

OMEGA HEALTHCARE INVESTORS INC
Form 10-Q
November 07, 2018

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 September 30, 2018

or

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

For the transition period from _____ to _____

OMEGA HEALTHCARE INVESTORS, INC.

OHI HEALTHCARE PROPERTIES LIMITED PARTNERSHIP

(Exact name of Registrant as specified in its charter)

Maryland

1-11316

38-3041398

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

(Omega Healthcare Investors, Inc.) Delaware	(Omega Healthcare Investors, Inc.) 333-203447-11	(Omega Healthcare Investors, Inc.) 36-4796206
(OHI Healthcare Properties Limited Partnership) (State of incorporation or organization)	(OHI Healthcare Properties Limited Partnership) (Commission file number)	(OHI Healthcare Properties Limited Partnership) (IRS Employer Identification No.)
303 International Circle, Suite 200, 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.

Omega Healthcare Investors, Inc. Yes No OHI Healthcare Properties Limited Partnership Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).

Omega Healthcare Investors, Inc. Yes No OHI Healthcare Properties Limited Partnership Yes No

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

Omega Healthcare Investors, Inc.

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

OHI Healthcare Properties Limited Partnership

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

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Omega Healthcare Investors, Inc. OHI Healthcare Properties Limited Partnership

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

Omega Healthcare Investors, Inc. Yes No OHI Healthcare Properties Limited Partnership Yes No
Indicate the number of shares outstanding of each of the issuers' classes of common stock as of October 31, 2018

Omega Healthcare Investors, Inc.
Common Stock, \$.10 par value 200,696,539

OHI Healthcare Properties Limited Partnership
N/A No common stock outstanding
(Class) (Number of shares)

EXPLANATORY NOTE

This report combines the quarterly reports on Form 10-Q for the period ended September 30, 2018 of Omega Healthcare Investors, Inc. and OHI Healthcare Properties Limited Partnership (“Omega OP”). Unless stated otherwise or the context otherwise requires, (i) references to “Omega” or the “Company” means Omega Healthcare Investors, Inc. and its consolidated subsidiaries, (ii) references to “Parent” refer to Omega Healthcare Investors, Inc. without regard to its consolidated subsidiaries, and (iii) references to “Omega OP” means OHI Healthcare Properties Limited Partnership and its consolidated subsidiaries.

Omega is a self-administered real estate investment trust (“REIT”) under the Internal Revenue Code of 1986. Omega is structured as an umbrella partnership REIT (“UPREIT”) under which all of Omega's assets are owned directly or indirectly by, and all of Omega's operations are conducted directly or indirectly through, its operating partnership subsidiary, Omega OP.

Parent directly owned approximately 96% of the issued and outstanding partnership units in Omega OP (the “Omega OP Units”) at September 30, 2018. Each Omega OP Unit (other than those owned by Parent) is redeemable at the election of the holder for cash equal to the then-fair market value of one share of common stock of Parent, subject to Parent’s election to exchange the Omega OP Units tendered for redemption for common stock of the Parent on a one-for-one basis in an unregistered transaction, subject to adjustment as set forth in the partnership agreement. The management of Parent consists of the same members as the management of Omega OP.

The financial results of Omega OP are consolidated into the financial statements of Omega. Omega has no significant assets other than its investments in Omega OP. Omega and Omega OP are managed and operated as one entity. Omega OP has no significant assets other than its interests in non-guarantor subsidiaries.

We believe it is important for investors to understand the few differences between Omega and Omega OP in the context of how we operate as a consolidated company. Omega acts as the general partner of Omega OP. Net proceeds from equity issuances by Parent are contributed to Omega OP in exchange for additional partnership units. Parent and Omega OP incur indebtedness. The net proceeds of the Parent’s borrowings are loaned to Omega OP. The outstanding senior notes and certain other debt of Parent is guaranteed by Omega OP.

The presentation of debt and related interest, including amounts accrued, stockholders’ equity, owners’ equity and noncontrolling interests are the main areas of difference between the consolidated financial statements of Omega and Omega OP. The differences between debt, stockholders’ equity and owners’ equity result from differences in the debt or equity issued at the Omega and Omega OP levels. With respect to owners’ equity, the units held by the partners in

Omega OP other than the Parent are accounted for as owners' equity in Omega OP's financial statements and as noncontrolling interests in Omega's financial statements. Although classified differently, total debt and equity of Omega and Omega OP are the same.

We believe combining the quarterly reports on Form 10-Q of Omega and Omega OP into this single report results in the following benefits:

- combined reports better reflect how management and the analyst community view the business as a single operating unit;
- combined reports enhance investors' understanding of Omega and Omega OP by enabling them to view the business as a whole and in the same manner as management;
- combined reports are more efficient for Omega and Omega OP and result in savings in time, effort and expense; and
- combined reports are more efficient for investors by reducing duplicative disclosure and providing a single document for their review.

In order to highlight the differences between Omega and Omega OP, the separate sections in this report for Omega and Omega OP specifically refer to Omega and Omega OP. In the sections that combine disclosure of Omega and Omega OP, this report refers to "we" and "us" actions or holdings as being "our" actions or holdings. Although Omega OP and its subsidiaries hold all of our assets, we believe that reference to "we," "us" or "our" in this context is appropriate because the business is one enterprise and we operate substantially all of our business through Omega OP.

OMEGA HEALTHCARE INVESTORS, INC.

OHI HEALTHCARE PROPERTIES LIMITED PARTNERSHIP

FORM 10-Q

September 30, 2018

TABLE OF CONTENTS

	Page No.
PART I Financial Information	
Item 1. Financial Statements of Omega Healthcare Investors, Inc.:	
<u>Consolidated Balance Sheets</u>	
<u>September 30, 2018 (unaudited) and December 31, 2017</u>	<u>2</u>
<u>Consolidated Statements of Operations (unaudited)</u>	
<u>Three and Nine months ended September 30, 2018 and 2017</u>	<u>3</u>
<u>Consolidated Statements of Comprehensive Income (Loss) (unaudited)</u>	
<u>Three and Nine months ended September 30, 2018 and 2017</u>	<u>4</u>
<u>Consolidated Statement of Changes in Equity (unaudited)</u>	
<u>Nine months ended September 30, 2018</u>	<u>5</u>
<u>Consolidated Statements of Cash Flows (unaudited)</u>	
<u>Nine months ended September 30, 2018 and 2017</u>	<u>6</u>
Financial Statements of OHI Healthcare Properties Limited Partnership:	
<u>Consolidated Balance Sheets</u>	
<u>September 30, 2018 (unaudited) and December 31, 2017</u>	<u>7</u>
<u>Consolidated Statements of Operations (unaudited)</u>	
<u>Three and Nine months ended September 30, 2018 and 2017</u>	<u>8</u>
<u>Consolidated Statements of Comprehensive Income (Loss) (unaudited)</u>	
<u>Three and Nine months ended September 30, 2018 and 2017</u>	<u>9</u>
<u>Consolidated Statement of Changes in Owners' Equity (unaudited)</u>	
<u>Nine months ended September 30, 2018</u>	<u>10</u>
<u>Consolidated Statements of Cash Flows (unaudited)</u>	
<u>Nine months ended September 30, 2018 and 2017</u>	<u>11</u>
<u>Notes to Consolidated Financial Statements</u>	
<u>September 30, 2018 (unaudited)</u>	<u>12</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition</u>	
<u>and Results of Operations</u>	<u>41</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>59</u>
Item 4. <u>Controls and Procedures</u>	<u>59</u>
PART II Other Information	

Item 1.	<u>Legal Proceedings</u>	<u>60</u>
Item 1A.	<u>Risk Factors</u>	<u>60</u>
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>60</u>
Item 6.	<u>Exhibits</u>	<u>61</u>

PART I – FINANCIAL INFORMATION

Item 1 - Financial Statements

OMEGA HEALTHCARE INVESTORS, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

	September 30, 2018 (Unaudited)	December 31, 2017
ASSETS		
Real estate properties		
Real estate investments	\$ 7,700,636	\$ 7,655,960
Less accumulated depreciation	(1,515,846)	(1,376,828)
Real estate investments – net	6,184,790	6,279,132
Investments in direct financing leases – net	163,467	364,965
Mortgage notes receivable – net	708,178	671,232
	7,056,435	7,315,329
Other investments – net	511,668	276,342
Investment in unconsolidated joint venture	32,159	36,516
Assets held for sale – net	17,826	86,699
Total investments	7,618,088	7,714,886
Cash and cash equivalents	9,768	85,937
Restricted cash	1,371	10,871
Accounts receivable – net	336,825	279,334
Goodwill	644,201	644,690
Other assets	31,711	37,587
Total assets	\$ 8,641,964	\$ 8,773,305
LIABILITIES AND EQUITY		
Revolving line of credit	\$ 360,000	\$ 290,000
Term loans – net	900,847	904,670
Secured borrowings – net	-	53,098

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

Senior notes and other unsecured borrowings – net	3,327,393	3,324,390
Accrued expenses and other liabilities	253,560	295,142
Deferred income taxes	14,198	17,747
Total liabilities	4,855,998	4,885,047
Equity:		
Common stock \$.10 par value authorized – 350,000 shares, issued and outstanding – 200,693 shares as of September 30, 2018 and 198,309 as of December 31, 2017	20,069	19,831
Common stock – additional paid-in capital	5,012,544	4,936,302
Cumulative net earnings	2,068,295	1,839,356
Cumulative dividends paid	(3,606,181)	(3,210,248)
Accumulated other comprehensive loss	(32,382)	(30,150)
Total stockholders’ equity	3,462,345	3,555,091
Noncontrolling interest	323,621	333,167
Total equity	3,785,966	3,888,258
Total liabilities and equity	\$ 8,641,964	\$ 8,773,305

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited

(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue				
Rental income	\$ 192,276	\$ 194,063	\$ 579,075	\$ 580,597
Income from direct financing leases	264	614	1,374	31,722
Mortgage interest income	18,396	16,920	51,809	49,173
Other investment income	10,259	7,245	27,883	21,437
Miscellaneous income	657	796	1,791	4,250
Total operating revenues	221,852	219,638	661,932	687,179
Expenses				
Depreciation and amortization	70,711	71,925	210,681	212,268
General and administrative	14,240	11,560	45,952	35,625
Acquisition costs	-	-	-	(22)
Impairment on real estate properties	22,868	17,837	26,685	35,610
Impairment on direct financing leases	-	194,659	15	197,968
(Recovery) provision for uncollectible accounts	(2,000)	11,899	6,363	13,667
Total operating expenses	105,819	307,880	289,696	495,116
Income (loss) before other income and expense	116,033	(88,242)	372,236	192,063
Other income (expense)				
Interest income and other - net	(1,214)	4	496	262
Interest expense	(47,764)	(47,383)	(143,857)	(140,509)
Interest – amortization of deferred financing costs	(2,238)	(2,228)	(6,723)	(7,273)
Interest – refinancing costs	-	-	-	(21,965)
Contractual settlement	-	-	-	10,412
Realized gain on foreign exchange	27	95	20	235
Total other expense	(51,189)	(49,512)	(150,064)	(158,838)
Income (loss) before (loss) gain on assets sold	64,844	(137,754)	222,172	33,225
(Loss) gain on assets sold – net	(5,361)	693	9,248	7,491
Income (loss) from continuing operations	59,483	(137,061)	231,420	40,716
Income tax expense	(804)	(999)	(2,185)	(2,690)
Income (loss) from unconsolidated joint venture	383	545	(254)	1,728
Net income (loss)	59,062	(137,515)	228,981	39,754

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

Net (income) loss attributable to noncontrolling interest	(2,456)	5,837	(9,619)	(1,735)
Net income (loss) available to common stockholders	\$ 56,606	\$ (131,678)	\$ 219,362	\$ 38,019
Earnings per common share available to common stockholders:				
Basic:				
Net income (loss) available to common stockholders	\$ 0.28	\$ (0.67)	\$ 1.10	\$ 0.19
Diluted:				
Net income (loss)	\$ 0.28	\$ (0.67)	\$ 1.10	\$ 0.19
Weighted-average shares outstanding, basic	200,910	197,890	199,773	197,445
Weighted-average shares outstanding, diluted	210,437	206,662	208,905	206,502

See notes to consolidated financial statements.

3

OMEGA HEALTHCARE INVESTORS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

Unaudited

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss)	\$ 59,062	\$ (137,515)	\$ 228,981	\$ 39,754
Other comprehensive (loss) income:				
Foreign currency translation	(3,518)	5,022	(9,802)	19,630
Cash flow hedges	1,196	2,351	7,472	198
Total other comprehensive (loss) income	(2,322)	7,373	(2,330)	19,828
Comprehensive income (loss)	56,740	(130,142)	226,651	59,582
Comprehensive (income) loss attributable to noncontrolling interest	(2,359)	5,524	(9,521)	(2,579)
Comprehensive income (loss) attributable to common stockholders	\$ 54,381	\$ (124,618)	\$ 217,130	\$ 57,003

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Unaudited

(in thousands, except per share amounts)

	Common Stock Par Value	Additional Paid-in Capital	Cumulative Net Earnings	Cumulative Dividends	Accumulated Other Comprehensive Loss	Total Stockholders' Equity	Noncontrolling Interest	Total Equity
Balance at December 31, 2017 (198,309 common shares & 8,772 Omega OP Units)	\$ 19,831	\$ 4,936,302	\$ 1,839,356	\$ (3,210,248)	\$ (30,150)	\$ 3,555,091	\$ 333,167	\$ 3,888,258
Cumulative effect of accounting change (see Note 1)	-	-	9,577	-	-	9,577	423	10,000
Balance at January 1, 2018 (198,309 common shares & 8,772 Omega OP Units)	19,831	4,936,302	1,848,933	(3,210,248)	(30,150)	3,564,668	333,590	3,898,258
Grant of restricted stock to company directors (38 shares at \$30.36 per share)	4	(4)	-	-	-	-	-	-
Stock-based compensation expense	-	12,107	-	-	-	12,107	-	12,107
Vesting/exercising of equity compensation plan, net of tax withholdings (89 shares)	9	(1,663)	-	-	-	(1,654)	-	(1,654)
	126	36,778	-	-	-	36,904	-	36,904

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

Dividend reinvestment and stock purchase plan (1,257 shares at an average of \$29.36 per share)									
Deferred compensation directors (35 shares at \$30.42 per share)	3	191	-	-	-	194	-	194	
Equity Shelf Program (912 shares at \$29.82 per share, net of issuance costs)	91	27,111	-	-	-	27,202	-	27,202	
Common dividends declared (\$1.98 per share)	-	-	-	(395,933)	-	(395,933)	-	(395,933)	
Conversion of Omega OP Units to common stock (53 share at \$32.98 per share)	5	1,722	-	-	-	1,727	-	1,727	
Redemption of Omega OP Units (57 units at \$32.52 per share)	-	-	-	-	-	-	(1,845)	(1,845)	
Omega OP Units distributions	-	-	-	-	-	-	(17,645)	(17,645)	
Comprehensive income:									
Foreign currency translation	-	-	-	-	(9,390)	(9,390)	(412)	(9,802)	
Cash flow hedges	-	-	-	-	7,158	7,158	314	7,472	
Net income	-	-	219,362	-	-	219,362	9,619	228,981	
Total comprehensive income									226,651
Balance at September 30, 2018 (200,693 shares & 8,715 Omega OP Units)	\$ 20,069	\$ 5,012,544	\$ 2,068,295	\$ (3,606,181)	\$ (32,382)	\$ 3,462,345	\$ 323,621	\$ 3,785,960	

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited (in thousands)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities		
Net income	\$ 228,981	\$ 39,754
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	210,681	212,268
Impairment on real estate properties	31,860	35,610
Impairment on direct financing leases	15	197,968
Provision for uncollectible accounts	6,363	13,667
Interest - amortization of deferred financing costs	6,723	17,468
Accretion of direct financing leases	89	(6,139)
Stock-based compensation expense	12,107	11,350
Gain on assets sold – net	(9,248)	(7,491)
Amortization of acquired in-place leases - net	(7,518)	(9,101)
Effective yield receivable on mortgage notes	(889)	(1,558)
Interest paid-in-kind	(4,944)	-
Change in operating assets and liabilities – net:		
Contractual receivables	2,265	(35,418)
Straight-line rent receivables	(46,787)	(13,559)
Lease inducements	(32,315)	1,342
Other operating assets and liabilities	(48,918)	(28,893)
Net cash provided by operating activities	348,465	427,268
Cash flows from investing activities		
Acquisition of real estate	(52,744)	(345,268)
Net proceeds from sale of real estate investments	246,351	69,788
Investments in construction in progress	(98,760)	(69,409)
Investments in direct financing leases	-	(6,951)
Proceeds from sale of direct financing lease	16,947	33,074
Placement of mortgage loans	(62,185)	(29,324)
Collection of mortgage principal	25,612	1,058
Distributions from unconsolidated joint venture	4,407	10,966
Capital improvements to real estate investments	(24,425)	(25,293)
Receipts from insurance proceeds	6,911	-
Investments in other investments	(374,784)	(86,075)
Proceeds from other investments	162,118	45,045
Cash acquired	-	2,341
Net cash used in investing activities	(150,552)	(400,048)

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

Cash flows from financing activities		
Proceeds from credit facility borrowings	1,003,000	1,487,000
Payments on credit facility borrowings	(933,000)	(1,312,000)
Receipts of other long-term borrowings	-	1,346,749
Payments of other long-term borrowings	(2,049)	(1,252,463)
Payments of financing related costs	(8)	(29,198)
Receipts from dividend reinvestment plan	36,904	30,136
Payments for exercised options and restricted stock	(1,654)	(2,120)
Net proceeds from issuance of common stock	27,202	22,196
Dividends paid	(395,738)	(373,424)
Redemption of Omega OP Units	(118)	(48)
Distributions to Omega OP Unit Holders	(17,645)	(16,819)
Net cash used in financing activities	(283,106)	(99,991)
Effect of foreign currency translation on cash, cash equivalents and restricted cash	(476)	409
Decrease in cash, cash equivalents and restricted cash	(85,669)	(72,362)
Cash, cash equivalents and restricted cash at beginning of period	96,808	107,276
Cash, cash equivalents and restricted cash at end of period	\$ 11,139	\$ 34,914
See notes to consolidated financial statements.		

OHI HEALTHCARE PROPERTIES LIMITED PARTNERSHIP

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

	September 30, 2018 (Unaudited)	December 31, 2017
ASSETS		
Real estate properties		
Real estate investments	\$ 7,700,636	\$ 7,655,960
Less accumulated depreciation	(1,515,846)	(1,376,828)
Real estate investments – net	6,184,790	6,279,132
Investments in direct financing leases – net	163,467	364,965
Mortgage notes receivable – net	708,178	671,232
	7,056,435	7,315,329
Other investments – net	511,668	276,342
Investment in unconsolidated joint venture	32,159	36,516
Assets held for sale – net	17,826	86,699
Total investments	7,618,088	7,714,886
Cash and cash equivalents	9,768	85,937
Restricted cash	1,371	10,871
Accounts receivable – net	336,825	279,334
Goodwill	644,201	644,690
Other assets	31,711	37,587
Total assets	\$ 8,641,964	\$ 8,773,305
LIABILITIES AND OWNERS' EQUITY		
Term loan – net	\$ 99,521	\$ 99,423
Secured borrowings – net	-	53,098
Accrued expenses and other liabilities	205,583	226,028
Deferred income taxes	14,198	17,747
Intercompany loans payable	4,536,696	4,488,751
Total liabilities	4,855,998	4,885,047
Owners' Equity:		
General partners' equity	3,462,345	3,555,091
Limited partners' equity	323,621	333,167
Total owners' equity	3,785,966	3,888,258
Total liabilities and owners' equity	\$ 8,641,964	\$ 8,773,305

See notes to consolidated financial statements.

7

OHI HEALTHCARE PROPERTIES LIMITED PARTNERSHIP

CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited

(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue				
Rental income	\$ 192,276	\$ 194,063	\$ 579,075	\$ 580,597
Income from direct financing leases	264	614	1,374	31,722
Mortgage interest income	18,396	16,920	51,809	49,173
Other investment income	10,259	7,245	27,883	21,437
Miscellaneous income	657	796	1,791	4,250
Total operating revenues	221,852	219,638	661,932	687,179
Expenses				
Depreciation and amortization	70,711	71,925	210,681	212,268
General and administrative	14,240	11,560	45,952	35,625
Acquisition costs	-	-	-	(22)
Impairment on real estate properties	22,868	17,837	26,685	35,610
Impairment on direct financing leases	-	194,659	15	197,968
(Recovery) provision for uncollectible accounts	(2,000)	11,899	6,363	13,667
Total operating expenses	105,819	307,880	289,696	495,116
Income (loss) before other income and expense	116,033	(88,242)	372,236	192,063
Other income (expense)				
Interest income and other - net	(1,214)	4	496	262
Interest expense	(47,764)	(47,383)	(143,857)	(140,509)
Interest – amortization of deferred financing costs	(2,238)	(2,228)	(6,723)	(7,273)
Interest – refinancing costs	-	-	-	(21,965)
Contractual settlement	-	-	-	10,412
Realized gain on foreign exchange	27	95	20	235
Total other expense	(51,189)	(49,512)	(150,064)	(158,838)
Income (loss) before (loss) gain on assets sold	64,844	(137,754)	222,172	33,225
(Loss) gain on assets sold – net	(5,361)	693	9,248	7,491
Income (loss) from continuing operations	59,483	(137,061)	231,420	40,716
Income tax expense	(804)	(999)	(2,185)	(2,690)

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

Income (loss) from unconsolidated joint venture	383	545	(254)	1,728
Net income (loss)	\$ 59,062	\$ (137,515)	\$ 228,981	\$ 39,754
Earnings per unit:				
Basic:				
Net income (loss)	\$ 0.28	\$ (0.67)	\$ 1.10	\$ 0.19
Diluted:				
Net income (loss)	\$ 0.28	\$ (0.67)	\$ 1.10	\$ 0.19
Weighted-average Omega OP Units outstanding, basic	209,625	206,662	208,523	206,231
Weighted-average Omega OP Units outstanding, diluted	210,437	206,662	208,905	206,502
See notes to consolidated financial statements.				

8

OHI HEALTHCARE PROPERTIES LIMITED PARTNERSHIP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

Unaudited

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss)	\$ 59,062	\$ (137,515)	\$ 228,981	\$ 39,754
Other comprehensive (loss) income:				
Foreign currency translation	(3,518)	5,022	(9,802)	19,630
Cash flow hedges	1,196	2,351	7,472	198
Total other comprehensive (loss) income	(2,322)	7,373	(2,330)	19,828
Comprehensive income (loss)	\$ 56,740	\$ (130,142)	\$ 226,651	\$ 59,582

See notes to consolidated financial statements.

9

OHI HEALTHCARE PROPERTIES LIMITED PARTNERSHIP

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY

Unaudited

(in thousands)

	General Partners' Omega OP Units	Limited Partners' Omega OP Units	Total Omega OP Units	General Partners' Equity	Limited Partners' Equity	Total Owners' Equity
Balance at December 31, 2017	198,309	8,772	207,081	\$ 3,555,091	\$ 333,167	\$ 3,888,258
Cumulative effect of accounting change (see Note 1)	-	-	-	9,577	423	10,000
Balance at January 1, 2018	198,309	8,772	207,081	3,564,668	333,590	3,898,258
Contributions from partners	2,384	-	2,384	76,480	-	76,480
Distributions to partners	-	-	-	(395,933)	(17,645)	(413,578)
Omega OP Unit redemptions	-	(57)	(57)	-	(1,845)	(1,845)
Comprehensive income						
Foreign currency translation	-	-	-	(9,390)	(412)	(9,802)
Cash flow hedges	-	-	-	7,158	314	7,472
Net income	-	-	-	219,362	9,619	228,981
Total comprehensive income						226,651
Balance at September 30, 2018	200,693	8,715	209,408	\$ 3,462,345	\$ 323,621	\$ 3,785,966

See notes to consolidated financial statements.

OHI HEALTHCARE PROPERTIES LIMITED PARTNERSHIP

CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited (in thousands)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities		
Net income	\$ 228,981	\$ 39,754
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	210,681	212,268
Impairment on real estate properties	31,860	35,610
Impairment loss on direct financing leases	15	197,968
Provision for uncollectible accounts	6,363	13,667
Interest - amortization of deferred financing costs	6,723	17,468
Accretion of direct financing leases	89	(6,139)
Stock-based compensation expense	12,107	11,350
Gain on assets sold – net	(9,248)	(7,491)
Amortization of acquired in-place leases - net	(7,518)	(9,101)
Effective yield receivable on mortgage notes	(889)	(1,558)
Interest paid-in-kind	(4,944)	-
Change in operating assets and liabilities – net:		
Contractual receivables	2,265	(35,418)
Straight-line rent receivables	(46,787)	(13,559)
Lease inducements	(32,315)	1,342
Other operating assets and liabilities	(48,918)	(28,893)
Net cash provided by operating activities	348,465	427,268
Cash flows from investing activities		
Acquisition of real estate	(52,744)	(345,268)
Net proceeds from sale of real estate investments	246,351	69,788
Investments in construction in progress	(98,760)	(69,409)
Investments in direct financing leases	-	(6,951)
Proceeds from sale of direct financing lease	16,947	33,074
Placement of mortgage loans	(62,185)	(29,324)
Collection of mortgage principal	25,612	1,058
Distributions from unconsolidated joint venture	4,407	10,966
Capital improvements to real estate investments	(24,425)	(25,293)
Receipts from insurance proceeds	6,911	-
Investments in other investments	(374,784)	(86,075)
Proceeds from other investments	162,118	45,045
Cash acquired	-	2,341
Net cash used in investing activities	(150,552)	(400,048)
Cash flows from financing activities		
Proceeds from intercompany loans payable to Omega	1,003,000	2,833,749

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

Repayment of intercompany loans payable to Omega	(935,049)	(2,564,463)
Payment of financing related costs incurred by Omega	(8)	(29,198)
Equity contributions from general partners	62,452	50,212
Distributions to general partners	(395,738)	(373,424)
Distributions to limited partners	(17,645)	(16,819)
Redemption of Omega OP Units	(118)	(48)
Net cash used in financing activities	(283,106)	(99,991)
Effect of foreign currency translation on cash, cash equivalents and restricted cash	(476)	409
Decrease in cash, cash equivalents and restricted cash	(85,669)	(72,362)
Cash, cash equivalents and restricted cash at beginning of period	96,808	107,276
Cash, cash equivalents and restricted cash at end of period	\$ 11,139	\$ 34,914

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC. AND OHI HEALTHCARE PROPERTIES LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

September 30, 2018

NOTE 1 – BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Business Overview and Organization

Omega Healthcare Investors, Inc. (“Omega”) was formed as a real estate investment trust (“REIT”) and incorporated in the State of Maryland on March 31, 1992. Omega is structured as an umbrella partnership REIT (“UPREIT”) under which all of Omega’s assets are owned directly or indirectly by, and all of Omega’s operations are conducted directly or indirectly through, its operating partnership subsidiary, OHI Healthcare Properties Limited Partnership (“Omega OP”). Omega OP was formed as a limited partnership and organized in the State of Delaware on October 24, 2014. Unless stated otherwise or the context otherwise requires, the terms the “Company,” “we,” “our” and “us” means Omega and Omega OP, collectively.

The Company has one reportable segment consisting of investments in healthcare-related real estate properties located in the United States (“U.S.”) and the United Kingdom (“U.K.”). Our core business is to provide financing and capital to the long-term healthcare industry with a particular focus on skilled nursing facilities (“SNFs”) and, to a lesser extent, assisted living facilities (“ALFs”), independent living facilities and rehabilitation and acute care facilities. Our core portfolio consists of long-term leases and mortgage agreements. All of our leases are “triple-net” leases, which require the tenants to pay all property-related expenses. Our mortgage revenue derives from fixed rate mortgage loans, which are secured by first mortgage liens on the underlying real estate and personal property of the mortgagor. Our other investment income derives from fixed and variable rate loans, which are either unsecured or secured by the collateral of the borrower.

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”). Omega has exclusive control over Omega OP’s day-to-day management pursuant to the Partnership Agreement. As of September 30, 2018, Omega owned approximately 96% of the issued and outstanding units of partnership interest in Omega OP (“Omega OP Units”), and investors owned approximately 4% of the outstanding Omega OP Units.

Basis of Presentation

The accompanying unaudited consolidated financial statements 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. 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 filed with the SEC on February 23, 2018.

Omega’s 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, and Omega’s net earnings are reduced by the portion of net earnings attributable to noncontrolling interests.

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

Variable Interest Entities

GAAP requires us to identify entities for which control is achieved through means other than voting rights and to determine which business enterprise is the primary beneficiary of variable interest entities (“VIEs”). A VIE is broadly defined as an entity with one or more of the following characteristics: (a) the total equity investment at risk is insufficient to finance the entity’s activities without additional subordinated financial support; (b) as a group, the holders of the equity investment at risk lack (i) the ability to make decisions about the entity’s activities through voting or similar rights, (ii) the obligation to absorb the expected losses of the entity, or (iii) the right to receive the expected residual returns of the entity; or (c) the equity investors have voting rights that are not proportional to their economic interests, and substantially all of the entity’s activities either involve, or are conducted on behalf of, an investor that has disproportionately few voting rights. We may change our original assessment of a VIE upon subsequent events such as the modification of contractual arrangements that affects the characteristics or adequacy of the entity’s equity investments at risk and the disposition of all or a portion of an interest held by the primary beneficiary.

Our variable interests in VIEs may be in the form of equity ownership, leases, guarantees and/or loans with our operators. We analyze our agreements and investments to determine whether our operators or unconsolidated joint venture are VIEs and, if so, whether we are the primary beneficiary.

We consolidate a VIE when we determine that we are its primary beneficiary. We identify the primary beneficiary of a VIE as the enterprise that has both: (i) the power to direct the activities of the VIE that most significantly impact the entity’s economic performance; and (ii) the obligation to absorb losses or the right to receive benefits of the VIE that could be significant to the entity. Factors considered in determining whether we are the primary beneficiary of an entity include: (i) our voting rights, if any; (ii) our involvement in day-to-day capital and operating decisions; (iii) our risk and reward sharing; (iv) the financial condition of the operator or joint venture and (iv) our representation on the VIE’s board of directors. We perform this analysis on an ongoing basis.

As of September 30, 2018, we have not consolidated any VIEs, as we do not have the power to direct the activities of any VIEs that most significantly impact their economic performance and we do not have the obligation to absorb losses or receive benefits of the VIEs that could be significant to the entity. See Note 6 – Variable Interest Entities.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand and highly liquid investments with a maturity date of three months or less when purchased. These investments are stated at cost, which approximates fair value. The majority of our cash, cash equivalents and restricted cash are held at major commercial banks. Certain cash account balances exceed FDIC insurance limits of \$250,000 per account and, as a result, there is a concentration of credit risk related to amounts in excess of the insurance limits. We regularly monitor the financial stability of these financial institutions

and believe that we are not exposed to any significant credit risk in cash, cash equivalents or restricted cash.

Restricted Cash

Restricted cash consists primarily of liquidity deposits escrowed for tenant obligations required by us pursuant to certain contractual terms. Prior to June 1, 2018, restricted cash also included other deposits required by the U.S. Department of Housing and Urban Development (“HUD”) in connection with our mortgage borrowings guaranteed by HUD. For additional information see Note 2 – Properties and Investments and Note 14 – Borrowing Activities and Arrangements.

13

Real Estate Investment Impairment

Management evaluates our real estate investments for impairment indicators at each reporting period, including the evaluation of our assets' useful lives. The judgment regarding the existence of impairment indicators is based on factors such as, but not limited to, market conditions, operator performance including the current payment status of contractual obligations and expectations of the ability to meet future contractual obligations, legal structure, as well as our intent with respect to holding or disposing of the asset. If indicators of impairment are present, management evaluates the carrying value of the related real estate investments in relation to management's estimate of future undiscounted cash flows of the underlying facilities. The estimated future undiscounted cash flows are generally based on the related lease which relates to one or more properties and may include cash flows from the eventual disposition of the asset. In some instances, there may be various potential outcomes for a real estate investment and its potential future cash flows. In these instances, the undiscounted future cash flows used to assess the recoverability are probability-weighted based on management's best estimates as of the date of evaluation. Provisions for impairment losses related to long-lived assets are recognized when expected future undiscounted cash flows based on our intended use of the property are determined to be less than the carrying values of the assets. An adjustment is made to the net carrying value of the real estate investments for the excess of carrying value over fair value. The fair value of the real estate investment is determined based on current market conditions and considers matters such as rental rates and occupancies for comparable properties, recent sales data for comparable properties, and, where applicable, contracts or the results of negotiations with purchasers or prospective purchasers. Additionally, our evaluation of fair value may consider valuing the property as a nursing home as well as alternative uses. All impairments are taken as a period cost at that time, and depreciation is adjusted going forward to reflect the new value assigned to the asset. Management's impairment evaluation process, and when applicable, impairment calculations involve estimation of the future cash flows from management's intended use of the property as well as the fair value of the property. Changes in the facts and circumstances that drive management's assumptions may result in an impairment of the Company's assets in a future period that could be material to the Company's results of operations.

For the three months ended September 30, 2018 and 2017, we recognized impairment on real estate properties of \$22.9 million and \$17.8 million, respectively. For the nine months ended September 30, 2018 and 2017, we recognized impairment on real estate properties of \$26.7 million and \$35.6 million, respectively. For additional information see Note 2 – Properties and Investments.

Allowance for Losses on Mortgages, Other Investments and Direct Financing Leases

The allowances for losses on mortgage notes receivable, other investments and direct financing leases (collectively, our "loans") are maintained at a level believed adequate to absorb potential losses. The determination of the allowances is based on a quarterly evaluation of these loans, including general economic conditions and estimated collectability of loan payments. We evaluate the collectability of our loans based on a combination of factors, including, but not limited to, delinquency status, financial strength of the borrower and guarantors, if applicable, and the value of the underlying collateral. If such factors indicate that there is greater risk of loan charge-offs, additional allowances or

placement on non-accrual status may be required. A loan is impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due as scheduled according to the contractual terms of the loan agreements. Consistent with this definition, all loans on non-accrual status may be deemed impaired. To the extent circumstances improve and the risk of collectability is diminished, we will return these loans to full accrual status. When management identifies potential loan impairment indicators, the loan is written down to the present value of the expected future cash flows. In cases where expected future cash flows are not readily determinable, the loan is written down to the fair value of the underlying collateral, if applicable. We may base our valuation on a loan's observable market price, if any, or the fair value of collateral, net of sales costs, if the repayment of the loan is expected to be provided solely by the sale of the collateral.

14

We account for impaired loans using (a) the cost-recovery method, and/or (b) the cash basis method. We generally utilize the cost-recovery method for impaired loans for which impairment reserves were recorded. We utilize the cash basis method for impaired loans for which no impairment reserves were recorded because the net present value of the discounted cash flows expected under the loan and/or the underlying collateral supporting the loan were equal to or exceeded the book value of the loan. Under the cost-recovery method, we apply cash received against the outstanding loan balance prior to recording interest income. Under the cash basis method, we apply cash received to principal or interest income based on the terms of the agreement. As of September 30, 2018 and December 31, 2017, we had \$81.0 million and \$177.5 million, respectively, of reserves on our loans. For additional information see Note 3 – Direct Financing Leases, Note 4 – Mortgage Notes Receivable and Note 5 – Other Investments.

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 on an interim basis, we assess qualitative factors such as a significant decline in real estate valuations, current macroeconomic conditions, state of the equity and capital markets and our overall financial and operating performance or a significant decline in the value of our market capitalization, 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. On an annual basis during the fourth quarter of each fiscal year, or on an interim basis if we conclude it is more likely than not that the fair value of the reporting unit is less than its carrying value, we perform a two-step goodwill impairment test to identify potential impairment and measure the amount of impairment we will recognize, if any.

Noncontrolling Interests

Noncontrolling interests is the portion of equity not attributable to the respective reporting entity. 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, or owners' equity on our Consolidated Balance Sheets. We include net income attributable to the noncontrolling interests in net income in our Consolidated Statements of Operations.

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.

The noncontrolling interest for Omega represents the outstanding Omega OP Units held by outside investors.

Foreign Operations

The U.S. dollar is the functional currency for our consolidated subsidiaries operating in the U.S. The functional currency for our consolidated subsidiaries operating in the U.K. is the British Pound (“GBP”). For our consolidated subsidiaries whose functional currency is not the U.S. dollar (“USD”), we translate their financial statements into the USD. We translate assets and liabilities at the exchange rate in effect as of the financial statement date. Revenue and expense accounts are translated using an average exchange rate for the period. Gains and losses resulting from translation are included in Omega OP’s owners’ equity and Omega’s accumulated other comprehensive loss (“AOCL”), as a separate component of equity and a proportionate amount of gain or loss is allocated to noncontrolling interests.

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 in which case the adjustments are included in Omega OP’s owners’ equity and Omega’s AOCL and a proportionate amount of gain or loss is allocated to noncontrolling interests.

Derivative Instruments

Cash flow hedges

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 the 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 is 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 in qualifying cash flow hedging relationships, the gain or loss on the derivative is recognized in Omega OP's owners' equity and Omega's AOCL as a separate component of equity and a proportionate amount of gain or loss is allocated to noncontrolling interest. We formally document all relationships between hedging instruments and hedged items, as well as our 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 liabilities or assets on 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 September 30, 2018 and December 31, 2017, \$8.9 million and \$1.5 million, respectively, of qualifying cash flow hedges were recorded at fair value in other assets on our Consolidated Balance Sheets.

Net investment hedge

The Company is exposed to fluctuations in the GBP against its functional currency, the USD, relating to its investments in healthcare-related real estate properties located in the U.K. The Company uses a nonderivative, GBP-denominated term loan to manage its exposure to fluctuations in the GBP-USD exchange rate. The foreign currency transaction gain or loss on the nonderivative hedging instrument that is designated and qualifies as a net investment hedge is reported in Omega OP's owners' equity and Omega's AOCL in 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 rent 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, modification, or renewal of the lease, and are amortized as a reduction of rental revenue over the non-cancellable lease term.

On a quarterly basis, and more frequently as appropriate, 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 any. 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 loan 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. If the accounts receivable balance is subsequently deemed uncollectible, the receivable and allowance for doubtful account balance are written off.

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

	September 30, 2018	December 31, 2017
	(in thousands)	
Contractual receivables	\$ 36,917	\$ 43,258
Effective yield interest receivables	12,562	11,673
Straight-line rent receivables	241,113	216,054
Lease inducements	49,221	16,812
Allowance	(2,988)	(8,463)
Accounts receivable – net	\$ 336,825	\$ 279,334

During the first quarter of 2018, we wrote-off approximately \$7.8 million of straight-line rent receivables to provision for uncollectible accounts, as a result of facility transitions to other operators.

During the second quarter of 2018, we placed two of our operators on a cash basis for revenue recognition purposes and wrote-off approximately \$2.8 million of straight-line rent receivables and reserved approximately \$0.6 million of contractual receivables to provision for uncollectible accounts related to these two operators. The provision for uncollectible accounts was offset by a recovery of approximately \$2.8 million.

During the third quarter of 2018, the provision for uncollectible accounts was offset by a recovery of approximately \$2.0 million.

During the first quarter of 2018, we paid an existing operator approximately \$50 million in exchange for a reduction of such operator's participation in an in-the-money purchase option. As a result, we recorded an approximate \$28 million lease inducement that will be amortized as a reduction to rental income over the remaining term of the lease. The remaining \$22 million was recorded as a reduction to the initial contingent liability which was included in accrued expenses and other liabilities on our Consolidated Balance Sheets.

Reclassification

Certain prior quarter amounts have been reclassified to conform to the current quarter presentation.

17

Accounting Pronouncements Adopted in 2018

In 2014, the Financial Accounting Standards Board (“FASB”) issued 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. In addition, the FASB issued targeted updates to clarify specific implementation issues of ASU 2014-09. These updates included ASU 2016-08, Principal versus Agent Considerations (Reporting Revenue Gross versus Net), ASU 2016-10, Identifying Performance Obligations and Licensing, and ASU 2016-12, Narrow-Scope Improvements and Practical Expedients. As a result of adopting ASU 2014-09 and its updates on January 1, 2018, the Company recognized \$10.0 million of deferred gain resulting from the sale of facilities to a third-party in December 2017 through opening equity on January 1, 2018. The Company adopted ASU 2014-09 and its subsequent updates in accordance with the modified retrospective approach. The adoption of ASU 2014-09 and its related updates did not have a material impact on our consolidated financial statements, as a substantial portion of our revenue consists of rental income from leasing arrangements and interest income from loan arrangements, both of which are specifically excluded from ASU 2014-09 and its updates.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities (“ASU 2017-12”). The purpose of this updated guidance is to better align the financial reporting for hedging activities with the economic objectives of those activities. The transition guidance provides companies with the option of early adopting the new standard using a modified retrospective transition method in any interim period after issuance of the update, or alternatively requires adoption for fiscal years beginning after December 15, 2018. This adoption method will require the Company to recognize the cumulative effect of initially applying ASU 2017-12 as an adjustment to accumulated other comprehensive income (loss) with a corresponding adjustment to the opening balance of equity as of the beginning of the fiscal year that an entity adopts the update. On January 1, 2018, the Company adopted ASU 2017-12 using the modified retrospective transition method. As a result of adopting the standard, the Company made certain adjustments to its existing hedge designation documentation for active hedging relationships in order to take advantage of specific provisions in the new guidance and to fully align its documentation with ASU 2017-12. The adoption of ASU 2017-12 did not have a material impact on our consolidated financial statements.

Recent Accounting Pronouncements - Pending Adoption

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. As a result of the pending adoption of ASU 2016-02, the Company may be

required to record real estate tax revenues and an equal and offsetting real estate tax expense, as a result of our operators paying real estate taxes on our behalf, subject to further amendment. In addition, the Company will be required to recognize a right of use asset and corresponding lease liability for assets that the Company leases. In July 2018, the FASB issued ASU 2018-11, Leases: Targeted Improvements (“ASU 2018-11”) to simplify the implementation of ASU 2016-02. This targeted improvement permits the adoption of ASU 2016-02 at the adoption date instead of the earliest comparative period presented in the financial statements and a practical expedient permitting lessors to not separate nonlease components from the associated lease component if certain conditions are met. Upon adoption of ASU 2016-02 and its updates, we intend to transition to the new leasing accounting standard on January 1, 2019, without modifying our prior year balance sheet and recognizing the cumulative-effect adjustment to opening equity. We continue to evaluate the other impacts of adopting ASU 2016-02 and its updates on our consolidated financial statements.

18

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326) (“ASU 2016-13”), which changes the impairment model for most financial assets. The new model uses a forward-looking expected loss method, which will generally result in earlier recognition of allowances for losses. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019 and early adoption is permitted for annual and interim periods beginning after December 15, 2018. We are currently evaluating the impact of adopting ASU 2016-13 on our consolidated financial statements.

NOTE 2 – PROPERTIES AND INVESTMENTS

Leased Property

Our leased real estate properties consisted of 720 SNFs, 116 ALFs, 14 specialty facilities and one medical office building at September 30, 2018. These properties are leased under provisions of single or master operating leases with initial terms typically ranging from five to 15 years, plus renewal options. Also see Note 3 – Direct Financing Leases for information regarding additional properties accounted for as direct financing leases. Substantially all of our operating 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 between 2.0% and 3.0%; (ii) an increase based on the change in pre-determined formulas from year to year (e.g., 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.

A summary of our investment in leased real estate properties is as follows:

	September 30, 2018	December 31, 2017
	(in thousands)	
Buildings	\$ 6,064,061	\$ 6,098,119
Land	785,040	795,874
Furniture, fixtures and equipment	446,036	440,737
Site improvements	246,836	227,150
Construction in progress	158,663	94,080
Total real estate investments	7,700,636	7,655,960
Less accumulated depreciation	(1,515,846)	(1,376,828)

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

Real estate investments - net \$ 6,184,790 \$ 6,279,132

The following table summarizes the significant acquisitions that occurred in 2018:

Period	Number of		Country/ State	Total Investment (in millions)	Land	Building & Site Improvements	Furniture & Fixtures	Initial Annual Cash Yield(3)	
	SNF	ALF							
Q1	-	1	UK	\$ 4.0 (1)	\$ 0.9	\$ 2.9	\$ 0.2	8.5	%
Q1	-	1	UK	5.7 (2)	1.4	4.1	0.2	8.5	%
Q1	1	-	PA	7.4	1.6	5.4	0.4	9.5	%
Q1	1	-	VA	13.2	2.4	10.5	0.3	9.5	%
Q2	5	-	TX	22.8	0.5	20.4	1.9	9.5	%
Total	7	2		\$ 53.1	\$ 6.8	\$ 43.3	\$ 3.0		

- (1) Omega recorded a non-cash deferred tax liability of approximately \$0.4 million in connection with this acquisition.
- (2) Omega recorded a non-cash deferred tax liability of approximately \$0.2 million in connection with this acquisition.
- (3) The cash yield is based on the purchase price.

For the nine months ended September 30, 2018, we acquired two parcels of land (not reflected in the table above) for approximately \$3.5 million with the intent of building new facilities for our existing operators.

During the third quarter of 2018, we transitioned 21 SNFs and one ALF subject to direct financing leases (not reflected in the table above) with a net carrying value of approximately \$184.5 million from an existing operator to five existing operators subject to single or master operating leases with an initial annual cash yield of approximately 9%. We recorded approximately \$184.5 million of real estate investments consisting of land (\$11.2 million), building and site improvements (\$159.1 million) and furniture and fixtures (\$14.2 million) in partial satisfaction of the direct financing lease. In connection with these transitions, we provided the new operators with working capital loans with a maximum borrowing capacity of \$35.7 million, commitments to fund capital improvements up to \$10.6 million and indemnities with a maximum funding of \$7.4 million. Claims against these indemnities must occur within 18 months to 36 months. These indemnities were provided to the new operators upon transition and would be utilized in the event that the prior operator does not perform under its transition agreements. The Company does not expect to fund a material amount under these indemnity agreements.

Asset Sales, Impairments and Other

During the first quarter of 2018, we sold 14 facilities (five of which were previously held for sale at December 31, 2017) subject to operating leases for approximately \$74.7 million in net cash proceeds recognizing a gain on sale of approximately \$17.5 million. In addition, we recorded impairments on real estate properties of approximately \$4.9 million on 17 facilities (16 of which were subsequently reclassified to assets held for sale).

During the second quarter of 2018, we sold 45 facilities and one ancillary building (33 of which were previously held for sale at March 31, 2018) subject to operating leases for approximately \$147.2 million in net cash proceeds recognizing a loss on sale of approximately \$2.9 million. In addition, we recorded impairments of approximately \$4.1 million on nine facilities (three of which were subsequently reclassified to assets held for sale). Our second quarter 2018 impairments were offset by \$5.2 million of insurance proceeds received related to a facility destroyed in November 2017.

Of the 45 facilities sold during the second quarter of 2018, we sold 12 SNFs on June 1, 2018 (12 of which were previously held for sale at March 31, 2018) secured by HUD mortgages to subsidiaries of an existing operator. The Company sold the 12 SNF facilities with carrying values of approximately \$62 million for approximately \$78 million which consisted of \$25 million of cash consideration and their assumption of approximately \$53 million of our HUD mortgages. See Note 14 – Borrowing Activities and Arrangements for additional details. Simultaneously, subsidiaries of the operator assumed our HUD restricted cash accounts, deposits and escrows. The Company recorded a gain on sale of approximately \$11 million after approximately \$5 million of closing and other transaction related costs. In connection with this sale, we provided a principal of an existing operator an unsecured loan of approximately \$39.7 million. See Note 5 – Other Investments for details.

During the third quarter of 2018, we sold five facilities and one ancillary building (one of which was previously held for sale at June 30, 2018) subject to operating leases for approximately \$24.4 million in net cash proceeds recognizing a loss on sale of approximately \$5.4 million. In addition, we recorded impairments of approximately \$22.9 million on eight facilities (five of which were subsequently reclassified to assets held for sale).

Our recorded impairments were primarily the result of decisions to exit certain non-strategic facilities and/or operators. We reduced the net book value of the impaired facilities to their estimated fair values or, with respect to the facilities reclassified to assets held for sale, to their estimated fair values less costs to sell. To estimate the fair value of the facilities, we utilized a market approach which considered binding sale agreements (a Level 1 input) and/or Level 3 inputs which generally consist of non-binding offers from unrelated third parties. Also see Note 8 – Assets Held For Sale.

20

NOTE 3 – DIRECT FINANCING LEASES

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

	September 30, 2018	December 31, 2017
	(in thousands)	
Minimum lease payments receivable	\$ 28,577	\$ 64,893
Less unearned income	(16,839)	(37,633)
Investment in non-Orianna direct financing leases	11,738	27,260
Investment in Orianna direct financing leases	227,776	509,877
Less allowance for loss on Orianna direct financing leases	(76,047)	(172,172)
Investment in direct financing leases – net	\$ 163,467	\$ 364,965
Properties subject to direct financing leases	18	41
Number of direct financing leases	3	5

The following minimum rents are due under our direct financing leases for the remainder of 2018 and the subsequent five years (in thousands):

2018(1)	2019(1)	2020(1)	2021(1)	2022(1)	2023(1)
\$ 294	\$ 1,166	\$ 1,170	\$ 1,084	\$ 1,106	\$ 1,128

- (1) Amounts due from Orianna have been excluded from the contractual minimum rent payments due under our direct financing leases as the facilities are expected to be transitioned or sold. See below for additional

information.

In June 2018, we sold one SNF with a carrying value of approximately \$15.4 million subject to a direct financing lease to an unrelated third-party for approximately \$15.4 million.

Orianna Direct Financing Lease and Operating Lease

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” which does business as “Orianna Health Systems” and is herein referred to as “Orianna”), pursuant to four 50-year master leases providing for contractual 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 16 facilities remaining under our master lease with Orianna as of September 30, 2018 are located in South Carolina (14), Georgia (1) and Tennessee (1). Our recorded investment in this direct financing lease, net of the \$76.0 million allowance, amounted to \$151.7 million as of September 30, 2018. We have not recognized any direct financing lease income from Orianna for the period from July 1, 2017 through September 30, 2018.

Orianna has not satisfied the contractual payments due under the terms of the remaining direct financing lease or the separate operating lease covering four facilities with the Company and the collectability of future amounts due is uncertain.

21

In March 2018, Orianna commenced voluntary Chapter 11 proceedings in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division (the “Bankruptcy Court”). As described in Orianna’s filings with the Bankruptcy Court, we entered into a Restructuring Support Agreement (“RSA”) that was expected to form the basis for Orianna’s restructuring. The RSA provided for the recommencement, in April 2018, of partial rent payments at \$1.0 million per month and established a specific timeline for the implementation of Orianna’s planned restructuring. The RSA provided for the transition of 23 facilities to new operators and the potential sale of the remaining 19 facilities subject to the plan of reorganization as approved by the Bankruptcy Court. On July 25, 2018, Omega terminated the restructuring support agreement with its tenant, 4 West Holdings, and the sponsor of Orianna’s restructuring plan. During the third quarter of 2018, we transitioned 22 facilities with a net carrying value of approximately \$184.5 million from Orianna to five existing operators with annual contractual rent of approximately \$16.8 million. See Note 2 – Properties and Investments. In addition, we sold Orianna’s headquarters with a carrying value of approximately \$1.5 million to an unrelated third-party for approximately \$1.5 million.

To provide liquidity to Orianna during their Chapter 11 proceedings, we entered into a senior secured superpriority debtor-in-possession (“DIP”) credit agreement with Orianna for a revolving credit and term loan DIP facility of up to \$30 million, which DIP facility was approved by the Bankruptcy Court on an interim basis on March 9, 2018 and on a final basis on May 14, 2018. On July 23, 2018, we notified Orianna that it was in default under the DIP facility. See Note 5 – Other Investments.

In 2017, we recorded an allowance for loss on direct financing leases of \$172.2 million with Orianna covering 38 facilities in the Southeast region of the U.S. The amount of the allowance was determined based on the fair value of the facilities subject to the direct financing lease. To estimate the fair value of the underlying collateral, we utilized an income approach and Level 3 inputs. Our estimate of fair value assumed annual rents ranging between \$32.0 million and \$38.0 million, rental yields between 9% and 10%, current and projected operating performance of the facilities, coverage ratios and bed values. Such assumptions are subject to change based on changes in market conditions and the ultimate resolution of this matter. Such changes could be significantly different than the currently estimated fair value and such differences could have a material impact on our financial statements. During the third quarter of 2018, we reduced our investment in the Orianna direct financing leases and the corresponding allowance for loss by approximately 55%, as a result of the transition of 22 facilities to five existing operators.

In addition to our direct financing leases with Orianna, we own four facilities and lease them to Orianna under a master lease which expires in 2026. The four facility lease is being accounted for as an operating lease. We have not recognized any income on this operating lease for the period from July 1, 2017 through September 30, 2018, as Orianna did not pay the contractual amounts due and collectability is uncertain. Our recorded investment in the four facilities subject to this operating lease was \$36.8 million as of September 30, 2018. Subsequent to September 30, 2018, Orianna rejected the lease of these four facilities and as a result we expect to transition these facilities to other existing operators.

NOTE 4 – MORTGAGE NOTES RECEIVABLE

As of September 30, 2018, mortgage notes receivable relate to six fixed rate mortgage notes on 53 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 six states that are operated by five independent healthcare operating companies. We monitor compliance with mortgages and when necessary have initiated collection, foreclosure and other proceedings with respect to certain outstanding mortgage notes.

Mortgage interest income is recognized as earned over the terms of the related mortgage notes, typically 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 the application of security deposits.

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

	September 30, 2018	December 31, 2017
	(in thousands)	
Mortgage note due 2027; interest at 10.18%	\$ 112,500	\$ 112,500
Mortgage notes due 2029; interest at 9.86% (1)	534,780	476,320
Other mortgage notes outstanding (2)	65,803	87,317
Mortgage notes receivable, gross	713,083	676,137
Allowance for loss on mortgage notes receivable (3)	(4,905)	(4,905)
Total mortgages — net	\$ 708,178	\$ 671,232

- (1) Approximates the weighted average interest rate on 39 facilities. Two notes totaling approximately \$18.7 million are construction mortgages maturing in 2018 and 2019. The remaining loan balance matures in 2029.
- (2) Other mortgage notes outstanding have a weighted average interest rate of 11.25% per annum and maturity dates between 2018 and 2028.
- (3) The allowance for loss on mortgage notes receivable relates to one mortgage with an operator. The carrying value and fair value of the mortgage note receivable is approximately \$1.5 million at September 30, 2018 and December 31, 2017.

\$112.5 Million of Mortgage Note due 2027

On January 17, 2014, we entered into a \$112.5 million first mortgage loan with an existing operator. The loan is secured by seven SNFs and two ALFs located in Pennsylvania and Ohio, respectively. The mortgage is cross-defaulted and cross-collateralized with our existing master lease with the operator. In March 2018, we extended the maturity date to January 31, 2027 and provided an option to extend the maturity for a five year period through January 31, 2032 and a second option to extend the maturity through September 30, 2034.

\$534.8 Million of Mortgage Notes due 2029

On June 30, 2014, we entered into a mortgage loan agreement with Ciena Healthcare (“Ciena”) to refinance/consolidate \$117 million in existing mortgages with maturity dates ranging from 2021 to 2023 on 17 facilities into one mortgage and simultaneously provide mortgage financing for an additional 14 facilities. The \$415 million mortgage (the “Master Mortgage”) matures in 2029 and is secured by 30 facilities. The Master Mortgage note bore an initial interest rate of 9.0% per annum which increases each year by 0.225% per annum. As of September 30, 2018, the outstanding principal balance of the Master Mortgage note is approximately \$409.6 million and the interest rate is 9.9% per annum.

Subsequent to June 30, 2014, the Company amended its Master Mortgage with Ciena to provide for additional borrowings in the form of incremental facility mortgages, construction and/or improvement mortgages with maturity dates in 2018, 2019 and 2029 with initial annual interest rates ranging between 8.5% and 10% and fixed annual escalators of 2% or 2.5% over the prior year’s interest rate, or a fixed increase of 0.225% per annum. As of September 30, 2018 the outstanding principal balance of these mortgage notes are approximately \$81.0 million.

In June 2018, we amended the Master Mortgage with the addition of a \$44.7 million mortgage note related to five SNFs located in Michigan. The mortgage note matures on June 30, 2029 and bears an initial annual interest rate of 9.5% which increases each year by 0.225%. As of September 30, 2018 the outstanding principal balance of this mortgage note is approximately \$44.2 million. Additionally, the Company committed to fund an additional \$9.6 million to Ciena if certain performance metrics are achieved by the portfolio.

The mortgage notes with Ciena are cross-defaulted and cross-collateralized with our existing master lease and other investment notes with the operator.

Mortgage notes paid off

In January 2018, one of our operators repaid two construction loans with a total outstanding balance of approximately \$21.2 million. These construction loans bore interest at 8.75%.

NOTE 5 – OTHER INVESTMENTS

A summary of our other investments is as follows:

	September 30, 2018	December 31, 2017
	(in thousands)	
Other investment notes due 2018 - 2022; interest at 9.64% (1)	\$ 40,242	\$ 15,115
Other investment notes due 2019 - 2023; interest at 11.13% (1)	22,120	40,985
Other investment note due 2019; interest at 9.35%	131,675	-
Other investment notes due 2020; interest at 13.06% (1)	69,590	49,490
Other investment notes due 2021 - 2024; interest at 6.00%	39,423	7,000
Other investment notes due 2023; interest at 7.32% (1)	65,000	64,050
Other investment note due 2023; interest at 12.00%	59,389	49,708
Other investment notes due 2024 - 2025; interest at 8.41% (1)	45,287	31,987
Other investment notes outstanding (2)	38,942	18,380
Other investments, gross	511,668	276,715
Allowance for loss on other investments (3)	-	(373)
Total other investments	\$ 511,668	\$ 276,342

- (1) Approximate weighted average interest rate as of September 30, 2018.
- (2) Other investment notes have a weighted average interest rate of 8.60% and maturity dates through 2029.
- (3) The allowance for loss on other investments relates to one loan with an operator that was fully reserved at December 31, 2017 and written off during the second quarter of 2018.

Other investment notes due 2018 - 2022

In March 2018, we agreed to provide senior secured superpriority DIP financing to Orianna consisting of a \$14.2 million term loan and a \$15.8 million revolving credit facility. The DIP financing has been approved by the Bankruptcy Court. The DIP financing is secured by a security interest in and liens on substantially all of Orianna's existing and future real and personal property. The \$14.2 million term loan bears interest at 1-month LIBOR plus 5.5% per annum and matured on September 30, 2018. Orianna has borrowed the full amount of the term loan to repay their previous secured working capital lender. As of September 30, 2018, approximately \$14.2 million is outstanding on this term loan. The \$15.8 million revolving credit facility bears interest at 1-month LIBOR plus 9.0% per annum

and matured on September 30, 2018. The borrowings under the revolving credit facility are to be used for general business expenses and other uses permitted under the loan documents. As of September 30, 2018, approximately \$10.8 million is outstanding on this revolving credit facility.

On July 23, 2018, Omega notified Orianna that it was in default under the DIP facility and, as a result of such default, Omega (a) declared the amounts owing under the DIP facility to be immediately due and payable, (b) terminated the DIP facility and any further commitment of Omega to extend credit to Orianna under the DIP facility, and (c) restricted Orianna's use of cash collateral solely to payment of those amounts contained in a budget approved by Omega. Omega also informed Orianna that while Omega did not (as of such date) intend to immediately collect amounts owing under the DIP facility, Omega may at any time in the future exercise further rights and remedies under the DIP facility.

In May 2017, we provided Orianna an \$18.8 million maximum borrowing secured revolving working capital loan that bears interest at 9% per annum (with one-half (1/2) of all accrued interest to be paid-in-kind and added to the loan balance) and matures on April 30, 2022. This revolving working capital loan has a default rate of 5% per annum.

As of September 30, 2018, approximately \$15.2 million is outstanding on this revolving working capital loan. Pursuant to the Bankruptcy Court's interim order approving the DIP financing, Orianna is obligated to pay one-half (1/2) of all accrued post-bankruptcy interest payable on this revolving working capital loan at the default rate. As of September 30, 2018, our total other investments outstanding with Orianna was approximately \$40.2 million.

Other investment note due 2019

On September 28, 2018, we provided a \$131.3 million secured term loan to an unrelated third party. The loan is secured by a collateral assignment of mortgages covering seven SNFs, three independent living facilities and one ALF. The loan bears interest at 9.35% per annum and matures on February 28, 2019, subject to a one-time 90-day extension. The loan requires monthly interest payments with the principal balance due at maturity. The borrower used the proceeds to repay existing indebtedness and pay a one-time distribution to its equity holders. In connection with this loan we incurred approximately \$0.4 million of origination costs which are deferred and recognized over the term of the loan. The outstanding balance on this loan was \$131.7 million including origination costs at September 30, 2018.

Other investment notes due 2020

On July 29, 2016, we provided Genesis HealthCare, Inc. (“Genesis”) a \$48.0 million secured term loan bearing interest at LIBOR with a floor of 1% plus 13% maturing on July 29, 2020. The \$48.0 million term loan (and the \$16.0 million term loan discussed below) is secured by a perfected first priority lien on and security interest in certain collateral of Genesis. The term loan required monthly principal payments of \$0.25 million through July 2019, and \$0.5 million from August 2019 through maturity. In addition, a portion of the monthly interest accrued to the outstanding principal balance of the loan. In November 2017, we provided Genesis forbearance through February 2018. The forbearance allowed for the deferral of principal payments and permitted Genesis to accrue all interest due to the outstanding principal balance of the loan.

On March 6, 2018, we amended certain terms of the \$48.0 million secured term loan. As of February 22, 2018, the \$48.0 million term loan bears interest at a fixed rate of 14% per annum, of which 9% per annum will be paid-in-kind. Additionally, the amended term loan does not require monthly payments of principal. All principal and accrued and unpaid interest will be due at maturity on July 29, 2020. As of September 30, 2018, approximately \$53.2 million is outstanding on this term loan.

Also on March 6, 2018, we provided Genesis an additional \$16.0 million secured term loan bearing interest at a fixed rate of 10% per annum, of which 5% per annum will be paid-in-kind and matures on July 29, 2020. As of September 30, 2018, approximately \$16.4 million is outstanding on this term loan. As of September 30, 2018, our total other investments outstanding with Genesis was approximately \$69.6 million.

Other investment note due 2021

Simultaneously with the sale of 12 SNFs to subsidiaries of an existing operator we provided a principal of the existing operator a \$39.7 million unsecured loan bearing interest at 6% per annum that matures on May 31, 2021. The loan requires quarterly principal payments of \$0.6 million commencing on October 1, 2018 and additional quarterly principal payments of \$0.3 million in the future. The borrower has one option to extend the loan to May 31, 2024 subject to an extension fee. A \$7.0 million loan provided to the same principal in 2017 was repaid with proceeds from the \$39.7 million loan.

On August 1, 2018, we amended the \$39.7 million unsecured loan mentioned above to provide an additional \$5.1 million unsecured loan to fund a lease termination fee in connection with the sale of two facilities. The \$5.1 million unsecured loan bears interest at 6% per annum and matures on May 31, 2024. The lease termination fee has been deferred and is being recognized over the remaining term of the lease with this operator. As of September 30, 2018, approximately \$39.4 million is outstanding on this unsecured loan.

25

Other investment note due 2023

On February 26, 2016, we acquired and funded a \$50.0 million mezzanine loan at a discount of approximately \$0.75 million. In May 2018, the Company amended the mezzanine loan with the borrower which is secured by an equity interest in subsidiaries of the borrower. As part of the refinancing, the Company increased the mezzanine loan by \$10.0 million, extended the maturity date to May 31, 2023 and fixed the interest rate at 12% per annum. The mezzanine loan requires semi-annual principal payments of \$2.5 million commencing December 31, 2018. As of September 30, 2018, our total other investments outstanding with this borrower was approximately \$59.4 million. In connection with the amendment, the Company recognized fees of approximately \$1.1 million of which \$0.5 million was paid at closing with the remainder due at maturity. The discount and loan fees are deferred and are being recognized on an effective basis over the term of the loan.

Other investment note due 2024-2025

On September 30, 2016, we acquired and amended a term loan with a fair value of approximately \$37.0 million with Agemo Holdings LLC (“Agemo” an entity formed in May 2018 to silo the leases and loans formerly held by Signature Healthcare). A \$5.0 million tranche of the term loan that bore interest at 13% per annum was repaid in August 2017. The remaining \$32.0 million tranche of the term loan bears interest at 9% per annum and currently matures on December 31, 2024. The \$32.0 million term loan (and the \$25.0 million working capital loan discussed below) is secured by a security interest in the collateral of Agemo.

On May 7, 2018, the Company provided Agemo a \$25.0 million secured working capital loan bearing interest at 7% per annum that matures on April 30, 2025. The proceeds of the working capital loan are for paying operating expenses, settlement payments, fees, taxes and other costs approved by the Company. As of September 30, 2018, approximately \$13.3 million is outstanding on this working capital loan. Our total loans outstanding with Agemo at September 30, 2018 approximate \$45.3 million. On May 7, 2018, the Company also provided principals of Agemo a one year unsecured \$2.8 million loan. The proceeds were used to pay down the Company’s contractual receivables outstanding.

Other investments note

On December 28, 2017, we provided \$10.0 million of financing to a third-party to acquire ten SNFs previously owned by us. The loan bears interest at 10% per annum and requires principal payments of \$5.0 million in December 2018, \$2.0 million in December 2019 and \$3.0 million at maturity in December 2020. In March 2018, the third-party buyer repaid \$5.0 million related to this financing.

NOTE 6 – VARIABLE INTEREST ENTITIES

As of September 30, 2018, Orianna and Agemo are VIEs. Below is a summary of our assets and liabilities associated with each operator as of September 30, 2018:

	Operator	
	Orianna	Agemo
	(in thousands)	
Assets		
Real estate investments - net	\$ 36,778	\$ 415,632
Investments in direct financing leases - net	151,729	-
Other investments - net	40,242	45,287
Contractual receivables - net	236	17,593
Straight-line rent receivables	-	31,447
Lease inducement	-	1,323
Above market lease	-	3
Subtotal	228,985	511,285
Liabilities		
Letters of credit	-	(9,253)
Subtotal	-	(9,253)
Collateral		
Personal guarantee	-	(15,000)
Other collateral	(213,743)	(415,632)
Subtotal	(213,743)	(430,632)
Maximum exposure to loss	\$ 15,242	\$ 71,400

In determining our maximum exposure to loss from these VIEs, we considered the underlying value of the real estate subject to leases with these operators and other collateral, if any, supporting our other investments, which may include accounts receivable, security deposits, letters of credit or personal guarantees, if any. See Note 5 – Other Investments regarding the terms of other investments with these two operators and Note 16 – Commitments and Contingencies regarding our commitment to provide capital expenditure funding to our operators which includes Agemo.

The table below reflects our total revenues from Orianna and Agemo for the three and nine months ended September 30, 2018:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	Operator Orianna	Agemo	Operator Orianna	Agemo
	(in thousands)			
Revenue				
Rental income	\$ -	\$ 14,810	\$ -	\$ 44,521
Other investment income	1,058	973	2,721	2,521
Total	\$ 1,058	\$ 15,783	\$ 2,721	\$ 47,042

NOTE 7 – INVESTMENT IN UNCONSOLIDATED JOINT VENTURE

On November 1, 2016, we invested approximately \$50.0 million for an approximate 15% ownership interest in a joint venture operating as Second Spring Healthcare Investments. The other approximate 85% interest is owned by affiliates of Lindsey Goldberg LLC. We account for our investment in the joint venture using the equity method. On November 1, 2016, the joint venture acquired 64 SNFs for approximately \$1.1 billion and leased them to Genesis. During the second quarter of 2018, the joint venture sold 12 SNF facilities subject to an operating lease for approximately \$149.3 million in net cash proceeds and recognized a loss on sale of approximately \$4.4 million. During the third quarter of 2018, the joint venture sold one SNF facility subject to an operating lease for approximately \$14.7 million in net cash proceeds and recognized a loss on sale of approximately \$0.2 million.

We receive asset management fees from the joint venture for services provided. For the three months ended September 30, 2018 and 2017, we recognized \$0.5 million of asset management fees in each period. For the nine months ended September 30, 2018 and 2017, we recognized \$1.5 million of asset management fees in each period. These fees are included in miscellaneous income in the accompanying Consolidated Statements of Operations. The accounting policies for the unconsolidated joint venture are the same as those of the Company.

NOTE 8 – ASSETS HELD FOR SALE

The following is a summary of our assets held for sale:

	Properties Held For Sale Number of Properties	Net Book Value (in thousands)
December 31, 2017	22	\$ 86,699
Properties sold/other (1)	(5)	(9,307)
Properties added (2)	16	66,027
March 31, 2018	33	143,419
Properties sold/other (1)	(33)	(143,419)
Properties added (2)	3	3,782
June 30, 2018	3	3,782
Properties sold/other (1)	(1)	(1,730)
Properties added (2)	8	15,774
September 30, 2018(3)	10	\$ 17,826

- (1) In the first quarter of 2018, we sold five facilities for approximately \$13.1 million in net cash proceeds recognizing a gain on sale of approximately \$3.5 million. In the second quarter of 2018, we sold 33 facilities for approximately \$96.4 million in net cash proceeds recognizing a gain on sale of approximately \$3.5 million. In the third quarter of 2018, we sold one facility for approximately \$1.6 million in cash proceeds recognizing a loss on sale of approximately \$0.1 million.
- (2) In the first quarter of 2018, we recorded \$3.5 million of impairments to reduce 16 facilities and one ancillary building's net book value to their estimated fair values less costs to sell before they were reclassified to assets held for sale. In the second quarter of 2018, we recorded approximately \$2.5 million of impairments to reduce three facilities' net book value to their estimated fair values less cost to sell before they were reclassified to assets held for sale. In the third quarter of 2018, we recorded approximately \$6.9 million of impairments to reduce five facilities' net book value to their estimated fair values less cost to sell before they were reclassified to assets held for sale.
- (3) We plan to sell the facilities classified as assets held for sale at September 30, 2018 within the next twelve months.

NOTE 9 – INTANGIBLES

The following is a summary of our intangibles as of September 30, 2018 and December 31, 2017:

	September 30, 2018	December 31, 2017
	(in thousands)	
Assets:		
Goodwill	\$ 644,201	\$ 644,690
Above market leases	\$ 22,426	\$ 22,426
In-place leases	-	167
Accumulated amortization	(17,602)	(17,059)
Net intangible assets	\$ 4,824	\$ 5,534
Liabilities:		
Below market leases	\$ 143,669	\$ 164,443
Accumulated amortization	(74,435)	(83,824)
Net intangible liabilities	\$ 69,234	\$ 80,619

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. The net amortization related to the above and below market leases is included in our Consolidated Statements of Operations as an adjustment to rental income.

For the three months ended September 30, 2018 and 2017, our net amortization related to intangibles was \$2.2 million and \$2.9 million, respectively. For the nine months ended September 30, 2018 and 2017, our net amortization related to intangibles was \$7.5 million and \$9.1 million, respectively. The estimated net amortization related to these intangibles for the remainder of 2018 and the subsequent four years is as follows: remainder of 2018 – \$2.1 million; 2019 – \$8.2 million; 2020 – \$8.0 million; 2021– \$7.6 million and 2022 – \$7.0 million. As of September 30, 2018, the weighted average remaining amortization period of above market leases and below market leases is approximately seven years and nine years, respectively.

The following is a summary of our goodwill as of September 30, 2018:

	(in thousands)
Balance as of December 31, 2017	\$ 644,690
Less: foreign currency translation	(489)
Balance as of September 30, 2018	\$ 644,201

NOTE 10 – CONCENTRATION OF RISK

As of September 30, 2018, our portfolio of real estate investments consisted of 932 healthcare facilities, located in 41 states and the U.K. and operated by 67 third-party operators. Our investment in these facilities, net of impairments and allowances, totaled approximately \$8.6 billion at September 30, 2018, with approximately 99% of our real estate investments related to long-term care facilities. Our portfolio is made up of 738 SNFs, 116 ALFs, 14 specialty facilities, one medical office building, fixed rate mortgages on 51 SNFs and two ALFs, and ten facilities that are held for sale. At September 30, 2018, we also held other investments of approximately \$511.7 million, consisting primarily of secured loans to third-party operators of our facilities and a \$32.2 million investment in an unconsolidated joint venture.

At September 30, 2018, we had investments with one operator/or manager that exceeded 10% of our total investments: Ciena. Ciena also generated approximately 10% of our total revenues for the three and nine months ended September 30, 2018 and 2017. At September 30, 2018, the three states in which we had our highest concentration of investments were Texas (10%), Florida (10%) and Michigan (8%).

NOTE 11 – STOCKHOLDERS’/OWNERS’ EQUITY

The Board of Directors has declared common stock dividends as set forth below:

Record Date	Payment Date	Dividend per Common Share
January 31, 2017	February 15, 2017	\$ 0.62
May 1, 2017	May 15, 2017	0.63
August 1, 2017	August 15, 2017	0.64
October 31, 2017	November 15, 2017	0.65
January 31, 2018	February 15, 2018	0.66
April 30, 2018	May 15, 2018	0.66
July 31, 2018	August 15, 2018	0.66
October 31, 2018	November 15, 2018	0.66

On the same dates listed above, Omega OP Unit holders received the same distributions per unit as those paid to the common stockholders of Omega.

\$500 Million Equity Shelf Program

For the three months ended September 30, 2018, no shares of our common stock were issued under our \$500 million Equity Shelf Program. For the nine months ended September 30, 2018, we issued 0.9 million shares of our common stock at an average price of \$29.82 per share, net of issuance costs, generating net proceeds of \$27.2 million.

Dividend Reinvestment and Common Stock Purchase Plan

For the three months ended September 30, 2018, approximately 0.3 million shares of our common stock at an average price of \$31.82 per share were issued through our Dividend Reinvestment and Common Stock Purchase Plan for gross proceeds of approximately \$9.9 million. For the nine months ended September 30, 2018, approximately 1.3 million shares of our common stock at an average price of \$29.36 per share were issued through our Dividend Reinvestment and Common Stock Purchase Plan for gross proceeds of approximately \$36.9 million.

Accumulated Other Comprehensive Loss

The following is a summary of our accumulated other comprehensive loss, net of tax where applicable:

	As of and For the Three Months Ended September 30, 2018		As of and For the Nine Months Ended September 30, 2018	
	2018	2017	2018	2017
	(in thousands)			
Foreign Currency Translation:				
Beginning balance	\$ (35,417)	\$ (40,343)	\$ (26,033)	\$ (54,948)
Translation (loss) gain	(5,165)	10,850	(14,542)	25,315
Realized gain	27	95	20	235
Ending balance	(40,555)	(29,398)	(40,555)	(29,398)
Derivative Instruments:				
Cash flow hedges:				
Beginning balance	7,739	(1,380)	1,463	(1,420)
Unrealized gain (loss)	1,248	(332)	7,218	(1,682)
Realized (loss) gain(1)	(52)	490	254	1,880
Ending balance	8,935	(1,222)	8,935	(1,222)
Net investment hedge:				
Beginning balance	(3,970)	(2,190)	(7,070)	-
Unrealized gain (loss)	1,620	(3,730)	4,720	(5,920)
Ending balance	(2,350)	(5,920)	(2,350)	(5,920)
Total accumulated other comprehensive loss for Omega OP(2)	(33,970)	(36,540)	(33,970)	(36,540)
Add: portion included in noncontrolling interest	1,588	1,697	1,588	1,697
Total accumulated other comprehensive loss for Omega	\$ (32,382)	\$ (34,843)	\$ (32,382)	\$ (34,843)

- (1) Recorded in interest expense on the Consolidated Statements of Operations.
- (2) These amounts are included in owners' equity.

NOTE 12 – TAXES

Omega is a REIT for United States federal income tax purposes, and Omega OP is a pass through entity for United States federal income tax purposes.

Since our inception, Omega has elected to be taxed as a REIT under the applicable provisions of the Internal Revenue Code (“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 each tax year and certain other requirements are met, including asset and income tests. 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 would 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. We test our compliance within the REIT taxation rules to ensure that we are in compliance with the REIT rules on a quarterly and annual basis. We review our distributions and projected distributions each year to ensure we have met and will continue to meet the annual REIT distribution requirements. In 2018, we expect to pay dividends in excess of our taxable income.

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 September 30, 2018, 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 \$5.8 million. The loss carry-forward is fully reserved as of September 30, 2018, with a valuation allowance due to uncertainties regarding realization. Our net operating loss carryforwards will be carried forward for no more than 20 years.

For the three months ended September 30, 2018 and 2017, we recorded approximately \$0.2 million and \$0.7 million, respectively, of state and local income tax provision. For the nine months ended September 30, 2018 and 2017, we recorded approximately \$0.6 million and \$2.2 million, respectively, of state and local income tax provision. For the three months ended September 30, 2018 and 2017, we recorded approximately \$0.6 million and \$0.3 million, respectively, of tax provision for foreign income taxes. For the nine months ended September 30, 2018 and 2017, we recorded approximately \$1.6 million and \$0.5 million, respectively, of tax provision for foreign income taxes. The expenses were included in income tax expense on our Consolidated Statements of Operations.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted. The Tax Act includes numerous changes to existing U.S. tax law, including lowering the statutory U.S. federal corporate income tax rate from 35% to 21% effective January 1, 2018. The Company has completed its preliminary assessment of these changes, and has determined that there is an immaterial impact to the consolidated financial statements.

NOTE 13 – STOCK-BASED COMPENSATION

On June 8, 2018, our stockholders approved the 2018 Stock Incentive Plan (the "2018 Plan"), which amended and restated the Company's 2013 Stock Incentive Plan (the "2013 Plan"). The 2018 Plan is a comprehensive incentive compensation plan that allows for various types of equity-based compensation, including restricted stock units (including performance-based restricted stock units), stock awards (including restricted stock), deferred restricted stock units, incentive stock options, non-qualified stock options, stock appreciation rights, dividend equivalent rights,

performance unit awards, certain cash-based awards (including performance-based cash awards) and other stock-based awards. The 2018 Plan increases the number of shares of common stock available for issuance under the 2013 Plan by 4.5 million.

The following is a summary of our stock-based compensation expense for the three and nine months ended September 30, 2018 and 2017, respectively:

	Three Months Ended September 30, 2018		2017		Nine Months Ended September 30, 2018		2017	
	(in thousands)							
Stock-based compensation expense	\$ 3,962	\$ 3,872	\$ 12,107	\$ 11,350				

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 service 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. We awarded 169,900 RSUs to employees on January 1, 2018.

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 achieve vesting, 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 vesting 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 for awards before 2016 and in the FTSE NAREIT Equity Health Care Index for awards granted in or after 2016 (both “Relative TSR”). Vesting, in general, requires that the employee remain employed by us until the date specified in the applicable PRSU or LTIP 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. Dividends on the PRSUs are accrued and only paid to the extent the applicable performance requirements are met. 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 677,488 LTIP Units to employees on January 1, 2018.

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 334,544 Relative TSR PRSUs to employees on January 1, 2018.

33

The following table summarizes our total unrecognized compensation cost as of September 30, 2018 associated with RSUs, PRSU awards, and LTIP Unit awards to employees:

	Grant Date	Shares	Average Fair Value Per Unit/Share	Total Compensation Cost (in millions)	Weighted Average Period of Expense Recognition (in months)	Unrecognized Compensation Cost (in millions)	Performance Period	Vesting Dates
RSUs								
3/17/16 RSU	2016	130,006	\$ 34.78	\$ 4.50	33	\$ 0.40	N/A	12/31/2018
1/1/2017 RSU	2017	140,416	31.26	4.40	36	1.80	N/A	12/31/2019
1/1/2018 RSU	2018	169,900	27.54	4.70	36	3.50	N/A	12/31/2020
Restricted Stock Units								
Total		440,322	\$ 30.86	\$ 13.60		\$ 5.70		
TSR PRSUs and LTIP Units								
3/31/15 2017 LTIP Units	2015	137,249	\$ 14.66	\$ 2.00	45	\$ 0.10	1/1/2015-12/31/2017	Quarterly in 2018
4/1/2015 2017 LTIP Units	2015	53,387	14.81	0.80	45	0.10	1/1/2015-12/31/2017	Quarterly in 2018
3/17/2016 2018 LTIP Units	2016	370,152	13.21	4.90	45	1.60	1/1/2016-12/31/2018	Quarterly in 2019
1/1/2017 2019 LTIP Units	2017	399,726	12.61	5.00	48	2.80	1/1/2017-12/31/2019	Quarterly in 2020
1/1/2018 2020 LTIP Units	2018	677,488	7.31	5.00	48	4.00	1/1/2018-12/31/2020	Quarterly in 2021
TSR PRSUs & LTIP Total		1,638,002	\$ 10.80	\$ 17.70		\$ 8.60		
Relative TSR PRSUs								

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

3/31/15 2017								Quarterly in
Relative TSR	2015	137,249	\$ 22.50	\$ 3.10	45	\$ 0.20	1/1/2015-12/31/2017	2018
4/1/2015 2017								Quarterly in
Relative TSR	2015	53,387	22.92	1.20	45	0.10	1/1/2015-12/31/2017	2018
3/17/2016 2018								Quarterly in
Relative TSR	2016	305,563	16.44	5.00	45	1.60	1/1/2016-12/31/2018	2019
1/1/2017 2019								Quarterly in
Relative TSR	2017	285,338	18.04	5.10	48	2.90	1/1/2017-12/31/2019	2020
1/1/2018 2020								Quarterly in
Relative TSR	2018	334,544	16.65	5.60	48	4.50	1/1/2018-12/31/2020	2021
Relative TSR								
PRSU _s Total		1,116,081	\$ 17.97	\$ 20.00		\$ 9.30		
Grand Total		3,194,405	\$ 16.07	\$ 51.30		\$ 23.60		

- (1) Total shares/units and compensation costs are net of shares/units cancelled.
- (2) This table excludes approximately \$1.1 million of unrecognized compensation costs related to outstanding director restricted stock grants.

NOTE 14 – BORROWING ACTIVITIES AND ARRANGEMENTS

Secured and Unsecured Borrowings

The following is a summary of our borrowings:

	Maturity	Annual Interest Rate as of September 30, 2018	September 30, 2018	December 31, 2017
(in thousands)				
Secured borrowings:				
HUD mortgages assumed December 2011	2044	-	\$ -	\$ 53,666
Deferred financing costs – net			-	(568)
Total secured borrowings – net(1)			-	53,098
Unsecured borrowings:				
Revolving line of credit	2021	3.43%	360,000	290,000
U.S. term loan	2022	3.69%	425,000	425,000
Sterling term loan (2)	2022	2.17%	130,410	135,130
Omega OP term loan(1)	2022	3.69%	100,000	100,000
2015 term loan	2022	3.80%	250,000	250,000
Discounts and deferred financing costs – net(3)			(4,563)	(5,460)
Total term loans – net			900,847	904,670
2023 notes	2023	4.375%	700,000	700,000
2024 notes	2024	4.950%	400,000	400,000
2025 notes	2025	4.500%	400,000	400,000
2026 notes	2026	5.250%	600,000	600,000
2027 notes	2027	4.500%	700,000	700,000

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

2028 notes	2028	4.750%	550,000	550,000
Other	2018	-	-	1,500
Subordinated debt	2021	9.000%	20,000	20,000
Discount – net			(19,160)	(21,073)
Deferred financing costs – net			(23,447)	(26,037)
Total senior notes and other unsecured borrowings – net			3,327,393	3,324,390
Total unsecured borrowings - net			4,588,240	4,519,060
Total secured and unsecured borrowings – net (4)			\$ 4,588,240	\$ 4,572,158

- (1) These amounts represent borrowings that were incurred by Omega OP or wholly owned subsidiaries of Omega OP.
- (2) This borrowing is denominated in British Pounds Sterling.
- (3) The amount includes \$0.5 million of net deferred financing costs related to the Omega OP term loan as of September 30, 2018.
- (4) All borrowings are direct borrowings of Omega unless otherwise noted.

HUD Mortgage Disposition

On June 1, 2018, subsidiaries of an existing operator assumed approximately \$53 million of our indebtedness guaranteed by HUD that secured 12 separate facilities located in Arkansas. In connection with our disposition of the mortgages we wrote-off approximately \$0.6 million of unamortized deferred costs that are recorded in (Loss) gain on assets sold – net on our Consolidated Statements of Operations. These fixed rate mortgages had a weighted average interest rate of approximately 3.06% per annum and matured in July 2044. See Note 2 – Properties and Investments.

Certain of our other secured and unsecured borrowings are subject to customary affirmative and negative covenants, including financial covenants. As of September 30, 2018 and December 31, 2017, we were in compliance with all affirmative and negative covenants, including financial covenants, for our secured and unsecured borrowings. Omega OP, the guarantor of Parent’s outstanding senior notes, does not directly own any substantive assets other than its interest in non-guarantor subsidiaries.

NOTE 15 – FINANCIAL INSTRUMENTS

The net carrying amount of cash and cash equivalents, restricted cash, contractual receivables and accrued expenses and other liabilities reported in the Consolidated Balance Sheets approximates fair value because of the short maturity of these instruments (Level 1).

At September 30, 2018 and December 31, 2017, the net carrying amounts and fair values of our other financial instruments were as follows:

	September 30, 2018		December 31, 2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:	(in thousands)			
Investments in direct financing leases – net	\$ 163,467	\$ 163,467	\$ 364,965	\$ 364,965
Mortgage notes receivable – net	708,178	732,354	671,232	686,772
Other investments – net	511,668	508,050	276,342	281,031
Total	\$ 1,383,313	\$ 1,403,871	\$ 1,312,539	\$ 1,332,768

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

Liabilities:

Revolving line of credit	\$ 360,000	\$ 360,000	\$ 290,000	\$ 290,000
U.S. term loan	422,923	425,000	422,498	425,000
Sterling term loan	129,771	130,410	134,360	135,130
Omega OP term loan(1)	99,521	100,000	99,423	100,000
2015 term loan	248,632	250,000	248,390	250,000
4.375% notes due 2023 – net	694,351	694,052	693,474	711,190
4.95% notes due 2024 – net	394,439	406,283	393,680	420,604
4.50% notes due 2025 – net	395,211	392,121	394,640	399,874
5.25% notes due 2026 – net	594,850	607,864	594,321	625,168
4.50% notes due 2027 – net	687,615	668,625	686,516	681,007
4.75% notes due 2028 – net	540,631	534,077	539,882	550,667
HUD debt – net(1)	-	-	53,098	51,817
Subordinated debt – net	20,296	22,664	20,376	23,646
Other	-	-	1,500	1,500
Total	\$ 4,588,240	\$ 4,591,096	\$ 4,572,158	\$ 4,665,603

(1) These amounts represent borrowings that were incurred by Omega OP or wholly owned subsidiaries of Omega OP.

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, 2017). 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.

- 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). For the Orianna direct financing lease, the Company estimated the fair value of its investment based on the estimated fair value of the collateral using an income approach considering inputs such as, current and projected operating performance of the facilities, projected rent, prevailing capitalization rates and/or coverages and bed values (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 a 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 a present value technique based on inputs from 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 16 – COMMITMENTS AND CONTINGENCIES

Litigation

On November 16, 2017, a purported securities class action complaint captioned Dror Gronich v. Omega Healthcare Investors, Inc., C. Taylor Pickett, Robert O. Stephenson, and Daniel J. Booth was filed against the Company and certain of its officers in the United States District Court for the Southern District of New York, Case No. 1:17-cv-08983-NRB (the “Gronich Securities Class Action”). On November 17, 2017, a second purported securities class action complaint captioned Steve Klein v. Omega Healthcare Investors, Inc., C. Taylor Pickett, Robert O. Stephenson, and Daniel J. Booth was filed against the Company and the same officers in the United States District Court for the Southern District of New York, Case No. 1:17-cv-09024-NRB (together with the Gronich Class Action, the “Securities Class Action”). Thereafter, the Court considered a series of applications by various shareholders to be named lead plaintiff, consolidated the two actions and designated Royce Setzer as the lead plaintiff.

37

Pursuant to a Scheduling Order entered by the Court, lead plaintiff Setzer and additional plaintiff Earl Holtzman filed a Consolidated Amended Class Action Complaint on May 25, 2018 (the “Amended Complaint”). The Securities Class Action purports to be a class action brought on behalf of shareholders who acquired the Company’s securities between May 3, 2017 and October 31, 2017. The Securities Class Action alleges that the defendants violated the Securities Exchange Act of 1934, as amended (the “Exchange Act”), by making materially false and/or misleading statements, and by failing to disclose material adverse facts about the Company’s business, operations, and prospects, including the financial and operating results of one of the Company’s operators, the ability of such operator to make timely rent payments, and the impairment of certain of the Company’s leases and the uncollectibility of certain receivables. The Securities Class Action, which purports to assert claims for violations of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, as well as Section 20(a) of the Exchange Act, seeks an unspecified amount of monetary damages, interest, fees and expenses of attorneys and experts, and other relief. The Company and the officers named in the Amended Complaint filed a Motion to Dismiss on July 17, 2018. Briefing on the Motion to Dismiss is complete.

Although the Company denies the material allegations of the Securities Class Action and intends to vigorously pursue its defense, we are in the early stages of this litigation and are unable to predict the outcome of the case or to estimate the amount of potential costs.

The Company’s Board of Directors received a demand letter, dated April 9, 2018, from an attorney for a purported current shareholder of the Company relating to the subject matter covered by the Securities Class Action (the “Shareholder Demand”). The letter demanded that the Board of Directors conduct an investigation into the statements and other matters at issue in the Securities Class Action and commence legal proceedings against each party identified as being responsible for the alleged activities. After due consideration, and in the exercise of its business judgment, the Board determined that it is not in the best interests of the Company to commence litigation against any current or former officers or directors based on the matters raised in the Shareholder Demand.

On August 22, 2018, Stourbridge Investments LLC, a purported shareholder of the Company, filed a derivative action purportedly on behalf of the Company in the U.S. District Court for the Southern District of New York against the current directors of the Company as well as certain officers alleging violations of Section 14(a) of the Securities Exchange Act of 1934 and state-law claims including breach of fiduciary duty. Stourbridge Investments LLC v. Callen et al., No. 1:18-cv-07638. The complaint alleges, among other things, that the defendants are responsible for the Company’s failure to disclose the financial condition of Orianna Health Systems, the alleged non-disclosures that are also the subject of the Securities Class Action described above. The defendants in the action are the three individual defendants named in the Securities Class Action (Messrs. Pickett, Booth and Stephenson), as well as the Company’s non-management directors. The plaintiff did not make a demand on the Company to bring the action prior to filing it, but rather alleges that demand would have been futile. The parties have entered into a stipulation in which they agreed to stay the case, including any response by defendants, pending the entry of judgment or a voluntary dismissal with prejudice in the Securities Class Action. The agreed-upon stipulation and order to stay the case were entered by the Court on October 25, 2018.

In addition, we are subject to various other 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.

38

Commitments

We have committed to fund the construction of new leased and mortgaged facilities and other capital improvements. We expect the funding of these commitments to be completed over the next several years. Our remaining commitments at September 30, 2018, are outlined in the table below (in thousands):

Total commitment	\$ 687,329
Amounts funded (1)	(431,442)
Remaining commitment	\$ 255,887

(1) Includes finance costs.

NOTE 17 – EARNINGS PER SHARE/UNIT

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

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

	Omega			
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
	(in thousands, except per share amounts)			
Numerator:				
Net income (loss)	\$ 59,062	\$ (137,515)	\$ 228,981	\$ 39,754
Less: net (income) loss attributable to noncontrolling interests	(2,456)	5,837	(9,619)	(1,735)
Net income (loss) available to common stockholders	\$ 56,606	\$ (131,678)	\$ 219,362	\$ 38,019
Denominator:				
Denominator for basic earnings per share	200,910	197,890	199,773	197,445
Effect of dilutive securities:				
Common stock equivalents	812	-	382	271
Noncontrolling interest – Omega OP Units	8,715	8,772	8,750	8,786
Denominator for diluted earnings per share	210,437	206,662	208,905	206,502
Earnings per share – basic:				
Net income (loss) available to common stockholders	\$ 0.28	\$ (0.67)	\$ 1.10	\$ 0.19
Earnings per share – diluted:				
Net income (loss)	\$ 0.28	\$ (0.67)	\$ 1.10	\$ 0.19

	Omega OP			
	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2018	2017	
(in thousands, except per share amounts)				
Numerator:				
Net income (loss)	\$ 59,062	\$ (137,515)	\$ 228,981	\$ 39,754
Denominator:				
Denominator for basic earnings per unit	209,625	206,662	208,523	206,231
Effect of dilutive securities:				
Omega OP Unit equivalents	812	-	382	271
Denominator for diluted earnings per unit	210,437	206,662	208,905	206,502
Earnings per unit – basic:				
Net income (loss) available to Omega OP Unit holders	\$ 0.28	\$ (0.67)	\$ 1.10	\$ 0.19
Earnings per unit – diluted:				
Net income (loss)	\$ 0.28	\$ (0.67)	\$ 1.10	\$ 0.19

NOTE 18 – SUPPLEMENTAL DISCLOSURE TO CONSOLIDATED STATEMENTS OF CASH FLOWS

The following are supplemental disclosures to the consolidated statements of cash flows for the nine months ended September 30, 2018 and 2017:

	Nine Months Ended September 30,	
	2018	2017
	(in thousands)	
Reconciliation of cash and cash equivalents and restricted cash:		
Cash and cash equivalents	\$ 9,768	\$ 24,318
Restricted cash	1,371	10,596
Cash, cash equivalents and restricted cash at end of period	\$ 11,139	\$ 34,914
Supplemental information:		
Interest paid during the period, net of amounts capitalized	\$ 172,863	\$ 147,266
Taxes paid during the period	\$ 3,600	\$ 3,124
Non cash investing activities		
Non cash acquisition of real estate (See Note 2)	\$ (880)	\$ (27,170)
Non cash proceeds from sale of real estate investments (See Note 2)	53,118	-
Non cash investment in other investments (See Note 5)	(16,153)	(6,353)
Non cash proceeds from other investments (see Note 5)	7,000	30,187
Non cash settlement of direct financing lease	-	18,989
Total	\$ 43,085	\$ 15,653
Non cash financing activities		
Non cash disposition of other long-term borrowings (See Note 14)	\$ (53,118)	\$ -
Change in fair value of cash flow hedges	7,423	(276)
Remeasurement of debt denominated in a foreign currency	(4,720)	5,920
Total	\$ (50,415)	\$ 5,644

40

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

Forward-Looking Statements and 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;
- (ii) uncertainties relating to the business operations of the operators of our assets, including those relating to reimbursement by third-party payors, regulatory matters and occupancy levels;
- (iii) the ability of any of Omega’s operators in bankruptcy to reject unexpired lease obligations, modify the terms of Omega’s mortgages and impede the ability of Omega to collect unpaid rent or interest during the pendency of a bankruptcy proceeding and retain security deposits for the debtor’s obligations, and other costs and uncertainties associated with operator bankruptcies;
- (iv) our ability to re-lease, otherwise transition, or sell underperforming assets or assets held for sale on a timely basis and on terms that allow us to realize the carrying value of these assets;
- (v) the availability and cost of capital to us;
- (vi) changes in our credit ratings and the ratings of our debt securities;
- (vii) competition in the financing of healthcare facilities;
- (viii) regulatory and other changes in the healthcare sector;
- (ix) changes in the financial position of our operators;
- (x) the effect of economic and market conditions generally and, particularly, in the healthcare industry;
- (xi) changes in interest rates;
- (xii) the amount and yield of any additional investments;
- (xiii) changes in tax laws and regulations affecting real estate investment trusts (“REITs”);
- (xiv) the potential impact of changes in the skilled nursing facility (“SNF”) and assisted living facility (“ALF”) markets 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

(xv) our ability to maintain our status as a REIT.

Overview

Omega Healthcare Investors, Inc. (“Omega”) was formed as a real estate investment trust (“REIT”) and incorporated in the State of Maryland on March 31, 1992. Omega is structured as an umbrella partnership REIT (“UPREIT”) under which all of Omega's assets are owned directly or indirectly by, and all of Omega's operations are conducted directly or indirectly through, its operating partnership subsidiary, OHI Healthcare Properties Limited Partnership (“Omega OP”). Omega OP was formed as a limited partnership and organized in the State of Delaware on October 24, 2014. Unless stated otherwise or the context otherwise requires, the terms the “Company,” “we,” “our” and “us” means Omega and Omega OP, collectively.

41

The Company has one reportable segment consisting of investments in healthcare-related real estate properties located in the United States (“U.S.”) and the United Kingdom (“U.K.”). Our core business is to provide financing and capital to the long-term healthcare industry with a particular focus on SNFs and, to a lesser extent, ALFs, independent living facilities and rehabilitation and acute care facilities. Our core portfolio consists of long-term leases and mortgage agreements. All of our leases are “triple-net” leases, which require the tenants to pay all property-related expenses. Our mortgage revenue derives from fixed rate mortgage loans, which are secured by first mortgage liens on the underlying real estate and personal property of the mortgagor. Our other investment income derives from fixed and variable rate loans, which are either unsecured or secured by the collateral of the borrower.

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”). Omega has exclusive control over Omega OP’s day-to-day management pursuant to the Partnership Agreement. As of September 30, 2018, Omega owned approximately 96% of the issued and outstanding units of partnership interest in Omega OP (“Omega OP Units”), and investors owned approximately 4% of the Omega OP Units.

Our portfolio of real estate investments at September 30, 2018, consisted of 932 healthcare facilities, located in 41 states and the U.K. and operated by 67 third-party operators. Our investment in these facilities, net of impairments and allowances, totaled approximately \$8.6 billion at September 30, 2018, with approximately 99% of our real estate investments related to long-term care facilities. Our portfolio is made up of: (i) 738 SNFs, (ii) 116 ALFs, (iii) 14 specialty facilities, (iv) one medical office building, (v) fixed rate mortgages on 51 SNFs and two ALFs and (vi) ten facilities that are held for sale. At September 30, 2018, we also held other investments of approximately \$511.7 million, consisting primarily of secured loans to third-party operators of our facilities and a \$32.2 million investment in an unconsolidated joint venture.

In 2017, we began implementation of a strategic asset repositioning program, disposing of non-core assets and reinvesting the proceeds in assets we envision holding for the long-term. This program is expected to continue for the remainder of 2018 and is designed to position the Company for future growth.

As of September 30, 2018 and December 31, 2017, we do not have any material properties or operators with facilities that are not materially occupied.

Omega’s 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, and Omega’s net earnings are reduced by the portion of net earnings attributable to noncontrolling interests. Omega OP’s consolidated financial statements include the accounts of (i) Omega OP, and (ii) all direct and indirect wholly owned subsidiaries of Omega OP. All intercompany transactions and balances have been eliminated in consolidation.

Taxation

Omega is a REIT for United States federal income tax purposes, and Omega OP is a pass through entity for United States federal income tax purposes.

Since our inception, Omega has elected to be taxed as a REIT under the applicable provisions of the Internal Revenue Code (“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 each tax year and certain other requirements are met, including asset and income tests. 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.

42

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 would 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. We test our compliance within the REIT taxation rules to ensure that we are in compliance with the REIT rules on a quarterly and annual basis. We review our distributions and projected distributions each year to ensure we have met and will continue to meet the annual REIT distribution requirements. In 2018, we expect to pay dividends in excess of our taxable income.

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 September 30, 2018, 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 \$5.8 million. The loss carry-forward is fully reserved as of September 30, 2018, with a valuation allowance due to uncertainties regarding realization. Our net operating loss carryforwards will be carried forward for no more than 20 years.

For the three months ended September 30, 2018 and 2017, we recorded approximately \$0.2 million and \$0.7 million, respectively, of state and local income tax provision. For the nine months ended September 30, 2018 and 2017, we recorded approximately \$0.6 million and \$2.2 million, respectively, of state and local income tax provision. For the three months ended September 30, 2018 and 2017, we recorded approximately \$0.6 million and \$0.3 million, respectively, of tax provision for foreign income taxes. For the nine months ended September 30, 2018 and 2017, we recorded approximately \$1.6 million and \$0.5 million, respectively, of tax provision for foreign income taxes. The expenses were included in income tax expense on our Consolidated Statements of Operations.

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”). The Trump administration has brought several Congressional efforts to repeal and replace the Affordable Care Act. Under any new legislation, we expect additional rules, regulations and interpretations to be issued that may materially affect our operators’ financial condition and operations. Even if the Healthcare Reform Law is not ultimately amended or repealed, the new administration could propose changes impacting implementation of the Healthcare Reform Law. The ultimate composition and timing of any legislation enacted under the new administration that would impact the current implementation of the Healthcare Reform Law remains uncertain. 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, whether in its current form or as amended or repealed.

43

Reform Requirements for Long-Term Care Facilities. On October 4, 2016, the Centers for Medicare and Medicaid Services (“CMS”) issued a final rule modifying the conditions of participation in Medicare and Medicaid for SNFs. CMS stated that the regulations, last updated in 1991, were “necessary to reflect the substantial advances that had been made over the past several years in the theory and practice of service delivery and safety” within long-term care. The extensive modifications require SNFs to implement new processes; make changes to current practices; and create new policies and procedures within a short timeframe to remain in compliance with their conditions for participation. Changes include provisions related to staff training, discharge planning, infection prevention and control programs, and pharmacy services, among others. While many of the regulations became effective on November 28, 2016, some of the regulations became effective in Phase 2 on November 28, 2017, with others becoming effective in Phase 3, beginning on November 28, 2019. CMS delayed for eighteen months the imposition of any fines for failure to implement Phase 2 of the new “Requirements of Participation” implemented in November 2017. CMS also announced a freeze on the inspection star ratings for any surveys occurring between November 28, 2017 and November 27, 2018. CMS estimates the average cost for a SNF to implement the new regulations is estimated to be \$62,900 the first year and \$55,000 each year thereafter.

Reimbursement Generally. A significant portion of our operators’ revenue is derived from government-funded reimbursement programs, consisting primarily of Medicare and Medicaid. As federal and state governments continue to 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. 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. 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, or prospective changes to the Healthcare Reform Law under the Trump administration, 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 by the states 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. While the federal government committed to paying the entire cost for Medicaid coverage for newly eligible beneficiaries from 2014 through 2016, the federal share declines to 95% in 2017, 94% in 2018, 93% in 2019, and 90% in 2020 and subsequent years. Although the Supreme Court ruled on June 28, 2012 that states could not be required to expand Medicaid or risk losing federal

funding of their existing Medicaid programs, as of September 30, 2018, thirty-four (34) states including the District of Columbia have expanded Medicaid eligibility with additional states continuing to consider expansion.

Medicare. On July 31, 2018, CMS issued a final rule regarding the fiscal year (“FY”) 2019 Medicare payment rates and quality payment programs for SNFs, which continues the trend of shifting Medicare payments from volume to value. Proposed aggregate payments to SNFs effective October 1, 2018 for FY 2019 are expected to increase by \$820 million over FY 2017 payments. This reimbursement increase is attributable to a 2.4% market basket increase as required under the Bipartisan Budget Act of 2018. As mandated by the Improving Medicare Post-Acute Care Transformation Act of 2014 (“IMPACT Act”), the annual update is reduced by two percentage points for SNFs that fail to submit required quality data to CMS under the SNF Quality Reporting Program (“QRP”).

44

CMS additionally finalized the previously proposed rule to replace the SNF PPS RUG-IV case-mix classification methodology with a new value-based Patient Driven Payment Model (“PDPM”). The PDPM is designed to improve the incentives to treat the needs of the whole patient, rather on the volume of services the patient receives. The PDPM will be effective October 1, 2019 (FY 2020) to allow time for education and training of SNFs in preparation for the new payment model.

These prospective reimbursement changes as well as the value-based purchasing programs applicable to SNFs under the 2014 Protecting Access to Medicare Act, which become effective in FY 2019, could have a material adverse effect on our operators’ financial condition and operations, adversely impacting their ability to meet their obligations to us.

In addition to FY 2018 Medicare payment rates, SNFs continue to be impacted by the “Bipartisan Budget Act of 2018,” which extended Medicare sequestration, which generally cuts Medicare provider and plan payments by 2% across the board, for an additional two years through 2027.

Furthermore, while the exceptions review process for therapy caps stipulated by MACRA expired December 31, 2017, the Bipartisan Budget Act of 2018 permanently repealed the therapy caps and the exceptions review process that applied to Medicare Part B therapy coverage as of January 1, 2018. The industry estimates that these changes may potentially (i) result in the restoration of Medicare Part B SNF revenues that would have declined had the therapy caps remained in place and (ii) permit continued medically necessary services to maintain beneficiary quality of care levels. However, it reduced the reimbursement rate for Medicare Part B therapy services performed by therapy assistants to 85% of the physician fee schedule beginning January 1, 2022 which may offset some of the additional expenses. The Bipartisan Budget Act of 2018 also restored the limited post-pay claims review process and eliminated a threat to future SNF Medicare payment rates by ending the “Independent Payment Advisory Board” established under the Healthcare Reform Law.

Relatedly, CMS released a final rule on December 1, 2017 to significantly scale back mandatory participation in the bundled payment program for Lower Extremity Joint Replacement (“CJR”) procedures that went into effect on April 1, 2016, and was mandatory for all hospitals paid under the Medicare Inpatient Prospective Payment System that are located in the 67 selected metropolitan statistical areas (“MSAs”). Effective January 1, 2018, CJR program participation under the final rule became voluntary for the eligible hospitals in 33 of the MSAs covered by the program as of February 2018. The CJR program will remain mandatory in the 34 MSAs for the duration of the program, with an exception for certain low volume and rural hospitals. CMS anticipates the number of mandatory participating hospitals to decrease from approximately 700 under this rule. SNFs receiving Medicare revenues related to hospital discharges subject to CJR bundled payment programs in the identified geographic areas could be either positively or negatively affected by the CJR bundled payment program.

Quality of Care Initiatives. In addition to quality or value based reimbursement reforms, CMS has implemented a number of initiatives focused on the quality of care provided by long term care facilities that could affect our operators. 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 August 2016, CMS announced a modification to the Five Star Quality Rating System through the introduction of new quality measures based primarily on Medicare claims data submitted by hospitals, including: (1) percentage of short-stay residents who were successfully discharged to the community; (2) percentage of short-stay residents who have had an outpatient emergency department visit; (3) percentage of short-stay residents who were re-hospitalized after a nursing home admission; (4) percentage of short-stay residents who made improvements in function; and (5) percentage of long-stay residents whose ability to move independently worsened. These ratings were incorporated into the nursing home rating system in July 2016 and were phased in through January 2017. 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.

Office of the Inspector General Activities. Beginning June 15, 2017, the Office of Inspector General (“OIG”) began updating its Work Plan website monthly in order to enhance transparency around the OIG’s continuous work planning efforts. The OIG reported in its January 2018 update that it would review the quality of care provided to Medicare beneficiaries, including elders and disabled persons, who are being treated at inpatient and outpatient medical facilities for conditions that may be the result of abuse or neglect. The OIG referenced prior reviews which indicated problems with the quality of care and the reporting and investigation of potential abuse or neglect at group homes, nursing homes, and skilled nursing facilities. The OIG additionally included a review of the staffing levels reported by SNFs as part of its August 2018 updates.

This review supplements the OIG’s Work Plan for government fiscal year 2017 that included seven projects related specifically to nursing homes: (1) determining to what extent State agencies investigate serious nursing home complaints within the required timeframes; (2) unreported incidents of potential abuse and neglect in SNFs; (3) review of SNF Medicare reimbursement documentation (determine if it meets requirements for each particular resource utilization group); (4) the SNF Adverse Event Screening Tool, which will disseminate practical information about the SNF Adverse Event Trigger Tool; (5) review of the National Background Check Program for long-term care employees; (6) compliance with the SNF prospective payment system requirement related to a three-day qualifying inpatient hospital stay; and (7) review of potentially avoidable hospitalizations of Medicare and Medicaid-Eligible nursing facility residents and prevention and detection services provided by nursing homes. Additionally, regional Recovery Audit Contractor program auditors along with the OIG and Department of Justice are expected to continue their efforts to evaluate SNF Medicare claims for any excessive therapy charges. In addition to the seven projects identified on the fiscal year 2017 Work Plan, subsequent updates indicated that the OIG would review whether ambulance services paid by Medicare Part B were subject to Part A SNF consolidated billing requirements. This review is ongoing.

Department of Justice. SNFs are under intense scrutiny for the quality of care being rendered to residents and appropriate billing practices. The Department of Justice launched ten regional Elder Justice Task Forces in 2016 which are coordinating and enhancing efforts to pursue SNFs that provide grossly substandard care to their residents. They are also focusing on therapy billing issues. These Task Forces are composed of representatives from the U.S. Attorneys’ Offices, State Medicaid Fraud Control Units, state and local prosecutors’ offices, U.S. Department of Health and Human Services (“HHS”), State Adult Protective Services agencies, Long Term Care Ombudsmen programs, and law enforcement.

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.

Several of our operators have responded to subpoenas and other requests for information regarding their operations in connection with inquiries by the U.S. Department of Justice or other regulatory agencies.

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 (“HITECH”), and the corresponding regulations promulgated thereunder (collectively referred to herein as “HIPAA”). The HITECH Act expanded the scope of these provisions by mandating individual notification in instances of breaches of protected health information, providing enhanced penalties for HIPAA violations, and granting enforcement authority to states’ Attorneys General in addition to the HHS Office for Civil Rights. HHS continued its auditing program in 2016 to assess compliance efforts by covered entities and business associates. Through a second phase of audits, which commenced for covered entities in July 2016, HHS focused on a review of policies and procedures adopted and employed by covered entities and their business associates to meet selected standards and implementation specifications of the HIPAA Privacy, Security, and Breach Notification Rules. Covered entities and business associates selected for a desk audit have the potential to be selected for an on-site audit. The HHS Office for Civil Rights reported that as of February 2018, the Phase 2 desk audits of covered entities and business associates were completed, and additional comprehensive on-site audits would be conducted as part of a permanent audit program going forward.

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. As set forth in the recent conditions of participation final rule issued on October 4, 2016, CMS prohibited pre-dispute arbitration agreements between SNFs and residents effective November 28, 2016, thereby increasing potential liabilities for SNFs and long-term care providers. Subsequently, the authority of CMS to restrict the rights of these parties to arbitrate was challenged by litigation in various jurisdictions, and enforcement by CMS was suspended on November 7, 2016 following the issuance of a preliminary injunction by the U.S. District Court for the Northern District of Mississippi. In a reversal from its previous position, CMS issued a proposed rule on June 5, 2017, that lifts CMS' ban on pre-dispute arbitration agreements in the long-term care setting. The proposed rule continues to face challenges by certain industry groups.

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, 2017. 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 differences may be material to the consolidated financial statements. We have described our most critical accounting policies in our 2017 Annual Report on Form 10-K for the year ended December 31, 2017, 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, 2017. See Note 2 – Summary of Significant Accounting Policies to our Annual Report on Form 10-K for the year ended December 31, 2017.

Accounting Pronouncements Adopted in 2018

In 2014, the Financial Accounting Standards Board (“FASB”) issued 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. In addition, the FASB issued targeted updates to clarify specific implementation issues of ASU 2014-09. These updates included ASU 2016-08, Principal versus Agent Considerations (Reporting Revenue Gross versus Net), ASU 2016-10, Identifying Performance Obligations and Licensing, and ASU 2016-12, Narrow-Scope Improvements and Practical Expedients. As a result of adopting ASU 2014-09 and its updates on January 1, 2018, the Company recognized \$10.0 million of deferred gain resulting from the sale of facilities to a third-party in December 2017 through opening equity on January 1, 2018. The Company adopted ASU 2014-09 and its subsequent updates in accordance with the modified retrospective approach. The adoption of ASU 2014-09 and its related updates did not have a material impact on our consolidated financial statements, as a substantial portion of our revenue consists of rental income from leasing arrangements and interest income from loan arrangements, both of which are specifically excluded from ASU 2014-09 and its updates.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities (“ASU 2017-12”). The purpose of this updated guidance is to better align the financial reporting for hedging activities with the economic objectives of those activities. The transition guidance provides companies with the option of early adopting the new standard using a modified retrospective transition method in any interim period after issuance of the update, or alternatively requires adoption for fiscal years beginning after December 15, 2018. This adoption method will require the Company to recognize the cumulative effect of initially applying ASU 2017-12 as an adjustment to accumulated other comprehensive income (loss) with a corresponding adjustment to the opening balance of equity as of the beginning of the fiscal year that an entity adopts the update. On January 1, 2018, the Company adopted ASU 2017-12 using the modified retrospective transition method. As a result of adopting the standard, the Company made certain adjustments to its existing hedge designation documentation for active hedging relationships in order to take advantage of specific provisions in the new guidance and to fully align its documentation with ASU 2017-12. The adoption of ASU 2017-12 did not have a material impact on our consolidated financial statements.

Recent Accounting Pronouncements - Pending Adoption

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. As a result of the pending adoption of ASU 2016-02, the Company may be required to record real estate tax revenues and an equal and offsetting real estate tax expense, as a result of our operators paying real estate taxes on our behalf, subject to further amendment. In addition, the Company will be required to recognize a right of use asset and corresponding lease liability for assets that the Company leases. In July 2018, the FASB issued ASU 2018-11, Leases: Targeted Improvements (“ASU 2018-11”) to simplify the implementation of ASU 2016-02. This targeted improvement permits the adoption of ASU 2016-02 at the adoption date instead of the earliest comparative period presented in the financial statements and a practical expedient permitting lessors to not separate nonlease components from the associated lease component if certain conditions are met. Upon adoption of ASU 2016-02 and its updates, we intend to transition to the new leasing accounting standard on January 1, 2019, without modifying our prior year balance sheet and recognizing the cumulative-effect adjustment to opening equity. We continue to evaluate the other impacts of adopting ASU 2016-02 and its updates on our consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326) (“ASU 2016-13”), which changes the impairment model for most financial assets. The new model uses a forward-looking expected loss method, which will generally result in earlier recognition of allowances for losses. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019 and early adoption is permitted for annual and interim periods beginning after December 15, 2018. We are currently evaluating the impact of adopting ASU 2016-13 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.

49

Three Months Ended September 30, 2018 and 2017

Operating Revenues

Our operating revenues for the three months ended September 30, 2018 totaled \$221.9 million, an increase of \$2.2 million over the same period in 2017. The \$2.2 million increase was primarily the result of (i) a \$3.0 million increase in other investment income primarily related to new loans and additional funding to existing operators made throughout 2017 and 2018 and (ii) a \$1.5 million increase in mortgage income was primarily related to new notes and additional funding to existing operators made throughout 2017 and 2018. These increases were offset by (i) \$1.8 million decrease in rental income resulting from facility sales and rent from four cash basis operators, offset by additional revenue from facility acquisitions, facility transitions and lease amendments and (ii) a \$0.4 million decrease in the direct financing lease income related to a facility sale in the second quarter of 2018.

Operating Expenses

Operating expenses for the three months ended September 30, 2018, totaled \$105.8 million, a decrease of approximately \$202.1 million over the same period in 2017. The \$202.1 million decrease was primarily due to: (i) a \$194.7 million decrease in impairment loss on direct financing leases related to New Ark Investment Inc. (“New Ark” which does business as “Orianna Health Systems” and is herein referred to as “Orianna”) incurred in the third quarter of 2017 and (ii) a \$13.9 million decrease in provisions for uncollectible accounts primarily related to the Orianna portfolio. These decreases were offset by (i) a \$5.0 million increase in impairments on real estate properties and (ii) a \$2.7 million increase in general and administrative expenses.

Other Income (Expense)

For the three months ended September 30, 2018, total other expenses were \$51.2 million, an increase of approximately \$1.7 million over the same period in 2017. The increase was primarily due to a \$1.2 million decrease in interest income and other – net primarily related to the change in the fair value of warrants to acquire shares of another public company.

Nine Months Ended September 30, 2018 and 2017

Operating Revenues

Our operating revenues for the nine months ended September 30, 2018 totaled \$661.9 million, a decrease of \$25.2 million over the same period in 2017. The \$25.2 million decrease was primarily the result of (i) a \$30.3 million decrease in the direct financing lease income related to Orianna, (ii) a \$2.5 million decrease in miscellaneous income primarily related to the reversal of operator earn-outs in the second quarter of 2017 and fewer late fees in 2018 and (iii) a \$1.5 million decrease in rental income resulting from facility sales and cash basis operators, offset by additional revenue from facility acquisitions, facility transitions and lease amendments. The decrease was offset by: (i) a \$6.4 million increase in other investment income primarily related to new notes and additional funding to existing operators made throughout 2017 and 2018 and (ii) a \$2.6 million increase in mortgage interest income primarily related to additional funding on mortgages to existing operators, partially offset by mortgage loan payoffs.

50

Operating Expenses

Operating expenses for the nine months ended September 30, 2018, totaled \$289.7 million, a decrease of approximately \$205.4 million over the same period in 2017. The \$205.4 million decrease was primarily due to: (i) \$198.0 million decrease in impairment loss on direct financing leases related to our Orianna portfolio incurred in the third quarter of 2017, (ii) a \$8.9 million decrease in impairments on real estate properties; \$31.9 million of impairments on 34 facilities in 2018, offset by \$5.2 million of insurance proceeds received related to a facility destroyed in November 2017, as compared to \$35.6 million of impairments on 14 facilities in the same period of 2017 and (iii) a \$7.3 million decrease in provision for uncollectible accounts related to the reserve and/or write-off of contractual receivables and straight-line receivables, offset by rent recoveries from Orianna. These decreases were offset by a \$10.3 million increase in general and administrative expenses resulting from higher professional service fees related to operator restructurings and a \$2.0 million buyout of an in-the-money purchase option to an unrelated third-party.

Other Income (Expense)

For the nine months ended September 30, 2018, total other expenses were \$150.1 million, a decrease of approximately \$8.8 million over the same period in 2017. The decrease was primarily related to a \$22.0 million decrease in interest - refinance costs related to the redemption of the \$400 million 5.875% senior notes and the restructuring of the credit facility in the second quarter of 2017, offset by (i) a \$10.4 million favorable contractual settlement with an unrelated third-party related to a contingent liability obligation that originated in 2012 and was resolved in the first quarter of 2017 and (ii) a \$3.3 million increase in interest expense related to higher debt balances outstanding to fund new investments and higher blended borrowing costs.

National Association of Real Estate Investment Trusts Funds From Operations

Our funds from operations (“NAREIT FFO”) for the three months ended September 30, 2018 was \$159.4 million compared to a deficit of \$(46.8) million for the same period in 2017. Our NAREIT FFO for the nine months ended September 30, 2018 was \$462.9 million compared to \$285.1 million for the same period in 2017.

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 (computed in accordance with GAAP), adjusted for the effects of asset dispositions and certain non-cash items, primarily depreciation and amortization and impairment on real estate assets, and after adjustments for unconsolidated partnerships and joint ventures. Adjustments for unconsolidated partnerships

and joint ventures are calculated to reflect funds from operations on the same basis. 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 and nine months ended September 30, 2018 and 2017:

	Three Months Ended		Nine Months Ended	
	September 30, 2018	2017	September 30, 2018	2017
	(in thousands)			
Net income (loss)	\$ 59,062	\$ (137,515)	\$ 228,981	\$ 39,754
Add back loss (deduct gain) from real estate dispositions	5,361	(693)	(9,248)	(7,491)
Add back loss from real estate dispositions - unconsolidated joint venture	30	-	670	-
	64,453	(138,208)	220,403	32,263
Elimination of non-cash items included in net income:				
Depreciation and amortization	70,711	71,925	210,681	212,268
Depreciation – unconsolidated joint venture	1,381	1,657	4,504	4,973
Add back impairments on real estate properties	22,868	17,837	26,685	35,610
Add back impairments on real estate properties - unconsolidated joint venture	-	-	608	-
NAREIT FFO (a)	\$ 159,413	\$ (46,789)	\$ 462,881	\$ 285,114

(a) Includes amounts allocated to Omega stockholders and Omega OP Unit holders.

Portfolio and Recent Developments

The following table summarizes the significant acquisitions that occurred in 2018:

Number of Facilities	Country/ Investment	Total Land	Building & Site Improvements	Furniture & Fixtures	Initial Annual
-------------------------	------------------------	---------------	------------------------------------	----------------------------	-------------------

Edgar Filing: OMEGA HEALTHCARE INVESTORS INC - Form 10-Q

Period	SNF	ALF	State	(in millions)				Cash Yield(3)		
Q1	-	1	UK	\$ 4.0	(1)	\$ 0.9	\$ 2.9	\$ 0.2	8.5	%
Q1	-	1	UK	5.7	(2)	1.4	4.1	0.2	8.5	%
Q1	1	-	PA	7.4		1.6	5.4	0.4	9.5	%
Q1	1	-	VA	13.2		2.4	10.5	0.3	9.5	%
Q2	5	-	TX	22.8		0.5	20.4	1.9	9.5	%
Total	7	2		\$ 53.1		\$ 6.8	\$ 43.3	\$ 3.0		

- (1) Omega recorded a non-cash deferred tax liability of approximately \$0.4 million in connection with the acquisition.
- (2) Omega recorded a non-cash deferred tax liability of approximately \$0.2 million in connection with the acquisition.
- (3) The cash yield is based on the purchase price.

For the nine months ended September 30, 2018, we acquired two parcels of land (not reflected in the table above) for approximately \$3.5 million with the intent of building new facilities for our existing operators.

In June 2018, we amended our original \$415.0 million mortgage with Ciena Healthcare (“Ciena”) with the addition of a \$44.7 million mortgage note related to five SNFs located in Michigan. The mortgage note matures on June 30, 2029 and bears an initial annual interest rate of 9.5% which increases each year by 0.225%. As of September 30, 2018, the outstanding principal balance of this mortgage note is approximately \$44.2 million. Additionally, the Company committed to fund an additional \$9.6 million to Ciena if certain performance metrics are achieved by the portfolio.

On February 26, 2016, we acquired and funded a \$50.0 million mezzanine loan at a discount of approximately \$0.75 million. In May 2018, the Company amended the mezzanine loan with the borrower which is secured by an equity interest in subsidiaries of the borrower. As part of the refinancing, the Company increased the mezzanine loan by \$10.0 million, extended the maturity date to May 31, 2023 and fixed the interest rate at 12% per annum. The mezzanine loan requires semi-annual principal payments of \$2.5 million commencing December 31, 2018. As of September 30, 2018, our total other investments outstanding with this borrower was approximately \$59.4 million.

During the third quarter of 2018, we transitioned 21 SNFs and one ALF subject to direct financing leases (not reflected in the table above) with a net carrying value of approximately \$184.5 million from Orianna to five existing operators subject to single or master operating leases with an initial annual cash yield of approximately 9%. We recorded approximately \$184.5 million of real estate investments consisting of land (\$11.2 million), building and site improvements (\$159.1 million) and furniture and fixtures (\$14.2 million) in partial satisfaction of the direct financing lease. In connection with these transitions, we provided the new operators with working capital loans with a maximum borrowing capacity of \$35.7 million, commitments to fund capital improvements up to \$10.6 million and indemnities with a maximum funding of \$7.4 million. Claims against these indemnities must occur within 18 months to 36 months. These indemnities were provided to the new operators upon transition and would be utilized in the event that the prior operator does not perform under its transition agreements. The Company does not expect to fund a material amount under these indemnity agreements.

On September 28, 2018, we provided a \$131.3 million secured term loan to an unrelated third party. The loan bears interest at 9.35% per annum and matures on February 28, 2019, subject to a one-time 90-day extension. The loan requires monthly interest payments with the principal balance due at maturity. The borrower used the proceeds to repay existing indebtedness and pay a one-time distribution to its equity holders. In connection with this loan we incurred approximately \$0.4 million of origination costs which are deferred and recognized over the term of the loan. The outstanding balance on this loan was \$131.7 million including origination costs at September 30, 2018. In satisfaction of this loan, on or before maturity, we expect to obtain fee simple title to seven SNFs, three independent living facilities, and one ALF with a fair value of approximately \$131.3 million as of September 30, 2018. The facilities are located in Pennsylvania and Virginia and are currently operated by an existing operator. We expect to amend our existing master lease with this operator to add these facilities to the master lease when we receive fee simple title to the facilities.

As of September 30, 2018, we have ten facilities, totaling \$17.8 million classified as assets held for sale. We expect to sell these facilities over the next twelve months.

Asset Sales, Impairments, Accounts Receivable and Other

Asset Sales

During the first quarter of 2018, we sold 14 facilities (five of which were previously held for sale at December 31, 2017) subject to operating leases for approximately \$74.7 million in net cash proceeds recognizing a gain on sale of approximately \$17.5 million.

During the second quarter of 2018, we sold 45 facilities and one ancillary building (33 of which were previously held for sale at March 31, 2018) subject to operating leases for approximately \$147.2 million in net cash proceeds recognizing a loss on sale of approximately \$2.9 million.

53

Of the 45 facilities sold during the second quarter of 2018, we sold 12 SNFs on June 1, 2018 (12 of which were previously held for sale at March 31, 2018) secured by HUD mortgages to subsidiaries of an existing operator. The Company sold the 12 SNF facilities with carrying values of approximately \$62 million for approximately \$78 million which consisted of \$25 million of cash consideration and their assumption of approximately \$53 million of our HUD mortgages. Simultaneously, subsidiaries of the operator assumed our HUD restricted cash accounts, deposits and escrows. The Company recorded a gain on sale of approximately \$11 million after approximately \$5 million of closing and other transaction related costs. In connection with this sale, we provided a principal of an existing operator an unsecured loan of approximately \$39.7 million bearing interest at 6% per annum and maturing on May 31, 2021. The unsecured loan requires quarterly principal payments of \$0.6 million commencing on October 1, 2018 and additional quarterly principal payments of \$0.3 million in the future. The borrower has one option to extend the loan to May 31, 2024 subject to an extension fee. A \$7.0 million loan provided to the same principal in 2017 was repaid with proceeds from the \$39.7 million loan.

On August 1, 2018, we amended the \$39.7 million unsecured loan mentioned above to provide an additional \$5.1 million unsecured loan to fund a lease termination fee in connection with the sale of two additional facilities during the third quarter of 2018. The \$5.1 million unsecured loan bears interest at 6% per annum and matures on May 31, 2024. The lease termination fee has been deferred and is being recognized over the remaining term of the lease with this operator. As of September 30, 2018, approximately \$39.4 million is outstanding on this unsecured loan.

During the third quarter of 2018, we sold five facilities and one ancillary building (one of which was previously held for sale at June 30, 2018) subject to operating leases for approximately \$24.4 million in net cash proceeds recognizing a loss on sale of approximately \$5.4 million.

In June 2018, we sold one SNF with a carrying value of approximately \$15.4 million subject to a direct financing lease to an unrelated third-party for approximately \$15.4 million.

Impairments

During the first quarter of 2018, we recorded impairments on real estate properties of approximately \$4.9 million on 17 facilities (16 of which were subsequently reclassified to assets held for sale).

During the second quarter of 2018, we recorded impairments of approximately \$4.1 million on nine facilities (three of which were subsequently reclassified to assets held for sale). Our second quarter 2018 impairments were offset by \$5.2 million of insurance proceeds received related to a facility destroyed in November 2017.

During the third quarter of 2018, we recorded impairments of approximately \$22.9 million on eight facilities (five of which were subsequently reclassified to assets held for sale).

Our recorded impairments were primarily the result of decisions to exit certain non-strategic facilities and/or operators. We reduced the net book value of the impaired facilities to their estimated fair values or, with respect to the facilities reclassified to assets held for sale, to their estimated fair values less costs to sell. To estimate the fair value of the facilities, we utilized a market approach which considered binding sale agreements (a Level 1 input) and/or Level 3 inputs which generally consist of non-binding offers from unrelated third parties.

54

Accounts Receivable

As of September 30, 2018, we have approximately \$33.9 million of contractual receivables outstanding – net of allowances. Of the \$33.9 million of contractual receivables outstanding – net of allowances, approximately \$20.1 million relates to Orianna, Agemo Holdings LLC (“Agemo” an entity formed in May 2018 to silo the leases and loans formerly held by Signature Healthcare), and Daybreak Venture LLC (“Daybreak”). Orianna and Daybreak are on a cash basis of accounting for purposes of revenue recognition, see additional discussion below. In addition to the contractual receivables, we have approximately \$39.9 million of straight-line rent receivables and/or lease inducements associated with these operators as of September 30, 2018. For the three and nine months ended September 30, 2018, we recorded approximately \$22.7 million and \$65.0 million of rental income, respectively, \$2.0 million and \$5.2 million of other investment income and no income from direct financing leases for these operators.

Other

Orianna has not satisfied the contractual payments due under the terms of the remaining direct financing lease or the separate operating lease covering four facilities with the Company and the collectability of future amounts due is uncertain.

In March 2018, Orianna commenced voluntary Chapter 11 proceedings in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division (the “Bankruptcy Court”). As described in Orianna’s filings with the Bankruptcy Court, we entered into a Restructuring Support Agreement (“RSA”) that was expected to form the basis for Orianna’s restructuring. The RSA provided for the recommencement, in April 2018, of partial rent payments at \$1.0 million per month and established a specific timeline for the implementation of Orianna’s planned restructuring. The RSA provided for the transition of 23 facilities to new operators and the potential sale of the remaining 19 facilities subject to the plan of reorganization as approved by the Bankruptcy Court. On July 25, 2018, Omega terminated the restructuring support agreement with its tenant, 4 West Holdings, and the sponsor of Orianna’s restructuring plan. The Company is evaluating and/or pursuing alternative courses of action to protect its assets and shareholder value, and working with operators to protect the interests of residents of the facilities.

During the third quarter of 2018, we transitioned 22 facilities subject to direct financing leases with a net carrying value of approximately \$184.5 million from Orianna to five existing operators with annual contractual rent of approximately \$16.8 million. In addition, we sold Orianna’s headquarters with a carrying value of approximately \$1.5 million to an unrelated third-party for approximately \$1.5 million.

To provide liquidity to Orianna during their Chapter 11 proceedings, we entered into a senior secured superpriority debtor-in-possession (“DIP”) credit agreement with Orianna for a revolving credit and term loan DIP facility of up to \$30 million, which DIP facility was approved by the Bankruptcy Court on an interim basis on March 9, 2018 and on a final basis on May 14, 2018. The DIP financing consists of a \$14.2 million term loan and a \$15.8 million revolving credit facility which are secured by a security interest in and liens on substantially all of Orianna’s existing and future real and personal property. The \$14.2 million term loan bears interest at 1-month LIBOR plus 5.5% per annum and matured on September 30, 2018. Orianna has borrowed the full amount of the term loan to repay their previous secured working capital lender. As of September 30, 2018, approximately \$14.2 million is outstanding on this term loan. The \$15.8 million revolving credit facility bears interest at 1-month LIBOR plus 9.0% per annum and matured on September 30, 2018. The borrowings under the revolving credit facility are for general business expenses and other uses permitted under the loan documents. As of September 30, 2018, approximately \$10.8 million is outstanding on this revolving credit facility.

On July 23, 2018, Omega notified Orianna that it was in default under the DIP facility and, as a result of such default, Omega (a) declared the amounts owing under the DIP facility to be immediately due and payable, (b) terminated the DIP facility and any further commitment of Omega to extend credit to Orianna under the DIP facility, and (c) restricted Orianna’s use of cash collateral solely to payment of those amounts contained in a budget approved by Omega. Omega also informed Orianna that while Omega did not (as of such date) intend to immediately collect amounts owing under the DIP facility, Omega may at any time in the future exercise further rights and remedies under the DIP facility.

In May 2017, we provided Orianna an \$18.8 million maximum borrowing secured revolving working capital loan that bears interest at 9% per annum (with one-half (1/2) of all accrued interest to be paid-in-kind and added to the loan balance) and matures on April 30, 2022. This revolving working capital loan has a default rate of 5% per annum. As of September 30, 2018, approximately \$15.2 million is outstanding on this revolving working capital loan. Pursuant to the Bankruptcy Court's order approving the DIP financing, Orianna is obligated to pay one-half (1/2) of all accrued post-bankruptcy interest payable on this revolving working capital loan at the default rate. As of September 30, 2018, our total other investments outstanding with Orianna approximate \$40.2 million.

In 2017, we recorded an allowance for loss on direct financing leases of \$172.2 million with Orianna covering 38 facilities in the Southeast region of the U.S. The amount of the allowance was determined based on the fair value of the facilities subject to the direct financing lease. To estimate the fair value of the underlying collateral, we utilized an income approach and Level 3 inputs. Our estimate of fair value assumed annual rents ranging between \$32.0 million and \$38.0 million, rental yields between 9% and 10%, current and projected operating performance of the facilities, coverage ratios and bed values. Such assumptions are subject to change based on changes in market conditions and the ultimate resolution of this matter. Such changes could be significantly different than the currently estimated fair value and such differences could have a material impact on our financial statements. During the third quarter of 2018, we reduced our investment in the Orianna direct financing leases and the corresponding allowance for loss by approximately 55%, as a result of the transitions of 22 facilities to five existing operators.

The 16 facilities remaining under our direct financing lease with Orianna as of September 30, 2018 are located in South Carolina (14), Georgia (1) and Tennessee (1). Our recorded investment in this direct financing lease, net of the \$76.0 million allowance, amounted to \$151.7 million as of September 30, 2018. We have not recognized any direct financing lease income from Orianna for the period from July 1, 2017 through September 30, 2018. In addition to our direct financing leases with Orianna, we own four facilities and lease them to Orianna under a master lease which expires in 2026. The four facility lease is being accounted for as an operating lease. We have not recognized any income on this operating lease for the period from July 1, 2017 through September 30, 2018, as Orianna did not pay the contractual amounts due and collectability is uncertain. Our recorded investment in the four facilities subject to this operating lease was \$36.8 million as of September 30, 2018. Subsequent to September 30, 2018, Orianna rejected the lease of these four facilities and as a result we expect to transition these facilities to other existing operators.

On May 7, 2018, Omega and Signature Healthcare entered into a consensual, out-of-court restructuring agreement. The restructuring involves multiple third-party constituents, including other third-party landlords, a new working capital lender, medical malpractice claimants, and other third-party interests. As part of the restructuring, Signature Healthcare was reorganized to separate each of its primary portfolios with its major landlords into three distinct lease silos and separate virtually all other legal obligations. As part of this restructuring, Signature Healthcare formed Agemo Holdings LLC ("Agemo") to be the holding company of the lessees and loans of the Omega portfolio, and for which Omega agreed to:

- defer up to \$6.3 million of rent per annum for 3 years commencing May 1, 2018;
- provide capital expenditure funds to be used for the general maintenance and capital improvements of our 59 facilities in the amount of approximately \$4.5 million per year for 3 years;

- extend a 7-year working capital term loan at 7% for an amount up to \$25 million with a maturity date of April 30, 2025 (\$13.3 million is outstanding as of September 30, 2018);
- extend the term of the master lease by two years to December 31, 2030 and;
- extend the maturity date of the existing term loan by two years to December 31, 2024.

As part of the restructuring, Signature Healthcare entered into new working capital credit facilities with its new working capital lender for each of its separate silos, including Agemo. In addition, as part of our restructure, certain third-party guarantors of the Agemo master lease were required to contribute approximately \$7.8 million in funds to the enterprise to be used to reduce the outstanding contractual receivables owed to Omega from Agemo. On May 8, 2018, the Company received \$5.0 million in cash from the guarantors and a one-year term note from the principals of Agemo for approximately \$2.8 million.

56

During the third quarter of 2017, we placed Daybreak on a cash basis for revenue recognition as a result of nonpayment. During the fourth quarter of 2017, we executed a Settlement and Forbearance Agreement with Daybreak which permitted Daybreak to defer payments up to 23% of their contractual rent for the remainder of 2017, subject to certain conditions. During 2018, rent returned to the full contractual amount and we expect that past due rent will begin to be repaid in 2019.

The Company continues to closely monitor the performance of all of its operators, as well as industry trends and developments generally.

Liquidity and Capital Resources

At September 30, 2018, we had total assets of \$8.6 billion, total equity of \$3.8 billion and debt of \$4.6 billion, representing approximately 54.8% of total capitalization.

Financing Activities and Borrowing Arrangements

HUD Mortgage Disposition

On June 1, 2018, subsidiaries of an existing operator assumed approximately \$53 million of our indebtedness guaranteed by HUD that secured 12 separate facilities located in Arkansas. In connection with our disposition of the mortgages we wrote-off approximately \$0.6 million of unamortized deferred costs that are recorded in (Loss) gain on assets sold – net on our Consolidated Statements of Operations. These fixed rate mortgages had a weighted average interest rate of approximately 3.06% per annum and matured in July 2044.

Certain of our other secured and unsecured borrowings are subject to customary affirmative and negative covenants, including financial covenants. As of September 30, 2018 and December 31, 2017, we were in compliance with all affirmative and negative covenants, including financial covenants, for our secured and unsecured borrowings. Omega OP, the guarantor of Parent's outstanding senior notes, does not directly own any substantive assets other than its interest in non-guarantor subsidiaries.

\$500 Million Equity Shelf Program

For the three months ended September 30, 2018, no shares of our common stock were issued under our \$500 million Equity Shelf Program. For the nine months ended September 30, 2018, we issued 0.9 million shares of our common stock at an average price of \$29.82 per share, net of issuance costs, generating net proceeds of \$27.2 million.

Dividend Reinvestment and Common Stock Purchase Plan

For the three months ended September 30, 2018, approximately 0.3 million shares of our common stock at an average price of \$31.82 per share were issued through our Dividend Reinvestment and Common Stock Purchase Plan for gross proceeds of approximately \$9.9 million. For the nine months ended September 30, 2018, approximately 1.3 million shares of our common stock at an average price of \$29.36 per share were issued through our Dividend Reinvestment and Common Stock Purchase Plan for gross proceeds of approximately \$36.9 million.

Dividends

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

For the three and nine months ended September 30, 2018, we paid dividends of approximately \$132.7 million and \$395.7 million, to our common stockholders, respectively. On the 15th of February, May and August 2018, we paid dividends of \$0.66 per outstanding common share to common stockholders of record as of the last business day of January, April and July 2018, respectively. For the three and nine months ended September 30, 2018, Omega OP paid distributions of approximately \$5.9 million and \$17.6 million, respectively, to holders of Omega OP Units other than Omega. The Omega OP Unit holders received the same distributions per unit as those paid to the common stockholders of Omega.

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; (iv) general and administrative expenses and (v) our operators' ability to pay amounts owed. The timing, source and amount of cash flows provided by or used in financing activities and 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, cash equivalents and restricted cash totaled \$11.1 million as of September 30, 2018, a decrease of \$85.7 million as compared to the balance at December 31, 2017. The following is a discussion of changes in cash, cash equivalents and restricted cash due to operating, investing and financing activities, which are presented in our Consolidated Statements of Cash Flows.

58

Operating Activities – Operating activities generated \$348.5 million of net cash flow for the nine months ended September 30, 2018, as compared to \$427.3 million for the same period in 2017, a decrease of \$78.8 million which is primarily due to the loss of direct financing lease income from Oriana and cash payments for lease inducements of which we paid one operator approximately \$28.4 million during the first quarter of 2018.

Investing Activities – Net cash flow from investing activities was an outflow of \$150.6 million for the nine months ended September 30, 2018, as compared to an outflow of \$400.0 million for the same period in 2017. The \$249.5 million change in cash flow from investing activities related primarily to (i) a \$292.5 million decrease in real estate acquisitions, (ii) a \$176.6 million increase in proceeds from sale of real estate investments and (iii) a \$6.9 million increase in receipts from insurance proceeds. Offsetting these changes were: (i) a \$171.6 million increase in other investments – net primarily related to funding more other investments in 2018, (ii) a \$29.4 million increase in investments in construction in progress in 2018, as compared to the same period in 2017, (iii) a \$16.1 million decrease in proceeds from the sale of direct financing lease assets and (iv) an \$8.3 million increase in mortgages – net primarily related to funding additional mortgages in 2018.

Financing Activities – Net cash flow from financing activities was an outflow of \$283.1 million for the nine months ended September 30, 2018, as compared to an outflow of \$100.0 million for the same period in 2017. The \$183.1 million change in cash from financing activities was primarily related to (i) a net \$105.0 million decrease in cash proceeds from our credit facility, (ii) a net \$96.3 million increase in cash from our other long-term borrowings, primarily resulting from the second quarter 2017 issuance of \$550.0 million 4.75% senior notes due 2028 and \$150.0 million 4.5% senior notes due 2025, offset by the repayment of the \$400.0 million 5.875% senior notes due 2024 and a reduction in borrowings outstanding under our credit facility and (iii) a \$22.3 million increase in dividends paid, offset by (i) a \$29.2 million decrease in financing related costs in 2018, as compared to the same period in 2017, (ii) a \$6.8 million increase in net proceeds from our dividend reinvestment plan in 2018, as compared to the same period in 2017 and (iii) a \$5.0 million increase in cash proceeds from the issuance of common stock in 2018, as compared to the same period in 2017.

Item 3 – Quantitative and Qualitative Disclosures about Market Risk

During the quarter ended September 30, 2018, 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, 2017.

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, management evaluated the effectiveness of the design and operation of the disclosure controls and procedures of Omega and Omega OP (for purposes of this Item 4, the “Companies”) as of September 30, 2018. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that disclosure controls and procedures of the Companies were effective at a reasonable assurance level as of September 30, 2018.

Internal Control Over Financial Reporting

There were no changes in the Companies' 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 16 – Commitments and Contingencies in the Consolidated Financial Statements - Part I, Item 1 hereto, which is hereby incorporated by reference in response to this item.

Item 1A – Risk Factors

There have been no material changes to our risk factors as previously disclosed in Item 1A contained in Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

During the quarterly period ended September 30, 2018, Omega issued an aggregate of 51,021 shares of Omega common stock in exchange for an equivalent number of Omega OP Units tendered to Omega OP for redemption in accordance with the provisions of the Partnership Agreement. The Company issued these shares of Omega common stock in reliance on an exemption from registration under Section 4(a)(2) of the Securities Act of 1933, as amended, based upon factual representations received from the limited partners who received the Omega common stock.

Item 6-Exhibits

Exhibit No.

- 10.1 Form of Amendment dated September 7, 2018 to Equity Distribution Agreement dated September 3, 2015 (Incorporated by reference to Form 8-K filed September 7, 2018).
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer of Omega Healthcare Investors, Inc.*
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer of Omega Healthcare Investors, Inc.*
- 31.3 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer of OHI Healthcare Properties Limited Partnership.*
- 31.4 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer of OHI Healthcare Properties Limited Partnership.*
- 32.1 Section 1350 Certification of the Chief Executive Officer of Omega Healthcare Investors, Inc.*
- 32.2 Section 1350 Certification of the Chief Financial Officer of Omega Healthcare Investors, Inc.*
- 32.3 Section 1350 Certification of the Chief Executive Officer of OHI Healthcare Properties Limited Partnership.*
- 32.4 Section 1350 Certification of the Chief Financial Officer of OHI Healthcare Properties Limited Partnership.*
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

* Exhibits that are filed herewith.

SIGNATURES

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

OMEGA HEALTHCARE INVESTORS, INC.

Registrant

Date: November 7, 2018 By: /S/ C. TAYLOR PICKETT
C. Taylor Pickett
Chief Executive Officer

Date: November 7, 2018 By: /S/ ROBERT O. STEPHENSON
Robert O. Stephenson
Chief Financial Officer

OHI HEALTHCARE PROPERTIES LIMITED PARTNERSHIP

Co-Registrant

By: Omega Healthcare Investors, Inc., its General Partner

Date: November 7, 2018 By: /S/ C. TAYLOR PICKETT
C. Taylor Pickett
Chief Executive Officer

Date: November 7, 2018 By: /S/ ROBERT O. STEPHENSON
Robert O. Stephenson
Chief Financial Officer

62
