

OMEGA HEALTHCARE INVESTORS INC  
Form 10-Q  
May 09, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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 March 31, 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

38-3041398

(State of incorporation)

(IRS Employer  
Identification No.)

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

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

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

Yes

No

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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

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 May 2, 2011.

Common Stock, \$.10 par value	101,614,459
(Class)	(Number of shares)

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OMEGA HEALTHCARE INVESTORS, INC.  
FORM 10-Q  
March 31, 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)

	March 31, 2011 (Unaudited)	December 31, 2010
<b>ASSETS</b>		
Real estate properties		
Land and buildings	\$2,335,799	\$2,366,856
Less accumulated depreciation	(395,918 )	(380,995 )
Real estate properties – net	1,939,881	1,985,861
Mortgage notes receivable – net	110,323	108,557
	2,050,204	2,094,418
Other investments – net	28,348	28,735
	2,078,552	2,123,153
Assets held for sale – net	811	670
Total investments	2,079,363	2,123,823
Cash and cash equivalents	3,381	6,921
Restricted cash	20,180	22,399
Accounts receivable – net	95,981	92,819
Other assets	58,698	57,172
Operating assets for owned and operated properties	324	873
Total assets	\$2,257,927	\$2,304,007
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Revolving line of credit	\$69,000	\$—
Secured borrowings	200,378	201,296
Unsecured borrowings – net	975,573	975,669
Accrued expenses and other liabilities	117,317	121,859
Operating liabilities for owned and operated properties	470	1,117
Total liabilities	1,362,738	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 – 101,371 shares as of March 31, 2011 and 99,233 as of December 31, 2010	10,137	9,923
Common stock – additional paid-in-capital	1,425,186	1,376,131
Cumulative net earnings	574,911	580,824
Cumulative dividends paid	(1,115,045)	(1,071,300)
Total stockholders' equity	895,189	1,004,066
Total liabilities and stockholders' equity	\$2,257,927	\$2,304,007

See notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2011	2010
<b>Revenue</b>		
Rental income	\$66,337	\$47,209
Mortgage interest income	3,498	2,614
Other investment income – net	641	746
Miscellaneous	-	3,729
Nursing home revenues of owned and operated assets	-	4,380
<b>Total operating revenues</b>	<b>70,476</b>	<b>58,678</b>
<b>Expenses</b>		
Depreciation and amortization	25,218	14,687
General and administrative	5,226	3,710
Acquisition costs	45	220
Impairment loss on real estate properties	24,971	-
Nursing home expenses of owned and operated assets	230	4,572
<b>Total operating expenses</b>	<b>55,690</b>	<b>23,189</b>
<b>Income before other income and expense</b>	<b>14,786</b>	<b>35,489</b>
<b>Other income (expense)</b>		
Interest income	11	15
Interest expense	(20,000 )	(13,575 )
Interest – amortization of deferred financing costs	(694 )	(978 )
Interest – refinancing costs	(16 )	-
<b>Total other expense</b>	<b>(20,699 )</b>	<b>(14,538 )</b>
<b>Net (loss) income</b>	<b>(5,913 )</b>	<b>20,951</b>
Preferred stock dividends	(1,691 )	(2,271 )
Preferred stock redemption	(3,472 )	-
<b>Net (loss) income available to common stockholders</b>	<b>\$(11,076 )</b>	<b>\$18,680</b>
<b>(Loss) income per common share available to common shareholders:</b>		
<b>Basic:</b>		
Net (loss) income	\$(0.11 )	\$0.21
<b>Diluted:</b>		
Net (loss) income	\$(0.11 )	\$0.21
<b>Dividends declared and paid per common share</b>	<b>\$0.37</b>	<b>\$0.32</b>
<b>Weighted-average shares outstanding, basic</b>	<b>100,074</b>	<b>88,840</b>
<b>Weighted-average shares outstanding, diluted</b>	<b>100,086</b>	<b>88,961</b>

Components of other comprehensive income:		
Net (loss) income	\$ (5,913	) \$ 20,951
Unrealized gain on other investments	-	38
Total comprehensive (loss) income	\$ (5,913	) \$ 20,989

See notes to consolidated financial statements.



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

	Preferred Stock	Common Stock Par Value	Additional Paid-in Capital	Cumulative Net Earnings	Cumulative Dividends	Total
Balance at December 31, 2010 (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 shares at \$22.00 per share)	—	1	(1 )	—	—	—
Amortization of restricted stock	—	—	1,465	—	—	1,465
Vesting of restricted stock (grants 68 shares)	—	7	(1,261 )	—	—	(1,254 )
Dividend reinvestment plan (795 shares at \$22.08 per share)	—	80	17,445	—	—	17,525
Grant of stock as payment of directors fees (2 shares at an average of \$22.35 per share)	—	—	37	—	—	37
Equity Shelf Program (1,261 shares at \$22.78 per share, net of issuance costs)	—	126	27,982	—	—	28,108
Preferred stock redemption	(108,488 )	—	3,388	—	(3,472 )	(108,572 )
Net loss	—	—	—	(5,913 )	—	(5,913 )
Common dividends (\$0.37 per share).	—	—	—	—	(37,068 )	(37,068 )
Preferred dividends (Series D of \$0.74 per share)	—	—	—	—	(3,205 )	(3,205 )
Balance at March 31, 2011 (101,371 common shares)	\$—	\$ 10,137	\$ 1,425,186	\$ 574,911	\$(1,115,045)	\$ 895,189

See notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2011	2010
Cash flows from operating activities		
Net (loss) income	\$(5,913 )	\$20,951
Adjustment to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	25,218	14,687
Impairment loss on real estate properties	24,971	—
Amortization of deferred financing costs	694	978
Restricted stock amortization expense	1,479	839
Amortization of in-place leases	(1,616 )	—
Amortization of straightline mortgage interest income	(421 )	—
Other	(38 )	(98 )
Change in operating assets and liabilities – net of amounts assumed/acquired:		
Accounts receivable, net	(93 )	90
Straight-line rent	(3,403 )	(1,946 )
Lease inducement	755	(276 )
Other operating assets and liabilities	(2,829 )	3,491
Operating assets and liabilities for owned and operated properties	(98 )	81
Net cash provided by operating activities	38,706	38,797
Cash flows from investing activities		
Placement of mortgage loans	(1,749 )	—
Proceeds from sale of real estate investments	—	28
Capital improvements and funding of other investments	(4,325 )	(9,139 )
Proceeds from other investments	980	461
Investments in other investments	(593 )	(14,322 )
Collection of mortgage principal – net	20	30
Net cash used in investing activities	(5,667 )	(22,942 )
Cash flows from financing activities		
Proceeds from credit facility borrowings	117,000	6,000
Payments on credit facility borrowings	(48,000 )	(100,100 )
Receipts of other long-term borrowings	—	196,556
Payments of other long-term borrowings	(604 )	(59,354 )
Payment of financing related costs	(534 )	(4,291 )
Receipts from dividend reinvestment plan	17,525	12,214
Net proceeds from issuance of common stock	28,108	36,739
Payments from exercised options and restricted stock – net	(1,254 )	4
Dividends paid	(40,268 )	(30,599 )
Redemption of preferred stock	(108,552 )	—
Net cash (used in) provided by financing activities	(36,579 )	57,169
(Decrease) increase in cash and cash equivalents	(3,540 )	73,024
Cash and cash equivalents at beginning of period	6,921	2,170
Cash and cash equivalents at end of period	\$3,381	\$75,194
Interest paid during the period, net of amounts capitalized	\$16,896	\$7,814
Non-cash investing activities		

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Non-cash settlement of mortgage obligations	\$—	\$(12,395 )
Non-cash acquisition of real estate properties	—	12,395
Net non-cash investing activities	\$—	\$—

See notes to consolidated financial statements.

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OMEGA HEALTHCARE INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Unaudited  
March 31, 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, 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 relates to the amounts currently owed to us under the terms of the lease agreement. Straight-line receivables relates to the difference between the rental revenue recognized on a straight-line basis and the amounts due to us contractually. 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.



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

	March 31, 2011	December 31, 2010
	(in thousands)	
Contractual receivables	\$7,870	\$5,354
Straight-line receivables	66,201	62,423
Lease inducements	28,271	29,026
Allowance	(6,361 )	(3,984 )
Accounts receivable – net	\$95,981	\$92,819

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 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 370 SNFs, 10 assisted living facilities (“ALFs”) and five specialty facilities at March 31, 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, 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 facilities were leased and operated by affiliates of Formation 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.

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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 the Company objected. At the hearing held on April 21, 2011, the Company stated its 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.

The Company intends to file a timely notice of appeal, taking the position that the Court's Order is final and appealable. The Order is stayed under Connecticut law (thereby prohibiting any actions in furtherance of the Order to close) during the period in which the Company has to file its appeal (20 days) and then during the pendency of such appeal; however, the receiver and/or the State may seek an order from the Court to lift the stay.

As a result of these developments, during the three months ended March 31, 2011, the Company 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.

### Oklahoma Facility

In March 2011, we agreed to sell a property to an operator and recorded an impairment charge of approximately \$0.6 million related to the pending transaction based on the sales price less costs to sell. We have classified the asset as held-for-sale-net as of March 31, 2011.

### 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. During the first quarter of 2011, we amortized approximately \$0.4 million of above-market adjustments related to the assumed debt and approximately \$1.6 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.

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	Pro Forma Three Months Ended March 31, 2011          2010 (in thousands, except per share amount, unaudited)	
Revenues	\$70,476	\$75,640
Net (loss) income available to common stockholders	(11,076 )	22,473
Earnings per share – diluted:		
Net (loss) income available to common stockholders – as reported	\$(0.11 )	\$0.21
Net (loss) income available to common stockholders – pro forma	(0.11 )	0.25

## Held for Sale

At March 31, 2011, we had two SNFs classified as held-for-sale with an aggregate net book value of approximately \$0.8 million.

## Mortgage Notes Receivable

Our mortgage notes receivable relate to 13 long-term care facilities and two construction mortgages on two facilities currently under construction. The mortgage notes are secured by first mortgage liens on the borrowers' underlying real estate and personal property. The mortgage notes receivable relate to facilities located in four (4) states, which are operated by four (4) 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 March 31, 2011, none of our mortgages were in default or in foreclosure proceedings. The mortgage properties are cross-collateralized with the master lease agreement.

Mortgage interest income is recognized as earned over the terms of the related mortgage notes. 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.

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On August 6, 2008, we entered into a Master Transaction Agreement (“MTA”) with affiliates of Formation whereby Formation 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 Formation, in accordance with the terms of the MTA. These 13 facilities are located in Connecticut (5), Rhode Island (4), New Hampshire (3) and Massachusetts (1). As part of the transaction, Genesis Healthcare (“Genesis”) has entered into a long-term management agreement with Formation 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 Formation/Genesis upon licensure from the state of Vermont. As a result of the transition of the operations to Formation, 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 March 31,	
	2011	2010
	(in thousands)	
Nursing home revenues	\$—	\$4,380
Nursing home expenses	230	4,572
Loss from nursing home operations	\$(230 )	\$(192 )

## NOTE 4 – CONCENTRATION OF RISK

As of March 31, 2011, our portfolio of real estate investments consisted of 400 healthcare facilities, located in 35 states and operated by 50 third-party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately \$2.4 billion at March 31, 2011, with approximately 99% of our real estate investments related to long-term care facilities. This portfolio is made up of 370 SNFs, 10 ALFs, five specialty facilities, fixed rate mortgages on 13 SNFs, and two SNFs that are held-for-sale. At March 31, 2011, we also held miscellaneous investments of approximately \$28.3 million, consisting primarily of secured loans to third-party operators of our facilities.

At March 31, 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 three month period ended March 31, 2011. The two states in which we had our highest concentration of investments were Florida (24%) and Ohio (15%) at March 31, 2011.

For the three-month period ended March 31, 2011, our revenues from operations totaled \$70.5 million, of which approximately \$9.6 million was from CommuniCare (14%) and \$8.3 million was from Sun Healthcare (12%). No other operator generated more than 9% of our revenues from operations for the three-month period ended March 31, 2011.



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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 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, to be 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 regular quarterly dividends of approximately \$0.52344 per preferred share on the Series D Preferred Stock that were 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 \$320 million revolving senior secured 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. The TRS had a net operating loss carry-forward as of March 31, 2011 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.



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## NOTE 7 – STOCK-BASED COMPENSATION

The following is a summary of our stock-based compensation expense for the three-month periods ended March 31, 2011 and 2010, respectively:

	Three Months Ended March 31,	
	2011	2010
	(in thousands)	
Stock-based compensation expense	\$ 1,479	\$ 839

## 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 March 31, 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.

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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 March 31, 2011, none of these PRSUs are vested or earned.

The following table summarizes our total unrecognized compensation cost as of March 31, 2011 associated with outstanding restricted stock and PRSU awards to employees:

	Shares/ Units	Grant Date Average Fair Value Per Unit/ Share	Total Compensation Cost (in millions)	Weighted Average Period of Expense Recognition (in months)	Unrecognized Compensation Cost (in millions)
Restricted stock	428,503	\$22.44	\$ 9.6	36	\$ 8.8
2011 Annual PRSUs	124,244	\$11.04	1.4	12	1.0
Multi-year TSR PRSUs	279,550	\$11.06	3.1	48	2.9
Multi-year relative TSR PRSUs	93,183	\$12.26	1.1	48	1.1
Total	925,480	\$16.45	\$ 15.2		\$ 13.8

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 March 31, 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 March 31, 2011, the unrecognized compensation cost associated with the directors is approximately \$0.4 million.

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## NOTE 8 – FINANCING ACTIVITIES AND BORROWING ARRANGEMENTS

## Secured and Unsecured Borrowings

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

	Maturity	Current Rate	March 31, 2011	December 31, 2010
(in thousands)				
Secured borrowings:				
Revolving lines of credit	2014	4.34%	\$ 69,000	\$ —
HUD Berkadia mortgages (1)	2036 - 2040	6.61%	65,731	66,128
HUD Capital Funding mortgages	2040 - 2045	4.85%	134,647	135,168
Total secured borrowings			200,378	201,296
Unsecured borrowings:				
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%	21,356	21,403
Premium			971,356	971,403
Total unsecured borrowings			4,217	4,266
Totals – net			975,573	975,669
			\$ 1,244,951	\$ 1,176,965

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

## Bank Credit Agreements

At March 31, 2011, we had \$69.0 million outstanding under our \$320 million revolving senior secured credit facility (the “2010 Credit Facility”), and no letters of credit outstanding, leaving availability of \$251.0 million.

The 2010 Credit Facility is priced at LIBOR plus an applicable percentage (ranging from 325 basis points to 425 basis points) based on the consolidated leverage and is not subject to a LIBOR floor. Our applicable percentage above LIBOR was 375 basis points as of March 31, 2011.

## \$140 Million Equity Shelf Program

During the three months ended March 31, 2011, 1.3 million shares of our common stock were issued through our \$140 million Equity Shelf Program (the “2010 ESP”) for net proceeds of approximately \$28.1 million, net of \$0.6 million of commissions.

## NOTE 9 - FINANCIAL INSTRUMENTS

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

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	2011		2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(in thousands)				
<b>Assets:</b>				
Cash and cash equivalents	\$3,381	\$3,381	\$6,921	\$6,921
Restricted cash	20,180	20,180	22,399	22,399
Mortgage notes receivable – net	110,323	111,568	108,557	109,610
Other investments – net	28,348	26,525	28,735	25,317
Totals	\$162,232	\$161,654	\$166,612	\$164,247
<b>Liabilities:</b>				
Revolving lines of credit	\$69,000	\$69,000	\$—	\$—
7.00% Notes due 2016 – net	174,259	186,985	174,221	187,079
7.50% Notes due 2020 – net	196,944	218,027	196,857	212,837
6.75% Notes due 2022 – net	583,014	610,573	583,188	576,019
HUD debt (1)	200,378	213,692	201,296	214,643
Subordinated debt (1)	21,356	24,090	21,403	23,248
Totals	\$1,244,951	\$1,322,367	\$1,176,965	\$1,213,826

(1) The carrying value of debt includes a fair value adjustment to reflect value of the debt assumed as part of the June 29, 2010 acquisition of the HUD portfolio.

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.

- 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.

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## 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.

On January 7, 2010, LCT SE Texas Holdings, L.L.C., an affiliate of Mariner Health Care and the lessee of four facilities located in the Houston area, filed a petition in the District Court of Harris County, Texas (No. 2010-01120) against four landlord entities, the member interests of which we purchased as part of the December 2009 acquisition from CapitalSource. On April 19, 2011, the Court dismissed with prejudice Plaintiff's claims against the Defendants, all pursuant to a joint motion to dismiss filed by the parties.

## 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 March 31,	
	2011	2010
	(in thousands, except per share amounts)	
Numerator:		
Net (loss) income	\$(5,913 )	\$20,951
Preferred stock dividends	(1,691 )	(2,271 )
Preferred stock redemption	(3,472 )	—
Numerator for net income available to common per share - basic and diluted	\$(11,076 )	\$18,680
Denominator:		
Denominator for basic earnings per share	100,074	88,840
Effect of dilutive securities:		
Restricted stock	—	109
Stock option incremental shares	—	10
Deferred stock	12	2
Denominator for diluted earnings per share	100,086	88,961
Earnings per share – basic:		
Net (loss) income – basic	\$(0.11 )	\$0.21

Earnings per share – diluted:

Net (loss) income – diluted	\$ (0.11	)	\$ 0.21
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NOTE 12 – CONSOLIDATING FINANCIAL STATEMENTS

As of March 31, 2011, we had outstanding (i) \$175 million 7.00% Senior Notes due 2016, (ii) \$200 million 7.50% 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 three months ended March 31, 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 three-month periods ended March 31, 2011, the non-guarantor subsidiaries have not engaged in investing or financing activities other than the principal payment of \$0.6 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.

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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)

	March 31, 2011			
	Issuer & Subsidiary Guarantors	Non – Guarantor Subsidiaries	Elimination Company	Consolidated
Land and buildings	\$2,022,453	\$ 313,346	\$—	\$ 2,335,799
Less accumulated depreciation	(384,164 )	(11,754 )	—	(395,918 )
Real estate properties – net	1,638,289	301,592	—	1,939,881
Mortgage notes receivable – net	110,323	—	—	110,323
	1,748,612	301,592	—	2,050,204
Other investments – net	28,348	—	—	28,348
	1,776,960	301,592	—	2,078,552
Assets held for sale – net	811	—	—	811
Total investments	1,777,771	301,592	—	2,079,363
Cash and cash equivalents	3,381	—	—	3,381
Restricted cash	7,691	12,489	—	20,180
Accounts receivable – net	94,266	1,715	—	95,981
Investment in affiliates	79,337	—	(79,337 )	—
Other assets	37,411	21,287	—	58,698
Operating assets for owned and operated properties	324	—	—	324
Total assets	\$2,000,181	\$ 337,083	(79,337 )	\$ 2,257,927
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>				
Revolving line of credit	\$69,000	\$ —	\$—	\$ 69,000
Secured borrowings	—	200,378	—	200,378
Unsecured borrowings – net	954,217	21,356	—	975,573
Accrued expenses and other liabilities	81,305	36,012	—	117,317
Intercompany payable	—	74,868	(74,868 )	—
Operating liabilities for owned and operated properties	470	—	—	470
Total liabilities	1,104,992	332,614	(74,868 )	1,362,738
Stockholders' equity:				
Common stock \$.10 par value authorized – 200,000 shares issued and outstanding – 101,371 shares as of March 31, 2011 and 99,233 as of December 31, 2010	10,137	—	—	10,137
Common stock – additional paid-in-capital	1,425,186	—	—	1,425,186
Cumulative net earnings	574,911	4,469	(4,469 )	574,911
Cumulative dividends paid	(1,115,045)	—	—	(1,115,045 )

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Total stockholders' equity	895,189	4,469	(4,469 )	895,189
Total liabilities and stockholders' equity	\$2,000,181	\$ 337,083	\$(79,337 )	\$ 2,257,927

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

	Three Months Ended March 31, 2011			
	Issuer & Subsidiary Guarantors	Non – Guarantor Subsidiaries	Elimination	Consolidated
<b>Revenue</b>				
Rental income	\$57,843	\$ 8,494	\$-	\$ 66,337
Mortgage interest income	3,498	-	-	3,498
Other investment income – net	641	-	-	641
Nursing home revenues of owned and operated assets	-	-	-	-
Total operating revenues	61,982	8,494	-	70,476
<b>Expenses</b>				
Depreciation and amortization	21,533	3,685	-	25,218
General and administrative	5,143	83	-	5,226
Acquisition costs	45	-	-	45
Impairment loss on real estate properties	24,971	-	-	24,971
Nursing home expenses of owned and operated assets	230	-	-	230
Total operating expenses	51,922	3,768	-	55,690
Income before other income and expense	10,060	4,726	-	14,786
<b>Other income (expense):</b>				
Interest income	4	7	-	11
Interest expense	(17,208 )	(2,792 )	-	(20,000 )
Interest – amortization of deferred financing costs	(694 )	-	-	(694 )
Interest – refinancing costs	(16 )	-	-	(16 )
Equity in earnings	1,941	-	(1,941 )	-
Total other expense	(15,973 )	(2,785 )	(1,941 )	(20,699 )
Net (loss) income	(5,913 )	1,941	(1,941 )	(5,913 )
Preferred stock dividends	(1,691 )	-	-	(1,691 )
Preferred stock redemption	(3,472 )	-	-	(3,472 )
Net (loss) income available to common stockholders	\$(11,076 )	\$ 1,941	\$(1,941 )	\$ (11,076 )

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

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

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

- (i) those items discussed under “Risk Factors” in Item 1A to our annual report on Form 10-K for the year ended December 31, 2010, 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.

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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 facilities for an aggregate purchase price of approximately \$296 million; (ii) on June 9, 2010, we acquired 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 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 March 31, 2011, consisted of 400 healthcare facilities (including two facilities held for sale), located in 35 states and operated by 50 third-party operators. Our gross investment in these facilities totaled approximately \$2.4 billion at March 31, 2011, with 99% of our real estate investments related to long-term healthcare facilities. This portfolio is made up of (i) 370 SNFs, (ii) 10 assisted living facilities (“ALFs”), (iii) five specialty facilities, (iv) fixed rate mortgages on 13 SNFs and (v) two SNFs that are held for sale. At March 31, 2011, we also held other investments of approximately \$28.3 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.

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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.

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 the next eight years. We expect significant rule making and regulations under the Healthcare Reform Law to be promulgated during that time.

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. On January 31, 2011, a Florida District Court ruled that the entire Healthcare Reform Law is unconstitutional. This judgment has been stayed pending appeal. Other courts have ruled in favor of the law or have only struck down certain provisions of the law. These cases are under appeal, and others are in process. We cannot predict the ultimate outcome of any of the litigation. Further, various Congressional leaders have indicated a desire to revisit some or all of the health care reform law during 2011. While the Senate voted against repealing the whole Healthcare Reform Law, there are a number of bills and budget proposals that have been introduced, which seek to repeal, change or defund certain provisions of the 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. 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.





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Reimbursement. Many state governments and the federal government are 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.

Medicaid. Current market and economic conditions, as well as the implementation of rules under the Healthcare Reform Law, will likely have a significant impact on state budgets and healthcare spending. Fiscal conditions have continued to deteriorate, and many states are experiencing significant budget gaps.

Many states are 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. 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 Recovery and Reinvestment Act of 2009 (the "ARRA"), which was signed into law on February 17, 2009, provides for enhanced federal Medicaid matching rates that may provide some relief to states. Because states have discretion with respect to their Medicaid programs, some states may address budget shortfalls outside of Medicaid by reallocating state funds that otherwise would have been spent on Medicaid expenditures. As a result, the impact of the ARRA Medicaid funding on our operators will depend on how states choose to use the funding. Further, the ARRA funding is currently scheduled to end on June 30, 2011. Many states are concerned that the lack of funds will have a negative impact on their budgets.

Medicare. On July 22, 2010, The Centers for Medicare and Medicaid Studies, commonly referred to as CMS, published a notice with comment period on Medicare's prospective payment system for SNFs for federal fiscal year 2011. The notice with comment period includes an increase in payments to nursing homes equal to \$542 million or 1.7%. The impact of reimbursement changes among our operators may vary, depending in part on the characteristics of the patient populations of the individual facilities.

Under the Healthcare Reform Law, beginning in fiscal year 2012, the SNF market basket will be reduced by a productivity adjustment equal to the ten-year rolling average of changes in "annual economy-wide private non-farm business multifactor productivity" as projected by the Secretary of Health and Human Services. This could result in significant cuts to Medicare reimbursement, thereby negatively impacting our operators.

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 back one year to October 1, 2011. The Medicare and Medicaid Extenders Act of 2010 repealed the provision in 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. In response to this increase, CMS proposed a rule on April 28, 2011, which may impact SNF

reimbursement rates. The proposed rule indicates that CMS is considering implementing one of two options for FY 2012, with one option for 2012 being a significant reduction in the nursing component case mix index for RUG IV therapy groups. The estimated effect is an 11.3% decrease in total Medicare reimbursement. The second option is to establish the annual update of rates based on a standard market basket increase (of 2.7 percentage points), reduced by a multifactor productivity adjustment (of 1.2 percentage points), which results in a net 1.5% rate increase. 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. We expect that the implementation of either proposed parity adjustment would reduce operator coverage ratios, and would restore reimbursement levels consistent with pre-RUG IV levels. However, we do not believe the implementation of either parity adjustment would have a material effect on our portfolio. Additionally, the Medicare Payment Advisory Commission (MedPAC) recommended that Congress eliminate the update to Medicare payment rates for skilled nursing facilities for fiscal year 2012. Such reductions in Medicare reimbursements will likely have a negative impact on revenues.

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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 Accounting 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 2011, 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, they could result in further scrutiny and/or oversight of nursing homes.

Fraud and Abuse Laws and Regulations. There are various extremely complex 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 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.

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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, known as HIPAA. HIPAA was amended by the American Recovery and Reinvestment Act of 2009, known as the Stimulus Bill, to increase penalties for HIPAA violations, imposing stricter requirements on healthcare providers, in most cases requiring 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 and expanding possibilities for enforcement. Our operators may have to expend significant funds to secure the health information they hold, including upgrading their computer systems. If our operators are found in violation of HIPAA, such operators may be required to pay large penalties. Compliance with public notification requirements in the event of a breach could cause reputational harm to their business. Obligations to pay large penalties or tarnishing of reputations could adversely affect the ability of our operators to pay their 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, potentially jeopardizing their ability to meet their obligations to us.

Additional federal, state and local laws affect how our operators conduct their operations, including federal and state laws designed to protect 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 how our operators conduct their operations (including laws and regulations involving: fire, health and safety; quality of services, 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 thus their ability to meet their obligations to us.

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Legislative and Regulatory Developments. Each year, legislative proposals are introduced or proposed in Congress and in some state legislatures that would result in major changes in the healthcare system, either nationally or at the state level. We are unable to predict accurately whether any proposals will be adopted, or if adopted, what effect, if any, these proposals would have on our operators or our business.

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 March 31, 2011 and 2010

Operating Revenues

Our operating revenues for the three months ended March 31, 2011 totaled \$70.5 million, an increase of \$11.8 million over the same period in 2010. The \$11.8 million increase relates primarily to an increase in rental income of approximately \$19.1 million due to the CapitalSource acquisitions that occurred in December 2009 and June 2010 (approximately \$1.6 million resulted from in-place lease intangibles amortization). This was partially offset by a decrease in rental income from an operator's, for which we record revenue on a cash basis, failure to pay contractual rent. In addition, approximately \$0.9 million of the increase in mortgage income is due to (i) two new construction-to-permanent mortgage loans that we entered into with an operator in August 2010 and (ii) \$15.9 million first mortgage loan that we entered into with an operator in December 2010. Offsetting the above noted increases are (i) a decrease of \$3.7 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 (ii) a decrease of \$4.4 million in owned and operated assets due to the deconsolidation of owned and operated facilities effective June 1, 2010.

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Operating Expenses

Operating expenses for the three months ended March 31, 2011 totaled \$55.7 million, an increase of approximately \$32.5 million over the same period in 2010. The increase was primarily due to: (i) an increase in depreciation and amortization expense of \$10.5 million primarily associated with the CapitalSource acquisitions that occurred in December 2009 and June 2010; (ii) \$25.0 million provision for impairment on real estate assets in 2011; and (iii) an increase of \$1.5 million in general and administrative expense primarily related to expenses incurred in connection with the CapitalSource acquisitions and the 2011 equity compensation program, offset by the reduction of \$4.3 million in owned and operated assets primarily due to the deconsolidation of owned and operated facilities effective June 1, 2010.

Other Income (Expense)

For the three months ended March 31, 2011, total other expenses were \$20.7 million, an increase of approximately \$6.2 million over the same period in 2010. The increase in interest expense of approximately \$6.2 million was primarily due to an increase in borrowings outstanding, including debt assumed to finance the CapitalSource acquisitions. Interest expense also includes approximately \$0.4 million of amortization associated with the fair value adjustment for the debt assumed with the HUD acquisition and approximately \$0.3 million of amortization mortgage insurance premium expense associated with HUD acquisition. This was offset by a decrease of \$0.3 million in amortization of deferred financing costs related to the (i) \$100 million GECC term loan payoff in October 2010 and (ii) 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 March 31, 2011, was \$14.1 million, compared to \$33.4 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.





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The following table presents our FFO results for the three-month ended March 31, 2011 and 2010:

	Three Months Ended March 31,	
	2011	2010
	(in thousands)	
Net (loss) income available to common stockholders	\$(11,076	) \$18,680
Elimination of non-cash items included in net income:		
Depreciation and amortization	25,218	14,687
Funds from operations available to common stockholders	\$14,142	\$33,367

### 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. During the first quarter of 2011, we amortized approximately \$0.4 million of above-market adjustments related to the assumed debt and approximately \$1.6 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 facilities were leased and operated by affiliates of Formation and were managed by Genesis, and had approximately 472 licensed beds as of March 31, 2011. The Superior Court, Judicial District of Hartford, Connecticut (the “Court”) appointed a receiver.

The receiver 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 the Company objected. At the hearing held on April 21, 2011,

the Company stated its 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.

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The Company intends to file a timely notice of appeal, taking the position that the Court's Order is final and appealable. The Order is stayed under Connecticut law (thereby prohibiting any actions in furtherance of the Order to close) during the period in which the Company has to file its appeal (20 days) and then during the pendency of such appeal; however, the receiver and/or the State may seek an order from the Court to lift the stay.

As a result of these developments, during the three months ended March 31, 2011, the Company 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.

## Oklahoma Facility

In March 2011, we agreed to sell a property to an operator and recorded an impairment charge of approximately \$0.6 million related to the pending transaction.

## Liquidity and Capital Resources

At March 31, 2011, we had total assets of \$2.3 billion, stockholders' equity of \$0.9 billion and debt of \$1.2 billion, representing approximately 58.2% of total capitalization.

The following table shows the amounts due in connection with the contractual obligations described below as of March 31, 2011.

	Total	Payments due by period			More than 5 years
		Less than 1 year	1-3 years	3-5 years	
			(in thousands)		
Debt(1)	\$1,219,287	\$2,498	\$5,418	\$250,035	\$961,336
Interest payments on long-term debt	873,007	80,468	160,514	154,017	478,008
Operating lease obligations(2)	2,621	297	620	654	1,050
Total	\$2,094,915	\$83,263	\$166,552	\$404,706	\$1,440,394

(1) The \$1.2 billion of debt outstanding includes \$69 million in borrowings under the \$320 million revolving senior secured credit facility due in April 2014, \$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, \$53 million of HUD debt at a 6.61% weighted average annual interest rate maturing between January 2036 and May 2040, and \$128 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 March 31, 2011, we had \$69.0 million outstanding under our \$320 million revolving senior secured credit facility (the "2010 Credit Facility"), and no letters of credit outstanding, leaving availability of \$251.0 million.



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The 2010 Credit Facility is priced at LIBOR plus an applicable percentage (ranging from 325 basis points to 425 basis points) based on our consolidated leverage and is not subject to a LIBOR floor. Our applicable percentage above LIBOR was 375 basis points as of March 31, 2011. We intend to use the 2010 Credit Facility for acquisitions and general corporate purposes.

### \$140 Million Equity Shelf Program

During the three months ended March 31, 2011, 1.3 million shares of our common stock were issued through our \$140 million Equity Shelf Program (the "2010 ESP") for net proceeds of \$28.1 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 \$320 million revolving senior secured 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 2010 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. The credit agreement defines FFO as net income (or loss) plus depreciation and amortization and shall be adjusted for charges related to: (i) restructuring our debt; (ii) redemption of preferred stock; (iii) litigation charges up to \$5.0 million; (iv) non-cash charges for accounts and notes receivable up to \$5.0 million; (v) non-cash compensation related expenses; (vi) non-cash impairment charges; and (vii) tax liabilities in an amount not to exceed \$8.0 million.

For the three months ended March 31, 2011, we paid total dividends of \$40.3 million.

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, to be paid May 16, 2011 to common stockholders of record on April 29, 2011.

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Liquidity

We believe our liquidity and various sources of available capital, including cash from operations, our existing availability under our 2010 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 \$3.4 million as of March 31, 2011, a decrease of \$3.5 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 \$38.7 million for the three months ended March 31, 2011, as compared to \$38.8 million for the same period in 2010, a decrease of \$91 thousand.

Investing Activities – Net cash flow from investing activities was an outflow of \$5.7 million for the three months ended March 31, 2011, as compared to an outflow of \$22.9 million for the same period in 2010. The decrease in cash outflow from investing activities of \$17.3 million relates to the \$1.7 million construction-to-permanent mortgage loans with one of our operators in the first quarter of 2011, offset by (i) \$4.8 million related to a reduction of capital improvement funding in the first quarter of 2011 compared to the first quarter of 2010 and (ii) \$13.0 million mortgage backed certificates that we purchased in the first quarter of 2010.

Financing Activities – Net cash flow from financing activities was an outflow of \$36.6 million for the three months ended March 31, 2011 as compared to an inflow of \$57.2 million for the same period in 2010. The \$93.7 million change in financing activities was primarily a result of: (i) a net proceeds of our credit facility of \$69.0 million during the first quarter of 2011 compared to \$94.1 million net payments for the same period 2010 and (ii) an increase in net proceeds from our dividend reinvestment proceeds of \$5.3 million during the first quarter of 2011 compared to the same period 2010. Offsetting these increases were: (i) \$108.6 million related to preferred stock redemption in the first quarter of 2011, (ii) net proceeds of \$196.6 million of our 7.5% Senior Notes due 2020 issued in February 2010, (iii) the repayment of \$59.4 million during the first quarter of 2010 in debt assumed as part of the December 22, 2009 CapitalSource acquisition, (iv) an increase in dividend payment of \$9.7 million during the first quarter of 2011 due to an increase in the number of shares outstanding, (v) a decrease in net proceeds of \$8.6 million from our common stock issued through our Equity Shelf Program during the first quarter of 2011 compared to the same period in 2010, and (vi) the payment of \$4.3 million in payments of deferred financing costs associated with the issuance of our \$200 million 7.5% senior notes in February 2010 compared to \$0.5 million during the first quarter of 2011.





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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 2010 Credit Facility can vary based on the interest rate option we choose to utilize. The interest rates per annum applicable to the 2010 Credit Facility are the reserve-adjusted LIBOR Rate (the “Eurodollar Rate”), 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 for a Eurodollar Loan with an interest period of one month plus 1.25%, in each case, plus the applicable margin. The applicable margin with respect to the 2010 Credit Facility is determined in accordance with a performance grid based on our consolidated leverage ratio. The applicable margin may range from 4.25% to 3.25% in the case of Eurodollar Rate advances, from 3.0% to 2.0% in the case of base rate advances, and from 4.25% to 3.25% in the case of letter of credit fees. As of March 31, 2011, the total amount of debt outstanding on the 2010 Credit Facility was \$69.0 million, which is subject to interest rate fluctuations.

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

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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. We have not experienced any material changes from the risk factors previously described therein, except as set forth below.

Our operators depend on reimbursement from governmental and other third-party payors and reimbursement rates from such payors may be reduced.

Changes in the reimbursement rate or methods of payment from third-party payors, including the Medicare and Medicaid programs, or the implementation of other measures to reduce reimbursements for services provided by our operators, has in the past, and could in the future, result in a substantial reduction in our operators' revenues and operating margins. For example, CMS issued a proposed rule on April 28, 2011 that may impact SNF reimbursement rates. The proposed rule indicates that CMS is considering implementing one of two options for FY 2012, with one option for 2012 being a significant reduction in the nursing component case mix index for RUG IV therapy groups. The estimated effect is an 11.3% decrease in total Medicare reimbursement. The second option is to establish the annual update of rates based on a standard market basket increase (of 2.7 percentage points), reduced by a multifactor productivity adjustment (of 1.2 percentage points), which results in a net 1.5% rate increase. We expect the implementation of either proposed parity adjustment would reduce operator coverage ratios at least back to pre RUG-IV level and possibly a bit more due to increased costs.

Additionally, net revenue realizable under third-party payor agreements can change after examination and retroactive adjustment by payors during the claims settlement processes or as a result of post-payment audits. Payors may disallow requests for reimbursement based on determinations that certain costs are not reimbursable or reasonable or because additional documentation is necessary or because certain services were not covered or were not medically necessary. There also continue to be new legislative and regulatory proposals that could impose further limitations on government and private payments to healthcare providers. In some cases, states have enacted or are considering enacting measures designed to reduce their Medicaid expenditures and to make changes to private healthcare insurance. We cannot assure you that adequate reimbursement levels will continue to be available for the services provided by our operators, which are currently being reimbursed by Medicare, Medicaid or private third-party payors. Significant limits on the scope of services reimbursed and on reimbursement rates could have a material adverse effect on our operators' liquidity, financial condition and results of operations, which could cause the revenues of our operators to decline and jeopardize their ability to meet their obligations to us.

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Government budget deficits could lead to a reduction in Medicare and Medicaid reimbursement.

Many states are focusing on the reduction of expenditures under their Medicaid programs, which may result in a reduction in reimbursement rates for our operators. These potential reductions could be compounded by the potential for federal cost-cutting efforts that could lead to reductions in reimbursement to our operators under both the Medicare and Medicaid programs. Potential reductions in Medicare and Medicaid reimbursement to our operators could reduce the cash flow of our operators and their ability to make rent or mortgage payments to us. 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. 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 place some operators in financial distress, which in turn could adversely affect us.

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Item 6 – Exhibits

Exhibit No.

- 3.1 Amended and Restated Bylaws, effective as of the conclusion of the Company’s 2011 Annual Meeting of Stockholders. (Incorporated by reference to Exhibit 3.1 to the Company’s Form 8-K, filed on April 20, 2011).
- 10.1 Sixth Amendment to Second Consolidated Amended and Restated Master Lease dated as of March 31, 2011 by and among OHI Asset (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.

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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: May 9, 2011  
C. Taylor Pickett  
Chief Executive Officer

By: /S/ C. TAYLOR PICKETT

Date: May 9, 2011  
Robert O. Stephenson  
Chief Financial Officer

By: /S/ ROBERT O. STEPHENSON

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