62                   |
| \$31.5 million other investment note due 2017 | 24,500                | 23,750               |
| \$2.5 million other investment note due 2015  | 1,640                 | 546                  |
| \$6.0 million other investment note due 2013  | 5,439                 | 5,439                |
| \$1.3 million other investment note due 2017  | 1,300                 | 1,300                |
| \$1.5 million other investment note due 2014  | 1,456                 | 1,456                |
| Notes receivable, gross(1)                    | 51,429                | 48,298               |
| Allowance for loss on notes receivable        | (1,977 )              | (1,977 )             |
| Notes receivable, net                         | 49,452                | 46,321               |
| Other   | 2,400                 | 2,400                |
| Marketable securities                         | -                     | 4,333                |
| Total other investments                       | \$ 51,852             | \$ 53,054            |

(1) The majority of these notes bear interest at approximately 10% annually.

## Redemption of Diversicare Preferred Stock

On August 20, 2014, Diversicare redeemed the shares of its Series C non-convertible, redeemable preferred stock held by Omega, which had a liquidation preference of approximately \$4.9 million and a dividend rate of 7% per annum. We received approximately \$5.0 million in net proceeds from the redemption of our Diversicare preferred shares. The preferred shares were originally issued to Omega in 2006 in connection with the restructuring of preferred stock and master lease agreements between Diversicare and Omega. We recorded a gain of \$0.6 million in other investment income.

## \$31.5 Million Other Investment Note due 2017

In February 2014, we amended our five year 10.0% term loan agreement with an existing operator allowing for an additional draw of \$3.5 million at a 10.5% interest rate. The loan matures in January 2017.

## NOTE 5 – CONCENTRATION OF RISK

As of September 30, 2014, our portfolio of real estate investments consisted of 564 healthcare facilities, located in 38 states and operated by 50 third-party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately \$4.3 billion at September 30, 2014, with approximately 99% of our real estate investments related to long-term care facilities. Our portfolio is made up of 477 SNFs, 19 ALFs, 11 specialty facilities, fixed rate mortgages on 53 SNFs and two ALFs, and two SNFs that are closed/held-for-sale. At September 30, 2014, we also held miscellaneous investments of approximately \$51.9 million, consisting primarily of

secured loans to third-party operators of our facilities.

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At September 30, 2014, we had investments with one operator and/or manager that exceeded 10% of our total investments: New Ark (13%). The three states in which we had our highest concentration of investments were Florida (14%), Michigan (11%) and Ohio (9%) at September 30, 2014.

For the three-month period ended September 30, 2014, our revenues from operations totaled \$130.7 million, of which approximately \$15.0 million were from New Ark (12%) and \$13.8 million were from Genesis HealthCare (“Genesis”) (11%). No other operator generated more than 10% of our revenues from operations for the three-month period ended September 30, 2014.

For the nine-month period ended September 30, 2014, our revenues from operations totaled \$373.5 million, of which approximately \$43.3 million were from New Ark (12%) and \$41.4 million were from Genesis (11%). No other operator generated more than 10% of our revenues from operations for the nine-month period ended September 30, 2014.

#### NOTE 6 – DIVIDENDS

On October 16, 2014, the Board of Directors declared a common stock dividend of \$0.52 per share, increasing the quarterly common dividend by \$0.01 per share over the previous quarter. The common dividends are to be paid November 17, 2014 to common stockholders of record on October 31, 2014.

On July 15, 2014, the Board of Directors declared a common stock dividend of \$0.51 per share, increasing the quarterly common dividend by \$0.01 per share over the prior quarter, which was paid August 15, 2014 to common stockholders of record on July 31, 2014.

On April 18, 2014, the Board of Directors declared a common stock dividend of \$0.50 per share, increasing the quarterly common dividend by \$0.01 per share over the prior quarter, which was paid May 15, 2014 to common stockholders of record on April 30, 2014.

On January 15, 2014, the Board of Directors declared a common stock dividend of \$0.49 per share, increasing the quarterly common dividend by \$0.01 per share over the prior quarter, which was paid February 17, 2014 to common stockholders of record on January 31, 2014.

#### NOTE 7 – 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 pays federal, state and local income tax on its net income at the applicable corporate rates. As of September 30, 2014, the TRS had a net operating loss carry-forward of approximately \$1.0 million. The loss carry-forward is fully reserved with a valuation allowance as of September 30, 2014.

## NOTE 8 – STOCK-BASED COMPENSATION

The following is a summary of our stock-based compensation expense for the three- and nine-month periods ended September 30, 2014 and 2013, respectively:

|                                  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|----------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                                  | 2014                                | 2013     | 2014                               | 2013     |
|                                  | (in thousands)                      |          |                                    |          |
| Stock-based compensation expense | \$ 2,022                            | \$ 1,509 | \$ 6,570                           | \$ 4,433 |

## Restricted Stock and Restricted Stock Units

Restricted stock and restricted stock units (“RSUs”) are subject to forfeiture if the holder’s service to us terminates prior to vesting, subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company. Prior to vesting, ownership of the shares/units cannot be transferred. The restricted stock has the same dividend and voting rights as our common stock. RSUs accrue dividend equivalents but have no voting rights.

Restricted stock and RSUs are valued at the price of our common stock on the date of grant. We expense the cost of these awards ratably over their vesting period.

On December 31, 2013, we granted 213,741 RSUs to six employees. The RSUs vest ratably over the three year period ending December 31, 2016, 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.

On January 1, 2014, we granted 122,137 RSUs to six employees. The RSUs vest on December 31, 2016, 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.

## Performance Restricted Stock Units

Performance restricted stock units (“PRSUs”) are subject to forfeiture if the performance requirements are not achieved or if the holder’s service to us terminates prior to vesting, subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company. The PRSUs awarded in January 2011, January 2013, December 2013 and January 2014 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 based on performance and related dividend equivalents based on dividends paid to stockholders during the applicable performance period. The vesting requirements are based on either the (i) total shareholders return (“TSR”) of Omega or (ii) Omega’s TSR relative to other real estate investment trusts in the MSCI U.S. REIT Index. We expense the cost of these awards ratably over their service period.

Prior to vesting and distribution of shares, ownership of the PRSUs cannot be transferred. The dividends on the PRSUs accumulate and if vested are paid when the shares are distributed to the employee.

PRSUs (for Performance Periods 2011 through 2013)



In January 2011, we awarded PRSUs to six employees, including: (i) 279,550 multi-year absolute TSR PRSUs and (ii) 93,183 multi-year relative TSR PRSUs. On January 1, 2013, we awarded to the six employees 124,244 annual TSR PRSUs for the year ended December 31, 2013 (“2013 Annual TSR PRSUs”).

#### 2013 Annual TSR PRSUs

The TSR goal for the 2013 Annual TSR PRSUs was achieved at the high level and 124,244 shares vested and were distributed to the employees in January 2014.

#### Multi-year TSR PRSUs (for the 2011- 2013 Performance Period)

The number of shares earned under the multi-year TSR PRSUs depended generally on the level of achievement of TSR for the three years ending December 31, 2013. In January 2014, the board of directors reviewed the performance and determined the performance targets were met at the high level. The multi-year 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 (for the 2011- 2013 Performance Period)

The number of shares earned under the multi-year relative TSR PRSUs depended 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. In January 2014, the board of directors reviewed the performance and determined the performance targets were met at the high level. 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.

#### PRSUs (for 2013- 2016 Performance Periods)

In December 2013, we awarded six types of PRSUs to six employees: (i) 77,371 PRSUs that vest based on TSR for the one year period starting December 31, 2013 and ending December 31, 2014 (“2014 Transition TSR PRSUs”), (ii) 77,369 PRSUs that vest based on the TSR for the two year period starting December 31, 2013 and ending December 31, 2015 (“2015 Transition TSR PRSUs”), (iii) 115,785 PRSUs that vest based on TSR for the three year period starting December 31, 2013 and ending December 31, 2016 (“2016 Transition TSR PRSUs”), (iv) 77,371 PRSUs that vest based on relative TSR for the one year period starting December 31, 2013 and ending December 31, 2014 (“2014 Transition Relative TSR PRSUs”), (v) 77,368 Transition PRSUs that vest based on relative TSR for the two year period starting December 31, 2013 and ending December 31, 2015 (“2015 Transition Relative TSR PRSUs”), and (vi) 115,781 PRSUs that vest based on relative TSR for the three year period starting December 31, 2013 and ending December 31, 2016 (“2016 Transition Relative TSR PRSUs”).

#### 2014 Transition TSR PRSUs

The number of shares earned under the 2014 Transition TSR PRSUs depends generally on the level of achievement of Omega’s TSR for the period beginning December 31, 2013 and ending December 31, 2014. The 2014 Transition TSR PRSUs vest on December 31, 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.

#### 2015 Transition TSR PRSUs

The number of shares earned under the 2015 Transition TSR PRSUs depends generally on the level of achievement of Omega’s TSR for the period beginning December 31, 2013 and ending December 31, 2015. The 2015 Transition TSR PRSUs vest on December 31, 2015, 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.

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#### 2016 Transition TSR PRSUs

The number of shares earned under the 2016 Transition TSR PRSUs depends generally on the level of achievement of Omega's TSR for the period beginning December 31, 2013 and ending December 31, 2016. The 2016 Transition TSR PRSUs vest on December 31, 2016, 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.

#### 2014 Transition Relative TSR PRSUs

The number of shares earned under the 2014 Transition Relative TSR PRSUs depends generally on the level of achievement of TSR relative to the MSCI U.S. REIT Index for the period beginning December 31, 2013 and ending December 31, 2014. The 2014 Transition Relative TSR PRSUs vest on December 31, 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.

#### 2015 Transition Relative TSR PRSUs

The number of shares earned under the 2015 Transition Relative TSR PRSUs depends generally on the level of achievement of TSR relative to MSCI U.S. REIT Index for the period beginning December 31, 2013 and ending December 31, 2015. The 2015 Transition Relative TSR PRSUs vest on December 31, 2015, 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.

#### 2016 Transition Relative TSR PRSUs

The number of shares earned under the 2016 Transition Relative TSR PRSUs depends generally on the level of achievement of TSR relative to MSCI U.S. REIT Index for the period beginning December 31, 2013 and ending December 31, 2016. The 2016 Transition Relative TSR PRSUs vest on December 31, 2016, 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.

#### PRSUs (for 2014- 2016 Performance Periods)

In January 2014, we awarded two types of PRSUs to six employees: (i) 154,584 PRSUs that vest based on TSR for the three year period starting January 1, 2014 and ending December 31, 2016 ("2016 TSR PRSUs"), and (ii) 154,584 PRSUs that vest based on relative TSR for the three year period starting January 1, 2014 and ending December 31, 2016 ("2016 Relative TSR PRSUs").

#### 2016 TSR PRSUs

The number of shares earned under the 2016 TSR PRSUs depends generally on the level of achievement of Omega's TSR for the period beginning January 1, 2014 and ending December 31, 2016. The 2016 TSR PRSUs vest quarterly in 2017 in equal increments, 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.

#### 2016 Relative TSR PRSUs

The number of shares earned under the 2016 Relative TSR PRSUs depends generally on the level of achievement of Omega's TSR relative to MSCI U.S. REIT Index for the period beginning January 1, 2014 and ending December 31, 2016. The 2016 Relative TSR PRSUs vest quarterly in 2017 in equal increments, 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 following table summarizes our total unrecognized compensation cost as of September 30, 2014 associated with outstanding restricted stock, restricted stock units and PRSU awards to employees:

|                                    | Grant Year | 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) |
|------------------------------------|------------|---------------|---|---------------------------------------|--|--|
| Multi-year TSR PRSUs               | 2011       | 279,550       | \$ 11.06                                      | \$ 3.1                                | 44   | \$ -   |
| Multi-year Relative TSR PRSUs      | 2011       | 93,183        | 12.26   | 1.1                                   | 44   | -  |
| Restricted stock units             | 2013       | 213,741       | 29.80   | 6.4                                   | 36   | 4.8  |
| 2014 Transition TSR PRSUs          | 2013       | 77,371        | 8.27  | 0.6                                   | 12   | 0.2  |
| 2015 Transition TSR PRSUs          | 2013       | 77,369        | 7.48  | 0.6                                   | 24   | 0.4  |
| 2016 Transition TSR PRSUs          | 2013       | 115,785       | 8.67  | 1.0                                   | 36   | 0.8  |
| 2014 Transition Relative TSR PRSUs | 2013       | 77,371        | 11.68   | 0.9                                   | 12   | 0.2  |
| 2015 Transition Relative TSR PRSUs | 2013       | 77,368        | 13.06   | 1.0                                   | 24   | 0.6  |
| 2016 Transition Relative TSR PRSUs | 2013       | 115,781       | 14.25   | 1.7                                   | 36   | 1.2  |
| Restricted stock units             | 2014       | 122,137       | 29.80   | 3.6                                   | 36   | 2.7  |
| 2016 TSR PRSUs                     | 2014       | 154,584       | 8.67  | 1.4                                   | 48   | 1.1  |
| 2016 Relative TSR PRSUs            | 2014       | 154,584       | 14.25   | 2.2                                   | 48   | 1.8  |
| Total                              |            | 1,558,824     | \$ 15.12                                      | \$ 23.6                               |  | \$ 13.8                                      |

We used a Monte Carlo model to estimate the fair value for PRSUs granted to the employees.

#### Director Restricted Stock Grants

As of September 30, 2014, we had 45,303 shares of restricted stock outstanding to directors. The directors' restricted shares are scheduled to vest over the next three years. As of September 30, 2014, the unrecognized compensation cost associated with outstanding director restricted stock grants is approximately \$0.7 million.

## NOTE 9 – FINANCING ACTIVITIES AND BORROWING ARRANGEMENTS

## Secured and Unsecured Borrowings

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

|  | Maturity       | Current<br>Rate |   | September<br>30,<br>2014 | December<br>31,<br>2013 |
|--|----------------|-----------------|---|--------------------------|-------------------------|
| (in thousands)                         |                |                 |   |                          |                         |
| Secured borrowings:                    |                |                 |   |                          |                         |
| HUD mortgages assumed June 2010 (1)    | 2040 -<br>2045 | 4.85            | % | \$126,907                | \$128,641               |
| HUD mortgages assumed October 2011 (1) | 2040           | 4.87            | % | 30,492                   | 31,145                  |
| HUD mortgages assumed December 2011(1) | 2044           | 3.06            | % | 57,714                   | 58,592                  |
| HUD mortgages assumed December 2012(1) | 2040 -<br>2045 | 4.64            | % | 41,290                   | 80,153                  |
| Total secured borrowings               |                |                 |   | 256,403                  | 298,531                 |
| Unsecured borrowings:                  |                |                 |   |                          |                         |
| Revolving line of credit               | 2018           | 1.65            | % | 3,000                    | 326,000                 |
| Term loan                              | 2019           | 1.65            | % | 200,000                  | 200,000                 |
|  |                |                 |   | 203,000                  | 526,000                 |
| 2020 notes                             | 2020           | 7.50            | % | 200,000                  | 200,000                 |
| 2022 notes                             | 2022           | 6.75            | % | 575,000                  | 575,000                 |
| 2024 notes                             | 2024           | 5.875           | % | 400,000                  | 400,000                 |
| 2024 notes                             | 2024           | 4.95            | % | 400,000                  | —                       |
| 2025 notes                             | 2025           | 4.50            | % | 250,000                  | —                       |
| Subordinated debt                      | 2021           | 9.00            | % | 20,782                   | 20,892                  |
|  |                |                 |   | 1,845,782                | 1,195,892               |
| (Discount) premium - net               |                |                 |   | (3,805 )                 | 3,995                   |
| Total unsecured borrowings             |                |                 |   | 2,044,977                | 1,725,887               |
| Totals – net                           |                |                 |   | \$2,301,380              | \$2,024,418             |

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

Certain of our other secured and unsecured borrowings are subject to customary affirmative and negative covenants, including financial covenants. As of December 31, 2013 and September 30, 2014, we were in compliance with all affirmative and negative covenants, including financial covenants, for our secured and unsecured borrowings.

**Bank Credit Facilities**

On June 27, 2014, we entered into a new \$1.2 billion unsecured credit facility, comprised of a \$1 billion senior unsecured revolving credit facility (the “Revolving Credit Facility”) and a \$200 million senior unsecured term loan

facility (the “Term Loan Facility” and, collectively, the “2014 Credit Facilities”).

The 2014 Credit Facilities replace our previous \$700 million senior unsecured credit facility (the “2012 Credit Facilities”). The 2014 Credit Facilities include an “accordion feature” that permits us to expand our borrowing capacity by \$550 million, for maximum aggregate commitments of up to \$1.75 billion.

The Revolving Credit Facility is priced at LIBOR plus an applicable percentage (beginning at 130 basis points, with a range of 92.5 to 170 basis points) based on our ratings from Standard & Poor’s, Moody’s and/or Fitch Ratings, plus a facility fee based on the same ratings (initially 25 basis points, with a range of 12.5 to 30 basis points). The Revolving Credit Facility will be used for acquisitions and general corporate purposes. At September 30, 2014, we had \$3 million in borrowings outstanding under the Revolving Credit Facility. The Revolving Credit Facility matures on June 27, 2018, subject to a one-time option by us to extend such maturity date by one year.

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The Term Loan Facility is also priced at LIBOR plus an applicable percentage (beginning at 150 basis points, with a range of 100 to 195 basis points) based on our ratings from Standard & Poor's, Moody's and/or Fitch Ratings. At September 30, 2014, we had \$200 million in borrowings outstanding under the Term Loan Facility. The Term Loan Facility matures on June 27, 2019.

For the nine month period ended September 30, 2014, we recorded a non-cash charge of approximately \$2.6 million relating to the write-off of unamortized deferred financing costs associated with the termination of the 2012 Credit Facilities.

#### HUD Mortgage Loans Payoff

On September 30, 2014, we paid approximately \$36.1 million to retire four mortgages guaranteed by U.S. Department of Housing and Urban Development ("HUD"). The payoff resulted in a \$1.6 million gain on the extinguishment of the debt due to the write-off of the \$3.3 million premium recorded at the time of acquisition offset by a prepayment fee of approximately \$1.7 million.

#### Issuance of \$250 Million of Senior Notes

On September 11, 2014, we sold \$250 million aggregate principal amount of our 4.50% Senior Notes due 2025, or the 2025 Notes. The 2025 Notes were sold at an issue price of 99.131% of their face value before the initial purchasers' discount resulting in gross proceeds of approximately \$247.8 million. We used the net proceeds of the offering to repay a portion of our indebtedness outstanding under our Revolving Credit Facility.

The 2025 Notes were issued pursuant to an indenture dated as of September 11, 2014 among Omega, certain of its subsidiaries, as guarantors, and U.S. Bank National Association, as trustee. The 2025 Notes mature on January 15, 2025. The 2025 Notes bear an interest rate of 4.50% per annum, payable semi-annually in arrears on January 15 and July 15 of each year, commencing on July 15, 2015. The notes are fully and unconditionally guaranteed, jointly and severally, by our existing and future subsidiaries that guarantee indebtedness for money borrowed of Omega in a principal amount at least equal to \$50 million (including as of the date hereof our existing senior notes and the facilities under our revolving credit agreement). We may redeem some or all of the notes prior to October 15, 2024 at a price equal to 100% of the principal amount thereof plus a "make-whole" premium, and accrued and unpaid interest, if any, to, but not including, the applicable redemption date. The notes are redeemable on or after October 15, 2024 at a redemption price equal to 100% of the principal amount thereof plus accrued and unpaid interest, if any, to, but not including, the applicable redemption date.

#### Issuance of \$400 Million of Senior Notes and Exchange Offer

On March 11, 2014, we sold \$400 million aggregate principal amount of our 4.95% Senior Notes due 2024. These notes were sold at an issue price of 98.58% of the principal amount of the notes, before the initial purchasers' discount resulting in gross proceeds of approximately \$394.3 million. We used the net proceeds of the offering to repay in full our \$200 million 2013 Term Loan Facility defined below, and a portion of our indebtedness outstanding under our Revolving Credit Facility.

On August 26, 2014, we commenced an offer to exchange \$400 million of our 4.95% Senior Notes due 2024 that have been registered under the Securities Act of 1933 ("exchange notes") for the \$400 million of our 4.95% Senior Notes due 2024 privately placed in March 2014 ("initial notes"). Approximately 99.875% of the \$400 million 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 October 17, 2014, 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.

### Repayment of \$200 Million Term Loan

On December 27, 2013, we entered into a new \$200 million senior unsecured, deferred draw, term loan facility (the “2013 Term Loan Facility”) that was scheduled to mature on February 29, 2016.

The 2013 Term Loan Facility was priced at LIBOR plus an applicable percentage (beginning at 175 basis points, with a range of 110 to 230 basis points) based on the Company’s ratings from Standard & Poor’s, Moody’s and/or Fitch Ratings.

In January 2014, we drew all \$200 million under the 2013 Term Loan Facility and used the proceeds to (i) fund a new mortgage investment and (ii) repay outstanding borrowings under the 2012 Revolving Credit Facility. In March 2014, we paid off and terminated the 2013 Term Loan Facility with proceeds from the sale of our 4.95% Senior Notes due 2024 (see above). In addition, we recorded a non-cash charge of approximately \$2.0 million relating to the write-off of deferred financing costs associated with the termination of the 2013 Term Loan Facility.

### \$250 Million Equity Shelf Program

On March 18, 2013, we entered into separate Equity Distribution Agreements (collectively, the “2013 Equity Shelf Agreements”) to sell shares of our common stock having an aggregate gross sales price of up to \$250 million (the “2013 Equity Shelf Program”) with several financial institutions, each as a sales agent and/or principal (collectively, the “Managers”).

For the three-month period ended September 30, 2014, we issued approximately 0.1 million shares under the 2013 Equity Shelf Program, at an average price of \$37.93 per share, generating gross proceeds of approximately \$5.0 million, before \$75 thousand of commissions. For the nine-month period ended September 30, 2014, we issued approximately 1.8 million shares under the 2013 Equity Shelf Program, at an average price of \$34.33 per share, generating gross proceeds of approximately \$63.5 million, before \$1.2 million of commissions.

### Dividend Reinvestment and Common Stock Purchase Plan

For the three-month period ended September 30, 2014, approximately 0.5 million shares of our common stock at an average price of \$37.51 per share were issued through our Dividend Reinvestment and Common Stock Purchase Program for gross proceeds of approximately \$20.5 million. For the nine-month period ended September 30, 2014, approximately 1.9 million shares of our common stock at an average price of \$34.09 per share were issued through our Dividend Reinvestment and Common Stock Purchase Program for gross proceeds of approximately \$66.3 million.

## NOTE 10 – FINANCIAL INSTRUMENTS

At September 30, 2014 and December 31, 2013, the carrying amounts and fair values of our financial instruments were as follows:

|                                       | September 30, 2014 |               | December 31, 2013  |               |
|---------------------------------------|--------------------|---------------|--------------------|---------------|
|                                       | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |
|                                       | (in thousands)     |               |                    |               |
| Assets:                               |                    |               |                    |               |
| Cash and cash equivalents             | \$452              | \$452         | \$2,616            | \$2,616       |
| Restricted cash                       | 31,821             | 31,821        | 31,759             | 31,759        |
| Investment in direct financing leases | 536,687            | 536,687       | 529,445            | 529,445       |
| Mortgage notes receivable – net       | 647,590            | 634,448       | 241,515            | 240,482       |
| Other investments – net               | 51,852             | 52,529        | 53,054             | 50,124        |
| Totals                                | \$1,268,402        | \$1,255,937   | \$858,389          | \$854,426     |
| Liabilities:                          |                    |               |                    |               |
| Revolving line of credit              | \$3,000            | \$3,000       | \$326,000          | \$326,000     |
| Term loan                             | 200,000            | 200,000       | 200,000            | 200,000       |
| 7.50% notes due 2020 – net            | 198,149            | 255,040       | 197,890            | 256,852       |
| 6.75% notes due 2022 – net            | 580,584            | 753,536       | 581,105            | 735,687       |
| 5.875% notes due 2024 – net           | 400,000            | 438,251       | 400,000            | 411,266       |
| 4.95% notes due 2024 – net            | 394,626            | 403,261       | —                  | —             |
| 4.50% notes due 2025 – net            | 247,836            | 244,163       | —                  | —             |
| HUD debt                              | 256,403            | 260,832       | 298,531            | 287,718       |
| Subordinated debt                     | 20,782             | 28,906        | 20,892             | 28,849        |
| Totals                                | \$2,301,380        | \$2,586,989   | \$2,024,418        | \$2,246,372   |

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 Annual Report on Form 10-K for the year ended December 31, 2013). 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) (Level 1).

**Mortgage notes receivable:** The fair value 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 3).

**Direct financing leases:** The fair value of the direct financing receivables are estimated using a discounted cash flow analysis, using interest rates being offered for similar leases to borrowers with similar credit ratings (Level 3).

**Other investments:** Other investments are primarily comprised of: (i) notes receivable and (ii) an investment in a 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 3). 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 3).

Revolving line of credit and term loan: 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 3).

Senior notes and subordinated debt: 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).

HUD debt: The fair value of our borrowings under HUD debt agreements are estimated based on quote obtained by HUD debt brokers (Level 2).

#### NOTE 11 – 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 12 – 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<br>September 30,      |           | Nine Months Ended<br>September 30, |            |
|--|--|-----------|------------------------------------|------------|
|  | 2014                                     | 2013      | 2014                               | 2013       |
|  | (in thousands, except per share amounts) |           |                                    |            |
| Numerator:   |  |           |                                    |            |
| Net income   | \$ 61,713                                | \$ 38,137 | \$ 164,359                         | \$ 125,315 |
| Numerator for net income available to common stockholders’ per share - basic and diluted | \$ 61,713                                | \$ 38,137 | \$ 164,359                         | \$ 125,315 |
| Denominator:   |  |           |                                    |            |
| Denominator for basic earnings per share   | 127,464                                  | 117,600   | 126,132                            | 115,527    |
| Effect of dilutive securities:   |  |           |                                    |            |
| Common stock equivalents   | 964                                      | 862       | 763                                | 808        |
| Denominator for diluted earnings per share   | 128,428                                  | 118,462   | 126,895                            | 116,335    |
| Earnings per share – basic:  |  |           |                                    |            |
| Net income – basic   | \$ 0.48                                  | \$ 0.32   | \$ 1.30                            | \$ 1.08    |
| Earnings per share – diluted:  |  |           |                                    |            |

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|                      |         |         |         |         |
|----------------------|---------|---------|---------|---------|
| Net income – diluted | \$ 0.48 | \$ 0.32 | \$ 1.30 | \$ 1.08 |
|----------------------|---------|---------|---------|---------|

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NOTE 13 – CONSOLIDATING FINANCIAL STATEMENTS

As of September 30, 2014, we had outstanding: (i) \$200 million 7.5% Senior Notes due 2020, (ii) \$575 million 6.75% Senior Notes due 2022, (iii) \$400 million 5.875% Senior Notes due 2024, (iv) \$400 million 4.95% Senior Notes due 2024 and (v) \$250 million 4.5% Senior Notes due 2025, 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. All of our subsidiaries that guarantee the Senior Notes also guarantee the 2014 Credit Facilities. 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 or the 2014 Credit Facilities.

As of and prior to March 31, 2010, the non-guarantor subsidiaries were minor and insignificant. On June 29, 2010, we designated as “unrestricted subsidiaries” the 39 subsidiaries we acquired from CapitalSource subject to HUD indebtedness, of which 12 subsidiaries were re-designated as “restricted subsidiaries” and subsidiary guarantors in July 2013 due to the retirement of the HUD related debt on 11 facilities. During the fourth quarter of 2011, we designated as “unrestricted subsidiaries” 20 subsidiaries we acquired subject to HUD indebtedness, of which six subsidiaries were re-designated as “restricted subsidiaries” and subsidiary guarantors in July 2012 due to the retirement of the HUD related mortgages on five facilities. During the fourth quarter of 2012, we designated as “unrestricted subsidiaries” eight subsidiaries we acquired subject to HUD indebtedness. The following summarized condensed consolidating financial information reflects these changes.

For the three months ended September 30, 2014 and 2013, the operating cash flow of the non-guarantor subsidiaries approximated net income of the non-guarantor subsidiaries, adjusted for depreciation and amortization expense and rent recorded on straight-line basis. On September 30, 2014, we retired four HUD mortgages, \$34.3 million related to the outstanding principal of the four HUD mortgages, \$3.3 million related to the noncash write off of unamortized premium recorded at the time of acquisition offset by a prepayment fee of approximately \$1.7 million.

During the nine months ended September 30, 2014, the non-guarantor subsidiaries also made \$3.8 million of routine principal payments. For the nine-month period ended September 30, 2013, the non-guarantor subsidiaries did not engage in investing or financing activities other than the principal payment of \$3.4 million for the HUD mortgages on the facilities owned by the non-guarantor subsidiaries. All of the subsidiary guarantors of our outstanding Senior Notes and 2014 Credit Facilities, and all of our non-guarantor subsidiaries, are 100% 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, 2014                   |                               |                        |              |
|---|--------------------------------------|-------------------------------|------------------------|--------------|
|   | Issuer &<br>Subsidiary<br>Guarantors | Non-Guarantor<br>Subsidiaries | Elimination<br>Company | Consolidated |
| <b>ASSETS</b>                                   |                                      |                               |                        |              |
| Real estate properties                          |                                      |                               |                        |              |
| Land and buildings                              | \$ 2,684,567                         | \$ 458,789                    | \$ -                   | \$ 3,143,356 |
| Less accumulated depreciation                   | (725,746 )                           | (68,359 )                     | -                      | (794,105 )   |
| Real estate properties – net                    | 1,958,821                            | 390,430                       | -                      | 2,349,251    |
| Investment in direct financing leases           | 536,687                              | -                             | -                      | 536,687      |
| Mortgage notes receivable – net                 | 647,590                              | -                             | -                      | 647,590      |
|   | 3,143,098                            | 390,430                       | -                      | 3,533,528    |
| Other investments – net                         | 51,852                               | -                             | -                      | 51,852       |
|   | 3,194,950                            | 390,430                       | -                      | 3,585,380    |
| Assets held for sale – net                      | 6,670                                | -                             | -                      | 6,670        |
| Total investments                               | 3,201,620                            | 390,430                       | -                      | 3,592,050    |
| <br>  |                                      |                               |                        |              |
| Cash and cash equivalents                       | 452                                  | -                             | -                      | 452          |
| Restricted cash                                 | 7,013                                | 24,808                        | -                      | 31,821       |
| Accounts receivable – net                       | 153,569                              | 9,059                         | -                      | 162,628      |
| Investment in affiliates                        | 140,802                              | -                             | (140,802 )             | -            |
| Other assets                                    | 43,612                               | 26,939                        | -                      | 70,551       |
| Total assets                                    | \$ 3,547,068                         | \$ 451,236                    | \$ (140,802 )          | \$ 3,857,502 |
| <b>LIABILITIES AND STOCKHOLDERS’<br/>EQUITY</b> |                                      |                               |                        |              |
| Revolving line of credit                        | \$ 3,000                             | \$ -                          | \$ -                   | \$ 3,000     |
| Term loan                                       | 200,000                              | -                             | -                      | 200,000      |
| Secured borrowings                              | -                                    | 256,403                       | -                      | 256,403      |
| Unsecured borrowings – net                      | 1,821,195                            | 20,782                        | -                      | 1,841,977    |
| Accrued expenses and other liabilities          | 116,496                              | 33,249                        | -                      | 149,745      |
| Intercompany payable                            | -                                    | 102,200                       | (102,200 )             | -            |
| Total liabilities                               | 2,140,691                            | 412,634                       | (102,200 )             | 2,451,125    |
| <br>  |                                      |                               |                        |              |
| Stockholders’ equity:                           |                                      |                               |                        |              |
| Common stock                                    | 12,741                               | -                             | -                      | 12,741       |
| Common stock – additional paid-in capital       | 2,131,033                            | -                             | -                      | 2,131,033    |
| Cumulative net earnings                         | 1,091,008                            | 38,602                        | (38,602 )              | 1,091,008    |
| Cumulative dividends paid                       | (1,828,405)                          | -                             | -                      | (1,828,405)  |
| Total stockholders’ equity                      | 1,406,377                            | 38,602                        | (38,602 )              | 1,406,377    |
| Total liabilities and stockholders’ equity      | \$ 3,547,068                         | \$ 451,236                    | \$ (140,802 )          | \$ 3,857,502 |



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

|   | December 31, 2013                    |                                    |                        |              |
|---|--------------------------------------|------------------------------------|------------------------|--------------|
|   | Issuer &<br>Subsidiary<br>Guarantors | Non –<br>Guarantor<br>Subsidiaries | Elimination<br>Company | Consolidated |
| <b>ASSETS</b>                               |                                      |                                    |                        |              |
| Real estate properties                      |                                      |                                    |                        |              |
| Land and buildings                          | \$2,642,047                          | \$ 457,500                         | \$—                    | \$ 3,099,547 |
| Less accumulated depreciation               | (653,858 )                           | (53,552 )                          | —                      | (707,410 )   |
| Real estate properties – net                | 1,988,189                            | 403,948                            | —                      | 2,392,137    |
| Investment in direct financing leases       | 529,445                              | —                                  | —                      | 529,445      |
| Mortgage notes receivable – net             | 241,515                              | —                                  | —                      | 241,515      |
|   | 2,759,149                            | 403,948                            | —                      | 3,163,097    |
| Other investments – net                     | 53,054                               | —                                  | —                      | 53,054       |
|   | 2,812,203                            | 403,948                            | —                      | 3,216,151    |
| Assets held for sale – net                  | 1,356                                | —                                  | —                      | 1,356        |
| Total investments                           | 2,813,559                            | 403,948                            | —                      | 3,217,507    |
| Cash and cash equivalents                   | 2,616                                | —                                  | —                      | 2,616        |
| Restricted cash                             | 6,827                                | 24,932                             | —                      | 31,759       |
| Accounts receivable – net                   | 140,331                              | 7,173                              | —                      | 147,504      |
| Investment in affiliates                    | 108,707                              | —                                  | (108,707 )             | —            |
| Other assets                                | 36,723                               | 26,107                             | —                      | 62,830       |
| Total assets                                | \$3,108,763                          | \$ 462,160                         | \$(108,707 )           | \$ 3,462,216 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b> |                                      |                                    |                        |              |
| Revolving line of credit                    | \$326,000                            | \$ —                               | \$—                    | \$ 326,000   |
| Term loan                                   | 200,000                              | —                                  | —                      | 200,000      |
| Secured borrowings                          | —                                    | 298,531                            | —                      | 298,531      |
| Unsecured borrowings – net                  | 1,178,995                            | 20,892                             | —                      | 1,199,887    |
| Accrued expenses and other liabilities      | 103,665                              | 34,030                             | —                      | 137,695      |
| Intercompany payable                        | —                                    | 83,065                             | (83,065 )              | —            |
| Total liabilities                           | 1,808,660                            | 436,518                            | (83,065 )              | 2,162,113    |
| Stockholders' equity:                       |                                      |                                    |                        |              |
| Common stock                                | 12,353                               | —                                  | —                      | 12,353       |
| Common stock – additional paid-in-capital   | 1,998,169                            | —                                  | —                      | 1,998,169    |
| Cumulative net earnings                     | 926,649                              | 25,642                             | (25,642 )              | 926,649      |
| Cumulative dividends paid                   | (1,637,068)                          | —                                  | —                      | (1,637,068 ) |
| Total stockholders' equity                  | 1,300,103                            | 25,642                             | (25,642 )              | 1,300,103    |
| Total liabilities and stockholders' equity  | \$3,108,763                          | \$ 462,160                         | \$(108,707 )           | \$ 3,462,216 |

OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATING STATEMENTS OF OPERATIONS

Unaudited

(in thousands, except per share amounts)

|  | Three Months Ended September 30, 2014 |                                    |             |              | Nine Months Ended September 30, 2014 |                                    |             |              |
|--|---------------------------------------|------------------------------------|-------------|--------------|--------------------------------------|------------------------------------|-------------|--------------|
|  | Issuer &<br>Subsidiary<br>Guarantors  | Non –<br>Guarantor<br>Subsidiaries | Elimination | Consolidated | Issuer &<br>Subsidiary<br>Guarantors | Non –<br>Guarantor<br>Subsidiaries | Elimination | Consolidated |
| Revenue  |                                       |                                    |             |              |                                      |                                    |             |              |
| Rental income  | \$85,020                              | \$ 12,516                          | \$ -        | \$ 97,536    | \$252,076                            | \$ 37,620                          | \$ -        | \$ 289,696   |
| Income from<br>direct financing<br>leases  | 14,211                                | -                                  | -           | 14,211       | 42,441                               | -                                  | -           | 42,441       |
| Mortgage interest<br>income  | 16,883                                | -                                  | -           | 16,883       | 36,132                               | -                                  | -           | 36,132       |
| Other investment<br>income – net   | 2,035                                 | -                                  | -           | 2,035        | 5,197                                | -                                  | -           | 5,197        |
| Total operating<br>revenues  | 118,149                               | 12,516                             | -           | 130,665      | 335,846                              | 37,620                             | -           | 373,466      |
| Expenses   |                                       |                                    |             |              |                                      |                                    |             |              |
| Depreciation and<br>amortization   | 25,619                                | 4,492                              | -           | 30,111       | 78,049                               | 14,807                             | -           | 92,856       |
| General and<br>administrative  | 5,898                                 | 89                                 | -           | 5,987        | 18,502                               | 279                                | -           | 18,781       |
| Acquisition costs  | 259                                   | -                                  | -           | 259          | 399                                  | -                                  | -           | 399          |
| Provision for<br>impairment on<br>real estate<br>properties                      | 2,102                                 | -                                  | -           | 2,102        | 3,660                                | -                                  | -           | 3,660        |
| Provision for<br>uncollectible<br>mortgages, notes<br>and accounts<br>receivable | (15 )                                 | -                                  | -           | (15 )        | 2,730                                | -                                  | -           | 2,730        |
| Total operating<br>expenses  | 33,863                                | 4,581                              | -           | 38,444       | 103,340                              | 15,086                             | -           | 118,426      |
| Income before<br>other income and<br>expense                                     | 84,286                                | 7,935                              | -           | 92,221       | 232,506                              | 22,534                             | -           | 255,040      |
| Other income<br>(expense):   |                                       |                                    |             |              |                                      |                                    |             |              |
| Interest income  | 2                                     | 9                                  | -           | 11           | 12                                   | 24                                 | -           | 36           |
| Interest expense   | (27,158 )                             | (3,715 )                           | -           | (30,873 )    | (76,202 )                            | (11,199 )                          | -           | (87,401 )    |
|  | (1,238 )                              | (5 )                               | -           | (1,243 )     | (3,095 )                             | (16 )                              | -           | (3,111 )     |

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|  |           |          |             |           |            |           |              |            |
|--|-----------|----------|-------------|-----------|------------|-----------|--------------|------------|
| Interest –<br>amortization of<br>deferred financing<br>costs |           |          |             |           |            |           |              |            |
| Interest –<br>refinancing gain<br>(costs)                    | -         | 1,617    | -           | 1,617     | (4,685 )   | 1,617     | -            | (3,068 )   |
| Equity in earnings   | 5,841     | -        | (5,841 )    | -         | 12,960     | -         | (12,960 )    | -          |
| Total other<br>expense                                       | (22,553 ) | (2,094 ) | (5,841 )    | (30,488 ) | (71,010 )  | (9,574 )  | (12,960 )    | (93,544 )  |
| Income before<br>gain (loss) on<br>assets sold               | 61,733    | 5,841    | (5,841 )    | 61,733    | 161,496    | 12,960    | (12,960 )    | 161,496    |
| (Loss) gain on<br>assets sold – net                          | (20 )     | -        | -           | (20 )     | 2,863      | -         | -            | 2,863      |
| Net income<br>available to<br>common<br>stockholders         | \$61,713  | \$ 5,841 | \$ (5,841 ) | \$ 61,713 | \$ 164,359 | \$ 12,960 | \$ (12,960 ) | \$ 164,359 |

## OMEGA HEALTHCARE INVESTORS, INC.

## CONSOLIDATING STATEMENTS OF OPERATIONS

Unaudited

(in thousands, except per share amounts)

|   | Three Months Ended September 30, 2013 |                                    |             |              | Nine Months Ended September 30, 2013 |                                    |             |              |
|---|---------------------------------------|------------------------------------|-------------|--------------|--------------------------------------|------------------------------------|-------------|--------------|
|   | Issuer &<br>Subsidiary<br>Guarantors  | Non –<br>Guarantor<br>Subsidiaries | Elimination | Consolidated | Issuer &<br>Subsidiary<br>Guarantors | Non –<br>Guarantor<br>Subsidiaries | Elimination | Consolidated |
| Revenue   |                                       |                                    |             |              |                                      |                                    |             |              |
| Rental income   | \$ 81,289                             | \$ 12,548                          | \$ -        | \$ 93,837    | \$ 242,253                           | \$ 37,762                          | \$ -        | \$ 280,015   |
| Mortgage<br>interest income   | 7,289                                 | -                                  | -           | 7,289        | 22,070                               | -                                  | -           | 22,070       |
| Other<br>investment<br>income – net   | 2,175                                 | -                                  | -           | 2,175        | 5,492                                | -                                  | -           | 5,492        |
| Total operating<br>revenues   | 90,753                                | 12,548                             | -           | 103,301      | 269,815                              | 37,762                             | -           | 307,577      |
| Expenses  |                                       |                                    |             |              |                                      |                                    |             |              |
| Depreciation<br>and amortization  | 27,034                                | 5,168                              | -           | 32,202       | 80,885                               | 15,501                             | -           | 96,386       |
| General and<br>administrative   | 5,372                                 | 90                                 | -           | 5,462        | 15,859                               | 283                                | -           | 16,142       |
| Acquisition<br>costs  | (9 )                                  | -                                  | -           | (9 )         | 134                                  | -                                  | -           | 134          |
| Provision for<br>uncollectible<br>mortgages,<br>notes and<br>accounts<br>receivable | 2,321                                 | -                                  | -           | 2,321        | 2,386                                | -                                  | -           | 2,386        |
| Total operating<br>expenses   | 34,718                                | 5,258                              | -           | 39,976       | 99,264                               | 15,784                             | -           | 115,048      |
| Income before<br>other income<br>and expense  | 56,035                                | 7,290                              | -           | 63,325       | 170,551                              | 21,978                             | -           | 192,529      |
| Other income<br>(expense):  |                                       |                                    |             |              |                                      |                                    |             |              |
| Interest income   | (4 )                                  | 7                                  | -           | 3            | (1 )                                 | 21                                 | -           | 20           |
| Interest expense  | (20,725 )                             | (3,767 )                           | -           | (24,492 )    | (63,429 )                            | (11,687 )                          | -           | (75,116 )    |
| Interest –<br>amortization of<br>deferred<br>financing costs                        | (694 )                                | (5 )                               | -           | (699 )       | (2,069 )                             | (10 )                              | -           | (2,079 )     |
|   | -                                     | -                                  | -           | -            | 11,112                               | -                                  | -           | 11,112       |

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|  |           |          |             |           |            |           |             |            |
|--|-----------|----------|-------------|-----------|------------|-----------|-------------|------------|
| Interest –<br>refinancing gain                       |           |          |             |           |            |           |             |            |
| Equity in<br>earnings                                | 3,525     | -        | (3,525 )    | -         | 10,302     | -         | (10,302)    | -          |
| Total other<br>expense                               | (17,898)  | (3,765 ) | (3,525 )    | (25,188 ) | (44,085 )  | (11,676)  | (10,302)    | (66,063 )  |
| Income before<br>gain (loss) on<br>assets sold       | 38,137    | 3,525    | (3,525 )    | 38,137    | 126,466    | 10,302    | (10,302)    | 126,466    |
| Loss on assets<br>sold – net                         | -         | -        | -           | -         | (1,151 )   | -         | -           | (1,151 )   |
| Net income<br>available to<br>common<br>stockholders | \$ 38,137 | \$ 3,525 | \$ (3,525 ) | \$ 38,137 | \$ 125,315 | \$ 10,302 | \$ (10,302) | \$ 125,315 |

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**NOTE 14 – SUBSEQUENT EVENTS**

On October 31, 2014, we, along with our newly formed subsidiaries, OHI Healthcare Properties Holdco, Inc. (“Merger Sub”) and OHI Healthcare Properties Limited Partnership, L.P. (“Omega Operating Partnership”), entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Aviv REIT, Inc. (“Aviv”) and Aviv Healthcare Properties Limited Partnership, L.P. (the “Aviv Operating Partnership”). The Merger Agreement provides for the merger of Aviv with and into the Merger Sub (the “Merger”), with the Merger Sub surviving as a wholly-owned subsidiary of Omega. At the effective time of the Merger, and subject to the terms and subject to the conditions set forth in the Merger Agreement, each outstanding share of Aviv common stock shall be converted into the right to receive 0.90 of a share of Omega common stock. In connection with the Merger, holders of limited partnership units of the Aviv Operating Partnership will receive units of an Omega Operating Partnership based on the same exchange ratio as provided for Aviv common stock in the Merger Agreement. The Omega Operating Partnership units will be convertible into Omega common stock on a 1:1 basis following the completion of the Merger (subject to adjustment based on future events as provided for in the Omega Partnership Agreement).



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. These 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, 2013 and in Part II, Item 1A of this report (if any);
- (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, 2014, consisted of 564 healthcare facilities (including two facilities that are closed/held for sale), located in 38 states and operated by 50 third-party operators. Our gross investment in these facilities totaled approximately \$4.3 billion at September 30, 2014, with 99% of our real estate investments related to long-term healthcare facilities. Our portfolio is made up of: (i) 477 SNFs, (ii) 19 assisted living facilities (“ALFs”), (iii) 11 specialty facilities, (iv) fixed rate mortgages on 53 SNFs and two ALFs and (v) two SNFs that are closed/held for sale. At September 30, 2014, we also held other investments of approximately \$51.9 million, consisting primarily of secured loans to third-party operators of our facilities.

Our consolidated financial statements include the accounts of (i) Omega and (ii) all direct and indirect wholly owned subsidiaries of Omega. All inter-company accounts and transactions have been eliminated in consolidation of the financial statements.

On October 31, 2014, we, along with our newly formed subsidiaries, OHI Healthcare Properties Holdco, Inc. (“Merger Sub”) and OHI Healthcare Properties Limited Partnership, L.P. (“Omega Operating Partnership”), entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Aviv REIT, Inc. (“Aviv”) and Aviv Healthcare Properties Limited Partnership, L.P. (the “Aviv Operating Partnership”). The Merger Agreement provides for the merger of Aviv with and into the Merger Sub (the “Merger”), with the Merger Sub surviving as a wholly-owned subsidiary of Omega. At the effective time of the Merger, and subject to the terms and subject to the conditions set forth in the Merger Agreement, each outstanding share of Aviv common stock shall be converted into the right to receive 0.90 of a share of Omega common stock. In connection with the Merger, holders of limited partnership units of the Aviv Operating Partnership will receive units of an Omega Operating Partnership based on the same exchange ratio as provided for Aviv common stock in the Merger Agreement. The Omega Operating Partnership units will be convertible into Omega common stock on a 1:1 basis following the completion of the Merger (subject to adjustment based on future events as provided for in the Omega Partnership Agreement).

#### 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, 2013.

#### Government Regulation and Reimbursement

The health care industry is heavily regulated. Our operators are subject to extensive and complex federal, state and local healthcare laws and regulations. These laws and regulations are subject to frequent and substantial changes resulting from the adoption of new legislation, rules and regulations, and administrative and judicial interpretations of existing law. The ultimate timing or effect of these changes, which may be applied retroactively, cannot be predicted. Changes in laws and regulations impacting our operators, in addition to regulatory non-compliance by our operators, can have a significant effect on the operations and financial condition of our operators, which in turn may adversely impact us. See “Item 1A – Risk Factors.” The following is a discussion of certain laws and regulations generally applicable to our operators, and in certain cases, to us.

**Healthcare Reform.** A substantial amount of rules and regulations have been issued under the Patient Protection and Affordable Care Act, as amended by the Health Care and Education and Reconciliation Act of 2010 (collectively referred to as the “Healthcare Reform Law”). We expect additional rules, regulations and interpretations under the

Healthcare Reform Law that may materially affect our operators' financial condition and operations. For example, although the U.S. Supreme Court has upheld the Healthcare Reform Law (other than the requirement that states expand Medicaid beginning in 2014), the Healthcare Reform Law and the implementation thereof continue to receive challenge and scrutiny from Congress, state attorneys general and legislators, and private individuals and organizations. In addition, certain measures recently taken under the authority of, or in connection with, the Healthcare Reform Law may lead to additional modification and/or clarification in the future, including the following:

On January 3, 2013, a new federal Commission on Long-Term Care was established and tasked with developing a plan for the establishment, implementation and financing of a high-quality system to provide long-term care services. In September 2013, the Commission released a report with 38 proposals for legislative and administrative actions to promote the establishment and financing of a long-term care services system that will ensure the availability of such services to those who need them. The Commission recommended creating a national advisory committee and convening a 2015 White House Conference on aging.

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 ten categories, including prescription drugs, rehabilitative and habilitative services, and chronic disease management. As required under the law, each state has defined the essential health benefits required in that state.

The Healthcare Reform Law requires SNFs to implement a compliance and ethics program that is effective in preventing and detecting criminal, civil and administrative violations and in promoting quality of care. The Department of Health and Human Services (“HHS”) has not yet issued the proposed regulations to implement this law that were due in March 2012.

Given the complexity of the Healthcare Reform Law and the substantial requirements for regulation thereunder, the impact of the Healthcare Reform Law on our operators or their ability to meet their obligations to us cannot be predicted. 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. Our operators may not be successful in modifying 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). 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.

**Reimbursement Generally.** A significant portion of our operators’ revenue is derived from governmentally-funded reimbursement programs, consisting primarily of Medicare and Medicaid. In recent years, the federal government and many state governments have focused on reducing expenditures under the 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 such as those described below, could result in a significant reduction of reimbursement rates to our operators under both the Medicare and Medicaid programs.

On April 1, 2014, President Obama signed the “Protecting Access to Medicare Act of 2014” which calls for HHS to develop a value based purchasing program for SNFs aimed at lowering readmission rates. Beginning in 2018, 2% of SNFs’ Medicare payments could be withheld and about 70% of those dollars would be distributed to SNFs with reduced hospital readmissions.

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/or reductions of 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.

**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

condition, which in turn could negatively impact us.

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The Healthcare Reform Law provided for Medicaid coverage to 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%. Pursuant to the law, states may delay Medicaid expansion after 2014, but the federal payment rates will be less.

However, on June 28, 2012, the Supreme Court ruled that states could not be required to expand Medicaid or risk losing federal funding of their existing Medicaid programs. Twenty-seven states and the District of Columbia have expanded or are expanding Medicaid coverage as contemplated by the Healthcare Reform Law, with many of the remaining states involved in a variety of legislative proposals or discussions. HHS has stated that it will consider a limited number of premium assistance demonstration programs from states that want to privatize Medicaid expansion. States must provide a choice between at least two qualified health plans that offer very similar benefits as those required by the health insurance exchanges. Arkansas became the first state to obtain federal approval to use Medicaid funding to purchase private insurance for low-income residents. Iowa, Michigan and Pennsylvania have also secured waivers, and Indiana has a pending waiver for alternative Medicaid expansion plans.

Medicare. The Center for Medicaid and Medicare Services (“CMS”) estimates that aggregate Medicare payments to SNFs will increase by \$750 million, or 2.0%, for the federal fiscal year that begins October 1, 2014 relative to payments in the prior federal fiscal year. This estimated increase is attributable to a 2.5% market based increase, reduced by a 0.5% multifactor productivity adjustment required by law.

Provisions contained in the American Taxpayer Relief Act (“ATRA”) of 2012, known colloquially as the fiscal cliff deal, are designed to reduce Medicare payments to SNFs by an estimated \$600 million during 2012 to 2022. It also reduces payments for multiple procedures or therapies provided on the same day, which will result in approximately \$1.8 billion savings to Medicare over the next 10 years, which will impact SNFs as well. Under ATRA, sequestration cuts impacting domestic and defense spending became effective March 1, 2013. Although Medicaid is exempted from the sequestration cuts, they included a 2% cut in payments to Medicare providers and suppliers, which amounted to an estimated \$11.3 billion in cuts in federal fiscal year 2013. The Bipartisan Budget Act of 2013 provides for \$63 billion in sequestration relief in federal fiscal years 2014 and 2015 which will be split evenly between defense and nondefense programs. It is unknown how Medicare will be impacted.

The “Protecting Access to Medicare Act of 2014” also extended the Medicare therapy cap exceptions process through March 31, 2015. The statutory Medicare Part B outpatient cap for occupational therapy is \$1,920 for 2014, and the combined cap for physical therapy and speech therapy is also \$1,920 for 2014. 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. The exception process permits medically necessary therapy services beyond the cap 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 under its “Five Star Quality Rating System.” Facility rankings, ranging from five stars (“much above average”) to one star (“much below average”) are updated on a monthly basis. SNFs are required to provide information for the CMS Nursing Home Compare website regarding staffing and quality measures. Based on this data and the results of state health inspections, SNFs are then rated based

on the five-star rating system. Beginning in 2015, CMS is making changes to the rating system including: (1) revising scoring methodology by which quality measure ratings are calculated for SNFs; (2) increasing the number and type of quality measures that are not solely based on self-reported data and (3) adding critical measures to staffing such as turnover and retention. 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 future in the CMS five-star rating system.

Office of the Inspector General Activities. The Office of Inspector General's (the "OIG") Work Plan for government fiscal year 2014, 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) Medicare Part A billing; (2) billing patterns for Part B services; (3) state agency verification of deficiency corrections; (4) background checks for employees; and (5) hospitalization of residents for manageable and preventable conditions. The OIG will also 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, as amended, the Health Information Technology for Economic and Clinical Health Act, and the corresponding regulations promulgated thereunder ("HIPAA"). On January 25, 2013, the Office for Civil Rights issued a final rule modifying HIPAA to increase the requirements on our operators. Some of the new requirements include, among other things: making business associates subject to the HIPAA Privacy and Security Rules which will require new business associate agreements; changes in determining whether a breach of unsecured protected health information occurred; new requirements for the Notice of Privacy Practices; and decreasing the time to disclose

protected health information and requiring disclosures to be electronic under certain conditions. HHS has been conducting audits of covered entities to evaluate compliance with HIPAA, and has announced that in 2014 it will continue its audit program which will also include business associates and will focus on security risk assessments.

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. At least one state is allowing residents to sue a SNF for failing to comply with staffing quality measures. 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, 2013. 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 2013 Annual Report on Form 10-K in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

#### Recent Accounting Pronouncements

#### Discontinued Operations

In April 2014, we adopted the Financial Accounting Standards Board's ("FASB") Accounting Standards Update No 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity (ASU 2014-08). ASU 2014-08 changes the criteria for determining which disposals can be presented as discontinued

operations and modified related disclosure requirements. Under the new guidance, a discontinued operation is defined as: (i) a disposal of a component or group of components that is disposed of or is classified as held for sale that represents a strategic shift that has or will have a major effect on an entity's operations and financial results or (ii) an acquired business or nonprofit activity that is classified as held for sale on the date of acquisition. The standard states that a strategic shift could include a disposal of (i) a major geographical area of operations, (ii) a major line of business, (iii) a major equity method investment, or (iv) other major parts of an entity.

The standard expands the disclosures for discontinued operations and requires new disclosures related to individually material disposals that do not meet the definition of a discontinued operation, an entity's continuing involvement with a discontinued operation following the disposal date and retained equity method investments in a discontinued operation. The guidance is effective for annual periods beginning on or after December 15, 2014 and interim periods within that year. Early adoption is permitted, and calendar year-end companies may early adopt the guidance in the first quarter of 2014, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issue. We have chosen to adopt the guidance effective January 1, 2014 and determined that the adoption had no impact on our consolidated financial statements.

### Revenue Recognition

In May 2014, the FASB issued a comprehensive new revenue recognition standard that will supersede nearly all existing revenue recognition guidance under GAAP. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. We will be required to apply the new standard in the first quarter of 2017 and are assessing whether the new standard will have a material effect on our financial position or results of operations.

### 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, 2014 and 2013

#### Operating Revenues

Our operating revenues for the three months ended September 30, 2014, totaled \$130.7 million, an increase of \$27.4 million over the same period in 2013. The \$27.4 million increase was primarily the result of: (i) approximately \$14.2 million of direct financing lease revenue associated with direct financing lease agreements we entered into with the Ark Holding Company, Inc. in November 2013, now known as New Ark Investment, Inc. ("New Ark"), (ii) \$9.6 million increase in mortgage interest income primarily due to (a) the \$415 million new multiple facility mortgage we entered into with an existing operator in the second quarter of 2014 and (b) the \$112.5 million mortgage we entered into with an existing operator in the first quarter of 2014 and (iii) additional \$3.7 million rental income associated with acquisitions and lease amendments made in the fourth quarter of 2013 and throughout 2014.

#### Operating Expenses

Operating expenses for the three months ended September 30, 2014, totaled \$38.4 million, a decrease of approximately \$1.5 million over the same period in 2013. The decrease was primarily due to: (i) a decrease of \$2.1 million in depreciation expense as a result of shorter lived assets acquired over the past few years becoming fully depreciated, (ii) a decrease of \$2.3 million in provision for uncollectible receivables related to the write-off of straight-line receivables for 11 Arkansas facilities that were transitioned from an existing operator to a new operator during the third quarter of 2013, offset by (i) a \$2.1 million increase in provision for impairments on real estate properties, (ii) a \$0.5 million of increase in stock based compensation expense related to the new incentive stock plan and (iii) a \$0.3 million increase in acquisition costs.



#### Other Income (Expense)

For the three months ended September 30, 2014, total other expenses were \$30.5 million, an increase of approximately \$5.3 million over the same period in 2013. The increase was primarily the result of an increase of approximately \$6.4 million in interest expense due to an increase in borrowings outstanding to fund new investments made since September 30, 2013 and a \$0.5 million increase in deferred financing costs offset by a \$1.6 million gain in interest refinancing costs related the early extinguishment of HUD debt in September 2014.

#### Nine Months Ended September 30, 2014 and 2013

#### Operating Revenues

Our operating revenues for the nine months ended September 30, 2014, totaled \$373.5 million, an increase of \$65.9 million over the same period in 2013. The \$65.9 million increase was primarily the result of: (i) \$42.4 million of direct financing lease revenue associated with direct financing lease agreements we entered into with New Ark in November 2013, (ii) \$14.1 million increase in mortgage interest income primarily due to: (a) the \$415 million new multiple facility mortgage we entered into with an existing operator in the second quarter of 2014 and (b) the \$112.5 million mortgage we entered into with an existing operator in the first quarter of 2014 and (iii) additional \$9.7 million rental income associated with acquisitions and lease amendments made since January 1, 2013 offset by a \$0.4 million decrease in other investment income primarily related to a mezzanine loan that was paid off in December 2013.

#### Operating Expenses

Operating expenses for the nine months ended September 30, 2014, totaled \$118.4 million, an increase of approximately \$3.4 million over the same period in 2013. The increase was primarily due to: (i) \$3.7 million provision for impairment on real estate properties, (ii) \$2.6 million increase in general and administrative expense and (iii) \$0.3 million increase in provision for uncollectible receivables offset by a reduction of \$3.5 million for depreciation and amortization expense. The decrease in depreciation expense is the result of shorter lived assets acquired over the past few years becoming fully depreciated. The increase in general and administrative expense is primarily due to an increase of \$2.1 million for stock based compensation expense related to the new incentive stock plan.

#### Other Income (Expense)

For the nine months ended September 30, 2014, total other expenses were \$93.5 million, an increase of approximately \$27.5 million over the same period in 2013. The increase was primarily the result of: (i) an increase of approximately \$12.3 million in interest expense due to an increase in borrowings outstanding and (ii) an increase of approximately \$14.2 million in interest refinancing charge associated with (a) \$2.6 million write-off of deferred financing costs associated with the termination of our previous \$700 million senior unsecured credit facility (the "2012 Credit Facilities"), (b) \$2.0 million write-off of deferred financing costs associated with the termination of our 2013 Term Loan Facility as defined under "Repayment of \$200 Million Term Loan" below and (c) \$1.7 million prepayment penalty on the payoff of HUD debt in June 2014, partially offset by \$3.3 million gain related the early extinguishment of debt write off of premium on the HUD debt paid off in September 2014. In 2013, we recorded an \$11.1 million gain related to the early extinguishment of debt in May 2013.

#### Funds From Operations

Our funds from operations available to common stockholders (“FFO”), for the three months ended September 30, 2014, was \$93.9 million, compared to \$70.3 million, for the same period in 2013. Our FFO for the nine months ended September 30, 2014 was \$258.0 million, compared to \$222.9 million for the same period in 2013.



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 periods ended September 30, 2014 and 2013:

|   | Three Months Ended |          | Nine Months Ended |           |
|---|--------------------|----------|-------------------|-----------|
|   | September 30,      |          | September 30,     |           |
|   | 2014               | 2013     | 2014              | 2013      |
|   | (in thousands)     |          |                   |           |
| Net income available to common stockholders               | \$61,713           | \$38,137 | \$164,359         | \$125,315 |
| Add back loss (deduct gain) from real estate dispositions | 20                 | —        | (2,863 )          | 1,151     |
| Sub-total   | 61,733             | 38,137   | 161,496           | 126,466   |
| Elimination of non-cash items included in net income:     |                    |          |                   |           |
| Depreciation and amortization                             | 30,111             | 32,202   | 92,856            | 96,386    |
| Add back impairments on real estate properties            | 2,102              | —        | 3,660             | —         |
| Funds from operations available to common stockholders    | \$93,946           | \$70,339 | \$258,012         | \$222,852 |

#### Portfolio and Recent Developments

##### \$8 Million New Investment in Q3 2014

On July 1, 2014, we purchased one SNF located in Texas from an unrelated third party for approximately \$8.2 million and leased it to an existing operator of Omega. The 125 bed SNF was added to the operator’s existing master lease with an initial annual cash yield of 9.5%. We allocated approximately \$8.2 million consisting of land (\$0.4 million), building and site improvements (\$7.4 million), and furniture and fixtures (\$0.4 million). We have not recorded goodwill in connection with this transaction.



#### Transition of Two West Virginia Facilities to a New Operator in Q3 2014

On July 1, 2014, we transitioned two West Virginia SNFs that we previously leased to Diversicare Healthcare Services (“Diversicare” and formerly known as Advocat) to a new unrelated third party operator. The two facilities represent 150 operating beds. We amended our Diversicare master lease to reflect the transition of the two facilities to the new operator and for the nine-months ended September 30, 2014 recorded a \$0.8 million provision for uncollectible straight-line accounts receivable. Simultaneous with the Diversicare master lease amendment, we entered into a 12-year master lease with a new third party operator.

#### \$34.6 Million of New Investment in Q2 and Q3 2014

On June 27, 2014, we purchased two SNFs from an unrelated third party for approximately \$17.3 million and leased them to an existing operator of Omega. The SNFs, located in Georgia and South Carolina with a total of 213 beds, were combined into a 12 year master lease with an initial cash yield of 9.5%.

In the third quarter of 2014, we purchased a third SNF in South Carolina with 132 beds that was added to the master lease. The combined purchase price, including the third SNF, was \$34.6 million. We allocated approximately \$34.6 million consisting of land (\$0.9 million), building and site improvements (\$32.1 million), and furniture and fixtures (\$1.6 million). We have not recorded goodwill in connection with this transaction.

#### \$415 Million of New Investment in Q2 2014

On June 30, 2014, we entered into an agreement to refinance/consolidate \$117 million in existing mortgages on 17 facilities into one mortgage and simultaneously provide mortgage financing for an additional 14 facilities. The new \$415 million mortgage is secured by 31 facilities totaling 3,430 licensed beds all located in the state of Michigan. The new loan bears an initial annual cash interest rate of 9.0% and increases by 0.225% per year (e.g., beginning in year 2 the interest rate will be 9.225%, in year 3 the rate will be 9.45%, etc.).

One of the existing mortgages that was refinanced/consolidated into the new \$415 million mortgage included annual interest rate escalators and required the mortgagee to pay a prepayment penalty in the event the mortgage was retired early which required us to record an effective yield interest receivable. In connection with the refinancing/consolidating transaction which was entered into at market terms, the old mortgage was considered to be retired early since the modifications made to the terms of the mortgage were more than minor. As on the date of the refinancing/consolidation transaction, the effective yield interest receivable was approximately \$2.0 million. We forgave the prepayment penalty associated with the retired mortgage and recorded a \$2.0 million provision to write-off the effective yield interest receivable related to the retired mortgage.

#### \$113 Million of New Investment in Q1 2014

On January 17, 2014, we entered into a \$112.5 million first mortgage loan with an existing operator of Omega. The loan is secured by 7 SNFs and 2 ALFs with a total of 798 operating beds located in Pennsylvania (7) and Ohio (2). The loan is cross-defaulted and cross-collateralized with our existing master lease with the operator. The loan bears an initial annual cash interest rate of 9.5% and matures in January 2024.

#### \$4.7 Million of New Investment in Q1 2014

On January 30, 2014, we acquired an ALF in Arizona from an unrelated third party for approximately \$4.7 million. The operations of the 90 bed facility were transitioned to an existing operator of Omega. We allocated approximately \$4.7 million consisting of land (\$0.4 million), building and site improvements (\$3.9 million), and furniture and fixtures (\$0.4 million). We have not recorded goodwill in connection with this transaction.

#### Assets Sold and Closures

During the three-month period ended September 30, 2014, we sold a closed held-for-sale SNF in Indiana for approximately \$0.1 million, resulting in a \$20 thousand loss. We closed one SNF in Texas, and recorded a \$2.1 million impairment charge to reduce the carrying value of the facility to its estimated fair value. We also reclassified one SNF in Vermont with a carrying value of approximately \$6.0 million to assets held-for-sale and recorded a \$23 thousand impairment charge to reduce the carrying value of the facility to its estimated fair value.

In second quarter of 2014, we sold a parcel of undeveloped land in Texas to a third party for approximately \$0.3 million. We also closed a 75 bed developmental disability facility in Indiana and recorded a \$1.6 million impairment charge to reduce the carrying value of the facility to its estimated fair value based upon estimated future cash flows less cost to sell (Level 3).

In first quarter of 2014, we sold one SNF in Louisiana for approximately \$1.0 million, resulting in a \$0.8 million gain. We also sold two closed held-for-sale SNFs for total cash proceeds of \$2.6 million, generating a \$2.1 million gain.

#### Assets Held for Sale

At September 30, 2014, we had one SNF and one parcel of land classified as held-for-sale with an aggregate net book value of approximately \$6.7 million.

#### Liquidity and Capital Resources

At September 30, 2014, we had total assets of \$3.9 billion, stockholders' equity of \$1.4 billion and debt of \$2.3 billion, representing approximately 62.1% of total capitalization.

#### Financing Activities and Borrowing Arrangements

Certain of our other secured and unsecured borrowings are subject to customary affirmative and negative covenants, including financial covenants. As of December 31, 2013 and September 30, 2014, we were in compliance with all affirmative and negative covenants, including financial covenants, for our secured and unsecured borrowings.

#### Bank Credit Facilities

On June 27, 2014, we entered into a new \$1.2 billion unsecured credit facility, comprised of a \$1 billion senior unsecured revolving credit facility (the "Revolving Credit Facility") and a \$200 million senior unsecured term loan facility (the "Term Loan Facility" and, collectively, the "2014 Credit Facilities").

The 2014 Credit Facilities replace our previous \$700 million 2012 Credit Facilities. The 2014 Credit Facilities include an "accordion feature" that permits us to expand our borrowing capacity by \$550 million, for maximum aggregate

commitments of up to \$1.75 billion.

The Revolving Credit Facility is priced at LIBOR plus an applicable percentage (beginning at 130 basis points, with a range of 92.5 to 170 basis points) based on our ratings from Standard & Poor's, Moody's and/or Fitch Ratings, plus a facility fee based on the same ratings (initially 25 basis points, with a range of 12.5 to 30 basis points). The Revolving Credit Facility will be used for acquisitions and general corporate purposes. At September 30, 2014, we had \$3.0 million in borrowings outstanding under the Revolving Credit Facility. The Revolving Credit Facility matures on June 27, 2018, subject to a one-time option by us to extend such maturity date by one year.

The Term Loan Facility is also priced at LIBOR plus an applicable percentage (beginning at 150 basis points, with a range of 100 to 195 basis points) based on our ratings from Standard & Poor's, Moody's and/or Fitch Ratings. At September 30, 2014, we had \$200 million in borrowings outstanding under the Term Loan Facility. The Term Loan Facility matures on June 27, 2019.

For the nine month period ended September 30, 2014, we recorded a non-cash charge of approximately \$2.6 million relating to the write-off of unamortized deferred financing costs associated with the termination of the 2012 Credit Facilities.

#### HUD Mortgage Loans Payoff

On September 30, 2014, we paid approximately \$36.1 million to retire four mortgages guaranteed by U.S. Department of Housing and Urban Development ("HUD"). The payoff resulted in a \$1.6 million gain on the extinguishment of the debt due to the write-off of the \$3.3 million premium recorded at the time of acquisition offset by a prepayment fee of approximately \$1.7 million.

#### Issuance of \$250 Million of Senior Notes

On September 11, 2014, we sold \$250 million aggregate principal amount of our 4.50% Senior Notes due 2025, or the 2025 Notes. The 2025 Notes were sold at an issue price of 99.131% of their face value before the initial purchasers' discount resulting in gross proceeds of approximately \$247.8 million. We used the net proceeds of the offering to repay a portion of our indebtedness outstanding under our Revolving Credit Facility.

The 2025 Notes were issued pursuant to an indenture dated as of September 11, 2014 among Omega, certain of its subsidiaries, as guarantors, and U.S. Bank National Association, as trustee. The 2025 Notes mature on January 15, 2025. The 2025 Notes bear an interest rate of 4.50% per annum, payable semi-annually in arrears on January 15 and July 15 of each year, commencing on July 15, 2015. The notes are fully and unconditionally guaranteed, jointly and severally, by our existing and future subsidiaries that guarantee indebtedness for money borrowed of Omega in a principal amount at least equal to \$50 million (including as of the date hereof our existing senior notes and the facilities under our revolving credit agreement). We may redeem some or all of the notes prior to October 15, 2024 at a price equal to 100% of the principal amount thereof plus a "make-whole" premium, and accrued and unpaid interest, if any, to, but not including, the applicable redemption date. The notes are redeemable on or after October 15, 2024 at a redemption price equal to 100% of the principal amount thereof plus accrued and unpaid interest, if any, to, but not including, the applicable redemption date.

#### Redemption of Diversicare Preferred Stock

On August 20, 2014, Diversicare redeemed the shares of its Series C non-convertible, redeemable preferred stock held by Omega, which had a liquidation preference of approximately \$4.9 million and a dividend rate of 7% per annum. We received approximately \$5.0 million in net proceeds from the redemption of our Diversicare preferred shares. The

Diversicare preferred shares were originally issued to Omega in 2006 in connection with the restructuring of preferred stock and master lease agreements between Diversicare and Omega. We recorded a gain of \$0.6 million in other investment income.

### Repayment of \$200 Million Term Loan

On December 27, 2013, we entered into a new \$200 million senior unsecured, deferred draw, term loan facility (the “2013 Term Loan Facility”) that was scheduled to mature on February 29, 2016.

The 2013 Term Loan Facility was priced at LIBOR plus an applicable percentage (beginning at 175 basis points, with a range of 110 to 230 basis points) based on our ratings from Standard & Poor’s, Moody’s and/or Fitch Ratings.

In January 2014, we drew all \$200 million under the 2013 Term Loan Facility and used the proceeds to (i) fund a new mortgage investment and (ii) repay outstanding borrowings under the 2012 Revolving Credit Facility. In March 2014, we paid off and terminated the 2013 Term Loan Facility with proceeds from the sale of our 4.95% Senior Notes due 2024 (see below). In addition, we recorded a non-cash charge of approximately \$2.0 million relating to the write-off of deferred financing costs associated with the termination of the 2013 Term Loan Facility.

### Issuance of \$400 Million of Senior Notes and Exchange Offer

On March 11, 2014, we sold \$400 million aggregate principal amount of our 4.95% Senior Notes due 2024. These notes were sold at an issue price of 98.58% of the principal amount of the notes, before the initial purchasers’ discount resulting in gross proceeds of approximately \$394.3 million. We used the net proceeds of the offering to repay in full our \$200 million 2013 Term Loan Facility and a portion of our indebtedness outstanding under our 2012 Revolving Credit Facility.

On August 26, 2014, we commenced an offer to exchange \$400 million of our 4.95% Senior Notes due 2024 that have been registered under the Securities Act of 1933 (“exchange notes”) for the \$400 million of our 4.95% Senior Notes due 2024 privately placed in March 2014 (“initial notes”). Approximately 99.875% of the \$400 million 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 October 17, 2014, 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.

### \$250 Million Equity Shelf Program

On March 18, 2013, we entered into separate Equity Distribution Agreements (collectively, the “2013 Equity Shelf Agreements”) to sell shares of our common stock having an aggregate gross sales price of up to \$250 million (the “2013 Equity Shelf Program”) with several financial institutions, each as a sales agent and/or principal (collectively, the “Managers”).

For the three-month period ended September 30, 2014, we issued approximately 0.1 million shares under the 2013 Equity Shelf Program, at an average price of \$37.93 per share, generating gross proceeds of approximately \$5.0 million, before \$75 thousand of commissions. For the nine-month period ended September 30, 2014, we issued approximately 1.8 million shares under the 2013 Equity Shelf Program, at an average price of \$34.33 per share, generating gross proceeds of approximately \$63.5 million, before \$1.2 million of commissions.

### Dividend Reinvestment and Common Stock Purchase Plan



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For the three-month period ended September 30, 2014, approximately 0.5 million shares of our common stock at an average price of \$37.51 per share were issued through our Dividend Reinvestment and Common Stock Purchase Program for gross proceeds of approximately \$20.5 million. For the nine-month period ended September 30, 2014, approximately 1.9 million shares of our common stock at an average price of \$34.09 per share were issued through our Dividend Reinvestment and Common Stock Purchase Program for gross proceeds of approximately \$66.3 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.

For the three- and nine- months ended September 30, 2014, we paid total dividends of \$65.8 million and \$191.3 million, respectively.

On October 16, 2014, the Board of Directors declared a common stock dividend of \$0.52 per share, increasing the quarterly common dividend by \$0.01 per share over the previous quarter. The common dividends are to be paid November 17, 2014 to common stockholders of record on October 31, 2014.

## Liquidity

We believe our liquidity and various sources of available capital, including cash from operations, our existing availability under our 2014 Credit Facilities 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 \$0.5 million as of September 30, 2014, a decrease of \$2.2 million as compared to the balance at December 31, 2013. 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 – Operating activities generated \$259.6 million of net cash flow for the nine months ended September 30, 2014, as compared to \$200.1 million for the same period in 2013, an increase of \$59.5 million. The increase was primarily due to the additional cash flow generated from new investments, including the facilities acquired and leased throughout 2013 and 2014 as well as the new investments in mortgage financing.

Investing Activities – Net cash flow from investing activities was an outflow of \$461.0 million for the nine months ended September 30, 2014, as compared to an outflow of \$69.8 million for the same period in 2013. The \$391.2 million increase in cash outflow from investing activities relates primarily to (i) the \$406.1 million of net mortgage investment made in 2014 compared to \$2.9 million during the same period in 2013 and (ii) \$47.5 million acquisitions made in 2014 compared to \$2.4 million during the same period in 2013. Offsetting the increases of the cash outflow were: (i) in 2014 we had a net cash inflow of \$1.2 million from other investments – net compared to a net cash outflow of \$28.1 million for the same period in 2013, (ii) a decrease of \$11.0 million in our capital renovation program investment compared to the same period of 2013, (iii) an increase of \$1.8 million in proceeds from the sale of real estate in 2014 compared to the same period in 2013 and (iv) in September 2013 we funded a \$15 million deposit for the proposed \$525 million investment scheduled for Q4 2013.

Financing Activities – Net cash flow from financing activities was an inflow of \$199.2 million for the nine months ended September 30, 2014 as compared to an outflow of \$64.2 million for the same period in 2013. The \$263.4 million change in financing activities was primarily a result of: (i) an increase in proceeds of \$782.8 million in long term borrowings including (a) cash proceeds of \$394 million from our 4.95% Senior Notes due 2024 issued in March 2014; (b) cash proceeds of \$200 million on the 2013 Term Loan Facility in the first quarter of 2014 and (c) cash proceeds of \$247.8 million from our 4.5% Senior Notes due 2025 issued in September 2014, as compared to (d) \$59.4 million proceeds from HUD debt refinancing during the first quarter of 2013 and (ii) an increase in net proceeds of \$18.4 million from our dividend reinvestment plan compared to the same period in 2013. Offsetting these increases were: (i) an increase in net payments of \$265 million on the credit facility compared to the same period in 2013, (ii) an increase of \$124.6 million in payments of long term borrowings primarily due to early extinguishment of \$200 million 2013 Term Loan Facility and \$38.0 million HUD mortgage loans payoff including routine HUD debt principal in 2014 as compared to a \$113.4 million HUD mortgage payoff including routine HUD debt principal for the same period in 2013, (iii) dividend payments increased by \$32.2 million due to an increase in number of shares outstanding and an increase of \$0.12 per share in the common dividends and (iv) a decrease in net proceeds of \$98.2 million from our common stock issued through our Equity Shelf Program compared to the same period in 2013.

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

There have been no material changes in our primary market risk exposures or how those exposures are managed from the information disclosed under Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2013.

### 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.

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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, 2014. 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, 2014.

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 11 – 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, 2013, with the Securities and Exchange Commission on February 11, 2014, which sets forth certain risk factors in Item 1A therein. In addition to the risk factors described therein, investors should consider the following risk factors arising from the proposed merger with Aviv.

***Consummation of the Merger with Aviv is subject to certain conditions that may not be satisfied.***

Consummation of the Merger with Aviv is subject certain conditions, including, among others:

- the approval of the stockholders of both our company and Aviv;
- the effectiveness of a registration statement covering the shares of common stock to be issued to the stockholders of Aviv;
- the accuracy of the representations and warranties and compliance with the respective covenants of the parties, subject to certain materiality qualifiers;
- the absence of certain legal impediments;
- the receipt by each party of an opinion from each party’s respective counsel as to the tax treatment of the transaction;
- the receipt by each party of an opinion as to the other party’s tax qualification as REIT;
- the election to the Omega’s board of three directors designated by Aviv;
- stockholder approval of an amendment to our Charter increasing the number of shares of common stock authorized to be issued;
- the completion of a series of transactions resulting in the combination of the Aviv Operating Partnership with the Omega Operating Partnership, thereby creating an umbrella partnership REIT structure, or UPREIT, for Omega; and
- certain other customary conditions.

We cannot provide any assurance that the Merger will be completed, or that there will not be a delay in the completion of the Merger. Any delay could, among other things, result in additional transaction costs, loss of revenue or other negative effects resulting from uncertainty about completion of the Merger. While the Merger Agreement is in force, we are subject to certain restrictions on the conduct of our business, which may adversely affect our ability to execute certain of our business strategies.

In the event the Merger Agreement is terminated or the transaction is materially delayed for any reason, the price of our common stock may be impacted. If the Merger Agreement is terminated, we may incur substantial fees in connection with the termination of the transactions and we will not recognize the anticipated benefits of the Merger. In addition, if the Merger is not completed, we may experience negative reactions from the financial markets and from our operators, employees and others, or be subject to litigation commenced against us to perform our obligations

under the Merger Agreement.

***The anticipated benefits of the Merger with Aviv may not be realized fully and may take longer to realize than expected.***

The success of the Merger will depend, in part, on the combined company's ability to successfully integrate the businesses of the Company and Aviv, which currently operate as independent public companies, and realize the anticipated benefits, including synergies, cost savings, and economies of scale, from the combination. If we are unable to achieve these objectives within the anticipated time frame, or at all, the anticipated benefits may not be realized fully or at all, or may take longer to realize than expected and the value of the combined company's common stock may be harmed.



The Merger is the largest and most significant acquisition the Company has undertaken. We will incur significant transaction and Merger-related costs in connection with the Merger and the integration process. We may encounter material challenges in connection with this integration process, including, without limitation:

the diversion of management's attention from ongoing business concerns and performance shortfalls at one or both of the companies as a result of the devotion of management's attention to the Merger;

managing a larger combined company;

integrating two unique corporate cultures, which may prove to be challenging;

the possibility of faulty assumptions underlying expectations regarding the integration process;

consolidating corporate and administrative infrastructures and eliminating duplicative operations; and

unforeseen expenses or delays associated with the Merger.

Many of these factors will be outside of our control and any one of them could result in increased costs, decreases in the amount of expected revenues and diversion of management's time and energy, which could materially impact our business, financial condition and results of operations.

***We might need additional financing, which may not be available on favorable terms.***

We intend to refinance substantially all of Aviv's outstanding indebtedness. We currently anticipate that our available sources of liquidity, including borrowings under our revolving credit facility, are sufficient to finance all or substantially all of the transactions contemplated by the Merger Agreement. However, to the extent additional financing necessary or desirable, such additional financing may not be available on favorable terms, if at all. Our ability to obtain financing is generally not a condition to closing under the Merger Agreement unless the terms of the financing available would have a material adverse effect on the combined company. If we are unable to obtain sufficient financing or other sources of capital, we may be subject to significant monetary or other damages under the Merger Agreement.

***The Merger will substantially reduce the percentage ownership interests of our current stockholders; it may not be accretive and may cause dilution to our earnings per share, which may negatively affect the market price of our common stock.***

If the Merger is completed, the investors in Aviv and the Aviv Operating Partnership are expected to beneficially own approximately 30% of the common stock of the combined company after the Merger. Our expectations of the benefits of the Merger are based on preliminary estimates, which may materially change, due to additional transaction and integration-related costs, the failure to realize all of the benefits anticipated in the Merger, or unforeseen liabilities or other issues existing or arising with the business of Aviv or otherwise resulting from the Merger. All of these factors could cause dilution to our earnings per share and funds from operations or decrease or delay the expected accretive effect of the Merger and cause a decrease in the price of our common stock.

Item 6–Exhibits

Exhibit No.

- 2.1 Agreement and Plan of Merger, dated as of October 30, 2014, by and among Omega Healthcare Investors, Inc., OHI Healthcare Properties Holdco, Inc., OHI Healthcare Properties Limited Partnership, L.P., Aviv REIT, Inc., and Aviv Healthcare Properties Limited Partnership (Incorporated by reference to Exhibit 2.1 to the Company’s Current Report on Form 8-K, filed on November 5, 2014).
- 4.1 Indenture, dated as of September 11, 2014, by and among Omega Healthcare Investors, Inc., the subsidiary guarantors named therein and U.S. Bank National Association, as trustee, related to the 4.50% Senior Notes due 2025, including the Form of 4.50% Senior Notes and Form of Subsidiary Guarantee related thereto. (Incorporated by reference to Exhibit 4.1 to the Company’s Current Report on Form 8-K, filed on September 11, 2014).
- 4.2 Registration Rights Agreement, dated as of September 11, 2014, by and among Omega Healthcare Investors, Inc., the subsidiary guarantors named therein, and J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Agricole Securities (USA) Inc. and RBS Securities Inc., collectively on behalf of the several Initial Purchasers. (Incorporated by reference to Exhibit 4.2 to the Company’s Current Report on Form 8-K, filed on September 11, 2014).
- 10.1 Ownership Limit Waiver Agreement dated as of October 30, 2014 by and between Omega Healthcare Investors, Inc., and LG Aviv L.P (Incorporated by reference to Exhibit 10,1 to the Company’s Current Report on Form 8-K, filed on November 5, 2014).
- 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.

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, 2014

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

Date: November 7, 2014

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