OMEGA HEALTHCARE INVESTORS INC
Form 10-Q
November 08, 2010

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

FORM 10-Q

(Mark One)
X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2010

or

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

For the transition period from _______________ to _______________

Commission file number 1-11316

OMEGA HEALTHCARE INVESTORS, INC.
(Exact name of Registrant as specified in its charter)

Maryland	38-3041398
(State of incorporation)	(IRS Employer Identification No.)

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

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

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

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if

any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of October 29, 2010.

Common Stock, $.10 par value	98,488,048
(Class)	(Number of shares)

OMEGA HEALTHCARE INVESTORS, INC.
FORM 10-Q
September 30, 2010

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PART I – FINANCIAL INFORMATION

Item 1 - Financial Statements

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

	September 30, 2010	December 31, 2009
	(Unaudited)	
ASSETS		
Real estate properties		
Land and buildings	$2,352,372	$1,669,843
Less accumulated depreciation	(355,274)	(296,441)
Real estate properties – net	1,997,098	1,373,402
Mortgage notes receivable – net	90,252	100,223
	2,087,350	1,473,625
Other investments – net	31,340	32,800
	2,118,690	1,506,425
Assets held for sale – net	670	877
Total investments	2,119,360	1,507,302
Cash and cash equivalents	1,192	2,170
Restricted cash	21,151	9,486
Accounts receivable – net	90,780	81,558
Other assets	60,440	50,778
Operating assets for owned and operated properties	635	3,739
Total assets	$2,293,558	$1,655,033
LIABILITIES AND STOCKHOLDERS' EQUITY		
Revolving line of credit	$143,000	$94,100
Secured borrowings	302,210	159,354
Unsecured borrowings – net	702,947	484,695
Accrued expenses and other liabilities	122,739	49,895
Operating liabilities for owned and operated properties	1,579	1,762
Total liabilities	1,272,475	789,806
Stockholders' equity:		
Preferred stock issued and outstanding – 4,340 shares Series D with an aggregate liquidation preference of $108,488	108,488	108,488
Common stock $.10 par value authorized – 200,000 shares issued and outstanding – 98,236 shares as of September 30, 2010 and 88,266 as of December 31, 2009	9,824	8,827
Common stock – additional paid-in-capital	1,358,564	1,157,931
Cumulative net earnings	575,855	522,388
Cumulative dividends paid	(1,031,648)	(932,407)
Total stockholders' equity	1,021,083	865,227
Total liabilities and stockholders' equity	$2,293,558	$1,655,033

See notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenue				
Rental income	$66,299	$41,226	$165,028	$123,626
Mortgage interest income	2,576	2,915	7,709	8,686
Other investment income – net	746	694	3,282	1,844
Miscellaneous	103	160	3,852	364
Nursing home revenues of owned and operated assets	-	4,758	7,336	13,545
Total operating revenues	69,724	49,753	187,207	148,065
Expenses				
Depreciation and amortization	27,742	11,093	58,880	33,014
General and administrative	4,376	2,675	11,758	8,920
Acquisition costs	78	-	1,490	-
Impairment loss on real estate properties	-	89	155	159
Nursing home expenses of owned and operated assets	480	4,899	7,849	15,750
Total operating expenses	32,676	18,756	80,132	57,843
Income before other income and expense	37,048	30,997	107,075	90,222
Other income (expense):				
Interest income	11	2	88	19
Interest expense	(19,070)	(9,171)	(47,350)	(26,656)
Interest – amortization of deferred financing and refinancing costs	(978)	(690)	(6,342)	(2,216)
Litigation settlements	-	-	-	4,527
Total other expense	(20,037)	(9,859)	(53,604)	(24,326)
Income before loss on assets sold	17,011	21,138	53,471	65,896
Loss on assets sold – net	(4)	-	(4)	(24)
Net income	17,007	21,138	53,467	65,872
Preferred stock dividends	(2,271)	(2,271)	(6,814)	(6,814)
Net income available to common	$14,736	$18,867	$46,653	$59,058
Income per common share available to common shareholders:				
Basic:				
Net income	$0.15	$0.23	$0.50	$0.71
Diluted:				
Net income	$0.15	$0.22	$0.50	$0.71
Dividends declared and paid per common share	$0.36	$0.30	$1.00	$0.90

Weighted-average shares outstanding, basic	95,698	83,740	92,523	82,903
Weighted-average shares outstanding, diluted	95,987	83,858	92,700	83,004
Components of other comprehensive income:				
Net income	$17,007	$21,138	$53,467	$65,872
Total comprehensive income	$17,007	$21,138	$53,467	$65,872

See notes to consolidated financial statements.

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

	Preferred Stock	Common Stock Par Value	Additional Paid-in Capital	Cumulative Net Earnings	Cumulative Dividends	Total
Balance at December 31, 2009 (88,266 common shares)	$108,488	$8,827	$1,157,931	$522,388	$(932,407)	$865,227
Issuance of common stock:						
Grant of restricted stock (13 shares at $20.00 per share)	—	1	(1)	—	—	—
Amortization of restricted stock	—	—	1,732	—	—	1,732
Dividend reinvestment plan (2,154 shares at $20.00 per share)	—	216	42,853	—	—	43,069
Exercised options (15 shares at an average exercise price of $6.12 per share)	—	1	88	—	—	89
Grant of stock as payment of directors fees (6 shares at an average of $19.60 per share)	—	1	112	—	—	113
Equity Shelf Program (6,789 shares at $20.72 per share, net of issuance costs)	—	679	136,255	—	—	136,934
Issuance of common stock for acquisition (995 shares at $19.80 per share)	—	99	19,594	—	—	19,693
Net income	—	—	—	53,467	—	53,467
Common dividends ($1.00 per share).	—	—	—	—	(92,427)	(92,427)
Preferred dividends (Series D of $1.57 per share)	—	—	—	—	(6,814)	(6,814)
Balance at September 30, 2010 (98,236 common shares)	$108,488	$9,824	$1,358,564	$575,855	$(1,031,648)	$1,021,083

See notes to consolidated financial statements.

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

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Cash flows from operating activities		
Net income	$53,467	$65,872
Adjustment to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	58,880	33,014
Impairment loss on real estate properties	155	159
Amortization of deferred financing and refinancing costs	6,342	2,216
Restricted stock amortization expense	1,756	1,439
Loss (gain) on assets sold – net	4	24
Amortization of other non-cash interest charges	27	—
Amortization of in-place leases	(1,852)	—
Other	(113)	(129)
Gain on sale of securities	(789)	—
Change in operating assets and liabilities – net of amounts assumed/acquired:		
Accounts receivable, net	(2,033)	219
Straight-line rent	(6,928)	(6,987)
Lease inducement	(261)	532
Other operating assets and liabilities	(1,132)	10,117
Operating assets and liabilities for owned and operated properties	2,921	7,959
Net cash provided by operating activities	110,444	114,435
Cash flows from investing activities		
Acquisition of real estate – net of liabilities assumed and escrows acquired	(343,180)	—
Placement of mortgage loans	(2,372)	—
Proceeds from sale of real estate investments	81	85
Capital improvements and funding of other investments	(25,658)	(14,640)
Proceeds from other investments	18,720	39,515
Investments in other investments	(16,436)	(39,075)
Collection of mortgage principal – net	60	403
Net cash used in investing activities	(368,785)	(13,712)
Cash flows from financing activities		
Proceeds from credit facility borrowings	314,000	138,500
Payments on credit facility borrowings	(265,100)	(193,000)
Receipts of other long-term borrowings	196,556	—
Payments of other long-term borrowings	(59,882)	—
Payment of financing related costs	(9,231)	(4,574)
Receipts from dividend reinvestment plan	43,069	17,073
Net proceeds from issuance of common stock	136,934	23,095
Payments from exercised options – net	89	—
Dividends paid	(99,072)	(81,380)
Net cash provided by (used in) financing activities	257,363	(100,286)
(Decrease) increase in cash and cash equivalents	(978)	437
Cash and cash equivalents at beginning of period	2,170	209
Cash and cash equivalents at end of period	$1,192	$646

Interest paid during the period, net of amounts capitalized	$41,764	$24,508
Non-cash investing activities		
Assumed debt obligations	$202,015	$—
Non-cash settlement of mortgage obligations	(12,395)	—
Non-cash acquisition of real estate properties	12,395	—
Stock consideration issued for acquisition	19,693	—
Net non-cash investing activities	$221,708	$—

See notes to consolidated financial statements.

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OMEGA HEALTHCARE INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Unaudited
September 30, 2010

NOTE 1 – BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Business Overview

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

On July 7, 2008, we took ownership and/or possession of 15 facilities through bankruptcy court proceedings which were previously operated by Haven Eldercare (Haven). Prior to July 7, 2008, we had (i) leased eight facilities to Haven under a master lease agreement and (ii) provided mortgage financing to a Haven entity for seven facilities that we had previously consolidated according to accounting rules regarding variable interest entities then in place. As a result of the bankruptcy court judgment, the bankruptcy court retired the mortgage on the seven facilities in exchange for ownership of the facilities and awarded us certain other operational assets of Haven as well. Accordingly, effective July 7, 2008, we were no longer required to consolidate the Haven entity for which we had provided the mortgage because all of the assets of the Haven entity were transferred to us and we no longer had a variable interest in the Haven entity. In addition to receiving title to the seven facilities and certain other operational assets, on July 7, 2008, we assumed operating responsibility for the 15 Haven facilities. In July 2008, a new entity (TC Healthcare) was formed to operate these properties on our behalf through the use of an independent contractor. TC Healthcare's managing member and sole voting member, an individual with experience in operating these types of facilities, has no equity investment at risk and is unrelated to Omega. Omega and TC Healthcare entered into an agreement that requires Omega to provide the working capital requirements for TC Healthcare and to absorb the operating losses of TC Healthcare. The agreement also provides Omega with the right to receive the economic benefits of the entity. TC Healthcare is a variable interest entity as the entity does not have sufficient equity investment at risk to support its operations without subordinated financial support. Additionally, Omega has the power to direct the activities of TC Healthcare as Omega has the unilateral right to replace the shareholder. Omega is deemed the primary beneficiary of TC Healthcare as Omega has the controlling economic interest in the entity and therefore, consolidated the operations of TC Healthcare.

Basis of Presentation

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

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Our consolidated financial statements include the accounts of Omega, all direct and indirect wholly owned subsidiaries of Omega, and TC Healthcare, an entity and interim operator created to operate the 15 facilities we assumed as a result of the bankruptcy of one of our former tenants/operators. We consolidate the financial results of TC Healthcare into our financial statements based on the applicable consolidation accounting literature. We include the operating results and assets and liabilities of these facilities for the period of time that TC Healthcare was responsible for the operations of the facilities. Thirteen of these facilities were transitioned from TC Healthcare to a new tenant/operator on September 1, 2008. The two remaining facilities were transitioned to the new tenant/operator on June 1, 2010 upon approval by state regulators of the operating license transfer and as of such date, TC Healthcare no longer operates these facilities. The operating revenues and expenses and related operating assets and liabilities of the two facilities through September 30, 2010 are shown on a gross basis in our Consolidated Statements of Income and Consolidated Balance Sheets, respectively. TC Healthcare is responsible for the collection of the accounts receivable earned and the liabilities incurred prior to the date of the transition to the new tenant/operator. All inter-company accounts and transactions have been eliminated in consolidation of the financial statements.

Accounts Receivable

Accounts receivable includes: contractual receivables, straight-line rent receivables and lease inducements, net of an estimated provision for losses related to uncollectible and disputed accounts. Contractual receivables relates to the rents currently owed to us under the terms of the lease agreement. Straight-line receivables relates to the difference between the rental revenue recognized on a straight-line basis and the amounts due to us contractually. Lease inducements result from value provided by us to the lessee of the lease and will be amortized as a reduction of rental revenue over the lease term. On a quarterly basis, we review the collection of our contractual payments and determine the appropriateness of our allowance for uncollectible contractual rents. In the case of a lease recognized on a straight-line basis, we generally provide an allowance for straight-line accounts receivable when certain conditions or indicators of adverse collectability are present.

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

	September 30, 2010	December 31, 2009
	(in thousands)	
Contractual receivables	$6,107	$2,818
Straight-line receivables	58,185	52,395
Lease inducements	29,281	29,020
Allowance	(2,793)	(2,675)
Accounts receivable – net	$90,780	$81,558

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

Accounts receivable from owned and operated assets consist of amounts due from Medicare and Medicaid programs, other government programs, managed care health plans, commercial insurance companies and individual patients. Amounts recorded include estimated provisions for loss related to uncollectible accounts and disputed items. For additional information, see Note 3 – Owned and Operated Assets.

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Implementation of New Accounting Pronouncements

In January 2010, the FASB issued guidance on fair value measurements and disclosures. This guidance specifies that a reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. In addition, a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number) related to Level 3 fair value measurements as part of a reconciliation of the beginning and ending balances. The guidance further clarifies the disclosure regarding the level of disaggregation and input and valuation techniques. The adoption of this guidance did not impact our financial position or results of operations.

In February 2010, the FASB issued guidance on subsequent events. This guidance provides a definition for SEC filers and eliminates the requirement to disclose the date through which subsequent events have been evaluated. The adoption of this guidance did not impact our financial position or results of operations.

In June 2009, the FASB issued guidance to significantly amend the consolidation guidance applicable to variable interest entities ("VIEs"). The consolidation model was modified to one based on control and economics, and replaces the current quantitative primary beneficiary analysis with a qualitative analysis. The primary beneficiary of a VIE will be the entity that has (i) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and (ii) the obligation to absorb losses or receive benefits that could potentially be significant to the VIE. If multiple unrelated parties share such power, as defined, no party will be required to consolidate the VIE. Further, the guidance requires continual reconsideration of the primary beneficiary of a VIE and adds an additional reconsideration event for determination of whether an entity is a VIE. The amendments also require expanded disclosures related to VIEs which are largely consistent with the disclosure framework currently applied by us. The new guidance was effective January 1, 2010 for us. The adoption of this guidance did not impact our financial position or results of operations.

NOTE 2 –PROPERTIES AND INVESTMENTS

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

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

Leased Property

Our leased real estate properties, represented by 370 SNFs, 10 assisted living facilities ("ALFs") and five specialty facilities at September 30, 2010, are leased under provisions of single leases and master leases with initial terms typically ranging from 5 to 15 years, plus renewal options. Substantially all of our leases contain provisions for specified annual increases over the rents of the prior year and are generally computed in one of three methods depending on specific provisions of each lease as follows: (i) a specific annual percentage increase over the prior year's rent, generally 2.5%; (ii) an increase based on the change in pre-determined formulas from year to year (i.e., such as increases in the Consumer Price Index ("CPI")); or (iii) specific dollar increases over prior years. Under the terms of the leases, the lessee is responsible for all maintenance, repairs, taxes and insurance on the leased properties.

143 Facility CapitalSource Acquisitions

In November 2009, we entered into a securities purchase agreement (the "CapitalSource Purchase Agreement") with CapitalSource Inc. (NYSE: CSE) ("CapitalSource") and several of its affiliates, pursuant to which we agreed to purchase CapitalSource subsidiaries owning 80 long term care facilities, plus an option to purchase CapitalSource subsidiaries owning an additional 63 facilities (the "Option"), for approximately $565 million. The purchase price for the CapitalSource subsidiaries subject to the Option was approximately $295 million. We accounted for these acquisitions as business combinations.

First Closing

On December 22, 2009, we purchased CapitalSource entities owning 40 facilities and an Option to purchase CapitalSource entities owning 63 additional facilities for an aggregate purchase price of approximately $294.1 million. The consideration consisted of: (i) approximately $184.2 million in cash; (ii) 2,714,959 shares of Omega common stock and (iii) the assumption of approximately $59.4 million of 6.8% mortgage debt maturing on December 31, 2011. We incurred approximately $1.8 million in transaction costs, of which $1.6 million was recognized during 2009. We valued the 2,714,959 shares of our common stock at approximately $52.8 million on December 22, 2009.

The 40 facilities represent 5,264 available beds located in 12 states, and are part of 15 in-place triple net leases among 12 operators. The 12 leases generate approximately $31 million of annualized revenue.

We are in the process of gathering the information necessary to complete the purchase price allocation of the December 22, 2009 acquisition. As of September 30, 2010, we have allocated approximately $277.6 million to land ($22.5 million), building and site improvements ($239.7 million) and furniture and fixtures ($15.4 million). In addition, we allocated approximately $10.2 million to in-place above market leases assumed at the first closing and approximately $16.2 million to in-place below market leases assumed at the first closing. We estimate the net impact to revenue of amortizing the assumed in-place above and below market leases associated with the December 22, 2009 acquisition as follows (in millions):

Less than 1 year	1-3 years	3-5 years	Thereafter
1.6	2.3	1.9	(0.6)

The fair value of the debt assumed approximated face value. We have not recorded goodwill in connection with this transaction.

HUD Portfolio Closing

On June 29, 2010, we purchased CapitalSource entities owning 40 facilities for an aggregate purchase price of approximately $271 million. We also paid consideration of approximately $15 million for escrow accounts transferred to us at closing. The 40 facilities are encumbered by approximately $182 million in long-term mortgage financing guaranteed by the U.S. Department of Housing and Urban Development ("HUD") and $20 million in subordinated notes. The following summarizes the consideration paid at closing:

- $65 million in cash,
- $202 million face value of assumed debt, which includes $20 million of 9.0% unsecured debt maturing in December 2021, $53 million of HUD debt at a 6.61% weighted average annual interest rate maturing between January 2036 and May 2040, and $129 million of new HUD Debt at a 4.85% annual interest rate maturing between January 2040 and January 2045, and

- 995 thousand shares of our common stock valued at approximately $19 million on June 29, 2010.

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The 40 facilities represent 4,882 available beds located in two states, and are part of 13 in-place triple net leases among two operators. The 13 leases generate approximately $30 million of annualized revenue.

We are in the process of gathering the information necessary to complete the purchase price allocation of the June 29, 2010 acquisition. As of September 30, 2010, we have allocated approximately $312.4 million to land ($32.7 million), building and site improvements ($267.1 million) and furniture and fixtures ($12.6 million). In addition, we allocated approximately $5.7 million to in-place above market leases assumed at the HUD portfolio closing and approximately $24.0 million to in-place below market leases assumed at the HUD portfolio closing. We estimate the net impact to revenue of amortizing the assumed in-place above and below market leases associated with the June 29, 2010 acquisition as follows (in millions):

Less than 1 year	1-3 years	3-5 years	Thereafter
3.6	6.2	4.9	2.7

In addition, we recorded approximately $22.5 million of fair value adjustment related to the above market debt assumed based on the terms of comparable debt. We estimate amortization will average approximately $1.3 million per year for the next five years. We have not recorded goodwill in connection with this transaction.

Option Exercise and Closing

On April 20, 2010, we provided notice of our intent to exercise our Option to acquire CapitalSource entities owning 63 facilities. On June 9, 2010, we completed our purchase of the 63 CapitalSource facilities for an aggregate purchase price of approximately $293 million in cash. We used a combination of cash and borrowings of under our $320 million revolving senior secured credit facility to fund the acquisition.

The 63 facilities represent 6,607 available beds located in 19 states, and are part of 30 in-place triple net leases among 18 operators. The 30 leases generate approximately $34 million of annualized revenue.

We are in the process of gathering the information necessary to complete the purchase price allocation of the June 9, 2010 acquisition. As of September 30, 2010, we have allocated approximately $330.1 million to land ($35.0 million), building and site improvements ($275.8 million) and furniture and fixtures ($19.3 million). In addition, we allocated approximately $13.0 million to in-place above market leases assumed at the Option portfolio closing and approximately $24.8 million to in-place below market leases assumed at the Option portfolio closing. We estimate the net impact to revenue of amortizing the assumed in-place above and below market leases associated with the June 9, 2010 acquisition as follows:

Less than 1 year	1-3 years	3-5 years	Thereafter
0.6	2.6	3.3	5.2

We have not recorded goodwill in connection with this transaction. We incurred approximately $1.2 million in transaction costs associated with the HUD portfolio and Option portfolio closings.

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The facilities acquired from CapitalSource on December 22, 2009, June 9, 2010 and June 29, 2010 are included in our results of operations from the date of acquisition. The following unaudited pro forma results of operation reflect each of the CapitalSource transactions as if they occurred on January 1, 2009. In the opinion of management, all significant necessary adjustments to reflect the effect of the acquisition have been made. The following pro forma information is not indicative of future operations.

	Pro Forma			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands, except per share amount, unaudited)			
Revenues	$69,724	$74,575	$218,420	$222,532
Net income available to common	$14,736	$23,652	$52,746	$73,412
Earnings per share – diluted:				
Net income available to common – as reported	$0.15	$0.22	$0.50	$0.71
Net income available to common – pro forma	$0.15	$0.27	$0.56	$0.85

Held for Sale

At September 30, 2010, we owned one SNF classified as held-for-sale with an aggregate net book value of approximately $0.7 million.

Ciena Construction Mortgage Loan

In August 2010, we agreed to a Construction Mortgage Loan for an aggregate of $5.6 million to affiliates of Ciena Health Care Management Inc. for the purpose of constructing a new skilled nursing facility in Michigan. The loan is an interest only loan and bears interest at an annual rate of 12.5% and mature on the 10th anniversary of the completion of construction of the facility. During the third quarter of 2010, we funded approximately $2.4 million for the construction of the 120 bed facility.

Purchase of Mortgage Backed Certificate Securities

In March 2010, we purchased, in the open market, two series of mortgage backed certificates with a face value of $14 million for approximately $12.9 million. The securities yield, including the amortization of the discount, is approximately 10% annually. The certificates were part of a $250 million trust that was secured by 65 SNFs owned by CapitalSource, 63 of which we acquired on June 9, 2010 as part of the Option closing. On June 21, 2010, these mortgage back certificates were retired at par for approximately $14.0 million, generating a gain of approximately $0.8 million which is included in the accompanying consolidated statement of income.

Mortgage Notes Receivable

Our mortgage notes receivable relate to 10 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 three (3) states, operated by two (2) independent healthcare operating companies. We monitor compliance with mortgages and when necessary have initiated collection, foreclosure and other proceedings with respect to certain outstanding loans. As of September 30, 2010, none of our mortgages were in default or in foreclosure proceedings. The mortgage properties are cross-collateralized with the master lease agreement.

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In late 2009, we began discussion with a mortgagee regarding final payment of the $12.4 million balance due on a mortgage that relates to four facilities and that matured February 28, 2010. The mortgagee was current on all interest and other obligations. Through these discussions, we determined that the mortgagee was not likely to raise the capital necessary to repay the mortgage. We evaluated the mortgage for impairment due to the mortgagee's likely inability to repay the amount due. Our evaluation indicated that although the loan was impaired, no impairment reserve was required because the collateral supporting the loan exceeds the net mortgage balance due to us. In February 2010, the mortgagee surrendered ownership of the properties to us in exchange for the payment of the mortgage note due. We have leased these facilities to an existing operator.

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

NOTE 3 – OWNED AND OPERATED ASSETS

On June 1, 2010, the remaining two owned and operated facilities were transitioned to a third party operator/tenant and are now part of a master lease agreement with Formation. As a result of the transition to Formation, we no longer operate any owned and operated facilities, effective June 1, 2010.

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

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

Effective September 1, 2008, we completed the operational transfer of 12 SNFs and one ALF to affiliates of Formation, in accordance with the terms of the MTA. The 13 facilities are located in Connecticut (5), Rhode Island (4), New Hampshire (3) and Massachusetts (1). As part of the transaction, Genesis Healthcare ("Genesis") has entered into a long-term management agreement with Formation to oversee the day-to-day operations of each of these facilities. The two remaining facilities in Vermont, which were operated by TC Healthcare until May 31, 2010, have been transferred to Formation/Genesis. Our consolidated financial statements include the results of operations of Vermont facilities from July 7, 2008 to May 31, 2010.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Nursing home revenues	$ —	$ 4,758	$ 7,336	$ 13,545
Nursing home expenses	480	4,899	7,849	15,750
Loss from nursing home operations	$ (480)	$ (141)	$ (513)	$ (2,205)

NOTE 4 – CONCENTRATION OF RISK

As of September 30, 2010, our portfolio of real estate investments consisted of 396 healthcare facilities, located in 35 states and operated by 49 third-party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately $2.4 billion at September 30, 2010, with approximately 99% of our real estate investments related to long-term care facilities. This portfolio is made up of 370 SNFs, 10 ALFs, five specialty facilities, fixed rate mortgages on 10 SNFs, and one SNF that is currently held for sale. At September 30, 2010, we also held miscellaneous investments of approximately $31.3 million, consisting primarily of secured loans to third-party operators of our facilities.

At September 30, 2010, approximately 15% of our real estate investments were leased to and operated by two public companies: Sun Healthcare Group, Inc ("Sun") (9%) and Advocat Inc. ("Advocat") (6%). Our largest private company operators and/or managers (by investment) were CommuniCare Health Services ("CommuniCare") (13%), Airamid Health Management, LLC through its subsidiaries, ("Airamid") (11%) and Signature Holdings II, LLC ("Signature") (9%). No other operator represents more than 6% of our investments. The three states in which we had our highest concentration of investments were Florida (24%), Ohio (14%) and Pennsylvania (7%) at September 30, 2010.

For the three-month period ended September 30, 2010, our revenues from operations totaled $69.7 million, of which approximately $8.8 million were from CommuniCare (13%), $8.0 million from Sun (12%) and $6.3 million from Airamid (9%). No other operator generated more than 9% of our revenues from operations for the three-month period ended September 30, 2010.

For the nine-month period ended September 30, 2010, our revenues from operations totaled $187.2 million, of which approximately $26.4 million were from CommuniCare (14%), $23.7 million from Sun (13%) and $16.7 million from Advocat (9%). No other operator generated more than 8% of our revenues from operations for the nine-month period ended September 30, 2010.

Sun and Advocat are subject to the reporting requirements of the SEC and are required to file with the SEC annual reports containing audited financial information and quarterly reports containing unaudited interim financial information. Sun and Advocat's filings with the SEC can be found at the SEC's website at www.sec.gov. We are providing this data for information purposes only, and you are encouraged to obtain Sun's and Advocat's publicly available filings from the SEC.

NOTE 5 –DIVIDENDS

Common Dividends

On October 14, 2010, the Board of Directors declared a common stock dividend of $0.37 per share, increasing the quarterly common dividend by $0.01 per share over the prior quarter. The common dividends are to be paid November 15, 2010 to common stockholders of record on October 29, 2010.

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On July 15, 2010, the Board of Directors declared a common stock dividend of $0.36 per share, increasing the quarterly common dividend by $0.04, or 12.5%, per share over the prior quarter. The common dividends were paid August 16, 2010 to common stockholders of record on July 30, 2010.

On April 15, 2010, the Board of Directors declared a common stock dividend of $0.32 per share that was paid May 17, 2010 to common stockholders of record on April 30, 2010.

On January 20, 2010, the Board of Directors declared a common stock dividend of $0.32 per share, increasing the quarterly common dividend by $0.02 per share over the prior quarter. The common dividends were paid on February 16, 2010 to common stockholders of record on January 29, 2010.

Series D Preferred Dividends

On October 14, 2010, the Board of Directors declared the regular quarterly dividends for the 8.375% Series D Cumulative Redeemable Preferred Stock ("Series D Preferred Stock") to stockholders of record on October 29, 2010. The stockholders of record of the Series D Preferred Stock on October 29, 2010 will be paid dividends in the amount of $0.52344 per preferred share on November 15, 2010. The liquidation preference for our Series D Preferred Stock is $25.00 per share. Regular quarterly preferred dividends for the Series D Preferred Stock represent dividends for the period August 1, 2010 through October 31, 2010.

On July 15, 2010, the Board of Directors declared regular quarterly dividends of approximately $0.52344 per preferred share on the Series D Preferred Stock that were paid August 16, 2010 to preferred stockholders of record on July 30, 2010.

On April 15, 2010, the Board of Directors declared regular quarterly dividends of approximately $0.52344 per preferred share on the Series D Preferred Stock that were paid May 17, 2010 to preferred stockholders of record on April 30, 2010.

On January 20, 2010, the Board of Directors declared regular quarterly dividends of approximately $0.52344 per preferred share on the Series D Preferred Stock that were paid February 16, 2010 to preferred stockholders of record on January 29, 2010.

NOTE 6 – TAXES

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

Subject to the limitation under the REIT asset test rules, we are permitted to own up to 100% of the stock of one or more taxable REIT subsidiary ("TRSs"). Currently, we have one TRS that is taxable as a corporation and that pays federal, state and local income tax on its net income at the applicable corporate rates. The TRS had a net operating loss carry-forward as of September 30, 2010 of $1.1 million. The loss carry-forward is fully reserved with a valuation allowance as we concluded it was more-likely-than-not that the deferred tax asset would not be realized.

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NOTE 7 – STOCK-BASED COMPENSATION

The following is a summary of our stock based compensation expense for the three- and nine- month periods ended September 30, 2010 and 2009, respectively:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Restricted stock expense	$450	$480	$1,756	$1,439

2007 Stock Awards

In May 2007, we granted 286,908 shares of restricted stock and 247,992 performance restricted stock units ("PRSU") to five executive officers under the 2004 Plan Stock Incentive Plan.

Restricted Stock Award

The restricted stock awards vest one-seventh on December 31, 2007 and two-sevenths on December 31, 2008, December 31, 2009, and December 31, 2010, respectively, subject to continued employment on the vesting date (as defined in the agreements filed with the SEC on May 8, 2007). As of September 30, 2010, 204,935 shares of restricted stock have vested under the restricted stock award.

Performance Restricted Stock Units

We awarded two types of PRSUs (annual and cliff vesting awards) to the five executives. One half of the PRSU awards vest annually in equal increments on December 31, 2008, December 31, 2009, and December 31, 2010, respectively. The other half of the PRSU awards cliff vest on December 31, 2010. Vesting on both types of awards requires achievement of total shareholder return (as defined in the agreements filed with the SEC on May 8, 2007).

On March 29, 2010, the Compensation Committee of Omega's Board of Directors (the "Committee") determined that, based on the 26% Total Shareholder Return actually achieved for the twelve month period ended December 31, 2009 and in light of the challenging economic and capital market conditions that prevailed generally during 2009, it was appropriate to waive the vesting requirement solely with respect to the PRSUs that would have vested on December 31, 2009 had a cumulative, annualized Total Shareholder Return of 11% been achieved. As a result of the modification to the 2009 PRSUs, we recorded approximately $0.4 million of additional expense which was recorded during the first quarter of 2010 and accrued dividends of approximately $0.1 million related to this vesting.

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Each PRSU represents the right to one share of common stock and dividend equivalents based on dividends paid to stockholders during the applicable performance period. The following table summarizes our total unrecognized compensation cost associated with the restricted stock awards and PRSUs awarded in May 2007 as of September 30, 2010:

	Shares/ Units	Grant Date Fair Value Per Unit/ Share	Total Compensation Cost	Weighted Average Period of Expense Recognition (in months)	Unrecognized Compensation Cost
	(in thousands, except share and per share amounts)				
Restricted stock	286,908	$17.06	$ 4,895	44	$ 334
2008 Annual performance restricted stock units	41,332	8.78	363	20	-
2009 Annual performance restricted stock units, including modification	41,332	19.10	789	32	-
2010 Annual performance restricted stock units	41,332	8.14	255	44	17
3 year cliff vest performance restricted stock units	123,996	6.17	765	44	52
Total	534,900		$ 7,067		$ 403

As of September 30, 2010, we had 1,995 stock options and 26,267 shares of restricted stock outstanding to directors. The stock options were fully vested as of January 1, 2007 and the directors' restricted shares are scheduled to vest over the next three years. As of September 30, 2010, the unrecognized compensation cost associated with the directors is approximately $0.3 million.

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NOTE 8 – FINANCING ACTIVITIES AND BORROWING ARRANGEMENTS

Secured and Unsecured Borrowings

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

	Maturity	Current Rate	September 30, 2010	December 31, 2009
			(in thousands)	
Secured borrowings:				
Revolving lines of credit	2014	4.26 %	$143,000	$94,100
GECC Term loan	2014	6.50 %	100,000	100,000
CapitalSource mortgage	2011	6.80 %	—	59,354
HUD Berkadia mortgages (1)	2036 - 2040	6.61 %	53,088	—
HUD Capital Funding mortgage	2040 - 2045	4.85 %	128,399	—
			281,487	159,354
Fair value adjustment at assumption date (2)			20,723	—
Total secured borrowings			302,210	159,354
Unsecured borrowings:				
2014 Notes	2014	7.0 %	$310,000	$310,000
2016 Notes	2016	7.0 %	175,000	175,000
2020 Notes	2020	7.5 %	200,000	—
HUD subordinated debt	2021	9.0 %	20,000	—
			705,000	485,000
Discount			(3,504)	(305)
Fair value adjustment at assumption date (2)			1,451	—
Total unsecured borrowings			702,947	484,695
Totals - net			$1,148,157	$738,149

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

(2) Adjustment to reflect assumption of debt to fair market value. The debt was assumed as part of the HUD Portfolio closing on June 29, 2010.

Bank Credit Agreements

At September 30, 2010, we had $143.0 million outstanding under our new $320 million revolving senior secured credit facility (the "2010 Credit Facility"), and no letters of credit outstanding, leaving availability of $177.0 million.

On April 13, 2010, we entered into our 2010 Credit Facility and concurrently terminated our $200 million revolving senior secured credit facility (the "2009 Credit Facility"). The 2010 Credit Facility matures in four years, on April 13, 2014; provided, we have refinanced or repaid our $310 million, 7% senior notes due April 2014 (the "2014 Notes") prior to December 31, 2013. In the event the 2014 Notes have not been refinanced or repaid on or prior to December 31, 2013, the maturity date of the 2010 Credit Facility will become December 31, 2013. The 2010 Credit Facility includes an "accordion feature" that permits us to expand our borrowing capacity to $420 million during our first three years. At March 31, 2010, deferred financing fees associated with the 2009 Credit Facility were $3.5 million. These fees were written–off in April 2010.

The 2010 Credit Facility is priced at LIBOR plus an applicable percentage (ranging from 325 basis points to 425 basis points) based on the consolidated leverage and is not subject to a LIBOR floor. Our applicable percentage above LIBOR is currently 350 basis points.

$200 Million Senior Notes

On February 9, 2010, we issued and sold $200 million aggregate principal amount of 7.5% senior notes due 2020 (the "2020 Notes"). The 2020 Notes mature on February 15, 2020 and pay interest semi-annually on August 15th and February 15th.

We may redeem the 2020 Notes, in whole at any time or in part from time to time, at redemption prices of 103.75%, 102.5% and 101.25% of the principal amount thereof if the redemption occurs during the respective 12-month periods beginning on February 15 of the years 2015, 2016 and 2017, respectively, and at a redemption price of 100% of the principal amount thereof on and after February 15, 2018, in each case, plus any accrued and unpaid interest to the redemption date. In addition, until February 15, 2013 we may redeem up to 35% of the 2020 Notes with the net proceeds of one or more public equity offerings at a redemption price of 107.5% of the principal amount of the 2020 Notes to be so redeemed, plus any accrued and unpaid interest to the redemption date. If we undergo a change of control, we may be required to offer to purchase the notes from holders at a purchase price equal to 101% of the principal amount plus accrued interest.

The 2020 Notes were sold at an issue price of 98.278% of the principal amount, resulting in gross proceeds of approximately $197 million. We used the net proceeds from the sale of the 2020 Notes, after discounts and expenses, to (i) repay outstanding borrowings of approximately $59 million of debt assumed in connection with our December 22, 2009 CapitalSource acquisition, (ii) repay outstanding borrowings under our 2009 Credit Facility, and (iii) for working capital and general corporate purposes, including the acquisition of healthcare-related properties such as the CapitalSource acquisitions. The 2020 Notes are guaranteed by substantially all of our subsidiaries as of the date of issuance. The entities we acquired on June 29, 2010 from CapitalSource which own 40 facilities (see "Completed HUD Portfolio Closing" in Note 2) and the entities created to effect the acquisition are not guarantors of our 2020 Notes, or our outstanding 2014 or 2016 Notes. As of September 30, 2010, our subsidiaries that are not guarantors of these Notes accounted for approximately $343.5 million of our total assets.

On October 20, 2010, we commenced an offer to exchange $200 million of our 7½% Senior Notes due 2020 (the "Exchange Notes"), which were issued in February of 2010 in a private placement (the "Private Notes"). The exchange offer is being conducted upon the terms and subject to the conditions set forth in our prospectus dated October 20, 2010, and the related letter of transmittal.

The terms of the Exchange Notes are substantially identical to the terms of the Private Notes, including subsidiary guarantees, except that provisions relating to transfer restrictions, registration rights and additional interest will not apply to the Exchange Notes.

The exchange offer is scheduled to expire at 5:00 p.m., New York City time, on November 22, 2010, unless extended. Private Notes tendered pursuant to the exchange offer may be withdrawn at any time prior to the expiration date by following the procedures set forth in the exchange offer prospectus and the related letter of transmittal.

$59 Million Mortgage Debt

In connection with the December 22, 2009 closing under the CapitalSource Purchase Agreement, we assumed $59.4 million of 6.8% mortgage debt maturing on December 31, 2011 with a one year extension right. The mortgage debt was secured by 12 facilities per the terms of the mortgage debt agreement. On February 16, 2010, we used proceeds from the offering of our $200 million 7.5% Senior Notes due 2020 to repay the assumed mortgage debt.

HUD Mortgage Loans and Subordinate Notes

In connection with the June 29, 2010, acquisition of the HUD Portfolio from CapitalSource, we assumed 29 HUD mortgage loans from CapitalSource. The face value of eleven of the HUD loans assumed was $53.2 million with a weighted average annual interest rate of 6.61% and mature between January 2036 and May 2040. The face value for the other eighteen HUD loans assumed was $128.8 million, and mature between January 2040 and January 2045 and all have an annual interest rate of 4.85%. We also assumed five separate $4.0 million subordinated notes that mature in December 2021 with an annual interest rate of 9%.

In accordance with the guidance for a business combination, we are required to allocate the fair value of the assets purchased and liabilities assumed, including identifiable intangible in the CapitalSource transaction at their fair values. Our preliminary estimate of the fair value of the HUD mortgage loans assumed is approximately $21.0 million greater than the face value of the loans as market rates for comparable loans at the acquisition date were less than the stated rates on the loans. Our preliminary estimate of the fair value of the subordinated notes assumed is approximately $1.5 million greater than the face value of the subordinated notes as market rates for comparable notes at the acquisition date were less than the stated rates on the notes. We will amortize the impact of the fair value adjustment for the mortgage loans and subordinated notes over there terms, respectively, utilizing an effective interest method. We estimate amortization of the fair value adjustment to average approximately $1.3 million per year over the next five years.

Our long-term borrowings require us to meet certain property level financial covenants and corporate financial covenants, including prescribed leverage, fixed charge coverage, minimum net worth, limitations on additional indebtedness and limitations on dividend payouts. As of September 30, 2010, we were in compliance with all property level and corporate financial covenants.

Equity Issuance and Programs

1.0 Million Share Common Stock Issuance

On June 29, 2010, in connection with our acquisition of certain subsidiaries of CapitalSource, we issued approximately 1.0 million shares of our common stock to the selling stockholder. The closing price of the common stock was $19.80 per share.

$140 Million Equity Shelf Program

On June 25, 2010, we entered into separate equity distribution agreements (the “Agreements”) to sell shares of our common stock having an aggregate gross sales price of up to $140,000,000 (the “2010 ESP”) with each of BofA Merrill Lynch, Credit Agricole Securities (USA) Inc., Deutsche Bank Securities, Jefferies & Company, Inc., RBS Securities Inc., Stifel Nicolaus & Company, Incorporated and UBS Securities LLC, each as sales agents and/or principal (collectively, the “Managers”). Under the terms of the Agreements, we may from time to time offer and sell shares of our common stock, having an aggregate gross sales price of up to $140,000,000 through or to the Managers. We will pay each Manager compensation from the sales of the shares equal to 2% of the gross sales price per share of shares sold through such Manager under the applicable Agreement. During the three months ended September 30, 2010, 3.0 million shares of our common stock were issued through the 2010 ESP for net proceeds of approximately $63.4 million, net of $1.3 million of commissions.

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$100 Million Equity Shelf Program

We issued a total of 5.2 million shares of common stock, generating a total of $97.6 million of net proceeds under our $100 million Equity Shelf Program, which was terminated in April of 2010.

NOTE 9 - FINANCIAL INSTRUMENTS

At September 30, 2010 and December 31, 2009, the carrying amounts and fair values of our financial instruments were as follows:

	September 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:	(in thousands)			
Cash and cash equivalents	$1,192	$1,192	$2,170	$2,170
Restricted cash	21,151	21,151	9,486	9,486
Mortgage notes receivable – net	90,252	88,413	100,223	98,251
Other investments – net	31,340	27,772	32,800	29,725
Totals	$143,935	$138,528	$144,679	$139,632
Liabilities:				
Revolving lines of credit	$143,000	$143,000	$94,100	$94,100
6.50% GECC Term loan	100,000	103,862	100,000	100,000
6.80% CapitalSource Mortgage Note	—	—	59,354	59,354
7.00% Notes due 2014 – net	310,554	350,100	310,673	315,196
7.00% Notes due 2016 – net	174,171	185,264	174,022	175,710
7.50 % Notes due 2020 – net	196,771	209,557	—	—
HUD debt (1)	202,210	212,296	—	—
Subordinated debt (1)	21,451	23,314	—	—
Totals	$1,148,157	$1,227,393	$738,149	$744,360

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

Fair value estimates are subjective in nature and are dependent on a number of important assumptions, including estimates of future cash flows, risks, discount rates and relevant comparable market information associated with each financial instrument (see Note 2 – Summary of Significant Accounting Policies of our 2009 Annual Report on Form 10-K). The use of different market assumptions and estimation methodologies may have a material effect on the reported estimated fair value amounts. Accordingly, the estimates presented above are not necessarily indicative of the amounts we would realize in a current market exchange.

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

- Cash and cash equivalents and restricted cash: The carrying amount of cash and cash equivalents and restricted cash reported in the balance sheet approximates fair value because of the short maturity of these instruments (i.e., less than 90 days).

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

    - Other investments: Other investments are primarily comprised of: (i) notes receivable; and (ii) an investment in redeemable non-convertible preferred security of an unconsolidated business accounted for using the cost method of accounting. The fair values of notes receivable are estimated using a discounted cash flow analysis, using interest rates being offered for similar loans to borrowers with similar credit ratings. The fair value of the investment in the unconsolidated business is estimated using discounted cash flow and volatility assumptions or, if available, quoted market value and considers the terms of the underlying arrangement.

- Revolving lines of credit: The fair value of our borrowings under variable rate agreements are estimated using an expected present value technique based on expected cash flows discounted using the current market rates.

- Senior notes and other long-term borrowings: The fair value of our borrowings under fixed rate agreements are estimated based on open market trading activity provided by a third party.

NOTE 10 – LITIGATION

On January 7, 2010, LCT SE Texas Holdings, L.L.C. ("LCT"), an affiliate of Mariner Health Care and the lessee of four facilities located in the Houston area (the "LCT Facilities"), filed a petition in the District Court of Harris County, Texas (No. 2010-01120) against four landlord entities (the "CSE Entities"), the member interests of which we purchased as part of the December 2009 CapitalSource acquisition. The petition relates to a right of first refusal ("ROFR") under the master lease between LCT and the CSE Entities. The petition alleges, among other things, that (i) the notice of the acquisition of the member's interests of the CSE Entities was not proper under the ROFR provision in the master lease, (ii) the purchase price allocated to the member's interests of the CSE Entities (or the LCT Facilities) pursuant to the CapitalSource Purchase Agreement and specified in the notice to LCT of its ROFR, if any, was not a bona fide offer, did not represent "true market value", and failed to trigger the ROFR, and (iii) we tortiously interfered with LCT's right to exercise the ROFR. The petition seeks a declaratory adjudication with respect to the identified claims above, a claim for specific performance permitting LCT to exercise its ROFR, and unspecified actual and punitive damages relating to breach of the master lease by the CSE Entities and tortious interference against us. We believe that the litigation is defensible. In addition, under the CapitalSource Purchase Agreement and related transaction documents, CapitalSource has agreed to indemnify us for any losses, including reasonable legal expenses, incurred by us in connection with this litigation.

During the first quarter of 2010, we agreed to settle a lawsuit for approximately $3.7 million in cash with a prior tenant for breach of contract related to failure to pay rent owed to us. We recorded the settlement as miscellaneous income in the accompanying consolidated statements of income.

NOTE 11– EARNINGS PER SHARE

The computation of basic Earnings Per Share ("EPS") is computed by dividing net income available to common stockholders by the weighted-average number of shares of common stock outstanding during the relevant period. Diluted EPS is computed using the treasury stock method, which is net income divided by the total weighted-average number of common outstanding shares plus the effect of dilutive common equivalent shares during the respective period. Dilutive common shares reflect the assumed issuance of additional common shares pursuant to certain of our share-based compensation plans, including stock options, restricted stock and performance restricted stock units.

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

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
	(in thousands, except per share amounts)			
Numerator:				
Income from continuing operations	$17,007	$21,138	$53,467	$65,872
Preferred stock dividends	(2,271)	(2,271)	(6,814)	(6,814)
Numerator for net income available to common per share - basic and diluted	$14,736	$18,867	$46,653	$59,058
Denominator:				
Denominator for basic earnings per share	95,698	83,740	92,523	82,903
Effect of dilutive securities:				
Restricted stock	281	107	168	89
Stock option incremental shares	—	11	3	11
Deferred stock	8	—	6	1
Denominator for diluted earnings per share	95,987	83,858	92,700	83,004
Earnings per share – basic:				
Net income – basic				