

OMEGA HEALTHCARE INVESTORS INC
Form POS AM
January 29, 2007

As filed with the Securities and Exchange Commission on January 29, 2007
Registration No. 333-117655

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

Amendment No. 3 to
FORM S-3
on FORM S-11

**FOR REGISTRATION UNDER THE SECURITIES ACT OF 1933
OF SECURITIES OF CERTAIN REAL ESTATE COMPANIES**

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

MARYLAND
(State or other jurisdiction of
incorporation or organization)

38-3041398
(I.R.S. Employer Identification No.)

**9690 Deereco Road, Suite 100
Timonium, Maryland 21093
(410) 427-1700**
(Address, including zip code, and telephone number, including
area code, of registrant's principal executive offices)

**C. Taylor Pickett
Chief Executive Officer
Omega Healthcare Investors, Inc.
9690 Deereco Road, Suite 100
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(410) 427-1700**
(Name, address, including zip code, and telephone number,
including area code, of agent for service)

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Approximate date of commencement of proposed sale to the public: From time to time or at one time after the effective date of this registration statement.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box.

Explanatory Note

On December 14, 2006, Omega Healthcare Investors, Inc. ("Omega") filed amendments to its Form 10-K for the fiscal year ended December 31, 2005 and its Forms 10-Q for the periods ended March 31, 2006 and June 30, 2006 (the "Restatements") to restate certain historical results, to correct errors in previously reported amounts related to tax matters and asset values, and to record certain straight-line rental income. Omega also filed its Form 10-Q for the period ending September 30, 2006 on December 15, 2006. As a consequence, Omega has filed on Form S-11 this post-effective amendment to its Registration Statement on Form S-3 because Omega is currently ineligible to use Form S-3.

Pursuant to Rule 429 under the Securities Act of 1933, as amended, the prospectus included in this Post-Effective Amendment to Registration Statement is a combined prospectus that also relates to the Registration Statement on Form S-3, Registration No. 333-69675, filed by the Registrant on December 23, 1998, as amended. Of the dollar amount of the securities initially registered pursuant to Registration Statement No. 333-69675, \$45,538,801 remain unsold. Pursuant to Rule 429, this Registration Statement shall act, upon effectiveness, as Post-Effective Amendment No. 4 to Registration Statement No. 333-69675.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED JANUARY 29, 2007

PROSPECTUS

\$390,796,000

Debt Securities
Preferred Stock
Common Stock
Warrants

We may from time to time offer and sell in one or more series:

· debt securities;

· warrants to purchase debt securities;

· shares of our preferred stock;

· warrants to purchase shares of our preferred stock;

· shares of our common stock; and

· warrants to purchase shares of our common stock.

The debt securities warrants, the preferred stock warrants and the common stock warrants are collectively referred to herein as the securities warrants. The debt securities, the preferred stock, the common stock and the securities warrants are collectively referred to herein as the securities. The securities offered by this prospectus will have an aggregate public offering price of \$390,796,000. We will provide the specific terms of these securities in supplements to this prospectus prepared in connection with each offering. The debt securities may be convertible into preferred stock, common stock or debt securities of another series. The preferred stock may be convertible into common stock or preferred stock of another series. No securities may be sold under this prospectus without delivery of the applicable prospectus supplement. You should read this prospectus and the prospectus supplements carefully before you invest in the securities.

Securities may be sold directly, through agents from time to time or through underwriters or dealers. If any of our agents or any underwriter is involved in the sale of the securities, the name of the agent or underwriter and any applicable commission or discount will be set forth in the accompanying prospectus supplement. See “Plan of Distribution.” The net proceeds to us from the sale also will be set forth in the applicable prospectus supplement.

See “Risk Factors” on page 5 for a discussion of matters that you should consider before investing in these securities.

Our common stock is traded on the New York Stock Exchange under the symbol "OHI". On January 25, 2007, the closing price of our common stock was \$18.08 per share.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is _____, 2007

We have not authorized any dealer, salesman or other person to give any information or to make any representation other than those contained in this prospectus. You must not rely upon any information or representation not contained in this prospectus or the applicable prospectus supplement. This prospectus does not constitute an offer to sell or the solicitation of an offer to buy any securities other than the registered securities to which they relate, nor does this prospectus nor any applicable prospectus supplement constitute an offer to sell or the solicitation of an offer to buy securities in any jurisdiction to any person to whom it is unlawful to make such offer or solicitation in such jurisdiction.

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You should rely only on the information provided in this prospectus. We have not authorized anyone to provide you with different information. You should not assume that the information in this prospectus is accurate as of any date other than the date on the front of this prospectus or those documents, as applicable.

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the SEC utilizing a “shelf” registration process. Under this shelf registration process, we may sell any combination of the securities described in this prospectus in one or more offerings up to a total dollar amount of \$390,796,000. This prospectus provides you with a general description of the securities we may offer. Each time we sell securities, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. You should read both this prospectus and any prospectus supplement together with additional information described under the heading “Available Information.”

All references to “you” in this prospectus refer to those persons who invest in the securities being offered by this prospectus, and all references to “we,” “us” and “our” in this prospectus refer to Omega Healthcare Investors, Inc., a Maryland corporation, and its subsidiaries.

SUMMARY

The following summary may not contain all the information that may be important to you. You should read the entire prospectus and the documents we have filed with the Securities and Exchange Commission before making a decision to invest in our common stock.

Our Company

We were incorporated in the State of Maryland on March 31, 1992. We are a self-administered real estate investment trust, or REIT, investing in income-producing healthcare facilities, principally long-term care facilities located in the United States. We provide lease or mortgage financing to qualified operators of skilled nursing facilities and, to a lesser extent, assisted living facilities, rehabilitation and acute care facilities. We have historically financed investments through borrowings under our revolving credit facilities, private placements or public offerings of debt or equity securities, the assumption of secured indebtedness, or a combination of these methods.

At September 30, 2006, our portfolio of domestic investments consisted of 241 healthcare facilities, located in 27 states and operated by 33 third-party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately \$1.3 billion at September 30, 2006, with approximately 98% of our real estate investments related to long-term care facilities. This portfolio is made up of:

- 227 long-term healthcare facilities;
- two rehabilitation hospitals owned and leased to third parties;
- fixed rate mortgages on 10 long-term healthcare facilities; and
- two long-term healthcare facilities that are currently held for sale.

At September 30, 2006, we also held other investments of approximately \$37 million, consisting primarily of secured loans to third-party operators of our facilities.

Summary of Financial Information

The following tables summarize our revenues and real estate assets by asset category for 2005, 2004 and 2003. (See “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Note 3 - Properties” and “Note 4 - Mortgage Notes Receivable” to our audited consolidated financial statements for the year ended December 31, 2005 included elsewhere herein).

Revenues by Asset Category
(in thousands)

	Year ended December 31,		
	2005 (Restated)	2004 (Restated)	2003 (Restated)
Core assets:			
Lease rental income	\$ 94,945	\$ 70,107	\$ 58,357
Mortgage interest income	6,527	13,266	14,656
Total core asset revenues	101,472	83,373	73,013
Other asset revenue	4,075	3,129	2,922
Miscellaneous income	4,459	831	1,048
Total revenue before owned and operated assets	110,006	87,333	76,983
Owned and operated assets revenue	—	—	4,395
Total revenue	\$ 110,006	\$ 87,333	\$ 81,378

Real Estate Assets by Asset Category
(in thousands)

	As of December 31,	
	2005 (Restated)	2004 (Restated)
Core assets:		
Leased assets	\$ 994,327	\$ 803,753
Mortgaged assets	104,522	118,058
Total core assets	1,098,849	921,811
Other assets	28,918	34,766
Total real estate assets before held for sale assets	1,127,767	956,577
Held for sale assets	2,735	3,992
Total real estate assets	\$ 1,130,502	\$ 960,569

Our principal executives offices are located at 9690 Deereco Road, Suite 100, Timonium, Maryland 21093, and our telephone number is (410) 427-1700.

RECENT DEVELOPMENTS

Advocat Inc.

In November 2000, Advocat Inc., or Advocat, an operator of various skilled nursing facilities owned by or mortgaged to us, was in default on its obligations to us. As a result, we entered into an agreement with Advocat with respect to the restructuring of Advocat's obligations pursuant to leases and mortgages for the facilities then operated by Advocat, which is referred to herein as the Initial Advocat Restructuring. As part of the Initial Advocat Restructuring in 2000, Advocat issued to us (i) 393,658 shares of Advocat's Series B non-voting, redeemable (on or after September 30, 2007), convertible preferred stock, which was convertible into up to 706,576 shares of Advocat's common stock (representing 9.9% of the outstanding shares of Advocat's common stock on a fully diluted, as-converted basis and accruing dividends at 7% per annum), and (ii) a secured convertible subordinated note in the amount of \$1.7 million bearing interest at 7% per annum with a September 30, 2007 maturity.

Subsequent to the Initial Advocat Restructuring, Advocat's operations and financial condition have improved and there has been a significant increase in the market value of Advocat's common stock from approximately \$0.31 per share at the time of the Initial Advocat Restructuring to the closing price on October 20, 2006 of \$18.84. As a result of the significant increase in the value of the common stock underlying the Series B preferred stock of Advocat held by us, on October 20, 2006 we again restructured our relationship with Advocat, which is referred to herein as the Second Advocat Restructuring, by entering into a Restructuring Stock Issuance and Subscription Agreement with Advocat, or the 2006 Advocat Agreement. Pursuant to the 2006 Advocat Agreement, we exchanged the Advocat Series B preferred stock and subordinated note issued in the Initial Advocat Restructuring for 5,000 shares of Advocat's Series C non-convertible, redeemable (at our option after September 30, 2010) preferred stock with a face value of approximately \$4.9 million and a dividend rate of 7% payable quarterly, and a secured non-convertible subordinated note in the amount of \$2.5 million maturing September 30, 2007 and bearing interest at 7% per annum. As part of the Second Advocat Restructuring, we also amended our Consolidated Amended and Restated Master Lease by and between one of our subsidiaries, as lessor, and a subsidiary of Advocat, as lessee, to commence a new 12-year lease term through September 30, 2018 (with a renewal option for an additional 12 year term) and Advocat has agreed to increase the master lease annual rent by approximately \$687,000 to approximately \$14 million commencing on January 1, 2007.

Amendment to New Credit Facility

At September 30, 2006, we had \$157.5 million outstanding under our \$200 million revolving senior secured credit facility, as amended, or the New Credit Facility, and \$2.5 million was utilized for the issuance of letters of credit, leaving availability of \$40.0 million. The \$157.5 million of outstanding borrowings had a blended interest rate of 6.57% at September 30, 2006.

On October 23, 2006, we entered into a Second Amendment, Waiver and Consent to Credit Agreement, or the Second Amendment, pursuant to which the lenders under the New Credit Facility waived any potential misrepresentations and events of default that could have been caused by the restatement of certain of our financial statements reflected in amendments to our Annual Report on Form 10-K for the period ending December 31, 2005 and our Quarterly Reports on Form 10-Q for the three-month periods ended March 31, 2006 and June 30, 2006, respectively, referred to herein as the Restatement.

Discontinued Operations

We are re-issuing as set forth elsewhere in this prospectus, in an updated format, our historical financial statements for the fiscal years ended December 31, 2005, 2004, and 2003, in connection with the requirements of Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," or SFAS

No. 144. The provisions of SFAS No. 144 require, among other things, that the primary assets and liabilities and the results of operations of our real properties that have been sold subsequent to January 1, 2003, or are held for disposition subsequent to January 1, 2003, be classified as discontinued operations and segregated in our consolidated Statements of Operations and Balance Sheets. In compliance with SFAS No. 144, we have presented the net operating results and the assets and liabilities of those properties sold or classified as held for disposition through September 30, 2006, as discontinued operations. Under SEC requirements, the same reclassification of continuing and discontinued operations as prescribed by SFAS No. 144 is required for all previously issued annual financial statements if those financial statements are included in subsequent filings with the SEC under the Securities Act of 1933, even though those financial statements relate to periods prior to the date of the reclassification. This reclassification has no effect on our reported net income available to common stockholders.

This prospectus updates our Ratio of Earnings to Fixed Charges, Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends, Selected Financial Data, Management's Discussion and Analysis of Financial Conditions and Results of Operations, and the consolidated Financial Statements for the fiscal years ended December 31, 2005, 2004 and 2003, to reflect the primary assets and liabilities and the results of operations of the Company's real properties that have been sold prior to September 30, 2006 or are held for disposition at September 30, 2006, as discontinued operations. All other material items in this prospectus remain unchanged with respect to information included in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2005 (the "Form 10-K/A").

RISK FACTORS

You should carefully consider the risks described below. These risks are not the only ones that we may face. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us. If any of the following risks occurs, our business, financial condition or results of operations could be materially and adversely affected.

Risks Related to the Operators of Our Facilities

Our financial position could be weakened and our ability to fulfill our obligations under our indebtedness could be limited if any of our major operators were unable to meet their obligations to us or failed to renew or extend their relationship with us as their lease terms expire, or if we were unable to lease or re-lease our facilities or make mortgage loans on economically favorable terms. These adverse developments could arise due to a number of factors, including those listed below.

Our recent efforts to restructure and stabilize our portfolio may not prove to be successful.

In large part as a result of the 1997 changes in Medicare reimbursement of services provided by SNFs and reimbursement cuts imposed under state Medicaid programs, a number of operators of our properties have encountered significant financial difficulties during the last several years. In 1999, our investment portfolio consisted of 216 properties and our largest public operators (by investment) were Sun Healthcare Group, Inc., or Sun, Integrated Health Services, or IHS, Advocat, Inc., or Advocat, and Mariner Health Care, Inc., or Mariner. Some of these operators, including Sun, IHS and Mariner, subsequently filed for bankruptcy protection. Other of our operators were required to undertake significant restructuring efforts. We have restructured our arrangements with many of our operators whereby we have renegotiated lease and mortgage terms, re-leased properties to new operators and have closed and/or disposed of properties. At September 30, 2006, our investment portfolio consisted of 241 properties and our largest public operators (by investment) were Sun (17%) and Advocat (8%). Our largest private company operators (by investment) were CommuniCare Health Services, or CommuniCare, (15%), Haven Eldercare, LLC, or Haven, (9%), Home Quality Management, Inc., or HQM, (8%), Guardian LTC Management, Inc., or Guardian, (7%), Nexion Health, Inc., or Nexion, (6%), and Essex Healthcare Corporation, or Essex, (6%). We cannot assure you that our recent efforts to restructure and stabilize our property portfolio will be successful.

The bankruptcy, insolvency or financial deterioration of our operators could delay our ability to collect unpaid rents or require us to find new operators for rejected facilities.

We are exposed to the risk that our operators may not be able to meet their obligations, which may result in their bankruptcy or insolvency. Although our leases and loans provide us the right to terminate an investment, evict an operator, demand immediate repayment and other remedies, title 11 of the United States Code, 11 U.S.C. §§ 101-1330, as amended and supplemented, or the Bankruptcy Code, affords certain protections to a party that has filed for bankruptcy that would probably render certain of these remedies unenforceable, or, at the very least, delay our ability to pursue such remedies. In addition, an operator in bankruptcy may be able to restrict our ability to collect unpaid rent or mortgage payments during the bankruptcy case.

Furthermore, the receipt of liquidation proceeds or the replacement of an operator that has defaulted on its lease or loan could be delayed by the approval process of any federal, state or local agency necessary for the transfer of the property or the replacement of the operator licensed to manage the facility. In addition, some significant expenditures associated with real estate investment, such as real estate taxes and maintenance costs, are generally not reduced when circumstances cause a reduction in income from the investment. In order to protect our investments, we may take possession of a property or even become licensed as an operator, which might expose us to successor liability under government programs (or otherwise) or require us to indemnify subsequent operators to whom we might transfer the

operating rights and licenses. Third-party payors may also suspend payments to us following foreclosure until we receive the required licenses to operate the facilities. Should such events occur, our income and cash flow from operations would be adversely affected.

A debtor may have the right to assume or reject a lease with us under bankruptcy law and his or her decision could delay or limit our ability to collect rents thereunder.

If one or more of our lessees files bankruptcy relief, the Bankruptcy Code provides that a debtor has the option to assume or reject the unexpired lease within a certain period of time. However, our lease arrangements with operators that operate more than one of our facilities are generally made pursuant to a single master lease covering all of that operator's facilities leased from us, and consequently, it is possible that in bankruptcy the debtor-lessee may be required to assume or reject the master lease as a whole, rather than making the decision on a facility by facility basis, thereby preventing the debtor-lessee from assuming only the better performing facilities and terminating the leasing arrangement with respect to the poorer performing facilities. The Bankruptcy Code generally requires that a debtor must assume or reject a contract in its entirety. Thus, a debtor cannot choose to keep the beneficial provisions of a contract while rejecting the burdensome ones; the contract must be assumed or rejected as a whole. However, where under applicable law a contract (even though it is contained in a single document) is determined to be divisible or severable into different agreements, or similarly where a collection of documents are determined to constitute separate agreements instead of a single, integrated contract, then in those circumstances a debtor/trustee may be allowed to assume some of the divisible or separate agreements while rejecting the others. Whether a master lease agreement would be determined to be a single contract or a divisible agreement, and hence whether a bankruptcy court would require a master lease agreement to be assumed or rejected as a whole, would depend on a number of factors some of which may include, but may not necessarily be limited to, the following:

- applicable state law;
- the parties' intent;
- whether the master lease agreement and related documents were executed contemporaneously;
- the nature and purpose of the relevant documents;
- whether the obligations in various documents are independent;
- whether the leases are coterminous;
- whether a single check is paid for all properties;
- whether rent is apportioned among the leases;
- whether termination of one lease constitutes termination of all;
- whether the leases may be separately assigned or sublet;
- whether separate consideration exists for each lease; and
- whether there are cross-default provisions.

The Bankruptcy Code provides that a debtor has the power and the option to assume, assume and assign to a third party, or reject the unexpired lease. In the event that the unexpired lease is assumed on behalf of the debtor-lessee, obligations under the lease generally would be entitled to administrative priority over other unsecured pre-bankruptcy claims. If the debtor chooses to assume the lease (or assume and assign the lease), then the debtor is required to cure all monetary defaults, or provide adequate assurance that it will promptly cure such defaults. However, the debtor-lessee may not have to cure historical non-monetary defaults under the lease to the extent that they have not

resulted in an actual pecuniary loss, but the debtor-lessee must cure non-monetary defaults under the lease from the time of assumption going forward. A debtor must generally pay all rent payments coming due under the lease after the bankruptcy filing but before the assumption or rejection of the lease. The Bankruptcy Code provides that the debtor-lessee must make the decision regarding assumption, assignment or rejection within a certain period of time. For cases filed on or after October 17, 2005, the time period to make the decision is 120 days, subject to one extension “for cause.” A bankruptcy court may only further extend this period for 90 days unless the lessor consents in writing.

If a tenant rejects a lease under the Bankruptcy Code, it is deemed to be a pre-petition breach of the lease, and the lessor's claim arising therefrom may be limited to any unpaid rent already due plus an amount equal to the rent reserved under the lease, without acceleration, for the greater of one year, and 15%, not to exceed three years, of the remaining term of such lease, following the earlier of the petition date and repossession or surrender of the leased property. If the debtor rejects the lease, the facility would be returned to us. In that event, if we were unable to re-lease the facility to a new operator on favorable terms or only after a significant delay, we could lose some or all of the associated revenue from that facility for an extended period of time.

With respect to our mortgage loans, the imposition of an automatic stay under bankruptcy law could negatively impact our ability to foreclose or seek other remedies against a mortgagor.

Generally, with respect to our mortgage loans, the imposition of an automatic stay under the Bankruptcy Code precludes us from exercising foreclosure or other remedies against the debtor without first obtaining stay relief from the bankruptcy court. Pre-petition creditors generally do not have rights to the cash flows from the properties underlying the mortgages unless their security interest in the property includes such cash flows. Mortgagees may, however, receive periodic payments from the debtor/mortgagors. Such payments are referred to as adequate protection payments. The timing of adequate protection payments and whether the mortgagees are entitled to such payments depends on negotiating an acceptable settlement with the mortgagor (subject to approval of the bankruptcy court) or on the order of the bankruptcy court in the event a negotiated settlement cannot be achieved.

A mortgagee also is treated differently from a landlord in three key respects. First, the mortgage loan is not subject to assumption, assumption and assignment, or rejection. Second, the mortgagee's loan may be divided into a secured claim for the portion of the mortgage debt that does not exceed the value of the property securing the debt and a general unsecured claim for the portion of the mortgage debt that exceeds the value of the property. A secured creditor such as our company is entitled to the recovery of interest and reasonable fees, costs and charges provided for under the agreement under which such claim arose only if, and to the extent that, the value of the collateral exceeds the amount owed. If the value of the collateral exceeds the amount of the debt, interest as well as reasonable fees, costs, and charges are not necessarily required to be paid during the progress of the bankruptcy case, but they will accrue until confirmation of a plan of reorganization/liquidation and are generally paid at confirmation or such other time as the court orders unless the debtor voluntarily makes a payment. If the value of the collateral held by a secured creditor is less than the secured debt (including such creditor's secured debt and the secured debt of any creditor with a more senior security interest in the collateral), interest on the loan for the time period between the filing of the case and confirmation may be disallowed. Finally, while a lease generally would either be assumed, assumed and assigned, or rejected with all of its benefits and burdens intact, the terms of a mortgage, including the rate of interest and the timing of principal payments, may be modified under certain circumstances if the debtor is able to effect a "cram down" under the Bankruptcy Code. Before such a "cram down" is allowed, the Bankruptcy Court must conclude that the treatment of the secured creditor's claim is "fair and equitable."

If an operator files bankruptcy, our leases with the debtor could be recharacterized as a financing agreement, which could negatively impact our rights under the lease.

Another risk regarding our leases is that in an operator's bankruptcy the leases could be re-characterized as a financing agreement. In making such a determination, a bankruptcy court may consider certain factors, which may include, but are not necessarily limited to, the following:

- whether rent is calculated to provide a return on investment rather than to compensate the lessor for loss, use and possession of the property;
- whether the property is purchased specifically for the lessee's use or whether the lessee selected, inspected, contracted for, and received the property;

- whether the transaction is structured solely to obtain tax advantages;
- whether the lessee is entitled to obtain ownership of the property at the expiration of the lease, and whether any option purchase price is unrelated to the value of the land; and
- whether the lessee assumed many of the obligations associated with outright ownership of the property, including responsibility for maintenance, repair, property taxes and insurance.

If an operator defaults under one of our mortgage loans, we may have to foreclose on the mortgage or protect our interest by acquiring title to the property and thereafter making substantial improvements or repairs in order to maximize the facility's investment potential. Operators may contest enforcement of foreclosure or other remedies, seek bankruptcy protection against our exercise of enforcement or other remedies and/or bring claims for lender liability in response to actions to enforce mortgage obligations. If an operator seeks bankruptcy protection, the automatic stay provisions of the Bankruptcy Code would preclude us from enforcing foreclosure or other remedies against the operator unless relief is first obtained from the court having jurisdiction over the bankruptcy case. High "loan to value" ratios or declines in the value of the facility may prevent us from realizing an amount equal to our mortgage loan upon foreclosure.

Operators that fail to comply with the requirements of governmental reimbursement programs such as Medicare or Medicaid, licensing and certification requirements, fraud and abuse regulations or new legislative developments may be unable to meet their obligations to us.

Our operators are subject to numerous federal, state and local laws and regulations that are subject to frequent and substantial changes (sometimes applied retroactively) resulting from legislation, adoption of rules and regulations, and administrative and judicial interpretations of existing law. The ultimate timing or effect of these changes cannot be predicted. These changes may have a dramatic effect on our operators' costs of doing business and on the amount of reimbursement by both government and other third-party payors. The failure of any of our operators to comply with these laws, requirements and regulations could adversely affect their ability to meet their obligations to us. In particular:

- ***Medicare and Medicaid.*** A significant portion of our SNF operators' revenue is derived from governmentally-funded reimbursement programs, primarily Medicare and Medicaid, and failure to maintain certification and accreditation in these programs would result in a loss of funding from such programs. Loss of certification or accreditation could cause the revenues of our operators to decline, potentially jeopardizing their ability to meet their obligations to us. In that event, our revenues from those facilities could be reduced, which could in turn cause the value of our affected properties to decline. State licensing and Medicare and Medicaid laws also require operators of nursing homes and assisted living facilities to comply with extensive standards governing operations. Federal and state agencies administering those laws regularly inspect such facilities and investigate complaints. Our operators and their managers receive notices of potential sanctions and remedies from time to time, and such sanctions have been imposed from time to time on facilities operated by them. If they are unable to cure deficiencies, which have been identified or which are identified in the future, such sanctions may be imposed and if imposed may adversely affect our operators' revenues, potentially jeopardizing their ability to meet their obligations to us.
- ***Licensing and Certification.*** Our operators and facilities are subject to regulatory and licensing requirements of federal, state and local authorities and are periodically audited by them to confirm compliance. Failure to obtain licensure or loss or suspension of licensure would prevent a facility from operating or result in a suspension of reimbursement payments until all licensure issues have been resolved and the necessary licenses obtained or reinstated. Our SNFs require governmental approval, in the form of a certificate of need that generally varies by state and is subject to change, prior to the addition or construction of new beds, the addition of services or certain capital expenditures. Some of our facilities may be unable to satisfy current and future certificate of need

requirements and may for this reason be unable to continue operating in the future. In such event, our revenues from those facilities could be reduced or eliminated for an extended period of time or permanently.

Fraud and Abuse Laws and Regulations. There are various extremely complex and largely uninterpreted federal and state laws governing a wide array of referrals, relationships and arrangements and prohibiting fraud by healthcare providers, including criminal provisions that prohibit filing false claims or making false statements to receive payment or certification under Medicare and Medicaid, or failing to refund overpayments or improper payments. Governments are devoting increasing attention and resources to anti-fraud initiatives against healthcare providers. The Health Insurance Portability and Accountability Act of 1996 and the Balanced Budget Act expanded the penalties for healthcare fraud, including broader provisions for the exclusion of providers from the Medicare and Medicaid programs. Furthermore, the Office of Inspector General of the U.S. Department of Health and Human Services in cooperation with other federal and state agencies continues to focus on the activities of SNFs in certain states in which we have properties. In addition, the federal False Claims Act allows a private individual with knowledge of fraud to bring a claim on behalf of the federal government and earn a percentage of the federal government's recovery. Because of these incentives, these so-called "whistleblower" suits have become more frequent. The violation of any of these laws or regulations by an operator may result in the imposition of fines or other penalties that could jeopardize that operator's ability to make lease or mortgage payments to us or to continue operating its facility.

Legislative and Regulatory Developments. Each year, legislative proposals are introduced or proposed in Congress and in some state legislatures that would affect major changes in the healthcare system, either nationally or at the state level. The Medicare Prescription Drug, Improvement and Modernization Act of 2003, or Medicare Modernization Act, which is one example of such legislation, was enacted in late 2003. The Medicare reimbursement changes for the long term care industry under this Act are limited to a temporary increase in the per diem amount paid to SNFs for residents who have AIDS. The significant expansion of other benefits for Medicare beneficiaries under this Act, such as the expanded prescription drug benefit, could result in financial pressures on the Medicare program that might result in future legislative and regulatory changes with impacts for our operators. Other proposals under consideration include efforts by individual states to control costs by decreasing state Medicaid reimbursements, a federal "Patient Protection Act" to protect consumers in managed care plans, efforts to improve quality of care and reduce medical errors throughout the health care industry and cost-containment initiatives by public and private payors. We cannot accurately predict whether any proposals will be adopted or, if adopted, what effect, if any, these proposals would have on operators and, thus, our business.

Regulatory proposals and rules are released on an ongoing basis that may have major impacts on the healthcare system generally and the skilled nursing and long-term care industries in particular.

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

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

revenues of our operators to decline and potentially jeopardize their ability to meet their obligations to us.

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Our operators may be subject to significant legal actions that could subject them to increased operating costs and substantial uninsured liabilities, which may affect their ability to pay their lease and mortgage payments to us.

As is typical in the healthcare industry, our operators are often subject to claims that their services have resulted in resident injury or other adverse effects. Many of these operators have experienced an increasing trend in the frequency and severity of professional liability and general liability insurance claims and litigation asserted against them. The insurance coverage maintained by our operators may not cover all claims made against them nor continue to be available at a reasonable cost, if at all. In some states, insurance coverage for the risk of punitive damages arising from professional liability and general liability claims and/or litigation may not, in certain cases, be available to operators due to state law prohibitions or limitations of availability. As a result, our operators operating in these states may be liable for punitive damage awards that are either not covered or are in excess of their insurance policy limits. We also believe that there has been, and will continue to be, an increase in governmental investigations of long-term care providers, particularly in the area of Medicare/Medicaid false claims, as well as an increase in enforcement actions resulting from these investigations. Insurance is not available to cover such losses. Any adverse determination in a legal proceeding or governmental investigation, whether currently asserted or arising in the future, could have a material adverse effect on an operator's financial condition. If an operator is unable to obtain or maintain insurance coverage, if judgments are obtained in excess of the insurance coverage, if an operator is required to pay uninsured punitive damages, or if an operator is subject to an uninsurable government enforcement action, the operator could be exposed to substantial additional liabilities.

Increased competition as well as increased operating costs have resulted in lower revenues for some of our operators and may affect the ability of our tenants to meet their payment obligations to us.

The healthcare industry is highly competitive and we expect that it may become more competitive in the future. Our operators are competing with numerous other companies providing similar healthcare services or alternatives such as home health agencies, life care at home, community-based service programs, retirement communities and convalescent centers. We cannot be certain the operators of all of our facilities will be able to achieve occupancy and rate levels that will enable them to meet all of their obligations to us. Our operators may encounter increased competition in the future that could limit their ability to attract residents or expand their businesses and therefore affect their ability to pay their lease or mortgage payments.

The market for qualified nurses, healthcare professionals and other key personnel is highly competitive and our operators may experience difficulties in attracting and retaining qualified personnel. Increases in labor costs due to higher wages and greater benefits required to attract and retain qualified healthcare personnel incurred by our operators could affect their ability to pay their lease or mortgage payments. This situation could be particularly acute in certain states that have enacted legislation establishing minimum staffing requirements.

Risks Related to Us and Our Operations

In addition to the operator related risks discussed above, there are a number of risks directly associated with us and our operations.

We rely on external sources of capital to fund future capital needs, and if we encounter difficulty in obtaining such capital, we may not be able to make future investments necessary to grow our business or meet maturing commitments.

In order to qualify as a REIT under the Internal Revenue Code, we are required, among other things, to distribute each year to our stockholders at least 90% of our REIT taxable income. Because of this distribution requirement, we may not be able to fund, from cash retained from operations, all future capital needs, including capital needs to make investments and to satisfy or refinance maturing commitments. As a result, we rely on external sources of capital,

including debt and equity financing. If we are unable to obtain needed capital at all or only on unfavorable terms from these sources, we might not be able to make the investments needed to grow our business, or to meet our obligations and commitments as they mature, which could negatively affect the ratings of our debt and even, in extreme circumstances, affect our ability to continue operations. Our access to capital depends upon a number of factors over which we have little or no control, including general market conditions and the market's perception of our growth potential and our current and potential future earnings and cash distributions and the market price of the shares of our capital stock. Generally speaking, difficult capital market conditions in our industry during the past several years and our need to stabilize our portfolio have limited our access to capital. The "related party tenant" issue discussed in "Note 15 - Restatement of Previously Issued Financial Statements" to our audited consolidated financial statements for the year ended December 31, 2005 included elsewhere in this prospectus may make it more difficult for us to raise additional capital unless and until we enter into a closing agreement with the Internal Revenue Service, or IRS, or otherwise resolve such issue. While we currently have sufficient cash flow from operations to fund our obligations and commitments, we may not be in position to take advantage of attractive investment opportunities for growth in the event that we are unable to access the capital markets on a timely basis or we are only able to obtain financing on unfavorable terms.

Our ability to raise capital through sales of equity is dependent, in part, on the market price of our common stock, and our failure to meet market expectations with respect to our business could negatively impact the market price of our common stock and limit our ability to sell equity.

As with other publicly-traded companies, the availability of equity capital will depend, in part, on the market price of our common stock which, in turn, will depend upon various market conditions and other factors that may change from time to time including:

- the extent of investor interest;
- the general reputation of REITs and the attractiveness of their equity securities in comparison to other equity securities, including securities issued by other real estate-based companies;
- our financial performance and that of our operators;
- the contents of analyst reports about us and the REIT industry;
- general stock and bond market conditions, including changes in interest rates on fixed income securities, which may lead prospective purchasers of our common stock to demand a higher annual yield from future distributions;
- our failure to maintain or increase our dividend, which is dependent, to a large part, on growth of funds from operations which in turn depends upon increased revenues from additional investments and rental increases; and
- other factors such as governmental regulatory action and changes in REIT tax laws.

The market value of the equity securities of a REIT is generally based upon the market's perception of the REIT's growth potential and its current and potential future earnings and cash distributions. Our failure to meet the market's expectation with regard to future earnings and cash distributions would likely adversely affect the market price of our common stock.

We are subject to risks associated with debt financing, which could negatively impact our business, limit our ability to make distributions to our stockholders and to repay maturing debt.

Financing for future investments and our maturing commitments may be provided by borrowings under our revolving senior secured credit facility, as amended, or New Credit Facility, private or public offerings of debt, the assumption of secured indebtedness, mortgage financing on a portion of our owned portfolio or through joint ventures. We are subject to risks normally associated with debt financing, including the risks that our cash flow will be insufficient to make timely payments of interest, that we will be unable to refinance existing indebtedness and that the terms of refinancing will not be as favorable as the terms of existing indebtedness. If we are unable to refinance or extend principal payments due at maturity or pay them with proceeds from other capital transactions, our cash flow may not be sufficient in all years to pay distributions to our stockholders and to repay all maturing debt. Furthermore, if prevailing interest rates, changes in our debt ratings or other factors at the time of refinancing result in higher interest rates upon refinancing, the interest expense relating to that refinanced indebtedness would increase, which could reduce our profitability and the amount of dividends we are able to pay. Moreover, additional debt financing increases the amount of our leverage.

Certain of our operators account for a significant percentage of our revenues.

Based on existing contractual rent and lease payments regarding the restructuring of certain existing investments, as of September 30, 2006, Advocat, Sun and Communicare each account for over 10% of our current contractual monthly revenues, with Sun, Communicare and Advocat accounting for approximately 18%, 15% and 11%, respectively, of our current contractual monthly revenues. Additionally, as of September 30, 2006, our top six operators, which each accounted for over 5% of current contractual monthly revenues, collectively account for approximately 66% of our current contractual monthly revenues. The failure or inability of any of these operators to pay their obligations to us could materially reduce our revenues and net income, which could in turn reduce the amount of dividends we pay and cause our stock price to decline.

Unforeseen costs associated with the acquisition of new properties could reduce our profitability.

Our business strategy contemplates future acquisitions that may not prove to be successful. For example, we might encounter unanticipated difficulties and expenditures relating to any acquired properties, including contingent liabilities, or newly acquired properties might require significant management attention that would otherwise be devoted to our ongoing business. If we agree to provide funding to enable healthcare operators to build, expand or renovate facilities on our properties and the project is not completed, we could be forced to become involved in the development to ensure completion or we could lose the property. These costs may negatively affect our results of operations.

Our assets may be subject to impairment charges.

We periodically, but not less than annually, evaluate our real estate investments and other assets for impairment indicators. The judgment regarding the existence of impairment indicators is based on factors such as market conditions, operator performance and legal structure. If we determine that a significant impairment has occurred, we would be required to make an adjustment to the net carrying value of the asset, which could have a material adverse affect on our results of operations and funds from operations in the period in which the write-off occurs. During the nine months ended September 30, 2006, we recognized an impairment loss associated with one facility for approximately \$100,000.

We may not be able to sell certain closed facilities for their book value.

From time to time, we close facilities and actively market such facilities for sale. To the extent we are unable to sell these properties for our book value, we may be required to take a non-cash impairment charge or loss on the sale, either of which would reduce our net income.

Our substantial indebtedness could adversely affect our financial condition.

We have substantial indebtedness and we may increase our indebtedness in the future. As of September 30, 2006, we had total debt of approximately \$684 million, of which \$158 million consisted of borrowings under our Credit Facility, \$310 million of which consisted of our 7% senior notes due 2014 and \$175 million of which consisted of our 7% senior notes due 2016. Our level of indebtedness could have important consequences to our stockholders. For example, it could:

- limit our ability to satisfy our obligations with respect to holders of our capital stock;
- increase our vulnerability to general adverse economic and industry conditions;
- limit our ability to obtain additional financing to fund future working capital, capital expenditures and other general corporate requirements, or to carry out other aspects of our business plan;
- require us to dedicate a substantial portion of our cash flow from operations to payments on indebtedness, thereby reducing the availability of such cash flow to fund working capital, capital expenditures and other general corporate requirements, or to carry out other aspects of our business plan;
- require us to pledge as collateral substantially all of our assets;
- require us to maintain certain debt coverage and financial ratios at specified levels, thereby reducing our financial flexibility;
- limit our ability to make material acquisitions or take advantage of business opportunities that may arise;
- expose us to fluctuations in interest rates, to the extent our borrowings bear variable rates of interests;
- limit our flexibility in planning for, or reacting to, changes in our business and industry; and
- place us at a competitive disadvantage compared to our competitors that have less debt.

Our real estate investments are relatively illiquid.

Real estate investments are relatively illiquid and, therefore, tend to limit our ability to vary our portfolio promptly in response to changes in economic or other conditions. All of our properties are “special purpose” properties that could not be readily converted to general residential, retail or office use. Healthcare facilities that participate in Medicare or Medicaid must meet extensive program requirements, including physical plant and operational requirements, which are revised from time to time. Such requirements may include a duty to admit Medicare and Medicaid patients, limiting the ability of the facility to increase its private pay census beyond certain limits. Medicare and Medicaid facilities are regularly inspected to determine compliance and may be excluded from the programs—in some cases without a prior hearing—for failure to meet program requirements. Transfers of operations of nursing homes and other healthcare-related facilities are subject to regulatory approvals not required for transfers of other types of commercial operations and other types of real estate. Thus, if the operation of any of our properties becomes unprofitable due to competition, age of improvements or other factors such that our lessee or mortgagor becomes unable to meet its obligations on the lease or mortgage loan, the liquidation value of the property may be substantially less, particularly relative to the amount owing on any related mortgage loan, than would be the case if the property were readily adaptable to other uses. The receipt of liquidation proceeds or the replacement of an operator that has defaulted on its lease or loan could be delayed by the approval process of any federal, state or local agency necessary for the transfer of the property or the replacement of the operator with a new operator licensed to manage the facility. In addition,

certain significant expenditures associated with real estate investment, such as real estate taxes and maintenance costs, are generally not reduced when circumstances cause a reduction in income from the investment. Should such events occur, our income and cash flows from operations would be adversely affected.

As an owner or lender with respect to real property, we may be exposed to possible environmental liabilities.

Under various federal, state and local environmental laws, ordinances and regulations, a current or previous owner of real property or a secured lender, such as us, may be liable in certain circumstances for the costs of investigation, removal or remediation of, or related releases of, certain hazardous or toxic substances at, under or disposed of in connection with such property, as well as certain other potential costs relating to hazardous or toxic substances, including government fines and damages for injuries to persons and adjacent property. Such laws often impose liability without regard to whether the owner knew of, or was responsible for, the presence or disposal of such substances and liability may be imposed on the owner in connection with the activities of an operator of the property. The cost of any required investigation, remediation, removal, fines or personal or property damages and the owner's liability therefore could exceed the value of the property and/or the assets of the owner. In addition, the presence of such substances, or the failure to properly dispose of or remediate such substances, may adversely affect our operators' ability to attract additional residents, the owner's ability to sell or rent such property or to borrow using such property as collateral which, in turn, would reduce the owner's revenues.

Although our leases and mortgage loans require the lessee and the mortgagor to indemnify us for certain environmental liabilities, the scope of such obligations may be limited. For instance, most of our leases do not require the lessee to indemnify us for environmental liabilities arising before the lessee took possession of the premises. Further, we cannot assure you that any such mortgagor or lessee would be able to fulfill its indemnification obligations.

The industry in which we operate is highly competitive. This competition may prevent us from raising prices at the same pace as our costs increase.

We compete for additional healthcare facility investments with other healthcare investors, including other REITs. The operators of the facilities compete with other regional or local nursing care facilities for the support of the medical community, including physicians and acute care hospitals, as well as the general public. Some significant competitive factors for the placing of patients in skilled and intermediate care nursing facilities include quality of care, reputation, physical appearance of the facilities, services offered, family preferences, physician services and price. If our cost of capital should increase relative to the cost of capital of our competitors, the spread that we realize on our investments may decline if competitive pressures limit or prevent us from charging higher lease or mortgage rates.

We are named as defendants in litigation arising out of professional liability and general liability claims relating to our previously owned and operated facilities that if decided against us, could adversely affect our financial condition.

We and several of our wholly-owned subsidiaries have been named as defendants in professional liability and general liability claims related to our owned and operated facilities. Other third-party managers responsible for the day-to-day operations of these facilities have also been named as defendants in these claims. In these suits, patients of certain previously owned and operated facilities have alleged significant damages, including punitive damages, against the defendants. The lawsuits are in various stages of discovery and we are unable to predict the likely outcome at this time. We continue to vigorously defend these claims and pursue all rights we may have against the managers of the facilities, under the terms of the management agreements. We have insured these matters, subject to self-insured retentions of various amounts. There can be no assurance that we will be successful in our defense of these matters or in asserting our claims against various managers of the subject facilities or that the amount of any settlement or judgment will be substantially covered by insurance or that any punitive damages will be covered by insurance.

We are subject to significant anti-takeover provisions.

Our articles of incorporation and bylaws contain various procedural and other requirements which could make it difficult for stockholders to effect certain corporate actions. Our Board of Directors is divided into three classes and our Board members are elected for terms that are staggered. Our Board of Directors also has the authority to issue additional shares of preferred stock and to fix the preferences, rights and limitations of the preferred stock without stockholder approval. We have also adopted a stockholders rights plan which provides for share purchase rights to become exercisable at a discount if a person or group acquires more than 9.9% of our common stock or announces a tender or exchange offer for more than 9.9% of our common stock. These provisions could discourage unsolicited acquisition proposals or make it more difficult for a third party to gain control of us, which could adversely affect the market price of our securities.

We may change our investment strategies and policies and capital structure.

Our Board of Directors, without the approval of our stockholders, may alter our investment strategies and policies if it determines in the future that a change is in our stockholders' best interests. The methods of implementing our investment strategies and policies may vary as new investments and financing techniques are developed.

If we fail to maintain our REIT status, we will be subject to federal income tax on our taxable income at regular corporate rates.

We were organized to qualify for taxation as a REIT under Sections 856 through 860 of the Internal Revenue Code. Except with respect to the potential Advocat "related party tenant" issue discussed below, we believe we have conducted, and we intend to continue to conduct, our operations so as to qualify as a REIT. Qualification as a REIT involves the satisfaction of numerous requirements, some on an annual and some on a quarterly basis, established under highly technical and complex provisions of the Internal Revenue Code for which there are only limited judicial and administrative interpretations and involve the determination of various factual matters and circumstances not entirely within our control. We cannot assure you that we will at all times satisfy these rules and tests.

If we were to fail to qualify as a REIT in any taxable year, as a result of a determination that we failed to meet the annual distribution requirement or otherwise, we would be subject to federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates with respect to each such taxable year for which the statute of limitations remains open. Moreover, unless entitled to relief under certain statutory provisions, we also would be disqualified from treatment as a REIT for the four taxable years following the year during which qualification is lost. This treatment would significantly reduce our net earnings and cash flow because of our additional tax liability for the years involved, which could significantly impact our financial condition.

In connection with exploring the potential disposition of the Advocat Series B preferred stock, we were advised by our tax counsel that due to the structure of the Series B preferred stock issued by Advocat to us in 2000 in connection with a prior restructuring, Advocat may be deemed to be a "related party tenant" under applicable federal income tax rules and, in such event, rental income from Advocat would not be qualifying income under the gross income tests that are applicable to REITs. In order to maintain qualification as a REIT, we annually must satisfy certain tests regarding the source of our gross income. The applicable federal income tax rules provide a "savings clause" for REITs that fail to satisfy the REIT gross income tests, if such failure is due to reasonable cause. A REIT that qualifies for the savings clause will retain its REIT status but will pay a tax. On December 15, 2006, we submitted to the IRS a request for a closing agreement to resolve the "related party tenant" issue. Since that time, we have had additional conversations with the IRS, who has encouraged us to move forward with the process of obtaining a closing agreement, and we will be submitting additional documentation in support of the issuance of a closing agreement with respect to this matter. While we believe there are valid arguments that Advocat should not be deemed a "related party tenant," the matter is still not free from doubt, and we believe it is in our best interest to move forward with the request for a closing agreement in order to resolve the matter, minimize potential penalties and obtain assurances regarding our continuing REIT status. If we are able to enter into the closing agreement with the IRS, the closing agreement will conclude that any failure to satisfy the gross income tests was due to reasonable cause. In the event that it is determined that the "savings clause" described above does not apply and we are unable to conclude a closing agreement with the IRS, we could be treated as having failed to qualify as a REIT for one or more taxable years. If we fail to qualify for taxation as a REIT for any taxable year, our income will be taxed at regular corporate rates, and we could be disqualified as a REIT for the following four taxable years.

To maintain our REIT status, we must distribute at least 90% of our taxable income each year.

We generally must distribute annually at least 90% of our taxable income to our stockholders to maintain our REIT status. 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.

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Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow.

Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, property and transfer taxes. Any of these taxes would decrease cash available for the payment of our debt obligations. In addition, we may derive income through Taxable REIT Subsidiaries, or TRSs, which will then be subject to corporate level income tax at regular rates.

Complying with REIT requirements may affect our profitability.

To qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the nature and diversification of our assets, the sources of our income and the amounts we distribute to our stockholders. Thus we may be required to liquidate otherwise attractive investments from our portfolio in order to satisfy the asset and income tests or to qualify under certain statutory relief provisions. We may also be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution (e.g., if we have assets which generate mismatches between taxable income and available cash). Then, having to comply with the distribution requirement could cause us to: (i) sell assets in adverse market conditions; (ii) borrow on unfavorable terms; or (iii) distribute amounts that would otherwise be invested in future acquisitions, capital expenditures or repayment of debt. As a result, satisfying the REIT requirements could have an adverse effect on our business results and profitability.

We depend upon our key employees and may be unable to attract or retain sufficient numbers of qualified personnel.

Our future performance depends to a significant degree upon the continued contributions of our executive management team and other key employees. Accordingly, our future success depends on our ability to attract, hire, train and retain highly skilled management and other qualified personnel. Competition for qualified employees is intense, and we compete for qualified employees with companies that may have greater financial resources than we have. Our employment agreements with our executive officers provide that their employment may be terminated by either party at any time. Consequently, we may not be successful in attracting, hiring, and training and retaining the people we need, which would seriously impede our ability to implement our business strategy.

In the event we are unable to satisfy regulatory requirements relating to internal controls, or if these internal controls over financial reporting are not effective, our business could suffer.

Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to do a comprehensive evaluation of their internal controls. As a result, each year we evaluate our internal controls over financial reporting so that our management can certify as to the effectiveness of our internal controls and our auditor can publicly attest to this certification. Our efforts to comply with Section 404 and related regulations regarding our management's required assessment of internal control over financial reporting and our independent auditors' attestation of that assessment has required, and continues to require, the commitment of significant financial and managerial resources. If for any period our management is unable to ascertain the effectiveness of our internal controls or if our auditors cannot attest to management's certification, we could be subject to regulatory scrutiny and a loss of public confidence, which could have an adverse effect on our business.

In connection with the restatement of our financial statements for the year ended December 31, 2005, we identified a material weakness in our internal control over financial reporting, which could materially and adversely affect our business and financial condition.

In connection with the restatement of our financial statements for the year ended December 31, 2005, our management identified a material weakness in internal control over financial reporting. Our management determined that as of December 31, 2005, we lacked sufficient internal control processes, procedures and personnel resources necessary to address accounting for certain complex and/or non-routine transactions. This material weakness resulted in errors in accounting for financial instruments, income taxes and straight-line rental revenue and could result in a material misstatement to our consolidated financial statements that would not be prevented or detected on a timely basis. Due to this material weakness, management concluded that we did not maintain effective internal control over financial reporting as of December 31, 2005.

While we have engaged in, and continue to engage in, substantial efforts to address the material weakness in our internal control over financial reporting, as of the date of this prospectus we have not concluded that our internal control over financial reporting is effective. We cannot be certain that any remedial measures we have taken or plan to take will ensure that we design, implement and maintain adequate controls over our financial processes and reporting in the future or will be sufficient to address and eliminate the material weakness. Our inability to remedy this identified material weakness or any additional deficiencies or material weaknesses that may be identified in the future, could, among other things, cause us to fail to file our periodic reports with the SEC in a timely manner or require us to incur additional costs or to divert management resources. Due to its inherent limitations, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation and presentation. These limitations may not prevent or detect all misstatements or fraud, regardless of their effectiveness.

Risks Related to Our Stock

The market value of our stock could be substantially affected by various factors.

The share price of our stock will depend on many factors, which may change from time to time, including:

- the market for similar securities issued by REITs;
- changes in estimates by analysts;
- our ability to meet analysts' estimates;
- general economic and financial market conditions; and
- our financial condition, performance and prospects.

Our issuance of additional capital stock, warrants or debt securities, whether or not convertible, may reduce the market price for our shares.

We cannot predict the effect, if any, that future sale of our capital stock, warrants or debt securities, or the availability of our securities for future sale, will have on the market price of our shares, including our common stock. Sales of substantial amounts of our common stock or preferred shares, warrants or debt securities convertible into or exercisable or exchangeable for common stock in the public market or the perception that such sales might occur could reduce the market price of our stock and the terms upon which we may obtain additional equity financing in the future.

In addition, we may issue additional capital stock in the future to raise capital or as a result of the following:

- The issuance and exercise of options to purchase our common stock. As of December 31, 2005, we had outstanding options to acquire approximately 0.2 million shares of our common stock. In addition, we may in the future issue additional options or other securities convertible into or exercisable for our common stock under our 2004 Stock Incentive Plan, our 2000 Stock Incentive Plan, as amended, or other remuneration plans we establish in the future. We may also issue options or convertible securities to our employees in lieu of cash bonuses or to our directors in lieu of director's fees.
- The issuance of shares pursuant to our dividend reinvestment and direct stock purchase plan.
- The issuance of debt securities exchangeable for our common stock.

The exercise of warrants we may issue in the future.

Lenders sometimes ask for warrants or other rights to acquire shares in connection with providing financing. We cannot assure you that our lenders will not request such rights.

There are no assurances of our ability to pay dividends in the future.

In 2001, our Board of Directors suspended dividends on our common stock and all series of preferred stock in an effort to generate cash to address then impending debt maturities. In 2003, we paid all accrued but unpaid dividends on all series of preferred stock and reinstated dividends on our common stock and all series of preferred stock. However, our ability to pay dividends may be adversely affected if any of the risks described above were to occur. Our payment of dividends is subject to compliance with restrictions contained in our New Credit Facility, the indenture relating to our outstanding 7% senior notes due 2014, the indenture relating to our outstanding 7% senior notes due 2016 and our preferred stock. All dividends will be paid at the discretion of our Board of Directors and will depend upon our earnings, our financial condition, maintenance of our REIT status and such other factors as our Board may deem relevant from time to time. There are no assurances of our ability to pay dividends in the future. In addition, our dividends in the past have included, and may in the future include, a return of capital.

Holders of our outstanding preferred stock have liquidation and other rights that are senior to the rights of the holders of our common stock.

Our Board of Directors has the authority to designate and issue preferred stock that may have dividend, liquidation and other rights that are senior to those of our common stock. As of the date of this filing, 4,739,500 shares of our 8.375% Series D cumulative redeemable preferred stock were issued and outstanding. The aggregate liquidation preference with respect to this outstanding preferred stock is approximately \$118.5 million, and annual dividends on our outstanding preferred stock are approximately \$9.9 million. Holders of our preferred stock are generally entitled to cumulative dividends before any dividends may be declared or set aside on our common stock. Upon our voluntary or involuntary liquidation, dissolution or winding up, before any payment is made to holders of our common stock, holders of our preferred stock are entitled to receive a liquidation preference of \$25 per share with respect to the Series D preferred stock, plus any accrued and unpaid distributions. This will reduce the remaining amount of our assets, if any, available to distribute to holders of our common stock. In addition, holders of our preferred stock have the right to elect two additional directors to our Board of Directors if six quarterly preferred dividends are in arrears.

Legislative or regulatory action could adversely affect purchasers of our stock.

In recent years, numerous legislative, judicial and administrative changes have been made in the provisions of the federal income tax laws applicable to investments similar to an investment in our stock. Changes are likely to continue to occur in the future, and we cannot assure you that any of these changes will not adversely affect our stockholder's stock. Any of these changes could have an adverse effect on an investment in our stock or on market value or resale potential. Stockholders are urged to consult with their own tax advisor with respect to the impact that recent legislation may have on their investment and the status of legislative, regulatory or administrative developments and proposals and their potential effect.

Recent changes in taxation of corporate dividends may adversely affect the value of our stock.

The Jobs and Growth Tax Relief Reconciliation Act of 2003 that was enacted into law May 28, 2003, among other things, generally reduces to 15% the maximum marginal rate of tax payable by individuals on dividends received from a regular C corporation. This reduced tax rate, however, will not apply to dividends paid to individuals by a REIT on its shares, except for certain limited amounts. While the earnings of a REIT that are distributed to its stockholders still generally will be subject to less combined federal income taxation than earnings of a non-REIT C corporation that are

distributed to its stockholders net of corporate-level tax, this legislation could cause individual investors to view the stock of regular C corporations as more attractive relative to the shares of a REIT than was the case prior to the enactment of the legislation. Individual investors could hold this view because the dividends from regular C corporations will generally be taxed at a lower rate while dividends from REITs will generally be taxed at the same rate as the individual's other ordinary income. We cannot predict what effect, if any, the enactment of this legislation may have on the value of the shares of REITs in general or on the value of our stock in particular, either in terms of price or relative to other investments.

Tax Risks

We have submitted to the Internal Revenue Service a request for a closing agreement and may not be able to obtain a closing agreement on satisfactory terms.

Management believes that certain of the terms of the Advocat Series B preferred stock previously held by us could be interpreted as affecting our compliance with federal income tax rules applicable to REITs regarding related party tenant income. See “Note 15 - Restatement of Previously Issued Financial Statements” to our audited consolidated financial statements for the year ended December 31, 2005 included elsewhere herein.

On December 15, 2006, we submitted to the IRS a request for a closing agreement to resolve the “related party tenant” issue. Since that time, we have had additional conversations with the IRS, who has encouraged us to move forward with the process of obtaining a closing agreement, and we will be submitting additional documentation in support of the issuance of a closing agreement with respect to this matter. While we believe there are valid arguments that Advocat should not be deemed a “related party tenant,” the matter still is not free from doubt, and we believe it is in our best interest to proceed with the request for a closing agreement with the IRS in order to resolve the matter, minimize potential interest charges and obtain assurances regarding its continuing REIT status. If obtained, a closing agreement will establish that any failure to satisfy the gross income tests was due to reasonable cause. In the event that it is determined that the “savings clause” described above does not apply, we could be treated as having failed to qualify as a REIT for one or more taxable years.

As noted above, we have completed the Second Advocat Restructuring and have been advised by tax counsel that we will not receive any non-qualifying related party tenant income from Advocat in future fiscal years. Accordingly, we do not expect to incur tax expense associated with related party tenant income in future periods commencing January 1, 2007, assuming we enter into a closing agreement with the IRS that recognizes that reasonable cause existed for any failure to satisfy the REIT gross income tests as explained above. We will continue to accrue an income tax liability related to this matter during 2006.

If we were to fail to qualify as a REIT for any taxable year, we would be subject to federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates for such year, and distributions to stockholders would not be deductible by us in computing our taxable income. Any such corporate tax liability could be substantial and, unless we were indemnified against such tax liability, would reduce the amount of cash we have available for distribution to our stockholders, which in turn could have a material adverse impact on the value of, and trading prices for, our securities. In addition, we would not be able to re-elect REIT status until the fifth taxable year following the initial year of disqualification unless we were to qualify for relief under applicable Internal Revenue Code provisions. Thus, for example, if the IRS successfully challenges our status as a REIT solely for our taxable year ended December 31, 2005 based on our ownership of the Advocat Series B preferred stock, we would not be able to re-elect REIT status until our taxable year which began January 1, 2010, unless we were to qualify for relief. See “Certain Federal Income Tax Considerations” beginning on page 90 of this prospectus for a discussion of the material federal income tax consequences relating to us and the acquisition, holding and disposition of our securities.

In the notes to the consolidated financial statements made part of our quarterly report on Form 10-Q filed with the Securities and Exchange Commission for the quarter ended September 30, 2006, we disclosed our accrual for a potential tax liability arising from our ownership of such securities. We believe, but can provide no assurance, that we currently have sufficient assets to pay any such tax liabilities. The ultimate resolution of any controversy over potential tax liabilities covered by the closing agreement may have a material adverse effect on our financial position, results of operations or cash flows, including if we are required to distribute deficiency dividends to our stockholders and/or pay additional taxes, interest and penalties to the IRS in amounts that exceed the amount of our reserves for potential tax liabilities. There can be no assurance that the IRS will not assess us with substantial taxes, interest and penalties above the amount for which we have reserved. The facts giving rise to our request for a closing agreement

are described in more detail under the caption “Certain Federal Income Tax Considerations” beginning on page 90 of this prospectus.

CAUTIONARY LANGUAGE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts included in this prospectus may constitute forward-looking statements. 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” set forth elsewhere in this prospectus;
- (ii) uncertainties relating to the business operations of the operators of our assets, including those relating to reimbursement by third-party payors, regulatory matters and occupancy levels;
- (iii) the ability of any operators in bankruptcy to reject unexpired lease obligations, modify the terms of our mortgages and impede our ability to collect unpaid rent or interest during the process of a bankruptcy proceeding and retain security deposits for the debtors’ obligations;
- (iv) our ability to sell closed assets on a timely basis and on terms that allow us to realize the carrying value of these assets;
- (v) our ability to negotiate appropriate modifications to the terms of our credit facility;
- (vi) our ability to manage, re-lease or sell any owned and operated facilities;
- (vii) the availability and cost of capital;
- (viii) competition in the financing of healthcare facilities;
- (ix) regulatory and other changes in the healthcare sector;
- (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;
- (xiv) our ability to maintain our status as a real estate investment trust;
- (xv) the impact of the material weakness identified in the management’s report on internal control over financial reporting included in our Form 10-K/A for the year ended December 31, 2005, including expenses that may be incurred in efforts to remediate such weakness and potential additional costs in preparing and finalizing financial statements in view of such material weakness; and

(xvi) changes in the ratings of our debt and preferred securities.

Any subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth or referred to above, as well as the risk factors contained in this prospectus. Except as required by law, we disclaim any obligation to update such statements or to publicly announce the result of any revisions to any of the forward-looking statements contained in this prospectus to reflect future events or developments.

RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth our ratio of earnings to fixed charges on a reported basis for the periods indicated. Earnings consist of income (loss) from continuing operations plus fixed charges. Fixed charges consist of interest expense and amortization of deferred financing costs. We have calculated the ratio of earnings to fixed charges by adding net income (loss) from continuing operations to fixed charges and dividing that sum by such fixed charges.

	Year Ended December 31,					Nine Months Ended September 30, 2006
	2001 (Restated)	2002 (Restated)	2003 (Restated)	2004 (Restated)	2005 (Restated)	
(Loss) income from continuing operations	\$ (21,533)	\$ (2,793)	\$ 27,718	\$ 13,499	\$ 34,443	\$ 42,842
Interest expense	33,204	34,381	23,388	44,008	34,771	35,244
Income before fixed charges	\$ 11,671	\$ 31,588	\$ 51,106	\$ 57,507	\$ 69,214	78,086
Interest expense	\$ 33,204	\$ 34,381	\$ 23,388	\$ 44,008	\$ 34,771	\$ 35,244
Total fixed charges	\$ 33,204	\$ 34,381	\$ 23,388	\$ 44,008	\$ 34,771	\$ 35,244
Earnings / fixed charge coverage ratio	*	*	2.2x	1.3x	2.0x	2.2x

*Our earnings were insufficient to cover fixed charges by \$21,533 and \$2,793 in 2001 and 2002, respectively. In addition, our ratio of earnings to fixed charges has been revised to reflect the impact of the implementation of the Statement of Accounting Standard No. 144, *Accounting for the Impairment and Disposal of Long-Lived Assets*.

**RATIO OF EARNINGS TO
COMBINED FIXED CHARGES AND PREFERRED STOCK DIVIDENDS**

The following table sets forth our ratio of earnings to combined fixed charges and preferred stock dividends for the periods indicated. Earnings consist of income (loss) from continuing operations plus fixed charges. Fixed charges consist of interest expense and amortization of deferred financing costs. We have calculated the ratio of earnings to combined fixed charges and preferred stock dividends by adding net income (loss) from continuing operations to fixed charges and dividing that sum by such fixed charges plus preferred dividends, irrespective of whether or not such dividends were actually paid.

	Year Ended December 31,					Nine Months Ended September
	2001 (Restated)	2002 (Restated)	2003 (Restated)	2004 (Restated)	2005 (Restated)	30, 2006
(Loss) income from continuing operations	\$ (21,533)	\$ (2,793)	\$ 27,718	\$ 13,499	\$ 34,443	\$ 42,842
Interest expense	33,204	34,381	23,388	44,008	34,771	35,244
Income before fixed charges	\$ 11,671	\$ 31,588	\$ 51,106	\$ 57,507	\$ 69,214	\$ 78,086
Interest expense	\$ 33,204	\$ 34,381	\$ 23,388	\$ 44,008	\$ 34,771	\$ 35,244
Preferred stock dividends	19,994	20,115	20,115	15,807	11,385	7,442
Total fixed charges and preferred dividends	\$ 53,198	\$ 54,496	\$ 43,503	\$ 59,815	\$ 46,156	\$ 42,686
Earnings / combined fixed charges and preferred dividends coverage ratio	*	*	1.2x	*	1.5x	1.8x

*Our earnings were insufficient to cover combined fixed charges and preferred stock dividends by \$41,527, \$22,908 and \$2,308 in 2001, 2002 and 2004, respectively. In addition, our ratio of earnings to combined fixed charges and preferred dividends has been revised to reflect the impact of the implementation of the Statement of Accounting Standard No. 144, *Accounting for the Impairment and Disposal of Long-Lived Assets*.

**MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS
AND DIVIDENDS**

Our shares of Common Stock are traded on the New York Stock Exchange under the symbol "OHI." The following table sets forth, for the periods shown, the high and low prices as reported on the New York Stock Exchange Composite for the periods indicated and cash dividends per share:

	2007			2006			2005								
	Quarter	High	Low	Dividends Per Share	Quarter	High	Low	Dividends Per Share	Quarter	High	Low	Dividends Per Share			
First through	\$ 18.08	\$ 16.69	\$ 0.26	First	\$ 14.03	\$ 12.36	\$ 0.23	First	\$ 11.950	\$ 10.310	\$ 0.20	Second	13.650	10.580	0.21

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January		Third	15.50	12.56	0.24	Third	14.280	12.390	0.22
25, 2007		Fourth	18.00	14.81	0.25	Fourth	13.980	11.660	0.22
	\$ 0.26				\$ 0.96				\$ 0.85

The closing price on January 18, 2007 was \$17.52 per share. As of January 18, 2007 there were 60,093,030 shares of common stock outstanding with 3,005 registered holders.

On January 16, 2007, our Board of Directors announced a common stock dividend of \$0.26 per share, to be paid February 15, 2007 to common stockholders of record on January 31, 2007.

We expect to continue our policy of paying regular cash dividends, although there is no assurance as to future dividends because they depend on future earnings, capital requirements and our financial condition. In addition, the payment of dividends is subject to the restrictions described in “Note 13 - Dividends” to our audited consolidated financial statements for the year ended December 31, 2005 included elsewhere in this prospectus.

SELECTED FINANCIAL DATA

The following table sets forth our selected financial data and operating data for our company on a historical basis. The following data should be read in conjunction with our audited consolidated financial statements and notes thereto and Management’s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere herein. We restated our audited financial results as of December 31, 2005 and 2004 and for the three years ended December 31, 2005, 2004 and 2003 and for each quarterly period in 2004, 2005 and 2006. See “Note 15 - Restatement of Previously Issued Financial Statements” to our audited consolidated financial statements included elsewhere in this prospectus.

Our historical operating results may not be comparable to our future operating results.

	Year Ended December 31,					Nine Months Ended September 30,	
	2005 (Restated)	2004 (Restated)	2003 (Restated)	2002 (Restated)	2001 (Restated)	2006 (Unaudited)	2005 (Restated)
(in thousands, except per share amounts)							
Operating Data							
Revenues from core operations	\$ 110,006	\$ 87,333	\$ 76,983	\$ 80,572	\$ 79,297	\$ 99,809	\$ 81,563
Revenues from nursing home operations	—	—	4,395	42,203	160,580	—	—
Total revenues	\$ 110,006	\$ 87,333	\$ 81,378	\$ 122,775	\$ 239,877	\$ 99,809	\$ 81,563
Income (loss) from continuing operations	\$ 34,443	\$ 13,499	\$ 27,718	\$ (2,793)	\$ (21,533)	\$ 42,842	\$ 24,842
Net income (loss) available to common	25,355	(36,715)	3,516	(32,801)	(35,567)	34,846	6,864
Per share amounts:							
Income (loss) from continuing operations:							
Basic	\$ 0.41	\$ (0.95)	\$ 0.20	\$ (0.66)	\$ (2.07)	\$ 0.61	\$ 0.27
Diluted	0.40	(0.95)	0.20	(0.66)	(2.07)	0.61	0.27
Net income (loss) available to common:							
Basic	\$ 0.49	\$ (0.81)	\$ 0.09	\$ (0.94)	\$ (1.77)	\$ 0.60	\$ 0.13
Diluted	0.49	(0.81)	0.09	(0.94)	(1.77)	0.60	0.13
Dividends, Common Stock ⁽¹⁾	0.85	0.72	0.15	—	—	0.71	0.63
Dividends, Series A Preferred ⁽¹⁾	—	1.16	6.94	—	—	—	—
Dividends, Series B Preferred ⁽¹⁾	1.09	2.16	6.47	—	—	—	—
	—	—	29.81	—	—	—	—

Dividends, Series C Preferred ⁽²⁾							
Dividends, Series D Preferred ⁽¹⁾	2.09	1.52	—	—	—	1.57	1.57
Weighted-average common shares outstanding, basic	51,738	45,472	37,189	34,739	20,038	58,203	51,050
Weighted-average common shares outstanding, diluted	52,059	45,472	38,154	34,739	20,038	58,407	51,386

	December 31,					Nine Months Ended September 30,	
	2005	2004	2003	2002	2001	2006	2005
	(Restated)	(Restated)	(Restated)	(Restated)	(Restated)	(Unaudited)	(Restated)
Balance Sheet Data							
Gross investments	\$ 1,130,502	\$ 960,569	\$ 840,726	\$ 880,669	\$ 937,817	\$ 1,310,647	\$ 966,392
Total assets	1,030,290	844,932	733,428	807,442	893,748	1,183,054	842,196
Revolving lines of credit	58,000	15,000	177,074	177,000	193,689	157,500	80,700
Other long-term borrowings	508,229	364,508	103,520	129,462	219,483	526,145	364,019
Stockholders' equity	440,943	442,935	440,130	482,995	452,024	466,460	372,119

(1) Dividends per share are those declared and paid during such period.

(2) Dividends per share are those declared during such period, based on the number of shares of common stock issuable upon conversion of the outstanding Series C preferred stock.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

At September 30, 2006, our portfolio of domestic investments consisted of 241 healthcare facilities, located in 27 states and operated by 33 third-party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately \$1.3 billion at September 30, 2006, with approximately 98% of our real estate investments related to long-term care facilities. This portfolio is made up of 227 long-term healthcare facilities, two rehabilitation hospitals owned and leased to third parties, fixed rate mortgages on 10 long-term healthcare facilities and two long-term healthcare facilities that are currently held for sale. At September 30, 2006, we also held other investments of approximately \$37 million, consisting primarily of secured loans to third-party operators of our facilities.

Medicare Reimbursement

All of our properties are used as healthcare facilities; therefore, we are directly affected by the risk associated with the healthcare industry. Our lessees and mortgagors, as well as any facilities that may be owned and operated for our own account from time to time, derive a substantial portion of their net operating revenues from third-party payors, including the Medicare and Medicaid programs. These programs are highly regulated by federal, state and local laws, rules and regulations and are subject to frequent and substantial change.

In 1997, the Balanced Budget Act significantly reduced spending levels for the Medicare and Medicaid programs, in part because the legislation modified the payment methodology for skilled nursing facilities, or SNFs by shifting payments for services provided to Medicare beneficiaries from a reasonable cost basis to a prospective payment system. Under the prospective payment system, SNFs are paid on a per diem prospective case-mix adjusted basis for all covered services. Implementation of the prospective payment system has affected each long-term care facility to a different degree, depending upon the amount of revenue such facility derives from Medicare patients.

Legislation adopted in 1999 and 2000 provided for a few temporary increases to Medicare payment rates, but these temporary increases have since expired. Specifically, in 1999 the Balanced Budget Refinement Act included a 4% across-the-board increase of the adjusted federal per diem payment rates for all patient acuity categories (known as "Resource Utilization Groups" or "RUGs") that were in effect from April 2000 through September 30, 2002. In 2000, the Benefits Improvement and Protection Act included a 16.7% increase in the nursing component of the case-mix adjusted federal periodic payment rate, which was implemented in April 2000 and also expired October 1, 2002. The October 1, 2002 expiration of these temporary increases has had an adverse impact on the revenues of the operators of SNFs and has negatively impacted some operators' ability to satisfy their monthly lease or debt payments to us.

The Balanced Budget Refinement Act and the Benefits Improvement and Protection Act also established temporary increases, beginning in April 2001, to Medicare payment rates to SNFs that were designated to remain in place until the Centers for Medicare and Medicaid Services, or CMS, implemented refinements to the existing RUG case-mix classification system to more accurately estimate the cost of non-therapy ancillary services. The Balanced Budget Refinement Act provided for a 20% increase for 15 RUG categories until CMS modified the RUG case-mix classification system. The Benefits Improvement and Protection Act modified this payment increase by reducing the 20% increase for three of the 15 RUGs to a 6.7% increase and instituting an additional 6.7% increase for eleven other RUGs.

On August 4, 2005, CMS published a final rule, effective October 1, 2005, establishing Medicare payments for SNFs under the prospective payment system for federal fiscal year 2006 (October 1, 2005 to September 30, 2006). The final rule modified the RUG case-mix classification system and added nine new categories to the system, expanding the number of RUGs from 44 to 53. The implementation of the RUG refinements triggered the expiration of the

temporary payment increases of 20% and 6.7% established by the Balanced Budget Refinement Act and the Benefits Improvement and Protection Act, respectively.

Additionally, CMS announced updates in the final rule to reimbursement rates for SNFs in federal fiscal year 2006 based on an increase in the “full market-basket” of 3.1%. In the August 4, 2005 notice, CMS estimated that the increases in Medicare reimbursements to SNFs arising from the refinements to the prospective payment system and the market basket update under the final rule would offset the reductions stemming from the elimination of the temporary increases during federal fiscal year 2006. CMS estimated that there would be an overall increase in Medicare payments to SNFs totaling \$20 million in fiscal year 2006 compared to 2005.

On July 27, 2006, CMS posted a notice updating the payment rates to SNFs for fiscal year 2007 (October 1, 2006 to September 30, 2007). The market basket increase factor is 3.1% for 2007. CMS estimates that the payment update will increase aggregate payments to SNFs nationwide by approximately \$560 million in fiscal year 2007 compared to 2006.

Nonetheless, we cannot accurately predict what effect, if any, these changes will have on our lessees and mortgagors in 2006 and beyond. These changes to the Medicare prospective payment system for SNFs, including the elimination of temporary increases, could adversely impact the revenues of the operators of nursing facilities and could negatively impact the ability of some of our lessees and mortgagors to satisfy their monthly lease or debt payments to us.

A 128% temporary increase in the per diem amount paid to SNFs for residents who have AIDS took effect on October 1, 2004. This temporary payment increase arose from the Medicare Prescription Drug Improvement and Modernization Act of 2003, or the Medicare Modernization Act. Although CMS also noted that the AIDS add-on was not intended to be permanent, the July 2006 notice updating payment rates for SNFs for fiscal year 2007 indicated that the increase will continue to remain in effect for fiscal year 2007.

A significant change enacted under the Medicare Modernization Act is the creation of a new prescription drug benefit, Medicare Part D, which went into effect January 1, 2006. The significant expansion of benefits for Medicare beneficiaries arising under the expanded prescription drug benefit could result in financial pressures on the Medicare program that might result in future legislative and regulatory changes with impacts for our operators. As part of this new program, the prescription drug benefits for patients who are dually eligible for both Medicare and Medicaid are being transitioned from Medicaid to Medicare, and many of these patients reside in long-term care facilities. The Medicare program experienced significant operational difficulties in transitioning prescription drug coverage for this population when the benefit went into effect on January 1, 2006, although it is unclear whether or how issues involving Medicare Part D might have any direct financial impacts on our operators.

On February 8, 2006, the President signed into law a \$39.7 billion budget reconciliation package called the Deficit Reduction Act of 2005, or Deficit Reduction Act, to lower the federal budget deficit. The Deficit Reduction Act included estimated net savings of \$8.3 billion from the Medicare program over 5 years.

The Deficit Reduction Act contained a provision reducing payments to SNFs for allowable bad debts. Previously, Medicare reimbursed SNFs for 100% of beneficiary bad debt arising from unpaid deductibles and coinsurance amounts. In 2003, CMS released a proposed rule seeking to reduce bad debt reimbursement rates for certain providers, including SNFs, by 30% over a three-year period. Subsequently, in early 2006 the Deficit Reduction Act reduced payments to SNFs for allowable bad debts by 30% effective October 1, 2005 for those individuals not dually eligible for Medicare and Medicaid. Bad debt payments for the dually eligible population will remain at 100%. Consistent with this legislation, CMS finalized its 2003 proposed rule on August 18, 2006, and the regulations became effective on October 1, 2006. CMS estimates that implementation of this bad debt provision will result in a savings to the Medicare program of \$490 million from FY 2006 to FY 2010. These reductions in Medicare payments for bad debt could have a material adverse effect on our operators’ financial condition and operations, which could adversely affect their ability to meet their payment obligations to us.

The Deficit Reduction Act also contained a provision governing the therapy caps that went into place under Medicare on January 1, 2006. The therapy caps limit the physical therapy, speech-language therapy and occupation therapy services that a Medicare beneficiary can receive during a calendar year. The therapy caps were in effect for calendar year 1999 and then suspended by Congress for three years. An inflation-adjusted therapy limit (\$1,590 per year) was implemented in September of 2002, but then once again suspended in December of 2003 by the Medicare Modernization Act. Under the Medicare Modernization Act, Congress placed a two-year moratorium on implementation of the caps, which expired at the end of 2005.

The inflation-adjusted therapy caps are set at \$1,740 for calendar year 2006. These caps do not apply to therapy services covered under Medicare Part A in a SNF, although the caps apply in most other instances involving patients in SNFs or long-term care facilities who receive therapy services covered under Medicare Part B. The Deficit Reduction Act permitted exceptions in 2006 for therapy services to exceed the caps when the therapy services are deemed medically necessary by the Medicare program. The Tax Relief and Health Care Act of 2006, signed into law on December 20, 2006, extends these exceptions through December 31, 2007. Future implementation of the therapy caps could have a material adverse effect on our operators' financial condition and operations, which could adversely affect their ability to meet their payment obligations to us.

In general, we cannot be assured that federal reimbursement will remain at levels comparable to present levels or that such reimbursement will be sufficient for our lessees or mortgagors to cover all operating and fixed costs necessary to care for Medicare and Medicaid patients. We also cannot be assured that there will be any future legislation to increase Medicare payment rates for SNFs, and if such payment rates for SNFs are not increased in the future, some of our lessees and mortgagors may have difficulty meeting their payment obligations to us.

Medicaid and Other Third-Party Reimbursement

Each state has its own Medicaid program that is funded jointly by the state and federal government. Federal law governs how each state manages its Medicaid program, but there is wide latitude for states to customize Medicaid programs to fit the needs and resources of their citizens. Currently, Medicaid is the single largest source of financing for long-term care in the United States. Rising Medicaid costs and decreasing state revenues caused by recent economic conditions have prompted an increasing number of states to cut or consider reductions in Medicaid funding as a means of balancing their respective state budgets. Existing and future initiatives affecting Medicaid reimbursement may reduce utilization of (and reimbursement for) services offered by the operators of our properties.

In recent years, many states have announced actual or potential budget shortfalls. As a result of these budget shortfalls, many states have announced that they are implementing or considering implementing "freezes" or cuts in Medicaid reimbursement rates, including rates paid to SNF and long-term care providers, or reductions in Medicaid enrollee benefits, including long-term care benefits. We cannot predict the extent to which Medicaid rate freezes, cuts or benefit reductions ultimately will be adopted, the number of states that will adopt them or the impact of such adoption on our operators. However, extensive Medicaid rate cuts, freezes or benefit reductions could have a material adverse effect on our operators' liquidity, financial condition and operations, which could adversely affect their ability to make lease or mortgage payments to us.

The Deficit Reduction Act included \$4.7 billion in estimated savings from Medicaid and the State Children's Health Insurance Program over five years. The Deficit Reduction Act gave states the option to increase Medicaid cost-sharing and reduce Medicaid benefits, accounting for an estimated \$3.2 billion in federal savings over five years. The remainder of the Medicaid savings under the Deficit Reduction Act comes primarily from changes to prescription drug reimbursement (\$3.9 billion in savings over five years) and tightened policies governing asset transfers (\$2.4 billion in savings over five years).

Asset transfer policies, which determine Medicaid eligibility based on whether a Medicaid applicant has transferred assets for less than fair value, became more restrictive under the Deficit Reduction Act, which extended the look-back period to five years, moved the start of the penalty period and made individuals with more than \$500,000 in home equity ineligible for nursing home benefits (previously, the home was excluded as a countable asset for purposes of Medicaid eligibility). These changes could have a material adverse effect on our operators' financial condition and operations, which could adversely affect their ability to meet their payment obligations to us.

Additional reductions in federal funding are expected for some state Medicaid programs as a result of changes in the percentage rates used for determining federal assistance on a state-by-state basis. Legislation has been introduced in

Congress that would partially mitigate the reductions for some states that would experience significant reductions in federal funding, although whether Congress will enact this or other legislation remains uncertain.

Finally, private payors, including managed care payors, increasingly are demanding discounted fee structures and the assumption by healthcare providers of all or a portion of the financial risk of operating a healthcare facility. Efforts to impose greater discounts and more stringent cost controls are expected to continue. Any changes in reimbursement policies that reduce reimbursement levels could adversely affect the revenues of our lessees and mortgagors, thereby adversely affecting those lessees' and mortgagors' abilities to make their monthly lease or debt payments to us.

Fraud and Abuse Laws and Regulations

There are various extremely complex and largely uninterpreted federal and state laws governing a wide array of referrals, relationships and arrangements and prohibiting fraud by healthcare providers, including criminal provisions that prohibit filing false claims or making false statements to receive payment or certification under Medicare and Medicaid, and failing to refund overpayments or improper payments. The federal and state governments are devoting increasing attention and resources to anti-fraud initiatives against healthcare providers. Penalties for healthcare fraud have been increased and expanded over recent years, including broader provisions for the exclusion of providers from the Medicare and Medicaid programs. The Office of the Inspector General for the U.S. Department of Health and Human Services, or OIG-HHS, has described a number of ongoing and new initiatives for 2007 to study instances of potential overbilling and/or fraud in SNFs and nursing homes under both Medicare and Medicaid. The OIG-HHS, in cooperation with other federal and state agencies, also continues to focus on the activities of SNFs in certain states in which we have properties.

In addition, the federal False Claims Act allows a private individual with knowledge of fraud to bring a claim on behalf of the federal government and earn a percentage of the federal government's recovery. Because of these monetary incentives, these so-called "whistleblower" suits have become more frequent. Some states currently have statutes that are analogous to the federal False Claims Act. The Deficit Reduction Act encourages additional states to enact such legislation and may encourage increased enforcement activity by permitting states to retain 10% of any recovery for that state's Medicaid program if the enacted legislation is at least as rigorous as the federal False Claims Act. The violation of any of these laws or regulations by an operator may result in the imposition of fines or other penalties that could jeopardize that operator's ability to make lease or mortgage payments to us or to continue operating its facility.

Legislative and Regulatory Developments

Each year, legislative and regulatory proposals are introduced or proposed in Congress and state legislatures as well as by federal and state agencies that, if implemented, could result in major changes in the healthcare system, either nationally or at the state level. In addition, regulatory proposals and rules are released on an ongoing basis that may have major impacts on the healthcare system generally and the industries in which our operators do business. Legislative and regulatory developments can be expected to occur on an ongoing basis at the local, state and federal levels that have direct or indirect impacts on the policies governing the reimbursement levels paid to our facilities by public and private third-party payors, the costs of doing business and the threshold requirements that must be met for facilities to continue operation or to expand.

The Medicare Modernization Act, which is one example of such legislation, was enacted in December 2003. The significant expansion of other benefits for Medicare beneficiaries under this Act, such as the prescription drug benefit, could create financial pressures on the Medicare program that might result in future legislative and regulatory changes with impacts on our operators. Although the creation of a prescription drug benefit for Medicare beneficiaries was expected to generate fiscal relief for state Medicaid programs, the structure of the benefit and costs associated with its implementation may mitigate the relief for states that originally was anticipated.

The Deficit Reduction Act is another example of such legislation. The provisions in the legislation designed to create cost savings from both Medicare and Medicaid could diminish reimbursement for our operators under both Medicare

and Medicaid.

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CMS also launched the Nursing Home Quality Initiative program in 2002, which requires nursing homes participating in Medicare to provide consumers with comparative information about the quality of care at the facility. In the fall of 2007, CMS plans to initiate a new quality campaign, Advancing Excellence for America's Nursing Home Residents, to be conducted over the next two years with the ultimate goal being improvement in quality of life and efficiency of care delivery. In the event any of our operators do not maintain the same or superior levels of quality care as their competitors, patients could choose alternate facilities, which could adversely impact our operators' revenues. In addition, the reporting of such information could lead in the future to reimbursement policies that reward or penalize facilities on the basis of the reported quality of care parameters.

In late 2005, CMS began soliciting public comments regarding a demonstration to examine pay-for-performance approaches in the nursing home setting that would offer financial incentives for facilities to deliver high quality care. In June 2006, Abt Associates published recommendations for CMS on how to design this demonstration project. The proposed three-year demonstration could begin as early as late 2006 or early 2007, with CMS inviting state agencies to participate in the project. Other proposals under consideration include efforts by individual states to control costs by decreasing state Medicaid reimbursements in the current or future fiscal years and federal legislation addressing various issues, such as improving quality of care and reducing medical errors throughout the health care industry. We cannot accurately predict whether specific proposals will be adopted or, if adopted, what effect, if any, these proposals would have on operators and, thus, our business.

Critical Accounting Policies and Estimates

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, and a summary of our significant accounting policies is included in "Note 2 - Summary of Significant Accounting Policies" to our audited consolidated financial statements for the year ended December 31, 2005, included elsewhere in this prospectus. Our preparation of the financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenue and expenses during the reporting period.

We have identified five significant accounting policies that we believe are critical accounting policies. These critical accounting policies are those that have the most impact on the reporting of our financial condition and those requiring significant assumptions, judgments and estimates. With respect to these critical accounting policies, we believe the application of judgments and assessments is consistently applied and produces financial information that fairly presents the results of operations for all periods presented. The five critical accounting policies are:

Revenue Recognition

With the exception of certain master leases, rental income and mortgage interest income are recognized as earned over the terms of the related master leases and mortgage notes, respectively. 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 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, or CPI); or (iii) specific dollar increases over prior years. Revenue under lease arrangements with specific determinable increases is recognized over the term of the lease on a straight-line basis. SEC Staff Accounting Bulletin No. 101 "*Revenue Recognition in Financial Statements*," or SAB 101, does not provide for the recognition of contingent revenue until all possible contingencies have been eliminated. We consider the operating history of the lessee, the general condition of the industry and various other factors when evaluating whether all possible contingencies have been eliminated. We have historically not included, and generally expect in the future not to include, contingent rents as income until received. We follow a policy related to rental income whereby we typically consider a lease to be non-performing after 90 days of non-payment of past due amounts and do not recognize unpaid rental income from that lease until the amounts have been received.

In the case of rental revenue recognized on a straight-line basis, we will generally discontinue recording rent on a straight-line basis if the lessee becomes delinquent in rent owed under the terms of the lease. Reserves are taken against earned revenues from leases when collection becomes questionable or when negotiations for restructurings of troubled operators result in significant uncertainty regarding ultimate collection. The amount of the reserve is estimated based on what management believes will likely be collected. Once the recording of straight-line rent is suspended, we will evaluate the collectibility of the related straight-line rent asset. If it is determined that the delinquency is temporary, we will resume booking rent on a straight-line basis once payment is received for past due rents, after taking into account application of security deposits. If it appears that we will not collect future rent due under our leases, we will record a provision for loss related to the straight-line rent asset.

Recognizing rental income on a straight-line basis results in recognized revenue exceeding contractual amounts due from our tenants. Such cumulative excess amounts are included in accounts receivable and were \$18.4 million and \$13.8 million, net of allowances, at September 30, 2006 and December 31, 2005, respectively. See “Note 2 - Restatement of Previously Issued Financial Statements” to our unaudited consolidated financial statements for the periods ended September 30, 2006 included elsewhere in this prospectus. In the case of a lease recognized on a straight-line basis, we will generally provide an allowance for straight-line accounts receivable when certain conditions or indicators of collectibility are present (e.g., among other things, lessee payment delinquencies, bankruptcy indicators, etc.). At September 30, 2006 and December 31, 2005, the allowance for straight-line accounts receivable was \$6.5 million and \$6.7 million, respectively.

Gains on sales of real estate assets are recognized pursuant to the provisions of SFAS No. 66, *Accounting for Sales of Real Estate*. The specific timing of the recognition of the sale and the related gain is measured against the various criteria in SFAS No. 66 related to the terms of the transactions and any continuing involvement associated with the assets sold. To the extent the sales criteria are not met, we defer gain recognition until the sales criteria are met.

Depreciation and Asset Impairment

Under GAAP, real estate assets are stated at the lower of depreciated cost or fair value, if deemed impaired. Depreciation is computed on a straight-line basis over the estimated useful lives of 20 to 40 years for buildings and improvements and three to ten years for furniture, fixtures and equipment. Management periodically, but not less than annually, evaluates our real estate investments for impairment indicators, 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 and legal structure. If indicators of impairment are present, management evaluates the carrying value of the related real estate investments in relation to the future undiscounted cash flows of the underlying facilities. Provisions for impairment losses related to long-lived assets are recognized when expected future undiscounted cash flows are determined to be permanently less than the carrying values of the assets. An adjustment is made to the net carrying value of the leased properties and other long-lived assets for the excess of historical cost over fair value. The fair value of the real estate investment is determined by market research, which includes valuing the property as a nursing home as well as other 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.

If we decide to sell rental properties or land holdings, we evaluate the recoverability of the carrying amounts of the assets. If the evaluation indicates that the carrying value is not recoverable from estimated net sales proceeds, the property is written down to estimated fair value less costs to sell. Our estimates of cash flows and fair values of the properties are based on current market conditions and consider 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.

During the nine months ended September 30, 2006, we recognized an impairment loss associated with one facility of approximately \$0.1 million.

Loan Impairment

Management, periodically but not less than annually, evaluates our outstanding loans and notes receivable. When management identifies potential loan impairment indicators, such as non-payment under the loan documents, impairment of the underlying collateral, financial difficulty of the operator or other circumstances that may impair full execution of the loan documents, and management believes these indicators are permanent, then the loan is written down to the present value of the expected future cash flows. In cases where expected future cash flows cannot be estimated, the loan is written down to the fair value of the collateral. The fair value of the loan is determined by market research, which includes valuing the property as a nursing home as well as other alternative uses.

In accordance with FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan* and FASB Statement No. 118, *Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures*, we currently account for impaired loans using the cost-recovery method applying cash received against the outstanding principal balance prior to recording interest income. See “Note 8 - Investments in Debt and Equity Securities” to our audited consolidated financial statements for the year ended December 31, 2005 included elsewhere in this prospectus.

Assets Held for Sale and Discontinued Operations

Pursuant to the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the operating results of specified real estate assets that have been sold, or otherwise qualify as held for disposition (as defined by SFAS No. 144), are reflected as discontinued operations in the consolidated statements of operations for all periods presented.

Consolidation of Variable Interest Entities

Financial Accounting Standards Board Interpretation No. 46R, *Consolidation of Variable Interest Entities*, or FIN 46R, addresses the consolidation by business enterprises of variable interest entities, or VIEs. FIN 46R provides criteria that, if met, would create a VIE, which would then be subject to consolidation. If an entity is determined to be a VIE, the party deemed to be the primary beneficiary is required to consolidate the VIE. The primary beneficiary is the party that has the most variability in expected gains or losses of the VIE.

In order to determine which party is the primary beneficiary, we must calculate the expected losses and expected residual returns of the VIE. The analysis requires a projection of expected cash flows and the assignment of probabilities to each possible cash flow outcome. Estimating expected cash flows and assigning probabilities of each outcome of the VIE requires us to use significant judgment. If assumptions used to estimate the expected cash flows prove to be inaccurate, our conclusions regarding which party is the VIE’s primary beneficiary could be incorrect, resulting in us improperly consolidating the VIE when we are not the primary beneficiary or not consolidating the VIE when we are the primary beneficiary.

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 consolidated financial statements and accompanying notes included elsewhere in this prospectus.

Our Board of Directors, including our Audit Committee, concluded on October 24, 2006, to restate our audited financial results as of December 31, 2005 and 2004 and for the three years ended December 31, 2005, 2004 and 2003 and for other periods affected, including our unaudited financial statements for each quarterly period in 2004, 2005 and 2006 as necessary, which is referred to herein as the Restatement. As a result, we have previously filed with the Securities and Exchange Commission, or SEC, amendments to our Annual Report on Form 10-K for the period ending December 31, 2005 and our Quarterly Reports on Form 10-Q for the three-month periods ended March 31, 2006 and June 30, 2006, respectively, reflecting the restated matters. As more fully described in “Note 15 - Restatement of Previously Issued Financial Statements” to our audited consolidated financial statements included elsewhere in this prospectus, we have restated our previously issued consolidated financial statements to correct errors in previously reported amounts related to income tax matters and certain debt and equity investments in Advocat Inc., or Advocat, as well as of the recording of certain straight-line rental income. All financial information contained herein has been revised to reflect the restatements.

The Restatement reflects the following adjustments that affect the three- and nine-month periods ended September 30, 2005:

1. We recorded asset values for securities received from Advocat (and the increases therein) since the completion of the restructuring of Advocat obligations pursuant to leases and mortgages for the facilities then operated by Advocat in 2000. These adjustments increased net income by \$0.4 million and \$0.8 million for the three and nine months ended September 30, 2005, respectively. These adjustments also increased total assets by \$5.4 million as of December 31, 2005. Changes in the fair value of the securities not currently recognized in net income were reflected in other comprehensive income.
2. As a result of our holdings of Advocat securities, we recorded reserves related to a potential tax liability arising from our ownership of such securities. This tax liability along with related interest expense had not been previously accrued for and this adjustment decreased net income by \$0.6 million and \$1.8 million for the three and nine months ended September 30, 2005, respectively. The amount accrued represents the estimated liability, which remains subject to final resolution and therefore is subject to change.
3. Subsequent to October 25, 2006, we made a correction to our accounting for certain leases because these leases contain provisions (such as increases in rent based on the lesser of a fixed amount or two times the CPI) that require us to record rental income on a straight-line basis subject to an appropriate evaluation of collectibility. We had not previously recorded rental income on these leases on a straight-line basis. As a result of this adjustment, our net income increased by \$0.8 million and \$2.1 million for the three and nine months ended September 30, 2005, respectively. In addition, net accounts receivable and retained earnings increased by \$9.1 million as of December 31, 2005, to reflect the effects of this adjustment from inception of the affected leases.

The Restatement reflects the following adjustments that affect the three-year period ended December 31, 2005:

1. We recorded asset values for securities received from Advocat (and the increases therein) since the completion of the restructuring of Advocat obligations pursuant to leases and mortgages for the facilities then operated by Advocat in 2000. These adjustments will increase total assets by \$5.4 million and \$5.1 million as of December 31, 2005 and 2004, respectively. These adjustments will also increase net income by \$1.6 million, \$1.9 million and \$0.0 million for the years ended December 31, 2005, 2004 and 2003, respectively. Changes in the fair value of the securities not currently recognized in net income will be reflected in other comprehensive income.
2. We determined that certain terms of the Advocat Series B non-voting, redeemable convertible preferred stock could be interpreted as affecting our compliance with federal income tax rules applicable to REITs regarding related party tenant income. As such, Advocat may be deemed to be a "related party tenant" under applicable federal income tax rules. In such event, rental income from Advocat would not be qualifying income under the gross income tests that are applicable to REITs. In order to maintain qualification as a REIT, we annually must satisfy certain tests regarding the source of our gross income. The applicable federal income tax rules provide a "savings clause" for REITs that fail to satisfy the REIT gross income tests if such failure is due to reasonable cause. A REIT that qualifies for the savings clause will retain its REIT status but will pay a tax under section 857(b)(5) and related interest. On December 15, 2006, we submitted to the IRS a request for a closing agreement to resolve the "related party tenant" issue. While we believe there are valid arguments that Advocat should not be deemed a "related party tenant," the matter is not free from doubt, and we believe it is in our best interest to request a closing agreement in order to resolve the matter, minimize potential interest charges and obtain assurances regarding our continuing REIT status. By submitting a request for a closing agreement, we believe we should be able to establish that any failure to satisfy the gross income tests was due to reasonable cause. As a result of our holding of Advocat securities, we recorded reserves related to a potential tax liability arising from our ownership of such securities. This tax liability along with related interest expense had not been previously accrued for and this adjustment will decrease net income by \$2.4 million, \$0.4 million and \$0.5 million for the years ended December 31, 2005, 2004

and 2003, respectively. The amount accrued represents the estimated liability, which remains subject to final resolution and therefore is subject to change.

3. We have made a correction to our accounting for certain leases because these leases contain provisions (such as increases in rent based on the lesser of a fixed amount or two times the Consumer Price Index) that require us to record rental income on a straight-line basis subject to an appropriate evaluation of collectibility. Historically, we have recorded rental income for leases with these provisions based on contractual scheduled rent payments, rather than on a straight-line basis in accordance with Statement of Financial Accounting Standard, or SFAS, No. 13, *Accounting for Leases*, and Financial Accounting Standards Board Technical Bulletin No. 88-1 *Issues Related to Accounting for Leases*. As a result of this adjustment, our net income will increase by \$2.8 million, \$1.9 million and \$1.1 million for the years ended December 31, 2005, 2004 and 2003, respectively. In addition, net accounts receivable and retained earnings will increase by \$9.1 million and \$6.3 million as of December 31, 2005 and 2004, respectively, to reflect the effects of this adjustment from inception of the affected leases.

Three Months Ended September 30, 2006 and 2005

Operating Revenues

Our operating revenues for the three months ended September 30, 2006 totaled \$35.2 million, an increase of \$8.1 million, over the same period in 2005. The \$8.1 million increase was primarily a result of new investments made throughout 2005 and 2006. The increase in operating revenues from new investments was partially offset by a reduction in mortgage interest income.

Detailed changes in operating revenues for the three months ended September 30, 2006 are as follows:

- Rental income was \$33.2 million, an increase of \$8.3 million over the same period in 2005. The increase was primarily due to new leases entered into throughout 2005 and during the third quarter of 2006, as well as from the consolidation of a VIE.
- Mortgage interest income totaled \$1.1 million, a decrease of \$0.2 million over the same period in 2005. The decrease was primarily the result of normal amortization and a \$10 million loan payoff that occurred in the second quarter of 2006.
- Other investment income totaled \$1.0 million, an increase of \$0.1 million over the same period in 2005. The primary reason for the increase was due to dividends and accretion income associated with the Advocat securities.

Operating Expenses

Operating expenses for the three months ended September 30, 2006 totaled \$14.2 million, an increase of approximately \$2.7 million over the same period in 2005. The increase was primarily due to \$2.2 million of increased depreciation expense and \$3.6 million of restricted stock expense, partially offset by a 2005 provision for impairment on real estate properties.

Detailed changes in our operating expenses for the three months ended September 30, 2006 versus the same period in 2005 are as follows:

- Our depreciation and amortization expense was \$8.4 million, compared to \$6.2 million for the same period in 2005. The increase is due to new investments placed throughout 2005 and during the third quarter of 2006, as well as the consolidation of a VIE in 2006.
- Our general and administrative expense, when excluding restricted stock amortization expense and compensation expense related to the performance restricted stock units, was \$2.0 million, compared to \$2.0 million for the same period in 2005.
- For the three months ended September 30, 2006, in accordance with FAS No. 123R, we recorded approximately \$3.3 million (included in general and administrative expense) of compensation expense associated with the performance restricted stock units (see “Note 7- Stock Based Compensation” to our unaudited consolidated financial statements for the periods ended September 30, 2006 included elsewhere in this prospectus).
- In 2005, we recorded a \$3.1 million provision for impairment charge to reduce the carrying value of two facilities to their estimated fair value.

Other Income (Expense)

For the three months ended September 30, 2006, our total other net expenses were \$7.0 million as compared to \$8.2 million for the same period in 2005. The significant changes are as follows:

- Our interest expense, excluding amortization of deferred costs and refinancing related interest expenses, for the three months ended September 30, 2006 was \$11.2 million, compared to \$7.7 million for the same period 2005. The increase of \$3.5 million was primarily due to higher debt on our balance sheet versus the same period in 2005 and from consolidation of a VIE in 2006.
- For the three months ended September 30, 2006, we sold our remaining 760,000 shares of common stock of Sun Healthcare Group, Inc., or Sun, for approximately \$7.6 million, realizing a gain on the sale of these securities of approximately \$2.7 million.
- For the three months ended September 30, 2006, in accordance with FASB No. 133, we recorded a \$1.8 million mark-to-market adjustment to reflect the fair value of our derivative instrument (i.e., the conversion feature of a redeemable convertible preferred stock security in Advocat, a publicly traded company; see “Note 2 - Restatement of Previously Issued Financial Statements” and “Note 8 - Investments in Debt and Equity Securities” to our unaudited consolidated financial statements for the periods ended September 30, 2006 included elsewhere in this prospectus).

Nine Months Ended September 30, 2006 and 2005

Operating Revenues

Our operating revenues for the nine months ended September 30, 2006 totaled \$99.8 million, an increase of \$18.2 million, over the same period in 2005. The \$18.2 million increase was primarily a result of new investments made throughout 2005 and 2006. The increase in operating revenues from new investments was partially offset by a reduction in mortgage interest income and one-time contractual interest revenue associated with the payoff of a mortgage during the first quarter of 2005.

Detailed changes in operating revenues for the nine months ended September 30, 2006 are as follows:

·Rental income was \$93.1 million, an increase of \$22.7 million over the same period in 2005. The increase was due to new leases entered into throughout 2005 and during the third quarter of 2006, as well as from the consolidation of a VIE.

- Mortgage interest income totaled \$3.4 million, a decrease of \$1.0 million over the same period in 2005. The decrease was primarily the result of normal amortization, a \$60 million loan payoff that occurred in the first quarter of 2005 and a \$10 million loan payoff that occurred in the second quarter of 2006.
- Other investment income totaled \$2.9 million, an increase of \$0.5 million over the same period in 2005. The primary reason for the increase was due to dividends and accretion income associated with the Advocat securities.
- Miscellaneous revenue was \$0.5 million, a decrease of \$4.0 million over the same period in 2005. The decrease was due to contractual revenue owed to us and received in the second quarter of 2005 resulting from a mortgage note prepayment that occurred in the first quarter of 2005.

Operating Expenses

Operating expenses for the nine months ended September 30, 2006 totaled \$33.9 million, an increase of approximately \$5.7 million over the same period in 2005. The increase was primarily due to \$5.5 million of increased depreciation expense and \$4.2 million of restricted stock expense, partially offset by a 2005 provision for impairment on real estate properties and by a 2005 leasehold termination expense.

Detailed changes in our operating expenses for the nine months ended September 30, 2006 versus the same period in 2005 are as follows:

- Our depreciation and amortization expense was \$23.4 million, compared to \$17.9 million for the same period in 2005. The increase is due to new investments placed throughout 2005 and during the third quarter of 2006, as well as from the consolidation of a VIE.
- Our general and administrative expense, when excluding restricted stock amortization expense and compensation expense related to the performance restricted stock units, was \$6.1 million, compared to \$5.6 million for the same period in 2005. The increase was primarily due to normal inflationary increases in goods and services.
- For the nine months ended September 30, 2006, in accordance with FAS No. 123R, we recorded approximately \$3.3 million (included in general and administrative expense) of compensation expense associated with the performance restricted stock units (see "Note 7 - Stock Based Compensation" to our unaudited consolidated financial statements for the periods ended September 30, 2006 included elsewhere in this prospectus).

· In 2006, we recorded a \$0.2 million provision for uncollectible notes receivable.

- In 2005, we recorded a \$3.1 million provision for impairment charge to reduce the carrying value of two facilities to their estimated fair value.
- In 2005, we recorded a \$0.8 million lease expiration accrual relating to disputed capital improvement requirements associated with a lease that expired June 30, 2005.

Other Income (Expense)

For the nine months ended September 30, 2006, our total other net expenses were \$22.5 million as compared to \$26.7 million for the same period in 2005. The significant changes are as follows:

- Our interest expense, excluding amortization of deferred costs and refinancing related interest expenses, for the nine months ended September 30, 2006 was \$30.2 million, compared to \$21.4 million for the same period 2005. The increase of \$8.8 million was primarily due to higher debt on our balance sheet versus the same period in 2005 and

from consolidation of a VIE in 2006.

- For the nine months ended September 30, 2006, we sold our remaining 760,000 shares of Sun's common stock for approximately \$7.6 million, realizing a gain on the sale of these securities of approximately \$2.7 million.
- For the nine months ended September 30, 2006, in accordance with FAS No. 133, we recorded a \$9.7 million mark-to-market adjustment to reflect the fair value of our derivative instrument (i.e., the conversion feature of a redeemable convertible preferred stock security in Advocat, a publicly traded company; see "Note 2 - Restatement of Previously Issued Financial Statements" and "Note 8 - Investments in Debt and Equity Securities" to our unaudited consolidated financial statements for the periods ended September 30, 2006 included elsewhere in this prospectus).
- For the nine months ended September 30, 2006, we recorded a \$0.8 million non-cash charge associated with the redemption of the remaining 20.7% of our \$100 million aggregate principal amount of 6.95% unsecured notes due 2007 not otherwise tendered in 2005.
- For the nine months ended September 30, 2006, we recorded a one time, non-cash charge of approximately \$2.7 million relating to the write-off of deferred financing costs associated with the termination of our prior credit facility.
- During the nine months ended September 30, 2005, we recorded a \$3.4 million provision for impairment of an equity security. In accordance with FASB No. 115, the \$3.4 million provision for impairment was to write-down our 760,000 share investment in Sun's common stock to its then current fair market value.

Taxes

So long as we qualify as a REIT and, among other things, we distribute 90% of our taxable income, we will not be subject to Federal income taxes on our income, except as described below. We are permitted to own up to 100% of a "taxable REIT subsidiary," or TRS. Currently, we have two TRSs that are taxable as corporations and that pay federal, state and local income tax on their net income at the applicable corporate rates. See "Certain Federal Income Tax Considerations - Taxation of Omega."

During the fourth quarter of 2006, we determined that certain terms of the Advocat Series B non-voting, redeemable convertible preferred stock held by us could be interpreted as affecting our compliance with federal income tax rules applicable to REITs regarding related party tenant income. As such, Advocat, one of our lessees, may be deemed to be a "related party tenant" under applicable federal income tax rules. In such event, our rental income from Advocat would not be qualifying income under the gross income tests that are applicable to REITs. In order to maintain qualification as a REIT, we annually must satisfy certain tests regarding the source of our gross income. The applicable federal income tax rules provide a "savings clause" for REITs that fail to satisfy the REIT gross income tests if such failure is due to reasonable cause. A REIT that qualifies for the savings clause will retain its REIT status but will pay a tax under section 857(b)(5) and related interest. We have submitted to the IRS a request for a closing agreement to resolve the "related party tenant" issue. While we believe there are valid arguments that Advocat should not be deemed a "related party tenant," the matter is not free from doubt, and we believe it is in our best interest to request a closing agreement in order to resolve the matter, minimize potential interest charges and obtain assurances regarding our continuing REIT status. By submitting a request for a closing agreement, we intend to establish that any failure to satisfy the gross income tests was due to reasonable cause (see "Note 2 - Restatement of Previously Issued Financial Statements" to our unaudited consolidated financial statements for the period ended September 30, 2006 included elsewhere in this prospectus). In the event that it is determined that the "savings clause" described above does not apply, we could be treated as having failed to qualify as a REIT for one or more taxable years. If we fail to qualify for taxation as a REIT for any taxable year, our income will be taxed at regular corporate rates, and we could be disqualified as a REIT for the following four taxable years.

As a result of the potential related party tenant issue described above and further discussed in “Note 2 - Restatement of Previously Issued Financial Statements” to our consolidated financial statements for the periods ended September 30, 2006 included elsewhere in this prospectus, we have recorded a \$0.6 million and \$1.7 million provision for income taxes, including related interest expense, for the three and nine months ended September 30, 2006, respectively, and \$0.6 million and \$1.8 million for the three and nine months ended September 30, 2005, respectively. The amount accrued represents the estimated liability and interest, which remains subject to final resolution and therefore is subject to change. In addition, in October 2006, we restructured our Advocat relationship and have been advised by tax counsel that we will not receive any non-qualifying related party tenant income from Advocat in future fiscal years. Accordingly, we do not expect to incur tax expense associated with related party tenant income in future periods commencing January 1, 2007, assuming we enter into a closing agreement with the IRS that recognizes that reasonable cause existed for any failure to satisfy the REIT gross income tests as explained above. We will continue to accrue an income tax liability related to this matter during 2006.

Loss from Discontinued Operations

Discontinued operations relate to properties we disposed of in 2006 or are currently held-for-sale and are accounted for as discontinued operations under SFAS No. 144. For the nine months ended September 30, 2006, we sold two SNFs in California and one in Illinois resulting in an accounting loss of approximately \$0.4 million.

At September 30, 2006, we had two assets held for sale with a net book value of approximately \$0.7 million.

During the three months ended March 31, 2006, a \$0.1 million provision for impairment charge was recorded to reduce the carrying value to its sales price of one facility that was under contract to be sold that was subsequently sold during the second quarter of 2006.

In accordance with SFAS No. 144, the \$0.4 million realized net loss is reflected in our consolidated statements of operations as discontinued operations. See “Note 11 - Discontinued Operations” to our unaudited consolidated financial statements for the period ended September 30, 2006 included elsewhere in this prospectus.

Funds From Operations

Our funds from operations available to common stockholders, or FFO, for the three months ended September 30, 2006, was \$19.3 million, compared to \$8.8 million, for the same period in 2005.

We calculate and report FFO in accordance with the definition and interpretive guidelines issued by the National Association of Real Estate Investment Trusts, or NAREIT, and, consequently, FFO is defined as net income available to common stockholders, adjusted for the effects of asset dispositions and certain non-cash items, primarily depreciation and amortization. We believe that FFO is an important supplemental measure of our operating performance. Because the historical cost accounting convention used for real estate assets requires depreciation (except on land), such accounting presentation implies that the value of real estate assets diminishes predictably over time, while real estate values instead have historically risen or fallen with market conditions. The term FFO was designed by the real estate industry to address this issue. FFO herein is not necessarily comparable to FFO of other real estate investment trusts, or REITs that do not use the same definition or implementation guidelines or interpret the standards differently from us.

We use FFO as one of several criteria to measure operating performance of our business. We further believe that by excluding the effect of depreciation, amortization and gains or losses from sales of real estate, all of which are based on historical costs and which may be of limited relevance in evaluating current performance, FFO can facilitate comparisons of operating performance between periods and between other REITs. We offer this measure to assist the users of our financial statements in evaluating our financial performance under GAAP, and FFO should not be

considered a measure of liquidity, an alternative to net income or an indicator of any other performance measure determined in accordance with GAAP. Investors and potential investors in our securities should not rely on this measure as a substitute for any GAAP measure, including net income.

In February 2004, NAREIT informed its member companies that it was adopting the position of the SEC with respect to asset impairment charges and would no longer recommend that impairment write-downs be excluded from FFO. In the tables included in this disclosure, we have applied this interpretation and have not excluded asset impairment charges in calculating our FFO. As a result, our FFO may not be comparable to similar measures reported in previous disclosures. According to NAREIT, there is inconsistency among NAREIT member companies as to the adoption of this interpretation of FFO. Therefore, a comparison of our FFO results to another company's FFO results may not be meaningful.

The following table presents our FFO results reflecting the impact of asset impairment charges (the SEC's interpretation) for the three and nine months ended September 30, 2006 and 2005:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(in thousands)			
Net income available to common stockholders	\$ 12,143	\$ 3,203	\$ 34,846	\$ 6,864
Add back loss (deduct gain) from real estate dispositions	(1,188)	(710)	(807)	3,492
Sub-total	10,955	2,493	34,039	10,356
Elimination of non-cash items included in net income:				
Depreciation and amortization	8,362	6,275	23,432	19,068
Funds from operations available to common stockholders	\$ 19,317	\$ 8,768	\$ 57,471	\$ 29,424

Year Ended December 31, 2005 compared to Year Ended December 31, 2004

Operating Revenues

Our operating revenues for the year ended December 31, 2005 totaled \$110.0 million, an increase of \$22.7 million, over the same period in 2004. The \$22.7 million increase was primarily a result of new investments made throughout 2004 and 2005, contractual interest revenue associated with the payoff of a mortgage note, re-leasing and restructuring activities completed throughout 2004 and 2005, as well as scheduled contractual increases in rents. The increase in operating revenues from new investments was partially offset by a reduction in mortgage interest income.

Detailed changes in operating revenues for the year ended December 31, 2005 are as follows:

- Rental income was \$94.9 million, an increase of \$24.8 million over the same period in 2004. The increase was primarily due to new leases entered into throughout 2004 and 2005, re-leasing and restructuring activities.
- Mortgage interest income totaled \$6.5 million, a decrease of \$6.7 million over the same period in 2004. The decrease is primarily the result of normal amortization and a \$60 million loan payoff that occurred in the first quarter of 2005.
- Other investment income totaled \$4.1 million, an increase of \$0.9 million over the same period in 2004. The primary reason for the increase was due to dividends and accretion income associated with the Advocat securities.
- Miscellaneous revenue was \$4.5 million, an increase of \$3.6 million over the same period in 2004. The increase was due to contractual revenue owed to us as a result of a mortgage note prepayment.

Operating Expenses

Operating expenses for the year ended December 31, 2005 totaled \$36.9 million, an increase of approximately \$8.9 million over the same period in 2004. The increase was primarily due to \$3.1 million non-cash provision for impairment charges recorded throughout 2005, a \$1.1 million lease expiration accrual recorded in 2005 and \$5.0 million of increased depreciation expense.

Detailed changes in our operating expenses for the year ended December 31, 2005 are as follows:

- Our depreciation and amortization expense was \$24.1 million, compared to \$19.1 million for the same period in 2004. The increase is due to new investments placed throughout 2004 and 2005.
- Our general and administrative expense, when excluding restricted stock amortization expense, was \$7.4 million, compared to \$7.7 million for the same period in 2004.
- A \$3.1 million provision for impairment charge was recorded to reduce the carrying value on one facility to its estimated fair value during the twelve months ended December 31, 2005.
- A \$0.1 million provision for uncollectible notes receivable.
- A \$1.1 million lease expiration accrual relating to disputed capital improvement requirements associated with a lease that expired June 30, 2005.

Other Income (Expense)

For the year ended December 31, 2005, our total other net expenses were \$36.3 million as compared to \$45.5 million for the same period in 2004. The significant changes are as follows:

- Our interest expense, excluding amortization of deferred costs and refinancing related interest expenses, for the year ended December 31, 2005 was \$29.9 million, compared to \$23.1 million for the same period 2004. The increase of \$6.8 million was primarily due to higher debt on our balance sheet versus the same period in 2004.
- For the year ended December 31, 2005, we recorded a \$2.8 million non-cash charge associated with the tender and purchase of 79.3% of our \$100 million aggregate principal amount of 6.95% unsecured notes due 2007.
- For the year ended December 31, 2005, we recorded a \$3.4 million provision for impairment on an equity security. In accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, we recorded the provision for impairment to write-down our 760,000 share investment in Sun common stock to its then current fair market value of \$4.9 million.
- For the year ended December 31, 2004, we recorded \$19.1 million of refinancing-related charges associated with refinancing our capital structure. The \$19.1 million consists of a \$6.4 million exit fee paid to our old bank syndication and a \$6.3 million non-cash deferred financing cost write-off associated with the termination of our \$225 million credit facility and our \$50 million acquisition facility, and a loss of approximately \$6.5 million associated with the sale of an interest rate cap.
- For the year ended December 31, 2005, we recorded a \$1.6 million in net cash proceeds resulting from settlement of a lawsuit filed by us against a former tenant.
- For the year ended December 31, 2004, we recorded a \$1.1 million mark-to-market adjustment to reflect the fair value of our derivative instrument (i.e., the conversion feature of a redeemable convertible preferred stock security

in Advocat, a publicly traded company; see “Note 15 - Restatement of Previously Issued Financial Statements” and “Note 5 - Other Investments” to our audited consolidated financial statements for the year ended December 31, 2005 included elsewhere in this prospectus).

For the year ended December 31, 2004, we recorded a \$3.0 million charge associated with professional liability claims made against our former owned and operated facilities.

2005 Income from Discontinued Operations

Discontinued operations relate to properties we disposed of in 2005 or are currently held-for-sale and are accounted for as discontinued operations under SFAS No. 144. For the year ended December 31, 2005, we sold eight SNFs, six ALFs and 50.4 acres of undeveloped land for combined cash proceeds of approximately \$53 million, net of closing costs and other expenses, resulting in a combined accounting gain of approximately \$8.0 million.

We had five assets held for sale as of December 31, 2005 with a combined net book value of \$2.7 million. During the three months ended March 31, 2005, a \$3.7 million provision for impairment charge was recorded to reduce the carrying value on two facilities, which were subsequently closed, to their estimated fair value. During the three months ended September 30, 2005, a \$2.3 million provision for impairment charge was recorded to reduce the carrying value on one facility to its estimated fair value. During the three months ended December 31, 2005, a \$0.5 million impairment charge was recorded to reduce the carrying value of one facility, currently under contract to be sold in the first quarter of 2006, to its sales price.

In accordance with SFAS No. 144, the \$8.0 million realized net gain as well as the combined \$6.5 million impairment charge is reflected in our consolidated statements of operations as discontinued operations.

Funds From Operations

Our FFO, for the year ended December 31, 2005, was \$42.7 million, compared to a deficit of \$18.5 million, for the same period in 2004.

The following table presents our FFO results reflecting the impact of asset impairment charges (the SEC's interpretation) for the years ended December 31, 2005 and 2004:

	Year Ended December 31,	
	2005	2004
	(Restated)	(Restated)
Net income (loss) available to common stockholders	\$ 25,355	\$ (36,715)
Deduct gain from real estate dispositions ⁽¹⁾	(7,969)	(3,310)
	17,386	(40,025)
Elimination of non-cash items included in net income (loss):		
Depreciation and amortization ⁽²⁾	25,277	21,551
Funds from operations available to common stockholders	\$ 42,663	\$ (18,474)

(1) The deduction of the gain from real estate dispositions includes the facilities classified as discontinued operations in our consolidated financial statements. The gain deducted includes \$8.0 million gain and \$3.3 million gain related to facilities classified as discontinued operations for the year ended December 31, 2005 and 2004, respectively.

(2) The add back of depreciation and amortization includes the facilities classified as discontinued operations in our consolidated financial statements. FFO for 2005 and 2004 includes depreciation and amortization of \$1.2 million and \$2.5 million, respectively, related to facilities classified as discontinued operations.

2005 Taxes

As a result of the possible related party tenant issue described above and further discussed in “Note 15 - Restatement of Previously Issued Financial Statements” to our audited consolidated financial statements for the year ended December 31, 2005 included elsewhere in this prospectus, we have recorded a \$2.4 million and \$0.4 million provision for income tax for the years ended December 31, 2005 and 2004, respectively. The amount accrued represents the estimated liability and interest, which remains subject to final resolution and therefore is subject to change. In addition, in October 2006, we restructured our Advocat relationship and have been advised by tax counsel that we will not receive any non-qualifying related party tenant income from Advocat in future fiscal years. Accordingly, we do not expect to incur tax expense associated with related party tenant income in future periods commencing January 1, 2007, assuming we enter into a closing agreement with the IRS that recognizes that reasonable cause existed for any failure to satisfy the REIT gross income tests as explained above. We will continue to accrue an income tax liability related to this matter during 2006.

In addition, for tax year 2005, preferred and common dividend payments of approximately \$56 million made throughout 2005 satisfy the 2005 REIT requirements relating to qualifying income (which states we must distribute at least 90% of our REIT taxable income for the taxable year and meet certain other conditions). We are permitted to own up to 100% of a TRS. Currently we have two TRSs that are taxable as corporations and that pay federal, state and local income tax on their net income at the applicable corporate rates. These TRSs had net operating loss carry-forwards as of December 31, 2005 of \$14.4 million. These loss carry-forwards were fully reserved with a valuation allowance due to uncertainties regarding realization.

Year Ended December 31, 2004 compared to Year Ended December 31, 2003

Operating Revenues

Our operating revenues for the year ended December 31, 2004 totaled \$87.3 million, an increase of \$6.0 million from the same period in 2003. When excluding nursing home revenues of owned and operated assets, revenues increased \$10.4 million. The \$10.4 million increase was primarily a result of new investments made in the second and fourth quarters of 2004, re-leasing and restructuring activities completed throughout 2003 and during the first quarter of 2004, as well as scheduled contractual increases in rents.

Detailed changes in operating revenues for the year ended December 31, 2004 are as follows:

- Rental income was \$70.1 million, an increase of \$11.8 million over the same period in 2003. The increase was primarily due to new leases entered into in April, November and December of 2004, re-leasing and restructuring activities.
- Mortgage interest income totaled \$13.3 million, a decrease of \$1.4 million over the same period in 2003. The decrease is primarily the result of mortgage payoffs during 2004, the restructuring of two mortgages during 2003 and normal amortization and was partially offset by a new mortgage placed in November 2004.
- Other investment income totaled \$3.1 million, an increase of \$0.2 million over the same period in 2003. The primary reason for the increase was due to recording of dividends and accretion income associated with the Advocat securities in 2004, partially offset by the impact of the sale of our investment in a Baltimore, Maryland asset leased by the United States Postal Service, or USPS, in 2003.

Operating Expenses

Operating expenses for the year ended December 31, 2004 totaled \$27.9 million, a decrease of approximately \$4.9 million over the same period in 2003. When excluding nursing home expenses of owned and operated assets in 2003, operating expenses increased \$0.6 million, primarily due to restricted stock amortization expense resulting from issuance of restricted stock grants in 2004. This increase was partially offset by reductions in general and administrative and legal costs.

Detailed changes in our operating expenses for the year ended December 31, 2004 are as follows:

- Our general and administrative expense, excluding legal expenses and restricted stock expense, was \$6.2 million, compared to \$6.6 million for the same period in 2003.
- Our legal expenses were \$1.5 million, compared to \$2.3 million for the same period in 2003. The decrease is largely attributable to a reduction of legal costs associated with our owned and operated facilities due to the releasing efforts, sales and/or closures of 33 owned and operated assets since December 31, 2001.
- Our restricted stock expense was \$1.1 million, compared to \$0 for the same period in 2003. The increase is due to the expense associated with restricted stock awards granted during 2004.
- As of December 31, 2004, we no longer owned any facilities that were previously recovered from customers. As a result, our nursing home expenses for owned and operated assets decreased to \$0 from \$5.5 million in 2003.

We believe that the presentation of our revenues and expenses, excluding nursing home owned and operated assets, provides a useful measure of the operating performance of our core portfolio as a REIT in view of the disposition of all of our owned and operated assets as of January 1, 2004.

Other Income (Expense)

For the year ended December 31, 2004, our total other net expenses were \$45.5 million as compared to \$21.0 million for the same period in 2003. The significant changes are as follows:

- Our interest expense, excluding amortization of deferred costs, for the year ended December 31, 2004 was \$23.1 million, compared to \$18.5 million for the same period in 2003. The increase of \$4.6 million was primarily due to higher debt on our balance sheet versus the same period in 2003.
- For the year ended December 31, 2004, we recorded \$19.1 million of refinancing-related charges associated with refinancing our capital structure. The \$19.1 million consists of a \$6.4 million exit fee paid to our old bank syndication and a \$6.3 million non-cash deferred financing cost write-off associated with the termination of our \$225 million credit facility and our \$50 million acquisition facility, and a loss of approximately \$6.5 million associated with the sale of an interest rate cap.
- For the year ended December 31, 2003, we recorded a \$2.6 million one-time, non-cash charge associated with the termination of two credit facilities syndicated by Fleet and Provident Bank during 2003.
- For the year ended December 31, 2004, we recorded a \$3.0 million charge associated with professional liability claims made against our former owned and operated facilities.
- For the year ended December 31, 2004, we recorded a \$1.1 million mark-to-market adjustment to reflect the fair value of our non-hedge derivative instrument (i.e., the conversion feature of a convertible preferred stock security in *Advocat*, a publicly traded company; see “Note 15 - Restatement of Previously Issued Financial Statements” and “Note 5 - Other Investments” to our audited consolidated financial statements for the year ended December 31, 2005 included elsewhere in this prospectus).
- For the year ended December 31, 2003, we recorded a legal settlement receipt of \$2.2 million. In 2000, we filed suit against a title company (later adding a law firm as a defendant), seeking damages based on claims of breach of contract and negligence, among other things, as a result of the alleged failure to file certain Uniform Commercial Code financing statements on our behalf.

2004 Taxes

As a result of the possible related party tenant issue described above and further discussed in “Note 15 - Restatement of Previously Issued Financial Statements,” to our audited consolidated financial statements for the year ended December 31, 2005, included elsewhere in this prospectus, we have recorded a \$0.4 million and \$0.5 million provision for income tax for the years ended December 31, 2004 and 2003, respectively. The amount accrued represents the estimated liability and interest, which remains subject to final resolution and therefore is subject to change. In addition, in October 2006, we restructured our Advocat relationship and have been advised by tax counsel that we will not receive any non-qualifying related party tenant income from Advocat in future fiscal years. Accordingly, we do not expect to incur tax expense associated with related party tenant income in future periods commencing January 1, 2007, assuming we enter into a closing agreement with the IRS that recognizes that reasonable cause existed for any failure to satisfy the REIT gross income tests as explained above. We will continue to accrue an income tax liability related to this matter during 2006.

In addition, for tax year 2004, preferred and common dividend payments of approximately \$49 million made throughout 2004 satisfy the 2004 REIT requirements relating to qualifying income (which states we must distribute at least 90% of our REIT taxable income for the taxable year and meet certain other conditions). We are permitted to own up to 100% of a TRS. At December 31, 2004, we had two TRSs that are taxable as corporations and that pay federal, state and local income tax on their net income at the applicable corporate rates. These TRSs had net operating loss carry-forwards as of December 31, 2004 of \$15.5 million. These loss carry-forwards were fully reserved with a valuation allowance due to uncertainties regarding realization.

2004 Income (Loss) from Discontinued Operations

Discontinued operations relate to properties we disposed of in 2004 and are accounted for as discontinued operations under SFAS No. 144. For the year ended December 31, 2004, we sold six closed facilities, realizing proceeds of approximately \$5.7 million, net of closing costs and other expenses, resulting in a net gain of approximately \$3.3 million. In accordance with SFAS No. 144, the \$3.3 million realized net gain is reflected in our consolidated statements of operations as discontinued operations.

Funds From Operations

Our FFO available to all equity holders, for the year ended December 31, 2004, was a deficit of \$18.5 million, a decrease of \$43.6 million as compared to \$25.1 million for the same period in 2003. Our FFO for the year ended December 31, 2004, was a deficit of \$18.5 million, a decrease of \$54.0 million as compared to \$35.6 million for the same period in 2003.

The following table presents our FFO results reflecting the impact of asset impairment charges (the SEC’s interpretation) for the years ended December 31, 2004 and 2003:

	Year Ended December 31,	
	2004	2003
	(Restated)	(Restated)
Net (loss) income available to common stockholders	\$ (36,715)	\$ 3,516
Add back loss (deduct gain) from real estate dispositions ⁽¹⁾	(3,310)	149
	(40,025)	3,665
Elimination of non-cash items included in net (loss) income:		
Depreciation and amortization ⁽²⁾	21,551	21,426
Funds from operations available to all equity holders	(18,474)	25,091
Series C Preferred Dividends	—	10,484

Funds from operations available to common stockholders	\$	(18,474)	\$	35,575
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(1) The add back of loss/deduction of gain from real estate dispositions includes the facilities classified as discontinued operations in our consolidated financial statements. The loss (deduct gain) add back includes \$3.3 million gain and \$0.8 million loss related to facilities classified as discontinued operations for the year ended December 31, 2004 and 2003, respectively.

(2) The add back of depreciation and amortization includes the facilities classified as discontinued operations in our consolidated financial statements. FFO for 2004 and 2003 includes depreciation and amortization of \$2.3 million and \$2.9 million, respectively, related to facilities classified as discontinued operations.

Portfolio Developments, New Investments and Recent Developments

Below is a brief description, by third-party operator, of our re-leasing, restructuring or new investment transactions that occurred since December 31, 2005.

Litchfield Transaction

On August 1, 2006, we completed a transaction with Litchfield Investment Company, LLC and its affiliates, or Litchfield, to purchase 30 skilled nursing facilities and one independent living center for a total investment of approximately \$171 million. The facilities total 3,847 beds and are located in the states of Colorado (5), Florida (7), Idaho (1), Louisiana (13), and Texas (5). The facilities were subject to master leases with three national healthcare providers, which are existing tenants of the Company. The tenants are Home Quality Management, Inc., or HQM, Nexion Health, Inc., or Nexion, and Peak Medical Corporation, which was acquired by Sun in December of 2005. We used a combination of cash on hand and \$150 million of borrowings under our New Credit Facility to finance the Litchfield transaction.

Simultaneously with the close of the purchase transaction, the seven HQM facilities were combined into an Amended and Restated Master Lease containing 13 facilities between us and HQM. In addition, the 18 Nexion facilities were combined into an Amended and Restated Master Lease containing 22 facilities between us and Nexion.

We entered into a Master Lease, Assignment and Assumption Agreement with Litchfield on the six Sun facilities. These six facilities are currently under a master lease that expires on September 30, 2007.

Guardian LTC Management, Inc.

On September 1, 2006, we completed a \$25.0 million investment with subsidiaries of Guardian LTC Management, Inc., or Guardian, an existing operator of ours. The transaction involved the purchase and leaseback of a SNF in Pennsylvania and termination of a purchase option on a combination SNF and rehabilitation hospital in West Virginia owned by us. The facilities were included in an existing master lease with Guardian with an increase in contractual annual rent of approximately \$2.6 million in the first year and the master lease now includes 17 facilities. In addition, the master lease term was extended from October 2014 through August 2016.

In accordance with FASB Statement No. 13, *Accounting Lease*, FAS No. 13 and FASB Technical Bulletin No. 88-1, *Issues Relating to Accounting for Leases*, or FASB TB No. 88-1, \$19.2 million of the \$25.0 million transaction amount will be accounted for as a lease inducement and is classified within accounts receivable - net on our consolidated balance sheets. The lease inducement will be amortized as a reduction to rental income on a straight-line basis over the term of the new master lease. The remaining payment to Guardian of \$5.8 million will be allocated to the purchase of the Pennsylvania SNF.

Advocat, Inc.

On October 20, 2006, as part of the Second Advocat Restructuring, we amended our master lease with Advocat to commence a new 12-year lease term through September 30, 2018 (with a renewal option for an additional 12 year term) and Advocat agreed to increase the master lease annual rent by approximately \$687,000 to approximately \$14 million commencing on January 1, 2007. See "Note 2 - Restatement of Previously Issued Financial Statements" to our unaudited consolidated financial statements for the periods ended September 30, 2006 included elsewhere in this prospectus.

The Second Advocat Restructuring will be accounted for as a new lease in accordance with FAS No. 13 and FASB TB No. 88-1. The fair value of the assets exchanged in the restructuring (i.e., the Series B non-voting redeemable convertible preferred stock and the secured convertible subordinated note, with a fair value of \$14.9 million and \$2.5 million, respectively, at October 20, 2006) in excess of the fair value of the assets received (the Series C non-voting redeemable non-convertible preferred stock and the secured non-convertible subordinated note, with a fair value of \$4.1 million and \$2.5 million, respectively, at October 20, 2006) will be recorded as a lease inducement of approximately \$10.8 million in the fourth quarter of 2006. The \$10.8 million lease inducement asset will be amortized as a reduction to rental income on a straight-line basis over the term of the new master lease. The exchange of securities will also result in a gain in the fourth quarter of 2006 of approximately \$3.0 million representing: (i) the fair value of the secured convertible subordinated note of \$2.5 million, previously reserved; (ii) the realization of the gain on investments previously classified in other comprehensive income of approximately \$1.1 million relating to the Series B non-voting redeemable convertible preferred stock; and (iii) a loss of approximately \$0.6 million resulting from the change in the fair value of the embedded derivative from September 30, 2006 to October 20, 2006. See also "Note 8 - Investments in Debt and Equity Securities" to our unaudited consolidated financial statements for the periods ended September 30, 2006 included elsewhere in this prospectus.

Hickory Creek Healthcare Foundation, Inc.

On June 16, 2006, we received approximately \$10 million in proceeds on a mortgage loan payoff. We held mortgages on 15 facilities located in Indiana, representing 619 beds.

Haven Eldercare, LLC

- During the three months ending March 31, 2006, Haven Eldercare, LLC, or Haven, an existing operator of ours, entered into a \$39 million first mortgage loan with General Electric Capital Corporation, or GE Loan. Haven used the \$39 million of proceeds to partially repay on a \$62 million mortgage it has with us. Simultaneously, we subordinated the payment of our remaining \$23 million on the mortgage note, due in October 2012, to that of the GE Loan. As a result of this transaction, the interest rate on our remaining mortgage note to Haven rose from 10% to approximately 15%, with annual escalators.
- In conjunction with the above transactions and the application of FIN 46R, we consolidated the financial statements and related real estate of this Haven entity into our financial statements. The consolidation resulted in the following changes to our consolidated balance sheet as of September 30, 2006: (1) an increase in total gross investments of \$39.0 million; (2) an increase in accumulated depreciation of \$1.2 million; (3) an increase in other long-term borrowings of \$39.0 million; and (4) a reduction of \$1.2 million in cumulative net earnings for the nine months ended September 30, 2006 due to the increased depreciation expense. General Electric Capital Corporation and Haven's other creditors do not have recourse to our assets. We have an option to purchase the mortgaged facilities for a fixed price in 2012. Our results of operations reflect the effects of the consolidation of this entity, which is being accounted for similarly to our other purchase-leaseback transactions.

Assets Sold

- On June 30, 2006, we sold two SNFs in California resulting in an accounting loss of approximately \$0.1 million.
- On March 31, 2006, we sold a SNF in Illinois resulting in an accounting loss of approximately \$0.2 million.

Held for Sale

- We had two assets held for sale as of September 30, 2006 with a net book value of approximately \$0.7 million.

·During the three months ended March 31, 2006, a \$0.1 million provision for impairment charge was recorded to reduce the carrying value to its sales price of one facility that was under contract to be sold, which was subsequently sold during the second quarter of 2006.

Liquidity and Capital Resources

At September 30, 2006, we had total assets of \$1.2 billion, stockholders' equity of \$466.5 million and debt of \$683.6 million, which represents approximately 59.4% of our total capitalization.

The following table shows the amounts due in connection with the contractual obligations described below as of September 30, 2006.

	Total	Payments due by period			More than 5 years
		Less than 1 year	1-3 years (In thousands)	3-5 years	
Long-term debt (1)	\$ 683,910	\$ 415	\$ 900	\$ 158,285	\$ 524,310
Other long-term liabilities	559	231	328	—	—
Total	\$ 684,469	\$ 646	\$ 1,228	\$ 158,285	\$ 524,310

(1) The \$683.9 million includes \$310 million aggregate principal amount of 7% Senior Notes due 2014, \$175 million aggregate principal amount of 7% Senior Notes due 2016, \$157.5 million in borrowings under the \$200 million revolving senior secured credit facility that matures in March 2010 and Haven's \$39 million first mortgage with General Electric Capital Corporation that expires in 2012.

Financing Activities and Borrowing Arrangements

Bank Credit Agreements

At September 30, 2006, we had \$157.5 million outstanding under our \$200 million revolving senior secured credit facility, as amended, or the New Credit Facility, and \$2.5 million was utilized for the issuance of letters of credit, leaving availability of \$40.0 million. The \$157.5 million of outstanding borrowings had a blended interest rate of 6.57% at September 30, 2006. The New Credit Facility, entered into on March 31, 2006, is being provided by Bank of America, N.A., as Administrative Agent, Deutsche Bank Trust Company Americas, UBS Securities LLC, General Electric Capital Corporation, LaSalle Bank N.A., and Citicorp North America, Inc. and will be used for acquisitions and general corporate purposes.

The New Credit Facility replaced our previous \$200 million senior secured credit facility, or the Prior Credit Facility, that was terminated on March 31, 2006. We will realize a 125 basis point savings on LIBOR-based loans under the New Credit Facility, as compared to LIBOR-based loans under our Prior Credit Facility. The New Credit Facility matures on March 31, 2010, and includes an "accordion feature" that permits us to expand our borrowing capacity to \$300 million during our first two years.

For the three-month period ending March 31, 2006, we recorded a one-time, non-cash charge of approximately \$2.7 million relating to the write-off of deferred financing costs associated with the termination of our Prior Credit Facility.

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, 2006, we were in compliance with all property level and corporate financial covenants.

On October 23, 2006, we entered into a Second Amendment, Waiver and Consent to Credit Agreement, or the Second Amendment, pursuant to which the lenders under the New Credit Facility waived any potential misrepresentations and events of default that could have been caused by the Restatement.

\$100 Million Aggregate Principal Amount of 6.95% Unsecured Notes Tender and Redemption

On December 16, 2005, we initiated a tender offer and consent solicitation for all of our outstanding \$100 million aggregate principal amount 6.95% notes due 2007, or the 2007 Notes. On December 30, 2005, we accepted for purchase the 79.3% of the aggregate principal amount of the 2007 Notes outstanding that were tendered. On December 30, 2005, our Board of Directors also authorized the redemption of all outstanding 2007 Notes that were not otherwise tendered. On December 30, 2005, upon our irrevocable funding of the full redemption price for the 2007 Notes and certain other acts required by the Indenture governing the 2007 Notes, the Trustee of the 2007 Notes certified in writing to us, or the Certificate of Satisfaction and Discharge, that the Indenture was satisfied and discharged as of December 30, 2005, except for certain administrative provisions. In accordance with FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*, or FAS 140, we removed 79.3% of the aggregate principal amount of the 2007 Notes, which were tendered in our tender offer and consent solicitation, and the corresponding portion of the funds held in trust by the Trustee to pay the tender price from our balance sheet and recognized \$2.8 million of additional interest expense associated with the tender offer. On January 18, 2006, we completed the redemption of the remaining 2007 Notes not otherwise tendered. Accordingly, we reduced other assets, representing the funds deposited with the Trustee, and unsecured borrowings by \$21 million. In connection with the redemption and in accordance with FAS 140, we recognized \$0.8 million of additional interest expense in the first quarter of 2006. As of January 18, 2006, none of the 2007 Notes remained outstanding.

Other Long-Term Borrowings

During the three months ended March 31, 2006, Haven used the \$39 million of proceeds from the GE Loan to partially repay a portion of a \$62 million mortgage it has with us. Simultaneously, we subordinated the payment of its remaining \$23 million on the mortgage note to that of the GE Loan. In conjunction with the above transactions and the application of FIN 46R, we consolidated the financial statements of this Haven entity into our financial statements, which contained the long-term borrowings with General Electric Capital Corporation of \$39.0 million. The loan has an interest rate of approximately seven percent and is due in 2012. The lender of the \$39.0 million does not have recourse to our assets. See "Note - 3 Properties; Leased Property" to our unaudited consolidated financial statements for the periods ended September 30, 2006 included elsewhere in this prospectus.

Dividends

In order to qualify as a REIT, we are required to distribute dividends (other than capital gain dividends) to our stockholders in an amount at least equal to (A) the sum of (i) 90% of our "REIT taxable income" (computed without regard to the dividends paid deduction and our net capital gain), and (ii) 90% of the net income (after tax), if any, from foreclosure property, minus (B) the sum of certain items of non-cash income. In addition, if we dispose of any built-in gain asset during a recognition period, we will be required to distribute at least 90% of the built-in gain (after tax), if any, recognized on the disposition of such asset. Such distributions must be paid in the taxable year to which they relate, or in the following taxable year if declared before we timely file our tax return for such year and paid on or before the first regular dividend payment after such declaration. In addition, such distributions are required to be made pro rata, with no preference to any share of stock as compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that such class is entitled to such a preference. To the extent that we do not distribute all of our net capital gain or do distribute at least 90%, but less than 100% of our "REIT taxable income," as adjusted, we will be subject to tax thereon at regular ordinary and capital gain corporate tax rates. In addition, our New Credit Facility has certain financial covenants that limit the distribution of dividends paid during a fiscal quarter to no more than 95% of our aggregate cumulative FFO as defined in the loan agreement governing the New Credit Facility, or the Loan Agreement, unless a greater distribution is required to maintain REIT status. The Loan Agreement defines FFO as net income (or loss) plus depreciation and amortization and shall be adjusted for charges related to: (i) restructuring our debt; (ii) redemption of preferred stock; (iii) litigation

charges up to \$5.0 million; (iv) non-cash charges for accounts and notes receivable up to \$5.0 million; (v) non-cash compensation related expenses; (vi) non-cash impairment charges; and (vii) tax liabilities in an amount not to exceed \$8.0 million.

Common Dividends

On October 24, 2006, the Board of Directors announced a common stock dividend of \$0.25 per share, an increase of \$0.01 per common share compared to the prior quarter, which was paid November 15, 2006 to common stockholders of record on November 3, 2006.

On July 17, 2006, the Board of Directors declared a common stock dividend of \$0.24 per share. The common dividend was paid August 15, 2006 to common stockholders of record on July 31, 2006.

On April 18, 2006, the Board of Directors declared a common stock dividend of \$0.24 per share, an increase of \$0.01 per common share compared to the prior quarter. The common dividend was paid May 15, 2006 to common stockholders of record on April 28, 2006.

On January 17, 2006, the Board of Directors declared a common stock dividend of \$0.23 per share, an increase of \$0.01 per common share compared to the prior quarter. The common stock dividend was paid February 15, 2006 to common stockholders of record on January 31, 2006.

Series D Preferred Dividends

On October 24, 2006, the Board of Directors declared the regular quarterly dividends for the 8.375% Series D Preferred Stock to stockholders of record on November 3, 2006. The stockholders of record of the Series D Preferred Stock on November 3, 2006 were paid dividends in the amount of \$0.52344 per preferred share on November 15, 2006. 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, 2006 through October 31, 2006.

On July 17, 2006, 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 15, 2006 to preferred stockholders of record on April 28, 2006.

On April 18, 2006, 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 15, 2006 to preferred stockholders of record on April 28, 2006.

On January 17, 2006, the Board of Directors declared regular quarterly dividends of approximately \$0.52344 per preferred share on the Series D Preferred Stock that were paid February 15, 2006 to preferred stockholders of record on January 31, 2006.

Liquidity

We believe our liquidity and various sources of available capital, including cash from operations, our existing availability under our New Credit Facility and expected proceeds from mortgage payoffs are more than 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;
- preferred stock dividends;
- common stock dividends; and
- growth through acquisitions of additional properties.

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

Cash and cash equivalents totaled \$0.0 million as of September 30, 2006, a decrease of \$3.9 million as compared to the balance at December 31, 2005. The following is a discussion of changes in cash and cash equivalents due to operating, investing and financing activities, which are presented in our Consolidated Statements of Cash Flows.

Operating Activities – Net cash flow from operating activities generated \$48.0 million for the nine months ended September 30, 2006, as compared to \$55.3 million for the same period in 2005. The \$7.2 million decrease is due primarily to: a \$19.2 million lease inducement with Guardian; partially offset by (i) incremental revenue associated with acquisitions completed throughout 2005 and 2006 and (ii) normal working capital fluctuations during the period.

Investing Activities – Net cash flow from investing activities was an outflow of \$166.8 million for the nine months ended September 30, 2006, as compared to an outflow of \$41.0 million for the same period in 2005. The \$125.7 million change in investing cash outflow was primarily due to: (i) an outflow of \$178.9 million for acquisitions completed during the nine months of 2006 as compared to \$120.7 million for the same period in 2005; (ii) a \$60.0 million mortgage payoff in 2005 as compared to a \$10.0 million mortgage payoff in 2006; (iii) \$1.5 million collected from the sale of real estate for the nine months ended September 30, 2006 as compared to \$25.9 million in 2005; and (iv) \$7.6 million of proceeds from the sale of Sun common stock in 2006.

Financing Activities – Net cash flow from financing activities was an inflow of \$114.8 million for the nine months ended September 30, 2006 as compared to an outflow of \$25.5 million for the same period in 2005. The increase in financing cash inflow of \$140.3 million was primarily a result of: (i) net borrowings of \$99.5 million on our New Credit Facility in 2006 versus net borrowings of \$65.7 million on our Prior Credit Facility in 2005; (ii) \$39.0 million of proceeds received in a Haven transaction; (iii) \$26.8 million of incremental optional cash purchases of our common stock through our dividend reinvestment for the nine months ended September 30, 2006 as compared to the same time period in 2005. The increase was partially offset by \$50.0 million redemption of the outstanding shares of Series B preferred stock in 2005.

Effects of Recently Issued Accounting Standards

In December 2004, the Financial Accounting Standards Board, or FASB, issued FAS No. 123 (revised 2004), *Share-Based Payment*, or FAS No. 123R, which is a revision of FAS No. 123, *Accounting for Stock-Based Compensation*. FAS No. 123R supersedes Accounting Principles Board, or APB, Opinion No. 25, *Accounting for Stock Issued to Employees*, and amends FAS No. 95, *Statement of Cash Flows*. Registrants were initially required to adopt FAS No. 123R as of the beginning of the first interim or annual period that begins after June 15, 2005. On April 14, 2005, subsequent to the end of our 2005 first quarter, the Securities and Exchange Commission adopted a new rule that allows companies to implement FAS No. 123R at the beginning of their next fiscal year, instead of the next reporting period, that begins after June 15, 2005. We adopted FAS No. 123R at the beginning of our 2006 fiscal year using the modified prospective method. The estimated additional expense to be recorded in 2006 as a result of this adoption is approximately \$3 thousand.

In July 2006, the FASB issued Interpretation No. 48, or FIN 48, “Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109.” FIN 48 prescribes a recognition threshold and measurement attribute for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. FIN 48 will require that the financial statements reflect

expected future tax consequences of such positions presuming the taxing authorities' full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is effective for annual periods beginning after December 15, 2006. We are currently evaluating the impact of adopting FIN 48 on our financial statements. Upon adoption, the cumulative effect of applying the provision of FIN 48 will be reported as an adjustment to the opening balance of cumulative net income for that fiscal year.

Quantitative and Qualitative Disclosure about Market Risk

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

The following disclosures of estimated fair value of financial instruments 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. 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 below are not necessarily indicative of the amounts we would realize in a current market exchange.

Mortgage notes receivable - The fair value of mortgage notes receivable is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Notes receivable - The fair value of notes receivable is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Embedded derivative - conversion feature of preferred stock investment - The fair value of this derivative instrument is determined using a pricing model and market data derived from Advocat's common stock, which had a market value of \$5.27 per common share at December 31, 2005.

The fair value of our embedded derivative (i.e., the conversion feature of a preferred stock investment) is subject to change due to fluctuations primarily resulting from the market value of Advocat's common stock. A ten percent increase in the value of Advocat's common stock to \$5.80 per common share would have resulted in a \$287,000 or 26% increase in the value of this derivative as of December 31, 2005. A ten percent decrease in the value of Advocat's common stock to \$4.74 per common share would have resulted in a \$246,000 or 24% decrease in the value of this derivative as of December 31, 2005. A ten percent increase in the value of Advocat's common stock as of September 30, 2006 to \$21.65 per common share would have resulted in a \$1.4 million or 12.9% increase in the value of this derivative as of September 30, 2006. A ten percent decrease in the value of Advocat's common stock as of September 30, 2006 to \$17.71 per common share would have resulted in a \$1.4 million or 12.9% decrease in the value of this derivative as of September 30, 2006.

Borrowings under lines of credit arrangement - The carrying amount approximates fair value because the borrowings are interest rate adjustable.

Senior unsecured notes - The fair value of the senior unsecured notes is estimated by discounting the future cash flows using the current borrowing rate available for the similar debt.

The market value of our long-term fixed rate borrowings and mortgages is subject to interest rate risks. Generally, the market value of fixed rate financial instruments will decrease as interest rates rise and increase as interest rates fall. The estimated fair value of our total long-term borrowings at December 31, 2005 was approximately \$568.7 million and at September 30, 2006 was approximately \$661.7 million. A one percent increase in interest rates would result in a decrease in the fair value of long-term borrowings by approximately \$31 million at December 31, 2005 and \$29 million at September 30, 2006.

While we currently do not engage in hedging strategies, we may engage in such strategies in the future, depending on management's analysis of the interest rate environment and the costs and risks of such strategies.

BUSINESS

Overview

We were incorporated in the State of Maryland on March 31, 1992. We are a self-administered real estate investment trust, or REIT, investing in income-producing healthcare facilities, principally long-term care facilities located in the United States. We provide lease or mortgage financing to qualified operators of skilled nursing facilities, or SNFs, and, to a lesser extent, assisted living facilities, or ALFs, rehabilitation and acute care facilities. We have historically financed investments through borrowings under our revolving credit facilities, private placements or public offerings of debt or equity securities, the assumption of secured indebtedness, or a combination of these methods.

At September 30, 2006, our portfolio of domestic investments consisted of 241 healthcare facilities, located in 27 states and operated by 33 third-party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately \$1.3 billion at September 30, 2006, with approximately 98% of our real estate investments related to long-term care facilities. This portfolio is made up of:

- 227 long-term healthcare facilities;
- two rehabilitation hospitals owned and leased to third parties;
- fixed rate mortgages on 10 long-term healthcare facilities; and
- two long-term healthcare facilities that are currently held for sale.

At September 30, 2006, we also held other investments of approximately \$37 million, consisting primarily of secured loans to third-party operators of our facilities. See “Summary - Recent Developments.”

Summary of Financial Information

The following tables summarize our revenues and real estate assets by asset category for 2005, 2004 and 2003. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Note 3 - Properties,” “Note 4 - Mortgage Notes Receivable” and “Note 15 - Restatement of Previously Issued Financial Statements” to our audited consolidated financial statements for the year ended December 31, 2005 included elsewhere in this prospectus.

Revenues by Asset Category (in thousands)

	Year ended December 31,		
	2005 (Restated)	2004 (Restated)	2003 (Restated)
Core assets:			
Lease rental income	\$ 94,945	\$ 70,107	\$ 58,357
Mortgage interest income	6,527	13,266	14,656
Total core asset revenues	101,472	83,373	73,013
Other asset revenue	4,075	3,129	2,922
Miscellaneous income	4,459	831	1,048
Total revenue before owned and operated assets	110,006	87,333	76,983
Owned and operated assets revenue	—	—	4,395
Total revenue	\$ 110,006	\$ 87,333	\$ 81,378

Real Estate Assets by Asset Category
(in thousands)

	As of December 31,	
	2005 (Restated)	2004 (Restated)
Core assets:		
Leased assets	\$ 994,327	\$ 803,753
Mortgaged assets	104,522	118,058
Total core assets	1,098,849	921,811
Other assets	28,918	34,766
Total real estate assets before held for sale assets	1,127,767	956,577
Held for sale assets	2,735	3,992
Total real estate assets	\$ 1,130,502	\$ 960,569

Investment Policies with Respect to Certain Activities

Investment Strategy. We maintain a diversified portfolio of long-term healthcare facilities and mortgages on healthcare facilities located throughout the United States. We acquire these assets for income purposes. In making investments, we generally have focused on established, creditworthy, middle-market healthcare operators that meet our standards for quality and experience of management. We have sought to diversify our investments in terms of geographic locations and operators.

In evaluating potential investments, we consider such factors as:

- the quality and experience of management and the creditworthiness of the operator of the facility;
- the facility's historical and forecasted cash flow and its ability to meet operational needs, capital expenditure requirements and lease or debt service obligations, providing a competitive return on our investment;
- the construction quality, condition and design of the facility;
- the geographic area of the facility;
- the tax, growth, regulatory and reimbursement environment of the jurisdiction in which the facility is located;
- the occupancy and demand for similar healthcare facilities in the same or nearby communities; and
- the payor mix of private, Medicare and Medicaid patients.

One of our fundamental investment strategies is to obtain contractual rent escalations under long-term, non-cancelable, "triple-net" leases and fixed-rate mortgage loans, and to obtain substantial liquidity deposits. Additional security is typically provided by covenants regarding minimum working capital and net worth, liens on accounts receivable and other operating assets, and various provisions for cross-default, cross-collateralization and corporate/personal guarantees, when appropriate.

We prefer to invest in equity ownership of properties. Due to regulatory, tax or other considerations, we sometimes pursue alternative investment structures, including convertible participating and participating mortgages, which can achieve returns comparable to equity investments. The following summarizes the primary investment structures we typically use. Average annualized yields reflect existing contractual arrangements. However, in view of the ongoing

financial challenges in the long-term care industry, we cannot assure you that the operators of our facilities will meet their payment obligations in full or when due. Therefore, the annualized yields as of January 1, 2006 set forth below are not necessarily indicative of or a forecast of actual yields, which may be lower.

Purchase/Leaseback. In a Purchase/Leaseback transaction, we purchase the property from the operator and lease it back to the operator over terms typically ranging from 5 to 15 years, plus renewal options. The leases originated by us generally provide for minimum annual rentals which are subject to annual formula increases based upon such factors as increases in the Consumer Price Index, or CPI. The average annualized yield from leases was approximately 10.8% at January 1, 2006.

Convertible Participating Mortgage. Convertible participating mortgages are secured by first mortgage liens on the underlying real estate and personal property of the mortgagor. Interest rates are usually subject to annual increases based upon increases in the CPI. Convertible participating mortgages afford us the option to convert our mortgage into direct ownership of the property, generally at a point five to ten years from inception. If we exercise our purchase option, we are obligated to lease the property back to the operator for the balance of the originally agreed term and for the originally agreed participations in revenues or CPI adjustments. This allows us to capture a portion of the potential appreciation in value of the real estate. The operator has the right to buy out our option at prices based on specified formulas. At December 31, 2005, we did not have any convertible participating mortgages.

Participating Mortgage. Participating mortgages are similar to convertible participating mortgages except that we do not have a purchase option. Interest rates are usually subject to annual increases based upon increases in the CPI. At December 31, 2005, we did not have any participating mortgages.

Fixed-Rate Mortgage. These mortgages have a fixed interest rate for the mortgage term and are secured by first mortgage liens on the underlying real estate and personal property of the mortgagor. The average annualized yield on these investments was approximately 10.4% at January 1, 2006.

The following table identifies the years of expiration of the 2006 payment obligations due to us. This information is provided solely to indicate the scheduled expiration of payment obligations due to us and is not a forecast of expected revenues.

	Rent	Mortgage Interest	Total	%
	(in thousands)			
2006	\$ 1,690	\$ 2,233	\$ 3,923	3.20%
2007	371	24	395	0.32
2008	1,038	—	1,038	0.85
2009	—	—	—	—
2010	22,412	1,453	23,865	19.48
Thereafter	86,072	7,193	93,265	76.14
Total	\$ 111,583	\$ 10,903	\$ 122,486	100.00%

The table set forth in “- Properties” below contains information regarding our real estate properties, their geographic locations, and the types of investment structures as of December 31, 2005.

Borrowing Policies. We may incur additional indebtedness and have historically sought to maintain annualized total debt-to-EBITDA ratio in the range of 4 to 5 times. Annualized EBITDA is defined as earnings before interest, taxes, depreciation and amortization for a twelve month period. We intend to periodically review our policy with respect to our total debt-to-EBITDA ratio and to modify the policy as our management deems prudent in light of prevailing market conditions. Our strategy generally has been to match the maturity of our indebtedness with the maturity of our investment assets and to employ long-term, fixed-rate debt to the extent practicable in view of market conditions in existence from time to time.

We may use proceeds of any additional indebtedness to provide permanent financing for investments in additional healthcare facilities. We may obtain either secured or unsecured indebtedness, and may obtain indebtedness which may be convertible into capital stock or be accompanied by warrants to purchase capital stock. Where debt financing is available on terms deemed favorable, we generally may invest in properties subject to existing loans, secured by mortgages, deeds of trust or similar liens on properties.

If we need capital to repay indebtedness as it matures, we may be required to liquidate investments in properties at times which may not permit realization of the maximum recovery on these investments. This could also result in adverse tax consequences to us. We may be required to issue additional equity interests in our company, which could dilute your investment in our company. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources.”

Federal Income Tax Considerations. We intend to make and manage our investments, including the sale or disposition of property or other investments, and to operate in such a manner as to qualify as a REIT under the Internal Revenue Code of 1986, as amended, or Internal Revenue Code, unless, because of changes in circumstances or changes in the Internal Revenue Code, our Board of Directors determines that it is no longer in our best interest to qualify as a REIT. So long as we qualify as a REIT, we generally will not pay federal income taxes on the portion of our taxable income which is distributed to stockholders. See “Certain General Income Tax Considerations.”

During the fourth quarter of 2006, we determined that certain terms of the Advocat Series B non-voting, redeemable convertible preferred stock held by us could be interpreted as affecting our compliance with federal income tax rules applicable to REITs regarding related party tenant income. As such, Advocat, one of our lessees, may be deemed to be a “related party tenant” under applicable federal income tax rules. In such event, our rental income from Advocat would not be qualifying income under the gross income tests that are applicable to REITs. In order to maintain qualification as a REIT, we annually must satisfy certain tests regarding the source of our gross income. The applicable federal income tax rules provide a “savings clause” for REITs that fail to satisfy the REIT gross income tests if such failure is due to reasonable cause. A REIT that qualifies for the savings clause will retain its REIT status but will pay a tax. We have submitted to the IRS a request for a closing agreement to resolve the “related party tenant” issue. While we believe there are valid arguments that Advocat should not be deemed a “related party tenant,” the matter is not free from doubt, and we believe it is in our best interest to request a closing agreement in order to resolve the matter, minimize potential penalties and obtain assurances regarding our continuing REIT status. By submitting a request for a closing agreement, we believe we should be able to establish that any failure to satisfy the gross income tests was due to reasonable cause. See “Note 15 - Restatement of Previously Issued Financial Statements” to our audited consolidated financial statements for the year ended December 31, 2005 included elsewhere in this prospectus.

As a result of the Advocat issue described above and further discussed in “Note 15 - Restatement of Previously Issued Financial Statements” to our audited consolidated financial statements for the year ended December 31, 2005 included elsewhere in this prospectus, we have recorded a \$2.4 million, \$0.4 million and \$0.5 million provision for income tax, including related interest expense, for the years ended December 31, 2005, 2004 and 2003, respectively and a \$1.8 million provision for income tax, including related interest expense, for the nine months ended September 30, 2006.

The amount accrued represents the estimated liability, which remains subject to final resolution and therefore is subject to change. In addition, in October 2006, we restructured our Advocat relationship and have been advised by tax counsel that we will not receive any non-qualifying related party tenant income from Advocat in future fiscal years (see “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Results of Operation”). Accordingly, we do not expect to incur tax expense associated with related party tenant income in future periods commencing January 1, 2007, assuming we enter into a closing agreement with the IRS that recognizes that reasonable cause existed for any failure to satisfy the REIT gross income tests as explained above. We will continue to accrue an income tax liability related to this matter during 2006.

Policies With Respect To Certain Activities. If our Board of Directors determines that additional funding is required, we may raise such funds through additional equity offerings, debt financing, and retention of cash flow (subject to provisions in the Internal Revenue Code concerning taxability of undistributed REIT taxable income) or a combination of these methods.

Borrowings may be in the form of bank borrowings, secured or unsecured, and publicly or privately placed debt instruments, purchase money obligations to the sellers of assets, long-term, tax-exempt bonds or financing from banks, institutional investors or other lenders, or securitizations, any of which indebtedness may be unsecured or may be secured by mortgages or other interests in our assets. Holders of such indebtedness may have recourse to all or any part of our assets or may be limited to the particular asset to which the indebtedness relates.

We have authority to offer our common stock or other equity or debt securities in exchange for property and to repurchase or otherwise reacquire our shares or any other securities and may engage in such activities in the future.

Subject to the percentage of ownership limitations and gross income and asset tests necessary for REIT qualification, we may invest in securities of other REITs, other entities engaged in real estate activities or securities of other issuers, including for the purpose of exercising control over such entities.

We may engage in the purchase and sale of investments. We do not underwrite the securities of other issuers.

Our officers and directors may change any of these policies without a vote of our stockholders.

In the opinion of our management, our properties are adequately covered by insurance.

Properties

At September 30, 2006, our real estate investments included long-term care facilities and rehabilitation hospital investments, either in the form of purchased facilities which are leased to operators, mortgages on facilities which are operated by the mortgagors or their affiliates and facilities subject to leasehold interests. The facilities are located in 27 states and are operated by 33 unaffiliated operators. The following table summarizes our property investments as of September 30, 2006:

Investment Structure/Operator	Number of Beds	Number of Facilities	Occupancy Percentage⁽¹⁾	Gross Investment (in thousands)
Purchase/Leaseback⁽²⁾				
Sun Healthcare Group, Inc	4,523	38	87	\$ 210,314
CommuniCare Health Services.	2,781	18	89	185,698
Haven Healthcare	1,787	15	90	117,230
HQM of Floyd County, Inc	1,466	13	87	98,369
Advocat, Inc	3,025	29	78	95,422
Guardian LTC Management, Inc	1,308	17	87	85,980
Nexion Management	2,588	22	76	81,008
Essex Health Care Corp	1,388	13	78	79,354
Seacrest Healthcare	720	6	92	44,223
Senior Management	1,413	8	70	35,243
Mark Ide Limited Liability Company	832	8	77	25,595
Harborside Healthcare Corporation	465	4	92	23,393
StoneGate SNF Properties, LP	664	6	88	21,781
Infinia Properties of Arizona, LLC	378	4	63	19,262
USA Healthcare, Inc	489	5	66	15,215
Rest Haven Nursing Center, Inc	200	1	91	14,400
Conifer Care Communities, Inc.	204	3	89	14,367
Washington N&R, LLC	286	2	75	12,152
Triad Health Management of Georgia II, LLC	304	2	98	10,000
The Ensign Group, Inc	271	3	92	9,656
Lakeland Investors, LLC	300	1	73	8,887
Hickory Creek Healthcare Foundation, Inc.	138	2	85	7,250
Liberty Assisted Living Centers, LP	120	1	85	5,995
Emeritus Corporation	52	1	69	5,674
Longwood Management Corporation	185	2	91	5,425
Generations Healthcare, Inc.	60	1	83	3,007
Skilled Healthcare	59	1	91	2,012
American Senior Communities, LLC	78	2	92	2,000
Healthcare Management Services	98	1	48	1,486
	26,182	229	83	1,240,398
Assets Held for Sale				
Closed Facilities	0	2	0	737
	0	2	0	737
Fixed Rate Mortgages⁽³⁾				
Advocat, Inc	423	4	82	12,600
Parthenon Healthcare, Inc.	300	2	74	10,693
CommuniCare Health Services	150	1	89	6,465

Texas Health Enterprises/HEA Mgmt. Group, Inc	147	1	64	1,294
Evergreen Healthcare	100	1	51	962
Paris Nursing Home, Inc	144	1	70	171
	1,264	10	75	32,185
Total	27,446	241	82 \$	1,273,320

- (1) Represents the most recent data provided by our operators.
- (2) Certain of our lease agreements contain purchase options that permit the lessees to purchase the underlying properties from us.
- (3) In general, many of our mortgages contain prepayment provisions that permit prepayment of the outstanding principal amounts thereunder.

The following table presents the concentration of our facilities by state as of September 30, 2006:

	Number of Facilities	Number of Beds	Gross Investment (in thousands)	% of Total Investment
Ohio	37	4,574	\$ 278,142	21.8
Florida	25	3,125	171,995	13.4
Pennsylvania	17	1,597	110,123	8.6
Texas	24	3,288	83,858	6.6
California	15	1,277	60,665	4.8
Louisiana	14	1,668	55,639	4.4
Colorado	8	955	53,002	4.2
Arkansas	12	1,281	43,133	3.4
Massachusetts	6	682	38,884	3.1
Rhode Island	4	639	38,740	3.0
Alabama	9	1,152	35,978	2.8
Connecticut	5	562	35,453	2.8
West Virginia	8	860	34,575	2.7
Kentucky	9	757	27,485	2.2
North Carolina	5	707	22,709	1.8
Idaho	4	480	21,796	1.7
New Hampshire	3	225	21,620	1.7
Arizona	4	378	19,262	1.5
Indiana	7	507	17,605	1.4
Tennessee	5	602	17,485	1.4
Washington	2	194	17,472	1.4
Iowa	5	489	15,215	1.2
Illinois	4	478	14,406	1.1
Vermont	2	279	14,227	1.1
Missouri	2	286	12,152	1.0
Georgia	2	304	10,000	0.8
Utah	1	100	962	0.1
Total (1)	239	27,446	\$ 1,272,583	100.0

(1) Excludes two facilities classified as Held For Sale at September 30, 2006.

Geographically Diverse Property Portfolio. Our portfolio of properties is broadly diversified by geographic location. We have healthcare facilities located in 27 states. Only one state comprised more than 10% of our rental and mortgage income in 2005. In addition, the majority of our 2005 rental and mortgage income was derived from facilities in states that require state approval for development and expansion of healthcare facilities. We believe that such state approvals may limit competition for our operators and enhance the value of our properties.

Large Number of Tenants. Our facilities are operated by 35 different public and private healthcare providers. Except for Sun, CommuniCare and Haven, which together hold approximately 43% of our portfolio (by investment), no single tenant holds greater than 10% of our portfolio (by investment).

Significant Number of Long-term Leases and Mortgage Loans. A large portion of our core portfolio consists of long-term lease and mortgage agreements. At December 31, 2005, approximately 95% of our leases and mortgages had primary terms that expire in 2010 or later. Our leased real estate properties are leased under provisions of single facility leases or master leases with initial terms typically ranging from 5 to 15 years, plus renewal options.

Substantially all of the leases and master leases provide for minimum annual rentals that are subject to annual increases based upon increases in the CPI or increases in revenues of the underlying properties, with certain limits. Under the terms of the leases, the lessee is responsible for all maintenance, repairs, taxes and insurance on the leased properties.

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Legal Proceedings

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

We and several of our wholly-owned subsidiaries have been named as defendants in professional liability claims related to our former owned and operated facilities. Other third-party managers responsible for the day-to-day operations of these facilities have also been named as defendants in these claims. In these suits, patients of certain previously owned and operated facilities have alleged significant damages, including punitive damages against the defendants. The majority of these lawsuits representing the most significant amount of exposure were settled in 2004. There currently is one lawsuit pending that is in the discovery stage, and we are unable to predict the likely outcome of this lawsuit at this time.

DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth the name and age of each of our executive officers and directors.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Bernard J. Korman(1),(3),(4)	75	Chairman of the Board of Directors
Thomas F. Franke(1),(4),(6)	76	Director
Harold J. Kloosterman(1),(2),(3),(4),(7)	64	Director
Edward Lowenthal(1),(2),(4)	62	Director
Stephen D. Plavin(1),(2),(4),(5)	47	Director
C. Taylor Pickett(3)	44	Chief Executive Officer and Director
Daniel J. Booth	43	Chief Operating Officer
R. Lee Crabill, Jr.	53	Senior Vice President of Operations
Robert O. Stephenson	43	Chief Financial Officer

- (1) Member of Compensation Committee.
 (2) Member of Audit Committee.
 (3) Member of Investment Committee.
 (4) Member of Nominating and Corporate Governance Committee.
 (5) Chairman of Audit Committee.
 (6) Chairman of Compensation Committee.
 (7) Chairman of Investment and Nominating and Corporate Governance Committees.

Set forth below are descriptions and backgrounds of each of our current executive officers and directors.

Directors of Our Company

Under the terms of our Articles of Incorporation, our Board of Directors is classified into three classes. Each class of directors serves for a term of three years, with one class being elected each year. As of the date of this prospectus, there are six directors, with two directors in each class.

Thomas F. Franke is a Director and has served in this capacity since March 31, 1992. Mr. Franke is Chairman and a principal owner of Cambridge Partners, Inc., an owner, developer and manager of multifamily housing in Grand Rapids, Michigan. He is also a principal owner of Laurel Healthcare (a private healthcare firm operating in the United States) and is a principal owner of Abacus Hotels LTD. (a private hotel firm in the United Kingdom). Mr. Franke was a founder and previously a director of Principal Healthcare Finance Limited and Omega Worldwide, Inc. His term expires in 2009.

Harold J. Kloosterman is a Director and has served in this capacity since September 1, 1992. Mr. Kloosterman has served as President since 1985 of Cambridge Partners, Inc., a company he formed in 1985. He has been involved in the development and management of commercial, apartment and condominium projects in Grand Rapids and Ann Arbor, Michigan and in the Chicago area. Mr. Kloosterman was formerly a Managing Director of Omega Capital from 1986 to 1992. Mr. Kloosterman has been involved in the acquisition, development and management of commercial and multifamily properties since 1978. He has also been a senior officer of LaSalle Partners, Inc. (now Jones Lang LaSalle). His term expires in 2008.

Bernard J. Korman is Chairman of the Board and has served in this capacity since March 8, 2004. He has served as a director since October 19, 1993. Mr. Korman has been Chairman of the Board of Trustees of Philadelphia Health Care Trust, a private healthcare foundation, since December 1995. Mr. Korman is also a director of The New America High Income Fund, Inc. (NYSE:HYB) (financial services) and NutraMax Products, Inc. (OTC:NUTP) (consumer health care products). He was formerly President, Chief Executive Officer and Director of MEDIQ Incorporated (OTC:MDDQP) (health care services) from 1977 to 1995. Mr. Korman also served as a director of Kramont Realty Trust (NYSE:KRT) (real estate investment trust) from June 2000 until its merger in April 2005 and of The Pep Boys, Inc. (NYSE:PBX) and served as its Chairman of the Board from May 28, 2003 until his retirement from such board in September 2004. Mr. Korman was previously a director of Omega Worldwide, Inc. His term expires in 2009.

Edward Lowenthal is a Director and has served in this capacity since October 17, 1995. From January 1997 to March 2002, Mr. Lowenthal served as President and Chief Executive Officer of Wellsford Real Properties, Inc. (AMEX:WRP) (a real estate merchant bank), and was President of the predecessor of Wellsford Real Properties, Inc. since 1986. Mr. Lowenthal also serves as a director of WRP, REIS, Inc. (a private provider of real estate market information and valuation technology), Ark Restaurants (Nasdaq:ARKR) (a publicly traded owner and operator of restaurants), American Campus Communities (NYSE:ACC) (a public developer, owner and operator of student housing at the university level), Desarrolladora Homex (NYSE: HXM) (a Mexican homebuilder) and serves as a trustee of the Manhattan School of Music. His term expires in 2007.

C. Taylor Pickett is the Chief Executive Officer of our company and has served in this capacity since June, 2001. Mr. Pickett is also a Director and has served in this capacity since May 30, 2002. Prior to joining our company, Mr. Pickett served as the Executive Vice President and Chief Financial Officer from January 1998 to June 2001 of Integrated Health Services, Inc., a public company specializing in post-acute healthcare services. He also served as Executive Vice President of Mergers and Acquisitions from May 1997 to December 1997 of Integrated Health Services. Prior to his roles as Chief Financial Officer and Executive Vice President of Mergers and Acquisitions, Mr. Pickett served as the President of Symphony Health Services, Inc. from January 1996 to May 1997. His term expires in 2008.

Stephen D. Plavin is a Director and has served in this capacity since July 17, 2000. Mr. Plavin has been Chief Operating Officer of Capital Trust, Inc., (NYSE:CT) a New York City-based mortgage REIT and investment management company and has served in this capacity since 1998. In this role, Mr. Plavin is responsible for all of the lending, investing and portfolio management activities of Capital Trust, Inc. His term expires in 2007.

Executive Officers of Our Company

At the date of this report, the executive officers of our company are:

C. Taylor Pickett is the Chief Executive Officer and has served in this capacity since June, 2001. See “—Directors of our Company” above for additional information.

Daniel J. Booth is the Chief Operating Officer and has served in this capacity since October, 2001. Prior to joining our company, Mr. Booth served as a member of Integrated Health Services’ management team since 1993, most recently serving as Senior Vice President, Finance. Prior to joining Integrated Health Services, Mr. Booth was Vice President in the Healthcare Lending Division of Maryland National Bank (now Bank of America).

R. Lee Crabill, Jr. is the Senior Vice President of Operations of our company and has served in this capacity since July, 2001. Mr. Crabill served as a Senior Vice President of Operations at Mariner Post-Acute Network, Inc. from 1997 through 2000. Prior to that, he served as an Executive Vice President of Operations at Beverly Enterprises.

Robert O. Stephenson is the Chief Financial Officer and has served in this capacity since August, 2001. Prior to joining our company, Mr. Stephenson served from 1996 to July 2001 as the Senior Vice President and Treasurer of Integrated Health Services, Inc. Prior to Integrated Health Services, Mr. Stephenson held various positions at CSX Intermodal, Inc., Martin Marietta Corporation and Electronic Data Systems.

As of January 18, 2007, we had 17 full-time employees, including the four executive officers listed above.

COMPENSATION DISCUSSION AND ANALYSIS

Our Compensation Discussion and Analysis (“CD&A”) addresses the following topics:

- the members and role of our Compensation Committee (the “Committee”);
- our compensation-setting process;
- our compensation philosophy and policies regarding executive compensation;
- the components of our executive compensation program; and
- our compensation decisions for fiscal year 2006 and for the first quarter of 2007.

In this Compensation Discussion and Analysis section, the terms “we,” “our,” “us” and the “Committee” refer to the Compensation Committee of Omega Healthcare Investors, Inc.’s Board of Directors.

The Compensation Committee

Committee Members and Independence

Thomas F. Franke, Harold J. Kloosterman, Bernard J. Korman, Edward Lowenthal, and Stephen D. Plavin are the members of the Committee. Mr. Franke, who has served on the Company’s Board of Directors since 1992, is the Chairman of the Committee. Each member of the Committee qualifies as an independent director under the New York Stock Exchange listing standards and under the Company’s Board of Directors’ standards of independence.

Role of the Committee

The Committee’s responsibilities and function are governed by its charter, which the Board of Directors has adopted and a copy of which is available at our website. The Committee administers our 2004 Stock Incentive Plan, our 2000 Stock Incentive Plan and our 1993 Deferred Compensation Plan and has responsibility for other incentive and benefit plans. The Committee determines the compensation of our executive officers and reviews with the Board of Directors all aspects of compensation for our executive officers.

The Committee is responsible to the Board for the following activities:

- The Committee determines and approves the compensation for the Chief Executive Officer and our other executive officers. In doing so, the Committee evaluates their performance in light of goals and objectives reviewed by the Committee and such other factors as the Committee deems appropriate in our best interests and in satisfaction of any applicable requirements of the New York Stock Exchange and any other legal or regulatory requirements.
- The Committee reviews and recommends for Board approval (or approves, where applicable) the adoption and amendment of our director and executive officer incentive compensation and equity-based plans. The Committee has the responsibility for recommending to the Board the level and form of compensation and benefits for directors.
- The Committee may administer our incentive compensation and equity-based plans and may approve such awards thereunder as the Committee deems appropriate.
- The Committee reviews and monitors succession plans for the Chief Executive Officer and our other senior executives.

- The Committee meets to review and discuss with management the CD&A required by the SEC rules and regulations. The Committee recommends to the Board whether the CD&A should be included in our proxy statement or other applicable SEC filings. The Committee prepares a Compensation Committee Report for inclusion in our applicable filings with the SEC. Such reports state whether the Committee reviewed and discussed with management the CD&A, and whether, based on such review and discussion, the Committee recommended to the Board that the CD&A be included in our proxy statement or other applicable SEC filings.
- The Committee should be consulted with respect to any employment agreements, severance agreements or change of control agreements that are entered into between us and any executive officer.
- To the extent not otherwise inconsistent with its obligations and responsibilities, the Committee may form subcommittees (which shall consist of one or more members of the Committee) and delegate authority to such subcommittees hereunder as it deems appropriate.

· The Committee reports to the Board as it deems appropriate and as the Board may request.

- The Committee performs such other activities consistent with its charter, our Bylaws, governing law, the rules and regulations of the New York Stock Exchange and such other requirements applicable to the Company as the Committee or the Board deems necessary or appropriate.

The responsibilities of a member of the Committee are in addition to those responsibilities set out for a member of the Board.

Committee Meetings

The Committee meets as often as necessary to perform its duties and responsibilities. The Committee met four times during the year ended December 31, 2006 and thus far has held three meetings in 2007. Mr. Franke works, from time to time, with Mr. Pickett and other members of the Committee to establish the agenda. The Committee typically meets in executive sessions without management and meets with the Company's legal counsel and outside advisors when necessary.

The Committee receives and reviews materials in advance of its meetings. These materials include information that management believes will be helpful to the Committee as well as materials the Committee has requested. Depending upon the agenda for the particular meeting, these materials may include, among other things:

- reports from compensation consultants or legal counsel;
- a comparison of the compensation of our executives and directors compared to its competitors prepared by members of the Committee, by management at the Committee's request or by a compensation consultant engaged by the Committee;
- financial reports on year-to-date performance versus budget and compared to prior year performance, as well as other financial data regarding us and our performance;
- reports on our strategic plan and budgets for future periods;
- information on the executive officers' stock ownership and option holdings; and
- reports on the levels of achievement of individual and corporate objectives.

The Compensation Committee Process

Committee Advisors

The Compensation Committee Charter grants the Committee the sole and direct authority to engage and terminate advisors and compensation consultants and to approve their fees and retention terms. These advisors and consultants report directly to the Committee and we are responsible for paying their fees.

The Committee had previously engaged a consulting group in 2004, The Schonbraun McCann Group LLP, or Schonbraun, in connection with determining the compensation of our executive officers for the current fiscal year, and the Committee also retained Schonbraun in late 2006 in connection with determining the compensation and incentive arrangements for our executive officers for fiscal year 2007. Schonbraun has not performed and has agreed not to perform in the future any work for us other than work for which it is engaged by the Committee. During late 2006 and early 2007, Schonbraun presented to the Committee analysis that included, but was not limited to, the status of our current compensation scheme as compared to our peer companies, the methodologies behind the research and analysis it used to determine the comparisons, the techniques it used to standardize the compensation schemes of peer companies in order to permit more accurate comparisons against our policies, and a proposed incentive compensation plan for executive officers. The Committee also requested that Schonbraun evaluate our current director compensation and prepare a proposal with respect to compensation for our directors in 2007.

Peer companies included in Schonbraun's 2006/2007 analysis were Alexandria Real Estate Equities, Inc., BioMed Realty Trust, Corporate Office Properties Trust Inc., Digital Realty Trust, Inc., First Potomac Realty Trust, Glenborough Realty Trust Incorporated, Health Care REIT, Inc., Healthcare Realty Trust, LTC Properties, Inc., Medical Properties Trust Inc., Nationwide Health Properties, Inc., Parkway Properties, Inc., Republic Property Trust, Ventas, Inc., Washington Real Estate Investment Trust and Windrose Medical Properties Trust. Analyses performed included a comparison of the total return to the stockholders of the respective companies, a comparison of salaries of comparable officers for each company and a comparison of the terms of officer employment agreements.

Also, our Chief Executive Officer meets with the Committee upon the Committee's request to provide information to the Committee regarding management's views regarding its performance as well as other factors the Chief Executive Officer believes should impact the compensation of our executive officers. In addition, the Chief Executive Officer provides his recommendation to the Committee regarding the compensation of the executive officers and the business and performance targets for incentive awards and bonuses.

Annual Evaluation

The Committee meets in one or more executive sessions each year to evaluate the performance of our named executive officers, to determine their bonuses for the prior year, to establish bonus metrics for the current year, to set their salaries for the current year, and to approve any grants to them of equity incentive compensation, as the case may be.

The Committee also performs an annual evaluation of its performance and the adequacy of its charter and reports to our Board of Directors regarding this evaluation.

Compensation Policy

Historically, the policy and the guidelines followed by the Committee have been directed toward providing compensation and incentives to our executive officers in order to achieve the following objectives:

- 1) Assist in attracting and retaining talented and well-qualified executives;

- 2) Reward performance and initiative;
- 3) Be competitive with other healthcare real estate investment trusts;

4) Be significantly related to accomplishments and our short-term and long-term successes, particularly measured in terms of growth in funds from operations on a per share basis;

(5) Align the interests of our executive officers with the interests of our stockholders; and

6) Encourage executives to achieve meaningful levels of ownership of our stock.

Elements of Compensation

The following is a discussion of each element of our executive compensation:

Annual Base Salary

Our approach to base compensation levels has been to offer competitive salaries in comparison with prevailing market practices. The Committee examined market compensation levels and trends in connection with the issuance of the executive employment contracts during 2004. Additionally, in connection with the issuance of these contracts, the Committee hired Schonbraun in 2004 to conduct a review and analysis of our peer group companies and to provide the Committee with executive base salaries of individuals then employed in similar positions in such companies. The employment agreements for each of the executive officers established a base annual salary and provided that the base salary should be reviewed on an annual basis to determine if increases are warranted.

In 2006 and 2007, the Committee evaluated and established the annual executive officer salaries for each fiscal year in connection with its annual review of management's performance and based on input from our Chairman of the Board of Directors and our Chief Executive Officer. The Committee undertook this evaluation and determination at the beginning of fiscal year 2006 and 2007 so that it could have available data for the recently completed prior fiscal year and so that it could set expectations for the beginning fiscal year. In undertaking the annual review, the Committee considered the decision-making responsibilities of each position and the experience, work performance and team-building skills of each incumbent officer, as well as our overall performance and the achievement of our strategic objectives and budgets. The Committee viewed work performance as the single most important measurement factor, followed by team-building skills and decision-making responsibilities.

We accrue salaries as they are earned by our officers, and thus all salaries earned during the year are expensed in the year earned. Each officer must include his salary in his taxable income in the year during which he receives it. We withhold appropriate tax withholdings from the salaries of the respective officers.

Annual Cash Bonus

Our historical compensation practices have embodied the principle that annual cash bonuses should be based primarily on achieving objectives that enhance long-term stockholder value is desirable in aligning stockholder and management interests.

The Committee has considered our overall financial performance for the fiscal year and the performance of the specific areas of our company under each incumbent officer's direct control. It was the Committee's view that this balance supported the accomplishment of overall objectives and rewarded individual contributions by executive officers. Individual annual bonuses for each named executive have been consistent with market practices for positions with comparable decision-making responsibilities and have been awarded in accordance with the terms of each executive officer's employment agreement.

In 2006, the executive officers were eligible for a cash bonus at the Committee's discretion based on the objective, subjective and personal performance goals set by the Committee. This bonus is in addition to any special bonus that

may be paid at the discretion of the Board. In determining the amount of the annual cash bonuses, the Committee considered a variety of factors, including the individual performance of each executive officer along with our achievement of certain financial benchmarks, the successful implementation of asset management initiatives, control of expenses and satisfaction of our strategic objectives. Considering these factors, the Committee set annual cash bonuses related to fiscal year 2006 for Messrs. Pickett, Booth, Stephenson, and Crabill at \$463,500, \$158,500, \$114,750 and \$123,000, respectively.

We accrue estimated bonuses for our executive officers throughout the year service is performed relating to such bonuses, and thus bonuses are expensed in the year they are earned, assuming they are approved by our Board of Directors. Each officer must include his bonus in his taxable income in the year during which he receives it, which is generally in the year following the year it is earned. We withhold appropriate tax withholdings from the bonus amounts awarded.

Restricted Stock Incentives

In 2004, we entered into restricted stock agreements with four executive officers under the Omega Healthcare Investors, Inc. 2004 Stock Incentive Plan. A total of 317,500 shares of restricted stock were granted, which equated to approximately \$3.3 million of deferred compensation. The shares vest thirty-three and one-third percent (33 %) on each of January 1, 2005, January 1, 2006 and January 1, 2007 so long as the executive officer remains employed on the vesting date, with vesting accelerating upon a qualifying termination of employment, upon the occurrence of a change of control (as defined in the restricted stock agreements), death or disability. In addition, we also entered into performance restricted stock unit agreements with our four executive officers. A total of 317,500 performance restricted stock units were granted under the Omega Healthcare Investors, Inc. 2004 Stock Incentive Plan. The performance restricted stock units were fully vested as December 31, 2006 following our attaining \$0.30 per share of common stock per fiscal quarter in "Adjusted Funds from Operations" (as defined in the agreement) for two (2) consecutive quarters. Dividend equivalents (plus an interest factor based on our company's cost of borrowing) accrued on unvested shares and were paid, according to the terms of the stock grant, because the performance restricted stock units vested. Dividend equivalents on vested performance restricted stock units are paid currently. Pursuant to the terms of the performance restricted stock unit agreements, each of the executive officers will not receive the vested shares attributable to the performance restricted stock units until the earlier of January 1, 2008, such executive officer is terminated without cause or quits for good reason (as defined in the performance restricted stock unit agreement), or the death or disability (as defined in performance restricted stock unit agreement) of the executive officer.

In 2006, the Committee did not make any grants under the 2004 Stock Incentive Plan, 2000 Stock Incentive Plan or 1993 Deferred Compensation Plan to any executive officer or employee.

We account for all stock and option awards in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* ("FAS 123R"). Executive officers recognize taxable income from stock option awards when a vested option is exercised. We generally receive a corresponding tax deduction for compensation expense in the year of exercise. The amount included in the executive officer's wages and the amount we may deduct is equal to the most recent closing common stock price on the date the stock options are exercised less the exercise price multiplied by the number of stock options exercised. We do not pay or reimburse any executive officer for any taxes due upon exercise of a stock option or upon vesting of an award.

Retirement Savings Opportunities

All employees may participate in our 401(k) Retirement Savings Plan, or 401(k) Plan. We provide this plan to help our employees save some amount of their cash compensation for retirement in a tax efficient manner. Under the 401(k) Plan, employees are eligible to make contributions, and we, at our discretion, may match contributions and make a profit sharing contribution. We do not provide an option for our employees to invest in our stock in the 401(k) plan.

Health and Welfare Benefits

We provide a competitive benefits package to all full-time employees which includes health and welfare benefits, such as medical, dental, disability insurance, and life insurance benefits. The plans under which these benefits are offered do not discriminate in scope, terms or operation in favor of officers and directors and are available to all salaried

employees. We have no structured executive perquisite benefits (e.g., club memberships or company vehicles) for any executive officer, including the named executive officers, and we currently do not provide supplemental pensions to our employees, including the named executive officers.

2006 Chief Executive Officer Compensation

In connection with retaining the services of Mr. Pickett to act as our Chief Executive Officer, we entered into an employment Agreement dated September 1, 2004 with Mr. Pickett. The Committee believes that the terms of the employment agreement are consistent with the duties and scope of responsibilities assigned to Mr. Pickett as Chief Executive Officer. In order to align Mr. Pickett's interests with our long-term interests, Mr. Pickett's compensation package includes significant equity-based compensation, including stock options and restricted stock. For a detailed description of the terms of the Employment Agreement, see "Compensation and Severance Agreements - C. Taylor Pickett Employment Agreement" below.

For the fiscal year ended December 31, 2006, the Committee awarded Mr. Pickett an annual cash bonus of \$463,500. This bonus was determined by the Committee substantially in accordance with the policies described above relating to all of our executive officers.

COMPENSATION COMMITTEE REPORT

The Committee reviewed and discussed the CD&A with management, and based on this review and discussion, the Committee recommended to the Board of Directors that the CD&A be included in this prospectus, in the Company's annual proxy statement and the Annual Report on Form 10-K for the year ended December 31, 2006.

Tax Deductibility of Executive Compensation

The SEC requires that this report comment upon our policy with respect to Section 162(m) of the Internal Revenue Code. Section 162(m) disallows a federal income tax deduction for compensation over \$1.0 million to any of the named executive officers unless the compensation is paid pursuant to a plan that is performance-related, non-discretionary and has been approved by our stockholders. We did not pay any compensation during 2006 that would be subject to Section 162(m). We believe that, because we qualify as a REIT under the Internal Revenue Code and therefore are not subject to federal income taxes on our income to the extent distributed, the payment of compensation that does not satisfy the requirements of Section 162(m) will not generally affect our net income, although to the extent that compensation does not qualify for deduction under Section 162(m), a larger portion of stockholder distributions may be subject to federal income taxation as dividend income rather than return of capital. We do not believe that Section 162(m) will materially affect the taxability of stockholder distributions, although no assurance can be given in this regard due to the variety of factors that affect the tax position of each stockholder. For these reasons, Section 162(m) does not directly govern the Compensation Committee's compensation policy and practices.

Compensation Committee of the Board of Directors

/s/ Thomas F. Franke

/s/ Harold J. Kloosterman

/s/ Bernard J. Korman

/s/ Edward Lowenthal

/s/ Stephen D. Plavin

Compensation Committee Interlocks and Insider Participation

Thomas F. Franke, Harold J. Kloosterman, Bernard J. Korman, Edward Lowenthal and Stephen D. Plavin were members of the Compensation Committee for the year ended December 31, 2006 and during such period, there were no Compensation Committee interlocks or insider participation in compensation decisions.

EXECUTIVE COMPENSATION**Summary Compensation Table**

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Non-qualified Deferred Compensation Earnings	All Other Compensation (\$)	Total (\$)
(A)	(B)	(C)	(1) (D)	(2) (E)	(F)	(G)	(H)	(3) (I)	(J)
Taylor Pickett	2006	\$ 515,000	\$ 463,500	\$ 1,317,500	\$ --	\$ --	\$ --	\$ 343,211	\$ 2,639,211
Robert Stephenson	2006	\$ 255,000	\$ 114,750	\$ 632,400	\$ --	\$ --	\$ --	\$ 168,172	\$ 1,170,322
Dan Booth	2006	\$ 317,000	\$ 158,500	\$ 790,500	\$ --	\$ --	\$ --	\$ 208,566	\$ 1,474,566
Lee Crabill	2006	\$ 246,000	\$ 123,000	\$ 606,050	\$ --	\$ --	\$ --	\$ 161,441	\$ 1,136,491

- (1) This amount represents the bonuses related to the performance in 2006 but paid in 2007.
- (2) The restricted common stock units were granted in 2004 and earned in 2006 because we attained \$0.30 per share of common stock per fiscal quarter in "Adjusted Funds from Operations," which target was previously set in 2004 by the Committee, valued at grant date price of \$10.54 times the number of units earned.
- (3) This amount includes:
- (i) dividends on units paid in January 2007 (see footnote 2 above);
 - (ii) interest earned on dividends on units paid in January 2007 (see footnote 2 above);
 - (iii) dividends on restricted stock that was paid during 2006, which vested on January 1, 2007; and
 - (iv) 401(K) matching contributions.

Outstanding Equity Awards at Fiscal Year End

Name	Option Awards					Stock Awards			
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#)	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)	Equity Incentive Plan Awards: Number of Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
(A)	(B)	(C)	(D)	(E)	(F)	(G)(1)	(H)(2)	(I)	(J)
Taylor Pickett						41,666	\$ 738,322		
Robert Stephenson						20,000	\$ 354,400		
Dan Booth						25,000	\$ 443,000		
Lee Crabill						19,166	\$ 339,622		

(1) These balances represent unvested restricted stock at December 31, 2006, which subsequently vested on January 1, 2007. These balances exclude performance restricted stock units, which were vested as of December 31, 2006 but will be distributed on January 1, 2008. The performance criteria for the receipt of these units was met in 2006. Messrs. Pickett, Stephenson, Booth and Crabill were awarded 125,000, 60,000, 75,000 and 57,500 of these performance restricted stock units, respectively.

(2) The market value is based on the closing price of our common stock on December 29, 2006 of \$17.72.

Option Exercises and Stock Vested

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$)
(A)	(B)	(C)	(D)	(E)
Taylor Pickett	80,274	\$ 785,891	—	\$ —

Robert Stephenson					
Dan Booth	91,667	\$	874,837	—	\$ —
Lee Crabill	—	\$	—	—	\$ —

(1) This amount represents the gain to the employee based on the market price of underlying shares at the date of exercise less the exercise price.

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Compensation and Severance Agreements

C. Taylor Pickett Employment Agreement

We entered into an employment agreement with C. Taylor Pickett, dated as of September 1, 2004, to be our Chief Executive Officer. The term of the agreement expires on December 31, 2007.

Mr. Pickett's current base salary is \$530,500 per year, subject to increase by us and provides that he will be eligible for an annual bonus of up to 125% of his base salary based on criteria determined by the Compensation Committee of our Board of Directors.

In connection with this employment agreement, we issued Mr. Pickett 125,000 shares of our restricted common stock on September 10, 2004, which vested 33 1/3% on each of January 1, 2005, January 1, 2006, and January 1, 2007. Dividends were paid on unvested shares and a dividend equivalent per share was paid in an amount equal to the dividend per share payable to stockholders of record as of July 30, 2004. Also in connection with this employment agreement, we issued Mr. Pickett 125,000 performance restricted stock units on September 10, 2004, which were fully vested as of December 31, 2006 because we had attained \$0.30 per share of common stock per fiscal quarter in "Adjusted Funds from Operations" (as defined in the agreement) for two (2) consecutive quarters. Dividend equivalents accrued on unvested shares and were paid upon vesting of the performance restricted stock units. Dividend equivalents on vested performance restricted stock units are paid currently. Pursuant to the terms of Mr. Pickett's performance restricted stock unit agreement, he will not receive the vested shares attributable to his performance restricted stock units until the earlier of January 1, 2008, he is terminated without cause or quits for good reason (as defined in the performance restricted stock unit agreement), or his the death or disability (as defined in performance restricted stock unit agreement).

If we terminate Mr. Pickett's employment without "cause" or if he resigns for "good reason," he will be entitled to payment of his cash compensation (the sum of his then current annual base salary plus average annual bonus payable based on the three completed fiscal years prior to termination of employment) for a period of three (3) years. "Cause" is defined in the employment agreement to include events such as willful refusal to perform duties, willful misconduct in performance of duties, unauthorized disclosure of confidential company information, or fraud or dishonesty against us. "Good reason" is defined in the employment agreement to include events such as our material breach of the employment agreement or our relocation of Mr. Pickett's employment to more than 50 miles away without his consent.

Mr. Pickett is required to execute a release of claims against us as a condition to the payment of severance benefits. Severance is not paid if the term of the employment agreement expires. Mr. Pickett's restricted common stock and performance restricted stock units will become fully vested upon the occurrence of Mr. Pickett's death, disability, termination of employment without cause or resignation for good reason, or a "change in control" (as defined in the respective restricted stock agreement). In the event of a termination by us without Cause or by Mr. Pickett for Good Reason, benefits are grossed up to cover federal excise taxes. If Mr. Pickett dies during the term of the employment agreement, his estate is entitled to a prorated bonus for the year of his death.

Mr. Pickett is restricted from using any of our confidential information during his employment and for two years thereafter or from using any trade secrets during his employment and for as long thereafter as permitted by applicable law. During the period of employment and for one year thereafter, Mr. Pickett is obligated not to provide managerial services or management consulting services to a competing business. Competing businesses is defined to include a defined list of competitors and any other business with the primary purpose of leasing assets to healthcare operators or financing ownership or operation of senior, retirement or healthcare related real estate. In addition, during the period of employment and for one year thereafter, Mr. Pickett agrees not to solicit clients or customers with whom he had material contact or to solicit our management level or key employees. If the term of the employment agreement expires at December 31, 2007 and as a result no severance is paid, then these provisions also expire at December 31, 2007.

Daniel J. Booth Employment Agreement

We entered into an employment agreement with Daniel J. Booth, dated as of September 1, 2004, to be our Chief Operating Officer. The term of the agreement expires on December 31, 2007.

Mr. Booth's current base salary is \$326,500 per year, subject to increase by us and provides that he will be eligible for an annual bonus of up to 75% of his base salary based on criteria determined by the Compensation Committee of our Board of Directors.

In connection with this employment agreement, we issued Mr. Booth 75,000 shares of our restricted common stock on September 10, 2004, which vested 33 1/3% on each of January 1, 2005, January 1, 2006, and January 1, 2007. Dividends were paid on unvested shares and a dividend equivalent per share was paid in an amount equal to the dividend per share payable to stockholders of record as of July 30, 2004. Also in connection with this employment agreement, we issued Mr. Booth 75,000 performance restricted stock units on September 10, 2004, which were fully vested as of December 31, 2006 because we had attained \$0.30 per share of common stock per fiscal quarter in "Adjusted Funds from Operations" (as defined in the agreement) for two (2) consecutive quarters. Dividend equivalents on vested performance restricted stock units are paid currently. Pursuant to the terms of Mr. Booth's performance restricted stock unit agreement, he will not receive the vested shares attributable to his performance restricted stock units until the earlier of January 1, 2008, he is terminated without cause or quits for good reason (as defined in the performance restricted stock unit agreement), or his the death or disability (as defined in performance restricted stock unit agreement).

If we terminate Mr. Booth's employment without "cause" or if he resigns for "good reason," he will be entitled to payment of his cash compensation (the sum of his then current annual base salary plus average annual bonus payable based on the three completed fiscal years prior to termination of employment) for a period of two (2) years. "Cause" is defined in the employment agreement to include events such as willful refusal to perform duties, willful misconduct in performance of duties, unauthorized disclosure of confidential company information, or fraud or dishonesty against us. "Good reason" is defined in the employment agreement to include events such as our material breach of the employment agreement or our relocation of Mr. Booth's employment to more than 50 miles away without his consent.

Mr. Booth is required to execute a release of claims against us as a condition to the payment of severance benefits. Severance is not paid if the term of the employment agreement expires. Mr. Booth's restricted common stock and performance restricted stock units will become fully vested upon the occurrence of Mr. Booth's death, disability, termination of employment without cause or resignation for good reason, or a "change in control" (as defined in the respective restricted stock agreement). In the event of a termination by us without Cause or by Mr. Booth for Good Reason, benefits are grossed up to cover federal excise taxes. If Mr. Booth dies during the term of the employment agreement, his estate is entitled to a prorated bonus for the year of his death.

Mr. Booth is restricted from using any of our confidential information during his employment and for two years thereafter or from using any trade secrets during his employment and for as long thereafter as permitted by applicable law. During the period of employment and for one year thereafter, Mr. Booth is obligated not to provide managerial services or management consulting services to a competing business. Competing businesses is defined to include a defined list of competitors and any other business with the primary purpose of leasing assets to healthcare operators or financing ownership or operation of senior, retirement or healthcare related real estate. In addition, during the period of employment and for one year thereafter, Mr. Booth agrees not to solicit clients or customers with whom he had material contact or to solicit our management level or key employees. If the term of the employment agreement expires at December 31, 2007 and as a result no severance is paid, then these provisions also expire at December 31, 2007.

Robert O. Stephenson Employment Agreement

We entered into an employment agreement with Robert O. Stephenson, dated as of September 1, 2004, to be our Chief Financial Officer. The term of the agreement expires on December 31, 2007.

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Mr. Stephenson's current base salary is \$262,700 per year, subject to increase by us and provides that he will be eligible for an annual bonus of up to 60% of his base salary based on criteria determined by the Compensation Committee of our Board of Directors.

In connection with this employment agreement, we issued Mr. Stephenson 60,000 shares of our restricted common stock on September 10, 2004, which vested 33 1/3% on each of January 1, 2005, January 1, 2006, and January 1, 2007. Dividends were paid on unvested shares and a dividend equivalent per share was paid in an amount equal to the dividend per share payable to stockholders of record as of July 30, 2004. Also in connection with this employment agreement, we issued Mr. Stephenson 60,000 performance restricted stock units on September 10, 2004, which were fully vested as of as of December 31, 2006 because we had attained \$0.30 per share of common stock per fiscal quarter in "Adjusted Funds from Operation" (as defined in the agreement) for two (2) consecutive quarters. Dividend equivalents on vested performance restricted stock units are paid currently. Pursuant to the terms of Mr. Stephenson's performance restricted stock unit agreement, he will not receive the vested shares attributable to his performance restricted stock units until the earlier of January 1, 2008, he is terminated without cause or quits for good reason (as defined in the performance restricted stock unit agreement), or his the death or disability (as defined in performance restricted stock unit agreement).

If we terminate Mr. Stephenson's employment without "cause" or if he resigns for "good reason," he will be entitled to payment of his cash compensation (the sum of his then current annual base salary plus average annual bonus payable based on the three completed fiscal years prior to termination of employment) for a period of one and one half (1.5) years. "Cause" is defined in the employment agreement to include events such as willful refusal to perform duties, willful misconduct in performance of duties, unauthorized disclosure of confidential company information, or fraud or dishonesty against us. "Good reason" is defined in the employment agreement to include events such as our material breach of the employment agreement or our relocation of Mr. Stephenson's employment to more than 50 miles away without his consent.

Mr. Stephenson is required to execute a release of claims against us as a condition to the payment of severance benefits. Severance is not paid if the term of the employment agreement expires. Mr. Stephenson's restricted common stock and performance restricted stock units will become fully vested upon the occurrence of Mr. Stephenson's death, disability, termination of employment without cause or resignation for good reason, or a "change in control" (as defined in the respective restricted stock agreement). In the event of a termination by us without Cause or by Mr. Stephenson for Good Reason, benefits are grossed up to cover federal excise taxes. If Mr. Stephenson dies during the term of the employment agreement, his estate is entitled to a prorated bonus for the year of his death.

Mr. Stephenson is restricted from using any of our confidential information during his employment and for two years thereafter or from using any trade secrets during his employment and for as long thereafter as permitted by applicable law. During the period of employment and for one year thereafter, Mr. Stephenson is obligated not to provide managerial services or management consulting services to a competing business. Competing businesses is defined to include a defined list of competitors and any other business with the primary purpose of leasing assets to healthcare operators or financing ownership or operation of senior, retirement or healthcare related real estate. In addition, during the period of employment and for one year thereafter, Mr. Stephenson agrees not to solicit clients or customers with whom he had material contact or to solicit our management level or key employees. If the term of the employment agreement expires at December 31, 2007 and as a result no severance is paid, then these provisions also expire at December 31, 2007.

R. Lee Crabill, Jr. Employment Agreement

We entered into an employment agreement with R. Lee Crabill, dated as of September 1, 2004, to be our Senior Vice President of Operations. The term of the agreement expires on December 31, 2007.

Mr. Crabill's current base salary is \$253,400 per year, subject to increase by us and provides that he will be eligible for an annual bonus of up to 60% of his base salary based on criteria determined by the Compensation Committee of our Board of Directors.

In connection with this employment agreement, we issued Mr. Crabill 57,500 shares of our restricted common stock on September 10, 2004, which vested 33 1/3% on each of January 1, 2005, January 1, 2006, and January 1, 2007. Dividends were paid on unvested shares and a dividend equivalent per share was paid in an amount equal to the dividend per share payable to stockholders of record as of July 30, 2004. Also in connection with this employment agreement, we issued Mr. Crabill 57,500 performance restricted stock units on September 10, 2004, which were fully vested as of as of December 31, 2006 because we had attained \$0.30 per share of common stock per fiscal quarter in “Adjusted Funds from Operations” (as defined in the agreement) for two (2) consecutive quarters. Dividend equivalents on vested performance restricted stock units are paid currently. Performance restricted stock units that have not become vested as of December 31, 2007 are forfeited. Pursuant to the terms of Mr. Crabill’s performance restricted stock unit agreement, he will not receive the vested shares attributable to his performance restricted stock units until the earlier of January 1, 2008, he is terminated without cause or quits for good reason (as defined in the performance restricted stock unit agreement), or his the death or disability (as defined in performance restricted stock unit agreement).

If we terminate Mr. Crabill’s employment without “cause” or if he resigns for “good reason,” he will be entitled to payment of his cash compensation (the sum of his then current annual base salary plus average annual bonus payable based on the three completed fiscal years prior to termination of employment) for a period of one and one half (1.5) years. “Cause” is defined in the employment agreement to include events such as willful refusal to perform duties, willful misconduct in performance of duties, unauthorized disclosure of confidential company information, or fraud or dishonesty against us. “Good reason” is defined in the employment agreement to include events such as our material breach of the employment agreement or our relocation of Mr. Crabill’s employment to more than 50 miles away without his consent.

Mr. Crabill is required to execute a release of claims against us as a condition to the payment of severance benefits. Severance is not paid if the term of the employment agreement expires. Mr. Crabill’s restricted common stock and performance restricted stock units will become fully vested upon the occurrence of Mr. Crabill’s death, disability, termination of employment without cause or resignation for good reason, or a “change in control” (as defined in the respective restricted stock agreement). In the event of a termination by us without Cause or by Mr. Crabill for Good Reason, benefits are grossed up to cover federal excise taxes. If Mr. Crabill dies during the term of the employment agreement, his estate is entitled to a prorated bonus for the year of his death.

Mr. Crabill is restricted from using any of our confidential information during his employment and for two years thereafter or from using any trade secrets during his employment and for as long thereafter as permitted by applicable law. During the period of employment and for one year thereafter, Mr. Crabill is obligated not to provide managerial services or management consulting services to a competing business. Competing businesses is defined to include a defined list of competitors and any other business with the primary purpose of leasing assets to healthcare operators or financing ownership or operation of senior, retirement or healthcare related real estate. In addition, during the period of employment and for one year thereafter, Mr. Crabill agrees not to solicit clients or customers with whom he had material contact or to solicit our management level or key employees. If the term of the employment agreement expires at December 31, 2007 and as a result no severance is paid, then these provisions also expire at December 31, 2007.

Option Grants/SAR Grants

No options or stock appreciation rights, or SARs, were granted to the named executive officers during 2006.

Long-Term Incentive Plan

For the period from August 14, 1992, the date of commencement of our operations, through December 31, 2006, we have had no long-term incentive plans.

Defined Benefit or Actuarial Plan

For the period from August 14, 1992, the date of commencement of our operations, through December 31, 2006, we have had no pension plans.

DIRECTOR COMPENSATION

Name	Fees earned or paid in cash (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Non-Qualified Deferred Comp Earnings	All Other Compensation (\$)	Total (\$)
(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
Thomas F. Franke	\$ 58,500	\$ 27,582	\$ --	\$ --	\$ --	\$ --	\$ 86,082
Harold J. Kloosterman	\$ 75,500	\$ 27,582	\$ --	\$ --	\$ --	\$ --	\$ 103,082
Bernard J. Korman	\$ 80,000	\$ 52,762	\$ --	\$ --	\$ --	\$ --	\$ 132,762
Edward Lowenthal	\$ 62,500	\$ 27,582	\$ --	\$ --	\$ --	\$ --	\$ 90,082
Stephen D. Plavin	\$ 72,500	\$ 27,582	\$ --	\$ --	\$ --	\$ --	\$ 100,082