

OMEGA HEALTHCARE INVESTORS INC  
Form 10-Q  
November 07, 2011

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, 2011

or

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

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

Commission file number 1-11316

OMEGA HEALTHCARE  
INVESTORS, INC.

(Exact name of Registrant as specified in its charter)

Maryland

(State of incorporation)

38-3041398  
(IRS Employer  
Identification No.)

200 International Circle, Suite 3500, Hunt Valley, MD 21030  
(Address of principal executive offices)

(410) 427-1700  
(Telephone number, including area code)

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

Yes  No

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

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated  
filer  Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of October 28, 2011.

|                               |                    |
|-------------------------------|--------------------|
| Common Stock, \$.10 par value | 103,166,383        |
| (Class)                       | (Number of shares) |

OMEGA HEALTHCARE INVESTORS, INC.  
FORM 10-Q  
September 30, 2011

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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>2011<br>(Unaudited) | December<br>31,<br>2010 |
|---|---|-------------------------|
| <b>ASSETS</b>   |   |                         |
| Real estate properties  |   |                         |
| Land and buildings  | \$2,341,012                             | \$2,366,856             |
| Less accumulated depreciation   | (445,272 )                              | (380,995 )              |
| Real estate properties – net  | 1,895,740                               | 1,985,861               |
| Mortgage notes receivable – net   | 119,076                                 | 108,557                 |
|   | 2,014,816                               | 2,094,418               |
| Other investments – net   | 30,394                                  | 28,735                  |
|   | 2,045,210                               | 2,123,153               |
| Assets held for sale – net  | 811                                     | 670                     |
| Total investments   | 2,046,021                               | 2,123,823               |
| Cash and cash equivalents   | 10,730                                  | 6,921                   |
| Restricted cash   | 19,835                                  | 22,399                  |
| Accounts receivable – net   | 96,615                                  | 92,819                  |
| Other assets  | 58,189                                  | 57,172                  |
| Operating assets for owned and operated properties  | 275                                     | 873                     |
| Total assets  | \$2,231,665                             | \$2,304,007             |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |   |                         |
| Revolving line of credit  | \$45,000                                | \$—                     |
| Secured borrowings  | 198,526                                 | 201,296                 |
| Unsecured borrowings – net  | 975,384                                 | 975,669                 |
| Accrued expenses and other liabilities  | 114,438                                 | 121,859                 |
| Operating liabilities for owned and operated properties   | 472                                     | 1,117                   |
| Total liabilities   | 1,333,820                               | 1,299,941               |
| Stockholders' equity:   |   |                         |
| Preferred stock issued and outstanding – 4,340 shares Series D with an aggregate liquidation preference of \$108,488 as of December 31, 2010                  | —                                       | 108,488                 |
| Common stock \$.10 par value authorized – 200,000 shares issued, and outstanding – 103,346 shares as of September 30, 2011 and 99,233 as of December 31, 2010 | 10,335                                  | 9,923                   |
| Common stock – additional paid-in-capital   | 1,468,598                               | 1,376,131               |
| Cumulative net earnings   | 614,137                                 | 580,824                 |
| Cumulative dividends paid   | (1,195,225)                             | (1,071,300)             |
| Total stockholders' equity  | 897,845                                 | 1,004,066               |
| Total liabilities and stockholders' equity  | \$2,231,665                             | \$2,304,007             |

See notes to consolidated financial statements.

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

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
|   | 2011                                | 2010      | 2011                               | 2010      |
| Revenue   |                                     |           |                                    |           |
| Rental income   | \$68,622                            | \$66,299  | \$203,446                          | \$165,028 |
| Mortgage interest income  | 3,617                               | 2,576     | 10,548                             | 7,709     |
| Other investment income – net   | 383                                 | 746       | 1,641                              | 3,282     |
| Miscellaneous   | 196                                 | 103       | 265                                | 3,852     |
| Nursing home revenues of owned and operated assets                    | -                                   | -         | -                                  | 7,336     |
| Total operating revenues  | 72,818                              | 69,724    | 215,900                            | 187,207   |
| Expenses  |                                     |           |                                    |           |
| Depreciation and amortization   | 24,871                              | 27,742    | 74,848                             | 58,880    |
| General and administrative  | 4,393                               | 4,376     | 14,549                             | 11,758    |
| Acquisition costs   | -                                   | 78        | 45                                 | 1,490     |
| Impairment on real estate properties                                  | -                                   | -         | 24,971                             | 155       |
| Provisions for uncollectible mortgages, notes and accounts receivable | -                                   | -         | 4,139                              | -         |
| Nursing home expenses of owned and operated assets                    | 148                                 | 480       | 603                                | 7,849     |
| Total operating expenses  | 29,412                              | 32,676    | 119,155                            | 80,132    |
| Income before other income and expense                                | 43,406                              | 37,048    | 96,745                             | 107,075   |
| Other income (expense):   |                                     |           |                                    |           |
| Interest income   | 12                                  | 11        | 35                                 | 88        |
| Interest expense  | (20,101 )                           | (19,070 ) | (60,173 )                          | (47,350 ) |
| Interest – amortization of deferred financing costs                   | (629 )                              | (978 )    | (2,026 )                           | (2,881 )  |
| Interest –refinancing costs   | (3,055 )                            | -         | (3,071 )                           | (3,461 )  |
| Total other expense   | (23,773 )                           | (20,037 ) | (65,235 )                          | (53,604 ) |
| Income before gain (loss) on assets sold                              | 19,633                              | 17,011    | 31,510                             | 53,471    |
| Gain (loss) on assets sold – net                                      | 1,803                               | (4 )      | 1,803                              | (4 )      |
| Net income  | 21,436                              | 17,007    | 33,313                             | 53,467    |
| Preferred stock dividends   | -                                   | (2,271 )  | (1,691 )                           | (6,814 )  |
| Preferred stock redemption  | -                                   | -         | (3,456 )                           | -         |
| Net income available to common stockholders                           | \$21,436                            | \$14,736  | \$28,166                           | \$46,653  |
| Income per common share available to common stockholders:             |                                     |           |                                    |           |
| Basic:  |                                     |           |                                    |           |
| Net income  | \$0.21                              | \$0.15    | \$0.28                             | \$0.50    |
| Diluted:  |                                     |           |                                    |           |
| Net income  | \$0.21                              | \$0.15    | \$0.28                             | \$0.50    |
| Dividends declared and paid per common share                          | \$0.40                              | \$0.36    | \$1.15                             | \$1.00    |

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|  |         |        |         |        |
|--|---------|--------|---------|--------|
| Weighted-average shares outstanding, basic   | 103,180 | 95,698 | 101,722 | 92,523 |
| Weighted-average shares outstanding, diluted | 103,231 | 95,987 | 101,772 | 92,700 |

Components of other comprehensive income:

|                            |          |          |          |          |
|----------------------------|----------|----------|----------|----------|
| Net income                 | \$21,436 | \$17,007 | \$33,313 | \$53,467 |
| Total comprehensive income | \$21,436 | \$17,007 | \$33,313 | \$53,467 |

See notes to consolidated financial statements.

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

|   | Preferred<br>Stock | 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, 2010<br>(99,233 common shares)  | \$ 108,488         | \$ 9,923                     | \$ 1,376,131                     | \$ 580,824                    | \$(1,071,300)           | \$ 1,004,066 |
| Issuance of common stock:   |                    |                              |                                  |                               |                         |              |
| Grant of restricted stock (13<br>shares at \$22.00 per share)                                   | —                  | 1                            | (1 )                             | —                             | —                       | —            |
| Amortization of restricted stock  | —                  | —                            | 4,478                            | —                             | —                       | 4,478        |
| Vesting of restricted stock<br>(grants 68 shares)   | —                  | 7                            | (1,261 )                         | —                             | —                       | (1,254 )     |
| Dividend reinvestment plan<br>(2,608 shares at \$21.10 per<br>share)                            | —                  | 261                          | 54,656                           | —                             | —                       | 54,917       |
| Grant of stock as payment of<br>directors fees (6 shares at an<br>average of \$20.17 per share) | —                  | 1                            | 112                              | —                             | —                       | 113          |
| Equity Shelf Program (1,419<br>shares at \$22.61 per share, net<br>of issuance costs)           | —                  | 142                          | 31,095                           | —                             | —                       | 31,237       |
| Preferred stock redemption  | (108,488 )         | —                            | 3,388                            | —                             | (3,456 )                | (108,556 )   |
| Net income  | —                  | —                            | —                                | 33,313                        | —                       | 33,313       |
| Common dividends (\$1.15 per<br>share).   | —                  | —                            | —                                | —                             | (117,264 )              | (117,264 )   |
| Preferred dividends (Series D<br>of \$0.74 per share)   | —                  | —                            | —                                | —                             | (3,205 )                | (3,205 )     |
| Balance at September 30, 2011<br>(103,346 common shares)  | \$—                | \$ 10,335                    | \$ 1,468,598                     | \$ 614,137                    | \$(1,195,225)           | \$ 897,845   |

See notes to consolidated financial statements.

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

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2011                               | 2010       |
| Cash flows from operating activities  |                                    |            |
| Net income  | \$33,313                           | \$53,467   |
| Adjustment to reconcile net income to cash provided by operating activities:  |                                    |            |
| Depreciation and amortization   | 74,848                             | 58,880     |
| Impairment on real estate properties  | 24,971                             | 155        |
| Provisions for uncollectible mortgages, notes, and accounts receivable        | 4,139                              | —          |
| Amortization of deferred financing and refinancing costs                      | 5,097                              | 6,342      |
| Restricted stock amortization expense   | 4,518                              | 1,756      |
| (Gain) loss on assets sold – net  | (1,803 )                           | 4          |
| Effective yield receivable on mortgage notes                                  | (932 )                             | —          |
| Amortization of in-place leases   | (4,640 )                           | (1,852 )   |
| Gain on sale of securities  | —                                  | (789 )     |
| Other   | (112 )                             | (113 )     |
| Change in operating assets and liabilities – net of amounts assumed/acquired: |                                    |            |
| Accounts receivable, net  | 355                                | (2,033 )   |
| Straight-line rent  | (9,896 )                           | (6,928 )   |
| Lease inducement  | 2,538                              | (261 )     |
| Other operating assets and liabilities  | (3,331 )                           | (1,105 )   |
| Operating assets and liabilities for owned and operated properties            | (47 )                              | 2,921      |
| Net cash provided by operating activities                                     | 129,018                            | 110,444    |
| Cash flows from investing activities  |                                    |            |
| Acquisition of real estate – net of liabilities assumed and escrows acquired  | (98 )                              | (343,180 ) |
| Placement of mortgage loans   | (10,461 )                          | (2,372 )   |
| Proceeds from sale of real estate investments                                 | 4,150                              | 81         |
| Capital improvements and funding of other investments                         | (12,012 )                          | (25,658 )  |
| Proceeds from other investments   | 3,186                              | 18,720     |
| Investments in other investments  | (4,845 )                           | (16,436 )  |
| Collection of mortgage principal – net  | 54                                 | 60         |
| Net cash used in investing activities   | (20,026 )                          | (368,785 ) |
| Cash flows from financing activities  |                                    |            |
| Proceeds from credit facility borrowings                                      | 289,000                            | 314,000    |
| Payments on credit facility borrowings  | (244,000 )                         | (265,100 ) |
| Receipts of other long-term borrowings  | —                                  | 196,556    |
| Payments of other long-term borrowings  | (1,836 )                           | (59,882 )  |
| Payments of financing related costs   | (4,236 )                           | (9,231 )   |
| Receipts from dividend reinvestment plan                                      | 54,917                             | 43,069     |
| Net proceeds from issuance of common stock                                    | 31,237                             | 136,934    |
| Payments from exercised options and restricted stock – net                    | (1,254 )                           | 89         |
| Dividends paid  | (120,455 )                         | (99,072 )  |
| Redemption of preferred stock   | (108,556 )                         | —          |
| Net cash (used in) provided by financing activities                           | (105,183 )                         | 257,363    |
| Increase (decrease) in cash and cash equivalents                              | 3,809                              | (978 )     |

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|   |          |           |
|---|----------|-----------|
| Cash and cash equivalents at beginning of period            | 6,921    | 2,170     |
| Cash and cash equivalents at end of period                  | \$10,730 | \$1,192   |
| Interest paid during the period, net of amounts capitalized | \$55,882 | \$41,764  |
| Non-cash investing activities                               |          |           |
| Assumed debt obligations                                    | \$—      | \$202,015 |
| Non-cash settlement of mortgage obligations                 | —        | (12,395 ) |
| Non-cash acquisition of real estate properties              | —        | 12,395    |
| Stock consideration issued for acquisition                  | —        | 19,693    |
| Net non-cash investing activities                           | \$—      | \$221,708 |

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Unaudited  
September 30, 2011

NOTE 1 – BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Business Overview

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

Basis of Presentation

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

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

Accounts Receivable

Accounts receivable includes: contractual 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 the lease 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 the collection of our contractual payments and determine the appropriateness of our allowance for uncollectible contractual rents. 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 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>2011 | December 31,<br>2010 |
|---------------------------|-----------------------|----------------------|
|                           | (in thousands)        |                      |
| Contractual receivables   | \$ 7,291              | \$ 5,354             |
| Straight-line receivables | 71,927                | 62,423               |
| Lease inducements         | 23,519                | 29,026               |
| Allowance                 | (6,122 )              | (3,984 )             |
| Accounts receivable – net | \$ 96,615             | \$ 92,819            |

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

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

## NOTE 2 – PROPERTIES AND INVESTMENTS

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

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

### Leased Property

Our leased real estate properties, represented by 369 SNFs, 10 assisted living facilities (“ALFs”) and five specialty facilities at September 30, 2011, 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.



## Connecticut Properties

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

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

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

As a result of these developments, during the three months ended March 31, 2011, we recorded an impairment charge of \$24.4 million to reduce the carrying values of the Connecticut SNFs to their estimated fair values. We estimated the fair value of these facilities based on the facilities’ potential sales value assuming that the facilities would not be used as skilled nursing facilities. As of November 1, 2011, all of the residents of the four facilities have been relocated and the receiver has surrendered possession of all of the facilities to us. We are actively marketing the facilities for sale and/or lease (for purposes other than the provision of skilled nursing care).

## 143 Facility CapitalSource Acquisitions (December 2009 and June 2010)

In November 2009, we entered into a securities purchase agreement (the “CapitalSource Purchase Agreement”) with CapitalSource Inc. (“CapitalSource”) and several of its affiliates, pursuant to which we agreed to purchase CapitalSource subsidiaries owning 80 long term care facilities, plus an option to purchase CapitalSource subsidiaries owning an additional 63 facilities (the “Option”), for approximately \$858 million. We accounted for these acquisitions as business combinations.

The transactions closed in three phases: (i) on December 22, 2009, we purchased CapitalSource entities owning 40 facilities for approximately \$271 million and an option to purchase CapitalSource entities owning 63 additional facilities for \$25 million; (ii) on June 9, 2010, we completed our purchase of the 63 CapitalSource facilities pursuant to the option for an aggregate purchase price of approximately \$293 million in cash, plus the \$25 million purchase option deposit, representing a total purchase price of \$318 million; and (iii) on June 29, 2010, we purchased CapitalSource entities owning 40 facilities for approximately \$271 million and paid approximately \$15 million for escrow accounts transferred to us at closing.

As of December 31, 2010, we completed our purchase price allocation for all three of these transactions. The allocation included the fair value adjustment for above-market debt assumed in the transactions as well as above and below-market in-place leases assumed. For the nine months ended September 30, 2011, we amortized approximately

\$1.1 million of above-market adjustments related to the assumed debt and approximately \$4.6 million of net below market in-place leases assumed from these transactions.

The facilities acquired from CapitalSource on June 9, 2010 and June 29, 2010 are included in our results of operations from the date of acquisition. The following unaudited pro forma results of operations reflect each of the CapitalSource transactions as if they occurred on January 1, 2010. In the opinion of management, all significant necessary adjustments to reflect the effect of the acquisition have been made. The following pro forma information is not indicative of future operations.

|   | Pro Forma                                   |          |  |           |
|---|---|----------|--|-----------|
|   | Three Months Ended<br>September 30,<br>2011 |          | Nine Months Ended<br>September 30,<br>2011 |           |
|   | 2010  | 2010     | 2010                                       | 2010      |
| (in thousands, except per share amount, unaudited)        |   |          |  |           |
| Revenues  | \$72,818                                    | \$69,724 | \$215,900                                  | \$218,964 |
| Net income available to common stockholders               | \$21,436                                    | \$14,736 | \$28,166                                   | \$53,552  |
| Earnings per share – diluted:                             |   |          |  |           |
| Net income available to common stockholders – as reported | \$0.21                                      | \$0.15   | \$0.28                                     | \$0.50    |
| Net income available to common stockholders – pro forma   | \$0.21                                      | \$0.15   | \$0.28                                     | \$0.57    |

#### Assets Sold or Held for Sale

##### Assets Sold

On September 30, 2011, we sold a SNF in North Carolina for approximately \$4.2 million resulting in a gain of approximately \$1.8 million.

##### Held for Sale

At September 30, 2011, we had two SNFs classified as held-for-sale with an aggregate net book value of approximately \$0.8 million.

##### Mortgage Notes Receivable

On July 18, 2011, we entered into a first mortgage loan with Nexion Health, Inc. (“Nexion”) in the amount of \$5.0 million. The mortgage loan matures on July 17, 2012 and carries an interest rate of 10% per year.

Our mortgage notes receivable relate to 15 long-term care facilities and one construction mortgage on a facility currently under construction. The mortgage notes are secured by first mortgage liens on the borrowers’ underlying real estate and personal property. The mortgage notes receivable relate to facilities located in five (5) states, which are operated by five (5) 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, 2011, none of our mortgages were in default or in foreclosure proceedings. Where appropriate, the mortgage properties are generally cross-collateralized with the master lease agreement.

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

### NOTE 3 – OWNED AND OPERATED ASSETS

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

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

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

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

|                                   | Three Months Ended |         | Nine Months Ended |         |
|-----------------------------------|--------------------|---------|-------------------|---------|
|                                   | September 30,      |         | September 30,     |         |
|                                   | 2011               | 2010    | 2011              | 2010    |
|                                   | (in thousands)     |         |                   |         |
| Nursing home revenues             | \$—                | \$—     | \$—               | \$7,336 |
| Nursing home expenses             | 148                | 480     | 603               | 7,849   |
| Loss from nursing home operations | \$(148)            | \$(480) | \$(603)           | \$(513) |

#### NOTE 4 – CONCENTRATION OF RISK

As of September 30, 2011, our portfolio of real estate investments consisted of 401 healthcare facilities, located in 35 states and operated by 49 third-party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately \$2.5 billion at September 30, 2011, with approximately 99% of our real estate investments related to long-term care facilities. This portfolio is made up of 369 SNFs, 10 ALFs, five specialty facilities, fixed rate mortgages on 15 SNFs, and two SNFs that are held-for-sale. At September 30, 2011, we also held miscellaneous investments of approximately \$30.4 million, consisting primarily of secured loans to third-party operators of our facilities. Included in the \$30.4 million miscellaneous investments is a working capital note with an operator that is secured by the operator's accounts receivables. We have classified the note as impaired but believe that the collateral supporting the working capital note is in excess of the balance and therefore, no reserve is recorded. As part of the 2011 MTA, the new third party lessee/operator will assume approximately \$15 million of the working capital note as well as the accounts receivables supporting the note related to the 12 facilities that are expected to be transitioned to the new operator. We are in the process of working with the Connecticut receiver to collect the Connecticut receivables that support the remaining portion of the note.

At September 30, 2011, we had two investments with operators and/or managers that exceeded 10% of our total investment: (i) CommuniCare Health Services ("CommuniCare") (13%) and (ii) Airamid Health Management, LLC through its subsidiaries and management relationships, ("Airamid") (11%). No other operator and/or manager represented more than 10% of our investments for the nine month period ended September 30, 2011. The two states in which we had our highest concentration of investments were Florida (24%) and Ohio (15%) at September 30, 2011.

For the three-month period ended September 30, 2011, our revenues from operations totaled \$72.8 million, of which approximately \$9.7 million was from CommuniCare (13%) and \$8.4 million was from Sun Healthcare ("Sun") (12%). No other operator generated more than 10% of our revenues from operations for the three-month period ended September 30, 2011.

For the nine-month period ended September 30, 2011, our revenues from operations totaled \$215.9 million, of which approximately \$28.9 million was from CommuniCare (13%) and \$25.1 million was from Sun (12%). No other operator generated more than 10% of our revenues from operations for the nine-month period ended September 30, 2011.

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

#### NOTE 5 – DIVIDENDS

##### Common Dividends

On October 13, 2011, the Board of Directors declared a common stock dividend of \$0.40 per share to be paid November 15, 2011 to common stockholders of record on October 31, 2011.

On July 14, 2011, the Board of Directors declared a common stock dividend of \$0.40 per share, increasing the quarterly common dividend by \$0.02, or 5.3%, per share over the prior quarter, that was paid August 15, 2011 to common stockholders of record on August 1, 2011.

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On April 14, 2011, the Board of Directors declared a common stock dividend of \$0.38 per share, increasing the quarterly common dividend by \$0.01 per share over the prior quarter, that was paid May 16, 2011 to common stockholders of record on April 29, 2011.

On January 14, 2011, the Board of Directors declared a common stock dividend of \$0.37 per share that was paid February 15, 2011 to common stockholders of record on January 31, 2011.

### Series D Preferred Dividends

On January 14, 2011, the Board of Directors declared a regular quarterly dividend of approximately \$0.52344 per preferred share on the Series D Preferred Stock that was paid February 15, 2011 to preferred stockholders of record on January 31, 2011.

### Redemption of Series D Preferred Stock

On March 7, 2011, pursuant to authorization from our Board of Directors, we redeemed all of the outstanding shares of our 8.375% Series D Cumulative Redeemable Preferred Stock at a redemption price of \$25 per share plus \$0.21519 per share in accrued and unpaid dividends up to and including the redemption date, for an aggregate redemption price of \$25.21519 per share. Dividends on the shares of Series D Preferred Stock ceased to accrue on and after the redemption date, after which the Series D Preferred Stock ceased to be outstanding.

We borrowed approximately \$103 million under our previous 2010 Credit Facility to fund the redemption price. In connection with the redemption of the Series D Preferred Stock, we wrote-off \$3.4 million of preferred stock issuance costs that reduced first quarter 2011 net income attributable to common stockholders by approximately \$0.03 per common share.

### NOTE 6 – TAXES

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

Subject to the limitation under the REIT asset test rules, we are permitted to own up to 100% of the stock of one or more taxable REIT subsidiaries (“TRSs”). Currently, we have one TRS that is taxable as a corporation and that pays federal, state and local income tax on its net income at the applicable corporate rates. As of September 30, 2011, the TRS had a net operating loss carry-forward of \$1.1 million. The loss carry-forward is fully reserved with a valuation allowance as we concluded it was more-likely-than-not that the deferred tax asset would not be realized.

### NOTE 7 – STOCK-BASED COMPENSATION

The following is a summary of our stock-based compensation expense for the three- and nine- month periods ended September 30, 2011 and 2010, respectively:

|                                  | Three Months Ended<br>September 30,<br>2011 |       | Nine Months Ended<br>September 30,<br>2011 |         |
|----------------------------------|---|-------|--|---------|
|                                  | 2011  | 2010  | 2011                                       | 2010    |
|                                  | (in thousands)                              |       |  |         |
| Stock-based compensation expense | \$1,520                                     | \$450 | \$4,518                                    | \$1,756 |

### 2011 Stock Awards

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



#### Restricted Stock Awards

The restricted stock awards vest 100% on December 31, 2013, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company. As of September 30, 2011, no shares of restricted stock have vested under these restricted stock awards.

#### Performance Restricted Stock Units

We awarded three types of PRSUs to the six employees: (i) 124,244 annual total shareholder return (“TSR”) PRSUs, (ii) 279,550 multi-year TSR PRSUs and (iii) 93,183 multi-year relative TSR PRSUs.

#### Annual TSR PRSUs

The number of shares earned under the annual PRSUs depends generally on the level of achievement of TSR for the year-ended December 31, 2011. The annual PRSUs vest on December 31, 2011, 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 TSR PRSUs

The number of shares earned under the multi-year TSR PRSUs depends generally on the level of achievement of TSR for the three-years ended December 31, 2013. 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

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

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

As of September 30, 2011, none of these PRSUs are vested or earned.

The following table summarizes our total unrecognized compensation cost as of September 30, 2011 associated with outstanding restricted stock and PRSU awards to employees:

|                               | Shares/<br>Units | Grant Date<br>Average<br>Fair<br>Value Per<br>Unit/ Share | Total<br>Compensation<br>Cost<br>(in millions) | Weighted<br>Average<br>Period of<br>Expense<br>Recognition<br>(in months) | Unrecognized<br>Compensation<br>Cost<br>(in millions) |
|-------------------------------|------------------|---|--|---|---|
| Restricted stock              | 428,503          | \$22.44   | \$ 9.6   | 36  | \$ 7.2  |
| 2011 Annual PRSUs             | 124,244          | \$11.04   | 1.4  | 12  | 0.3   |
| Multi-year TSR PRSUs          | 279,550          | \$11.06   | 3.1  | 44  | 2.5   |
| Multi-year relative TSR PRSUs | 93,183           | \$12.26   | 1.1  | 44  | 0.9   |
| Total                         | 925,480          | \$16.45   | \$ 15.2  |   | \$ 10.9   |

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

#### Director Grants

As of September 30, 2011, we had 29,799 shares of restricted stock outstanding to directors. The directors' restricted shares are scheduled to vest over the next three years. As of September 30, 2011, the unrecognized compensation cost associated with the directors is approximately \$0.3 million.

#### NOTE 8 – FINANCING ACTIVITIES AND BORROWING ARRANGEMENTS

##### Secured and Unsecured Borrowings

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

|                               | Maturity       | Current<br>Rate |      | September 30,<br>2011 | December 31,<br>2010 |
|-------------------------------|----------------|-----------------|------|-----------------------|----------------------|
| (in thousands)                |                |                 |      |                       |                      |
| Secured borrowings:           |                |                 |      |                       |                      |
| HUD Berkadia mortgages (1)    | 2036 -<br>2040 | 6.61            | % \$ | 64,933                | \$ 66,128            |
| HUD Capital Funding mortgages | 2040 -<br>2045 | 4.85            | %    | 133,593               | 135,168              |
| Total secured borrowings      |                |                 |      | 198,526               | 201,296              |
| Unsecured borrowings:         |                |                 |      |                       |                      |
| Revolving lines of credit     | 2015           | 2.72            | % \$ | 45,000                | \$ —                 |
| 2016 Notes                    | 2016           | 7.0             | %    | 175,000               | 175,000              |
| 2020 Notes                    | 2020           | 7.5             | %    | 200,000               | 200,000              |
| 2022 Notes                    | 2022           | 6.75            | %    | 575,000               | 575,000              |
| Subordinated debt             | 2021           | 9.0             | %    | 21,264                | 21,403               |
|                               |                |                 |      | 971,264               | 971,403              |
| Premium – net                 |                |                 |      | 4,120                 | 4,266                |
| Total unsecured borrowings    |                |                 |      | 1,020,384             | 975,669              |

|              |   |              |              |
|--------------|---|--------------|--------------|
| Totals – net |   | \$ 1,218,910 | \$ 1,176,965 |
| (1)          | Reflects the weighted average interest rate on the mortgages. |              |              |

## Bank Credit Agreements

At September 30, 2011, we had \$45.0 million outstanding under our new \$475 million unsecured revolving credit facility (the “2011 Credit Facility”), and no letters of credit outstanding, leaving availability of \$430.0 million.

On August 16, 2011, we entered into our new 2011 Credit Facility and concurrently terminated our previous \$320 million senior secured revolving credit facility (the “2010 Credit Facility”). The 2011 Credit Facility matures in four years, on August 17, 2015. The 2011 Credit Facility includes an “accordion feature” that permits us to expand our borrowing capacity to \$600 million. For the three month period ended September 30, 2011, we recorded a non-cash charge of approximately \$3.1 million relating to the write-off of deferred financing costs associated with the termination of the 2010 Credit Facility.

The 2011 Credit Facility is priced at LIBOR plus an applicable percentage (ranging from 225 basis points to 300 basis points) based on our consolidated leverage. In the event the Company achieves at least two investment grade ratings from Standard & Poor’s, Moody’s and/or Fitch Ratings, the 2011 Credit Facility will be priced at LIBOR plus an applicable percentage ranging from 150 basis points to 210 basis points (including a facility fee). The Company’s applicable percentage above LIBOR was 250 basis points at September 30, 2011 under the 2011 Credit Facility. The 2011 Credit Facility will be used for acquisitions and general corporate purposes.

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

## \$100 Million Stock Repurchase Program

On August 30, 2011, Omega’s Board of Directors authorized the repurchase of up to \$100 million of its outstanding common stock from time to time over the next 12 months.

We are authorized to repurchase shares of our common stock in open market and privately negotiated transactions at the times, and in the manner and amounts, as determined by Omega’s management and in accordance with the pricing guidelines approved by our Board of Directors and applicable law. The timing and amount of stock repurchases will depend on a variety of factors, including market conditions and corporate and regulatory considerations. We have no obligation to repurchase any amount of our common stock, and such repurchases, if any, may be discontinued at any time. We expect to fund stock repurchases under the program with borrowings under the 2011 Credit Facility.

On September 30, 2011, the Company entered open market transactions to repurchase 183,310 shares of its common stock at an average price of \$15.96 per share. This repurchase of these common shares settled in the ordinary course on October 5, 2011, subsequent to the end of the third quarter of 2011.

**\$140 Million Equity Shelf Program**

For the three months ended September 30, 2011, no shares of our common stock were issued through our \$140 million Equity Shelf Program (the “2010 ESP”). For the nine months ended September 30, 2011, 1.4 million shares of our common stock were issued through the 2010 ESP for net proceeds of approximately \$31.4 million, net of \$0.6 million of commissions.

**\$575 Million 6.75% Senior Notes Exchange Offer**

On June 2, 2011, we commenced an offer to exchange \$575 million of our 6.75% Senior Notes due 2022 that have been registered under the Securities Act of 1933 for \$575 million of our outstanding 6.75% Senior Notes due 2022, which were issued in October and November 2010 in two separate private placements.

All \$575 million outstanding aggregate principal amount of the initial notes were validly tendered and not withdrawn prior to the expiration of the exchange offer, and were exchanged for exchange notes as of July 14, 2011, pursuant to the terms of the exchange offer. The exchange notes are identical in all material respects to the initial notes, except that the issuance of the exchange notes was registered under the Securities Act of 1933 and the provisions of the initial notes relating to transfer restrictions, registration rights and additional interest relating to registrations delays do not apply to the exchange notes.

**NOTE 9 – FINANCIAL INSTRUMENTS**

At September 30, 2011 and December 31, 2010, the carrying amounts and fair values of our financial instruments were as follows:

|                                 | 2011                |                     | 2010                |                     |
|---------------------------------|---------------------|---------------------|---------------------|---------------------|
|                                 | Carrying<br>Amount  | Fair<br>Value       | Carrying<br>Amount  | Fair<br>Value       |
| (in thousands)                  |                     |                     |                     |                     |
| <b>Assets:</b>                  |                     |                     |                     |                     |
| Cash and cash equivalents       | \$ 10,730           | \$ 10,730           | \$ 6,921            | \$ 6,921            |
| Restricted cash                 | 19,835              | 19,835              | 22,399              | 22,399              |
| Mortgage notes receivable – net | 119,076             | 120,608             | 108,557             | 109,610             |
| Other investments – net         | 30,394              | 29,361              | 28,735              | 25,317              |
| <b>Totals</b>                   | <b>\$ 180,035</b>   | <b>\$ 180,534</b>   | <b>\$ 166,612</b>   | <b>\$ 164,247</b>   |
| <b>Liabilities:</b>             |                     |                     |                     |                     |
| Revolving lines of credit       | \$ 45,000           | \$ 45,000           | \$ —                | \$ —                |
| 7.00% Notes due 2016 – net      | 174,337             | 182,233             | 174,221             | 187,079             |
| 7.50% Notes due 2020 – net      | 197,116             | 198,939             | 196,857             | 212,837             |
| 6.75% Notes due 2022 – net      | 582,667             | 565,710             | 583,188             | 576,019             |
| HUD debt                        | 198,526             | 205,408             | 201,296             | 214,643             |
| Subordinated debt               | 21,264              | 22,371              | 21,403              | 23,248              |
| <b>Totals</b>                   | <b>\$ 1,218,910</b> | <b>\$ 1,219,661</b> | <b>\$ 1,176,965</b> | <b>\$ 1,213,826</b> |

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 2010 Annual Report on Form 10-K). The use of different market assumptions and estimation methodologies may have a material effect on the reported estimated fair value amounts.

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

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- Cash and cash equivalents and restricted cash: The carrying amount of cash and cash equivalents and restricted cash reported in the balance sheet approximates fair value because of the short maturity of these instruments (i.e., less than 90 days).
- Mortgage notes receivable: The fair values of the mortgage notes receivables are estimated using a discounted cash flow analysis, using interest rates being offered for similar loans to borrowers with similar credit ratings.
- Other investments: Other investments are primarily comprised of: (i) notes receivable and (ii) an investment in redeemable non-convertible preferred security of an unconsolidated business accounted for using the cost method of accounting. The fair values of notes receivable are estimated using a discounted cash flow analysis, using interest rates being offered for similar loans to borrowers with similar credit ratings. The fair value of the investment in the unconsolidated business is estimated using quoted market value and considers the terms of the underlying arrangement.
- Revolving lines of credit: The fair value of our borrowings under variable rate agreements are estimated using an expected present value technique based on expected cash flows discounted using the current market rates.
- Senior notes and other long-term borrowings: The fair value of our borrowings under fixed rate agreements are estimated based on open market trading activity provided by a third party.

#### NOTE 10 – LITIGATION

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

#### NOTE 11 – EARNINGS PER SHARE

The computation of basic earnings per share (“EPS”) is computed by dividing net income available to common stockholders by the weighted-average number of shares of common stock outstanding during the relevant period. Diluted EPS is computed using the treasury stock method, which is net income 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, |          |
|---|--|----------|------------------------------------|----------|
|   | 2011                                     | 2010     | 2011                               | 2010     |
|   | (in thousands, except per share amounts) |          |                                    |          |
| <b>Numerator:</b>   |  |          |                                    |          |
| Net income  | \$21,436                                 | \$17,007 | \$33,313                           | \$53,467 |
| Preferred stock dividends   | —  | (2,271 ) | (1,691 )                           | (6,814 ) |
| Preferred stock redemption  | —  | —        | (3,456 )                           | —        |
| Numerator for net income available to common per share -<br>basic and diluted | \$21,436                                 | \$14,736 | \$28,166                           | \$46,653 |
| <b>Denominator:</b>   |  |          |                                    |          |
| Denominator for basic earnings per share                                      | 103,180                                  | 95,698   | 101,722                            | 92,523   |
| <b>Effect of dilutive securities:</b>   |  |          |                                    |          |
| Restricted stock  | 38                                       | 281      | 38                                 | 168      |
| Stock option incremental shares   | —  | —        | —                                  | 3        |
| Deferred stock  | 13                                       | 8        | 12                                 | 6        |
| Denominator for diluted earnings per share                                    | 103,231                                  | 95,987   | 101,772                            | 92,700   |
| <b>Earnings per share – basic:</b>  |  |          |                                    |          |
| Net income – basic  | \$0.21                                   | \$0.15   | \$0.28                             | \$0.50   |
| <b>Earnings per share – diluted:</b>  |  |          |                                    |          |
| Net income – diluted  | \$0.21                                   | \$0.15   | \$0.28                             | \$0.50   |

#### NOTE 12 – CONSOLIDATING FINANCIAL STATEMENTS

As of September 30, 2011, we had outstanding (i) \$175 million 7% Senior Notes due 2016, (ii) \$200 million 7.5% Senior Notes due 2020 and (iii) \$575 million 6.75% Senior Notes due 2022, which we collectively refer to as the Senior Notes. The Senior Notes are fully and unconditionally guaranteed, jointly and severally, by each of our subsidiaries that guarantee other indebtedness of Omega or any of the subsidiary guarantors. Any subsidiary that we properly designate as an “unrestricted subsidiary” under the indentures governing the Senior Notes will not provide guarantees of the Senior Notes. As of and prior to March 31, 2010, the non-subsidiary guarantors were minor and insignificant. On June 29, 2010, we designated as “unrestricted subsidiaries” the 39 subsidiaries acquired from CapitalSource on such date (see Note 2). For the nine months ended September 30, 2011, the operating cash flow of the non-guarantor subsidiaries approximated net income of the non-guarantor subsidiaries, adjusted for depreciation and amortization expense. For the nine-month period ended September 30, 2011, the non-guarantor subsidiaries have not engaged in investing or financing activities other than the principal payment of \$1.8 million for the HUD mortgages on the facilities owned by the non-guarantor subsidiaries. All of the subsidiary guarantors of our outstanding senior notes are 100 percent owned by Omega.

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



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

|   | September 30, 2011                   |                                    |                        |              |
|---|--------------------------------------|------------------------------------|------------------------|--------------|
|   | Issuer &<br>Subsidiary<br>Guarantors | Non –<br>Guarantor<br>Subsidiaries | Elimination<br>Company | Consolidated |
| Land and buildings                                      | \$ 2,027,666                         | \$ 313,346                         | \$ —                   | \$ 2,341,012 |
| Less accumulated depreciation                           | (425,775 )                           | (19,497 )                          | —                      | (445,272 )   |
| Real estate properties – net                            | 1,601,891                            | 293,849                            | —                      | 1,895,740    |
| Mortgage notes receivable – net                         | 119,076                              | —                                  | —                      | 119,076      |
|   | 1,720,967                            | 293,849                            | —                      | 2,014,816    |
| Other investments – net                                 | 30,394                               | —                                  | —                      | 30,394       |
|   | 1,751,361                            | 293,849                            | —                      | 2,045,210    |
| Assets held for sale – net                              | 811                                  | —                                  | —                      | 811          |
| Total investments                                       | 1,752,172                            | 293,849                            | —                      | 2,046,021    |
| Cash and cash equivalents                               | 10,730                               | —                                  | —                      | 10,730       |
| Restricted cash   | 6,705                                | 13,130                             | —                      | 19,835       |
| Accounts receivable – net                               | 93,948                               | 2,667                              | —                      | 96,615       |
| Investment in affiliates                                | 76,213                               | —                                  | (76,213 )              | —            |
| Other assets  | 34,912                               | 23,277                             | —                      | 58,189       |
| Operating assets for owned and operated properties      | 275                                  | —                                  | —                      | 275          |
| Total assets  | \$ 1,974,955                         | \$ 332,923                         | (76,213 )              | \$ 2,231,665 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>             |                                      |                                    |                        |              |
| Revolving line of credit                                | \$ 45,000                            | \$ —                               | \$ —                   | \$ 45,000    |
| Secured borrowings                                      | —                                    | 198,526                            | —                      | 198,526      |
| Unsecured borrowings – net                              | 954,120                              | 21,264                             | —                      | 975,384      |
| Accrued expenses and other liabilities                  | 77,518                               | 36,920                             | —                      | 114,438      |
| Intercompany payable                                    | —                                    | 68,411                             | (68,411 )              | —            |
| Operating liabilities for owned and operated properties | 472                                  | —                                  | —                      | 472          |
| Total liabilities                                       | 1,077,110                            | 325,121                            | (68,411 )              | 1,333,820    |
| Stockholders' equity:                                   |                                      |                                    |                        |              |
| Common stock  | 10,335                               | —                                  | —                      | 10,335       |
| Common stock – additional paid-in-capital               | 1,468,598                            | —                                  | —                      | 1,468,598    |
| Cumulative net earnings                                 | 614,137                              | 7,802                              | (7,802 )               | 614,137      |
| Cumulative dividends paid                               | (1,195,225 )                         | —                                  | —                      | (1,195,225 ) |
| Total stockholders' equity                              | 897,845                              | 7,802                              | (7,802 )               | 897,845      |
|   | \$ 1,974,955                         | \$ 332,923                         | \$ (76,213 )           | \$ 2,231,665 |

Total liabilities and stockholders'  
equity

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

|   | December 31, 2010                    |                                    |                        |              |
|---|--------------------------------------|------------------------------------|------------------------|--------------|
|   | Issuer &<br>Subsidiary<br>Guarantors | Non –<br>Guarantor<br>Subsidiaries | Elimination<br>Company | Consolidated |
| Land and buildings                                      | \$ 2,053,510                         | \$ 313,346                         | \$ —                   | \$ 2,366,856 |
| Less accumulated depreciation                           | (372,925 )                           | (8,070 )                           | —                      | (380,995 )   |
| Real estate properties – net                            | 1,680,585                            | 305,276                            | —                      | 1,985,861    |
| Mortgage notes receivable – net                         | 108,557                              | —                                  | —                      | 108,557      |
|   | 1,789,142                            | 305,276                            | —                      | 2,094,418    |
| Other investments – net                                 | 28,735                               | —                                  | —                      | 28,735       |
|   | 1,817,877                            | 305,276                            | —                      | 2,123,153    |
| Assets held for sale – net                              | 670                                  | —                                  | —                      | 670          |
| Total investments                                       | 1,818,547                            | 305,276                            | —                      | 2,123,823    |
| Cash and cash equivalents                               | 6,921                                | —                                  | —                      | 6,921        |
| Restricted cash   | 9,279                                | 13,120                             | —                      | 22,399       |
| Accounts receivable – net                               | 91,729                               | 1,090                              | —                      | 92,819       |
| Investment in affiliates                                | 81,334                               | —                                  | (81,334 )              | —            |
| Other assets  | 36,653                               | 20,519                             | —                      | 57,172       |
| Operating assets for owned and operated properties      | 873                                  | —                                  | —                      | 873          |
| Total assets  | \$ 2,045,336                         | \$ 340,005                         | (81,334 )              | \$ 2,304,007 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>             |                                      |                                    |                        |              |
| Revolving line of credit                                | \$ —                                 | \$ —                               | \$ —                   | \$ —         |
| Secured borrowings                                      | —                                    | 201,296                            | —                      | 201,296      |
| Unsecured borrowings – net                              | 954,266                              | 21,403                             | —                      | 975,669      |
| Accrued expenses and other liabilities                  | 85,887                               | 35,972                             | —                      | 121,859      |
| Intercompany payable                                    | —                                    | 78,806                             | (78,806 )              | —            |
| Operating liabilities for owned and operated properties | 1,117                                | —                                  | —                      | 1,117        |
| Total liabilities                                       | 1,041,270                            | 337,477                            | (78,806 )              | 1,299,941    |
| Stockholders' equity:                                   |                                      |                                    |                        |              |
| Preferred stock   | 108,488                              | —                                  | —                      | 108,488      |
| Common stock  | 9,923                                | —                                  | —                      | 9,923        |
| Common stock – additional paid-in-capital               | 1,376,131                            | —                                  | —                      | 1,376,131    |
| Cumulative net earnings                                 | 580,824                              | 2,528                              | (2,528 )               | 580,824      |
| Cumulative dividends paid                               | (1,071,300 )                         | —                                  | —                      | (1,071,300 ) |
| Total stockholders' equity                              | 1,004,066                            | 2,528                              | (2,528 )               | 1,004,066    |
|   | \$ 2,045,336                         | \$ 340,005                         | \$ (81,334 )           | \$ 2,304,007 |

Total liabilities and stockholders'  
equity

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

|   | Three Months Ended September 30, 2011 |                                    |                        | Nine Months Ended September 30, 2011 |                                      |                                    |                        |                |
|---|---------------------------------------|------------------------------------|------------------------|--------------------------------------|--------------------------------------|------------------------------------|------------------------|----------------|
|   | Issuer &<br>Subsidiary<br>Guarantors  | Non –<br>Guarantor<br>Subsidiaries | Elimination<br>Company | Consolidated                         | Issuer &<br>Subsidiary<br>Guarantors | Non –<br>Guarantor<br>Subsidiaries | Elimination<br>Company | Consolidated   |
| <b>Revenue</b>  |                                       |                                    |                        |                                      |                                      |                                    |                        |                |
| Rental income   | \$60,333                              | \$ 8,289                           | \$ -                   | \$ 68,622                            | \$178,289                            | \$ 25,157                          | \$ -                   | \$ 203,446     |
| Mortgage interest<br>income                                 | 3,617                                 | -                                  | -                      | 3,617                                | 10,548                               | -                                  | -                      | 10,548         |
| Other investment<br>income – net                            | 383                                   | -                                  | -                      | 383                                  | 1,641                                | -                                  | -                      | 1,641          |
| Miscellaneous   | 196                                   | -                                  | -                      | 196                                  | 265                                  | -                                  | -                      | 265            |
| <b>Total operating<br/>revenues</b>                         | <b>64,529</b>                         | <b>8,289</b>                       | <b>-</b>               | <b>72,818</b>                        | <b>190,743</b>                       | <b>25,157</b>                      | <b>-</b>               | <b>215,900</b> |
| <b>Expenses</b>   |                                       |                                    |                        |                                      |                                      |                                    |                        |                |
| Depreciation and<br>amortization                            | 21,000                                | 3,871                              | -                      | 24,871                               | 63,421                               | 11,427                             | -                      | 74,848         |
| General and<br>administrative                               | 4,329                                 | 64                                 | -                      | 4,393                                | 14,324                               | 225                                | -                      | 14,549         |
| Acquisition costs   | -                                     | -                                  | -                      | -                                    | 45                                   | -                                  | -                      | 45             |
| Impairment loss<br>on real estate<br>properties             | -                                     | -                                  | -                      | -                                    | 24,971                               | -                                  | -                      | 24,971         |
| Provisions for<br>uncollectible<br>accounts<br>receivable   | -                                     | -                                  | -                      | -                                    | 4,139                                | -                                  | -                      | 4,139          |
| Nursing home<br>expenses of owned<br>and operated<br>assets | 148                                   | -                                  | -                      | 148                                  | 603                                  | -                                  | -                      | 603            |
| <b>Total operating<br/>expenses</b>                         | <b>25,477</b>                         | <b>3,935</b>                       | <b>-</b>               | <b>29,412</b>                        | <b>107,503</b>                       | <b>11,652</b>                      | <b>-</b>               | <b>119,155</b> |
| <b>Income before<br/>other income and<br/>expense</b>       | <b>39,052</b>                         | <b>4,354</b>                       | <b>-</b>               | <b>43,406</b>                        | <b>83,240</b>                        | <b>13,505</b>                      | <b>-</b>               | <b>96,745</b>  |
| <b>Other income<br/>(expense):</b>                          |                                       |                                    |                        |                                      |                                      |                                    |                        |                |
| Interest income   | 6                                     | 6                                  | -                      | 12                                   | 15                                   | 20                                 | -                      | 35             |
| Interest expense  | (17,374 )                             | (2,727 )                           | -                      | (20,101 )                            | (51,922 )                            | (8,251 )                           | -                      | (60,173 )      |
| Interest –<br>amortization of                               | (629 )                                | -                                  | -                      | (629 )                               | (2,026 )                             | -                                  | -                      | (2,026 )       |

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deferred financing  
costs

Interest

–refinancing costs (3,055 ) - - (3,055 ) (3,071 ) - - (3,071 )

Equity in earnings 1,633 - (1,633 ) - 5,274 - (5,274 ) -

Total other

expense (19,419) (2,721 ) (1,633 ) (23,773 ) (51,730) (8,231 ) (5,274 ) (65,235 )

Income before gain

on assets sold 19,633 1,633 (1,633 ) 19,633 31,510 5,274 (5,274 ) 31,510

Gain on assets

sold - net 1,803 - - 1,803 1,803 - - 1,803

Net income 21,436 1,633 (1,633 ) 21,436 33,313 5,274 (5,274 ) 33,313

Preferred stock

dividends - - - - (1,691 ) - - (1,691 )

Preferred stock

redemption - - - - (3,456 ) - - (3,456 )

Net income

available to

common

stockholders \$21,436 \$ 1,633 \$ (1,633 ) \$ 21,436 \$28,166 \$ 5,274 \$ (5,274 ) \$ 28,166

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

|  | Three Months Ended September 30, 2010 |                                    |                        | Nine Months Ended September 30, 2010 |                                      |                                    |                        |                |
|--|---------------------------------------|------------------------------------|------------------------|--------------------------------------|--------------------------------------|------------------------------------|------------------------|----------------|
|  | Issuer &<br>Subsidiary<br>Guarantors  | Non –<br>Guarantor<br>Subsidiaries | Elimination<br>Company | Consolidated                         | Issuer &<br>Subsidiary<br>Guarantors | Non –<br>Guarantor<br>Subsidiaries | Elimination<br>Company | Consolidated   |
| <b>Revenue</b>                                     |                                       |                                    |                        |                                      |                                      |                                    |                        |                |
| Rental income                                      | \$57,992                              | \$ 8,307                           | \$ -                   | \$ 66,299                            | \$156,569                            | \$ 8,459                           | \$ -                   | \$ 165,028     |
| Mortgage interest income                           | 2,576                                 | -                                  | -                      | 2,576                                | 7,709                                | -                                  | -                      | 7,709          |
| Other investment income – net                      | 746                                   | -                                  | -                      | 746                                  | 3,282                                | -                                  | -                      | 3,282          |
| Miscellaneous                                      | 103                                   | -                                  | -                      | 103                                  | 3,852                                | -                                  | -                      | 3,852          |
| Nursing home revenues of owned and operated assets | -                                     | -                                  | -                      | -                                    | 7,336                                | -                                  | -                      | 7,336          |
| <b>Total operating revenues</b>                    | <b>61,417</b>                         | <b>8,307</b>                       | <b>-</b>               | <b>69,724</b>                        | <b>178,748</b>                       | <b>8,459</b>                       | <b>-</b>               | <b>187,207</b> |
| <b>Expenses</b>                                    |                                       |                                    |                        |                                      |                                      |                                    |                        |                |
| Depreciation and amortization                      | 23,772                                | 3,970                              | -                      | 27,742                               | 54,836                               | 4,044                              | -                      | 58,880         |
| General and administrative                         | 4,146                                 | 230                                | -                      | 4,376                                | 11,525                               | 233                                | -                      | 11,758         |
| Acquisition costs                                  | 78                                    | -                                  | -                      | 78                                   | 1,490                                | -                                  | -                      | 1,490          |
| Impairment loss on real estate properties          | -                                     | -                                  | -                      | -                                    | 155                                  | -                                  | -                      | 155            |
| Nursing home expenses of owned and operated assets | 480                                   | -                                  | -                      | 480                                  | 7,849                                | -                                  | -                      | 7,849          |
| <b>Total operating expenses</b>                    | <b>28,476</b>                         | <b>4,200</b>                       | <b>-</b>               | <b>32,676</b>                        | <b>75,855</b>                        | <b>4,277</b>                       | <b>-</b>               | <b>80,132</b>  |
| <b>Income before other income and expense</b>      | <b>32,941</b>                         | <b>4,107</b>                       | <b>-</b>               | <b>37,048</b>                        | <b>102,893</b>                       | <b>4,182</b>                       | <b>-</b>               | <b>107,075</b> |
| <b>Other income (expense):</b>                     |                                       |                                    |                        |                                      |                                      |                                    |                        |                |
| Interest income                                    | 8                                     | 3                                  | -                      | 11                                   | 84                                   | 4                                  | -                      | 88             |
| Interest expense                                   | (16,154)                              | (2,916 )                           | -                      | (19,070 )                            | (44,370 )                            | (2,980 )                           | -                      | (47,350 )      |
| Interest – amortization of                         | (978 )                                | -                                  | -                      | (978 )                               | (2,881 )                             | -                                  | -                      | (2,881 )       |

deferred  
financing costs

|  |           |          |             |           |           |          |             |           |
|--|-----------|----------|-------------|-----------|-----------|----------|-------------|-----------|
| Interest –<br>refinancing costs                      | -         | -        | -           | -         | (3,461 )  | -        | -           | (3,461 )  |
| Equity in earnings                                   | 1,194     | -        | (1,194 )    | -         | 1,206     | -        | (1,206 )    | -         |
| Total other<br>expense                               | (15,930)  | (2,913 ) | (1,194 )    | (20,037 ) | (49,422 ) | (2,976 ) | (1,206 )    | (53,604 ) |
| Income before<br>gain (loss) on<br>assets sold       | 17,011    | 1,194    | (1,194 )    | 17,011    | 53,471    | 1,206    | (1,206 )    | 53,471    |
| Loss on assets<br>sold – net                         | (4 )      | -        | -           | (4 )      | (4 )      | -        | -           | (4 )      |
| Net income   | 17,007    | 1,194    | (1,194 )    | 17,007    | 53,467    | 1,206    | (1,206 )    | 53,467    |
| Preferred stock<br>dividends                         | (2,271 )  | -        | -           | (2,271 )  | (6,814 )  | -        | -           | (6,814 )  |
| Net income<br>available to<br>common<br>stockholders | \$ 14,736 | \$ 1,194 | \$ (1,194 ) | \$ 14,736 | \$ 46,653 | \$ 1,206 | \$ (1,206 ) | \$ 46,653 |

#### NOTE 13 – SUBSEQUENT EVENTS

On October 31, 2011, we completed approximately \$69 million of combined new investments with affiliates of Persimmon Ventures, LLC (“Persimmon”) a new operator to us.

##### Purchase / Lease Back Transaction

Effective October 31, 2011, we purchased three SNFs located in Maryland (2) and West Virginia (1), totaling 511 beds for a total investment of \$44 million, consisting of \$ 14 million in cash and the assumption of \$30 million, 4.87% (weighted-average) indebtedness guaranteed by the U.S. Department of Housing and Urban Development (“HUD”) maturing between March 2036 and August 2040.

In addition to the purchase / leaseback transaction described above, we have held back an additional \$17 million of cash in anticipation of taking title to a third Maryland facility within the next several months. The actual purchase and leaseback is subject to, amongst other things, the completion of a major renovation project.

##### Mortgage Transaction

Also on October 31, 2011, and simultaneous with the close of the above purchase / leaseback transaction, we entered into a first mortgage loan with Persimmon in the amount of \$25 million (the “Persimmon Loan”), secured by a lien on three SNFs, totaling 352 beds, all located in Maryland. The Persimmon Loan will be cross defaulted with the above related leases.

The overall combined transaction, including the aforementioned third Maryland leased facility, totals \$86 million, consisting of \$56 million in cash and \$30 million in assumed HUD indebtedness, with a combined initial annual yield of approximately 10%. The combined transaction includes 7 facilities located in 2 states with 938 beds.

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. 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 comparative 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, 2010, in Part II, Item 1A to our Quarterly Reports on Form 10-Q for the three months ending March 31, 2011 and June 30, 2011, and in Part II, Item 1A of this report;
- (ii) uncertainties relating to the business operations of the operators of our assets, including those relating to reimbursement by third-party payors, regulatory matters and occupancy levels;
- (iii) the ability of any operators in bankruptcy to reject unexpired lease obligations, modify the terms of our mortgages and impede our ability to collect unpaid rent or interest during the process of a bankruptcy proceeding and retain security deposits for the debtors’ obligations;
- (iv) our ability to sell closed or foreclosed assets on a timely basis and on terms that allow us to realize the carrying value of these assets;
- (v) our ability to negotiate appropriate modifications to the terms of our credit facilities;
- (vi) our ability to manage, re-lease or sell any owned and operated facilities;
- (vii) the availability and cost of capital;
- (viii) changes in our credit ratings and the ratings of our debt securities;
- (ix) competition in the financing of healthcare facilities;
- (x) regulatory and other changes in the healthcare sector;
- (xi) the effect of economic and market conditions generally and, particularly, in the healthcare industry;
- (xii) changes in the financial position of our operators;
- (xiii) changes in interest rates;
- (xiv) the amount and yield of any additional investments;
- (xv) changes in tax laws and regulations affecting real estate investment trusts; and
- (xvi) our ability to maintain our status as a real estate investment trust.

Overview

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

On November 17, 2009, we entered into a purchase agreement with CapitalSource, Inc. (“CapitalSource”) pursuant to which we agreed to purchase certain CapitalSource subsidiaries owning 80 long-term care facilities and an option to

purchase certain other CapitalSource subsidiaries owning an additional 63 long-term care facilities. Our acquisition of the CapitalSource subsidiaries pursuant to the terms of the purchase agreement was conducted in three separate closings: (i) on December 22, 2009, we acquired CapitalSource subsidiaries owning 40 long-term care facilities and an option to acquire an additional 63, for an aggregate purchase price of approximately \$296 million; (ii) on June 9, 2010, we exercised our option to acquire CapitalSource subsidiaries owning 63 long-term care facilities for an aggregate purchase price of approximately \$293 million; and (iii) on June 29, 2010, we acquired CapitalSource subsidiaries owning 40 long-term care facilities for an aggregate purchase price of approximately \$271 million.

We have identified a recent trend of reductions of expenditures under Medicare and Medicaid programs at the federal and state levels, resulting in a reduction of reimbursement rates and levels to our operators under both the Medicare and Medicaid programs. Current market and economic conditions may have a significant impact on state budgets and health care spending. These deficits, exacerbated by the potential for increased enrollment in Medicaid due to rising unemployment levels and declining family incomes, could cause states to further reduce state expenditures under their respective state Medicaid programs by lowering reimbursement rates.

We currently believe that our operator coverage ratios are strong and that our operators can absorb moderate reimbursement rate reductions under Medicaid and Medicare and still meet their obligations to us. However, significant limits on the scope of services reimbursed and on reimbursement rates and fees could have a material adverse effect on an operator's results of operations and financial condition, which could adversely affect the operator's ability to meet its obligations to us.

Our portfolio of investments at September 30, 2011, consisted of 401 healthcare facilities (including two facilities held for sale), located in 35 states and operated by 49 third-party operators. Our gross investment in these facilities totaled approximately \$2.5 billion at September 30, 2011, with 99% of our real estate investments related to long-term healthcare facilities. This portfolio is made up of (i) 369 SNFs, (ii) 10 assisted living facilities ("ALFs"), (iii) five specialty facilities, (iv) fixed rate mortgages on 15 SNFs and (v) two SNFs that are held for sale. At September 30, 2011, we also held other investments of approximately \$30.4 million, consisting primarily of secured loans to third-party operators of our facilities.

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

## Taxation

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

ended December 31, 2010.

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## Recent Developments Regarding Government Regulation and Reimbursement

**Healthcare Reform.** The Patient Protection and Affordable Care Act and accompanying Healthcare and Education Affordability and Reconciliation Act of 2010 (the “Healthcare Reform Law”) were signed into law in March 2010. This legislation represents the most comprehensive change to healthcare benefits since the inception of the Medicare program in 1965 and will affect reimbursement for governmental programs, private insurance and employee welfare benefit plans in various ways. Some changes under the Healthcare Reform Law have already occurred, such as changes to pre-existing condition requirements and coverage of dependents. Other changes, including taxes on so-called “Cadillac” health plans, will be implemented over time. There has already been significant rule making and regulations under the Healthcare Reform Law, and we expect significant additional rules and regulations.

The attorneys general for several states, as well as other individuals and organizations, have challenged the constitutionality of certain provisions of the Healthcare Reform Law, including the requirement that each individual carry health insurance. A number of the lawsuits have been ruled on by federal appeals courts, but those rulings were not consistent. Several parties have appealed to the U.S. Supreme Court. We cannot predict whether the Supreme Court will agree to hear these cases or how it will rule. Further, various Congressional leaders have indicated a desire to revisit some or all of the health care reform law during 2011 and 2012. While the U.S. Senate voted against repealing the entire Healthcare Reform Law, a number of bills and budget proposals seek to repeal, change or defund certain provisions of the law. For example, the 2011 budget eliminates two programs funded under the health care reform law: the Consumer Operated and Oriented Plan (CO-OP) and the Free Choice Voucher programs). Further, a number of states have passed legislation intended to block various requirements of the Healthcare Reform Law. Because of these challenges, we cannot predict whether any or all of the legislation will be implemented as enacted, overturned, repealed or modified.

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

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



In August 2011, the Budget Control Act of 2011 was enacted into law to increase the federal debt ceiling. The law included spending cuts of nearly \$1 trillion over the next 10 years. The law further created a Congressional committee that is tasked with recommending a plan that would reduce the federal deficit by another \$1.5 trillion over 10 years. Any such plan may include spending cuts and tax increases. The committee must recommend a plan to Congress by the end of November 2011, and Congress must act on the recommendations by the end of December 2011. In the event that the Committee is deadlocked, Congress does not pass the legislation or the President vetoes it, automatic spending cuts will become effective, including a likely 2% cut to Medicare providers. Changes to Medicare and Medicaid can be considered by the committee, but Medicaid is not subject to the automatic spending cuts. The committee has full legislative power and thus can recommend both spending changes and structural changes to Medicare and Medicaid. If funding for Medicare and/or Medicaid is reduced, it 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. In addition, Medicaid enrollment may significantly increase in the near future, as the Healthcare Reform Law allows states to increase the number of people who are eligible for Medicaid beginning in 2010 and simplifies enrollment in this program. Since our operators' profit margins on Medicaid patients are generally relatively low, more than modest reductions in Medicaid reimbursement and an increase in the number of Medicaid patients could adversely affect our operators' results of operations and financial conditions, which in turn could negatively impact us.

The American Reinvestment and Recovery Act of 2009 ("ARRA") and subsequent legislation provide additional federal Medicaid funding for states' Medicaid expenditures between October 1, 2008 and June 30, 2011. During this period, the share of Medicaid costs that were paid for by the federal government went up, and each state's share went down. Now that this additional funding has expired, we cannot predict whether the states will have sufficient funds for their Medicaid programs. Many states are concerned that the lack of funds will have a negative impact on their budgets.

Medicare. In 2009, the CMS finalized a revised case-mix classification system, the RUG-IV, and planned implementation for fiscal year 2010. However, the Healthcare Reform Law delayed implementation of RUG-IV to October 1, 2011. The Medicare and Medicaid Extenders Act of 2010 repealed the delay in implementation under the Healthcare Reform Law and provided that RUG-IV would be implemented immediately and applied retroactively to October 1, 2010. According to CMS, this change in case-mix classification methodology resulted in a significant increase in Medicare expenditures for FY 2011. In response to this increase, on July 29, 2011, CMS announced the final rule for SNF funding for fiscal year 2012. The final rule includes a recalibration of the case-mix indexes that form the RUG-IV and will result in a reduction of aggregate Medicare reimbursement to SNFs of \$4.47 billion or 12.6%. However, the reduction is partially offset by an update that reflects a 2.7% increase in the prices of a "market basket" of goods and services reduced by a 1.0% multi-factor productivity adjustment mandated by the Healthcare Reform Law. The combination of the recalibration and the update will yield a net reduction of aggregate Medicare reimbursement to SNFs of \$3.87 billion or 11.1%. We believe that the implementation of RUG-IV in 2010 had a positive effect on the cash flow and rent coverage ratios of our operators. This funding cut will reduce operator coverage ratios, however, we currently believe that our operator coverage ratios are adequate and that our operators can absorb the fiscal year 2012 reimbursement rate reductions and still meet their obligations to us.



The Medicare Payment Advisory Commission (MedPAC) recommended that Congress make no increases to Medicare payment rates for skilled nursing facilities for fiscal year 2012.

The Medicare Improvements for Patients and Providers Act of 2008 (the "MIPPA") became law on July 15, 2008, and made a variety of changes to Medicare, some of which may affect SNFs. For instance, the MIPPA extended the therapy cap exceptions process through December 31, 2009. The Healthcare Reform Law extended the therapy cap exceptions process through December 31, 2010, and the Medicare and Medicaid Extenders Act of 2010 further extended the therapy cap exceptions process through December 31, 2011. The therapy caps limit the physical therapy, speech-language therapy and occupational therapy services that a Medicare beneficiary can receive during a calendar year. These caps do not apply to therapy services covered under Medicare Part A for SNFs, although the caps apply in most other instances involving patients in SNFs or long-term care facilities who receive therapy services covered under Medicare Part B. Congress implemented a temporary therapy cap exceptions process, which permits medically necessary therapy services to exceed the payment limits. Expiration of the therapy cap exceptions process in the future could have a material adverse effect on our operators' financial condition and operations, which could adversely impact their ability to meet their obligations to us.

**Quality of Care Initiatives.** The CMS has implemented a number of initiatives focused on the quality of care provided by nursing homes that could affect our operators. For instance, in December 2008, the CMS released quality ratings for all of the nursing homes that participate in Medicare or Medicaid. Facility rankings, ranging from five stars ("much above average") to one star ("much below average") are updated on a monthly basis. The Healthcare Reform Law includes a requirement that the Government Accountability Office conduct a study of this ranking system, the results of which cannot be predicted. In the event any of our operators does not maintain or receive the same or superior ranking as its competitors, patients could choose alternate facilities, which could adversely impact our operators' revenues. In addition, the reporting of such information could lead to future reimbursement policies that reward or penalize facilities on the basis of the reported quality of care parameters.

**Office of the Inspector General Activities.** The Office of Inspector General's (the "OIG") Work Plan for fiscal year 2012, which describes projects that the OIG plans to address during the fiscal year, includes a number of projects related to nursing homes. 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 Laws and Regulations.** There are various civil and criminal federal and state laws governing a wide array of referrals, relationships and arrangements and prohibiting fraud by healthcare providers. Many of these complex laws raise issues that have not been clearly interpreted. 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 certain referrals by physicians to entities providing "designated health services" if these physicians have financial relationships with the entities. 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 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. Such fines or penalties could jeopardize that operator's ability to make lease or mortgage payments to us or to continue operating its facility.

Privacy Laws. Our operators are subject to federal, state and local laws and regulations designed to protect confidentiality and security of patient health information, including the privacy and security provisions in the federal Health Insurance Portability and Accountability Act of 1996 and the corresponding regulations promulgated thereunder (“HIPAA”). HIPAA was amended by the American Recovery and Reinvestment Act of 2009, known as the Stimulus Bill. The amendment increases penalties for HIPAA violations, imposes stricter requirements on healthcare providers, expands the scope of enforcement and, in most cases requires notification if there is a breach of an individual’s protected health information, including public announcements if the breach affects a significant number of individuals. As a result, our operators are required to expend the requisite resources to secure the health information in their possession. Operators found in violation of HIPAA may face large penalties. Compliance with public notification requirements in the event of a breach could cause reputational harm to an operator’s business. Such penalties and damaged reputations could adversely affect an operator’s ability to pay its obligations to us.

Licensing, Certification and Other Laws and Regulations. Our operators and facilities are subject to regulatory and licensing requirements of federal, state and local authorities and are periodically surveyed by these authorities. Failure to obtain licensure or loss or suspension of licensure would prevent a facility from operating and result in ineligibility for reimbursement until the necessary licenses are obtained or reinstated. In such event, our revenues from these facilities could be reduced or eliminated for an extended period of time or permanently.

In addition, licensing and Medicare and Medicaid laws require operators of nursing homes and ALFs to comply with extensive standards governing operations. Federal and state agencies administering those laws regularly inspect such 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. If our operators are unable to cure deficiencies, which have been identified or which are identified in the future, sanctions, including possible loss of license and/or right to receive reimbursement, may be imposed. If imposed, such sanctions may adversely affect our operators’ revenues and their ability to meet their obligations to us.

Additional federal, state and local laws and regulations affect how our operators conduct their operations, including federal and state laws and regulations protecting the confidentiality and security of patient health information, laws protecting consumers against deceptive practices, and laws generally affecting our operators’ management of 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). We are unable to predict the effect that potential changes in these requirements could have on the revenues of our operators, and their 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, 2010. 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 2010 Annual Report on Form 10-K in Item 7, Management’s Discussion and Analysis of Financial Condition and 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, 2011 and 2010

#### Operating Revenues

Our operating revenues for the three months ended September 30, 2011, totaled \$72.8 million, an increase of \$3.1 million over the same period in 2010. The \$3.1 million increase was primarily the result of additional rental income of \$2.3 million due to lease amendments and extensions and additional mortgage income of approximately \$1.0 million due to (i) two new construction-to-permanent mortgage loans that we entered into with an operator in August 2010; (ii) a \$15.9 million first mortgage loan that we entered into with an operator in December 2010 and (iii) a \$5.0 million first mortgage loan that we entered into with an operator in September 2011.

#### Operating Expenses

Operating expenses for the three months ended September 30, 2011, totaled \$29.4 million, a decrease of approximately \$3.3 million over the same period in 2010. The decrease was primarily due to (i) a decrease in depreciation and amortization expense of \$2.9 million primarily associated with the impairment of the Connecticut Properties; (ii) a decrease of \$1.1 million in general and administrative expense and (iii) a decrease of \$0.3 million related to expense related to our owned and operated assets, offset by the increase of \$1.1 million related to 2011 equity compensation program.

#### Other Income (Expense)

For the three months ended September 30, 2011, total other expenses were \$23.8 million, an increase of approximately \$3.7 million over the same period in 2010. The increase in interest expense of approximately \$1.0 million was primarily due to an increase in borrowings outstanding, including debt assumed or incurred to finance the CapitalSource acquisitions. In addition, an increase of \$3.1 million in interest refinancing costs related to the write-off of deferred cost associated with the termination of the \$320 million revolving senior secured credit facility (the "2010 Credit Facility"), offset by a \$0.3 million reduction in deferred financing costs.

### Nine Months Ended September 30, 2011 and 2010

#### Operating Revenues

Our operating revenues for the nine months ended September 30, 2011, totaled \$215.9 million, an increase of \$28.7 million over the same period in 2010. The \$28.7 million increase related primarily to an increase in rental income of approximately \$38.4 million due to the CapitalSource acquisitions that occurred in June 2010 (approximately \$2.8 million resulted from in-place lease intangibles amortization) and additional rents related to our capital renovation and improvement program. In addition, the increase in mortgage income of approximately \$2.8 million is primarily due to (i) two new construction-to-permanent mortgage loans that we entered into with an operator in August 2010; (ii) a \$15.9 million first mortgage loan that we entered into with an operator in December 2010; and (iii) a \$5.0 million first mortgage loan that we entered into with an operator in September 2011. Offsetting the above-noted increases are (i) a decrease of \$7.3 million in owned and operated assets due to the deconsolidation of owned and operated facilities effective June 1, 2010; (ii) a decrease of \$3.6 million in miscellaneous income resulting from a February 2010 legal

settlement with one of our prior operators for breach of contract due to failure to pay rent; and (iii) a decrease of \$1.6 million in other investment income primarily as a result of the sale of two mortgage backed certificates that were retired during the second quarter of 2010.

### Operating Expenses

Operating expenses for the nine months ended September 30, 2011, totaled \$119.2 million, an increase of approximately \$39.0 million over the same period in 2010. The increase was primarily due to (i) an increase in depreciation and amortization expense of \$16.0 million primarily associated with the CapitalSource acquisitions that occurred in June 2010 and additional depreciation associated with our capital renovation and improvement program; (ii) a \$25.0 million provision for impairment on real estate assets recorded in the first quarter of 2011 primarily related to our Connecticut properties (see Portfolio and Recent Developments – Connecticut Properties below); (iii) a \$4.1 million provision for uncollectible accounts receivable; (iv) an increase of \$2.8 million in general and administrative expense primarily related to the 2011 equity compensation program, offset by (v) the reduction of \$7.2 million in owned and operated assets primarily due to the deconsolidation of owned and operated facilities effective June 1, 2010 and (vi) a decrease of \$1.4 million in acquisition cost related to the expenses incurred in connection with the CapitalSource acquisitions.

### Other Income (Expense)

For the nine months ended September 30, 2011, total other expenses were \$65.2 million, an increase of approximately \$11.6 million over the same period in 2010. The increase in interest expense of approximately \$12.8 million was primarily due to an increase in borrowings outstanding, including debt assumed or incurred to finance the CapitalSource acquisitions. This was offset by (i) a decrease of \$0.4 million in interest refinancing costs primarily related to the write-off of \$3.1 million during the third quarter of 2011 associated with the termination of the \$320 million 2010 Credit Facility compared to the write-off a \$3.5 million during the second quarter of 2010 associated with the termination of the \$200 million 2009 Credit Facility and (ii) a decrease of \$0.9 million in amortization of deferred financing costs related to: (a) the termination of the \$200 million 2009 Credit Facility, (b) the \$100 million GECC term loan payoff in October 2010 and (c) the redemption of our outstanding \$310 million senior notes in December 2010.

### Preferred Stock Redemption

In connection with the March 7, 2011 redemption of the Series D Preferred Stock, we recorded a charge of \$3.5 million primarily related to the write-off of issuance costs.

### Funds From Operations

Our funds from operations available to common stockholders (“FFO”), for the three months ended September 30, 2011, was \$44.5 million, compared to \$42.5 million, for the same period in 2010.

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. 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 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 the three- and nine- months ended September 30, 2011 and 2010:

|   | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|----------|------------------------------------|-----------|
|   | 2011                                | 2010     | 2011                               | 2010      |
|   | (in thousands)                      |          |                                    |           |
| Net income available to common stockholders             | \$21,436                            | \$14,736 | \$28,166                           | \$46,653  |
| Deduct gain/add back loss from real estate dispositions | (1,803 )                            | 4        | (1,803 )                           | 4         |
| Sub-total   | 19,633                              | 14,740   | 26,363                             | 46,657    |
| Elimination of non-cash items included in net income:   |                                     |          |                                    |           |
| Depreciation and amortization                           | 24,871                              | 27,742   | 74,848                             | 58,880    |
| Funds from operations available to common stockholders  | \$44,504                            | \$42,482 | \$101,211                          | \$105,537 |

## Portfolio and Recent Developments

### 143 Facility CapitalSource Acquisitions

In November 2009, we entered into a securities purchase agreement (the “CapitalSource Purchase Agreement”) with CapitalSource and several of its affiliates, pursuant to which we agreed to purchase CapitalSource subsidiaries owning 80 long term care facilities, plus an option to purchase CapitalSource subsidiaries owning an additional 63 facilities, for approximately \$858 million. We accounted for these acquisitions as business combinations.

The transactions closed in three phases: (i) on December 22, 2009, we purchased CapitalSource entities owning 40 facilities for approximately \$271 million and an option to purchase CapitalSource entities owning 63 additional facilities for \$25 million; (ii) on June 9, 2010, we completed our purchase of the 63 CapitalSource facilities pursuant to the option for an aggregate purchase price of approximately \$293 million in cash, plus the \$25 million purchase option deposit, representing a total purchase price of \$318 million; and (iii) on June 29, 2010, we purchased CapitalSource entities owning 40 facilities for approximately \$271 million and paid approximately \$15 million for escrow accounts transferred to us at closing.

As of December 31, 2010, we completed our purchase price allocation for all of these transactions. The allocation included fair value adjustment for above-market debt assumed in the transactions as well as above and below-market in-place leases assumed. For the nine months ended September 30, 2011, we amortized approximately \$1.1 million of above-market adjustments related to the assumed debt and approximately \$4.6 million of net below market in-place leases assumed from these transactions.

### Connecticut Properties

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

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

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

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

### FC/SCH Facilities

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

### Nexion Health, Inc.

On July 18, 2011, we entered into a first mortgage loan with Nexion Health Management in the amount of \$5.0 million. The mortgage loan matures on July 18, 2012 and carries an interest rate of 10% per year.

## Assets Sold

On September 30, 2011, we sold a SNF in North Carolina for approximately \$4.2 million resulting in a gain of approximately \$1.8 million.

## Liquidity and Capital Resources

At September 30, 2011, we had total assets of \$2.2 billion, stockholders' equity of \$0.9 billion and debt of \$1.2 billion, representing approximately 57.6% of total capitalization.

The following table shows the amounts due in connection with the contractual obligations described below as of September 30, 2011.

|                                     | Total       | Payments due by period |                |           |                      |
|-------------------------------------|-------------|------------------------|----------------|-----------|----------------------|
|                                     |             | Less than<br>1 year    | 1-3 years      | 3-5 years | More than<br>5 years |
|                                     |             |                        |                |           |                      |
|                                     |             |                        | (in thousands) |           |                      |
| Debt(1)                             | \$1,194,054 | \$2,566                | \$5,566        | \$226,200 | \$959,722            |
| Interest payments on long-term debt | 830,053     | 78,629                 | 156,825        | 148,689   | 445,910              |
| Operating lease obligations(2)      | 2,473       | 302                    | 628            | 663       | 880                  |
| Total                               | \$2,026,580 | \$81,497               | \$163,019      | \$375,552 | \$1,406,512          |

(1) The \$1.2 billion of debt outstanding includes \$45 million in borrowings under the \$475 million revolving senior secured credit facility (the "2011 Credit Facility") due in August 2015, \$175 million aggregate principal amount of 7% Senior Notes due January 2016, \$200 million aggregate principal amount of 7.5% Senior Notes due February 2020, \$575 million aggregate principal amount of 6.75% Senior Notes due October 2022, \$20 million of 9.0% subordinated debt maturing in December 2021, \$52 million of HUD debt at a 6.61% weighted average annual interest rate maturing between January 2036 and May 2040, and \$127 million of HUD Debt at a 4.85% annual interest rate and maturing between January 2040 and January 2045.

(2) Relates primarily to the lease at the corporate headquarters.

## Financing Activities and Borrowing Arrangements

### Bank Credit Agreements

At September 30, 2011, we had \$45.0 million outstanding under our new \$475 million unsecured revolving credit facility (the "2011 Credit Facility"), and no letters of credit outstanding, leaving availability of \$430.0 million.

On August 16, 2011, we entered into our new 2011 Credit Facility and concurrently terminated our previous \$320 million senior secured revolving credit facility (the "2010 Credit Facility"). The 2011 Credit Facility matures in four years, on August 17, 2015. The 2011 Credit Facility includes an "accordion feature" that permits us to expand our borrowing capacity to \$600 million. For the three month period ending September 30, 2011, we recorded a non-cash charge of approximately \$3.1 million relating to the write-off of deferred financing costs associated with the termination of the 2010 Credit Facility.

The 2011 Credit Facility is priced at LIBOR plus an applicable percentage (ranging from 225 basis points to 300 basis points) based on our consolidated leverage. In the event the Company achieves at least two investment grade ratings

from Standard & Poor's, Moody's and/or Fitch Ratings, the 2011 Credit Facility will be priced at LIBOR plus an applicable percentage ranging from 150 basis points to 210 basis points (including a facility fee). The Company's applicable percentage above LIBOR was 250 basis points at September 30, 2011 under the 2011 Credit Facility. The 2011 Credit Facility will be used for acquisitions and general corporate purposes.

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

#### \$100 Million Stock Repurchase Program

On August 30, 2011, Omega's Board of Directors has authorized the repurchase of up to \$100 million of its outstanding common stock, from time to time over the next 12 months.

We are authorized to repurchase shares of our common stock in open market and privately negotiated transactions at the times, and in the manner and amounts, as determined by Omega's management and in accordance with the pricing guidelines approved by our Board of Directors and applicable law. The timing and amount of stock repurchases will depend on a variety of factors, including market conditions and corporate and regulatory considerations. We have no obligation to repurchase any amount of our common stock, and such repurchases, if any, may be discontinued at any time. We expect to fund stock repurchases under the program with borrowings under Omega's 2011 Credit Facility.

On September 30, 2011, the Company entered open market transactions to repurchase 183,310 shares of its common stock at an average price of \$15.96 per share. This repurchase of these common shares settled in the ordinary course on October 5, 2011, subsequent to the end of the third quarter of 2011

#### \$575 Million 6.75% Senior Notes Exchange Offer

On June 2, 2011, we commenced an offer to exchange \$575 million of our 6.75% Senior Notes due 2022 that have been registered under the Securities Act of 1933 for \$575 million of our outstanding 6.75% Senior Notes due 2022, which were issued in October and November 2010 in two separate private placements.

All \$575 million outstanding aggregate principal amount of the initial notes were validly tendered and not withdrawn prior to the expiration of the exchange offer, and were exchanged for exchange notes as of July 14, 2011, pursuant to the terms of the exchange offer. The exchange notes are identical in all material respects to the initial notes, except that the issuance of the exchange notes was registered under the Securities Act of 1933 and the provisions of the initial notes relating to transfer restrictions, registration rights and additional interest relating to registrations delays do not apply to the exchange notes.

#### \$140 Million Equity Shelf Program

For the three months ended September 30, 2011, no shares of our common stock were issued through our \$140 million Equity Shelf Program (the "2010 ESP"). For the nine months ended September 30, 2011, 1.4 million shares of our common stock were issued through the 2010 ESP for net proceeds of \$31.4 million, net of \$0.6 million of commissions.



### Redemption of Series D Preferred Stock

On March 7, 2011, pursuant to authorization from our Board of Directors, we redeemed all of the outstanding shares of our 8.375% Series D Cumulative Redeemable Preferred Stock at a redemption price of \$25 per share plus \$0.21519 per share in accrued and unpaid dividends up to and including the redemption date, for an aggregate redemption price of \$25.21519 per share. Dividends on the shares of Series D Preferred Stock ceased to accrue on and after the redemption date, after which the Series D Preferred Stock ceased to be outstanding.

We borrowed approximately \$103 million under our previous 2010 Credit Facility to fund the redemption price. In connection with the redemption of the Series D Preferred Stock, we wrote-off \$3.4 million of preferred stock issuance costs that reduced first quarter 2011 net income attributable to common stockholders by approximately \$0.03 per common share.

### Dividends

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

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

For the three- and nine- months ended September 30, 2011, we paid total dividends of \$41.4 million and \$120.5 million, respectively.

On October 13, 2011, the Board of Directors declared a common stock dividend of \$0.40 per share to be paid November 15, 2011 to common stockholders of record on October 31, 2011.

### Liquidity

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

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

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

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

Cash and cash equivalents totaled \$10.7 million as of September 30, 2011, an increase of \$3.8 million as compared to the balance at December 31, 2010. The following is a discussion of changes in cash and cash equivalents due to operating, investing and financing activities, which are presented in our Consolidated Statements of Cash Flows.

**Operating Activities** – Net cash flow from operating activities generated \$129.0 million for the nine months ended September 30, 2011, as compared to \$110.4 million for the same period in 2010, an increase of \$18.6 million. The increase is primarily due to the rental revenue from the June 2010 acquisition of 103 facilities from CapitalSource and the placement of additional mortgages, offset by additional interest associated with financing the acquisition and new mortgages and increased general and administrative costs associated with the acquisition.

**Investing Activities** – Net cash flow from investing activities was an outflow of \$20.0 million for the nine months ended September 30, 2011, as compared to an outflow of \$368.8 million for the same period in 2010. The decrease in cash outflow from investing activities relates primarily to the change in acquisition activities. During the nine months ended September 30, 2010, we acquired \$343.2 million real estate facilities and invested \$25.7 million in capital improvement projects. During the nine months ended September 30, 2011, we acquired land for \$0.1 million, placed a mortgage loan for \$5.0 million, invested \$5.5 million related to two construction-to-permanent mortgage loans with one of our operators and invested \$12.0 million in capital improvement projects. In addition, we received a net proceeds of \$4.2 million for the sale of real estate.

**Financing Activities** – Net cash flow from financing activities was an outflow of \$105.2 million for the nine months ended September 30, 2011 as compared to an inflow of \$257.4 million for the same period in 2010. The \$362.5 million change in financing activities was primarily due to the change in acquisition activity. In 2010, we raised debt and issued equity to fund acquisitions that occurred in June 2010. In addition to the changes in financing activity associated with financing our 2010 acquisitions, in 2011 we redeemed our preferred stock through the use of our prior 2010 Credit Facility; (ii) paid approximately \$21.4 million in additional dividends as a result of more shares outstanding; and (iii) increased our dividends per share in 2011 compared to 2010.

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

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



The interest rate charged on our 2011 Credit Facility can vary based on the interest rate option we choose to utilize. The interest rates per annum applicable to the 2011 Credit Facility are the reserve adjusted LIBOR Rate (the “Eurodollar Rate” or “Eurodollar”), plus the applicable margin (as defined below) or, at our option, the base rate, which will be the highest of (i) the rate of interest publicly announced by the administrative agent as its prime rate in effect, (ii) the federal funds effective rate from time to time plus 0.50% and (iii) the Eurodollar Rate determined on such day for a Eurodollar Loan with an interest period of one month plus 1.0%, in each case, plus the applicable margin (as defined below). The applicable margin with respect to the 2011 Credit Facility is determined in accordance with a performance grid based on our consolidated leverage ratio. The applicable margin may range from 3.0% to 2.25% in the case of Eurodollar advances, and from 2.0% to 1.25% in the case of base rate advances. Letter of credit fees may range from 3.0% to 2.25% per annum, based on the same performance grid. As of September 30, 2011, the total amount of debt outstanding on the 2011 Credit Facility was \$45 million, which is subject to interest rate fluctuations.

For additional information, refer to Item 7A as presented in our annual report on Form 10-K for the year ended December 31, 2010.

#### 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 that are designed to provide reasonable assurance that the information that we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

In connection with the preparation of this Form 10-Q, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2011. 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, 2011.

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

## PART II – OTHER INFORMATION

## Item 1 – Legal Proceedings

See Note 10 – Litigation to the Consolidated Financial Statements in 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, 2010, with the Securities and Exchange Commission on February 28, 2011, which sets forth our risk factors in Item 1A therein, as supplemented in Part II, Item 1A to our Quarterly Reports on Form 10-Q for the three months ended March 31, 2011 and June 30, 2011. We have not experienced any material changes from the risk factors previously described therein.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

## Issuer Purchases of Equity Securities in the Third Quarter of Fiscal 2011

| Period                                    | Common Stock                     |                              | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|---|----------------------------------|------------------------------|--|--|
|   | Total Number of Shares Purchased | Average Price Paid per Share |  |  |
| July 1, 2011 – July 31, 2011              | -                                | \$ -                         | -  | \$ -   |
| August 1, 2011 – August 31, 2011          | -                                | -                            | -  | 100,000,000  |
| September 1, 2011 – September 30, 2011(2) | 183,310                          | 15.96                        | 183,310  | 97,073,932   |
| Total                                     | 183,310                          | \$ 15.96                     | 183,310  | \$ 97,073,932  |

(1) On August 30, 2011, the Company announced that its Board of Directors had authorized the Company to repurchase up to \$100,000,000 shares of its common stock over the subsequent twelve months.

(2) On September 30, 2011, the Company entered open market transactions to repurchase 183,310 shares of common stock at an average price of \$15.96 per share. This repurchase settled in the ordinary course on October 5, 2011, subsequent to the end of the third quarter of 2011.

Item 6 – Exhibits

Exhibit No.

- |         |  |
|---------|--|
| 10.1    | Credit Agreement, dated as of August 16, 2011, among Omega Healthcare Investors, Inc., certain subsidiaries of Omega Healthcare Investors, Inc. identified therein as guarantors, the lenders named therein and Bank of America, N.A. Pursuant to a confidential treatment request, portions of this exhibit have been furnished separately to the Securities and Exchange Commission. |
| 10.2    | Seventh Amendment to Second Consolidated amended and Rested master Lease dated as of September 7, 2011, by and among OHI Asset III (PA) Trust as lessor and certain affiliated entities of Communicare Health Service as lessees.  |
| 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.*   |

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

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

OMEGA HEALTHCARE INVESTORS, INC.

Registrant

Date: November 7, 2011

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

Date: November 7, 2011

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