

OMEGA HEALTHCARE INVESTORS INC  
Form 10-Q  
May 06, 2016

**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, 2016**

**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  
   (IRS Employer)

(State of incorporation) Identification No.)

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

(Address of principal executive offices)

(410) 427-1700

(Telephone number, including area code)

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

Yes                       No

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

Yes                       No

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 April 29, 2016.

|                               |                    |
|-------------------------------|--------------------|
| Common Stock, \$.10 par value | 188,170,595        |
| (Class)                       | (Number of shares) |

**OMEGA HEALTHCARE INVESTORS, INC.**

**FORM 10-Q**

**March 31, 2016**

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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,<br>2016<br>(Unaudited) | December 31,<br>2015 |
|--|----------------------------------|----------------------|
| <b>ASSETS</b>                                |                                  |                      |
| Real estate properties                       |                                  |                      |
| Land and buildings                           | \$7,088,960                      | \$ 6,743,958         |
| Less accumulated depreciation                | (1,067,023)                      | (1,019,150 )         |
| Real estate properties – net                 | 6,021,937                        | 5,724,808            |
| Investments in direct financing leases – net | 590,622                          | 587,701              |
| Mortgage notes receivable                    | 660,569                          | 679,795              |
|  | 7,273,128                        | 6,992,304            |
| Other investments                            | 203,832                          | 89,299               |
|  | 7,476,960                        | 7,081,603            |
| Assets held for sale – net                   | 73,589                           | 6,599                |
| Total investments                            | 7,550,549                        | 7,088,202            |
| Cash and cash equivalents                    | 9,407                            | 5,424                |
| Restricted cash                              | 12,327                           | 14,607               |
| Accounts receivable – net                    | 208,269                          | 203,862              |
| Goodwill                                     | 645,568                          | 645,683              |
| Other assets                                 | 189,332                          | 61,231               |
| Total assets                                 | \$8,615,452                      | \$ 8,019,009         |
| <b>LIABILITIES AND EQUITY</b>                |                                  |                      |
| Revolving line of credit                     | \$530,000                        | \$ 230,000           |
| Term loans                                   | 1,100,000                        | 750,000              |
| Secured borrowings – net                     | 235,895                          | 236,204              |
| Unsecured borrowings – net                   | 2,353,297                        | 2,352,882            |
| Accrued expenses and other liabilities       | 328,932                          | 333,706              |
| Deferred income taxes                        | 14,795                           | 15,352               |
| Total liabilities                            | 4,562,919                        | 3,918,144            |

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Equity:

|  |             |              |
|--|-------------|--------------|
| Common stock \$.10 par value authorized – 350,000 shares, issued and outstanding – 188,167 shares as of March 31, 2016 and 187,399 as of December 31, 2015 | 18,817      | 18,740       |
| Common stock – additional paid-in capital  | 4,629,423   | 4,609,474    |
| Cumulative net earnings  | 1,428,077   | 1,372,522    |
| Cumulative dividends paid  | (2,361,580) | (2,254,038 ) |
| Accumulated other comprehensive loss   | (21,702 )   | (8,712 )     |
| Total stockholders' equity   | 3,693,035   | 3,737,986    |
| Noncontrolling interest  | 359,498     | 362,879      |
| Total equity   | 4,052,533   | 4,100,865    |
| Total liabilities and equity   | \$8,615,452 | \$ 8,019,009 |

See notes to consolidated financial statements.

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

|   | Three Months Ended<br>March 31, |            |
|---|---------------------------------|------------|
|   | 2016                            | 2015       |
| Revenue   |                                 |            |
| Rental income   | \$ 176,703                      | \$ 100,964 |
| Income from direct financing leases                                   | 15,442                          | 14,346     |
| Mortgage interest income  | 16,606                          | 16,579     |
| Other investment income – net   | 4,128                           | 1,531      |
| Total operating revenues  | 212,879                         | 133,420    |
| Expenses  |                                 |            |
| Depreciation and amortization   | 62,433                          | 30,610     |
| General and administrative  | 10,455                          | 6,014      |
| Acquisition and merger related costs                                  | 3,771                           | 4,868      |
| Impairment loss on real estate properties                             | 34,558                          | 5,982      |
| Provisions for uncollectible mortgages, notes and accounts receivable | 5,124                           | (2 )       |
| Total operating expenses  | 116,341                         | 47,472     |
| Income before other income and expense                                | 96,538                          | 85,948     |
| Other income (expense)  |                                 |            |
| Interest income   | 8                               | 193        |
| Interest expense  | (37,222 )                       | (32,359 )  |
| Interest – amortization of deferred financing costs                   | (2,132 )                        | (1,353 )   |
| Interest – refinancing costs  | (298 )                          | (9,377 )   |
| Realized loss on foreign exchange                                     | (22 )                           | -          |
| Total other expense   | (39,666 )                       | (42,896 )  |
| Income before gain on assets sold                                     | 56,872                          | 43,052     |
| Gain on assets sold – net   | 1,571                           | -          |
| Income from continuing operations before income taxes                 | 58,443                          | 43,052     |
| Income taxes  | (247 )                          | -          |
| Net income  | 58,196                          | 43,052     |
| Net income attributable to noncontrolling interest                    | (2,641 )                        | -          |
| Net income available to common stockholders                           | \$55,555                        | \$43,052   |

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|  |          |          |
|--|----------|----------|
| Net income   | \$58,196 | \$43,052 |
| Other comprehensive loss - foreign currency translation              | (4,730 ) | -        |
| Other comprehensive loss - cash flow hedges                          | (8,876 ) | -        |
| Total comprehensive income   | 44,590   | 43,052   |
| Deduct: comprehensive income attributable to noncontrolling interest | (2,025 ) | -        |
| Comprehensive income attributable to common stockholders             | \$42,565 | \$43,052 |
| Income per common share available to common stockholders:            |          |          |
| Basic:   |          |          |
| Net income available to common stockholders                          | \$0.30   | \$0.32   |
| Diluted:   |          |          |
| Net income   | \$0.29   | \$0.32   |
| Dividends declared per common share                                  | \$0.57   | \$0.89   |
| Weighted-average shares outstanding, basic                           | 188,228  | 134,346  |
| Weighted-average shares outstanding, diluted                         | 198,350  | 134,806  |

See notes to consolidated financial statements.



## OMEGA HEALTHCARE INVESTORS, INC.

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

## Unaudited

(in thousands, except per share amounts)

|   | Common<br>Stock<br>Par<br>Value | Additional<br>Paid-in<br>Capital | Cumulative<br>Net<br>Earnings | Cumulative<br>Dividends<br>Paid | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders'<br>Equity | Noncontrolling<br>interest | Total<br>Equity |
|---|---------------------------------|----------------------------------|-------------------------------|---------------------------------|---|----------------------------------|----------------------------|-----------------|
| Balance at<br>December 31,<br>2015 (187,399<br>common<br>shares &<br>8,956 OP<br>Units)                     | \$18,740                        | \$4,609,474                      | \$1,372,522                   | \$(2,254,038)                   | \$(8,712 )                                    | \$3,737,986                      | \$362,879                  | \$4,100,865     |
| Restricted<br>stock expense   | —                               | 2,778                            | —                             | —                               | —   | 2,778                            | —                          | 2,778           |
| Vesting of<br>equity<br>compensation<br>plan, net of<br>tax<br>withholdings<br>(105 shares)                 | 11                              | (2,391 )                         | —                             | —                               | —   | (2,380 )                         | —                          | (2,380 )        |
| Dividend<br>reinvestment<br>plan (660<br>shares at an<br>average of<br>\$29.84 per<br>share)                | 66                              | 19,530                           | —                             | —                               | —   | 19,596                           | —                          | 19,596          |
| Grant of stock<br>as payment of<br>directors fees<br>(3 shares at an<br>average of<br>\$28.18 per<br>share) | —                               | 87                               | —                             | —                               | —   | 87                               | —                          | 87              |
| Deferred<br>compensation  | —                               | (45 )                            | —                             | —                               | —   | (45 )                            | —                          | (45 )           |

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|               |          |             |             |               |             |             |           |             |
|---------------|----------|-------------|-------------|---------------|-------------|-------------|-----------|-------------|
| directors     |          |             |             |               |             |             |           |             |
| Common        |          |             |             |               |             |             |           |             |
| dividends     |          |             |             |               |             |             |           |             |
| declared      | —        | —           | —           | (107,542 )    | —           | (107,542 )  | —         | (107,542 )  |
| (\$0.57 per   |          |             |             |               |             |             |           |             |
| share)        |          |             |             |               |             |             |           |             |
| Cash          |          |             |             |               |             |             |           |             |
| conversion of |          |             |             |               |             |             |           |             |
| OP Units (9   | —        | (10 )       | —           | —             | —           | (10 )       | (274 )    | (284 )      |
| units)        |          |             |             |               |             |             |           |             |
| OP units      |          |             |             |               |             |             |           |             |
| distributions | —        | —           | —           | —             | —           | —           | (5,132 )  | (5,132 )    |
| Foreign       |          |             |             |               |             |             |           |             |
| currency      |          |             |             |               |             |             |           |             |
| translation   | —        | —           | —           | —             | (4,516 )    | (4,516 )    | (214 )    | (4,730 )    |
| Cash flow     |          |             |             |               |             |             |           |             |
| hedges        | —        | —           | —           | —             | (8,474 )    | (8,474 )    | (402 )    | (8,876 )    |
| Net income    | —        | —           | 55,555      | —             | —           | 55,555      | 2,641     | 58,196      |
| Balance at    |          |             |             |               |             |             |           |             |
| March 31,     |          |             |             |               |             |             |           |             |
| 2016 (188,167 | \$18,817 | \$4,629,423 | \$1,428,077 | \$(2,361,580) | \$(21,702 ) | \$3,693,035 | \$359,498 | \$4,052,533 |
| shares &      |          |             |             |               |             |             |           |             |
| 8,947 OP      |          |             |             |               |             |             |           |             |
| Units)        |          |             |             |               |             |             |           |             |

See notes to consolidated financial statements.

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

|  | <b>Three Months Ended</b> |           |
|--|---------------------------|-----------|
|  | <b>March 31,</b>          |           |
|  | 2016                      | 2015      |
| Cash flows from operating activities   |                           |           |
| Net income   | \$58,196                  | \$43,052  |
| Adjustment to reconcile net income to net cash provided by operating activities: |                           |           |
| Depreciation and amortization  | 62,433                    | 30,610    |
| Provision for impairment on real estate properties                               | 34,558                    | 5,982     |
| Provision for uncollectible mortgages, notes and accounts receivable             | 5,124                     | (2 )      |
| Amortization of deferred financing costs and refinancing costs                   | 2,430                     | 10,730    |
| Accretion of direct financing leases   | (2,921 )                  | (2,614 )  |
| Stock-based compensation   | 2,778                     | 1,610     |
| Gain on assets sold – net  | (1,571 )                  | —         |
| Amortization of acquired in-place leases - net                                   | (4,300 )                  | (1,192 )  |
| Change in operating assets and liabilities – net of amounts assumed/acquired:    |                           |           |
| Accounts receivable, net   | 560                       | (196 )    |
| Straight-line rent receivables   | (9,947 )                  | (5,275 )  |
| Lease inducements  | 647                       | (2,110 )  |
| Effective yield receivable on mortgage notes                                     | (819 )                    | (1,120 )  |
| Other operating assets and liabilities   | (19,989 )                 | 23,819    |
| Net cash provided by operating activities  | 127,179                   | 103,294   |
| Cash flows from investing activities   |                           |           |
| Acquisition of real estate – net of liabilities assumed and escrows acquired     | (416,104)                 | (6,300 )  |
| Investment in construction in progress   | (16,316 )                 | (5,851 )  |
| Deposit to acquire real estate   | (113,816)                 | —         |
| Placement of mortgage loans  | (6,162 )                  | (2,002 )  |
| Proceeds from sale of real estate investments                                    | 2,392                     | 255       |
| Capital improvements to real estate investments                                  | (9,544 )                  | (5,604 )  |
| Proceeds from other investments  | 1,461                     | 2,155     |
| Investments in other investments   | (116,003)                 | (1,468 )  |
| Collection of mortgage principal   | 312                       | 288       |
| Net cash used in investing activities  | (673,780)                 | (18,527 ) |
| Cash flows from financing activities   |                           |           |
| Proceeds from credit facility borrowings   | 670,000                   | 6,000     |
| Payments on credit facility borrowings   | (370,000)                 | (91,000 ) |
| Receipts of other long-term borrowings   | 350,000                   | 689,822   |
| Payments of other long-term borrowings   | (309 )                    | (347,883) |
| Payments of financing related costs  | (3,576 )                  | (21,318 ) |

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|   |           |           |
|---|-----------|-----------|
| Receipts from dividend reinvestment plan                            | 19,596    | 5,414     |
| Payments for exercised options and restricted stock - net           | (2,381 )  | (1,906 )  |
| Net proceeds from issuance of common stock                          | —         | 440,019   |
| Dividends paid  | (107,500) | (68,261 ) |
| Redemption of OP Units  | (10 )     | —         |
| Distributions to OP Unit Holders                                    | (5,131 )  | —         |
| Net cash provided by financing activities                           | 550,689   | 610,887   |
| <br>  |           |           |
| Increase in cash and cash equivalents                               | 4,088     | 695,654   |
| Effect of foreign currency translation on cash and cash equivalents | (105 )    | —         |
| Cash and cash equivalents at beginning of period                    | 5,424     | 4,489     |
| Cash and cash equivalents at end of period                          | \$9,407   | \$700,143 |
| Interest paid during the period, net of amounts capitalized         | \$36,597  | \$25,829  |

**Non-cash financing activities:**

|                   | <b>Three Months Ended</b> |             |
|-------------------|---------------------------|-------------|
|                   | <b>March 31,</b>          |             |
|                   | <b>2016</b>               | <b>2015</b> |
| Cash flow hedges  | \$ 8,876                  | \$ —        |
| Accrued dividends | —                         | 50,221      |
| Total             | \$ 8,876                  | \$ 50,221   |

See notes to consolidated financial statements.

**OMEGA HEALTHCARE INVESTORS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Unaudited**

**March 31, 2016**

**NOTE 1 – BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

**Business Overview and Organization**

Omega Healthcare Investors, Inc. (“Omega,” “we,” “our” or the “Company”) has one reportable segment consisting of investments in healthcare-related real estate properties located in the United States and the United Kingdom. Our core business is to provide financing and capital to the long-term healthcare industry with a particular focus on skilled nursing facilities (“SNFs”). 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 mortgage loans, which are secured by first mortgage liens on the underlying real estate and personal property of the mortgagor.

Omega was formed as a real estate investment trust (“REIT”) and incorporated in the State of Maryland on March 31, 1992. In April 2015, Aviv REIT, Inc., a Maryland corporation (“Aviv”), merged (the “Aviv Merger”) with and into a wholly owned subsidiary of Omega, pursuant to the terms of that certain Agreement and Plan of Merger, dated as of October 30, 2014 (the “Merger Agreement”), by and among the Company, Aviv, OHI Healthcare Properties Holdco, Inc., a Delaware corporation and a direct wholly-owned subsidiary of Omega (“Merger Sub”), OHI Healthcare Properties Limited Partnership, a Delaware limited partnership (“Omega OP”), and Aviv Healthcare Properties Limited Partnership, a Delaware limited partnership (the “Aviv OP”).

Prior to April 1, 2015 and in accordance with the Merger Agreement, Omega restructured the manner in which it holds its assets by converting to an umbrella partnership real estate investment trust structure (the “UPREIT Conversion”). As a result of the UPREIT Conversion and following the consummation of the Aviv Merger, substantially all of the Company’s assets are held by Omega OP.

Omega OP is governed by the Second Amended and Restated Agreement of Limited Partnership of OHI Healthcare Properties Limited Partnership, dated as of April 1, 2015 (the “Partnership Agreement”). Pursuant to the Partnership

Agreement, the Company and Merger Sub are the general partners of Omega OP, and have exclusive control over Omega OP's day-to-day management. As of March 31, 2016, the Company owned approximately 95% of the issued and outstanding units of partnership interest in Omega OP ("Omega OP Units"), and investors owned approximately 5% of the Omega OP Units.

### **Basis of Presentation**

The accompanying unaudited consolidated financial statements for Omega have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles ("GAAP") for complete financial statements. In our opinion, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the interim periods reported herein are not necessarily indicative of results to be expected for the full year. We have evaluated all subsequent events through the date of the filing of this Form 10-Q (refer to Note 17 – Subsequent Events). 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) Omega OP, and (iii) all direct and indirect wholly owned subsidiaries of Omega. All intercompany transactions and balances have been eliminated in consolidation.

## **Goodwill Impairment**

We assess goodwill for potential impairment during the fourth quarter of each fiscal year, or during the year if an event or other circumstance indicates that we may not be able to recover the carrying amount of the net assets of the reporting unit. In evaluating goodwill for impairment, we first assess qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the fair value of the reporting unit is less than its carrying amount. If we conclude that it is more likely than not that the fair value of the reporting unit is less than its carrying value, then we perform a two-step goodwill impairment test to identify potential impairment and measure the amount of impairment we will recognize, if any. The goodwill is not deductible for tax purposes.

## **Redeemable Limited Partnership Unitholder Interests and Noncontrolling Interests**

As of April 1, 2015 and after giving effect to the Aviv Merger, the Company owned approximately 138.8 million Omega OP Units and Aviv OP owned approximately 52.9 million Omega OP Units. Each of the Omega OP Units (other than the Omega OP Units owned by Omega) is redeemable at the election of the Omega OP Unit holder for cash equal to the then-fair market value of one share of Omega common stock, par value \$0.10 per share (“Omega Common Stock”), subject to the Company’s election to exchange the Omega OP Units tendered for redemption for unregistered shares of Omega Common Stock on a one-for-one basis, subject to adjustment as set forth in the Partnership Agreement.

Effective June 30, 2015, the Company (through Merger Sub, in its capacity as the general partner of Aviv OP) caused Aviv OP to make a distribution of Omega OP Units held by Aviv OP (or equivalent value) to Aviv OP investors (the “Aviv OP Distribution”) in connection with the liquidation of Aviv OP. As a result of the Aviv OP Distribution, Omega directly and indirectly owned approximately 95% of the outstanding Omega OP Units, and the other investors own approximately 5% of the outstanding Omega OP Units. As a part of the Aviv OP Distribution, Omega settled approximately 0.2 million units via cash settlement. As of March 31, 2016, Omega directly and indirectly owns approximately 95% of the outstanding Omega OP Units, and the other investors own approximately 5% of the outstanding Omega OP Units.

## **Noncontrolling Interests**

Noncontrolling interests is the portion of equity in the Omega OP not attributable to the Company. We present the portion of any equity that we do not own in consolidated entities as noncontrolling interests and classify those interests as a component of total equity, separate from total stockholders’ equity, on our Consolidated Balance Sheets. We include net income attributable to the noncontrolling interests in net income in our Consolidated Statements of



Operations and Comprehensive Income.

As our ownership of a controlled subsidiary increases or decreases, any difference between the aggregate consideration paid to acquire the noncontrolling interests and our noncontrolling interest balance is recorded as a component of equity in additional paid-in capital, so long as we maintain a controlling ownership interest.

**Foreign Operations**

The U.S. dollar is the functional currency for our consolidated subsidiaries operating in the United States. The functional currency for our consolidated subsidiaries operating in countries other than the United States is the principal currency in which the entity primarily generates and expends cash. For our consolidated subsidiaries whose functional currency is not the U.S. dollar, we translate their financial statements into the U.S. dollar. We translate assets and liabilities at the exchange rate in effect as of the financial statement date. Gains and losses resulting from this translation are included in accumulated other comprehensive loss (“AOCL”) as a separate component of equity and a proportionate amount of gain or loss is allocated to noncontrolling interest. Certain balance sheet items, primarily equity and capital-related accounts, are reflected at the historical exchange rate. Revenue and expense accounts are translated using an average exchange rate for the period.

We and certain of our consolidated subsidiaries may have intercompany and third-party debt that is not denominated in the entity's functional currency. When the debt is remeasured against the functional currency of the entity, a gain or loss can result. The resulting adjustment is reflected in results of operations, unless it is intercompany debt that is deemed to be long-term in nature and then the adjustments are included in AOCL.

## **Derivative Instruments**

During our normal course of business, we may use certain types of derivative instruments for the purpose of managing interest rate and currency risk. To qualify for hedge accounting, derivative instruments used for risk management purposes must effectively reduce the risk exposure that they are designed to hedge. In addition, at inception of a qualifying cash flow hedging relationship, the underlying transaction or transactions, must be, and are expected to remain, probable of occurring in accordance with the Company's related assertions. The Company recognizes all derivative instruments, including embedded derivatives required to be bifurcated, as assets or liabilities in the Consolidated Balance Sheets at their fair value which are determined using a market approach and Level 2 inputs. Changes in the fair value of derivative instruments that are not designated in hedging relationships or that do not meet the criteria of hedge accounting are recognized in earnings. For derivatives designated as qualifying cash flow hedging relationships, the change in fair value of the effective portion of the derivatives is recognized in AOCL as a separate component of equity and a proportionate amount of gain or loss is allocated to noncontrolling interest, whereas the change in fair value of the ineffective portion is recognized in earnings. We formally document all relationships between hedging instruments and hedged items, as well as its risk-management objectives and strategy for undertaking various hedge transactions. This process includes designating all derivatives that are part of a hedging relationship to specific forecasted transactions as well as recognized obligations or assets in the Consolidated Balance Sheets. We also assess and document, both at inception of the hedging relationship and on a quarterly basis thereafter, whether the derivatives are highly effective in offsetting the designated risks associated with the respective hedged items. If it is determined that a derivative ceases to be highly effective as a hedge, or that it is probable the underlying forecasted transaction will not occur, we discontinue hedge accounting prospectively and record the appropriate adjustment to earnings based on the current fair value of the derivative. As a matter of policy, we do not use derivatives for trading or speculative purposes. At March 31, 2016 and December 31, 2015, we had \$9.6 million and \$0.7 million, respectively, of qualifying cash flow hedges recorded at fair value in accrued expenses and other liabilities on our Consolidated Balance Sheets.

## **Accounts Receivable**

Accounts receivable includes: contractual receivables, effective yield interest receivables, straight-line rent receivables and lease inducements, net of an estimated provision for losses related to uncollectible and disputed accounts. Contractual receivables relate to the amounts currently owed to us under the terms of our lease and loan agreements. Effective yield interest receivables relate to the difference between the interest income recognized on an effective yield basis over the term of the loan agreement and the interest currently due to us according to the contractual agreement. Straight-line receivables relate to the difference between the rental revenue recognized on a straight-line

basis and the amounts currently due to us according to the contractual agreement. Lease inducements result from value provided by us to the lessee, at the inception or renewal of the lease, and are amortized as a reduction of rental revenue over the non-cancellable lease term.

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

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

|                                      | March<br>31,<br>2016<br>(in thousands) | December 31,<br>2015 |
|--------------------------------------|--|----------------------|
| Contractual receivables              | \$7,885                                | \$ 8,452             |
| Effective yield interest receivables | 8,636                                  | 9,028                |
| Straight-line receivables            | 181,715                                | 175,709              |
| Lease inducements                    | 10,335                                 | 10,982               |
| Allowance                            | (302 )                                 | (309 )               |
| Accounts receivable – net            | \$208,269                              | \$ 203,862           |

In the first quarter of 2016, we entered into agreements to transition 27 facilities from one of our former operators to a current operator. As a result of the transition, we wrote off approximately \$3.4 million of straight line receivable from the former operator.

We continuously evaluate the payment history and financial strength of our operators and have historically established allowance reserves for straight-line rent receivables 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.

### **Related Party Transactions**

The Company has a policy which generally requires related party transactions to be approved or ratified by the Audit Committee. A member of the Board of Directors of the Company, together with certain members of his immediate family, beneficially owned approximately 34% of the equity of Laurel Healthcare Holdings, Inc. ("Laurel"). On February 1, 2016, we acquired 10 SNFs from Laurel for approximately \$169.0 million in cash and leased them to an unrelated existing operator. Immediately following our acquisition, the unrelated existing operator acquired all of the outstanding equity interests of Laurel, including the interests previously held by a director of the Company and his family.

### **Recent Accounting Pronouncements**

In 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”), which outlines a comprehensive model for entities to use in accounting for revenue arising from contracts with customers. ASU 2014-09 states that “an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” While ASU 2014-09 specifically references contracts with customers, it may apply to certain other transactions such as the sale of real estate or equipment. ASU 2014-09 is effective for the Company beginning January 1, 2018. We are continuing to evaluate this guidance; however, we do not expect its adoption to have a significant impact on our consolidated financial statements, as a substantial portion of our revenue consists of rental income from leasing arrangements, which are specifically excluded from ASU 2014-09.

In February 2015, the FASB issued ASU No. 2015-02, *Amendments to the Consolidation Analysis* (“ASU 2015-02”), which amends certain requirements for determining whether a variable interest entity must be consolidated. The amendments in ASU 2015-02 are effective for annual and interim reporting periods of public entities beginning after December 31, 2015 and were adopted by the Company during the quarter ended March 31, 2016. The effect of this guidance was immaterial to the Company’s consolidated results of operations, financial position and cash flows.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments - Overall*, which makes limited amendments to the guidance in U.S. GAAP on the classification and measurement of financial instruments. The new standard significantly revises an entity's accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. It also amends certain disclosure requirements associated with the fair value of financial instruments. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, including interim periods therein. Early adoption is permitted specifically for the amendments pertaining to the presentation of certain fair value changes for financial liabilities measured at fair value. Early adoption of all other amendments is not permitted. Upon adoption, the Company will be required to make a cumulative-effect adjustment to the Consolidated Balance Sheet as of the beginning of the first reporting period in which the guidance is effective. We are currently evaluating the impact of adopting ASU 2016-01 on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases* ("ASU 2016-02") which amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. ASU 2016-02 will be effective for the Company beginning January 1, 2019. Early adoption of ASU 2016-02 as of its issuance is permitted. The new standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. We are currently evaluating the impact of adopting ASU 2016-02 on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation-Stock Compensation (Topic 718)* ("ASU 2016-09"). ASU 2016-09 amends the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. This guidance is effective for annual and interim reporting periods of public entities beginning after December 15, 2017, with early adoption permitted. We are currently evaluating the impact of adopting ASU 2016-09 on our consolidated financial statements.

## **NOTE 2 – PROPERTIES AND INVESTMENTS**

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

### **Leased Property**

Our leased real estate properties, represented by 800 SNFs, 84 assisted living facilities (“ALFs”), 16 specialty facilities and one medical office building at March 31, 2016, are leased under provisions of single or master leases with initial terms typically ranging from five 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 (e.g., 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.

The following tables summarize the significant acquisitions that occurred in 2016.

| Period | Number of Facilities |     | Country/<br>State | Total Investment | Land          |               | Building & Site Improvements | Furniture & Fixtures | Initial Cash Yield |
|--------|----------------------|-----|-------------------|------------------|---------------|---------------|------------------------------|----------------------|--------------------|
|        | SNF                  | ALF |                   |                  | (in millions) | (in millions) |                              |                      |                    |
| Q1     | -                    | 1   | UK                | \$ 8.3           |               | \$ 1.4        | \$ 6.7                       | \$ 0.2               | 7.00               |
| Q1     | -                    | 1   | UK                | 6.1              | (1)           | 0.6           | 5.3                          | 0.2                  | 7.00               |
| Q1     | 10                   | -   | OH, VA, MI        | 169.0            | (1) (3)       | 10.5          | 152.5                        | 6.0                  | 8.50               |
| Q1     | -                    | -   | FL                | 2.5              | (2)           | 2.5           | -                            | -                    | -                  |
| Q1     | -                    | 2   | GA                | 20.2             |               | 0.8           | 18.3                         | 1.1                  | 7.50               |
| Q1     | 3                    | -   | MD                | 25.0             |               | 2.5           | 19.9                         | 2.6                  | 8.50               |
| Q1     | 21                   | -   | VA, NC            | 212.5            | (1)           | 19.3          | 181.1                        | 12.1                 | 8.50               |
| Total  | 34                   | 4   |                   | \$ 443.6         |               | \$ 37.6       | \$ 383.8                     | \$ 22.2              |                    |

The Company estimated the fair value of the assets acquired on the acquisition date based on certain valuation (1) analyses that have yet to be finalized, and accordingly, the assets acquired, as detailed, are subject to adjustment once the analysis is completed.

(2) Accounted for as an asset acquisition.

(3) Acquired from a related party. Refer to Note -1 Related Party Transactions.

#### Aviv Merger

On April 1, 2015, Omega completed the Aviv Merger, which was structured as a stock-for-stock merger. Under the terms of the Merger Agreement, each outstanding share of Aviv common stock was converted into 0.90 of a share of Omega common stock. In connection with the Aviv Merger, Omega issued approximately 43.7 million shares of common stock to former Aviv stockholders. As a result of the Aviv Merger, Omega acquired 342 facilities, two facilities subject to direct financing leases, one medical office building, two mortgages and other investments. The facilities are located in 31 states and are operated by 38 third-party operators. Omega also assumed certain outstanding equity awards and other debt and liabilities. Based on the closing price of Omega's common stock on April 1, 2015, the fair value of the consideration exchanged was approximately \$2.3 billion.

The following table highlights the final allocation of the assets acquired, liabilities assumed and consideration transferred on April 1, 2015 (in thousands):

|                                    |             |
|------------------------------------|-------------|
| Fair value of net assets acquired: |             |
| Land and buildings                 | \$3,107,530 |



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|  |             |
|--|-------------|
| Investment in direct financing leases  | 26,823      |
| Mortgages notes receivable             | 19,246      |
| Other investments                      | 23,619      |
| Total investments                      | 3,177,218   |
| Goodwill                               | 630,679     |
| Accounts receivables and other assets  | 17,144      |
| Cash acquired                          | 84,858      |
| Accrued expenses and other liabilities | (223,002 )  |
| Debt                                   | (1,410,637) |
| Fair value of net assets acquired      | \$2,276,260 |

The completion of the final valuation did not result in material changes to our Consolidated Statements of Operations and Comprehensive Income or our Consolidated Balance Sheets from our preliminary purchase price allocation.

*Pro Forma Acquisition Results*

The facilities acquired in 2015 are included in our results of operations from the dates of acquisition. The following unaudited pro forma results of operations reflect the impact of those acquisitions as if they occurred on January 1, 2015. For a list of the 2015 transactions, refer to Note 3 – Properties in our Annual Report on Form 10-K for the year ended December 31, 2015. In the opinion of management, all significant necessary adjustments to reflect the effect of the acquisitions have been made.

|                               | Pro Forma<br>Three Months Ended<br>March 31, 2015<br>(in thousands, except per<br>share amounts, unaudited) |
|-------------------------------|---|
| Pro Forma Revenues            | \$ 202,531  |
| Pro Forma Net income          | \$ 66,521   |
| Earnings per share – diluted: |   |
| Net income – as reported      | \$ 0.32   |
| Net income – pro forma        | \$ 0.35   |

**Asset Sales, Impairments and Other**

During the first quarter of 2016, we recorded approximately \$34.6 million of impairments on 14 facilities located in six states. Our recorded impairments were primarily the result of a decision to exit certain non-strategic facilities and operators primarily related to facilities acquired in the Aviv Merger. We believe these facilities will be sold within 12 months. We reduced their net book values to their estimated fair value less costs to sell and reclassified them to assets held for sale in the first quarter of 2016. To estimate the fair value of the facilities, we utilized a market approach and Level 3 inputs (which generally consist of non-binding offers from unrelated third parties). In addition, we sold two SNFs (previously classified as held-for-sale) for approximately \$2.4 million in net proceeds recognizing a gain of approximately \$1.6 million. See Note 6 – Assets Held For Sale for details.

**NOTE 3 – DIRECT FINANCING LEASES**

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

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|   | March 31,<br>2016 | December 31,<br>2015 |
|---|-------------------|----------------------|
|   | (in thousands)    |                      |
| Minimum lease payments receivable             | \$4,308,355       | \$4,320,876          |
| Less unearned income                          | (3,717,733)       | (3,733,175 )         |
| Investment in direct financing leases - net   | \$590,622         | \$587,701            |
| Properties subject to direct financing leases | 59                | 59                   |

*New Ark Investment Inc.*

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

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

The 56 facilities represent 5,623 licensed beds located in 12 states, predominantly in the southeastern United States. The 56 facilities are separated by region and divided amongst four cross-defaulted master leases. The four regions include the Southeast (39 facilities), the Northwest (7 facilities), Texas (9 facilities) and Indiana (1 facility).

Additionally, in June and July of 2014, we purchased three facilities and subsequently leased them to New Ark under a twelve-year master lease expiring in 2026. The 2014 three facility lease is being accounted for as an operating lease.

#### *Aviv Merger*

On April 1, 2015, we acquired two additional direct financing leases as a result of the Aviv Merger.

As of March 31, 2016, the following minimum rents are due under our direct financing leases for the next five years (in thousands):

| Year 1   | Year 2   | Year 3   | Year 4   | Year 5   |
|----------|----------|----------|----------|----------|
| \$50,250 | \$50,961 | \$52,225 | \$53,507 | \$54,778 |

#### **NOTE 4 – MORTGAGE NOTES RECEIVABLE**

As of March 31, 2016, mortgage notes receivable relate to 24 fixed rate mortgages on 55 long-term care facilities. 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 ten states, operated by eight 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.

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

The outstanding principal amounts of mortgage notes receivable, net of allowances, were as follows:

|   | March<br>31,<br>2016<br>(in thousands) | December 31,<br>2015 |
|---|--|----------------------|
| Mortgage note due 2023; interest at 11.00%      | \$69,928                               | \$ 69,928            |
| Mortgage note due 2024; interest at 9.79%       | 112,500                                | 112,500              |
| Mortgage note due 2029; interest at 9.23%       | 413,095                                | 413,399              |
| Other mortgage notes outstanding <sup>(1)</sup> | 65,046                                 | 83,968               |
| Mortgage notes receivable, gross                | 660,569                                | 679,795              |
| Allowance for loss on mortgage notes receivable | —                                      | —                    |
| Total mortgages — net                           | \$660,569                              | \$ 679,795           |

<sup>(1)</sup> Other mortgage notes outstanding have stated interest rates ranging from 8.35% to 12.0% and maturity dates through 2053.

The following is a brief overview of certain mortgages entered into or assumed in 2016 or significant changes to mortgages previously reported.

*Conversion of Mortgage Notes due 2046 to Leased Properties*

In January 2016, we acquired three facilities via a deed-in-lieu of foreclosure from a mortgagee. The fair value of the facilities approximated the \$25 million carrying value of the mortgages. These facilities have 352 operating beds and are located in Maryland. Simultaneously we leased these facilities to an existing operator.

**NOTE 5 – OTHER INVESTMENTS**

A summary of our other investments is as follows:

| March<br>31,<br>2016 | December 31,<br>2015 |
|----------------------|----------------------|
|----------------------|----------------------|

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(in thousands)

|  |           |           |
|--|-----------|-----------|
| Other investment note due 2017; interest at 8.50%  | \$12,000  | \$ —      |
| Other investment note due 2017; interest at 8.50%  | 12,099    | —         |
| Other investment note due 2019; interest at 10.50% | 49,271    | —         |
| Other investment note due 2020; interest at 10.00% | 23,000    | 23,000    |
| Other investment note due 2028; interest at 8.50%  | 20,000    | —         |
| Other investment note due 2030; interest at 6.66%  | 31,905    | 26,966    |
| Other investment notes outstanding <sup>(1)</sup>  | 58,559    | 42,293    |
| Other investments, gross                           | 206,834   | 92,259    |
| Allowance for loss on other investments            | (3,002 )  | (2,960 )  |
| Total other investments                            | \$203,832 | \$ 89,299 |

<sup>(1)</sup>Other investment notes have maturity dates through 2028 and interest rates ranging from 6.50% to 12.0%.

The following is a brief overview of certain notes entered into in 2016.

*Other Investment notes due 2017*

On February 1, 2016, we provided an operator a \$15.0 million secured working capital note. The working capital note bears interest at 8.5% and matures in July 2017. As of March 31, 2016, approximately \$12.1 million has been drawn and remains outstanding.

On March 1, 2016, we provided an operator a \$15.0 million secured working capital note. The working capital note bears interest at 8.5% and matures in March 2017. As of March 31, 2016, approximately \$12.0 million has been drawn and remains outstanding.

*Other Investment note due 2019*

On February 26, 2016, we acquired and funded a \$50.0 million mezzanine note at a discount of approximately \$0.75 million to a new operator. The mezzanine note bears interest at 10.50% and matures in February 2019.

*Other Investment note due 2028*

On March 1, 2016, we provided an operator a \$20.0 million acquisition note. The acquisition note bears interest at 8.5% (increasing annually by 2.5%) and matures in March 2028.

**NOTE 6 – ASSETS HELD FOR SALE**

|                                 | <b>Number<br/>of<br/>Properties</b> | <b>Net Book Value<br/>(in thousands)</b> |
|---------------------------------|-------------------------------------|--|
| December 31, 2015               | 3                                   | \$ 6,599                                 |
| Properties sold <sup>(1)</sup>  | (2 )                                | (600 )                                   |
| Properties added <sup>(2)</sup> | 24                                  | 67,590                                   |
| March 31, 2016                  | 25                                  | \$ 73,589                                |

<sup>(1)</sup> In the first quarter of 2016, we sold two SNFs for approximately \$2.4 million in net proceeds recognizing a gain on sale of approximately \$1.6 million.

In the first quarter of 2016, we reclassified eight ALFs and 16 SNFs located in six states to assets held for sale. We <sup>(2)</sup>recorded approximately \$34.6 million impairment charges on 14 facilities to reduce their net book values to their estimated fair value less costs to sell. See Note 2 – Properties and Investments.



**NOTE 7 – INTANGIBLES**

The following is a summary of our intangibles as of March 31, 2016 and December 31, 2015:

|                            | <b>March<br/>31,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|----------------------------|-------------------------------|------------------------------|
|                            | (in thousands)                |                              |
| Assets:                    |                               |                              |
| Goodwill                   | \$645,568                     | \$ 645,683                   |
| Above market leases        | \$23,545                      | \$ 21,901                    |
| In-place leases            | 167                           | 386                          |
| Accumulated amortization   | (14,619 )                     | (14,162 )                    |
| Net intangible assets      | \$9,093                       | \$ 8,125                     |
| Liabilities:               |                               |                              |
| Below market leases        | \$166,486                     | \$ 165,331                   |
| Accumulated amortization   | (59,859 )                     | (55,131 )                    |
| Net intangible liabilities | \$106,627                     | \$ 110,200                   |

Goodwill was recorded in connection with the Aviv Merger and Care Homes Transaction (refer to Note 3 – Properties in our Annual Report on Form 10-K for the year ended December 31, 2015) and is shown as a separate line on our Consolidated Balance Sheets. Above market leases and in-place leases, net of accumulated amortization, are included in other assets on our Consolidated Balance Sheets. Below market leases, net of accumulated amortization, are included in accrued expenses and other liabilities on our Consolidated Balance Sheets.

For the three months ended March 31, 2016 and 2015, our net amortization related to intangibles was \$4.3 million and \$1.2 million, respectively. The estimated net amortization related to these intangibles for the remainder of 2016 and the subsequent four years is as follows: remainder of 2016 – \$9.8 million; 2017 – \$11.8 million; 2018 – \$10.6 million; 2019 – \$9.6 million and 2020 – \$9.4 million. As of March 31, 2016 the weighted average remaining amortization period of above market leases (inclusive of in-place leases) and in below market leases is approximately five years and 10 years, respectively.

The following is a reconciliation of our goodwill as of March 31, 2016:

|   |                |
|---|----------------|
|   | (in thousands) |
| Balance as of December 31, 2015   | \$ 645,683     |
| Add: additional valuation adjustments related to preliminary valuations | 275            |
| Less: foreign currency translation                                      | (390 )         |
| Balance as of March 31, 2016  | \$ 645,568     |

#### **NOTE 8 – CONCENTRATION OF RISK**

As of March 31, 2016, our portfolio of real estate investments consisted of 985 healthcare facilities, located in 42 states and the United Kingdom and operated by 83 third party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately \$8.4 billion at March 31, 2016, with approximately 99% of our real estate investments related to long-term care facilities. Our portfolio is made up of 800 SNFs, 84 ALFs, 16 specialty facilities, one medical office building, fixed rate mortgages on 53 SNFs and two ALFs, and 29 facilities that are closed/held-for-sale. At March 31, 2016, we also held miscellaneous investments of approximately \$203.8 million, consisting primarily of secured loans to third-party operators of our facilities.

At March 31, 2016, the three states in which we had our highest concentration of investments were Ohio (10%), Texas (9%) and Florida (8%). No single operator or manager generated more than 10% of our total revenues for the three months ended March 31, 2016.

#### **NOTE 9 – DIVIDENDS AND EQUITY**

On April 14, 2016, the Board of Directors declared a common stock dividend of \$0.58 per share, increasing the quarterly common dividend by \$0.01 per share over the prior quarter, to be paid May 16, 2016 to common stockholders of record on May 2, 2016.

On January 14, 2016, the Board of Directors declared a common stock dividend of \$0.57 per share, increasing the quarterly common dividend by \$0.01 per share over the previous quarter. The common dividends were paid February 16, 2016 to common stockholders of record as of February 2, 2016.

*Dividend Reinvestment and Common Stock Purchase Plan*

For the three-month period ended March 31, 2016, approximately 0.7 million shares of our common stock at an average price of \$29.84 per share were issued through our Dividend Reinvestment and Common Stock Purchase Program for gross proceeds of approximately \$19.7 million.

## NOTE 10 – TAXES

Since our inception, we have elected to be taxed as a REIT under the applicable provisions of the Internal Revenue Code (the “Code”). A REIT is generally not subject to federal income tax on that portion of its REIT taxable income which is distributed to its stockholders, provided that at least 90% of such taxable income is distributed and certain other requirements are met, including an asset and income test. So long as we qualify as a REIT under 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.

If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to federal income taxes on its taxable income at regular corporate rates and dividends paid to our stockholders will not be deductible by us in computing taxable income. Further, we will not be permitted to qualify for treatment as a REIT for federal income tax purposes for four years following the year in which qualification is denied, unless the Internal Revenue Service grants us relief under certain statutory provisions. Failing to qualify as a REIT could materially and adversely affect the Company’s net income; however, we believe we are organized and operate in such a manner as to qualify for treatment as a REIT. On a quarterly and annual basis, we test our compliance within the REIT taxation rules to ensure that we are in compliance with the REIT rules. We review our distributions and projected distributions each year to ensure we have met and will meet the annual REIT distribution requirements. In 2016, we expect to distribute dividends in excess of our taxable income.

As a result of our UPREIT Conversion, our Company and its subsidiaries may be subject to income or franchise taxes in certain states and municipalities. Also, as a result of our UPREIT Conversion, we created five wholly owned subsidiary REITs that are subject to all of the REIT qualification rules set forth in the Code. In December 2015, we merged the five wholly owned subsidiary REITs into one wholly owned subsidiary REIT which is subject to all of the REIT qualification rules set forth in the Code.

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”). We have elected for two of our active subsidiaries to be treated as TRSs. One of our TRSs is subject to federal, state and local income taxes at the applicable corporate rates and the other is subject to foreign income taxes. As of March 31, 2016, our TRS that is subject to federal, state and local income taxes at the applicable corporate rates had a net operating loss carry-forward of approximately \$0.9 million. The loss carry-forward is fully reserved as of March 31, 2016 with a valuation allowance due to uncertainties regarding realization.

During the first quarter of 2016, we recorded approximately \$0.1 million of state and local income tax provision and approximately \$0.1 million of provision for foreign income taxes.

**NOTE 11 – STOCK-BASED COMPENSATION**

Stock-based compensation expense was \$2,778 and \$1,610 for the three- month periods ended March 31, 2016 and 2015, respectively.

***Restricted Stock and Restricted Stock Units***

Restricted stock and restricted stock units (“RSUs”) are subject to forfeiture if the holder’s service to us terminates prior to vesting, subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company. Prior to vesting, ownership of the shares/units cannot be transferred. Restricted stock has the same dividend and voting rights as our common stock. RSUs accrue dividend equivalents but have no voting rights. Restricted stock and RSUs are valued at the price of our common stock on the date of grant. We expense the cost of these awards ratably over their vesting period.

The RSUs assumed from Aviv as part of the Aviv Merger were valued at the closing price of our stock on the date of the transaction. The portion of the vesting accruing prior to the acquisition was recorded as part of the purchase price consideration. The expense associated with the vesting that will occur after the date of the transaction will be recorded as stock compensation expense ratably over the remaining life of the RSUs.

We awarded 131,006 RSUs to employees on March 17, 2016.

***Performance Restricted Stock Units and LTIP Units***

Performance restricted stock units (“PRSUs”) and long term incentive plan units (“LTIP Units”) are subject to forfeiture if the performance requirements are not achieved or if the holder’s service to us terminates prior to vesting, subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company. The PRSUs and the LTIP Units have varying degrees of performance requirements to be earned and vested, and each PRSU and LTIP Units award represents the right to a variable number of shares of common stock or partnership units. Each LTIP Unit once earned and vested is convertible into one Omega OP Unit in Omega OP, subject to certain conditions. The earning requirements are based on either the (i) total shareholder return (“TSR”) of Omega or (ii) Omega’s TSR relative to other real estate investment trusts in the MSCI U.S. REIT Index or FTSE NAREIT Equity Health Care Index TSR (both “Relative TSR”). Vesting in general requires that the employee remain employed by us until the date specified in the applicable PRSU agreement, which may be later than the date that the TSR or Relative TSR requirements are satisfied. We expense the cost of these awards ratably over their service period.

Prior to vesting and the distribution of shares, ownership of the PRSUs cannot be transferred. Dividend equivalents on the PRSUs accumulate and with respect to PRSUs granted before 2015 are paid when the PRSUs vest and with respect to PRSUs granted in 2015 or later are paid once the PRSUs are earned. While each LTIP Unit is unearned, the employee receives a partnership distribution equal to 10% of the quarterly approved regular periodic distributions per Omega OP Unit. The remaining partnership distributions (which in the case of normal periodic distributions is equal to the total approved quarterly dividend on Omega’s common stock) on the LTIP Units accumulate, and if the LTIP Units are earned, the accumulated distributions are paid.

The number of shares or units earned under the TSR PRSUs or LTIP Units depends generally on the level of achievement of Omega’s TSR over the indicated performance period. We awarded 372,069 LTIP Units to employees on March 17, 2016.

The number of shares earned under the Relative TSR PRSUs depends generally on the level of achievement of Omega’s TSR relative to other real estate investment trusts in the MSCI U.S. REIT Index or FTSE NAREIT Equity Health Care Index TSR over the performance period indicated. We awarded 307,480 Relative TSR PRSUs to employees on March 17, 2016.

The following table summarizes our total unrecognized compensation cost as of March 31, 2016 associated with restricted stock, restricted stock units, PRSU awards, and LTIP Unit awards to employees:

| Grant Year                   | Shares/<br>Units <sup>(1)</sup> | Grant Date | Average Fair Value Per Unit/Share | Total Compensation Cost (in millions)<br>(2) | Weighted Average Unrecognized Compensation Performance |                    |                       | Vesting Dates       |
|------------------------------|---------------------------------|------------|-----------------------------------|--|--|--------------------|-----------------------|---------------------|
|                              |                                 |            |                                   |  | Period of Recognition (in months)                      | Cost (in millions) | Period                |                     |
| RSUs                         |                                 |            |                                   |  |  |                    |                       |                     |
| 2013 RSU                     | 2013                            | 195,822    | \$ 29.80                          | \$ 5.8                                       | 36   | \$ 1.4             | N/A                   | 12/31/14 - 12/31/16 |
| 2014 RSU                     | 2014                            | 106,778    | 29.80                             | 3.2  | 36   | 0.8                | N/A                   | 12/31/2016          |
| 3/31/15 RSU                  | 2015                            | 109,985    | 40.57                             | 4.5  | 33   | 2.8                | N/A                   | 12/31/2017          |
| 4/1/15 RSU                   | 2015                            | 40,464     | 40.74                             | 1.6  | 33   | 1.1                | N/A                   | 12/31/2017          |
| Assumed Aviv RSU             | 2015                            | 18,920     | 24.92                             | 0.5  | 21   | 0.2                | N/A                   | 12/31/2016          |
| Assumed Aviv RSU             | 2015                            | 7,799      | 35.08                             | 0.3  | 33   | 0.2                | N/A                   | 12/31/15-12/31/17   |
| 3/17/16 RSU                  | 2016                            | 131,006    | 34.78                             | 4.6  | 33   | 4.5                | N/A                   | 12/31/2018          |
| Restricted Stock Units Total |                                 | 610,774    | \$ 33.45                          | \$ 20.5                                      |  | \$ 11.0            |                       |                     |
| TSR PRSUs and LTIP Units     |                                 |            |                                   |  |  |                    |                       |                     |
| 2016                         |                                 |            |                                   |  |  |                    |                       |                     |
| Transition TSR               | 2013                            | 101,591    | 8.67                              | 0.9  | 36   | 0.2                | 12/31/2013-12/31/2016 | 12/31/2016          |
| 2016 TSR                     | 2014                            | 135,634    | 8.67                              | 1.2  | 48   | 0.5                | 1/1/2014-12/31/2016   | Quarterly in 2017   |
| 3/31/15 2017 LTIP Units      | 2015                            | 137,249    | 14.66                             | 2.0  | 45   | 1.5                | 1/1/2015-12/31/2017   | Quarterly in 2018   |
| 4/1/2015                     |                                 |            |                                   |  |  |                    |                       |                     |
| 2017 LTIP Units              | 2015                            | 54,151     | 14.80                             | 0.8  | 45   | 0.6                | 1/1/2015-12/31/2017   | Quarterly in 2018   |
| 7/31/15 2016                 |                                 |            |                                   |  |  |                    |                       |                     |
| Transition TSR               | 2015                            | 22,091     | 18.51                             | 0.4  | 5  | -                  | 12/31/2013-12/31/2016 | 12/31/2016          |

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|                            |          |   |          |         |    |         |                       |                   |
|----------------------------|----------|---|----------|---------|----|---------|-----------------------|-------------------|
| 7/31/15 2017<br>LTIP Units | 2015     | 5,823   | 8.78     | 0.1     | 5  | -       | 1/1/2015-12/31/2017   | 12/31/2017        |
| 3/17/16 2018<br>LTIP Units | 2016     | 372,069   | 13.21    | 4.9     | 45 | 4.9     | 1/1/2016-12/31/2018   | Quarterly in 2019 |
| TSR PRSUs<br>& LTIP Total  |          | 828,608   | \$ 12.44 | \$ 10.3 |    | \$ 7.7  |                       |                   |
| Relative TSR               |          |   |          |         |    |         |                       |                   |
| PRSUs                      |          |   |          |         |    |         |                       |                   |
| 2016                       |          |   |          |         |    |         |                       |                   |
| Transition                 | 2013     | 101,588   | 14.24    | 1.4     | 36 | 0.4     | 12/31/2013-12/31/2016 | 12/31/2016        |
| Relative TSR               |          |   |          |         |    |         |                       |                   |
| 2016                       |          |   |          |         |    |         |                       |                   |
| Relative TSR               | 2014     | 135,634   | 14.24    | 1.9     | 48 | 0.8     | 1/1/2014-12/31/2016   | Quarterly in 2017 |
| 3/31/15 2017               | 2015     | 137,249   | 22.50    | 3.1     | 45 | 2.3     | 1/1/2015-12/31/2017   | Quarterly in 2018 |
| Relative TSR               | 4/1/2015 |   |          |         |    |         |                       |                   |
| 2017                       | 2015     | 54,151  | 22.91    | 1.2     | 45 | 0.9     | 1/1/2015-12/31/2017   | Quarterly in 2018 |
| Relative TSR               |          |   |          |         |    |         |                       |                   |
| 7/31/15 2016               |          |   |          |         |    |         |                       |                   |
| Relative TSR               | 2015     | 22,100  | 19.60    | 0.4     | 5  | -       | 12/31/2013-12/31/2016 | 12/31/2016        |
| 7/31/15 2017               |          |   |          |         |    |         |                       |                   |
| Relative TSR               | 2015     | 5,826   | 17.74    | 0.1     | 5  | -       | 1/1/2015-12/31/2017   | 12/31/2017        |
| 3/17/16 2018               |          |   |          |         |    |         |                       |                   |
| Relative TSR               | 2016     | 307,480   | 16.45    | 5.1     | 45 | 5.0     | 1/1/2016-12/31/2018   | Quarterly in 2019 |
| Relative TSR               |          |   |          |         |    |         |                       |                   |
| PRSUs Total                |          |   |          |         |    |         |                       |                   |
|                            |          | 764,028   | \$ 17.41 | \$ 13.2 |    | \$ 9.4  |                       |                   |
| Grand Total                |          |   |          |         |    |         |                       |                   |
|                            |          | 2,203,410   | \$ 19.99 | \$ 44.0 |    | \$ 28.1 |                       |                   |
|                            | (1)      | Shares/units are net of shares cancelled.             |          |         |    |         |                       |                   |
|                            | (2)      | Total compensation costs are net of shares cancelled. |          |         |    |         |                       |                   |

### Director Restricted Stock Grants

As of March 31, 2016, we had 51,999 shares of restricted stock outstanding to directors. The directors' restricted shares are scheduled to vest over the next three years. As of March 31, 2016, the unrecognized compensation cost associated with outstanding director restricted stock grants is approximately \$1.2 million.



**NOTE 12 – BORROWING ACTIVITIES AND ARRANGEMENTS****Secured and Unsecured Borrowings**

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

|  |          | <b>Rate as of</b> |   | March 31,      | December 31, |
|--|----------|-------------------|---|----------------|--------------|
|  |          | <b>March 31,</b>  |   | 2016           | 2015         |
|  | Maturity | 2016              |   | 2016           | 2015         |
|  |          |                   |   | (in thousands) |              |
| <b>Secured borrowings:</b>                         |          |                   |   |                |              |
| GE term loan                                       | 2019     | 4.11              | % | \$ 180,000     | \$ 180,000   |
| HUD mortgages assumed December 2011 <sup>(1)</sup> | 2044     | 3.06              | % | 55,895         | 56,204       |
| Total secured borrowings                           |          |                   |   | 235,895        | 236,204      |
| <b>Unsecured borrowings:</b>                       |          |                   |   |                |              |
| Revolving line of credit                           | 2018     | 1.73              | % | 530,000        | 230,000      |
| Tranche A-1 term loan                              | 2019     | 1.93              | % | 200,000        | 200,000      |
| Tranche A-2 term loan                              | 2017     | 1.94              | % | 200,000        | 200,000      |
| Tranche A-3 term loan                              | 2021     | 1.93              | % | 350,000        | —            |
| Omega OP term loan                                 | 2017     | 1.94              | % | 100,000        | 100,000      |
| 2015 term loan                                     | 2022     | 2.23              | % | 250,000        | 250,000      |
|  |          |                   |   | 1,630,000      | 980,000      |
| 2024 notes   | 2024     | 5.875             | % | 400,000        | 400,000      |
| 2024 notes   | 2024     | 4.95              | % | 400,000        | 400,000      |
| 2025 notes   | 2025     | 4.50              | % | 250,000        | 250,000      |
| 2026 notes   | 2026     | 5.25              | % | 600,000        | 600,000      |
| 2027 notes   | 2027     | 4.50              | % | 700,000        | 700,000      |
| Subordinated debt                                  | 2021     | 9.00              | % | 20,000         | 20,000       |
|  |          |                   |   | 2,370,000      | 2,370,000    |
| Discount - net                                     |          |                   |   | (16,703 )      | (17,118 )    |
| Total unsecured borrowings                         |          |                   |   | 3,983,297      | 3,332,882    |
| Total – net  |          |                   |   | \$4,219,192    | \$ 3,569,086 |

Reflects the weighted average annual contractual interest rate on the mortgages at March 31, 2016 excluding a (1) third-party administration fee of approximately 0.5%. Secured by real estate assets with a net carrying value of \$68.6 million.

Certain of our other secured and unsecured borrowings are subject to customary affirmative and negative covenants, including financial covenants. As of March 31, 2016 and December 31, 2015, we were in compliance with all affirmative and negative covenants, including financial covenants, for our secured and unsecured borrowings.

### **Bank Credit Facilities**

On January 29, 2016, we amended our Omega Credit Facilities (as defined below) to add a \$350 million senior unsecured incremental term loan facility. As a result of the amendment, the Omega Credit Facilities now include a \$1.25 billion senior unsecured revolving credit facility (the “Revolving Credit Facility”), a \$200 million senior unsecured term loan facility (the “Tranche A-1 Term Loan Facility”), a \$200 million senior unsecured incremental term loan facility (the “Tranche A-2 Term Loan Facility”) and a \$350 million senior unsecured incremental term loan facility (the “Tranche A-3 Term Loan Facility” and, together with the Revolving Credit Facility, the Tranche A-1 Term Loan Facility and the Tranche A-2 Term Loan Facility, collectively, the “Omega Credit Facilities”). The Tranche A-1 Term Loan Facility, the Tranche A-2 Term Loan Facility and the Tranche A-3 Term Loan Facility may be referred to collectively herein as the “Omega Term Loan Facilities”.

The Tranche A-3 Term Loan Facility bears interest at LIBOR plus an applicable percentage (beginning at 150 basis points, with a range of 100 to 195 basis points) based on our ratings from Standard & Poor's, Moody's and/or Fitch Ratings. The Tranche A-3 Term Loan Facility matures on January 29, 2021.

### NOTE 13 – FINANCIAL INSTRUMENTS

At March 31, 2016 and December 31, 2015, the carrying amounts and fair values of our financial instruments were as follows:

|  | March 31, 2016     |                    | December 31, 2015  |                    |
|--|--------------------|--------------------|--------------------|--------------------|
|  | Carrying           | Fair               | Carrying           | Fair               |
|  | Amount             | Value              | Amount             | Value              |
|  | (in thousands)     |                    |                    |                    |
| <b>Assets:</b>                               |                    |                    |                    |                    |
| Cash and cash equivalents                    | \$9,407            | \$9,407            | \$5,424            | \$5,424            |
| Restricted cash                              | 12,327             | 12,327             | 14,607             | 14,607             |
| Investments in direct financing leases – net | 590,622            | 587,297            | 587,701            | 584,358            |
| Mortgage notes receivable – net              | 660,569            | 672,427            | 679,795            | 687,130            |
| Other investments – net                      | 203,832            | 203,751            | 89,299             | 90,745             |
| <b>Total</b>                                 | <b>\$1,476,757</b> | <b>\$1,485,209</b> | <b>\$1,376,826</b> | <b>\$1,382,264</b> |
| <b>Liabilities:</b>                          |                    |                    |                    |                    |
| Revolving line of credit                     | \$530,000          | \$530,000          | \$230,000          | \$230,000          |
| Tranche A-1 term loan                        | 200,000            | 200,000            | 200,000            | 200,000            |
| Tranche A-2 term loan                        | 200,000            | 200,000            | 200,000            | 200,000            |
| Tranche A-3 term loan                        | 350,000            | 350,000            | —                  | —                  |
| Omega OP term loan                           | 100,000            | 100,000            | 100,000            | 100,000            |
| 2015 term loan                               | 250,000            | 250,000            | 250,000            | 250,000            |
| 5.875% notes due 2024 – net                  | 400,000            | 431,815            | 400,000            | 429,956            |
| 4.95% notes due 2024 – net                   | 395,475            | 404,036            | 395,333            | 403,064            |
| 4.50% notes due 2025 – net                   | 248,152            | 241,082            | 248,099            | 242,532            |
| 5.25% notes due 2026 – net                   | 598,384            | 610,605            | 598,343            | 612,760            |
| 4.50% notes due 2027 – net                   | 690,705            | 666,652            | 690,494            | 667,651            |
| GE term loan due 2019                        | 180,000            | 180,000            | 180,000            | 180,000            |
| HUD debt – net                               | 55,895             | 54,319             | 56,204             | 52,678             |
| Subordinated debt – net                      | 20,581             | 24,342             | 20,613             | 24,366             |
| <b>Total</b>                                 | <b>\$4,219,192</b> | <b>\$4,242,851</b> | <b>\$3,569,086</b> | <b>\$3,593,007</b> |

Fair value estimates are subjective in nature and are dependent on a number of important assumptions, including estimates of future cash flows, risks, discount rates and relevant comparable market information associated with each

financial instrument (see Note 2 – Summary of Significant Accounting Policies in our Annual Report on Form 10-K for the year ended December 31, 2015). 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 Consolidated Balance Sheets approximates fair value because of the short maturity of these instruments (i.e., less than 90 days) (Level 1).

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

Mortgage notes receivable: The fair value of the mortgage notes receivables are estimated using a discounted cash flow analysis, using interest rates being offered for similar loans to borrowers with similar credit ratings (Level 3).

Other investments: Other investments are primarily comprised of notes receivable. The fair values of notes receivable are estimated using a discounted cash flow analysis, using interest rates being offered for similar loans to borrowers with similar credit ratings (Level 3).

Revolving line of credit and term loans: The fair value of our borrowings under variable rate agreements are estimated using an expected present value technique based on expected cash flows discounted using the current market rates (Level 3).

Senior notes and subordinated debt: The fair value of our borrowings under fixed rate agreements are estimated using an expected present value technique based on open market trading activity provided by a third party (Level 2).

HUD debt: The fair value of our borrowings under HUD debt agreements are estimated using an expected present value technique based on quotes obtained by HUD debt brokers (Level 2).

#### **NOTE 14 – LITIGATION**

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

#### **NOTE 15 – 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 and the assumed issuance of additional shares related to Omega OP Units held by outside investors.



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

|   | <b>Three Months Ended</b>                |           |
|---|--|-----------|
|   | <b>March 31,</b>                         |           |
|   | 2016                                     | 2015      |
|   | (in thousands, except per share amounts) |           |
| Numerator:  |  |           |
| Net income  | \$ 58,196                                | \$ 43,052 |
| Less: Net income attributable to noncontrolling interests | (2,641 )                                 | —         |
| Net income available to common stockholders               | \$ 55,555                                | \$ 43,052 |
| Denominator:  |  |           |
| Denominator for basic earnings per share                  | 188,228                                  | 134,346   |
| Effect of dilutive securities:                            |  |           |
| Common stock equivalents                                  | 1,175                                    | 460       |
| Noncontrolling interest – OP units                        | 8,947                                    | —         |
| Denominator for diluted earnings per share                | 198,350                                  | 134,806   |
| Earnings per share – basic:                               |  |           |
| Net income available to common stockholders               | \$ 0.30                                  | \$ 0.32   |
| Earnings per share – diluted:                             |  |           |
| Net income  | \$ 0.29                                  | \$ 0.32   |

#### **NOTE 16 – CONSOLIDATING FINANCIAL STATEMENTS**

As of March 31, 2016, we had outstanding: (i) \$400 million 5.875% Senior Notes due 2024, (ii) \$400 million 4.95% Senior Notes due 2024, (iii) \$250 million 4.5% Senior Notes due 2025, (iv) \$600 million 5.25% Senior Notes due 2026 and (v) \$700 million 4.5% Senior Notes due 2027 (collectively, the “Senior Notes”). The Senior Notes are fully and unconditionally guaranteed, jointly and severally, by each of our subsidiaries that guarantee other indebtedness of Omega or any of the subsidiary guarantors. All of our subsidiaries that guarantee the Senior Notes also guarantee amounts outstanding under the Omega Credit Facilities and 2015 term loan listed in Note 12 – Borrowing Activities and Arrangements. In addition, all such subsidiary guarantors that are subsidiaries of Omega OP also guarantee amounts outstanding under the Omega OP term loan listed in Note 12 – Borrowing Activities and Arrangements.

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. Our non-guarantor subsidiaries include, among others, all subsidiaries securing secured debt that is currently outstanding and our U.K. subsidiaries. The results and financial position of acquired

entities are included from the dates of their respective acquisitions.

The 2015 financial statements presented below have been adjusted to reflect our current guarantor and non-guarantor relationships as of March 31, 2016.



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

|  | March 31, 2016      |                     |               |              |
|--|---------------------|---------------------|---------------|--------------|
|  | <b>Issuer &amp;</b> | <b>Non –</b>        |               |              |
|  | <b>Subsidiary</b>   | <b>Guarantor</b>    | Elimination   | Consolidated |
|  | <b>Guarantors</b>   | <b>Subsidiaries</b> |               |              |
| <b>ASSETS</b>                          |                     |                     |               |              |
| Real estate properties                 |                     |                     |               |              |
| Land and buildings                     | \$6,518,739         | \$ 570,221          | \$ —          | \$ 7,088,960 |
| Less accumulated depreciation          | (1,034,122)         | (32,901 )           | —             | (1,067,023 ) |
| Real estate properties – net           | 5,484,617           | 537,320             | —             | 6,021,937    |
| Investment in direct financing leases  | 590,622             | —                   | —             | 590,622      |
| Mortgage notes receivable – net        | 660,569             | —                   | —             | 660,569      |
|  | 6,735,808           | 537,320             | —             | 7,273,128    |
| Other investments – net                | 203,832             | —                   | —             | 203,832      |
|  | 6,939,640           | 537,320             | —             | 7,476,960    |
| Assets held for sale – net             | 73,589              | —                   | —             | 73,589       |
| Total investments                      | 7,013,229           | 537,320             | —             | 7,550,549    |
| Cash and cash equivalents              | 8,985               | 422                 | —             | 9,407        |
| Restricted cash                        | 7,106               | 5,221               | —             | 12,327       |
| Accounts receivable – net              | 202,947             | 5,322               | —             | 208,269      |
| Goodwill                               | 630,678             | 14,890              | —             | 645,568      |
| Investment in affiliates               | 433,085             | 3,717               | (436,802 )    | —            |
| Other assets                           | 60,728              | 128,604             | —             | 189,332      |
| Total assets                           | \$8,356,758         | \$ 695,496          | \$ (436,802 ) | \$ 8,615,452 |
| <b>LIABILITIES AND EQUITY</b>          |                     |                     |               |              |
| Revolving line of credit               | \$530,000           | \$ —                | \$ —          | \$ 530,000   |
| Term loan                              | 1,100,000           | —                   | —             | 1,100,000    |
| Secured borrowings                     | —                   | 369,518             | (133,623 )    | 235,895      |
| Unsecured borrowings – net             | 2,353,297           | —                   | —             | 2,353,297    |
| Accrued expenses and other liabilities | 320,928             | 8,004               | —             | 328,932      |
| Deferred income taxes                  | —                   | 14,795              | —             | 14,795       |
| Intercompany payable                   | —                   | 10,916              | (10,916 )     | —            |
| Total liabilities                      | 4,304,225           | 403,233             | (144,539 )    | 4,562,919    |

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|   |             |            |               |              |
|---|-------------|------------|---------------|--------------|
| Stockholders' equity:                         |             |            |               |              |
| Common stock                                  | 18,817      | —          | —             | 18,817       |
| Equity investment in affiliates               | —           | 274,634    | (274,634 )    | —            |
| Common stock – additional paid-in capital     | 4,629,423   | —          | —             | 4,629,423    |
| Cumulative net earnings                       | 1,428,077   | 17,564     | (17,564 )     | 1,428,077    |
| Cumulative dividends paid                     | (2,361,580) | —          | —             | (2,361,580 ) |
| Accumulated other comprehensive income (loss) | (21,702 )   | 103        | (103 )        | (21,702 )    |
| Total stockholders' equity                    | 3,693,035   | 292,301    | (292,301 )    | 3,693,035    |
| Noncontrolling interest                       | 359,498     | (38 )      | 38            | 359,498      |
| Total equity                                  | 4,052,533   | 292,263    | (292,263 )    | 4,052,533    |
| Total liabilities and equity                  | \$8,356,758 | \$ 695,496 | \$ (436,802 ) | \$8,615,452  |

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

|  | December 31, 2015   |                     |               |              |
|--|---------------------|---------------------|---------------|--------------|
|  | <b>Issuer &amp;</b> | <b>Non –</b>        |               |              |
|  | <b>Subsidiary</b>   | <b>Guarantor</b>    | Elimination   | Consolidated |
|  | <b>Guarantors</b>   | <b>Subsidiaries</b> |               |              |
| <b>ASSETS</b>                          |                     |                     |               |              |
| Real estate properties                 |                     |                     |               |              |
| Land and buildings                     | \$6,184,507         | \$ 559,451          | \$ —          | \$ 6,743,958 |
| Less accumulated depreciation          | (991,314 )          | (27,836 )           | —             | (1,019,150 ) |
| Real estate properties – net           | 5,193,193           | 531,615             | —             | 5,724,808    |
| Investment in direct financing leases  | 587,701             | —                   | —             | 587,701      |
| Mortgage notes receivable – net        | 679,795             | —                   | —             | 679,795      |
|  | 6,460,689           | 531,615             | —             | 6,992,304    |
| Other investments – net                | 89,299              | —                   | —             | 89,299       |
|  | 6,549,988           | 531,615             | —             | 7,081,603    |
| Assets held for sale – net             | 6,599               | —                   | —             | 6,599        |
| Total investments                      | 6,556,587           | 531,615             | —             | 7,088,202    |
| Cash and cash equivalents              | 1,592               | 3,832               | —             | 5,424        |
| Restricted cash                        | 8,058               | 6,549               | —             | 14,607       |
| Accounts receivable – net              | 196,107             | 7,755               | —             | 203,862      |
| Goodwill                               | 630,404             | 15,279              | —             | 645,683      |
| Investment in affiliates               | 300,409             | —                   | (300,409 )    | —            |
| Other assets                           | 53,732              | 7,499               | —             | 61,231       |
| Total assets                           | \$7,746,889         | \$ 572,529          | \$ (300,409 ) | \$ 8,019,009 |
| <b>LIABILITIES AND EQUITY</b>          |                     |                     |               |              |
| Revolving line of credit               | \$230,000           | \$ —                | \$ —          | \$ 230,000   |
| Term loan                              | 750,000             | —                   | —             | 750,000      |
| Secured borrowings                     | —                   | 361,460             | (125,256 )    | 236,204      |
| Unsecured borrowings – net             | 2,352,882           | —                   | —             | 2,352,882    |
| Accrued expenses and other liabilities | 326,815             | 6,891               | —             | 333,706      |
| Deferred income taxes                  | —                   | 15,352              | —             | 15,352       |
| Intercompany payable                   | (13,673 )           | 13,673              | —             | —            |
| Total liabilities                      | 3,646,024           | 397,376             | (125,256 )    | 3,918,144    |

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|   |             |            |               |              |
|---|-------------|------------|---------------|--------------|
| Stockholders' equity:                         |             |            |               |              |
| Common stock                                  | 18,740      | —          | —             | 18,740       |
| Equity investment in affiliates               | —           | 156,830    | (156,830 )    | —            |
| Common stock – additional paid-in capital     | 4,609,474   | —          | —             | 4,609,474    |
| Cumulative net earnings                       | 1,372,522   | 18,246     | (18,246 )     | 1,372,522    |
| Cumulative dividends paid                     | (2,254,038) | —          | —             | (2,254,038 ) |
| Accumulated other comprehensive income (loss) | (8,712 )    | 77         | (77 )         | (8,712 )     |
| Total stockholders' equity                    | 3,737,986   | 175,153    | (175,153 )    | 3,737,986    |
| Noncontrolling interest                       | 362,879     | —          | —             | 362,879      |
| Total equity                                  | 4,100,865   | 175,153    | (175,153 )    | 4,100,865    |
| Total liabilities and equity                  | \$7,746,889 | \$ 572,529 | \$ (300,409 ) | \$ 8,019,009 |

## OMEGA HEALTHCARE INVESTORS, INC.

## CONSOLIDATING STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME

(in thousands, except per share amounts)

Three Months Ended March 31, 2016

Issuer &amp; Non –

Subsidiary Guarantor Elimination Consolidated

Guarantor Subsidiaries

|   |            |           |        |            |
|---|------------|-----------|--------|------------|
| Revenue   |            |           |        |            |
| Rental income   | \$ 163,393 | \$ 13,310 | \$ -   | \$ 176,703 |
| Income from direct financing leases                                   | 15,442     | -         | -      | 15,442     |
| Mortgage interest income  | 16,606     | -         | -      | 16,606     |
| Other investment income – net   | 4,128      | -         | -      | 4,128      |
| Total operating revenues  | 199,569    | 13,310    | -      | 212,879    |
| Expenses  |            |           |        |            |
| Depreciation and amortization   | 57,279     | 5,154     | -      | 62,433     |
| General and administrative  | 10,343     | 112       | -      | 10,455     |
| Acquisition costs   | 2,429      | 1,342     | -      | 3,771      |
| Impairment loss on real estate properties                             | 34,340     | 218       | -      | 34,558     |
| Provisions for uncollectible mortgages, notes and accounts receivable | 1,862      | 3,262     | -      | 5,124      |
| Total operating expenses  | 106,253    | 10,088    | -      | 116,341    |
| Income before other income and expense                                | 93,316     | 3,222     | -      | 96,538     |
| Other income (expense):   |            |           |        |            |
| Interest income   | 5          | 3         | -      | 8          |
| Interest expense  | (33,389 )  | (3,833 )  | -      | (37,222 )  |
| Interest – amortization of deferred financing costs                   | (2,126 )   | (6 )      | -      | (2,132 )   |
| Interest – refinancing costs  | (298 )     | -         | -      | (298 )     |
| Realized loss on foreign exchange                                     | (22 )      | -         | -      | (22 )      |
| Equity in earnings  | (682 )     | -         | 682    | -          |
| Total other expense   | (36,512 )  | (3,836 )  | 682    | (39,666 )  |
| Income before gain (loss) on assets sold                              | 56,804     | (614 )    | 682    | 56,872     |
| Gain on assets sold - net   | 1,571      | -         | -      | 1,571      |
| Income from continuing operations before income taxes                 | 58,375     | (614 )    | 682    | 58,443     |
| Income taxes  | (141 )     | (106 )    | -      | (247 )     |
| Net income  | 58,234     | (720 )    | 682    | 58,196     |
| Net income attributable to noncontrolling interest                    | (2,679 )   | 38        | -      | (2,641 )   |
| Net income available to common stockholders                           | \$ 55,555  | \$ (682 ) | \$ 682 | \$ 55,555  |

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|   |          |         |          |           |
|---|----------|---------|----------|-----------|
| Net income  | \$58,234 | \$ (720 | ) \$ 682 | \$ 58,196 |
| Other comprehensive loss – foreign currency translation                           | (4,730 ) | -       | -        | (4,730 )  |
| Other comprehensive loss – cash flow hedges                                       | (8,876 ) | -       | -        | (8,876 )  |
| Total comprehensive income  | 44,628   | (720    | ) 682    | 44,590    |
| (Deduct) add: comprehensive income (loss) attributable to noncontrolling interest | (2,063 ) | 38      | -        | (2,025 )  |
| Comprehensive income attributable to common stockholders                          | \$42,565 | \$ (682 | ) \$ 682 | \$ 42,565 |

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

Three Months Ended March 31, 2015

**Issuer & Non –****Subsidiary Guarantor Elimination Consolidated****GuarantorSubsidiaries**

|  |           |          |           |            |
|--|-----------|----------|-----------|------------|
| Revenue  |           |          |           |            |
| Rental income  | \$98,589  | \$ 2,375 | \$ -      | \$ 100,964 |
| Income from direct financing leases                                  | 14,346    | -        | -         | 14,346     |
| Mortgage interest income   | 16,579    | -        | -         | 16,579     |
| Other investment income – net  | 1,531     | -        | -         | 1,531      |
| Total operating revenues   | 131,045   | 2,375    | -         | 133,420    |
| Expenses   |           |          |           |            |
| Depreciation and amortization  | 29,611    | 999      | -         | 30,610     |
| General and administrative   | 5,985     | 29       | -         | 6,014      |
| Acquisition costs  | 4,868     | -        | -         | 4,868      |
| Provision for impairment on real estate properties                   | 5,982     | -        | -         | 5,982      |
| Provision for uncollectible mortgages, notes and accounts receivable | (2 )      | -        | -         | (2 )       |
| Total operating expenses   | 46,444    | 1,028    | -         | 47,472     |
| Income before other income and expense                               | 84,601    | 1,347    | -         | 85,948     |
| Other income (expense):  |           |          |           |            |
| Interest income  | 190       | 3        | -         | 193        |
| Interest expense   | (31,842 ) | (517 )   | -         | (32,359 )  |
| Interest – amortization of deferred financing costs                  | (1,348 )  | (5 )     | -         | (1,353 )   |
| Interest – refinancing costs   | (9,377 )  | -        | -         | (9,377 )   |
| Equity in earnings   | 828       | -        | (828 )    | -          |
| Total other expense  | (41,549 ) | (519 )   | (828 )    | (42,896 )  |
| Net income available to common stockholders                          | \$43,052  | \$ 828   | \$ (828 ) | \$ 43,052  |

## OMEGA HEALTHCARE INVESTORS, INC.

## CONSOLIDATING STATEMENTS OF CASH FLOWS

Unaudited (in thousands)

|   | Three Months Ended March 31, 2016                 |                                       |             |              |
|---|---|---------------------------------------|-------------|--------------|
|   | <b>Issuer &amp;<br/>Subsidiary<br/>Guarantors</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | Elimination | Consolidated |
| Cash flows from operating activities  |   |                                       |             |              |
| Net income  | \$58,234  | \$ (720                               | ) \$ 682    | \$ 58,196    |
| Adjustment to reconcile net income to cash provided by operating activities:  |   |                                       |             |              |
| Depreciation and amortization   | 57,279  | 5,154                                 | —           | 62,433       |
| Provision for impairment on real estate properties                            | 34,340  | 218                                   | —           | 34,558       |
| Provision for uncollectible mortgages, notes and accounts receivable          | 1,862   | 3,262                                 | —           | 5,124        |
| Amortization of deferred financing and refinancing costs                      | 2,424   | 6                                     | —           | 2,430        |
| Accretion of direct financing leases  | (2,921 )  | —                                     | —           | (2,921 )     |
| Stock-based compensation  | 2,778   | —                                     | —           | 2,778        |
| Gain on assets sold – net   | (1,571 )  | —                                     | —           | (1,571 )     |
| Amortization of acquired in-place leases - net                                | (4,300 )  | —                                     | —           | (4,300 )     |
| Change in operating assets and liabilities – net of amounts assumed/acquired: |   |                                       |             |              |
| Accounts receivable, net  | 581   | (21                                   | ) —         | 560          |
| Straight-line rent receivables  | (9,111 )  | (836                                  | ) —         | (9,947 )     |
| Lease inducements   | 647   | —                                     | —           | 647          |
| Effective yield receivable on mortgage notes                                  | (819 )  | —                                     | —           | (819 )       |
| Other operating assets and liabilities  | (10,793 )   | (8,514                                | ) (682 )    | (19,989 )    |
| Net cash provided by (used in) operating activities                           | 128,630   | (1,451                                | ) —         | 127,179      |
| Cash flows from investing activities  |   |                                       |             |              |
| Acquisition of real estate – net of liabilities assumed and escrows acquired  | (401,700)   | (14,404                               | ) —         | (416,104 )   |
| Investment in construction in progress  | (16,316 )   | —                                     | —           | (16,316 )    |
| Deposit to acquire real estate  | —   | (113,816                              | ) —         | (113,816 )   |
| Investment in U.K. subsidiary   | (127,239)   | 127,239                               | —           | —            |
| Placement of mortgage loans   | (6,162 )  | —                                     | —           | (6,162 )     |
| Proceeds from sale of real estate investments                                 | 2,392   | —                                     | —           | 2,392        |
| Capital improvements to real estate investments                               | (9,004 )  | (540                                  | ) —         | (9,544 )     |
| Proceeds from other investments   | 1,461   | —                                     | —           | 1,461        |
| Investments in other investments  | (116,003)   | —                                     | —           | (116,003 )   |
| Collection of mortgage principal  | 312   | —                                     | —           | 312          |



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|   |           |        |   |      |            |
|---|-----------|--------|---|------|------------|
| Net cash used in investing activities                               | (672,259) | (1,521 | ) | —    | (673,780 ) |
| Cash flows from financing activities                                |           |        |   |      |            |
| Proceeds from credit facility borrowings                            | 670,000   | —      |   | —    | 670,000    |
| Payments on credit facility borrowings                              | (370,000) | —      |   | —    | (370,000 ) |
| Receipts of other long-term borrowings                              | 350,000   | —      |   | —    | 350,000    |
| Payments of other long-term borrowings                              | —         | (309   | ) | —    | (309 )     |
| Payments of financing related costs                                 | (3,552 )  | (24    | ) | —    | (3,576 )   |
| Receipts from dividend reinvestment plan                            | 19,596    | —      |   | —    | 19,596     |
| Payments for exercised options and restricted stock – net           | (2,381 )  | —      |   | —    | (2,381 )   |
| Dividends paid  | (107,500) | —      |   | —    | (107,500 ) |
| Redemption of OP Units  | (10 )     | —      |   | —    | (10 )      |
| Distributions to OP Unit Holders                                    | (5,131 )  | —      |   | —    | (5,131 )   |
| Net cash provided by (used in) financing activities                 | 551,022   | (333   | ) | —    | 550,689    |
| Increase (decrease) in cash and cash equivalents                    | 7,393     | (3,305 | ) | —    | 4,088      |
| Effect of foreign currency translation on cash and cash equivalents | —         | (105   | ) | —    | (105 )     |
| Cash and cash equivalents at beginning of period                    | 1,592     | 3,832  |   | —    | 5,424      |
| Cash and cash equivalents at end of period                          | \$8,985   | \$ 422 |   | \$ — | \$ 9,407   |

## OMEGA HEALTHCARE INVESTORS, INC.

## CONSOLIDATING STATEMENTS OF CASH FLOWS

Unaudited (in thousands)

|   | Three Months Ended March 31, 2015    |                               |             |              |
|---|--------------------------------------|-------------------------------|-------------|--------------|
|   | Issuer &<br>Subsidiary<br>Guarantors | Non-Guarantor<br>Subsidiaries | Elimination | Consolidated |
| Cash flows from operating activities  |                                      |                               |             |              |
| Net income  | \$43,052                             | \$ 828                        | \$ (828 )   | \$ 43,052    |
| Adjustment to reconcile net income to cash provided by operating activities:  |                                      |                               |             |              |
| Depreciation and amortization   | 29,611                               | 999                           | —           | 30,610       |
| Provision for impairment on real estate properties                            | 5,982                                | —                             | —           | 5,982        |
| Provision for uncollectible mortgages, notes and accounts receivable          | (2 )                                 | —                             | —           | (2 )         |
| Amortization of deferred financing and refinancing costs                      | 10,725                               | 5                             | —           | 10,730       |
| Accretion of direct financing leases  | (2,614 )                             | —                             | —           | (2,614 )     |
| Stock-based compensation  | 1,610                                | —                             | —           | 1,610        |
| Amortization of acquired in-place leases - net                                | (1,192 )                             | —                             | —           | (1,192 )     |
| Change in operating assets and liabilities – net of amounts assumed/acquired: |                                      |                               |             |              |
| Accounts receivable, net  | (196 )                               | —                             | —           | (196 )       |
| Straight-line rent receivables  | (5,124 )                             | (151 )                        | —           | (5,275 )     |
| Lease inducements   | (2,110 )                             | —                             | —           | (2,110 )     |
| Effective yield receivable on mortgage notes                                  | (1,120 )                             | —                             | —           | (1,120 )     |
| Other operating assets and liabilities  | 23,373                               | (382 )                        | 828         | 23,819       |
| Net cash provided by operating activities                                     | 101,995                              | 1,299                         | —           | 103,294      |
| Cash flows from investing activities  |                                      |                               |             |              |
| Acquisition of real estate – net of liabilities assumed and escrows acquired  | (6,300 )                             | —                             | —           | (6,300 )     |
| Investment in construction in progress  | (5,851 )                             | —                             | —           | (5,851 )     |
| Placement of mortgage loans   | (2,002 )                             | —                             | —           | (2,002 )     |
| Proceeds from sale of real estate investments                                 | 255                                  | —                             | —           | 255          |
| Capital improvements to real estate investments                               | (4,605 )                             | (999 )                        | —           | (5,604 )     |
| Proceeds from other investments   | 2,155                                | —                             | —           | 2,155        |
| Investments in other investments  | (1,468 )                             | —                             | —           | (1,468 )     |
| Collection of mortgage principal  | 288                                  | —                             | —           | 288          |
| Net cash used in investing activities   | (17,528 )                            | (999 )                        | —           | (18,527 )    |
| Cash flows from financing activities  |                                      |                               |             |              |
| Proceeds from credit facility borrowings                                      | 6,000                                | —                             | —           | 6,000        |
| Payments on credit facility borrowings  | (91,000 )                            | —                             | —           | (91,000 )    |
| Receipts of other long-term borrowings  | 689,822                              | —                             | —           | 689,822      |

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|   |           |      |   |    |          |           |
|---|-----------|------|---|----|----------|-----------|
| Payments of other long-term borrowings                    | (347,583) | (300 | ) | —  | (347,883 | )         |
| Payments of financing related costs                       | (21,318   | )    | — | —  | (21,318  | )         |
| Receipts from dividend reinvestment plan                  | 5,414     | —    | — | —  | 5,414    |           |
| Payments for exercised options and restricted stock – net | (1,906    | )    | — | —  | (1,906   | )         |
| Net proceeds from issuance of common stock                | 440,019   | —    | — | —  | 440,019  |           |
| Dividends paid  | (68,261   | )    | — | —  | (68,261  | )         |
| Net cash provided by (used in) financing activities       | 611,187   | (300 | ) | —  | 610,887  |           |
| <br>  |           |      |   |    |          |           |
| Increase in cash and cash equivalents                     | 695,654   | —    | — | —  | 695,654  |           |
| Cash and cash equivalents at beginning of period          | 4,489     | —    | — | —  | 4,489    |           |
| Cash and cash equivalents at end of period                | \$700,143 | \$   | — | \$ | —        | \$700,143 |

**NOTE 17 – SUBSEQUENT EVENTS**

On April 1, 2016, we acquired 10 care homes (similar to ALFs in the United States) in the United Kingdom from an unrelated third party for approximately \$114 million in cash and leased them to an existing operator. The 10 care homes with 743 registered beds were added to the existing operator's master lease, which has an initial annual cash yield of 7%.

On April 29, 2016, four facilities with a carrying value of approximately \$15 million which were held for sale at March 31, 2016 were sold for approximately \$24 million. In conjunction with this transaction, the operator also paid us approximately \$55 million to retire approximately \$50 million of certain mortgages and other investments.

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

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

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

- (i) those items discussed under “Risk Factors” in Part I, Item 1A to our annual report on Form 10-K for the year ended December 31, 2015, and in Part II, Item 1A of this report (if any);
- (ii) uncertainties relating to the business operations of the operators of our assets, including those relating to reimbursement by third-party payors, regulatory matters and occupancy levels;
  - the ability of any operators in bankruptcy to reject unexpired lease obligations, modify the terms of our mortgages
- (iii) 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;
- (xvi) the possibility that we will not realize estimated synergies or growth as a result of our merger with Aviv, or that such benefits may take longer to realize than expected;
  - the potential impact of changes in the skilled nursing facility (“SNF”) and assisted living facility (“ALF”) market
- (xvii) or local real estate conditions on our ability to dispose of assets held for sale for the anticipated proceeds or on a timely basis, or to redeploy the proceeds therefrom on favorable terms; and

(xviii) our ability to maintain our status as a real estate investment trust.

## Overview

Omega Healthcare Investors, Inc. (“Omega,” “we,” “our” or the “Company”) has one reportable segment consisting of investments in healthcare-related real estate properties located in the United States and the United Kingdom. Our core business is to provide financing and capital to the long-term healthcare industry with a particular focus on SNFs. 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.

Omega was formed as a real estate investment trust (“REIT”) and incorporated in the State of Maryland on March 31, 1992. In April 2015, Aviv REIT Inc., a Maryland corporation (“Aviv”), merged (the “Aviv Merger”) with and into a wholly owned subsidiary of Omega, pursuant to the terms of that certain Agreement and Plan of Merger, dated as of October 30, 2014 (the “Merger Agreement”), by and among the Company, Aviv, OHI Healthcare Properties Holdco, Inc., a Delaware corporation and a direct wholly-owned subsidiary of Omega (“Merger Sub”), OHI Healthcare Properties Limited Partnership, a Delaware limited partnership (“Omega OP”), and Aviv Healthcare Properties Limited Partnership, a Delaware limited partnership (the “Aviv OP”). As a result of the Aviv Merger, Omega acquired 342 facilities, two facilities subject to direct financing leases, one medical office building and two mortgages and other investments. The facilities are located in 31 states and are operated by 38 third-party operators.

Prior to April 1, 2015 and in accordance with the Merger Agreement, Omega restructured the manner in which it holds its assets by converting to an umbrella partnership real estate investment trust structure (the “UPREIT Conversion”). As a result of the UPREIT Conversion and following the consummation of the Aviv Merger, substantially all of the Company’s assets are held by Omega OP.

Omega OP is governed by the Second Amended and Restated Agreement of Limited Partnership of OHI Healthcare Properties Limited Partnership, dated as of April 1, 2015 (the “Partnership Agreement”). Pursuant to the Partnership Agreement, the Company and Merger Sub are the general partners of Omega OP, and have exclusive control over Omega OP’s day-to-day management. As of March 31, 2016, the Company owned approximately 95% of the issued and outstanding units of partnership interest in Omega OP (“Omega OP Units”), and investors owned approximately 5% of the Omega OP Units.

Our portfolio of real estate investments at March 31, 2016, consisted of 985 healthcare facilities, located in 42 states and the United Kingdom and operated by 83 third party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately \$8.4 billion at March 31, 2016, with approximately 99% of our real estate investments related to long-term care facilities. Our portfolio is made up of: (i) 800 SNFs, (ii) 84 ALFs, (iii) 16 specialty facilities, (iv) one medical office building, (v) fixed rate mortgages on 53 SNFs and two ALFs and (vi) 29 facilities that are closed/held-for-sale. At March 31, 2016, we also held miscellaneous investments of approximately \$203.8 million, consisting primarily of secured loans to third-party operators of our facilities.

As of March 31, 2016 and December 31, 2015 we do not have any material properties or operators with facilities that are not materially occupied.

Our consolidated financial statements include the accounts of (i) Omega, (ii) Omega OP, and (iii) all direct and indirect wholly owned subsidiaries of Omega. All intercompany transactions and balances have been eliminated in consolidation.

## **Taxation**

Since our inception, we have elected to be taxed as a REIT under the applicable provisions of the Internal Revenue Code (the “Code”). A REIT is generally not subject to federal income tax on that portion of its REIT taxable income which is distributed to its stockholders, provided that at least 90% of such taxable income is distributed and certain other requirements are met, including an asset and income test. So long as we qualify as a REIT under 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.

If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to federal income taxes on its taxable income at regular corporate rates and dividends paid to our stockholders will not be deductible by us in computing taxable income. Further, we will not be permitted to qualify for treatment as a REIT for federal income tax purposes for four years following the year in which qualification is denied, unless the Internal Revenue Service grants us relief under certain statutory provisions. Failing to qualify as a REIT could materially and adversely affect the Company's net income; however, we believe we are organized and operate in such a manner as to qualify for treatment as a REIT. On a quarterly and annual basis, we test our compliance within the REIT taxation rules to ensure that we are in compliance with the REIT rules. We review our distributions and projected distributions each year to ensure we have met and will meet the annual REIT distribution requirements. In 2016, we expect to distribute dividends in excess of our taxable income.

As a result of our UPREIT Conversion, our Company and its subsidiaries may be subject to income or franchise taxes in certain states and municipalities. Also, as a result of our UPREIT Conversion, we created five wholly owned subsidiary REITs that are subject to all of the REIT qualification rules set forth in the Code. In December 2015, we merged the five wholly owned subsidiary REITs into one wholly owned subsidiary REIT which is subject to all of the REIT qualification rules set forth in the Code.



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”). We have elected for two of our active subsidiaries to be treated as TRSs. One of our TRSs is subject to federal, state and local income taxes at the applicable corporate rates and the other is subject to foreign income taxes. As of March 31, 2016, our TRS that is subject to federal, state and local income taxes at the applicable corporate rates had a net operating loss carry-forward of approximately \$0.9 million. The loss carry-forward is fully reserved as of March 31, 2016 with a valuation allowance due to uncertainties regarding realization.

During the first quarter of 2016, we recorded approximately \$0.1 million of state and local income tax provision and approximately \$0.1 million of provision for foreign income taxes.

### **Government Regulation and Reimbursement**

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

***Healthcare Reform.*** A substantial amount of rules and regulations have been issued under the Patient Protection and Affordable Care Act, as amended by the Health Care and Education and Reconciliation Act of 2010 (collectively referred to as the “Healthcare Reform Law”). We expect additional rules, regulations and interpretations under the Healthcare Reform Law to be issued that may materially affect our operators’ financial condition and operations.

Under the Healthcare Reform Law, a Federal Commission on Long-Term Care was established which issued its report in September 2013. One of its recommendations was the convening of the White House Conference on Aging which met in July, 2015. At that meeting, it was announced that the Centers for Medicare and Medicaid Services (“CMS”) was issuing a proposed rule on July 16, 2015 that included a significant number of revisions to the regulations covering the conditions of participation for SNFs to receive Medicare and Medicaid payments. These proposed regulations will substantially impact SNFs because they reflect the advances made over the past 24 years in the theory and practices of service delivery and safety, including the impact of other recent legislation emphasizing service quality, value over volume of services, and consistency in reporting. A final rule has not yet been published.

Given the complexity of the Healthcare Reform Law and the substantial requirements for regulation thereunder, the impact of the Healthcare Reform Law on our operators or their ability to meet their obligations to us cannot be predicted. The Healthcare Reform Law could result in decreases in payments to our operators or otherwise adversely affect the financial condition of our operators, thereby negatively impacting our financial condition. Our operators may not be successful in modifying their operations to lessen the impact of any increased costs or other adverse effects resulting from changes in governmental programs, private insurance and/or employee welfare benefit plans. The impact of the Healthcare Reform Law on each of our operators will vary depending on payor mix, resident conditions and a variety of other factors. In addition to the provisions relating to reimbursement, other provisions of the Healthcare Reform Law may impact our operators as employers (e.g., requirements related to providing health insurance for employees).

**Reimbursement Generally.** A significant portion of our operators' revenue is derived from governmentally-funded reimbursement programs, consisting primarily of Medicare and Medicaid. As federal and state governments focus on healthcare reform initiatives, and as the federal government and many states face significant current and future budget deficits, efforts to reduce costs by government payors will likely continue, which may result in reductions in reimbursement at both the federal and state levels. These cost-cutting measures could result in a significant reduction of reimbursement rates to our operators under both the Medicare and Medicaid programs. Additionally, new and evolving payor and provider programs, including but not limited to Medicare Advantage, dual eligible, accountable care organizations, and bundled payments could adversely impact our tenants' and operators' liquidity, financial condition or results of operations.

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 scope of services reimbursed and/or reductions of reimbursement rates could have a material adverse effect on our operators' results of operations and financial condition, which could adversely affect our operators' ability to meet their obligations to us.

**Medicaid.** State budgetary concerns, coupled with the implementation of rules under the Healthcare Reform Law, may result in significant changes in healthcare spending at the state level. Many states are currently focusing on the reduction of expenditures under their state Medicaid programs, which may result in a reduction in reimbursement rates for our operators. The need to control Medicaid expenditures may be exacerbated by the potential for increased enrollment in Medicaid due to unemployment and declines in family incomes. Since our operators' profit margins on Medicaid patients are generally relatively low, more than modest reductions in Medicaid reimbursement or an increase in the number of Medicaid patients could adversely affect our operators' results of operations and financial condition, which in turn could negatively impact us.

The Healthcare Reform Law provided for Medicaid coverage to be expanded to all individuals under age 65 with incomes up to 133% of the federal poverty level, beginning January 1, 2014. The federal government committed to paying the entire cost for Medicaid coverage for newly eligible beneficiaries from 2014 through 2016. In 2017, the federal share will decline to 95%; in 2018, to 94%; in 2019, to 93%; and in 2020 and subsequent years, to 90%.

On June 28, 2012, however, the Supreme Court ruled that states could not be required to expand Medicaid or risk losing federal funding of their existing Medicaid programs. As of March 14, 2016, thirty two states including the District of Columbia have expanded or are expanding Medicaid coverage as contemplated by the Healthcare Reform Law, with many of the remaining states involved in a variety of legislative proposals or discussions.

**Medicare.** On April 1, 2014, President Obama signed the "Protecting Access to Medicare Act of 2014" which calls for the United States Department of Health and Human Services ("HHS") to develop a value based purchasing program for

SNFs aimed at lowering readmission rates beginning on October 1, 2018.

On July 30, 2015, the Centers for Medicare & Medicaid Services (“CMS”) issued a final rule outlining the FY 2016 Medicare payment rates for SNFs. Aggregate payments to SNFs are projected to increase by \$430 million, or 1.2%, from payments in FY 2015. This estimated increase is attributable to a 2.3% market basket increase, reduced by a 0.6% forecast error adjustment and further reduced by 0.5% in accordance with the multifactor productivity adjustment required by law. The final rule also includes policies that advance setting measurable goals and timelines for paying SNFs based on the quality rather than the quantity of care to patients.

The “Medicare Access and CHIP Reauthorization Act of 2015” extended the Medicare therapy cap exceptions process through December 31, 2017. The statutory Medicare Part B outpatient cap for occupational therapy is \$1,960 for 2016, and the combined cap for physical therapy and speech therapy is also \$1,960 for 2016. These caps do not apply to therapy services covered under Medicare Part A for SNFs, although the caps apply in most other instances involving patients in SNFs or long-term care facilities who receive therapy services covered under Medicare Part B. The exception process permits medically necessary therapy services beyond the cap limits. Expiration of the therapy cap exceptions process in the future could have a material adverse effect on our operators’ financial condition and operations, which could adversely impact their ability to meet their obligations to us.

The “Bipartisan Budget Act of 2015” (“BBA”) was signed by President Obama on November 2, 2015. While the BBA provides \$80 billion in discretionary spending sequestration relief over two years, it also extended Medicare sequestration, which generally cuts Medicare provider and plan payments by 2% across the board, for an additional year, through 2025. The BBA also provides a uniform 2% reduction for 2024 instead of applying different rates during the first and second halves of the fiscal year. However, the fiscal year 2025 sequestration will be “front loaded,” such that, a 4% reduction will apply during the first six months of the fiscal year and no reduction will be imposed during the second half of the fiscal year.

***Quality of Care Initiatives.*** 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, CMS released quality ratings for all of the nursing homes that participate in Medicare or Medicaid under its “Five Star Quality Rating System.” Facility rankings, ranging from five stars (“much above average”) to one star (“much below average”) are updated on a monthly basis. SNFs are required to provide information for the CMS Nursing Home Compare website regarding staffing and quality measures. Based on this data and the results of state health inspections, SNFs are then rated based on the five-star rating system. In 2015, CMS made changes to the rating system including: (1) revising scoring methodology by which quality measure ratings are calculated for SNFs; (2) increasing the number and type of quality measures that are not solely based on self-reported data and (3) adding critical measures to staffing such as turnover and retention. It is possible that this or any other ranking system could lead to future reimbursement policies that reward or penalize facilities on the basis of the reported quality of care parameters.

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

***Office of the Inspector General Activities.*** The Office of Inspector General’s (the “OIG”) Work Plan for government fiscal year 2016, which describes projects that the OIG plans to address during the fiscal year, includes two projects related specifically to nursing homes. (1) compliance with various aspects of the SNF prospective payment system; and (2) background checks for employees.

***Fraud and Abuse.*** There are various federal and state civil and criminal laws and regulations governing a wide array of healthcare provider referrals, relationships and arrangements, including laws and regulations prohibiting fraud by healthcare providers. Many of these complex laws raise issues that have not been clearly interpreted by the relevant governmental authorities and courts.

These laws include: (i) federal and state false claims acts, which, among other things, prohibit providers from filing false claims or making false statements to receive payment from Medicare, Medicaid or other federal or state healthcare programs; (ii) federal and state anti-kickback and fee-splitting statutes, including the Medicare and Medicaid anti-kickback statute, which prohibit the payment or receipt of remuneration to induce referrals or recommendations of healthcare items or services, such as services provided in a SNF; (iii) federal and state physician self-referral laws (commonly referred to as the Stark Law), which generally prohibit referrals by physicians to entities for designated health services (some of which are provided in SNFs) with which the physician or an immediate family member has a financial relationship; (iv) the federal Civil Monetary Penalties Law, which prohibits, among other things, the knowing presentation of a false or fraudulent claim for certain healthcare services and (v) federal and state privacy laws, including the privacy and security rules contained in the Health Insurance Portability and Accountability Act of 1996, which provide for the privacy and security of personal health information.

Violations of healthcare fraud and abuse laws carry civil, criminal and administrative sanctions, including punitive sanctions, monetary penalties, imprisonment, denial of Medicare and Medicaid reimbursement and potential exclusion from Medicare, Medicaid or other federal or state healthcare programs. Additionally, there are criminal provisions that prohibit filing false claims or making false statements to receive payment or certification under Medicare and Medicaid, as well as failing to refund overpayments or improper payments. Violation of the anti-kickback statute or Stark Law may form the basis for a federal False Claims Act violation. These laws are enforced by a variety of federal, state and local agencies and can also be enforced by private litigants through, among other things, federal and state false claims acts, which allow private litigants to bring qui tam or whistleblower actions, which have become more frequent in recent years.

**Privacy.** Our operators are subject to various federal, state and local laws and regulations designed to protect the confidentiality and security of patient health information, including the federal Health Insurance Portability and Accountability Act of 1996, as amended, the Health Information Technology for Economic and Clinical Health Act, and the corresponding regulations promulgated thereunder (collectively referred to herein as “HIPAA”). In March 2016, the HHS Office for Civil Rights began Phase 2 of its HIPAA Audit Program which will include business as well as covered entities. The Audit will focus on compliance with the Privacy, Security, and Breach Notification Rules.

Various states have similar laws and regulations that govern the maintenance and safeguarding of patient records, charts and other information generated in connection with the provision of professional medical services. These laws and regulations require our operators to expend the requisite resources to secure protected health information, including the funding of costs associated with technology upgrades. Operators found in violation of HIPAA or any other privacy law or regulation may face large penalties. In addition, compliance with an operator’s notification requirements in the event of a breach of unsecured protected health information could cause reputational harm to an operator’s business.

**Licensing and Certification.** Our operators and facilities are subject to various federal, state and local licensing and certification laws and regulations, including laws and regulations under Medicare and Medicaid requiring operators of SNFs and ALFs to comply with extensive standards governing operations. Governmental agencies administering these laws and regulations regularly inspect our operators’ facilities and investigate complaints. Our operators and their managers receive notices of observed violations and deficiencies from time to time, and sanctions have been imposed from time to time on facilities operated by them. In addition, many states require certain healthcare providers to obtain a certificate of need, which requires prior approval for the construction, expansion or closure of certain healthcare facilities, which has the potential to impact some of our operators’ abilities to expand or change their businesses.

**Americans with Disabilities Act (the “ADA”).** Our properties must comply with the ADA and any similar state or local laws to the extent that such properties are public accommodations as defined in those statutes. The ADA may require removal of barriers to access by persons with disabilities in certain public areas of our properties where such removal is readily achievable. Should barriers to access by persons with disabilities be discovered at any of our properties, we may be directly or indirectly responsible for additional costs that may be required to make facilities ADA-compliant. Noncompliance with the ADA could result in the imposition of fines or an award of damages to private litigants. Our commitment to make readily achievable accommodations pursuant to the ADA is ongoing, and we continue to assess our properties and make modifications as appropriate in this respect.

**Other Laws and Regulations.** Additional federal, state and local laws and regulations affect how our operators conduct their operations, including laws and regulations protecting consumers against deceptive practices and otherwise generally affecting our operators’ management of their property and equipment and the conduct of their operations (including laws and regulations involving fire, health and safety; quality of services, including care and food service; residents’ rights, including abuse and neglect laws; and the health standards set by the federal Occupational Safety and Health Administration).

**General and Professional Liability.** Although arbitration agreements have been effective in limiting general and professional liabilities for SNF and long term care providers, there have been numerous lawsuits challenging the validity of arbitration agreements in long term care settings. On July 16, 2015, CMS issued a proposed rule on, Reform of Requirements for Long-Term Care Facilities, which would require SNFs to explain binding arbitration agreements to residents and their families before they sign them. The rule would also prohibit requiring arbitration agreements as a condition of admission. A final rule is projected by HHS to be published by September 2016. If this rule is finalized as proposed, there would likely be an increase in liabilities for SNF and long term care providers.



## **Critical Accounting Policies and Estimates**

Our financial statements are prepared in accordance with generally accepted accounting principles (“GAAP”) in the United States, 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, 2015. 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 2015 Annual Report on Form 10-K in Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations.

There have been no changes to our critical accounting policies or estimates since December 31, 2015. See Note 2 – Summary of Significant Accounting Policies to our Annual Report on Form 10-K for the year ended December 31, 2015.

## ***Recent Accounting Pronouncements***

In 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”), which outlines a comprehensive model for entities to use in accounting for revenue arising from contracts with customers. ASU 2014-09 states that “an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” While ASU 2014-09 specifically references contracts with customers, it may apply to certain other transactions such as the sale of real estate or equipment. ASU 2014-09 is effective for the Company beginning January 1, 2018. We are continuing to evaluate this guidance; however, we do not expect its adoption to have a significant impact on our consolidated financial statements, as a substantial portion of our revenue consists of rental income from leasing arrangements, which are specifically excluded from ASU 2014-09.

In February 2015, the FASB issued ASU No. 2015-02, *Amendments to the Consolidation Analysis* (“ASU 2015-02”), which amends certain requirements for determining whether a variable interest entity must be consolidated. The amendments in ASU 2015-02 are effective for annual and interim reporting periods of public entities beginning after December 31, 2015 and were adopted by the Company during the quarter ended March 31, 2016. The effect of this guidance was immaterial to the Company’s consolidated results of operations, financial position and cash flows.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments - Overall*, which makes limited amendments to the guidance in U.S. GAAP on the classification and measurement of financial instruments. The new standard significantly revises an entity's accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. It also amends certain disclosure requirements associated with the fair value of financial instruments. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, including interim periods therein. Early adoption is permitted specifically for the amendments pertaining to the presentation of certain fair value changes for financial liabilities measured at fair value. Early adoption of all other amendments is not permitted. Upon adoption, the Company will be required to make a cumulative-effect adjustment to the Consolidated Balance Sheet as of the beginning of the first reporting period in which the guidance is effective. We are currently evaluating the impact of adopting ASU 2016-01 on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases* ("ASU 2016-02") which amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. ASU 2016-02 will be effective for the Company beginning January 1, 2019. Early adoption of ASU 2016-02 as of its issuance is permitted. The new standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. We are currently evaluating the impact of adopting ASU 2016-02 on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation-Stock Compensation (Topic 718)* (“ASU 2016-09”). ASU 2016-09 amends the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. This guidance is effective for annual and interim reporting periods of public entities beginning after December 15, 2017, with early adoption permitted. We are currently evaluating the impact of adopting ASU 2016-09 on our consolidated financial statements.

## **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, 2016 and 2015***

#### ***Operating Revenues***

Our operating revenues for the three months ended March 31, 2016, totaled \$212.9 million, an increase of \$79.5 million over the same period in 2015. The \$79.5 million increase was primarily the result of: (i) \$57.8 million of rental income associated with the Aviv Merger; (ii) \$3.5 million of rental income related to the Care Homes Transaction (refer to Note 3 – Properties in our Annual Report on Form 10-K for the year ended December 31, 2015), (iii) \$12.3 million of additional rental income associated with other acquisitions and lease amendments made throughout 2016 and 2015, (iv) \$2.6 million increase in other investment income primarily related to new notes funded to operators in 2016 and (v) \$1.1 million increase in direct financing lease income primarily due to (a) two new direct financing leases assumed in the Aviv Merger and (b) incremental revenue associated with the New Ark direct financing lease.

#### ***Operating Expenses***

Operating expenses for the three months ended March 31, 2016, totaled \$116.3 million, an increase of approximately \$68.9 million over the same period in 2015. The increase was primarily due to: (i) a \$31.8 million increase in depreciation and amortization expense due to the Aviv Merger and Care Homes Transaction, as well as other acquisitions, (ii) a \$28.6 million increase in provision for impairment losses as a result of the Company exiting 14 facilities, (iii) a \$5.1 million increase in provision for uncollectible mortgages, notes and accounts receivable primarily

related to (a) the write-off of approximately \$3.4 million of straight line receivable from a former operator and (b) the reserve of approximately \$1.2 million of effective interest receivable associated with an existing operator who exercised their option to prepay certain mortgages with Omega and (iv) a \$4.4 million increase in general and administrative expenses primarily due to the Aviv Merger.

*Other Income (Expense)*

For the three months ended March 31, 2016, total other expenses were \$39.7 million, a decrease of approximately \$3.2 million over the same period in 2015. The decrease was primarily the result of a decrease of \$9.1 million in interest refinancing costs. In the first quarter of 2015, we incurred \$9.4 million in interest refinance costs related to the redemption of our \$200 million 7.5% notes due 2020 and early retirement of 21 mortgage loans guaranteed by U.S. Department of Housing and Urban Development (“HUD”). In the first quarter of 2016, we incurred \$0.3 million of interest refinancing costs. Offsetting the decrease was an increase of \$4.9 million in interest expense due to an increase in borrowings outstanding to fund new investments since January 2015, including the Aviv Merger and Care Homes Transaction.

*National Association of Real Estate Investment Trusts Funds From Operations*

Our funds from operations (“NAREIT FFO”) for the three months ended March 31, 2016 was \$153.6 million compared to \$79.6 million for the same period in 2015.

We calculate and report NAREIT FFO in accordance with the definition of Funds from Operations and interpretive guidelines issued by the National Association of Real Estate Investment Trusts (“NAREIT”), and, consequently, NAREIT FFO is defined as net income available to common stockholders, adjusted for the effects of asset dispositions and certain non-cash items, primarily depreciation and amortization and impairment on real estate assets. We believe that NAREIT 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. NAREIT FFO was designed by the real estate industry to address this issue. NAREIT FFO herein is not necessarily comparable to NAREIT FFO of other REITs that do not use the same definition or implementation guidelines or interpret the standards differently from us.

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

The following table presents our NAREIT FFO results for the three months ended March 31, 2016 and 2015:

|   | Three Months<br>Ended<br>March 31,<br>2016      2015<br>(in thousands)      |          |
|---|---|----------|
| Net income  | \$58,196  | \$43,052 |
| Deduct gain from real estate dispositions             | (1,571 )  | —        |
| Sub-total   | 56,625  | 43,052   |
| Elimination of non-cash items included in net income: |   |          |
| Depreciation and amortization                         | 62,433  | 30,610   |
| Add back impairments on real estate properties        | 34,558  | 5,982    |
| NAREIT FFO <sup>(a)</sup>                             | \$153,616   | \$79,644 |
| (a)   | Includes amounts allocated to Omega stockholders and Omega OP Unit holders. |          |

## Portfolio and Recent Developments

The following tables summarize the significant acquisitions that occurred in 2016.

| Period | Number of Facilities |     | Country/<br>State | Total Investment |         | Land<br>(in millions) | Building & Site<br>Improvements | Furniture<br>& Fixtures | Initial<br>Cash | Yield<br>(%) |
|--------|----------------------|-----|-------------------|------------------|---------|-----------------------|---------------------------------|-------------------------|-----------------|--------------|
|        | SNF                  | ALF |                   |                  |         |                       |                                 |                         |                 |              |
| Q1     | -                    | 1   | UK                | \$ 8.3           |         | \$ 1.4                | \$ 6.7                          | \$ 0.2                  | 7.00            |              |
| Q1     | -                    | 1   | UK                | 6.1              | (1)     | 0.6                   | 5.3                             | 0.2                     | 7.00            |              |
| Q1     | 10                   | -   | OH, VA, MI        | 169.0            | (1) (3) | 10.5                  | 152.5                           | 6.0                     | 8.50            |              |
| Q1     | -                    | -   | FL                | 2.5              | (2)     | 2.5                   | -                               | -                       | -               |              |
| Q1     | -                    | 2   | GA                | 20.2             |         | 0.8                   | 18.3                            | 1.1                     | 7.50            |              |
| Q1     | 3                    | -   | MD                | 25.0             |         | 2.5                   | 19.9                            | 2.6                     | 8.50            |              |
| Q1     | 21                   | -   | VA, NC            | 212.5            | (1)     | 19.3                  | 181.1                           | 12.1                    | 8.50            |              |
| Total  | 34                   | 4   |                   | \$ 443.6         |         | \$ 37.6               | \$ 383.8                        | \$ 22.2                 |                 |              |

The Company estimated the fair value of the assets acquired on the acquisition date based on certain valuation (1) analyses that have yet to be finalized, and accordingly, the assets acquired, as detailed, are subject to adjustment once the analysis is completed.

(2) Accounted for as an asset acquisition.

(3) Acquired from a related party. Refer to Note -1 Related Party Transactions.

### Acquisition of Aviv by Merger

On April 1, 2015, Omega completed the Aviv Merger, which was structured as a stock-for-stock merger. Under the terms of the Merger Agreement, each outstanding share of Aviv common stock was converted into 0.90 of a share of Omega common stock. In connection with the Aviv Merger, Omega issued approximately 43.7 million shares of common stock to former Aviv stockholders. As a result of the Aviv Merger, Omega acquired 342 facilities, two facilities subject to direct financing leases, one medical office building, two mortgages and other investments. The facilities are located in 31 states and are operated by 38 third-party operators. Omega also assumed certain outstanding equity awards and other debt and liabilities. Based on the closing price of Omega's common stock on April 1, 2015, the fair value of the consideration exchanged was approximately \$2.3 billion.

The following table highlights the final allocation of the assets acquired, liabilities assumed, and consideration exchanged on April 1, 2015 (in thousands):

|  |             |
|--|-------------|
| Fair value of net assets acquired:     |             |
| Land and buildings                     | \$3,107,530 |
| Investment in direct financing leases  | 26,823      |
| Mortgages notes receivable             | 19,246      |
| Other investments                      | 23,619      |
| Total investments                      | 3,177,218   |
| Goodwill                               | 630,679     |
| Accounts receivables and other assets  | 17,144      |
| Cash acquired                          | 84,858      |
| Accrued expenses and other liabilities | (223,002 )  |
| Debt                                   | (1,410,637) |
| Fair value of net assets acquired      | \$2,276,260 |

The completion of the final valuation did not result in material changes to our Consolidated Statements of Operations and Comprehensive Income or our Consolidated Balance Sheets from our preliminary purchase price allocation.

### ***Assets Impairments and Assets Held for Sale***

During the first quarter of 2016, we recorded approximately \$34.6 million of impairments on 14 facilities located in six states. We reduced their net book values to their estimated fair value less costs to sell and reclassified them to assets held for sale in the first quarter of 2016. To estimate the fair value of the facilities, we utilized a market approach and Level 3 inputs.

In the first quarter of 2016, we reclassified eight ALFs, and 16 SNFs to assets held for sale. In addition, we sold two SNFs previously classified as assets held for sale for approximately \$2.4 million in net proceeds recognizing a gain on sale of approximately \$1.6 million.

### **Liquidity and Capital Resources**

At March 31, 2016, we had total assets of \$8.6 billion, total equity of \$4.1 billion and debt of \$4.2 billion, representing approximately 51.0% of total capitalization.

### ***Financing Activities and Borrowing Arrangements***

Certain of our other secured and unsecured borrowings are subject to customary affirmative and negative covenants, including financial covenants. As of March 31, 2016 and December 31, 2015, we were in compliance with all affirmative and negative covenants, including financial covenants, for our secured and unsecured borrowings.

### ***Bank Credit Facilities***

On January 29, 2016, we amended our Omega Credit Facilities (as defined below) to add a \$350 million senior unsecured incremental term loan facility. As a result of the amendment, the Omega Credit Facilities now include a \$1.25 billion senior unsecured revolving credit facility (the "Revolving Credit Facility"), a \$200 million senior unsecured term loan facility (the "Tranche A-1 Term Loan Facility"), a \$200 million senior unsecured incremental term loan facility (the "Tranche A-2 Term Loan Facility") and a \$350 million senior unsecured incremental term loan facility (the "Tranche A-3 Term Loan Facility" and, together with the Revolving Credit Facility, the Tranche A-1 Term Loan Facility and the Tranche A-2 Term Loan Facility, collectively, the "Omega Credit Facilities"). The Tranche A-1 Term



Loan Facility, the Tranche A-2 Term Loan Facility and the Tranche A-3 Term Loan Facility may be referred to collectively herein as the “Omega Term Loan Facilities”.

The Tranche A-3 Term Loan Facility bears interest at LIBOR plus an applicable percentage (beginning at 150 basis points, with a range of 100 to 195 basis points) based on our ratings from Standard & Poor’s, Moody’s and/or Fitch Ratings. The Tranche A-3 Term Loan Facility matures on January 29, 2021.

At March 31, 2016, we had \$530.0 million of borrowings outstanding under the Revolving Credit Facility and \$750.0 million of borrowings outstanding under the Omega Term Loan Facilities.

#### *Dividend Reinvestment and Common Stock Purchase Plan*

For the three-month period ended March 31, 2016, approximately 0.7 million shares of our common stock at an average price of \$29.84 per share were issued through our Dividend Reinvestment and Common Stock Purchase Program for gross proceeds of approximately \$19.7 million.

#### *Dividends*

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

For the three months ended March 31, 2016, we paid dividends of \$107.5 million to our common stockholders.

### *Liquidity*

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

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

- normal recurring expenses;
- debt service payments;
- capital improvement programs;
- 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 \$9.4 million as of March 31, 2016, an increase of \$4.0 million as compared to the balance at December 31, 2015. The following is a discussion of changes in cash and cash equivalents due to operating, investing and financing activities, which are presented in our Consolidated Statements of Cash Flows.

*Operating Activities* – Operating activities generated \$127.2 million of net cash flow for the three months ended March 31, 2016, as compared to \$103.3 million for the same period in 2015. The increase was primarily related to additional cash flow generated from new investments primarily related to the Aviv Merger and Care Homes Transaction, including other facilities acquired and leased throughout 2015 and 2016.

Investing Activities – Net cash flow from investing activities was an outflow of \$673.8 million for the three months ended March 31, 2016, as compared to an outflow of \$18.5 million for the same period in 2015. The \$655.3 million increase in cash outflow from investing activities related primarily to (i) an increase of \$409.8 million in acquisitions in 2016 compared to the same period of 2015, (ii) a cash deposit of \$113.8 million to acquire 10 care homes in the United Kingdom completed on April 1, 2016, (iii) an increase of net cash outflow of \$115.2 million from other investments – net in 2016 compared to the same period of 2015, (iv) an increase of \$10.5 million investment in construction in progress in 2016 as compared to the same period of 2015 (v) an increase of \$4.2 million in mortgage investment in 2016 compared to the same period of 2015, (vi) an increase of \$3.9 million in our capital renovation program investment in 2016 compared to the same period of 2015.

Financing Activities – Net cash flow from financing activities was an inflow of \$550.7 million for the three months ended March 31, 2016 as compared to an inflow of \$610.9 million for the same period in 2015. The \$60.2 million decrease in cash inflow from financing activities was primarily a result of: (i) a decrease in net proceeds of \$440.0 million from issuance common stock in 2016 as compared to the same period in 2015, (ii) an increase of \$39.2 million in dividend payments due to an increase in number of shares outstanding and an increase of \$0.04 per share in the common dividends and (iii) \$5.1 million of distributions to Omega OP Unit holders in 2016, offset by (i) an increase of \$385 million net proceeds on the credit facility in 2016 as compared to the same period in 2015, (ii) an increase in net proceeds of \$14.2 million from our dividend reinvestment plan in 2016 as compared to the same period in 2015, and (iii) an decrease in financing related costs of \$17.7 million related to the Aviv Merger on April 1, 2015.

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

During the quarter ended March 31, 2016, there were no material changes in our primary market risk exposures or how those exposures are managed from the information disclosed under Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2015.

### **Item 4 – Controls and Procedures**

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

In connection with the preparation of this Form 10-Q, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2016. 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, 2016.

#### *Internal Control Over Financial Reporting*

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

## **PART II – OTHER INFORMATION**

### **Item 1 – Legal Proceedings**

See Note 14 – Litigation to the Consolidated Financial Statements in Part I, Item 1 hereto, which is hereby incorporated by reference in response to this item.

### **Item 1A – Risk Factors**

We filed our Annual Report on Form 10-K for the year ended December 31, 2015, with the Securities and Exchange Commission on February 26, 2016, which sets forth certain risk factors in Part I, Item 1A therein. We have not experienced any material changes from the risk factors previously described in our Annual Report on Form 10-K for the year ended December 31, 2015.

**Item 6—Exhibits**

Exhibit  
No.

- 4.1 Fifteenth Supplemental Indenture, dated as of March 29, 2016, among Omega Healthcare Investors, Inc., each of the subsidiary guarantors listed therein and U.S. Bank National Association, as trustee, related to the 5.875% Senior Notes due 2024, including the Form of 5.875% Senior Notes and Form of Subsidiary Guarantee related thereto.\*
- 4.2 Eighth Supplemental Indenture, dated as of March 29, 2016, among Omega Healthcare Investors, Inc., each of the subsidiary guarantors listed therein and U.S. Bank National Association, as trustee, related to the 4.950% Senior Notes due 2024, including the Form of 4.950% Senior Notes and Form of Subsidiary Guarantee related thereto.\*
- 4.3 Seventh Supplemental Indenture, dated as of March 29, 2016, among Omega Healthcare Investors, Inc., each of the subsidiary guarantors listed therein and U.S. Bank National Association, as trustee, related to the 4.50% Senior Notes due 2025, including the Form of 4.50% Senior Notes and Form of Subsidiary Guarantee related thereto.\*
- 4.4 Fourth Supplemental Indenture, dated as of March 29, 2016, among Omega Healthcare Investors, Inc., each of the subsidiary guarantors listed therein and U.S. Bank National Association, as trustee, related to the 4.500% Senior Notes due 2027, including the Form of 4.500% Senior Notes and Form of Subsidiary Guarantee related thereto.\*
- 4.5 Second Supplemental Indenture, dated as of March 29, 2016, among Omega Healthcare Investors, Inc., each of the subsidiary guarantors listed therein and U.S. Bank National Association, as trustee, related to the 5.250% Senior Notes due 2026, including the Form of 5.250% Senior Notes and Form of Subsidiary Guarantee related thereto.\*
- 10.1 First Amendment to Credit Agreement, dated as of August 7, 2015, among Omega Healthcare Properties Limited Partnership, certain subsidiaries of Omega Healthcare Properties Limited Partnership identified therein as guarantors, the lenders named therein and Bank of America, N.A., as administrative agent for such lenders (Incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K, filed with the SEC on January 7, 2016).
- 10.2 Third Amendment to Credit Agreement, dated as of January 29, 2016, among Omega Healthcare Investors, Inc., certain subsidiaries of Omega Healthcare Investors, Inc. identified therein as guarantors, the lenders named therein and Bank of America, N.A., as administrative agent for such lenders (Incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K, filed with the SEC on February 3, 2016).
- 10.3 Form of 2016 Employment Agreement Amendments (Incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K, filed with the SEC on March 23, 2016).+
- 10.4 Form of Time-Based Restricted Stock Unit Agreement for 2016 Grants (Incorporated by reference to Exhibit 10.2 to the Company’s Current Report on Form 8-K, filed with the SEC on March 23, 2016).+
- 10.5 Form of Performance-Based Restricted Stock Unit Agreement for 2016 Grants (Incorporated by reference to Exhibit 10.3 to the Company’s Current Report on Form 8-K, filed with the SEC on March 23, 2016).+
- 10.6 Form of Performance-Based LTIP Unit Agreement for 2016 Grants (Incorporated by reference to Exhibit 10.4 to the Company’s Current Report on Form 8-K, filed with the SEC on March 23, 2016).+

- 31.1 Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.\*
  - 31.2 Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.\*
  - 32.1 Section 1350 Certification of the Chief Executive Officer.\*
  - 32.2 Section 1350 Certification of the Chief Financial Officer.\*
  - 101.INS XBRL Instance Document.
  - 101.SCH XBRL Taxonomy Extension Schema Document.
  - 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
  - 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
  - 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
  - 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.
- \* Exhibits that are filed herewith.

+ Management contract or compensatory plan, contract or arrangement.

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 6, 2016 By: /S/ C. TAYLOR PICKETT  
C. Taylor Pickett  
Chief Executive Officer

Date: May 6, 2016 By: /S/ ROBERT O. STEPHENSON  
Robert O. Stephenson  
Chief Financial Officer