

Sabra Health Care REIT, Inc.  
Form 10-Q  
November 04, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014  
OR

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

Commission file number 001-34950

SABRA HEALTH CARE REIT, INC.  
(Exact Name of Registrant as Specified in Its Charter)

Maryland  
(State of Incorporation)  
18500 Von Karman Avenue, Suite 550  
Irvine, CA 92612  
(888) 393-8248  
(Address, zip code and telephone number of Registrant)

27-2560479  
(I.R.S. Employer Identification No.)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

As of October 31, 2014, there were 54,527,984 shares of the Registrant's \$0.01 par value Common Stock outstanding.



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SABRA HEALTH CARE REIT, INC. AND SUBSIDIARIES

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References throughout this document to “Sabra,” “we,” “our,” “ours” and “us” refer to Sabra Health Care REIT, Inc. and its direct and indirect consolidated subsidiaries and not any other person.

### STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Quarterly Report on Form 10-Q (this “10-Q”) contain “forward-looking” information as that term is defined by the Private Securities Litigation Reform Act of 1995. Any statements that do not relate to historical or current facts or matters are forward-looking statements. Examples of forward-looking statements include all statements regarding our expected future financial position, results of operations, cash flows, liquidity, financing plans, business strategy, budgets, the expected amounts and timing of dividends and other distributions, projected expenses and capital expenditures, competitive position, growth opportunities, potential investments, plans and objectives for future operations, and compliance with and changes in governmental regulations. You can identify some of the forward-looking statements by the use of forward-looking words such as “anticipate,” “believe,” “plan,” “estimate,” “expect,” “intend,” “should,” “may” and other similar expressions, although not all forward-looking statements contain these identifying words.

Our actual results may differ materially from those projected or contemplated by our forward-looking statements as a result of various factors, including, among others, the following:

- our dependence on Genesis HealthCare LLC (“Genesis”) until we are able to further diversify our portfolio;
- our dependence on the operating success of our tenants;
  - the dependence of our tenants on reimbursement from governmental and other third-party payors;
- the significant amount of and our ability to service our indebtedness;
- covenants in our debt agreements that may restrict our ability to make investments, incur additional indebtedness and refinance indebtedness on favorable terms;
- increases in market interest rates;
- our ability to raise capital through equity and debt financings;
- the relatively illiquid nature of real estate investments;
- competitive conditions in our industry;
- the loss of key management personnel or other employees;
- the impact of litigation and rising insurance costs on the business of our tenants;
- uninsured or underinsured losses affecting our properties and the possibility of environmental compliance costs and liabilities;
- our ability to maintain our status as a real estate investment trust (“REIT”); and
- compliance with REIT requirements and certain tax matters related to our status as a REIT.

We urge you to carefully consider these risks and review the additional disclosures we make concerning risks and other factors that may materially affect the outcome of our forward-looking statements and our future business and operating results, including those made in Part I, Item 1A, “Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2013 (our “2013 Annual Report on Form 10-K”), as such risk factors may be amended, supplemented or superseded from time to time by other reports we file with the Securities and Exchange Commission (the “SEC”), including subsequent Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q. We caution you that any forward-looking statements made in this 10-Q are not guarantees of future performance, events or results, and you should not place undue reliance on these forward-looking statements, which speak only as of the date of this report. We do not intend, and we undertake no obligation, to update any forward-looking information to reflect events or circumstances after the date of this 10-Q or to reflect the occurrence of unanticipated events, unless required by law to do so.

### TENANT INFORMATION

This 10-Q includes information regarding certain of our tenants, none of which are subject to SEC reporting requirements. The information related to our tenants provided in this 10-Q have been provided by such tenants and we have not independently verified this information. We have no reason to believe that such information is inaccurate in any material respect. We are providing this data for informational purposes only.



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## PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS  
 SABRA HEALTH CARE REIT, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (dollars in thousands, except per share data)

|  | September 30,<br>2014<br>(unaudited) | December 31,<br>2013 |
|--|--------------------------------------|----------------------|
| Assets   |                                      |                      |
| Real estate investments, net of accumulated depreciation of \$179,301 and \$151,078 as of September 30, 2014 and December 31, 2013, respectively                                   | \$ 1,568,268                         | \$ 915,418           |
| Loans receivable and other investments, net  | 250,674                              | 185,293              |
| Cash and cash equivalents  | 25,479                               | 4,308                |
| Restricted cash  | 6,537                                | 5,352                |
| Deferred tax assets  | 24,212                               | 24,212               |
| Prepaid expenses, deferred financing costs and other assets  | 142,196                              | 63,252               |
| Total assets   | \$ 2,017,366                         | \$ 1,197,835         |
| Liabilities  |                                      |                      |
| Mortgage notes   | \$ 124,714                           | \$ 141,328           |
| Revolving credit facility  | 614,000                              | 135,500              |
| Senior unsecured notes   | 550,000                              | 414,402              |
| Accounts payable and accrued liabilities   | 40,719                               | 22,229               |
| Tax liability  | 24,212                               | 24,212               |
| Total liabilities  | 1,353,645                            | 737,671              |
| Commitments and contingencies (Note 12)  |                                      |                      |
| Equity   |                                      |                      |
| Preferred stock, \$.01 par value; 10,000,000 shares authorized, 5,750,000 shares issued and outstanding as of September 30, 2014 and December 31, 2013                             | 58                                   | 58                   |
| Common stock, \$.01 par value; 125,000,000 shares authorized, 47,627,984 and 38,788,745 shares issued and outstanding as of September 30, 2014 and December 31, 2013, respectively | 476                                  | 388                  |
| Additional paid-in capital   | 771,844                              | 534,639              |
| Cumulative distributions in excess of net income   | (108,628                             | ) (74,921            |
| Total Sabra Health Care REIT, Inc. stockholders' equity  | 663,750                              | 460,164              |
| Noncontrolling interests   | (29                                  | ) —                  |
| Total equity   | 663,721                              | 460,164              |
| Total liabilities and equity   | \$ 2,017,366                         | \$ 1,197,835         |
| See accompanying notes to condensed consolidated financial statements.   |                                      |                      |

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SABRA HEALTH CARE REIT, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
 (dollars in thousands, except per share data)  
 (unaudited)

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2014                                | 2013       | 2014                               | 2013       |
| Revenues:   |                                     |            |                                    |            |
| Rental income   | \$38,165                            | \$31,699   | \$111,743                          | \$94,692   |
| Interest and other income                                     | 5,819                               | 1,227      | 16,064                             | 2,531      |
| Total revenues  | 43,984                              | 32,926     | 127,807                            | 97,223     |
| Expenses:   |                                     |            |                                    |            |
| Depreciation and amortization                                 | 9,762                               | 8,258      | 28,867                             | 24,726     |
| Interest  | 10,540                              | 9,739      | 32,668                             | 29,884     |
| General and administrative                                    | 6,226                               | 3,057      | 20,005                             | 11,196     |
| Total expenses  | 26,528                              | 21,054     | 81,540                             | 65,806     |
| Other income (expense):                                       |                                     |            |                                    |            |
| Loss on extinguishment of debt                                | (158                                | ) (351     | ) (22,454                          | ) (10,101  |
| Other income (expense)  | (100                                | ) 300      | 860                                | (600       |
| Total other income (expense)                                  | (258                                | ) (51      | ) (21,594                          | ) (10,701  |
| Net income  | 17,198                              | 11,821     | 24,673                             | 20,716     |
| Net loss attributable to noncontrolling interests             | 6                                   | —          | 29                                 | —          |
| Net income attributable to Sabra Health Care REIT, Inc.       | 17,204                              | 11,821     | 24,702                             | 20,716     |
| Preferred stock dividends                                     | (2,561                              | ) (2,579   | ) (7,682                           | ) (5,406   |
| Net income attributable to common stockholders                | \$14,643                            | \$9,242    | \$17,020                           | \$15,310   |
| Net income attributable to common stockholders, per:          |                                     |            |                                    |            |
| Basic common share  | \$0.31                              | \$0.25     | \$0.39                             | \$0.41     |
| Diluted common share  | \$0.31                              | \$0.24     | \$0.39                             | \$0.41     |
| Weighted-average number of common shares outstanding, basic   | 47,359,949                          | 37,358,334 | 43,358,620                         | 37,334,120 |
| Weighted-average number of common shares outstanding, diluted | 47,877,202                          | 37,828,573 | 43,840,550                         | 37,777,458 |

See accompanying notes to condensed consolidated financial statements.

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SABRA HEALTH CARE REIT, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF EQUITY  
 (dollars in thousands, except per share data)  
 (unaudited)

|  | Preferred Stock |        | Common Stock |        |                               | Cumulative<br>Distributions<br>in Excess of<br>Net Income | Total<br>Stockholders'<br>Equity | Noncontrol-<br>ling<br>Interests | Total<br>Equity |
|--|-----------------|--------|--------------|--------|-------------------------------|---|----------------------------------|----------------------------------|-----------------|
|  | Shares          | Amount | Shares       | Amount | Additional<br>Paid-in Capital |   |                                  |                                  |                 |
| Balance,<br>December 31, 2012                  | —               | \$—    | 37,099,209   | \$ 371 | \$ 353,861                    | \$(48,744 )   | \$ 305,488                       | \$ —                             | \$ 305,488      |
| Net income                                     | —               | —      | —            | —      | —                             | 20,716  | 20,716                           | —                                | 20,716          |
| Amortization of<br>stock-based<br>compensation | —               | —      | —            | —      | 5,693                         | —   | 5,693                            | —                                | 5,693           |
| Preferred stock<br>issuance                    | 5,750,000       | 58     | —            | —      | 138,199                       | —   | 138,257                          | —                                | 138,257         |
| Common stock<br>issuance                       | —               | —      | 234,734      | 2      | (2,951 )                      | —   | (2,949 )                         | —                                | (2,949 )        |
| Preferred dividends                            | —               | —      | —            | —      | —                             | (5,406 )  | (5,406 )                         | —                                | (5,406 )        |
| Common dividends<br>(\$1.02 per share)         | —               | —      | —            | —      | —                             | (38,609 )   | (38,609 )                        | —                                | (38,609 )       |
| Balance, September<br>30, 2013                 | 5,750,000       | \$ 58  | 37,333,943   | \$ 373 | \$ 494,802                    | \$(72,043 )   | \$ 423,190                       | \$ —                             | \$ 423,190      |

|  | Preferred Stock |        | Common Stock |        |                               | Cumulative<br>Distributions<br>in Excess of<br>Net Income | Total<br>Stockholders'<br>Equity | Noncontrol-<br>ling<br>Interests | Total<br>Equity |
|--|-----------------|--------|--------------|--------|-------------------------------|---|----------------------------------|----------------------------------|-----------------|
|  | Shares          | Amount | Shares       | Amount | Additional<br>Paid-in Capital |   |                                  |                                  |                 |
| Balance,<br>December 31, 2013                  | 5,750,000       | \$ 58  | 38,788,745   | \$ 388 | \$ 534,639                    | \$(74,921 )   | \$ 460,164                       | \$ —                             | \$ 460,164      |
| Net income                                     | —               | —      | —            | —      | —                             | 24,702  | 24,702                           | (29 )                            | 24,673          |
| Amortization of<br>stock-based<br>compensation | —               | —      | —            | —      | 7,092                         | —   | 7,092                            | —                                | 7,092           |
| Common stock<br>issuance                       | —               | —      | 8,839,239    | 88     | 230,113                       | —   | 230,201                          | —                                | 230,201         |
| Preferred dividends                            | —               | —      | —            | —      | —                             | (7,682 )  | (7,682 )                         | —                                | (7,682 )        |
| Common dividends<br>(\$1.12 per share)         | —               | —      | —            | —      | —                             | (50,727 )   | (50,727 )                        | —                                | (50,727 )       |
| Balance, September<br>30, 2014                 | 5,750,000       | \$ 58  | 47,627,984   | \$ 476 | \$ 771,844                    | \$(108,628 )  | \$ 663,750                       | \$(29 )                          | \$ 663,721      |

See accompanying notes to condensed consolidated financial statements.

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SABRA HEALTH CARE REIT, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (in thousands)  
 (unaudited)

|   | Nine Months Ended September |            |
|---|-----------------------------|------------|
|   | 30,                         |            |
|   | 2014                        | 2013       |
| Cash flows from operating activities:   |                             |            |
| Net income  | \$24,673                    | \$20,716   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                             |            |
| Depreciation and amortization   | 28,867                      | 24,726     |
| Non-cash interest income adjustments  | 217                         | 29         |
| Amortization of deferred financing costs  | 2,812                       | 2,395      |
| Stock-based compensation expense  | 6,337                       | 5,209      |
| Amortization of premium   | (33                         | ) (535     |
| Loss on extinguishment of debt  | 1,576                       | 858        |
| Straight-line rental income adjustments   | (13,074                     | ) (10,836  |
| Write-off of straight-line rental income  | 2,994                       | —          |
| Change in fair value of contingent consideration                                  | (860                        | ) 600      |
| Changes in operating assets and liabilities:                                      |                             |            |
| Prepaid expenses and other assets   | (2,529                      | ) (1,494   |
| Accounts payable and accrued liabilities  | 22,607                      | 10,413     |
| Restricted cash   | (2,348                      | ) (2,870   |
| Net cash provided by operating activities   | 71,239                      | 49,211     |
| Cash flows from investing activities:   |                             |            |
| Acquisitions of real estate   | (721,879                    | ) (6,175   |
| Origination and fundings of loans receivable                                      | (59,256                     | ) (26,393  |
| Preferred equity investment   | (11,300                     | ) (6,624   |
| Additions to real estate  | (1,151                      | ) (388     |
| Repayment of loans receivable   | 287                         | —          |
| Net proceeds from the sale of real estate   | —                           | 2,208      |
| Net cash used in investing activities   | (793,299                    | ) (37,372  |
| Cash flows from financing activities:   |                             |            |
| Proceeds from issuance of senior unsecured notes                                  | 350,000                     | 200,000    |
| Principal payments on senior unsecured notes                                      | (211,250                    | ) (113,750 |
| Proceeds from revolving credit facility   | 699,000                     | —          |
| Payments on revolving credit facility   | (220,500                    | ) (92,500  |
| Proceeds from mortgage notes  | 57,703                      | —          |
| Principal payments on mortgage notes  | (88,419                     | ) (10,081  |
| Payments of deferred financing costs  | (15,474                     | ) (8,598   |
| Issuance of preferred stock   | —                           | 138,257    |
| Issuance of common stock  | 229,825                     | (2,950     |
| Dividends paid on common and preferred stock                                      | (57,654                     | ) (42,677  |
| Net cash provided by financing activities   | 743,231                     | 67,701     |

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|   |          |          |
|---|----------|----------|
| Net increase in cash and cash equivalents         | 21,171   | 79,540   |
| Cash and cash equivalents, beginning of period    | 4,308    | 17,101   |
| Cash and cash equivalents, end of period          | \$25,479 | \$96,641 |
| Supplemental disclosure of cash flow information: |          |          |
| Interest paid                                     | \$26,705 | \$21,937 |
| Supplemental disclosure of non-cash transaction:  |          |          |
| Assumption of mortgage indebtedness               | \$14,102 | \$—      |
| Repayment of preferred equity investments         | \$6,949  | \$—      |

See accompanying notes to condensed consolidated financial statements.

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SABRA HEALTH CARE REIT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. BUSINESS

Overview

Sabra Health Care REIT, Inc. (“Sabra” or the “Company”) was incorporated on May 10, 2010 as a wholly owned subsidiary of Sun Healthcare Group, Inc. (“Old Sun”) and commenced operations on November 15, 2010. Sabra elected to be treated as a real estate investment trust (“REIT”) with the filing of its U.S. federal income tax return for the taxable year beginning January 1, 2011. Sabra believes that it has been organized and operated, and it intends to continue to operate, in a manner to qualify as a REIT. Sabra’s primary business consists of acquiring, financing and owning real estate property to be leased to third party tenants in the healthcare sector. Sabra owns substantially all of its assets and properties and conducts its operations through Sabra Health Care Limited Partnership, a Delaware limited partnership (the “Operating Partnership”), of which Sabra is the sole general partner, or by subsidiaries of the Operating Partnership. The Company’s investment portfolio is primarily comprised of skilled nursing/transitional care facilities, senior housing facilities, acute care hospitals, debt investments and preferred equity investments.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Basis of Presentation

The condensed consolidated financial statements include the accounts of Sabra, its wholly owned subsidiaries and a consolidated variable interest entity (“VIEs”). All significant intercompany balances and transactions have been eliminated in consolidation. The condensed consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (“GAAP”).

GAAP requires the Company to identify entities for which control is achieved through means other than voting rights and to determine which business enterprise is the primary beneficiary of VIEs. A VIE is broadly defined as an entity with one or more of the following characteristics: (a) the total equity investment at risk is insufficient to finance the entity's activities without additional subordinated financial support; (b) as a group, the holders of the equity investment at risk lack (i) the ability to make decisions about the entity's activities through voting or similar rights, (ii) the obligation to absorb the expected losses of the entity, or (iii) the right to receive the expected residual returns of the entity; or (c) the equity investors have voting rights that are not proportional to their economic interests, and substantially all of the entity's activities either involve, or are conducted on behalf of, an investor that has disproportionately few voting rights. If the Company were determined to be the primary beneficiary of the VIE, the Company would consolidate investments in the VIE. The Company may change its original assessment of a VIE due to events such as modifications of contractual arrangements that affect the characteristics or adequacy of the entity's equity investments at risk and the disposal of all or a portion of an interest held by the primary beneficiary. The Company identifies the primary beneficiary of a VIE as the enterprise that has both: (i) the power to direct the activities of the VIE that most significantly impact the entity's economic performance; and (ii) the obligation to absorb losses or the right to receive benefits of the VIE that could be significant to the entity. The Company performs this analysis on an ongoing basis.

As of September 30, 2014, the Company determined it was the primary beneficiary of one senior housing facility and has consolidated the operations of the facility in the accompanying condensed consolidated financial statements. As of September 30, 2014, the operations of the facility were not material to the Company’s results of operations, financial condition or cash flows.

As it relates to investments in loans, in addition to the Company's assessment of VIEs and whether the Company is the primary beneficiary of those VIEs, the Company evaluates the loan terms and other pertinent facts to determine if the loan investment should be accounted for as a loan or as a real estate joint venture. If an investment has the characteristics of a real estate joint venture, including if the Company participates in the majority of the borrower's expected residual profit, the Company would account for the investment as an investment in a real estate joint venture and not as a loan investment. Expected residual profit is defined as the amount of profit, whether called interest or another name, such as an equity kicker, above a reasonable amount of interest and fees expected to be earned by a

lender. At September 30, 2014, none of the Company's investments in loans are accounted for as real estate joint ventures.

As it relates to investments in joint ventures, based on the type of rights held by the limited partner(s), GAAP may preclude consolidation by the sole general partner in certain circumstances in which the general partner would otherwise

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consolidate the joint venture. The Company assesses limited partners' rights and their impact on the presumption of control of the limited partnership by the sole general partner when an investor becomes the sole general partner, and the Company reassesses if: there is a change to the terms or in the exercisability of the rights of the limited partners; the sole general partner increases or decreases its ownership of limited partnership interests; or there is an increase or decrease in the number of outstanding limited partnership interests. The Company also applies this guidance to managing member interests in limited liability companies.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with GAAP for interim financial information as contained within the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") and the rules and regulations of the Securities and Exchange Commission (the "SEC"), including the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the unaudited condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for financial statements. In the opinion of management, the financial statements for the unaudited interim periods presented include all adjustments, which are of a normal and recurring nature, necessary for a fair statement of the results for such periods. Operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. For further information, refer to the Company's consolidated financial statements and notes thereto for the year ended December 31, 2013 included in the Company's 2013 Annual Report on Form 10-K filed with the SEC.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could materially differ from those estimates.

Recently Issued Accounting Standards Update

In April 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity ("ASU No. 2014-08"), which changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. Under the new guidance, a discontinued operation is defined as a disposal of a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. The standard no longer precludes presentation as a discontinued operation if (i) there are operations and cash flows of the component that have not been eliminated from the reporting entity's ongoing operations, or (ii) there is significant continuing involvement with a component after its disposal. ASU No. 2014-08 is effective for public entities for interim and annual periods beginning after December 15, 2014, and will be applied prospectively. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). ASU 2014-09 is a comprehensive new revenue recognition model requiring a company to recognize revenue to depict the transfer of goods or services to a customer at an amount reflecting the consideration it expects to receive in exchange for those goods or services. In adopting ASU 2014-09, companies may use either a full retrospective or a modified retrospective approach. Additionally, this guidance requires improved disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The guidance specifically notes that lease contracts with customers are a scope exception. ASU 2014-09 is effective for the first interim period within annual reporting periods beginning after December 15, 2016, and early adoption is not permitted. The Company is currently in the process of evaluating the impact the adoption of ASU 2014-09 will have on the Company's financial position or results of operations.

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." ASU 2014-15 requires management to evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, and to provide certain disclosures when it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued. ASU 2014-15 is effective for the annual period ended December 31, 2016 and for annual periods and interim periods

thereafter with early adoption permitted. The adoption of ASU 2014-15 is not expected to materially impact the Company's consolidated financial statements.

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During the nine months ended September 30, 2014, the Company acquired six skilled nursing/transitional care facilities and 27 senior housing facilities for consideration totaling \$690.8 million. The consideration was allocated as follows (in thousands):

| Land     | Building and Improvements | Intangibles<br>Tenant Origination and Absorption Costs | Tenant Relationship | Total Consideration |
|----------|---------------------------|--|---------------------|---------------------|
| \$54,387 | \$ 625,536                | \$7,924  | \$2,991             | \$ 690,838          |

As of September 30, 2014, the purchase price allocations for the acquisitions completed during the three months ended September 30, 2014 are preliminary pending the receipt of information necessary to complete the valuation of certain tangible and intangible assets and liabilities and therefore are subject to change.

The tenant origination and absorption costs intangible assets and tenant relationship intangible assets acquired in connection with these acquisitions have weighted-average amortization periods as of the date of acquisition of 14 years and 24 years, respectively.

For the three and nine months ended September 30, 2014, the Company recognized \$3.9 million and \$8.3 million, respectively, of total revenues and \$1.0 million and \$3.3 million, respectively, of net income attributable to common stockholders from these properties.

**Holiday Portfolio**

On September 25, 2014, the Company acquired a portfolio of 21 independent living facilities (the “Holiday Portfolio”), located in 15 states, from affiliates of Holiday Acquisition Holdings Corp. (“Holiday”) for a total cash purchase price of \$550.0 million. Concurrently with the acquisition, certain wholly owned subsidiaries of the Company entered into a triple-net master lease agreement with certain wholly-owned subsidiaries of Holiday AL Holdings LP (collectively, “Holiday Tenant”), an affiliate of Holiday. The master lease has an initial term of 15 years with two five-year renewal options and provides for base rent in the first year of approximately \$30.3 million, with annual rent increases of 4.0% in years two and three and the greater of 3.5% or the change in the Consumer Price Index during the remainder of the lease term. The master lease is expected to generate annual lease revenues determined in accordance with GAAP, of \$39.3 million. The closing of the acquisition of one facility was deferred until October 7, 2014 and Holiday Tenant agreed to pay the full rental amount due under the lease notwithstanding the delay in the closing of the acquisition of this facility.

**Acquisition Earn-Out**

On February 14, 2014, the Company acquired four skilled nursing facilities and two senior housing facilities (the “Nye Portfolio”) for \$90.0 million. The Company may pay an earn-out based on incremental portfolio value created through the improvement of current operations as well as through expansion and conversion projects associated with these facilities. The earn-out amount will be determined based on portfolio performance following the third anniversary of the master lease. To determine the value of the contingent consideration, the Company used significant inputs not observable in the market to estimate the earn-out, made assumptions regarding the probability of the portfolio achieving the incremental value and then applied an appropriate discount rate. The Company estimated a contingent consideration liability of \$3.2 million at the time of purchase. As of September 30, 2014, based on the potential future performance of the Nye Portfolio, the contingent consideration liability is estimated at \$3.4 million and is included in accounts payable and accrued liabilities in the accompanying condensed consolidated balance sheet. During the three and nine months ended September 30, 2014, the Company recorded an adjustment to the contingent consideration liability of \$0.1 million and \$0.2 million, respectively, and included this amount in Other (expense) income on the accompanying condensed consolidated statements of income.



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## 4. REAL ESTATE PROPERTIES HELD FOR INVESTMENT

The Company's real estate properties held for investment consisted of the following (dollars in thousands):  
As of September 30, 2014

| Property Type                     | Number of Properties | Number of Beds/Units | Total Real Estate at Cost | Accumulated Depreciation | Total Real Estate Investments, Net |
|-----------------------------------|----------------------|----------------------|---------------------------|--------------------------|------------------------------------|
| Skilled Nursing/Transitional Care | 102                  | 11,460               | \$825,378                 | \$(151,842)              | ) \$673,536                        |
| Senior Housing                    | 50                   | 4,818                | 746,130                   | (17,395)                 | ) 728,735                          |
| Acute Care Hospitals              | 2                    | 124                  | 175,807                   | (9,873)                  | ) 165,934                          |
|                                   | 154                  | 16,402               | 1,747,315                 | (179,110)                | ) 1,568,205                        |
| Corporate Level                   |                      |                      | 254                       | (191)                    | ) 63                               |
|                                   |                      |                      | \$1,747,569               | \$(179,301)              | ) \$1,568,268                      |

As of December 31, 2013

| Property Type                     | Number of Properties | Number of Beds/Units | Total Real Estate at Cost | Accumulated Depreciation | Total Real Estate Investments, Net |
|-----------------------------------|----------------------|----------------------|---------------------------|--------------------------|------------------------------------|
| Skilled Nursing/Transitional Care | 96                   | 10,826               | \$737,188                 | \$(132,068)              | ) \$605,120                        |
| Senior Housing                    | 23                   | 1,518                | 153,247                   | (13,337)                 | ) 139,910                          |
| Acute Care Hospitals              | 2                    | 124                  | 175,807                   | (5,520)                  | ) 170,287                          |
|                                   | 121                  | 12,468               | 1,066,242                 | (150,925)                | ) 915,317                          |
| Corporate Level                   |                      |                      | 254                       | (153)                    | ) 101                              |
|                                   |                      |                      | \$1,066,496               | \$(151,078)              | ) \$915,418                        |

|                           | September 30, 2014 | December 31, 2013 |
|---------------------------|--------------------|-------------------|
| Building and improvements | \$1,476,202        | \$879,926         |
| Furniture and equipment   | 80,977             | 50,567            |
| Land improvements         | 4,392              | 4,392             |
| Land                      | 185,998            | 131,611           |
|                           | 1,747,569          | 1,066,496         |
| Accumulated depreciation  | (179,301)          | ) (151,078)       |
|                           | \$1,568,268        | \$915,418         |

## Operating Leases

As of September 30, 2014, all of the Company's real estate properties were leased under triple-net operating leases with expirations ranging from six to 18 years. As of September 30, 2014, the leases had a weighted-average remaining term of 11 years. The leases include provisions to extend the lease terms and other negotiated terms and conditions. The Company, through its subsidiaries, retains substantially all of the risks and benefits of ownership of the real estate assets leased to the tenants. In addition, the Company may receive additional security under these operating leases in the form of letters of credit and security deposits from the lessee or guarantees from the parent of the lessee or other related parties. Security deposits received in cash related to tenant leases are included in accounts payable and accrued liabilities in the accompanying condensed consolidated balance sheets and totaled \$15.6 million and \$1.6 million as of September 30, 2014 and December 31, 2013, respectively. As of September 30, 2014, 81 of the Company's 154 real estate properties held for investment were leased to subsidiaries of Genesis.

The Company monitors the creditworthiness of its tenants by reviewing credit ratings (if available) and evaluating the ability of the tenants to meet their lease obligations to the Company based on the tenants' financial performance, including the evaluation of any parent guarantees (or the guarantees of other related parties) of tenant lease obligations. Because formal credit ratings may not be available for most of the Company's tenants, the primary basis for the Company's evaluation of the credit quality of its tenants (and more specifically the tenants' ability to pay their rent obligations to the Company) is the tenants' lease coverage ratios. These coverage ratios include earnings before interest, taxes, depreciation, amortization and rent ("EBITDAR") to rent coverage and earnings before interest, taxes,

depreciation, amortization, rent and management fees

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(“EBITDARM”) to rent coverage at the facility level and consolidated EBITDAR to total fixed charge coverage at the parent guarantor level when such a guarantee exists. The Company obtains various financial and operational information from its tenants each month and reviews this information in conjunction with the above-described coverage metrics to determine trends and the operational and financial impact of the environment in the industry (including the impact of government reimbursement) and the management of the tenant’s operations. These metrics help the Company identify potential areas of concern relative to its tenants’ credit quality and ultimately the tenants’ ability to generate sufficient liquidity to meet its obligations, including its obligation to continue to pay the rent due to the Company.

As of September 30, 2014, the future minimum rental payments from the Company’s properties under non-cancelable operating leases were as follows (in thousands):

|   |             |
|---|-------------|
| October 1, 2014 through December 31, 2014 | \$41,907    |
| 2015                                      | 171,645     |
| 2016                                      | 175,883     |
| 2017                                      | 180,825     |
| 2018                                      | 185,817     |
| Thereafter                                | 1,410,600   |
|   | \$2,166,677 |

## 5.LOANS RECEIVABLE AND OTHER INVESTMENTS

As of September 30, 2014, the Company’s loans receivable and other investments consisted of the following (dollars in thousands):

| Investment         | Quantity | Facility Type                                 | Principal Balance as of September 30, 2014 | Book Value as of September 30, 2014 | Weighted Average Contractual Rate | Weighted Average Annualized Effective Rate | Maturity Date         |
|--------------------|----------|---|--|-------------------------------------|-----------------------------------|--|-----------------------|
| Loans Receivable:  |          |   |  |                                     |                                   |  |                       |
| Mortgage           | 4        | Skilled Nursing / Senior Housing / Acute Care | \$150,112                                  | \$150,515                           | 8.2                               | % 8.1                                      | % 10/31/16 - 1/31/18  |
| Construction       | 3        | Hospital / Acute Care                         | 62,541                                     | 62,845                              | 7.5                               | % 7.3                                      | % 9/30/16 - 10/31/18  |
| Mezzanine          | 2        | Skilled Nursing / Senior Housing              | 21,730                                     | 21,797                              | 11.3                              | % 11.1                                     | % 12/27/14 - 08/31/17 |
| Pre-development    | 5        | Senior Housing                                | 3,572                                      | 3,696                               | 9.0                               | % 8.2                                      | % 8/16/15 - 09/09/17  |
|                    | 14       |   | 237,955                                    | 238,853                             | 8.3                               | % 8.2                                      | %                     |
| Other Investments: |          |   |  |                                     |                                   |  |                       |
| Preferred Equity   | 4        | Senior Housing                                | 11,631                                     | 11,821                              | 11.9                              | % 11.9                                     | % NA                  |
| Total              | 18       |   | \$249,586                                  | \$250,674                           | 8.5                               | % 8.4                                      | %                     |

Meridian Mezzanine Loan

On August 15, 2014, the Company originated a \$15.5 million mezzanine loan (the “Meridian Mezzanine Loan”) with affiliates of Meridian ALZ Investors, LLC (“Meridian”) in connection with the Company’s previously announced pipeline agreement with Meridian. The proceeds of the mezzanine loan were used to repay the Company's existing preferred equity investment in an affiliate of Meridian totaling \$8.3 million (including accrued and unpaid preferred returns), resulting in a net investment by the Company of \$7.2 million. The Meridian Mezzanine Loan has a three-year term and bears interest at a fixed rate of 11.0% per annum. It is secured by Meridian's equity interest in two memory care facilities and a skilled nursing facility.

#### Chai Acquisition Option Exercise

On March 5, 2014, the Company exercised its option to purchase two skilled nursing facilities indirectly securing a related mezzanine loan for \$24.5 million.

At the closing of the acquisition, \$5.8 million of the sales proceeds were used to repay a portion of the mezzanine loan, resulting in the Company funding an additional \$18.7 million for the acquisition and leaving \$6.5 million outstanding under the

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mezzanine loan. The Company continues to have an option to purchase up to an additional \$25.5 million of the remaining ten properties securing the mezzanine loan.

## 6. DEBT

## Mortgage Indebtedness

The Company's mortgage notes payable consisted of the following (dollars in thousands):

| Interest Rate Type | Book Value as of September 30, 2014 | Book Value as of December 31, 2013 | Weighted Average Effective Interest Rate at September 30, 2014 | Maturity Date            |
|--------------------|-------------------------------------|------------------------------------|--|--------------------------|
| Fixed Rate         | \$124,714                           | \$54,688                           | 3.96   | % May 2031 - August 2051 |
| Variable Rate      | —                                   | 86,640                             | NA   | NA                       |
|                    | \$124,714                           | \$141,328                          | 3.96   | %                        |

**Mortgage Debt Refinancing.** On January 21, 2014, the Company refinanced \$44.8 million of existing variable rate mortgage indebtedness due August 2015 with mortgages guaranteed by the United States Department of Housing and Urban Development ("HUD") at an interest rate of 4.25% with maturities between 2039 and 2044. In addition, on April 8, 2014, the Company refinanced of \$11.6 million of variable rate mortgage indebtedness that was previously repaid with funds from its Revolving Credit Facility (defined below). This new \$11.6 million mortgage loan is guaranteed by HUD, has an interest rate of 4.10% and matures in 2044. In connection with these refinancings, the Company wrote off \$0.5 million in unamortized deferred financing costs during the nine months ended September 30, 2014 and included this amount in loss on extinguishment of debt on the accompanying condensed consolidated statements of income.

**Mortgage Debt Repayment.** On May 1, 2014, the Company repaid \$29.8 million of existing variable rate mortgage indebtedness, having an interest rate of 5.0% per annum, with proceeds from its Revolving Credit Facility. In connection with this repayment, the Company wrote off \$0.1 million in unamortized deferred financing costs during the nine months ended September 30, 2014 and included this amount in loss on extinguishment of debt on the accompanying condensed consolidated statements of income.

## Senior Unsecured Notes

**5.5% Notes due 2021.** On January 23, 2014, the Operating Partnership and Sabra Capital Corporation, wholly owned subsidiaries of the Company (the "Issuers"), completed an underwritten public offering of \$350.0 million aggregate principal amount of 5.5% senior unsecured notes (the "2021 Notes"). The 2021 Notes were sold at par, resulting in gross proceeds of \$350.0 million and net proceeds of approximately \$340.8 million after deducting underwriting discounts and other offering expenses. The 2021 Notes accrue interest at a rate of 5.5% per annum payable semiannually on February 1 and August 1 of each year.

On October 10, 2014, the Issuers issued an additional \$150.0 million aggregate principal amount of 2021 Notes, which are treated as a single class with, and have the same terms as, the existing 2021 Notes. The notes were issued at 99.5% providing net proceeds of approximately \$145.8 million (not including pre-issuance accrued interest), after deducting underwriting discounts and other offering expenses and a yield-to-maturity of 5.593%. The Company used the proceeds from this offering to repay borrowings outstanding under the Revolving Credit Facility.

The 2021 Notes are redeemable at the option of the Issuers, in whole or in part, at any time, and from time to time, on or after February 1, 2017, at the redemption prices set forth in the supplemental indenture governing the 2021 Notes (the "2021 Notes Indenture"), plus accrued and unpaid interest to the applicable redemption date. In addition, prior to February 1, 2017, the Issuers may redeem all or a portion of the 2021 Notes at a redemption price equal to 100% of the principal amount of the 2021 Notes redeemed, plus a "make-whole" premium, plus accrued and unpaid interest to the applicable redemption date. At any time, or from time to time, on or prior to February 1, 2017, the Issuers may redeem up to 35% of the principal amount of the 2021 Notes, using the proceeds of specific kinds of equity offerings, at a redemption price of 105.5% of the principal amount to be redeemed, plus accrued and unpaid interest, if any, to the applicable redemption date. Assuming the 2021 Notes are not redeemed, the 2021 Notes mature on February 1, 2021.

5.375% Notes Due 2023. On May 23, 2013, the Issuers completed an underwritten public offering of \$200.0 million aggregate principal amount of 5.375% senior unsecured notes (the "2023 Notes"). The 2023 Notes were sold at par, resulting in gross proceeds of \$200.0 million and net proceeds of approximately \$194.6 million after deducting underwriting discounts and

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other offering expenses. The 2023 Notes accrue interest at a rate of 5.375% per annum payable semiannually on June 1 and December 1 of each year.

The 2023 Notes are redeemable at the option of the Issuers, in whole or in part, at any time, and from time to time, on or after June 1, 2018, at the redemption prices set forth in the supplemental indenture governing the 2023 Notes (the “2023 Notes Indenture”), plus accrued and unpaid interest to the applicable redemption date. In addition, prior to June 1, 2018, the Issuers may redeem all or a portion of the 2023 Notes at a redemption price equal to 100% of the principal amount of the 2023 Notes redeemed, plus a “make-whole” premium, plus accrued and unpaid interest to the applicable redemption date. At any time, or from time to time, on or prior to June 1, 2016, the Issuers may redeem up to 35% of the principal amount of the 2023 Notes, using the proceeds of specific kinds of equity offerings, at a redemption price of 105.375% of the principal amount to be redeemed, plus accrued and unpaid interest, if any, to the applicable redemption date. Assuming the 2023 Notes are not redeemed, the 2023 Notes mature on June 1, 2023.

8.125% Notes due 2018. On October 27, 2010 and July 26, 2012, the Issuers issued \$225.0 million and \$100.0 million aggregate principal amount of 8.125% senior unsecured notes (the “2018 Notes”), respectively. Pursuant to exchange offers completed on March 14, 2011 and November 14, 2012, the Issuers exchanged the 2018 Notes that were issued in October 2010 and July 2012 for substantially identical 2018 Notes registered under the Securities Act of 1933, as amended. The 2018 Notes accrued interest at a rate of 8.125% per annum payable semiannually on May 1 and November 1 of each year.

On June 24, 2013, pursuant to the terms of the indenture governing the 2018 Notes (the “2018 Notes Indenture”), the Issuers redeemed \$113.8 million in aggregate principal amount of the then-outstanding 2018 Notes, representing 35% of the aggregate principal amount of the 2018 Notes outstanding. The 2018 Notes were redeemed at a redemption price of 108.125% of the principal amount redeemed, plus accrued and unpaid interest up to the redemption date. The redemption resulted in a \$9.8 million loss on extinguishment of debt, including \$9.3 million in payments made to noteholders for early redemption and \$0.5 million of write-offs associated with unamortized deferred financing costs and issuance premium.

On January 8, 2014, the Company commenced a cash tender offer with respect to any and all of the outstanding \$211.3 million of the 2018 Notes. Pursuant to the tender offer, the Company retired \$210.9 million of the 2018 Notes at a premium of 109.837%, plus accrued and unpaid interest, on January 23, 2014. Pursuant to the terms of the 2018 Notes Indenture, the remaining \$0.4 million of the 2018 Notes were called and were retired on February 11, 2014 at a redemption price of 109.485% plus accrued and unpaid interest. The tender offer and redemption resulted in \$21.6 million of tender offer and redemption related costs and write-offs for the nine months ended September 30, 2014, including \$20.8 million in payments made to noteholders for early redemption and \$0.8 million of write-offs associated with unamortized deferred financing and premium costs. These amounts are included in loss on extinguishment of debt on the accompanying condensed consolidated statements of income.

The obligations under the 2021 Notes and 2023 Notes (collectively, the “Senior Notes”) are fully and unconditionally guaranteed, jointly and severally, on an unsecured basis, by Sabra and certain of Sabra’s other existing and, subject to certain exceptions, future material subsidiaries; provided, however, that such guarantees are subject to release under certain customary circumstances. See Note 10, “Summarized Condensed Consolidating Information” for additional information concerning the circumstances pursuant to which the guarantors will be automatically and unconditionally released from their obligations under the guarantees.

The indentures governing the Senior Notes (the “Senior Notes Indentures”) contain restrictive covenants that, among other things, restrict the ability of Sabra, the Issuers and their restricted subsidiaries to: (i) incur or guarantee additional indebtedness; (ii) incur or guarantee secured indebtedness; (iii) pay dividends or distributions on, or redeem or repurchase, their capital stock; (iv) make certain investments or other restricted payments; (v) sell assets; (vi) create liens on their assets; (vii) enter into transactions with affiliates; (viii) merge or consolidate or sell all or substantially all of their assets; and (ix) create restrictions on the ability of Sabra’s restricted subsidiaries to pay dividends or other amounts to Sabra. Such limitations on distributions also include a limitation on the extent of allowable cumulative distributions made not to exceed the greater of (a) the sum of (x) 95% of cumulative Adjusted Funds from Operations and (y) the net proceeds from the issuance of common and preferred equity and (b) the minimum amount of distributions required for the Company to maintain its REIT status. The Senior Notes Indentures also provide for

customary events of default, including, but not limited to, the failure to make payments of interest or premium, if any, on, or principal of, the Senior Notes, the failure to comply with certain covenants and agreements specified in the Senior Notes Indentures for a period of time after notice has been provided, the acceleration of other indebtedness resulting from the failure to pay principal on such other indebtedness prior to its maturity, and certain events of insolvency. If any event of default occurs, the principal of, premium, if any, and accrued interest on all the then-outstanding Senior Notes may become due and payable immediately. The Company was in compliance with all applicable financial covenants under the Senior Notes Indentures related to the Senior Notes outstanding as of September 30, 2014.



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Revolving Credit Facility

On September 10, 2014, the Operating Partnership entered into a second amended and restated unsecured revolving credit facility (the “Revolving Credit Facility”) with certain lenders as set forth in the related credit agreement and Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer (each as defined in such credit agreement). The Revolving Credit Facility amends and restates the amended and restated secured revolving credit facility (the “Prior Revolving Credit Facility”) that the Operating Partnership and certain subsidiaries of the Operating Partnership entered into on July 29, 2013 and amended on October 15, 2013.

The Revolving Credit Facility provides for a borrowing capacity of \$650.0 million and provides an accordion feature allowing for an additional \$100.0 million of capacity, subject to terms and conditions, resulting in a maximum borrowing capacity of \$750.0 million. The Operating Partnership also has an option to convert up to \$200.0 million of the Revolving Credit Facility to a term loan subject to terms and conditions. On October 10, 2014, the Operating Partnership converted \$200.0 million of the outstanding borrowings under the Revolving Credit Facility to a term loan. Concurrent with the term loan conversion, the Company entered into a five-year interest rate cap contract that caps LIBOR at 2.0%.

While the Prior Revolving Credit Facility was secured by pledges of equity by the Company’s wholly-owned subsidiaries that own certain of the Company’s real estate assets, the Revolving Credit Facility is unsecured. The Revolving Credit Facility, including amounts that are converted into a term loan, has a maturity date of September 10, 2018, and includes a one year extension option. As of September 30, 2014, there was \$614.0 million outstanding under the Company’s Revolving Credit Facility.

In connection with the Revolving Credit Facility, the Company wrote off \$0.2 million of unamortized deferred financing costs during the nine months ended September 30, 2014. These amounts are included in loss on extinguishment of debt on the accompanying condensed consolidated statements of income.

Borrowings under the Revolving Credit Facility bear interest on the outstanding principal amount at a rate equal to an applicable percentage plus, at the Operating Partnership's option, either (a) LIBOR or (b) a base rate determined as the greater of (i) the federal funds rate plus 0.5%, (ii) the prime rate, and (iii) one-month LIBOR plus 1.0% (referred to as the “Base Rate”). The applicable percentage for borrowings will vary based on the Consolidated Leverage Ratio, as defined in the Revolving Credit Facility, and will range from 2.00% to 2.60% per annum for LIBOR based borrowings and 1.00% to 1.60% per annum for borrowings at the Base Rate. As of September 30, 2014, the interest rate on the Revolving Credit Facility was 2.46%. In addition, the Operating Partnership is required to pay an unused fee to the lenders equal to 0.25% or 0.35% per annum based on the amount of unused borrowings under the Revolving Credit Facility. During the three and nine months ended September 30, 2014, the Company incurred \$0.3 million and \$2.3 million, respectively, in interest expense on amounts outstanding under the Revolving Credit Facility. During the three and nine months ended September 30, 2014, the Company incurred \$0.5 million and \$1.1 million, respectively, of unused facility fees.

In the event that Sabra achieves at least two investment grade ratings from S&P, Moody’s and/or Fitch, the Operating Partnership can elect to reduce the applicable percentage for LIBOR or Base Rate borrowings. If the Operating Partnership makes this election, the applicable percentage for borrowings will vary based on the Debt Ratings at each Pricing Level, as defined in the credit agreement, and will range from 0.90% to 1.70% per annum for LIBOR based borrowings and 0.00% to 0.70% per annum for borrowings at the Base Rate. In addition, should the Operating Partnership elect this option, the unused fee will no longer apply and a facility fee ranging between 0.125% and 0.300% per annum will take effect based on the borrowing capacity regardless of amounts outstanding under the Revolving Credit Facility.

The obligations of the Operating Partnership under the Revolving Credit Facility are guaranteed by Sabra and certain subsidiaries of Sabra.

The Revolving Credit Facility contains customary covenants that include restrictions or limitations on the ability to make acquisitions and other investments, make distributions, incur additional indebtedness, engage in non-healthcare related business activities, enter into transactions with affiliates and sell or otherwise transfer certain assets as well as customary events of default. The Revolving Credit Facility also requires Sabra, through the Operating Partnership, to comply with specified financial covenants, which include a maximum leverage ratio, a minimum fixed charge

coverage ratio and a minimum tangible net worth requirement. As of September 30, 2014, the Company was in compliance with all applicable financial covenants under the Revolving Credit Facility.

Interest Expense

The Company incurred interest expense of \$10.5 million and \$32.7 million during the three and nine months ended September 30, 2014, respectively, and \$9.7 million and \$29.9 million during the three and nine months ended September 30,

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2013, respectively. Interest expense includes deferred financing costs amortization of \$0.9 million and \$2.8 million for the three and nine months ended September 30, 2014, respectively, and \$0.8 million and \$2.4 million for the three and nine months ended September 30, 2013, respectively. As of September 30, 2014 and December 31, 2013, the Company had \$7.9 million and \$4.7 million, respectively, of accrued interest included in accounts payable and accrued liabilities on the accompanying condensed consolidated balance sheets.

**Maturities**

The following is a schedule of maturities for the Company's outstanding debt as of September 30, 2014 (in thousands):

|   | Mortgage<br>Indebtedness | Senior Notes | Revolving<br>Credit Facility<br>(1) (2) | Total       |
|---|--------------------------|--------------|---|-------------|
| October 1, 2014 through December 31, 2014 | \$691                    | \$—          | \$—                                     | \$691       |
| 2015                                      | 2,823                    | —            | —                                       | 2,823       |
| 2016                                      | 2,917                    | —            | —                                       | 2,917       |
| 2017                                      | 3,013                    | —            | —                                       | 3,013       |
| 2018                                      | 3,114                    | —            | 614,000                                 | 617,114     |
| Thereafter                                | 112,156                  | 550,000      | —                                       | 662,156     |
|   | \$124,714                | \$550,000    | \$614,000                               | \$1,288,714 |

(1) Subject to a one-year extension option.

(2) On October 10, 2014, the Operating Partnership converted \$200.0 million of the outstanding borrowings under the Revolving Credit Facility to a term loan.

**7. FAIR VALUE DISCLOSURES**

The fair value for certain financial instruments is derived using a combination of market quotes, pricing models and other valuation techniques that involve significant management judgment. The price transparency of financial instruments is a key determinant of the degree of judgment involved in determining the fair value of the Company's financial instruments.

Financial instruments for which actively quoted prices or pricing parameters are available and whose markets contain orderly transactions will generally have a higher degree of price transparency than financial instruments whose markets are inactive or consist of non-orderly trades. The Company evaluates several factors when determining if a market is inactive or when market transactions are not orderly. The carrying values of cash and cash equivalents, restricted cash, the Revolving Credit Facility, accounts payable and accrued liabilities are reasonable estimates of fair value because of the short-term maturities of these instruments. Fair values for other financial instruments are derived as follows:

**Loans receivable:** These instruments are presented in the accompanying condensed consolidated balance sheets at their amortized cost and not at fair value. The fair value of the loans receivable were estimated using an internal valuation model that considered the expected cash flows for the loans receivable, the underlying collateral value and other credit enhancements.

**Preferred equity investments:** These instruments are presented in the accompanying condensed consolidated balance sheets at their cost and not at fair value. The fair value of the preferred equity investments were estimated using an internal valuation model that considered the expected future cash flows for the preferred equity investment, the underlying collateral value and other credit enhancements.

**Senior Notes:** The fair values of the Senior Notes were determined using third-party market quotes derived from orderly trades.

**Mortgage indebtedness:** The fair values of the Company's mortgage notes payable were estimated using a discounted cash flow analysis based on management's estimates of current market interest rates for instruments with similar characteristics, including remaining loan term, loan-to-value ratio, type of collateral and other credit enhancements.



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The following are the face values, carrying amounts and fair values of the Company's financial instruments as of September 30, 2014 and December 31, 2013 whose carrying amounts do not approximate their fair value (in thousands):

|                              | September 30, 2014        |                                |            | December 31, 2013         |                                |            |
|------------------------------|---------------------------|--------------------------------|------------|---------------------------|--------------------------------|------------|
|                              | Face Value <sup>(1)</sup> | Carrying Amount <sup>(2)</sup> | Fair Value | Face Value <sup>(1)</sup> | Carrying Amount <sup>(2)</sup> | Fair Value |
| Financial assets:            |                           |                                |            |                           |                                |            |
| Loans receivable             | \$237,955                 | \$238,853                      | \$237,385  | \$176,558                 | \$177,509                      | \$176,985  |
| Preferred equity investments | 11,631                    | 11,821                         | 12,268     | 7,695                     | 7,784                          | 7,950      |
| Financial liabilities:       |                           |                                |            |                           |                                |            |
| Senior Notes                 | 550,000                   | 550,000                        | 547,000    | 411,250                   | 414,402                        | 421,122    |
| Mortgage indebtedness        | 124,714                   | 124,714                        | 108,467    | 141,328                   | 141,328                        | 130,622    |

<sup>(1)</sup> Face value represents amounts contractually due under the terms of the respective agreements.

<sup>(2)</sup> Carrying amounts represent the book value of financial instruments and include unamortized premiums (discounts). The Company determined the fair value of financial instruments as of September 30, 2014 whose carrying amounts do not approximate their fair value with valuation methods utilizing the following types of inputs (in thousands):

|                              | Total     | Fair Value Measurements Using                                  |   |   |
|------------------------------|-----------|--|---|---|
|                              |           | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Financial assets:            |           |  |   |   |
| Loans receivable             | \$237,385 | \$—  | \$—   | \$237,385                                 |
| Preferred equity investments | 12,268    | —  | —   | 12,268                                    |
| Financial liabilities:       |           |  |   |   |
| Senior Notes                 | 547,000   | —  | 547,000                                       | —   |
| Mortgage indebtedness        | 108,467   | —  | —   | 108,467                                   |

Disclosure of the fair value of financial instruments is based on pertinent information available to the Company at the applicable dates and requires a significant amount of judgment. Despite increased capital market and credit market activity, transaction volume for certain financial instruments remains relatively low. This has made the estimation of fair values difficult and, therefore, both the actual results and the Company's estimate of fair value at a future date could be materially different.

During the nine months ended September 30, 2014, the Company recorded the following amounts measured at fair value (in thousands):

|                                    | Total   | Fair Value Measurements Using                                  |   |   |
|------------------------------------|---------|--|---|---|
|                                    |         | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Recurring Basis:                   |         |  |   |   |
| Contingent consideration liability | \$4,600 | \$—  | \$—   | \$4,600                                   |

The Company's contingent consideration liability is the result of two acquisitions of real estate properties (see Note 3, "Recent Real Estate Acquisitions" for further details regarding the new contingent liability). In order to determine the fair value of the Company's contingent consideration liability, the Company used significant inputs not observable in the market to estimate the liability, then developed probability-weighted scenarios of the potential future performance of the tenant and the resulting payout from these scenarios. As of September 30, 2014, the total contingent consideration liability was valued at \$4.6 million. The following reconciliation provides the details of activity during the nine months ended September 30, 2014 for contingent consideration liability recorded at fair value using Level 3

inputs:

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|                                  |         |   |
|----------------------------------|---------|---|
| Balance as of December 31, 2013  | \$7,500 |   |
| New contingent liability         | 3,200   |   |
| Decrease in contingent liability | (860    | ) |
| Payment of contingent liability  | (5,240  | ) |
| Balance as of September 30, 2014 | \$4,600 |   |

A corresponding amount equal to the decrease in contingent liability was included as other income on the accompanying condensed consolidated statements of income for the three and nine months ended September 30, 2014.

**8. EQUITY****Preferred Stock**

On March 21, 2013, the Company completed an underwritten public offering of 5.8 million shares of 7.125% Series A Cumulative Redeemable Preferred Stock (the "Series A Preferred Stock") at a price of \$25.00 per share, pursuant to an effective registration statement. The Company received net proceeds of \$138.3 million from the offering, after deducting underwriting discounts and other offering expenses. The Company classified the par value as preferred equity on its condensed consolidated balance sheets with the balance of the liquidation preference, net of any issuance costs, recorded as an increase in paid-in capital.

The holders of the Company's Series A Preferred Stock rank senior to the Company's common stock with respect to dividend rights and rights upon the Company's liquidation, dissolution or winding up of its affairs. At September 30, 2014, there were no dividends in arrears.

The Series A Preferred Stock does not have a stated maturity date, but the Company may redeem the Series A Preferred Stock on or after March 21, 2018, for \$25.00 per share, plus any accrued and unpaid dividends. The Company may redeem the Series A Preferred Stock prior to March 21, 2018, in limited circumstances to preserve its status as a REIT or pursuant to a specified change of control. Upon the occurrence of a specified change of control, each holder of Series A Preferred Stock will have the right to convert some or all of the shares of Series A Preferred Stock held by such holder into a number of shares of the Company's common stock equivalent to \$25.00 plus accrued and unpaid dividends, but not to exceed a cap of 1.7864 shares of common stock per share of Series A Preferred Stock (subject to certain adjustments).

**Common Stock**

The following table lists the cash dividends on common stock declared and paid by the Company during the nine months ended September 30, 2014:

| Declaration Date | Record Date       | Amount Per Share | Dividend Payable Date |
|------------------|-------------------|------------------|-----------------------|
| January 23, 2014 | February 15, 2014 | \$0.36           | February 28, 2014     |
| May 5, 2014      | May 15, 2014      | 0.38             | May 30, 2014          |
| July 30, 2014    | August 15, 2014   | 0.38             | August 29, 2014       |

On May 12, 2014, the Company completed an underwritten public offering of 8.1 million newly issued shares of its common stock pursuant to an effective registration statement. The Company received net proceeds, before expenses, of \$219.1 million from the offering, after giving effect to the issuance and sale of all 8.1 million shares of common stock (which included 1.1 million shares sold to the underwriters upon exercise of their option to purchase additional shares), at a price to the public of \$28.35 per share.

On October 3, 2014, the Company completed an underwritten public offering of 6.9 million newly issued shares of its common stock pursuant to an effective registration statement. The Company received net proceeds, before expenses, of \$160.6 million from the offering, after giving effect to the issuance and sale of all 6.9 million shares of common stock (which included 0.9 million shares sold to the underwriters upon exercise of their option to purchase additional shares), at a price to the public of \$24.25 per share.

During the nine months ended September 30, 2014, the Company issued 0.2 million shares of common stock as a result of restricted stock unit vestings and in connection with amounts payable under the Company's 2013 Bonus Plan pursuant to an election by certain participants to receive their bonus payment in shares of the Company's common

stock. During the nine months ended September 30, 2014, the Company issued 11,515 shares of common stock as a result of stock options exercised.

Upon any payment of shares as a result of restricted stock unit vestings, the participant is required to satisfy the related tax withholding obligation. The 2009 Performance Incentive Plan provides that the Company has the right at its option to (a) require the participant to pay such tax withholding or (b) reduce the number of shares to be delivered by a number of shares necessary to satisfy the related minimum applicable statutory tax withholding obligation. During the nine months ended September 30, 2014, pursuant to advance elections made by certain participants, the Company paid \$5.1 million in tax withholding obligations that were satisfied through a reduction in the number of shares delivered to those participants.

At-The-Market Common Stock Offering Program (“ATM Program”)

On March 18, 2013, the Company entered into a sales agreement (each, a “Sales Agreement”) with each of Barclays Capital Inc., Cantor Fitzgerald & Co., Credit Agricole Securities (USA) Inc., RBC Capital Markets, LLC, RBS Securities Inc. and Wells Fargo Securities, LLC (individually, a “Sales Agent” and together, the “Sales Agents”) to sell shares of its common stock having aggregate gross proceeds of up to \$100.0 million (the “ATM Shares”) from time to time through the Sales Agents.

Pursuant to the terms of the Sales Agreements, the ATM Shares may be sold by any method permitted by law deemed to be an “at-the-market” offering, including, without limitation, sales made directly on the NASDAQ Global Select Market, on any other existing trading market for the Company's common stock or to or through a market maker. In addition, with the Company's prior consent, the Sales Agents may also sell the ATM Shares in privately negotiated transactions. The Company will pay each Sales Agent a commission of up to 2% of the gross proceeds from the sales of ATM Shares sold pursuant to the applicable Sales Agreement.

During the three months ended September 30, 2014, the Company sold 0.4 million ATM Shares, at an average price of \$28.28 per share, generating gross proceeds of approximately \$10.3 million, before \$0.2 million of commissions.

During the nine months ended September 30, 2014, the Company sold 0.6 million ATM Shares, at an average price of \$28.05 per share, generating gross proceeds of approximately \$16.9 million, before \$0.3 million of commissions. As of September 30, 2014, the Company had \$44.8 million available under the ATM Program.

## 9. EARNINGS PER COMMON SHARE

The following table illustrates the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2014 and 2013 (in thousands, except share and per share amounts):

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2014                                | 2013       | 2014                               | 2013       |
| <b>Numerator</b>                                  |                                     |            |                                    |            |
| Net income attributable to common stockholders    | \$ 14,643                           | \$ 9,242   | \$ 17,020                          | \$ 15,310  |
| <b>Denominator</b>                                |                                     |            |                                    |            |
| Basic weighted average common shares              | 47,359,949                          | 37,358,334 | 43,358,620                         | 37,334,120 |
| Dilutive stock options and restricted stock units | 517,253                             | 470,239    | 481,930                            | 443,338    |
| Diluted weighted average common shares            | 47,877,202                          | 37,828,573 | 43,840,550                         | 37,777,458 |

Net income attributable to common stockholders, per:

|                      |        |        |        |        |
|----------------------|--------|--------|--------|--------|
| Basic common share   | \$0.31 | \$0.25 | \$0.39 | \$0.41 |
| Diluted common share | \$0.31 | \$0.24 | \$0.39 | \$0.41 |

Certain of our outstanding restricted stock units are considered participating securities because dividend payments are not forfeited even if the underlying award does not vest. Accordingly, the Company uses the two-class method when computing basic and diluted earnings per share. During the three months ended September 30, 2014 and 2013, no



restricted stock units were considered anti-dilutive. During the nine months ended September 30, 2014, approximately 5,000 restricted stock units were not included because they were considered anti-dilutive. During the nine months ended September 30, 2013, approximately 3,000 restricted stock units were not included because they were anti-dilutive. No stock options were considered anti-dilutive during the three and nine months ended September 30, 2014 and 2013.

#### 10.SUMMARIZED CONDENSED CONSOLIDATING INFORMATION

In connection with the offerings of the Senior Notes by the Issuers and the Issuers' previous offerings of the 2018 Notes (which were no longer outstanding as of September 30, 2014), the Company and certain 100% owned subsidiaries of the Company (the "Guarantors") have, jointly and severally, fully and unconditionally guaranteed the Senior Notes, subject to release under certain customary circumstances as described below. These guarantees are subordinated to all existing and future senior debt and senior guarantees of the Guarantors and are unsecured. The Company conducts all of its business through and derives virtually all of its income from its subsidiaries. Therefore, the Company's ability to make required payments with respect to its indebtedness (including the Senior Notes) and other obligations depends on the financial results and condition of its subsidiaries and its ability to receive funds from its subsidiaries.

A Guarantor will be automatically and unconditionally released from its obligations under the guarantees with respect to the Senior Notes in the event of:

- Any sale of the subsidiary Guarantor or of all or substantially all of its assets;
- A merger or consolidation of a subsidiary Guarantor with an issuer of the Senior Notes or another Guarantor, provided that the surviving entity remains a Guarantor;
- A subsidiary Guarantor is declared "unrestricted" for covenant purposes under the Senior Notes Indentures;
- The requirements for legal defeasance or covenant defeasance or to discharge the Senior Notes Indentures have been satisfied;
- A liquidation or dissolution, to the extent permitted under the Senior Notes Indentures, of a subsidiary Guarantor; and
- The release or discharge of the guaranty that resulted in the creation of the subsidiary guaranty, except a discharge or release by or as a result of payment under such guaranty.

Pursuant to Rule 3-10 of Regulation S-X, the following summarized condensed consolidating information is provided for the Company (the "Parent Company"), the Issuers, the Guarantors, and the Company's non-Guarantor subsidiaries with respect to the Senior Notes. This summarized financial information has been prepared from the books and records maintained by the Company, the Issuers, the Guarantors and the non-Guarantor subsidiaries. The summarized financial information may not necessarily be indicative of the results of operations or financial position had the Issuers, the Guarantors or non-Guarantor subsidiaries operated as independent entities. Sabra's investments in its consolidated subsidiaries are presented based upon Sabra's proportionate share of each subsidiary's net assets. The Guarantor subsidiaries' investments in the non-Guarantor subsidiaries and non-Guarantor subsidiaries' investments in Guarantor subsidiaries are presented under the equity method of accounting. Intercompany activities between subsidiaries and the Parent Company are presented within operating activities on the condensed consolidating statement of cash flows.

Condensed consolidating financial statements for the Company and its subsidiaries, including the Parent Company only, the Issuers, the combined Guarantor subsidiaries and the combined non-Guarantor subsidiaries, are as follows:

## CONDENSED CONSOLIDATING BALANCE SHEET

September 30, 2014

(in thousands)

(unaudited)

|   | Parent<br>Company | Issuers     | Combined<br>Guarantor<br>Subsidiaries | Combined Non-<br>Guarantor<br>Subsidiaries | Elimination    | Consolidated |
|---|-------------------|-------------|---------------------------------------|--|----------------|--------------|
| <b>Assets</b>   |                   |             |                                       |  |                |              |
| Real estate investments, net<br>of accumulated depreciation       | \$63              | \$—         | \$1,426,998                           | \$ 141,207                                 | \$—            | \$1,568,268  |
| Loans receivable and other<br>investments, net                    | —                 | —           | 250,674                               | —  | —              | 250,674      |
| Cash and cash equivalents   | 21,475            | —           | —                                     | 4,004                                      | —              | 25,479       |
| Restricted cash   | —                 | —           | 160                                   | 6,377                                      | —              | 6,537        |
| Deferred tax assets   | 24,212            | —           | —                                     | —  | —              | 24,212       |
| Prepaid expenses, deferred<br>financing costs and other<br>assets | 977               | 20,920      | 112,615                               | 7,684                                      | —              | 142,196      |
| Intercompany  | 230,614           | 965,828     | —                                     | —  | (1,196,442 )   | —            |
| Investment in subsidiaries  | 417,157           | 602,179     | 24,887                                | —  | (1,044,223 )   | —            |
| Total assets  | \$694,498         | \$1,588,927 | \$1,815,334                           | \$ 159,272                                 | \$(2,240,665 ) | \$2,017,366  |
| <b>Liabilities</b>  |                   |             |                                       |  |                |              |
| Mortgage notes  | \$—               | \$—         | \$—                                   | \$ 124,714                                 | \$—            | \$124,714    |
| Revolving credit facility   | —                 | 614,000     | —                                     | —  | —              | 614,000      |
| Senior unsecured notes  | —                 | 550,000     | —                                     | —  | —              | 550,000      |
| Accounts payable and<br>accrued liabilities                       | 6,536             | 7,770       | 24,864                                | 1,549                                      | —              | 40,719       |
| Tax liability   | 24,212            | —           | —                                     | —  | —              | 24,212       |
| Intercompany  | —                 | —           | 1,191,119                             | 5,323                                      | (1,196,442 )   | —            |
| Total liabilities   | 30,748            | 1,171,770   | 1,215,983                             | 131,586                                    | (1,196,442 )   | 1,353,645    |
| Total equity  | 663,750           | 417,157     | 599,351                               | 27,686                                     | (1,044,223 )   | 663,721      |
| Total liabilities and equity                                      | \$694,498         | \$1,588,927 | \$1,815,334                           | \$ 159,272                                 | \$(2,240,665 ) | \$2,017,366  |

## CONDENSED CONSOLIDATING BALANCE SHEET

December 31, 2013

(in thousands)

|   | Parent<br>Company | Issuers   | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-<br>Guarantor<br>Subsidiaries | Elimination    | Consolidated |
|---|-------------------|-----------|---------------------------------------|---|----------------|--------------|
| <b>Assets</b>   |                   |           |                                       |   |                |              |
| Real estate investments,<br>net of accumulated<br>depreciation    | \$101             | \$—       | \$751,771                             | \$163,546                                     | \$—            | \$915,418    |
| Loans receivable and<br>other investments, net                    | —                 | —         | 185,293                               | —   | —              | 185,293      |
| Cash and cash equivalents   | 3,551             | —         | —                                     | 757   | —              | 4,308        |
| Restricted cash   | —                 | —         | 121                                   | 5,231   | —              | 5,352        |
| Deferred tax assets   | 24,212            | —         | —                                     | —   | —              | 24,212       |
| Prepaid expenses,<br>deferred financing costs<br>and other assets | 1,217             | 9,207     | 46,694                                | 6,134   | —              | 63,252       |
| Intercompany  | 63,125            | 270,194   | —                                     | 42,637  | (375,956 )     | —            |
| Investment in subsidiaries  | 398,640           | 537,505   | 25,205                                | —   | (961,350 )     | —            |
| Total assets  | \$490,846         | \$816,906 | \$1,009,084                           | \$218,305                                     | \$(1,337,306 ) | \$1,197,835  |
| <b>Liabilities</b>  |                   |           |                                       |   |                |              |
| Mortgage notes  | \$—               | \$—       | \$—                                   | \$141,328                                     | \$—            | \$141,328    |
| Secured revolving credit<br>facility                              | —                 | —         | 135,500                               | —   | —              | 135,500      |
| Senior unsecured notes  | —                 | 414,402   | —                                     | —   | —              | 414,402      |
| Accounts payable and<br>accrued liabilities                       | 6,470             | 3,864     | 11,008                                | 887   | —              | 22,229       |
| Tax liability   | 24,212            | —         | —                                     | —   | —              | 24,212       |
| Intercompany  | —                 | —         | 375,956                               | —   | (375,956 )     | —            |
| Total liabilities   | 30,682            | 418,266   | 522,464                               | 142,215                                       | (375,956 )     | 737,671      |
| Total equity  | 460,164           | 398,640   | 486,620                               | 76,090  | (961,350 )     | 460,164      |
| Total liabilities and equity                                      | \$490,846         | \$816,906 | \$1,009,084                           | \$218,305                                     | \$(1,337,306 ) | \$1,197,835  |

## CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the Three Months Ended September 30, 2014

(dollars in thousands, except per share amounts)

(unaudited)

|   | Parent Company Issuers |          | Combined<br>Guarantor<br>Subsidiaries | Combined Non-<br>Guarantor<br>Subsidiaries | Elimination | Consolidated |   |
|---|------------------------|----------|---------------------------------------|--|-------------|--------------|---|
| Revenues:   |                        |          |                                       |  |             |              |   |
| Rental income   | \$ —                   | \$—      | \$33,290                              | \$ 4,875                                   | \$—         | \$38,165     |   |
| Interest and other income                                     | 2                      | —        | 5,141                                 | 676  | —           | 5,819        |   |
| Total revenues  | 2                      | —        | 38,431                                | 5,551                                      | —           | 43,984       |   |
| Expenses:   |                        |          |                                       |  |             |              |   |
| Depreciation and<br>amortization                              | 13                     | —        | 8,288                                 | 1,461                                      | —           | 9,762        |   |
| Interest  | —                      | 8,435    | 749                                   | 1,356                                      | —           | 10,540       |   |
| General and administrative                                    | 3,573                  | —        | 2,133                                 | 520  | —           | 6,226        |   |
| Total expenses  | 3,586                  | 8,435    | 11,170                                | 3,337                                      | —           | 26,528       |   |
| Other (expense) income:                                       |                        |          |                                       |  |             |              |   |
| Loss on extinguishment of<br>debt                             | —                      | —        | (158                                  | ) —  | —           | (158         | ) |
| Other income (expense)  | —                      | —        | (100                                  | ) —  | —           | (100         | ) |
| Total other (expense)<br>income                               | —                      | —        | (258                                  | ) —  | —           | (258         | ) |
| Income in subsidiary  | 20,788                 | 29,223   | 1,304                                 | —  | (51,315     | ) —          |   |
| Net income  | 17,204                 | 20,788   | 28,307                                | 2,214                                      | (51,315     | ) 17,198     |   |
| Net loss attributable to<br>noncontrolling interests          | —                      | —        | —                                     | 6  | —           | 6            |   |
| Net income attributable to<br>Sabra Health Care REIT,<br>Inc. | 17,204                 | 20,788   | 28,307                                | 2,220                                      | (51,315     | ) 17,204     |   |
| Preferred stock dividends                                     | (2,561                 | ) —      | —                                     | —  | —           | (2,561       | ) |
| Net income attributable to<br>common stockholders             | \$ 14,643              | \$20,788 | \$28,307                              | \$ 2,220                                   | \$(51,315   | ) \$14,643   |   |
| Net income attributable to<br>common stockholders, per:       |                        |          |                                       |  |             |              |   |
| Basic common share  |                        |          |                                       |  |             | \$0.31       |   |
| Diluted common share  |                        |          |                                       |  |             | \$0.31       |   |
| Weighted-average number<br>of common shares                   |                        |          |                                       |  |             | 47,359,949   |   |

|                         |            |
|-------------------------|------------|
| outstanding, basic      |            |
| Weighted-average number |            |
| of common shares        | 47,877,202 |
| outstanding, diluted    |            |

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## CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the Three Months Ended September 30, 2013

(dollars in thousands, except per share amounts)

(unaudited)

|   | Parent Company Issuers |           | Combined<br>Guarantor<br>Subsidiaries | Combined Non-<br>Guarantor<br>Subsidiaries | Elimination | Consolidated |
|---|------------------------|-----------|---------------------------------------|--|-------------|--------------|
| Revenues:   |                        |           |                                       |  |             |              |
| Rental income   | \$ —                   | \$—       | \$24,380                              | \$ 7,319                                   | \$—         | \$31,699     |
| Interest and other income   | 13                     | —         | 1,214                                 | —  | —           | 1,227        |
| Total revenues  | 13                     | —         | 25,594                                | 7,319                                      | —           | 32,926       |
| Expenses:   |                        |           |                                       |  |             |              |
| Depreciation and<br>amortization                                    | 13                     | —         | 6,365                                 | 1,880                                      | —           | 8,258        |
| Interest  | —                      | 7,147     | 817                                   | 1,775                                      | —           | 9,739        |
| General and administrative  | 2,996                  | —         | 41                                    | 20   | —           | 3,057        |
| Total expenses  | 3,009                  | 7,147     | 7,223                                 | 3,675                                      | —           | 21,054       |
| Other (expense) income:   |                        |           |                                       |  |             |              |
| Loss on extinguishment of<br>debt                                   | —                      | —         | (351                                  | ) —  | —           | (351 )       |
| Other income (expense)  | —                      | —         | 300                                   | —  | —           | 300          |
| Total other (expense)<br>income                                     | —                      | —         | (51                                   | ) —  | —           | (51 )        |
| Income in subsidiary  | 14,817                 | 21,964    | 982                                   | —  | (37,763 )   | —            |
| Net income  | 11,821                 | 14,817    | 19,302                                | 3,644                                      | (37,763 )   | 11,821       |
| Preferred dividends   | (2,579 )               | —         | —                                     | —  | —           | (2,579 )     |
| Net income attributable to<br>common stockholders                   | \$ 9,242               | \$ 14,817 | \$ 19,302                             | \$ 3,644                                   | \$(37,763 ) | \$ 9,242     |
| Net loss attributable to<br>common stockholders, per:               |                        |           |                                       |  |             |              |
| Basic common share  |                        |           |                                       |  |             | \$0.25       |
| Diluted common share  |                        |           |                                       |  |             | \$0.24       |
| Weighted-average number<br>of common shares<br>outstanding, basic   |                        |           |                                       |  |             | 37,358,334   |
| Weighted-average number<br>of common shares<br>outstanding, diluted |                        |           |                                       |  |             | 37,828,573   |





## CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the Nine Months Ended September 30, 2014

(dollars in thousands, except per share amounts)

(unaudited)

|   | Parent Company Issuers |           | Combined<br>Guarantor<br>Subsidiaries | Combined Non-<br>Guarantor<br>Subsidiaries | Elimination | Consolidated |
|---|------------------------|-----------|---------------------------------------|--|-------------|--------------|
| Revenues:   |                        |           |                                       |  |             |              |
| Rental income   | \$ —                   | \$—       | \$97,384                              | \$ 14,359                                  | \$—         | \$111,743    |
| Interest and other income                               | 9                      | —         | 14,039                                | 2,016                                      | —           | 16,064       |
| Total revenues  | 9                      | —         | 111,423                               | 16,375                                     | —           | 127,807      |
| Expenses:   |                        |           |                                       |  |             |              |
| Depreciation and amortization                           | 38                     | —         | 24,642                                | 4,187                                      | —           | 28,867       |
| Interest  | —                      | 24,189    | 4,642                                 | 3,837                                      | —           | 32,668       |
| General and administrative                              | 12,133                 | 2         | 6,142                                 | 1,728                                      | —           | 20,005       |
| Total expenses  | 12,171                 | 24,191    | 35,426                                | 9,752                                      | —           | 81,540       |
| Other (expense) income:                                 |                        |           |                                       |  |             |              |
| Loss on extinguishment of debt                          | —                      | (21,846   | ) (472                                | ) (136                                     | ) —         | (22,454      |
| Other income (expense)                                  | —                      | —         | 860                                   | —  | —           | 860          |
| Total other (expense) income                            | —                      | (21,846   | ) 388                                 | (136                                       | ) —         | (21,594      |
| Income in subsidiary                                    | 36,864                 | 82,901    | 4,368                                 | —  | (124,133    | ) —          |
| Net income  | 24,702                 | 36,864    | 80,753                                | 6,487                                      | (124,133    | ) 24,673     |
| Net loss attributable to noncontrolling interests       | —                      | —         | —                                     | 29   | —           | 29           |
| Net income attributable to Sabra Health Care REIT, Inc. | 24,702                 | 36,864    | 80,753                                | 6,516                                      | (124,133    | ) 24,702     |
| Preferred dividends                                     | (7,682                 | ) —       | —                                     | —  | —           | (7,682       |
| Net income attributable to common stockholders          | \$ 17,020              | —\$36,864 | \$80,753                              | —\$ 6,516                                  | \$(124,133  | ) \$17,020   |
| Net income attributable to common stockholders, per:    |                        |           |                                       |  |             |              |
| Basic common share                                      |                        |           |                                       |  |             | \$0.39       |
| Diluted common share                                    |                        |           |                                       |  |             | \$0.39       |

|  |            |
|--|------------|
| Weighted-average<br>number of common<br>shares outstanding, basic      | 43,358,620 |
| Weighted-average<br>number of common<br>shares outstanding,<br>diluted | 43,840,550 |

## CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the Nine Months Ended September 30, 2013

(dollars in thousands, except per share amounts)

(unaudited)

|  | Parent Company Issuers |          | Combined<br>Guarantor<br>Subsidiaries | Combined Non-<br>Guarantor<br>Subsidiaries | Elimination | Consolidated |
|--|------------------------|----------|---------------------------------------|--|-------------|--------------|
| Revenues:  |                        |          |                                       |  |             |              |
| Rental income  | \$ —                   | \$—      | \$72,733                              | \$ 21,959                                  | \$—         | \$94,692     |
| Interest and other income  | 82                     | —        | 2,449                                 | —  | —           | 2,531        |
| Total revenues   | 82                     | —        | 75,182                                | 21,959                                     | —           | 97,223       |
| Expenses:  |                        |          |                                       |  |             |              |
| Depreciation and<br>amortization                                       | 38                     | —        | 18,983                                | 5,705                                      | —           | 24,726       |
| Interest   | —                      | 21,585   | 2,797                                 | 5,502                                      | —           | 29,884       |
| General and<br>administrative  | 10,671                 | 4        | 453                                   | 68   | —           | 11,196       |
| Total expenses   | 10,709                 | 21,589   | 22,233                                | 11,275                                     | —           | 65,806       |
| Other (expense) income:  |                        |          |                                       |  |             |              |
| Loss on extinguishment<br>of debt                                      | —                      | (9,750 ) | (351 )                                | —  | —           | (10,101 )    |
| Other income (expense)   | —                      | —        | (600 )                                | —  | —           | (600 )       |
| Total other (expense)<br>income  | —                      | (9,750 ) | (951 )                                | —  | —           | (10,701 )    |
| Income in subsidiary   | 31,343                 | 62,682   | 2,892                                 | —  | (96,917 )   | —            |
| Net income   | 20,716                 | 31,343   | 54,890                                | 10,684                                     | (96,917 )   | 20,716       |
| Preferred dividends  | (5,406 )               | —        | —                                     | —  | —           | (5,406 )     |
| Net income attributable<br>to common stockholders                      | \$ 15,310              | \$31,343 | \$54,890                              | \$ 10,684                                  | \$(96,917 ) | \$15,310     |
| Net income attributable<br>to common stockholders,<br>per:             |                        |          |                                       |  |             |              |
| Basic common share   |                        |          |                                       |  |             | \$0.41       |
| Diluted common share   |                        |          |                                       |  |             | \$0.41       |
| Weighted-average<br>number of common<br>shares outstanding, basic      |                        |          |                                       |  |             | 37,334,120   |
| Weighted-average<br>number of common<br>shares outstanding,<br>diluted |                        |          |                                       |  |             | 37,777,458   |



## CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

For the Nine Months Ended September 30, 2014

(in thousands)

(unaudited)

|   | Parent Company | Issuers    | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-<br>Guarantor<br>Subsidiaries | Elimination  | Consolidated |
|---|----------------|------------|---------------------------------------|---|--------------|--------------|
| Net cash (used in)<br>provided by operating<br>activities | \$ 40,289      | \$—        | \$—                                   | \$30,950                                      | \$—          | \$71,239     |
| Cash flows from investing<br>activities:                  |                |            |                                       |   |              |              |
| Acquisitions of real estate                               | —              | —          | (713,778 )                            | (8,101 )                                      | —            | (721,879 )   |
| Origination of loans<br>receivable                        | —              | —          | (59,256 )                             | —   | —            | (59,256 )    |
| Preferred equity<br>investment                            | —              | —          | (11,300 )                             | —   | —            | (11,300 )    |
| Additions to real estate                                  | —              | —          | (1,128 )                              | (23 )   | —            | (1,151 )     |
| Repayment of loans<br>receivable                          | —              | —          | 287                                   | —   | —            | 287          |
| Investment in subsidiaries                                | (12,288 )      | (12,288 )  | —                                     | —   | 24,576       | —            |
| Intercompany financing                                    | (182,248 )     | (915,786 ) | —                                     | —   | 1,098,034    | —            |
| Net cash used in investing<br>activities                  | (194,536 )     | (928,074 ) | (785,175 )                            | (8,124 )                                      | 1,122,610    | (793,299 )   |
| Cash flows from<br>financing activities:                  |                |            |                                       |   |              |              |
| Proceeds from issuance of<br>senior unsecured notes       | —              | 350,000    | —                                     | —   | —            | 350,000      |
| Principal payments on<br>senior unsecured notes           | —              | (211,250 ) | —                                     | —   | —            | (211,250 )   |
| Proceeds from revolving<br>credit facility                | —              | 604,000    | 95,000                                | —   | —            | 699,000      |
| Payments on revolving<br>credit facility                  | —              | —          | (220,500 )                            | —   | —            | (220,500 )   |
| Proceeds from mortgage<br>notes                           | —              | —          | —                                     | 57,703  | —            | 57,703       |
| Principal payments on<br>mortgage notes                   | —              | —          | —                                     | (88,419 )                                     | —            | (88,419 )    |
| Payments of deferred<br>financing costs                   | —              | (9,212 )   | (5,111 )                              | (1,151 )                                      | —            | (15,474 )    |
| Issuance of common<br>stock                               | 229,825        | —          | —                                     | —   | —            | 229,825      |
| Dividends paid on<br>common and preferred<br>stock        | (57,654 )      | —          | —                                     | —   | —            | (57,654 )    |
| Contribution from Parent                                  | —              | 12,288     | —                                     | 12,288  | (24,576 )    | —            |
| Intercompany financing                                    | —              | 182,248    | 915,786                               | —   | (1,098,034 ) | —            |
|   | 172,171        | 928,074    | 785,175                               | (19,579 )                                     | (1,122,610 ) | 743,231      |

Net cash provided by  
(used in) financing  
activities

|  |           |     |     |         |     |          |
|--|-----------|-----|-----|---------|-----|----------|
| Net increase in cash and cash equivalents      | 17,924    | —   | —   | 3,247   | —   | 21,171   |
| Cash and cash equivalents, beginning of period | 3,551     | —   | —   | 757     | —   | 4,308    |
| Cash and cash equivalents, end of period       | \$ 21,475 | \$— | \$— | \$4,004 | \$— | \$25,479 |

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## CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

For the Nine Months Ended September 30, 2013

(in thousands)

(unaudited)

|  | Parent Company | Issuers    | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-<br>Guarantor<br>Subsidiaries | Elimination | Consolidated |
|--|----------------|------------|---------------------------------------|---|-------------|--------------|
| Net cash provided by operating activities            | \$ 36,878      | \$—        | \$—                                   | \$12,333                                      | \$—         | \$49,211     |
| Cash flows from investing activities:                |                |            |                                       |   |             |              |
| Acquisitions of real estate                          | —              | —          | (6,175 )                              | —   | —           | (6,175 )     |
| Origination of note receivable                       | —              | —          | (26,393 )                             | —   | —           | (26,393 )    |
| Preferred equity investment                          | —              | —          | (6,624 )                              | —   | —           | (6,624 )     |
| Additions to real estate                             | —              | —          | (388 )                                | —   | —           | (388 )       |
| Net proceeds from the sale of real estate            | —              | —          | —                                     | 2,208   | —           | 2,208        |
| Distribution from subsidiaries                       | 3,345          | 3,345      | —                                     | —   | (6,690 )    | —            |
| Intercompany financing                               | (52,041 )      | (132,883 ) | —                                     | —   | 184,924     | —            |
| Net cash (used in) provided by investing activities  | (48,696 )      | (129,538 ) | (39,580 )                             | 2,208   | 178,234     | (37,372 )    |
| Cash flows from financing activities:                |                |            |                                       |   |             |              |
| Proceeds from issuance of senior unsecured notes     | —              | 200,000    | —                                     | —   | —           | 200,000      |
| Principal payments on senior unsecured notes         | —              | (113,750 ) | —                                     | —   | —           | (113,750 )   |
| Payments on secured revolving credit facility        | —              | —          | (92,500 )                             | —   | —           | (92,500 )    |
| Principal payments on mortgage notes                 | —              | —          | —                                     | (10,081 )                                     | —           | (10,081 )    |
| Payments of deferred financing costs                 | —              | (5,408 )   | (3,011 )                              | (179 )  | —           | (8,598 )     |
| Issuance of common stock                             | (2,950 )       | —          | —                                     | —   | —           | (2,950 )     |
| Issuance of preferred stock                          | 138,257        | —          | —                                     | —   | —           | 138,257      |
| Dividends paid                                       | (42,677 )      | —          | —                                     | —   | —           | (42,677 )    |
| Distribution to Parent                               | —              | (3,345 )   | —                                     | (3,345 )                                      | 6,690       | —            |
| Intercompany financing                               | —              | 52,041     | 135,091                               | (2,208 )                                      | (184,924 )  | —            |
| Net cash provided by (used in) financing activities  | 92,630         | 129,538    | 39,580                                | (15,813 )                                     | (178,234 )  | 67,701       |
| Net increase (decrease) in cash and cash equivalents | 80,812         | —          | —                                     | (1,272 )                                      | —           | 79,540       |
| Cash and cash equivalents, beginning of period       | 15,075         | —          | —                                     | 2,026   | —           | 17,101       |
| Cash and cash equivalents, end of period             | \$ 95,887      | \$—        | \$—                                   | \$754   | \$—         | \$96,641     |





Table of Contents**11. PRO FORMA FINANCIAL INFORMATION**

The following table summarizes, on an unaudited pro forma basis, the consolidated results of operations of the Company for the three and nine months ended September 30, 2014 and 2013. The Company acquired six skilled nursing facilities and 27 senior housing facilities during the nine months ended September 30, 2014. The following unaudited pro forma information has been prepared to give effect to these acquisitions as if these acquisitions occurred on January 1, 2013. This pro forma information does not purport to represent what the actual results of operations of the Company would have been had these acquisitions occurred on January 1, 2013, nor does it purport to predict the results of operations for future periods.

|  | Three Months Ended<br>September 30,                |            | Nine Months Ended<br>September 30, |            |
|--|--|------------|------------------------------------|------------|
|  | 2014   | 2013       | 2014                               | 2013       |
|  | (in thousands, except share and per share amounts) |            |                                    |            |
| Revenues   | \$53,706   | \$46,572   | \$160,491                          | \$138,159  |
| Depreciation and amortization                                    | 13,483   | 13,004     | 40,573                             | 38,933     |
| Net income attributable to common stockholders                   | 22,456   | 16,328     | 40,221                             | 39,818     |
| Net income attributable to common stockholders, per:             |  |            |                                    |            |
| Basic common share   | \$0.47   | \$0.44     | \$0.93                             | \$1.07     |
| Diluted common share   | \$0.47   | \$0.43     | \$0.92                             | \$1.05     |
| Weighted-average number of common shares<br>outstanding, basic   | 47,359,949   | 37,358,334 | 43,358,620                         | 37,334,120 |
| Weighted-average number of common shares<br>outstanding, diluted | 47,877,202   | 37,828,573 | 43,840,550                         | 37,777,458 |

**12. COMMITMENTS AND CONTINGENCIES****Environmental**

As an owner of real estate, the Company is subject to various environmental laws of federal, state and local governments. The Company is not aware of any environmental liability that could have a material adverse effect on its financial condition or results of operations. However, changes in applicable environmental laws and regulations, the uses and conditions of properties in the vicinity of the Company's properties, the activities of its tenants and other environmental conditions of which the Company is unaware with respect to the properties could result in future environmental liabilities. Compliance with existing environmental laws is not expected to have a material adverse effect on the Company's financial condition and results of operations as of September 30, 2014.

**Income Taxes**

As a result of the Company's separation from Sun Healthcare Group, Inc. ("Sun") effective November 15, 2010 (the "Separation Date"), the Company is the surviving taxpayer for income tax purposes. Accordingly, tax positions taken prior to the Separation Date remained the Company's obligations after the Separation Date. Sun agreed to indemnify the Company against, among other things, federal, state and local taxes (including penalties and interest) related to periods prior to the Separation Date to the extent the deferred tax assets allocated to the Company are not sufficient and/or cannot be utilized to satisfy these taxes.

Effective December 1, 2012, Sun was acquired by Genesis HealthCare LLC ("Genesis"). As a result of its acquisition of Sun, Genesis became successor to the obligations of Sun described above.

**Legal Matters**

From time to time, the Company is party to legal proceedings that arise in the ordinary course of its business, including claims made before the Separation Date. Management is not aware of any legal proceedings where the

likelihood of a loss contingency is reasonably possible and the amount or range of reasonably possible losses is material to the Company's results of operations, financial condition or cash flows.

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13. SUBSEQUENT EVENTS

The Company evaluates subsequent events up until the date the condensed consolidated financial statements are issued.

Dividend Declaration

On November 3, 2014, the Company announced that its board of directors declared a quarterly cash dividend of \$0.39 per share of common stock. The dividend will be paid on November 26, 2014 to common stockholders of record as of the close of business on November 14, 2014.

On November 3, 2014, the Company also announced that its board of directors declared a quarterly cash dividend of \$0.4453125 per share of Series A Preferred Stock. The dividend will be paid on November 26, 2014 to preferred stockholders of record as of the close of business on November 14, 2014.

Investments

Subsequent to September 30, 2014, the Company invested \$81.7 million in four skilled nursing/transitional care facilities, four senior housing facilities and one debt investment.

Debt and Equity Offering

See Note 6, "Debt" and Note 8, "Equity" for details regarding the Company's October 2014 offering of an additional \$150.0 million aggregate principal amount of 2021 Notes and the Company's October 2014 equity offering.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The discussion below contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those which are discussed in the "Risk Factors" section in Part I, Item 1A of our 2013 Annual Report on Form 10-K. Also see "Statement Regarding Forward-Looking Statements" preceding Part I.

The following discussion and analysis should be read in conjunction with our accompanying condensed consolidated financial statements and the notes thereto.

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is organized as follows:

Overview

Recent Transactions

Critical Accounting Policies

Recently Issued Accounting Standards Update

Results of Operations

Liquidity and Capital Resources

Concentration of Credit Risk

Skilled Nursing Facility Reimbursement Rates

Obligations and Commitments

Off-Balance Sheet Arrangements

Overview

We began operating on November 15, 2010 as a self-administered, self-managed REIT that, directly or indirectly, owns and invests in real estate serving the healthcare industry.

Our investment portfolio is primarily comprised of skilled nursing/transitional care facilities, senior housing facilities, acute care hospitals, debt investments and preferred equity investments.

We expect to continue to grow our portfolio primarily through the acquisition of assisted living, independent living and memory care facilities and with a secondary focus on acquiring skilled nursing and transitional care facilities. We have and will continue to opportunistically acquire other types of healthcare real estate (including acute care hospitals) and originate financing secured directly or indirectly by healthcare facilities. We also expect to expand our portfolio through the development of purpose-built healthcare facilities through pipeline agreements and other arrangements with select developers. We further expect to work with existing operators to identify strategic development opportunities. These opportunities may involve replacing or renovating facilities in our portfolio that may have become less competitive and new development opportunities that present attractive risk-adjusted returns. In addition to pursuing acquisitions with triple-net leases, we expect to continue to pursue other forms of investment, including investments in senior housing through RIDEA-compliant structures, mezzanine and secured debt investments, and joint ventures for senior housing, memory care and skilled nursing assets.

With respect to our debt investments, in general, we originate loans when an attractive investment opportunity is presented and either (a) the property is under development or (b) the development of the property is completed but the operations of the facility are not yet stabilized. A key component of our strategy related to loan originations is our having the option to purchase the underlying real estate that secures our loan investments. These options become exercisable upon the occurrence of various criteria, such as the passage of time or the achievement of certain operating goals, and the purchase price is set in advance based on the same valuation methods we use to value our investments in healthcare real estate. This strategy allows us to diversify our revenue streams and build relationships with operators and developers, and provides us with the option to add new properties to our existing real estate portfolio if we determine that those properties enhance our investment portfolio and stockholder value at the time the options are exercisable.

As we acquire additional properties and expand our portfolio, we expect to further diversify by tenant, asset class and geography within the healthcare sector. We employ a disciplined, opportunistic approach in our healthcare real estate investment strategy by investing in assets that provide attractive opportunities for dividend growth and appreciation of asset values, while maintaining balance sheet strength and liquidity, thereby creating long-term stockholder value.

We elected to be treated as a REIT with the filing of our U.S. federal income tax return for the taxable year beginning January 1, 2011. We believe that we have been organized and have operated, and we intend to continue to operate, in a manner to qualify as a REIT. We operate through an umbrella partnership (commonly referred to as an UPREIT) structure in which substantially all of our properties and assets are held by Sabra Health Care Limited Partnership, a Delaware limited partnership

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(the “Operating Partnership”), of which we are the sole general partner, or by subsidiaries of the Operating Partnership.

### Recent Transactions

#### Issuance of Senior Notes

On October 10, 2014, the Operating Partnership and Sabra Capital Corporation (the “Issuers”) issued an additional \$150.0 million aggregate principal amount of 5.5% senior unsecured notes (the “2021 Notes”), which are treated as a single class with, and have the same terms as, the existing 2021 Notes. The notes were issued at 99.5% providing net proceeds of approximately \$145.8 million (not including pre-issuance accrued interest), after deducting underwriting discounts and other offering expenses and a yield-to-maturity of 5.593%. We used the proceeds from this offering to repay borrowings outstanding under the Revolving Credit Facility (defined below).

#### Equity Offering

On October 3, 2014, we completed an underwritten public offering of 6.9 million newly issued shares of our common stock pursuant to an effective registration statement. We received net proceeds, before expenses, of \$160.6 million from the offering, after giving effect to the issuance and sale of all 6.9 million shares of common stock (which included 0.9 million shares sold to the underwriters upon exercise of their option to purchase additional shares), at a price to the public of \$24.25 per share. We used the proceeds from this offering to repay borrowings outstanding under the Revolving Credit Facility.

#### Investments

Subsequent to September 30, 2014, we invested \$81.7 million in four skilled nursing/transitional care facilities, four senior housing facilities and one debt investment.

#### Avalon Portfolio

On September 29, 2014, we acquired four memory care facilities with a total of 115 beds located in Fort Worth and Arlington, Texas from affiliates of Avalon Care Group for \$25.9 million. Concurrently with the purchase, we entered into a triple-net master lease agreement with affiliates of the seller. The lease has an initial term of 10 years with two 5-year renewal options and provides for an annual rent escalator equal to the greater of 3.0% or the change in the Consumer Price Index, not to exceed 4.0%. The initial yield on cash rent is 7.75% with \$2.3 million in annual lease revenues determined in accordance with GAAP.

#### Holiday Portfolio

On September 25, 2014, we acquired a portfolio of 21 independent living facilities (the “Holiday Portfolio”), located in 15 states, from affiliates of Holiday Acquisition Holdings Corp. (“Holiday”) for a total cash purchase price of \$550.0 million. Concurrently with the acquisition, we entered into a triple-net master lease agreement with certain wholly-owned subsidiaries of Holiday AL Holdings LP (collectively, “Holiday Tenant”), an affiliate of Holiday. The master lease has an initial term of 15 years with two five-year renewal options and provides for base rent in the first year of approximately \$30.3 million, with annual rent increases of 4.0% in years two and three and the greater of 3.5% or the change in the Consumer Price Index during the remainder of the lease term. The master lease is expected to generate annual lease revenues determined in accordance with GAAP, of \$39.3 million. The closing of the acquisition of one facility was deferred until October 7, 2014 and Holiday Tenant agreed to pay the full rental amount due under the lease notwithstanding the delay in the closing of the acquisition of this facility.

#### Revolving Credit Facility and Term Loan

On September 10, 2014, the Operating Partnership entered into a second amended and restated unsecured revolving credit facility (the “Revolving Credit Facility”). The Revolving Credit Facility provides for a borrowing capacity of \$650.0 million and provides an accordion feature allowing for an additional \$100.0 million of capacity, subject to terms and conditions, resulting in a maximum borrowing capacity of \$750.0 million. The Operating Partnership also has an option to convert up to \$200.0 million of the Revolving Credit Facility to a term loan subject to terms and conditions. While the Prior Revolving Credit Facility (as defined in Note 6, “Debt,” in the Notes to the Condensed Consolidated Financial Statements) was secured by pledges of equity by our wholly owned subsidiaries that own certain of our real estate assets, the Revolving Credit Facility is unsecured.

On October 10, 2014, the Operating Partnership converted \$200.0 million of the outstanding borrowings under the Revolving Credit Facility to a term loan. Concurrent with the term loan conversion, we entered into a five-year interest rate cap contract that caps LIBOR at 2.0%.



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The Revolving Credit Facility, including amounts that are converted into a term loan, has a maturity date of September 10, 2018, and includes a one year extension option. Borrowings under the Revolving Credit Facility bear interest on the outstanding principal amount at a rate equal to an applicable percentage plus, at the Operating Partnership's option, either (a) LIBOR or (b) a base rate determined as the greater of (i) the federal funds rate plus 0.5%, (ii) the prime rate, and (iii) one-month LIBOR plus 1.0% (the "Base Rate"). The applicable percentage for borrowings will vary based on the Consolidated Leverage Ratio, as defined in the Revolving Credit Facility, and will range from 2.00% to 2.60% per annum for LIBOR based borrowings and 1.00% to 1.60% per annum for borrowings at the Base Rate. In addition, the Operating Partnership is required to pay an unused fee to the lenders equal to 0.25% or 0.35% per annum based on the amount of unused borrowings under the Revolving Credit Facility. See Note 6, "Debt," in the Notes to the Condensed Consolidated Financial Statements for further information.

### Meridian Mezzanine Loan

On August 15, 2014, we originated a \$15.5 million mezzanine loan (the "Meridian Mezzanine Loan") with affiliates of Meridian ALZ Investors, LLC ("Meridian") in connection with our previously announced pipeline agreement with Meridian. The proceeds of the mezzanine loan were be used to repay our existing preferred equity investment in an affiliate of Meridian totaling \$8.3 million (including accrued and unpaid preferred returns), resulting in a net investment by us of \$7.2 million. The Meridian Mezzanine Loan has a three-year term and bears interest at a fixed rate of 11.0% per annum. It is secured by Meridian's equity interest in two memory care facilities and a skilled nursing facility.

### Critical Accounting Policies

Our condensed consolidated interim financial statements have been prepared in accordance with GAAP and in conjunction with the rules and regulations of the SEC. The preparation of our financial statements requires significant management judgments, assumptions and estimates about matters that are inherently uncertain. These judgments affect the reported amounts of assets and liabilities and our disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. With different estimates or assumptions, materially different amounts could be reported in our financial statements. Additionally, other companies may utilize different estimates that may impact the comparability of our results of operations to those of companies in similar businesses. A discussion of the accounting policies that management considers critical in that they involve significant management judgments, assumptions and estimates is included in our 2013 Annual Report on Form 10-K filed with the SEC. There have been no significant changes to our critical accounting policies during the nine months ended September 30, 2014.

### Recently Issued Accounting Standards Update

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity ("ASU No. 2014-08"), which changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. Under the new guidance, a discontinued operation is defined as a disposal of a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. The standard no longer precludes presentation as a discontinued operation if (i) there are operations and cash flows of the component that have not been eliminated from the reporting entity's ongoing operations, or (ii) there is significant continuing involvement with a component after its disposal. ASU No. 2014-08 is effective for public entities for interim and annual periods beginning after December 15, 2014, and will be applied prospectively. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). ASU 2014-09 is a comprehensive new revenue recognition model requiring a company to recognize revenue to depict the transfer of goods or services to a customer at an amount reflecting the consideration it expects to receive in exchange for those goods or services. In adopting ASU 2014-09, companies may use either a full retrospective or a modified retrospective approach. Additionally, this guidance requires improved disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The guidance specifically notes that lease contracts with customers are a scope exception. ASU 2014-09 is effective for the first



interim period within annual reporting periods beginning after December 15, 2016, and early adoption is not permitted. We are currently in the process of evaluating the impact the adoption of ASU 2014-09 will have on our financial position or results of operations.

In August 2014, FASB issued ASU 2014-15, "Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." ASU 2014-15 requires management to evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, and to provide certain disclosures when it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued. ASU 2014-15 is effective for the annual

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period ended December 31, 2016 and for annual periods and interim periods thereafter with early adoption permitted. The adoption of ASU 2014-15 is not expected to materially impact our consolidated financial statements.

## Results of Operations

As of September 30, 2014, our investment portfolio included 154 real estate properties held for investment, 14 investments in loans receivable and four preferred equity investments. As of September 30, 2013, our investment portfolio included 120 real estate properties held for investment, six investments in loans receivable and two preferred equity investments. In general, we expect that our income and expenses related to our portfolio will increase in future periods as a result of investments made in 2014 and 2013 that we have owned for an entire period and anticipated future investments. The results of operations presented for the three and nine months ended September 30, 2014 and 2013 are not directly comparable due to the increase in investments made subsequent to the beginning of the respective comparable period in the preceding year.

Comparison of results of operations for the three months ended September 30, 2014 versus the three months ended September 30, 2013 (dollars in thousands):

|                                | Three Months Ended<br>September 30, |          | Increase<br>(Decrease) | Percentage<br>Difference | Increase due to                            |   |         |
|--------------------------------|-------------------------------------|----------|------------------------|--------------------------|--|---|---------|
|                                | 2014                                | 2013     |                        |                          | Acquisitions<br>and<br>Originations<br>(1) | Remaining<br>Increase<br>(Decrease) (2) |         |
| <b>Revenues:</b>               |                                     |          |                        |                          |  |   |         |
| Rental income                  | \$38,165                            | \$31,699 | \$6,466                | 20                       | %  | \$7,253                                 | \$(787) |
| Interest and other income      | 5,819                               | 1,227    | 4,592                  | 374                      | %  | 4,225                                   | 367     |
| <b>Expenses:</b>               |                                     |          |                        |                          |  |   |         |
| Depreciation and amortization  | 9,762                               | 8,258    | 1,504                  | 18                       | %  | 2,046                                   | (542)   |
| Interest                       | 10,540                              | 9,739    | 801                    | 8                        | %  | —                                       | 801     |
| General and administrative     | 6,226                               | 3,057    | 3,169                  | 104                      | %  | 1,897                                   | 1,272   |
| <b>Other (expense) income:</b> |                                     |          |                        |                          |  |   |         |
| Loss on extinguishment of debt | (158)                               | (351)    | 193                    | 55                       | %  | —                                       | 193     |
| Other income (expense)         | (100)                               | 300      | (400)                  | (133)                    | %  | —                                       | (400)   |

(1) Represents the dollar amount increase for the three months ended September 30, 2014 compared to the three months ended September 30, 2013 as a result of investments made on or after July 1, 2013.

(2) Represents the dollar amount increase (decrease) for the three months ended September 30, 2014 compared to the three months ended September 30, 2013 that is not a direct result of investments made after July 1, 2013.

## Rental Income

During the three months ended September 30, 2014, we recognized \$38.2 million of rental income compared to \$31.7 million for the three months ended September 30, 2013. The \$6.5 million increase in rental income is primarily due to an increase of \$7.3 million from properties acquired on or after July 1, 2013, partially offset by a decrease of \$0.8 million in rental income from properties acquired before April 1, 2013. The \$0.8 million decrease is primarily due to a \$0.6 million decrease related to the transition of operations on three facilities and the resulting modification of the lease terms and a \$0.2 million decrease due to the senior housing facility that is part of our RIDEA-compliant joint venture. The rental revenue related to the senior housing facility that is part of our RIDEA-compliant joint venture is eliminated upon consolidation. Amounts due under the terms of all of our lease agreements are subject to contractual increases, and there is no contingent rental income that may be derived from our properties.

## Interest and Other Income

During the three months ended September 30, 2014, we recognized \$5.8 million of interest and other income compared to \$1.2 million for the three months ended September 30, 2013. Interest and other income during the three months ended September 30, 2014 primarily consisted of income earned on our 14 loans receivable investments and preferred dividends on six preferred equity investments, two of which were repaid in August 2014. Our loans

receivable investments and preferred equity investments had a combined book value of \$250.7 million as of September 30, 2014. Interest and other income during the three months ended September 30, 2013 primarily consisted of income earned on six loans receivable investments and preferred dividends on our two preferred equity investments. These investments had a combined book value of \$46.1 million as of September 30, 2013. Interest and other income during the three months ended September 30, 2014 also includes \$0.7 million of operating revenues associated with the consolidation of our RIDEA-compliant joint venture. As a result of

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consolidating, we reflect the joint venture's operating revenues in our condensed consolidated statements of income beginning as of January 1, 2014.

Depreciation and Amortization

During the three months ended September 30, 2014, we incurred \$9.8 million of depreciation and amortization expense compared to \$8.3 million for the three months ended September 30, 2013. The \$1.5 million net increase in depreciation and amortization was primarily due to an increase of \$2.0 million from properties acquired on or after July 1, 2013, partially offset by a decrease of \$0.5 million related to assets that have been fully depreciated.

Interest Expense

We incur interest expense comprised of costs of borrowings plus the amortization of deferred financing costs related to our indebtedness. During the three months ended September 30, 2014, we incurred \$10.5 million of interest expense compared to \$9.7 million for the three months ended September 30, 2013. The \$0.8 million net increase is primarily related to (i) a \$5.1 million increase in interest expense and amortization of deferred financing costs related to the January 2014 issuance of the \$350.0 million aggregate principal amount of 2021 Notes (defined below) and (ii) a \$0.4 million increase in interest expense related to the borrowings outstanding on the Revolving Credit Facility during the three months ended September 30, 2014, partially offset by (x) a \$4.3 million net decrease in interest expense, amortization of deferred financing costs and premium related to the redemption of the then-outstanding 2018 Notes (defined below) completed in February 2014 and (y) a \$0.4 million decrease in interest expense primarily due to decreased interest rates on refinanced mortgage notes and the repayment of a \$29.8 million variable rate mortgage note.

General and Administrative Expenses

General and administrative expenses include compensation-related expenses as well as professional services, office costs, facility operating costs and other costs associated with acquisition pursuit activities. During the three months ended September 30, 2014, general and administrative expenses were \$6.2 million compared to \$3.1 million during the three months ended September 30, 2013. The \$3.2 million increase is primarily related to (i) a \$0.2 million increase in state income taxes, (ii) a \$0.2 million increase in legal, audit and professional fees, (iii) \$0.5 million of facility operating expenses, (iv) a \$1.8 million increase in acquisition pursuit costs from \$0.3 million during the three months ended September 30, 2013 to \$2.0 million during the three months ended September 30, 2014 and (v) a \$0.2 million increase in stock-based compensation. The increase in acquisition pursuit costs is primarily related to our acquisition of the Holiday Portfolio. The increase in stock-based compensation expense, from \$1.3 million during the three months ended September 30, 2013 to \$1.5 million during the three months ended September 30, 2014, is primarily the result of meeting certain performance criteria under the terms of our performance-based stock units. We expect stock-based compensation expense to fluctuate from period to period depending upon changes in our stock price and estimates associated with performance-based compensation.

Loss on Extinguishment of Debt

During the three months ended September 30, 2014 and 2013, we recognized \$0.2 million and \$0.4 million, respectively, of loss on debt extinguishment related to write-offs of deferred financing costs in connection with the Revolving Credit Facility.

Other Income (Expense)

During the three months ended September 30, 2014, we recognized \$0.1 million in other expense as a result of adjusting the fair value of our contingent consideration liability related to one acquisition of real estate properties (see Note 3, "Recent Real Estate Acquisitions" in the Notes to Condensed Consolidated Financial Statements for further details). During the three months ended September 30, 2013, we recognized \$0.3 million in other income as a result of adjusting the fair value of our contingent consideration liability related to the Stoney River Marshfield facility acquisition.

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Comparison of results of operations for the nine months ended September 30, 2014 versus the nine months ended September 30, 2013 (dollars in thousands):

|                                   | Nine Months Ended<br>September 30, |          | Increase /<br>(Decrease) | Percentage<br>Difference | Increase due to                            |   |           |
|-----------------------------------|------------------------------------|----------|--------------------------|--------------------------|--|---|-----------|
|                                   | 2014                               | 2013     |                          |                          | Acquisitions<br>and<br>Originations<br>(1) | Remaining<br>Increase<br>(Decrease) (2) |           |
| <b>Revenues:</b>                  |                                    |          |                          |                          |  |   |           |
| Rental income                     | \$111,743                          | \$94,692 | \$17,051                 | 18                       | %  | \$18,530                                | \$(1,479) |
| Interest and other income         | 16,064                             | 2,531    | 13,533                   | 535                      | %  | 11,319                                  | 2,214     |
| <b>Expenses:</b>                  |                                    |          |                          |                          |  |   |           |
| Depreciation and<br>amortization  | 28,867                             | 24,726   | 4,141                    | 17                       | %  | 5,646                                   | (1,505)   |
| Interest                          | 32,668                             | 29,884   | 2,784                    | 9                        | %  | —                                       | 2,784     |
| General and administrative        | 20,005                             | 11,196   | 8,809                    | 79                       | %  | 2,507                                   | 6,302     |
| <b>Other (expense) income:</b>    |                                    |          |                          |                          |  |   |           |
| Loss on extinguishment of<br>debt | (22,454)                           | (10,101) | (12,353)                 | (122)                    | %  | —                                       | (12,353)  |
| Other income (expense)            | 860                                | (600)    | 1,460                    | 243                      | %  | —                                       | 1,460     |

(1) Represents the dollar amount increase for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013 as a result of investments made on or after January 1, 2013.

(2) Represents the dollar amount increase (decrease) for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013 that is not a direct result of investments made after January 1, 2013.

**Rental Income**

During the nine months ended September 30, 2014, we recognized \$111.7 million of rental income compared to \$94.7 million for the nine months ended September 30, 2013. The \$17.1 million increase in rental income is primarily due to an increase of \$18.5 million from properties acquired on or after January 1, 2013, partially offset by a decrease of \$1.5 million in rental income. The \$1.5 million decrease is primarily due to a \$1.0 million decrease related to the transition of operations on three facilities and the resulting modification of the lease terms and a \$0.5 million decrease due to the senior housing facility that is part of our RIDEA-compliant joint venture. The rental revenue related to the senior housing facility that is part of our RIDEA-compliant joint venture is eliminated upon consolidation. Amounts due under the terms of all of our lease agreements are subject to contractual increases, and there is no contingent rental income that may be derived from our properties.

**Interest and Other Income**

During the nine months ended September 30, 2014, we recognized \$16.1 million of interest and other income compared to \$2.5 million for the nine months ended September 30, 2013. Interest and other income during the nine months ended September 30, 2014 primarily consisted of income earned on our 14 loans receivable investments and preferred dividends on six preferred equity investments, two of which were repaid in August 2014. Our loans receivable investments and preferred equity investments had a combined book value of \$250.7 million as of September 30, 2014. Interest and other income during the nine months ended September 30, 2013 primarily consisted of income earned on six loans receivable investments and preferred dividends on our two preferred equity investments. These investments had a combined book value of \$46.1 million as of September 30, 2013. Interest and other income during the nine months ended September 30, 2014 also includes operating revenues associated with consolidation of our RIDEA-compliant joint venture. As a result of consolidating, we reflect the joint venture's operating revenues of \$2.0 million in our condensed consolidated statements of income beginning as of January 1, 2014.

**Depreciation and Amortization**

During the nine months ended September 30, 2014, we incurred \$28.9 million of depreciation and amortization expense compared to \$24.7 million for the nine months ended September 30, 2013. The \$4.1 million net increase in

depreciation and amortization was primarily due to an increase of \$5.6 million from properties acquired on or after January 1, 2013, partially offset by a decrease of \$1.5 million related to assets that have been fully depreciated.

#### Interest Expense

We incur interest expense comprised of costs of borrowings plus the amortization of deferred financing costs related to our indebtedness. During the nine months ended September 30, 2014, we incurred \$32.7 million of interest expense compared to \$29.9 million for the nine months ended September 30, 2013. The \$2.8 million net increase is primarily related to (i) a \$14.2

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million increase in interest expense and amortization of deferred financing costs related to the January 2014 issuance of the \$350.0 million aggregate principal amount of 2021 Notes, (ii) a \$4.5 million increase in interest expense and amortization of deferred financing costs related to the May 2013 issuance of the \$200.0 million aggregate principal amount of 2023 Notes and (iii) a \$1.9 million increase in interest expense related to the borrowings outstanding on the Revolving Credit Facility during the nine months ended September 30, 2014, partially offset by (x) a \$16.5 million net decrease in interest expense, amortization of deferred financing costs and premium related to the redemption of the then-outstanding 2018 Notes completed in February 2014 and (y) a \$1.3 million decrease in interest expense primarily due to decreased interest rates on refinanced mortgage notes and the repayment of a \$29.8 million existing variable rate mortgage note.

**General and Administrative Expenses**

General and administrative expenses include compensation-related expenses as well as professional services, office costs, facility operating costs and other costs associated with acquisition pursuit activities. During the nine months ended September 30, 2014, general and administrative expenses were \$20.0 million compared to \$11.2 million during the nine months ended September 30, 2013. The \$8.8 million increase is primarily related to (i) a \$3.0 million straight-line rental income write-off primarily related to a change in ownership of one of our tenants and the resulting modification of the terms of a lease between us and the new tenant entity, (ii) a \$0.7 million increase in legal, audit and professional fees, (iii) a \$0.2 million holdback fee expense related to the Forest Park - Frisco contingent consideration, (iv) \$1.5 million of facility operating expenses, (v) a \$1.9 million increase in acquisition pursuit costs from \$0.7 million during the nine months ended September 30, 2013 to \$2.6 million during the nine months ended September 30, 2014 and (vi) a \$1.1 million increase in stock-based compensation. The increase in acquisition pursuit costs is primarily related to our acquisition of the Holiday Portfolio. The increase in stock-based compensation expense, from \$5.2 million during the nine months ended September 30, 2013 to \$6.3 million during the nine months ended September 30, 2014, is primarily the result of meeting certain performance criteria under the terms of our performance-based stock units. We expect acquisition pursuit costs to fluctuate from period to period depending on acquisition activity. We also expect stock-based compensation expense to fluctuate from period to period depending upon changes in our stock price and estimates associated with performance-based compensation.

**Loss on Extinguishment of Debt**

During the nine months ended September 30, 2014, we recognized \$22.5 million of loss on debt extinguishment. Of this amount, (i) \$21.7 million related to the redemption fee paid, the write-offs of deferred financing costs and issuance premium and legal fees paid in connection with the redemption of the then-outstanding 2018 Notes, (ii) \$0.6 million related to the write-offs of deferred financing costs in connection with our mortgage debt refinancing and repayment and (iii) \$0.2 million related to the write-offs of deferred financing costs in connection with the Revolving Credit Facility. During the nine months ended September 30, 2013, we recognized \$10.1 million of loss on debt extinguishment. Of this amount, \$9.8 million related to the write-offs of deferred financing costs and issuance premium and the redemption fee paid in connection with the June 2013 redemption of \$113.8 million in aggregate principal amount of the then-outstanding 2018 Notes and \$0.3 million related to the write-offs of deferred financing costs in connection with the Revolving Credit Facility.

**Other Income (Expense)**

During the nine months ended September 30, 2014, we recognized \$0.9 million in other income as a result of adjusting the fair value of our contingent consideration liability related to two acquisitions of real estate properties (see Note 3, "Recent Real Estate Acquisitions" in the Notes to Condensed Consolidated Financial Statements for further details). During the nine months ended September 30, 2013, we recognized \$0.6 million in other expense as a result of adjusting the fair value of our contingent consideration liability related to the Stoney River Marshfield facility acquisition.

**Funds from Operations and Adjusted Funds from Operations**

We believe that net income attributable to common stockholders as defined by GAAP is the most appropriate earnings measure. We also believe that funds from operations ("FFO"), as defined in accordance with the definition used by the National Association of Real Estate Investment Trusts ("NAREIT"), and adjusted funds from operations ("AFFO") (and related per share amounts) are important non-GAAP supplemental measures of our operating performance. Because

the historical cost accounting convention used for real estate assets requires straight-line depreciation (except on land), such accounting presentation implies that the value of real estate assets diminishes predictably over time. However, since real estate values have historically risen or fallen with market and other conditions, presentations of operating results for a REIT that uses historical cost accounting for depreciation could be less informative. Thus, NAREIT created FFO as a supplemental measure of operating performance for REITs that excludes historical cost depreciation and amortization, among other items, from net income attributable to common stockholders, as defined by GAAP. FFO is defined as net income attributable to common stockholders, computed in accordance with GAAP, excluding gains or losses from real estate dispositions, plus real estate depreciation and amortization and impairment charges. AFFO is defined as FFO excluding non-cash revenues (including, but not limited to,



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straight-line rental income adjustments and write-offs and non-cash interest income adjustments), non-cash expenses (including, but not limited to, stock-based compensation expense, amortization of deferred financing costs and amortization of debt premiums/discounts), acquisition pursuit costs and changes in fair value of contingent consideration. We believe that the use of FFO and AFFO (and the related per share amounts), combined with the required GAAP presentations, improves the understanding of our operating results among investors and makes comparisons of operating results among REITs more meaningful. We consider FFO and AFFO to be useful measures for reviewing comparative operating and financial performance because, by excluding gains or losses from real estate dispositions, impairment charges, and real estate depreciation and amortization, and for AFFO, by excluding non-cash revenues (including, but not limited to, straight-line rental income adjustments and write-offs and non-cash interest income adjustments), non-cash expenses (including, but not limited to, stock-based compensation expense, amortization of deferred financing costs and amortization of debt premiums/discounts), acquisition pursuit costs and changes in fair value of contingent consideration, FFO and AFFO can help investors compare our operating performance between periods or as compared to other companies. While FFO and AFFO are relevant and widely used measures of operating performance of REITs, they do not represent cash flows from operations or net income attributable to common stockholders as defined by GAAP and should not be considered an alternative to those measures in evaluating our liquidity or operating performance. FFO and AFFO also do not consider the costs associated with capital expenditures related to our real estate assets nor do they purport to be indicative of cash available to fund our future cash requirements. Further, our computation of FFO and AFFO may not be comparable to FFO and AFFO reported by other REITs that do not define FFO in accordance with the current NAREIT definition or that interpret the current NAREIT definition or define AFFO differently than we do.

The following table reconciles our calculations of FFO and AFFO for the three and nine months ended September 30, 2014 and 2013, to net income attributable to common stockholders, the most directly comparable GAAP financial measure, for the same periods (in thousands, except share and per share amounts):

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
|   | 2014                                | 2013      | 2014                               | 2013      |
| Net income attributable to common stockholders      | \$ 14,643                           | \$ 9,242  | \$ 17,020                          | \$ 15,310 |
| Depreciation and amortization of real estate assets | 9,762                               | 8,258     | 28,867                             | 24,726    |
| FFO   | 24,405                              | 17,500    | 45,887                             | 40,036    |
| Acquisition pursuit costs                           | 2,038                               | 281       | 2,617                              | 707       |
| Stock-based compensation expense                    | 1,545                               | 1,276     | 6,337                              | 5,209     |
| Straight-line rental income adjustments             | (4,641                              | ) (3,536  | ) (13,074                          | ) (10,836 |
| Amortization of deferred financing costs            | 940                                 | 806       | 2,812                              | 2,395     |
| Amortization of debt premiums                       | —                                   | (134      | ) (33                              | ) (535    |
| Change in fair value of contingent consideration    | 100                                 | (300      | ) (860                             | ) 600     |
| Non-cash portion of loss on extinguishment of debt  | 158                                 | 351       | 1,576                              | 859       |
| Non-cash interest income adjustments                | 77                                  | 17        | 217                                | 29        |
| Write-off of straight-line rental income            | —                                   | —         | 2,994                              | —         |
| AFFO  | \$ 24,622                           | \$ 16,261 | \$ 48,473                          | \$ 38,464 |
| FFO per diluted common share                        | \$ 0.51                             | \$ 0.46   | \$ 1.05                            | \$ 1.06   |
| AFFO per diluted common share                       | \$ 0.51                             | \$ 0.43   | \$ 1.10                            | \$ 1.01   |

Weighted average number of common shares outstanding, diluted:

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|      |            |            |            |            |
|------|------------|------------|------------|------------|
| FFO  | 47,877,202 | 37,828,573 | 43,840,550 | 37,777,458 |
| AFFO | 48,038,179 | 38,065,299 | 44,072,015 | 38,067,386 |

Set forth below is additional information related to certain other items included in net income attributable to common stockholders above, which may be helpful in assessing our operating results. Please see the accompanying condensed consolidated statements of cash flows for details of our operating, investing, and financing cash activities.

Significant Items Included in Net Income:

During the three and nine months ended September 30, 2014, we incurred \$0.2 million and \$22.5 million, respectively, of debt extinguishment loss. The \$0.2 million of debt extinguishment loss during the three months ended

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September 30, 2014 is related to write-offs of unamortized deferred financing costs in connection with the Revolving Credit Facility. The \$22.5 million of debt extinguishment loss during the nine months ended September 30, 2014 also includes \$20.9 million in payments made to noteholders for early redemption of the then-outstanding 2018 Notes and legal fees paid, \$0.8 million of write-offs associated with unamortized deferred financing and premium costs and \$0.6 million in write-offs of deferred financing costs in connection with our mortgage debt refinancing and repayment of a variable rate mortgage note. The entire amount of the loss on extinguishment of debt is included in FFO for the three and nine months ended September 30, 2014. AFFO for the nine months ended September 30, 2014 also includes the \$20.9 million early redemption premium and legal fees.

During the three and nine months ended September 30, 2014, we recognized \$0.1 million of other expense and \$0.9 million of other income, respectively, as a result of adjusting the fair value of our contingent consideration liability related to two acquisitions of real estate properties. See Note 3, “Recent Real Estate Acquisitions” in the Notes to Condensed Consolidated Financial Statements for further details. This entire amount is included in FFO for the three and nine months ended September 30, 2014.

During the nine months ended September 30, 2014, we recognized \$3.0 million of straight-line rental income write-off. The straight-line rental income write-off during the nine months ended September 30, 2014 is primarily due to a write-off related to a change in ownership of one of our tenants and the resulting modification of the terms of a lease between us and the new tenant entity. This entire amount is included in FFO for the nine months ended September 30, 2014.

During the three and nine months ended September 30, 2013, we incurred \$0.3 million and \$10.1 million, respectively, of debt extinguishment loss. The \$0.3 million of debt extinguishment loss during the three months ended September 30, 2013 consisted of write-offs of deferred financing costs in connection with the Revolving Credit Facility. The \$10.1 million of debt extinguishment loss during the nine months ended September 30, 2013 also included \$9.3 million for the cash payment made to noteholders for early redemption of \$113.8 million in aggregate principal amount of the then-outstanding 2018 Notes and \$0.5 million for the write-off of unamortized deferred financing costs and issuance premiums. The entire amount of the loss on extinguishment of debt is included in FFO for the three and nine months ended September 30, 2013 and the \$9.3 million early redemption premium is included in AFFO for the three and nine months ended September 30, 2013.

During the three and nine months ended September 30, 2013, we incurred \$0.3 million and \$0.6 million, respectively, of other income (expense), as a result of adjusting the fair value of our contingent consideration liability related to the Stoney River Marshfield facility acquisition. This entire amount is included in FFO for the three and nine months ended September 30, 2013.

**Liquidity and Capital Resources**

As of September 30, 2014, we had approximately \$61.3 million in liquidity, consisting of unrestricted cash and cash equivalents of \$25.3 million (excluding cash and cash equivalents associated with our RIDEA-compliant joint venture), and available borrowings under our Revolving Credit Facility of \$36.0 million. We completed an equity offering in October 2014 (as further described above under “—Recent Transactions—Equity Offering”), which provided net proceeds, before expenses, of \$160.6 million. We used the proceeds from this offering to repay borrowings outstanding under the Revolving Credit Facility.

On October 10, 2014, we completed an underwritten public offering of an additional \$150.0 million aggregate principal amount of 2021 Notes, providing net proceeds of approximately \$145.8 million (not including pre-issuance accrued interest), after deducting underwriting discounts and other offering expenses. We used the proceeds from this offering to repay borrowings outstanding under the Revolving Credit Facility.

After giving effect to the October 2014 equity offering and October 2014 offering of \$150.0 million aggregate principal amount of 2021 Notes, the use of the net proceeds from such offerings to repay a portion of the borrowings outstanding under our Revolving Credit Facility, the investments as described above under “—Recent Transactions—Investments, we had approximately \$312.9 million in liquidity, consisting of unrestricted cash and cash equivalents of \$2.9 million (excluding cash and cash equivalents associated with our RIDEA-compliant joint venture) and available borrowings under our Revolving Credit Facility of \$310.0 million.

The Revolving Credit Facility provides for a borrowing capacity of \$650.0 million and provides an accordion feature allowing for an additional \$100.0 million of capacity, subject to terms and conditions, resulting in a maximum borrowing capacity of \$750.0 million. The Operating Partnership also has an option to convert up to \$200.0 million of the Revolving Credit Facility to a term loan, subject to terms and conditions. On October 10, 2014, the Operating Partnership converted \$200.0 million of the outstanding borrowings under the Revolving Credit Facility to a term loan. Concurrent with the term loan conversion, we entered into a five-year interest rate cap contract that caps LIBOR at 2.0%.

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On May 2014, we completed an underwritten public offering of 8.1 million newly issued shares of our common stock pursuant to an effective registration statement. We received net proceeds, before expenses, of \$219.1 million from the offering, after giving effect to the issuance and sale of all 8.1 million shares of common stock (which included 1.1 million shares sold to the underwriters upon exercise of their option to purchase additional shares), at a price to the public of \$28.35 per share. A portion of these proceeds were used to repay borrowings outstanding under the Prior Revolving Credit Facility.

On January 23, 2014, we completed an underwritten public offering of \$350.0 million aggregate principal amount of the 2021 Notes, providing net proceeds of approximately \$340.8 million after deducting underwriting discounts and other offering expenses. A portion of these proceeds was used to (i) fund a tender offer for the 2018 Notes, (ii) fund the redemption price for 2018 Notes that were not retired in the tender offer and (iii) acquire the Nye Portfolio. See “—Loan Agreements.”

On March 18, 2013, we entered into a sales agreement (each, a “Sales Agreement”) with each of Barclays Capital Inc., Cantor Fitzgerald & Co., Credit Agricole Securities (USA) Inc., RBC Capital Markets, LLC, RBS Securities Inc. and Wells Fargo Securities, LLC (individually, a “Sales Agent” and together, the “Sales Agents”) to sell shares of our common stock having aggregate gross proceeds of up to \$100.0 million (the “ATM Shares”) from time to time through the Sales Agents.

Pursuant to the terms of the Sales Agreements, the ATM Shares may be sold by any method permitted by law deemed to be an “at-the-market” offering, including, without limitation, sales made directly on the NASDAQ Global Select Market, on any other existing trading market for our common stock or to or through a market maker. In addition, with our prior consent, the Sales Agents may also sell the ATM Shares in privately negotiated transactions. We will pay each Sales Agent a commission of up to 2% of the gross proceeds from the sales of ATM Shares sold pursuant to the applicable Sales Agreement. We are not obligated to sell and the Sales Agents are not obligated to buy or sell any ATM Shares under the Sales Agreements. No assurance can be given as to the price or amount of shares that we sell, or the dates when such sales will take place. During the three months ended September 30, 2014, we sold 0.4 million ATM Shares, at an average price of \$28.28 per share, generating gross proceeds of approximately \$10.3 million, before \$0.2 million of commissions. During the nine months ended September 30, 2014, we sold 0.6 million ATM Shares, at an average price of \$28.05 per share, generating gross proceeds of approximately \$16.9 million, before \$0.3 million of commissions. In addition, as of September 30, 2014, we had \$44.8 million available under the ATM Program.

In addition, we have filed a shelf registration statement with the SEC that expires in May 2016, which will allow us to offer and sell shares of common stock, preferred stock, warrants, rights, units, and certain of our subsidiaries to offer and sell debt securities, through underwriters, dealers or agents or directly to purchasers, on a continuous or delayed basis, in amounts, at prices and on terms we determine at the time of the offering.

We believe that our available cash, operating cash flows and borrowings available to us under the Revolving Credit Facility provide sufficient funds for our operations, scheduled debt service payments with respect to our Senior Notes (defined below), mortgage indebtedness on our properties, and dividend requirements for the next twelve months. In addition, we do not believe that the restrictions under our Senior Notes Indentures (defined below) significantly limit our ability to use our available liquidity for these purposes.

We intend to invest in additional healthcare properties as suitable opportunities arise and adequate sources of financing are available. We expect that future investments in properties, including any improvements or renovations of current or newly-acquired properties, will depend on and will be financed, in whole or in part, by our existing cash, borrowings available to us under our Revolving Credit Facility, future borrowings or the proceeds from issuances of common stock (including through our ATM Program), preferred stock, debt or other securities. In addition, we expect to seek financing from U.S. government agencies, including through Fannie Mae and HUD, in appropriate circumstances in connection with acquisitions.

### Cash Flows from Operating Activities

Net cash provided by operating activities was \$71.2 million for the nine months ended September 30, 2014. Operating cash inflows were derived primarily from the rental payments received under the lease agreements with subsidiaries of Genesis, rental payments from our other tenants and interest payments from borrowers under our loan investments.

Operating cash outflows consisted primarily of interest and early redemption payments on our outstanding debt and payment of general and administrative expenses. Net cash provided by operating activities during the nine months ended September 30, 2014, includes \$20.8 million in payments made to noteholders for early redemption of the then-outstanding 2018 Notes. We expect our annualized cash flows provided by operating activities to increase as a result of completed and anticipated future real estate investments.

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Cash Flows from Investing Activities

During the nine months ended September 30, 2014, net cash used in investing activities was \$793.3 million and consisted of \$721.9 million used in the acquisition of six skilled nursing/transitional care facilities, 27 senior housing facilities and four facilities that closed escrow subsequent to September 30, 2014, \$59.3 million used to originate four loans receivable and provide additional funding for existing loans receivable, \$11.3 million used for four preferred equity investments and \$1.2 million used for tenant improvements, partially offset by a \$0.3 million partial repayment of one loan receivable.

We expect to continue using available liquidity in connection with anticipated future real estate investments and loan originations.

Cash Flows from Financing Activities

During the nine months ended September 30, 2014, net cash provided by financing activities was \$743.2 million and consisted of \$350.0 million in proceeds from the January 2014 offering of 2021 Notes and \$229.8 million in net proceeds from the May 2014 equity offering and shares sold through the ATM Program, partially offset by the redemption of \$211.3 million in aggregate principal amount of the then-outstanding 2018 Notes, \$57.7 million of dividends paid to stockholders, a net decrease in mortgage borrowings resulting from the repayment of \$30.7 million in mortgage indebtedness and \$15.5 million of payments for deferred financing costs primarily related to the issuance of the 2021 Notes and the Revolving Credit Facility. In addition, during the nine months ended September 30, 2014, we borrowed \$699.0 million on our Revolving Credit Facility and repaid \$220.5 million during the same period.

Loan Agreements

2021 Notes. On January 23, 2014, the Issuers issued \$350.0 million aggregate principal amount of 2021 Notes. The 2021 Notes were sold at par, resulting in gross proceeds of \$350.0 million and net proceeds of approximately \$340.8 million after deducting underwriting discounts and other offering expenses. On October 10, 2014, the Issuers issued an additional \$150.0 million aggregate principal amount of 2021 Notes, which are treated as a single class with, and have the same terms as, the existing 2021 Notes. The notes were issued at 99.5% providing net proceeds of approximately \$145.8 million (not including pre-issuance accrued interest), after deducting underwriting discounts and other offering expenses and a yield-to-maturity of 5.593%. The Company used the proceeds from this offering to repay borrowings outstanding under the Revolving Credit Facility.

The 2021 Notes accrue interest at a rate of 5.5% per annum payable semiannually on February 1 and August 1 of each year. See Note 6, "Debt," in the Notes to Condensed Consolidated Financial Statements for additional information concerning the 2021 Notes.

2023 Notes. On May 23, 2013, the Issuers issued \$200.0 million aggregate principal amount of 5.375% senior notes due 2023 (the "2023 Notes"). The 2023 Notes were sold at par, resulting in gross proceeds of \$200.0 million and net proceeds of approximately \$194.6 million after deducting underwriting discounts and other offering expenses. The 2023 Notes accrue interest at a rate of 5.375% per annum payable semiannually on June 1 and December 1 of each year. See Note 6, "Debt," in the Notes to Condensed Consolidated Financial Statements for additional information concerning the 2023 Notes.

2018 Notes. On October 27, 2010 and July 26, 2012, the Issuers issued \$225.0 million and \$100.0 million aggregate principal amount of 8.125% senior unsecured notes (the "2018 Notes"), respectively. Pursuant to exchange offers completed on March 14, 2011 and November 14, 2012, the Issuers exchanged the 2018 Notes that were issued in October 2010 and July 2012 for substantially identical 2018 Notes registered under the Securities Act of 1933, as amended. The 2018 Notes accrued interest at a rate of 8.125% per annum payable semiannually on May 1 and November 1 of each year.

On June 24, 2013, pursuant to the terms of the indenture governing the 2018 Notes (the "2018 Notes Indenture"), the Issuers redeemed \$113.8 million in aggregate principal amount of the then-outstanding 2018 Notes, representing 35% of the aggregate principal amount of the 2018 Notes outstanding. The 2018 Notes were redeemed at a redemption price of 108.125% of the principal amount redeemed, plus accrued and unpaid interest up to the redemption date. The redemption resulted in a \$9.8 million loss on extinguishment of debt, including \$9.3 million in payments made to noteholders for early redemption and \$0.5 million of write-offs associated with unamortized deferred financing costs and issuance premium.

On January 8, 2014, we commenced a cash tender offer with respect to any and all of the outstanding \$211.3 million of the 2018 Notes. Pursuant to the tender offer, we retired \$210.9 million of the 2018 Notes at a premium of 109.837%, plus accrued and unpaid interest, on January 23, 2014. Pursuant to the terms of the 2018 Notes Indenture, the remaining \$0.4 million of the 2018 Notes were called and were retired on February 11, 2014 at a redemption price of 109.485% plus accrued and unpaid interest.



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The obligations under the 2021 Notes and the 2023 Notes (collectively, the “Senior Notes”) are fully and unconditionally guaranteed, jointly and severally, on an unsecured basis, by us and certain of our other existing and, subject to certain exceptions, future material subsidiaries; provided, however, that such guarantees are subject to release under certain customary circumstances. See Note 10, “Summarized Condensed Consolidating Information,” in the Notes to Condensed Consolidated Financial Statements for additional information concerning the circumstances pursuant to which the guarantors will be automatically and unconditionally released from their obligations under the guarantees.

See Note 6, “Debt,” in the Notes to Condensed Consolidated Financial Statements for additional information concerning restrictive covenants and events of default in the indentures governing the Senior Notes (the “Senior Notes Indentures”). As of September 30, 2014, we were in compliance with all applicable financial covenants under the Senior Notes Indentures.

**Revolving Credit Facility.** On September 10, 2014, the Operating Partnership entered into a second amended and restated unsecured revolving credit facility (the “Revolving Credit Facility”) with certain lenders as set forth in the related credit agreement and Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer (each as defined in such credit agreement). The Revolving Credit Facility amends and restates the amended and restated secured revolving credit facility (the “Prior Revolving Credit Facility”) that the Operating Partnership and certain subsidiaries of the Operating Partnership entered into on July 29, 2013 and amended on October 15, 2013. The Revolving Credit Facility provides for a borrowing capacity of \$650.0 million and provides an accordion feature allowing for an additional \$100.0 million of capacity, subject to terms and conditions, resulting in a maximum borrowing capacity of \$750.0 million. The Operating Partnership also has an option to convert up to \$200.0 million of the Revolving Credit Facility to a term loan subject to terms and conditions. On October 10, 2014, the Operating Partnership converted \$200.0 million of the outstanding borrowings under the Revolving Credit Facility to a term loan. Concurrent with the term loan conversion, we entered into a five-year interest rate cap contract that caps LIBOR at 2.0%.

While the Prior Revolving Credit Facility was secured by pledges of equity by our wholly owned subsidiaries that own certain of our real estate assets, the Revolving Credit Facility is unsecured. The Revolving Credit Facility, including amounts that are converted into a term loan, has a maturity date of September 10, 2018 and includes a one year extension option. As of September 30, 2014, there was \$614.0 million amounts outstanding under the Revolving Credit Facility, and we had \$36.0 million available for borrowing.

In connection with the Revolving Credit Facility, we wrote off \$0.2 million of unamortized deferred financing costs during the nine months ended September 30, 2014. These amounts are included in loss on extinguishment of debt on the accompanying condensed consolidated statements of income.

Borrowings under the Revolving Credit Facility bear interest on the outstanding principal amount at a rate equal to an applicable percentage plus, at the Operating Partnership's option, either (a) LIBOR or (b) a base rate determined as the greater of (i) the federal funds rate plus 0.5%, (ii) the prime rate, and (iii) one-month LIBOR plus 1.0% (the “Base Rate”). The applicable percentage for borrowings will vary based on the Consolidated Leverage Ratio, as defined in the Revolving Credit Facility, and will range from 2.00% to 2.60% per annum for LIBOR based borrowings and 1.00% to 1.60% per annum for borrowings at the Base Rate. As of September 30, 2014, the interest rate on the Revolving Credit Facility was 2.46%. In addition, the Operating Partnership is required to pay an unused fee to the lenders equal to 0.25% or 0.35% per annum based on the amount of unused borrowings under the Revolving Credit Facility. During the three and nine months ended September 30, 2014, we incurred \$0.3 million and \$2.3 million, respectively, in interest expense on amounts outstanding under the Revolving Credit Facility. During the three and nine months ended September 30, 2014, we incurred \$0.5 million and \$1.1 million, respectively, of unused facility fees.

In the event that we achieve at least two investment grade ratings from S&P, Moody’s and/or Fitch, the Operating Partnership can elect to reduce the applicable percentage for LIBOR or Base Rate borrowings. If the Operating Partnership makes this election, the applicable percentage for borrowings will vary based on the Debt Ratings at each Pricing Level, as defined in the credit agreement, and will range from 0.90% to 1.70% per annum for LIBOR based borrowings and 0.00% to 0.70% per annum for borrowings at the Base Rate. In addition, should the Operating Partnership elect this option, the unused fee will no longer apply and a facility fee ranging between 0.125% and

0.300% per annum will take effect based on the borrowing capacity regardless of amounts outstanding under the Revolving Credit Facility.

The obligations of the Operating Partnership under the Revolving Credit Facility are guaranteed by us and certain of our subsidiaries. See Note 6, "Debt," in the Notes to Condensed Consolidated Financial Statements for additional information concerning covenants contained in the Revolving Credit Facility. As of September 30, 2014, we were in compliance with all applicable financial covenants under the Revolving Credit Facility.

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## Mortgage Indebtedness

Of our 154 properties held for investment, 14 are subject to mortgage indebtedness to third parties that, as of September 30, 2014, totaled approximately \$124.7 million. As of September 30, 2014 and December 31, 2013, our mortgage notes payable consisted of the following (dollars in thousands):

| Interest Rate Type | Book Value as of<br>September 30, 2014 | Book Value as of<br>December 31, 2013 | Weighted Average<br>Effective Interest<br>Rate at<br>September 30, 2014 | Maturity<br>Date         |
|--------------------|--|---------------------------------------|---|--------------------------|
| Fixed Rate         | \$124,714                              | \$54,688                              | 3.96  | % May 2031 - August 2051 |
| Variable Rate      | —                                      | 86,640                                | NA  | NA                       |
|                    | \$124,714                              | \$141,328                             | 3.96  | %                        |

## Capital Expenditures

There were \$1.2 million and \$0.4 million of capital expenditures for the nine months ended September 30, 2014 and 2013, respectively. There are no present plans for the improvement or development of any unimproved or undeveloped property; however, from time to time we may agree to fund improvements our tenants make at our facilities. Accordingly, we anticipate that our aggregate capital expenditure requirements for the next 12 months will not exceed \$3.5 million, and that such expenditures will principally be for improvements to our facilities and result in incremental rental income.

## Dividends

We paid dividends of \$57.7 million on our common and preferred stock during the nine months ended September 30, 2014. On November 3, 2014, our board of directors declared a quarterly cash dividend of \$0.39 per share of common stock. The dividend will be paid on November 26, 2014 to common stockholders of record as of November 14, 2014. Also on November 3, 2014, our board of directors declared the a quarterly cash dividend of \$0.4453125 per share of Series A Preferred Stock. The dividend will be paid on November 26, 2014 to preferred stockholders of record as of the close of business on November 14, 2014.

## Concentration of Credit Risk

Concentrations of credit risks arise when a number of operators, tenants or obligors related to our investments are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations, including those to us, to be similarly affected by changes in economic conditions. We regularly monitor our portfolio to assess potential concentrations of risks.

Management believes our current portfolio is reasonably diversified across healthcare related real estate and geographical location and does not contain any other significant concentration of credit risks. Our portfolio of 154 real estate properties held for investment as of September 30, 2014 is diversified by location across 34 states. The properties in any one state did not account for more than 19% of our total rental revenue during the three and nine months ended September 30, 2014.

As of September 30, 2014, our two largest tenants, Genesis and Holiday, represented 37.1% and 18.2%, respectively, of our annualized revenues. The obligations under both master leases are guaranteed by their respective parent entities.

## Skilled Nursing Facility Reimbursement Rates

Medicare reimburses skilled nursing facilities for Medicare Part A services under the Prospective Payment System (“PPS”), as implemented pursuant to the Balanced Budget Act of 1997 and modified pursuant to subsequent laws, most recently the Patient Protection and Affordable Care Act of 2010 (the “Affordable Care Act”). PPS regulations predetermine a payment amount per patient, per day, based on a market basket index calculated for all covered costs. The amount to be paid is determined by classifying each patient into one of 66 Resource Utilization Group (“RUG”) categories that represent the level of services required to treat different conditions and levels of acuity.

The current system of 66 RUG categories, or Resource Utilization Group version IV (“RUG IV”), became effective as of October 1, 2010. RUG IV resulted from research performed by the Centers for Medicare & Medicaid Services (“CMS”) and was part of CMS's continuing effort to increase the correlation of the cost of services to the condition of individual patients.

On July 31, 2014, CMS released final fiscal year 2015 Medicare rates for skilled nursing facilities providing a net increase of 2.0% over fiscal year 2014 payments (comprised of a market basket increase of 2.5% and less the productivity adjustment of 0.5%).

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## Obligations and Commitments

The following table summarizes our contractual obligations and commitments in future years, including our Senior Notes, our Revolving Credit Facility and our mortgage indebtedness to third parties on certain of our properties. The following table is presented as of September 30, 2014 (in thousands):

|  | Total       | October 1<br>Through<br>December 31,<br>2014 | 2015     | Year Ended December 31, |          |            |           |
|--|-------------|--|----------|-------------------------|----------|------------|-----------|
|  |             |  | 2016     | 2017                    | 2018     | After 2018 |           |
| Mortgage indebtedness <sup>(1)</sup>     | \$201,440   | \$1,793                                      | \$7,171  | \$7,171                 | \$7,171  | \$7,171    | \$170,963 |
| Revolving Credit Facility <sup>(2)</sup> | 674,734     | 3,877  | 15,384   | 15,426                  | 15,384   | 624,663    | —         |
| Senior Notes <sup>(3)</sup>              | 771,875     | 5,375  | 30,000   | 30,000                  | 30,000   | 30,000     | 646,500   |
| Contingent consideration                 | 4,600       | —  | 1,200    | —                       | 3,400    | —          | —         |
| Operating lease                          | 115         | 24   | 91       | —                       | —        | —          | —         |
| Total                                    | \$1,652,764 | \$11,069                                     | \$53,846 | \$52,597                | \$55,955 | \$661,834  | \$817,463 |

(1) Mortgage indebtedness includes principal payments and interest payments through the maturity dates. Total interest on mortgage indebtedness, based on contractual rates, is \$76.7 million.

(2) Revolving Credit Facility includes payments related to the unused facility fee due to the lenders based on the amount of unused borrowings under the Revolving Credit Facility. On October 10, 2014, the Operating Partnership converted \$200.0 million of the outstanding borrowings under the Revolving Credit Facility to a term loan.

(3) Senior Notes includes interest payments through the maturity dates. Total interest on the Senior Notes is \$221.9 million.

In addition to the above, we have committed to provide up to \$88.7 million of funding related to three debt investments and two preferred equity investments. As of September 30, 2014, we had funded \$66.6 million of these commitments. The debt investments have maturity dates ranging from 2016 through 2018.

## Off-Balance Sheet Arrangements

None.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our primary market risk exposure is interest rate risk with respect to our indebtedness. As of September 30, 2014, this indebtedness included \$550.0 million aggregate principal amount of Senior Notes outstanding, \$124.7 million of mortgage indebtedness to third parties on certain of the properties that our subsidiaries own and \$614.0 million outstanding under the Revolving Credit Facility which is our only variable rate indebtedness. In addition, as of September 30, 2014, we had \$36.0 million available for borrowing under our Revolving Credit Facility.

As of September 30, 2014, after giving effect to the October 2014 equity offering and October 2014 offering of \$150.0 million aggregate principal amount of 2021 Notes, the use of the net proceeds from such offerings to repay a portion of the borrowings outstanding under our Revolving Credit Facility and the conversion of \$200.0 million of the outstanding borrowings under the Revolving Credit Facility to a term loan, our indebtedness would have been comprised of the \$700.0 million aggregate principal amount of Senior Notes outstanding, \$124.7 million of mortgage indebtedness to third parties on certain of the properties that our subsidiaries own, a \$200.0 million term loan and \$140.0 million outstanding under the Revolving Credit Facility and \$310.0 million available for borrowing. As a result of the above, \$340.0 million of our pro forma indebtedness as of September 30, 2014 would have had a variable interest rate.

From time to time, we may borrow under the Revolving Credit Facility to finance future investments in properties, including any improvements or renovations of current or newly acquired properties, or for other purposes. Because borrowings under the Revolving Credit Facility bear interest on the outstanding principal amount at a rate equal to an applicable percentage plus, at our option, either (a) LIBOR or (b) a base rate determined as the greater of (i) the federal funds rate plus 0.5%, (ii) the prime rate, and (iii) one-month LIBOR plus 1.0%, the interest rate we will be required to pay on any such borrowings will depend on then applicable rates and may vary. An increase in interest rates could make the financing of any investment by us more costly. Rising interest rates could also limit our ability to refinance our debt when it matures or cause us to pay higher interest rates upon refinancing and increase interest expense on refinanced indebtedness. Assuming a 100 basis point increase in the interest rate related to our variable rate debt, and assuming no change in our outstanding debt balance as of September 30, 2014, interest expense would increase by \$6.1 million (\$3.4 million on a pro forma basis after giving effect to the items specified in the immediately preceding paragraph) for the twelve months following September 30, 2014. As of September 30, 2014, the index underlying our variable rate mortgages was below 100 basis points and if this index was reduced to zero during the twelve months following September 30, 2014, interest expense on our variable rate debt would decrease by \$1.0 million (\$0.5 million on a pro forma basis after giving effect to the items specified in the immediately preceding paragraph).

We expect to manage our exposure to interest rate risk by maintaining a mix of fixed and variable rates for our indebtedness. We also may manage, or hedge, interest rate risks related to our borrowings by means of interest rate cap or swap agreements. On October 10, 2014, the Operating Partnership converted \$200.0 million of the outstanding borrowings under the Revolving Credit Facility to a term loan. Concurrent with the term loan conversion, the Company entered into a five-year interest rate cap contract that caps LIBOR at 2.0%.

**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

As of the end of the period covered by this report, management, including our chief executive officer and chief financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based upon, and as of the date of, the evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective as of September 30, 2014 to ensure that information required to be disclosed in the reports we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and our chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None of the Company or any of its subsidiaries is a party to, and none of their respective property is the subject of, any material legal proceeding, although we are from time to time party to legal proceedings that arise in the ordinary course of our business.

ITEM 1A. RISK FACTORS

There have been no material changes in our assessment of our risk factors from those set forth in our 2013 Annual Report on Form 10-K, other than the addition of the risk factors set forth below.

Risks Related to Our Recent Acquisition of the Holiday Portfolio

The intended benefits of the acquisition of the Holiday Portfolio may not be realized, which could have a negative impact on the market price of our common stock.

The acquisition of the Holiday Portfolio poses risks for our ongoing operations, including that:

• our future business and financial results will suffer if we do not effectively manage our expanded portfolio;

• our level of indebtedness increased substantially;

• the Holiday Portfolio, which is expected to contribute a significant portion of our future rents, may not perform as well as we anticipate or we may incur unanticipated costs and expenses relating to the Holiday Portfolio; and

• the intended benefits of the Holiday Portfolio may not be realized as quickly or to the extent anticipated by us or at all.

Any of these matters could have a negative impact on the market price of our common stock.

Holiday Tenant may be unable to cover its lease obligations to us and there can be no assurance that its indirect parent, Holiday AL Holdings LP (the "Guarantor"), will be able to cover any shortfall.

The Holiday Portfolio was previously owner-operated by Holiday. As a result, Holiday did not have a lease expense to cover like the lease expense that is payable to us under the master lease relating to the Holiday Portfolio. If Holiday Tenant is not able to satisfy its obligations to us, we would be entitled, among other remedies, to use any funds of Holiday Tenant then held by us as security for Holiday Tenant's performance of its obligations (approximately \$15.1 million) and to seek recourse against the Guarantor under the Guaranty. The guaranty of master lease (the "Guaranty") executed by the Guarantor in favor of us includes certain financial covenants of the Guarantor, including maintaining a minimum net worth of \$150 million, a minimum fixed charge coverage ratio of 1.10x and a maximum leverage ratio of 10x (as each term is defined in the Guaranty). As of September 30, 2014, the Guarantor has guaranteed, or agreed to guarantee, significant lease obligations of various other of its subsidiaries in addition to its guarantee of Holiday Tenants' obligations to us. In the future, the Guarantor may execute additional guaranties of the lease obligations of its subsidiaries without limitation. The Guarantor informed us that as of September 30, 2014, it had a net worth (calculated in accordance with the Guaranty) of approximately \$429.4 million. There can be no assurance that the Guarantor will have the resources necessary to satisfy its obligations to us under the Guaranty in the event that Holiday Tenant fails to satisfy its lease obligations to us in full, which could have a material adverse effect on us.

ITEM 6. EXHIBITS

Ex. Description

2.1 Agreement and Plan of Merger, dated as of September 23, 2010, by and between Sun Healthcare Group, Inc. and Sabra Health Care REIT, Inc. (incorporated by reference to Annex A to the proxy statement/prospectus included in Amendment No. 4 to the Registration Statement on Form S-4 (File No. 333-167040) filed by Sabra Health Care REIT, Inc. on September 28, 2010).





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- 2.2 Distribution Agreement, dated November 4, 2010, by and among Sun Healthcare Group, Inc., Sabra Health Care REIT, Inc. and SHG Services, Inc. (which has been renamed Sun Healthcare Group, Inc.) (incorporated by reference to Exhibit 2.1 of the Current Report on Form 8-K filed by Sabra Health Care REIT, Inc. on November 5, 2010).†
- 2.3 Purchase Agreement, dated September 25, 2014, between Sabra Health Care REIT, Inc. and certain affiliates of Holiday Acquisition Holdings LLC (incorporated by reference to Exhibit 2.1 of the Current Report on Form 8-K filed by Sabra Health Care REIT, Inc. on September 29, 2014).†
- 3.1 Articles of Amendment and Restatement of Sabra Health Care REIT, Inc., dated October 20, 2010, filed with the State Department of Assessments and Taxation of the State of Maryland on October 21, 2010 (incorporated by reference to Exhibit 3.1 of the Current Report on Form 8-K filed by Sabra Health Care REIT, Inc. on October 26, 2010).
- 3.1.1 Articles Supplementary designating Sabra Health Care REIT, Inc.'s 7.125% Series A Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 3.1 of the Current Report on Form 8-K filed by Sabra Health Care REIT, Inc. on March 21, 2013).
- 3.2 Amended and Restated Bylaws of Sabra Health Care REIT, Inc. (incorporated by reference to Exhibit 3.2 of the Current Report on Form 8-K filed by Sabra Health Care REIT, Inc. on October 26, 2010).
- 4.1 Fifth Supplemental Indenture, dated September 29, 2014, among Sabra Health Care Limited Partnership, Sabra Capital Corporation, Sabra Health Care REIT, Inc., the other guarantors named therein, and Wells Fargo Bank, National Association, as Trustee (incorporated by reference to Exhibit 4.7.5 of the Post-Effective Amendment No. 2 to Form S-3 Registration Statement filed by Sabra Health Care REIT, Inc. and the Co-Registrants on September 30, 2014).
- 10.1 Second Amended and Restated Credit Agreement, dated September 10, 2014, among Sabra Health Care Limited Partnership, as Borrower; Sabra Health Care REIT, Inc., as REIT Guarantor; the other guarantors party thereto; the lenders party thereto; Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer; Citizens Bank, National Association and Credit Agricole Corporate and Investment Bank, as Co-Syndication Agents; Barclays Bank, PLC, Citibank, N.A., Royal Bank of Canada, Wells Fargo Bank, N.A., J.P. Morgan Chase Bank, N.A., and Suntrust Bank, as Co-Documentation Agents; and Merrill Lynch, Pierce, Fenner & Smith, as Joint Lead Arranger and Sole Book Runner; and Citizens Bank, National Association and Credit Agricole Corporate and Investment Bank, as Joint Lead Arranger (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed by Sabra Health Care REIT, Inc. on September 11, 2014).
- 10.2 Master Lease, dated September 25, 2014, between Sabra Health Care Holdings III, LLC, Sabra Texas Holdings, L.P., Sabra Health Care Virginia II, LLC and Sabra Health Care Northeast, LLC, as landlords, and the tenants listed on the signature pages thereto (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed by Sabra Health Care REIT, Inc. on September 29, 2014).
- 10.3

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Guaranty of Master Lease, dated September 25, 2014, by Holiday AL Holdings LP in favor of Sabra Health Care Holdings III, LLC, Sabra Texas Holdings, L.P., Sabra Health Care Virginia II, LLC and Sabra Health Care Northeast, LLC (incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K filed by Sabra Health Care REIT, Inc. on September 29, 2014).

- 12.1\* Statement Re: Computation of Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends.
- 31.1\* Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2\* Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1\*\* Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002.

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|          |   |
|----------|---|
| 32.2**   | Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS* | XBRL Instance Document.   |
| 101.SCH* | XBRL Taxonomy Extension Schema Document.  |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document.  |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document.   |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document.  |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document.   |

\* Filed herewith.

\*\* Furnished herewith.

† Schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Registrants hereby agree to furnish supplementally copies of any of the omitted schedules and exhibits upon request by the Securities and Exchange Commission.

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SIGNATURES

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

SABRA HEALTH CARE REIT, INC.

Date: November 4, 2014

By: /S/ RICHARD K. MATROS  
Richard K. Matros  
Chairman, President and  
Chief Executive Officer  
(Principal Executive Officer)

Date: November 4, 2014

By: /S/ HAROLD W. ANDREWS, JR.  
Harold W. Andrews, Jr.  
Executive Vice President,  
Chief Financial Officer and Secretary  
(Principal Financial and Accounting Officer)