Strength Quality Stability

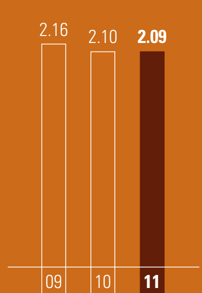
EXTENDICARE
REAL ESTATE INVESTMENT TRUST

2011 Annual Report

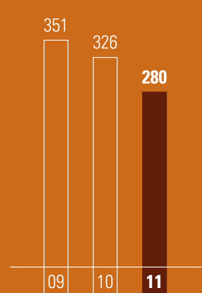
Financial Highlights[1]

(millions of dollars unless otherwise noted)	**2011**	2010	2009
Balance Sheet			
Cash and cash equivalents	**80.0**	267.8	134.0
Long-term debt, including current portion	**1,134.4**	1,241.2	1,234.0
Total assets	**1,830.7**	1,994.6	1,668.1
Unitholder Information[2]			
Funds from operations (FFO)	**63.4**	108.1	146.8
FFO *($ per basic unit)*	**0.76**	1.33	2.01
Adjusted funds from operations (AFFO)	**69.8**	110.7	146.1
AFFO *($ per basic unit)*	**0.84**	1.36	2.00
Distributions declared	**70.1**	68.8	61.3
Distributions declared *($ per basic unit)*	**0.84**	0.84	0.84
Weighed average units – Basic *(thousands)*	**83,408**	81,533	73,000
– Fully diluted *(thousands)*	**97,205**	95,346	86,817

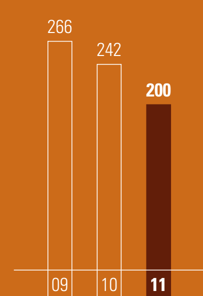
Revenue
(in billions of dollars)



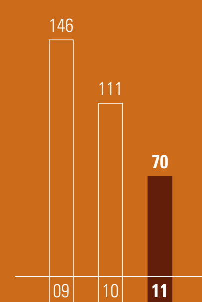
Net Operating Income[2]
(in millions of dollars)



EBITDA[2]
(in millions of dollars)



AFFO[2]
(in millions of dollars)



(1) This information has been prepared in accordance with IFRS, except for the selected information presented for 2009, which was prepared under previous Canadian GAAP.

(2) Refer to non-GAAP measures on page 71.

Corporate Profile

Extendicare Real Estate Investment Trust ("Extendicare REIT") is a leading North American provider of post-acute and long-term senior care services. The direct ownership and operation of the senior care centers and ancillary businesses is conducted by wholly owned subsidiaries of Extendicare REIT (collectively "Extendicare"). Through its network of owned and operated health care centers, Extendicare REIT's qualified and experienced workforce of 38,100 individuals is dedicated to helping people live better through a commitment to quality service that includes skilled nursing care, rehabilitative therapies and home health care services. Extendicare REIT's 261 senior care centers in Canada and the United States have capacity to care for approximately 28,100 residents.

Extendicare REIT is a specified investment flow-through trust (SIFT) that has been subject to SIFT tax since January 1, 2007. Monthly cash distributions paid to its unitholders are at the discretion of its board of trustees. Extendicare REIT's units trade on the TSX under the symbol EXE.UN.

More information is available at **www.extendicare.com**.

Forward-looking Statements – Information provided by Extendicare REIT from time to time, including this Annual Report, contains or may contain forward-looking statements concerning anticipated future events, results, circumstances, economic performance or expectations with respect to Extendicare REIT and its subsidiaries, including its business operations, business strategy and financial condition. Please refer to page 11 for a caution to the reader on the reliance of such statements.

Investment Highlights

Extendicare REIT generates strong cash flow and has a proven track record of growth through organic operations, new developments and acquisitions resulting from:

- Strong demographic trends toward an aging population in North America, leading to increased demand for rehabilitative and long-term resident health care services.
- Successful operation of health care business and ownership of real estate assets, which provide financial and operating flexibility and control.
- Long-term growth strategy enabled by property development experience, disciplined reinvestment programs, accretive acquisitions and expansion into ancillary lines of business.

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CEO's Message

Fellow Unitholders,

Extendicare REIT delivered solid financial and operational results in 2011 in spite of persistent weakness in the economy, a challenging U.S. regulatory and funding environment and the need to strengthen our reserves for self-insured liabilities. We were successful at implementing a wide range of operational and organizational changes well ahead of schedule that were aimed at improving efficiencies and lowering our overhead costs. Also, we created greater financial stability through prudent risk management and a focus on building a strong balance sheet for the long term. Through it all, we maintained our focus on our core business principles with an emphasis on the delivery of quality care and service to our residents in each of our centers across North America. In doing so, we continue to position Extendicare for ongoing success in a challenging health care environment.

Highlights of the Year

Debt Refinancing

Among our successes, the highlight of the year was clearly our achievement in refinancing a significant portion of our U.S. long-term debt, which is now in the final stages of completion. This was a huge undertaking, the significance of which cannot be overstated in terms of its contribution to strengthening our balance sheet with low-cost, long-term financing. Once finalized, our U.S. operations will have refinanced approximately US$636 million of its debt with US$520 million in 71 loan mortgages insured by the U.S. Department of Housing and Urban Development and cash on hand of US$116 million. Collectively, the weighted average all-in interest rate of the closed and committed loans is 4.35%, with an average term to maturity of about 33 years. We expect to realize savings of US$20 million in interest costs annually and have approximately 50 unencumbered centers valued at an estimated US$250 million.

In December 2011, the REIT's Canadian operations refinanced $72.4 million in mortgages on 20 centers insured by the Canadian Mortgage and Housing Corporation (CMHC) that were at fixed rates of 9.81% and due to mature in March 2013. The new debt consists of a total of $59.0 million in mortgages on 18 centers at a blended fixed rate of approximately 2.69% maturing in 2017-2022, and a variable-rate bridge loan of $13.3 million secured by two centers due in June 2013. The estimated annualized interest savings from this refinancing is $5 million.

U.S. Operations

In August, Extendicare's Sheboygan Progressive Care Center, located in Sheboygan, Wisconsin won the American Health Care Association's Silver Quality Award in recognition of its outstanding performance in the health care profession. Sheboygan Progressive was one of only 31 centers in the nation to receive this prestigious award. Twenty-four additional Extendicare centers received the Bronze Quality Award in 2011, bringing the total to 88 Extendicare centers to have been recognized with this award of excellence since the program's inception.

In January 2012, we completed the sale of our U.S. group purchasing organization to Managed Health Care Associates, Inc. for cash proceeds of US$56.0 million. While this business has been a good operation for Extendicare for a long time, we believed the time was right to participate in an industry consolidation that is under way in the group purchasing sector and monetize this investment.

Canadian Operations

Extendicare's Canadian operations EBITDA margin was 9.4%, down from 10.1% in 2010, primarily due to the effect of prior period adjustments recorded in both years. Excluding the impact of the prior period adjustments, the EBITDA margin improved to 9.7% this year from 9.5% in 2010. The average daily revenue rate increased by 3.5% over 2010 and our occupancy rates remained unchanged at a solid 98%. During 2011, we benefited from increased accommodation funding in Ontario that is estimated to improve our annual revenue by $2.6 million.

On the development side, Extendicare opened a new center in Edmonton, Alberta in November 2011. The new 180-bed, state-of-the-art nursing center replaces an existing 113-bed

We were successful at implementing a wide range of operational and organizational changes well ahead of schedule that were aimed at improving efficiencies and lowering our overhead costs.

center that Extendicare owned and operated in the area. We have also secured CMHC financing for 89% of the cost of the center at a 10-year fixed rate of 3.81%.

In Ontario, Extendicare was awarded projects in Timmins and Sault Ste. Marie under Phase 1 of the province's redevelopment program. We broke ground last spring and the projects are proceeding well with expected completion for both to be in the first half of 2013.

Challenges

Medicare Funding Reductions

In the third quarter, as part of the ongoing U.S. health care reform, the Centers for Medicare & Medicaid Services (CMS) announced reductions to Medicare funding that effectively reversed the 2010 advances in the reimbursement system through the implementation of MDS 3.0 and RUG-IV last October. The resulting CMS Final Rule included an 11.1% reduction in Medicare funding, the elimination of group therapy and changes in assessment practices that had been introduced in 2010. In response, we conducted a comprehensive operational review to identify greater system efficiencies and cost savings to mitigate the effects of the prospective reduction on EBITDA. These savings, which are now largely in place, are anticipated to reduce our general, administrative and non-wage operating costs by an estimated US$24 million on an annualized basis to contain our net reduction of EBITDA to between US$40 million and US$50 million. Throughout this process, our employees worked effectively as a team to minimize the effects of the funding reductions while ensuring that levels of quality care and service to our residents were protected.

Financial Results

For the year, Extendicare's revenue was $2,094.1 million, a 2.6% increase over 2010, excluding the adverse effect of foreign exchange. EBITDA was $200.1 million in 2011, a $36.5 million decline over 2010, excluding the adverse effect of foreign exchange. Excluding an increase in prior years' reserves for self-insured liabilities,

"We maintained our focus on our core business principles with an emphasis on the delivery of quality care and service to our residents."

Timothy L. Lukenda
President & Chief Executive Officer

As we go forward, we will continue to work to enhance the programs and services we provide to our customers and we will continue to make strategic investments in our properties.

EBITDA declined by $5.8 million due to the 2011 CMS Final Rule, with a margin of 11.6% this year compared to 12.2% in 2010.

In spite of these challenges, our distributions in 2011 totalled $70.1 million, or $0.84 per unit, representing 100% of AFFO for the same period.

Liability Reserves

As is the case each year, we conducted a year-end actuarial review of our self-insured general and professional liabilities, the results of which indicated the necessity to further strengthen our prior years' reserves by US$11.2 million in the 2011 fourth quarter. This was in addition to a previously reported strengthening of US$32.1 million after the third quarter review. The total adverse impact of these non-taxable reserves to our 2011 EBITDA, net earnings and AFFO was $42.8 million, or $0.51 per basic unit.

As a result of our initiative to aggressively resolve and close our portfolio of pre-existing claims, we experienced an escalation in settlement activity in the last half of 2011, resulting in a modification of our actuarial projections. Based on current claims activity levels, we believe that our future exposure has been adequately addressed. Barring any significant adverse new developments, we do not anticipate the need to make further material adjustments to our reserves. Extendicare continues to pursue strategies to mitigate liability claims with a view to reducing our exposure in the future. These efforts include dedicating additional resources to risk management, as well as expanding our best practices in the analysis and defense of pre-existing and new claims to reduce their frequency and cost. In addition, we have commenced a review of our portfolio with a strategy to divest of properties in geographic areas with a significantly higher than average loss experience or where other factors exist that have contributed to the need for unusual reserve adjustments.

Looking Ahead

In November 2011, the board of trustees of the REIT (the "Board") unanimously approved the conversion of the REIT from an income trust structure to a corporation by way of a plan of arrangement, subject to the approval of two-thirds of unitholders at the annual and special meeting to be held on May 8, 2012. The Board is confident that the reorganization is in the best interest of unitholders as it will facilitate a more attractive environment for Extendicare's securities, while broadening the potential investor base and positioning Extendicare for greater profitability and future growth.

At Extendicare, we believe quality is the key to our business. As we go forward, we will continue to work to enhance the programs and services we provide to our customers and to make strategic investments in our properties. We will also explore opportunities to expand in related health care businesses. Efforts such as these, combined with our strategic marketing initiatives, will help us successfully grow value for our unitholders in today's challenging economic environment.

Extendicare has a winning combination of strength, quality and stability. We have the financial strength and flexibility to adjust to changing financial conditions, to deliver consistently high quality levels of service to all of our customers, and the stability to drive our future growth and profitability for our stakeholders. We have a proven track record and history of success, a sound business model and an experienced management team with the determination and skills to succeed.

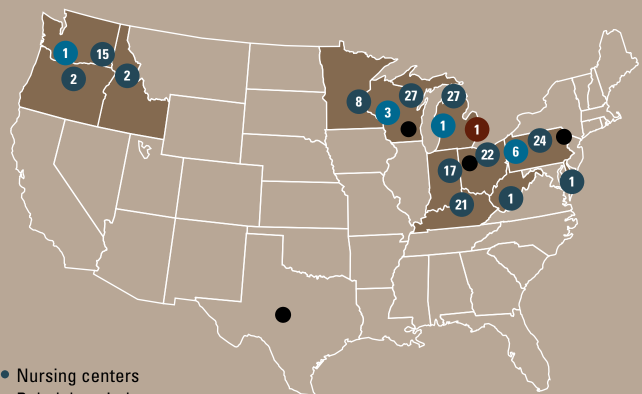
I would like to thank our Extendicare employees for their dedication and hard work, our customers for their loyalty, our Board for their support and our unitholders for their continued support. We remain confident in our future and believe that Extendicare will continue to be a leading provider of post-acute and long-term senior care services in North America.

(signed)

Timothy L. Lukenda
President & Chief Executive Officer

Operations Overview

U.S. Operations



- Nursing centers
- Rehab hospital
- Assisted living & retirement centers
- ProStep outpatient rehab (25 clinics)

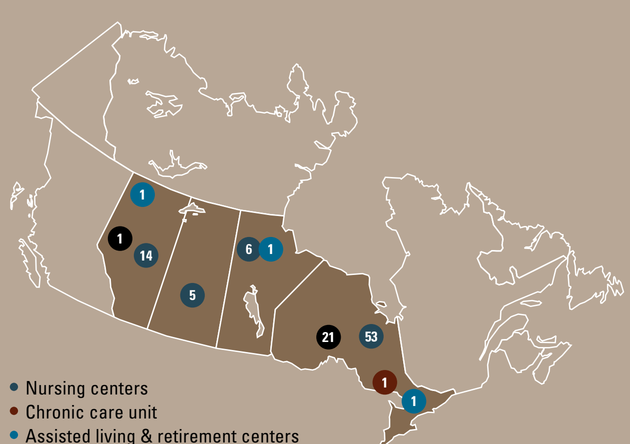
179	17,369	33%	53%
centers in 12 states	beds	quality mix census	quality mix revenue

- Revenue increased 1.3% to US$1,411.1 million
- Higher average daily revenue rates from two highest funding sources
  - Medicare Part A: increased 7.2% to US$504
  - Managed Care: increased 5.2% to US$443
- Two new skilled nursing centers opened during 2010 and 2011
  - 100-bed, Michiana Health and Rehabilitation center in Mishawaka, Indiana (November 2010)
  - 120-bed, Capital Area Health and Rehabilitation center in Lansing, Michigan (January 2011)
- Our Sheboygan Progressive Care Center in Wisconsin was awarded the *2011 Achievement in Quality Silver Award* from the American Health Care Association and the National Center for Assisted Living.
- Almost half, or 88, of our U.S. centers have been awarded the *2011 Achievement in Quality Bronze Award*.

Overview

Extendicare REIT's U.S. operations are conducted through its wholly owned subsidiary, Extendicare Health Services, Inc. (EHSI). The October 2011 Medicare reimbursement cuts reduced our Medicare Part A and Managed Care average daily rates by 11% and 7%, respectively, over the 2011 third quarter levels. We have successfully implemented cost cutting measures to help mitigate the adverse effect of the funding reductions, without affecting resident care. U.S. operations represented approximately 67% of consolidated revenue and EBITDA from continuing operations in 2011.

Canadian Operations



- Nursing centers
- Chronic care unit
- Assisted living & retirement centers
- ParaMed home health care (22 branches)

82	10,738	70%	98%
centers in 4 provinces	beds	of resident capacity in Ontario	occupancy

- Revenue increased 5.3% to $698.3 million
- Additional annual revenue gained through funding increases in Alberta and Ontario
- Three new centers in Alberta opened during 2010 and 2011
  - 280-bed continuing care center in Red Deer (September 2010)
  - 140-bed designated assisted living center in Lethbridge (January 2011)
  - 180-bed nursing center in Edmonton (November 2011)
- Two new state-of-the-art centers under construction in Ontario
  - 180-bed nursing center in Timmins (early 2013)
  - 256-bed nursing center in Sault Ste. Marie (early 2013)

Overview

Extendicare REIT's Canadian Operations are conducted through its wholly owned subsidiary, Extendicare (Canada) Inc. (ECI). Our average same-facility occupancy levels remained consistently close to full capacity in 2011. We continue to invest in our properties and develop new high-quality locations to meet the needs of our residents. Canadian operations represented approximately 33% of consolidated revenue and EBITDA from continuing operations in 2011.

Strength. Quality. Stability.

Extendicare prides itself on developing extensive programs and services designed to help people live better, and we have demonstrated our strength, quality and stability for close to 45 years.

Gardens, walking paths and outdoor seating areas encourage residents and guests to linger outside and socialize.

Extendicare has earned a reputation as a quality organization that consistently delivers excellence to its unitholders through its financial strength and its ability to rapidly adapt to the ever-changing health care environment.

A Tradition of Quality

Strength. Quality. Stability. These three words describe how Extendicare has sustained its growth for investors, as well as its commitment to the people it serves and employs during what can best be described as a turbulent economic and regulatory environment. Extendicare has earned a reputation as a quality organization that consistently delivers excellence to its unitholders through its financial strength and its ability to rapidly adapt to the ever-changing health care environment. Extendicare prides itself on developing extensive programs and services designed to help people live better, and we have demonstrated our strength, quality and stability for close to 45 years.

Strength

In 2011, Extendicare further enhanced its strong financial position by managing risk conservatively, implementing disciplined cost controls and strategically positioning our company for future growth through the completion of our debt refinancing initiative in both the U.S. and Canada.

In keeping with our disciplined approach to growth, the proposed conversion of Extendicare REIT from an income trust to a corporation in 2012 presents several opportunities, such as attracting new investors and providing greater access to larger pools of capital. This new structure will eliminate the administrative costs associated with the current income trust structure and establish a more liquid and attractive market for Extendicare.

Extendicare's greatest strength is its talented pool of employees and the depth of its managerial bench. With an average tenure of 24 years in the health care profession, Extendicare's senior leadership team has the skill to address and overcome the challenges the organization faces with reductions in funding and regulatory demands, without compromising quality.

Pet therapy is used as part of the healing process to reduce stress and promote positive interactions.

Quality

At Extendicare, we help people live better by providing high-quality health care and rehabilitation in a person-centered environment. Our core goal is to build upon Extendicare's reputation as a leading provider of a full range of post-acute services in our communities in North America. The post-acute arena is playing an increasingly critical role in improving the efficiency and effectiveness of health care delivery as a whole, by offering a lower-cost setting for the delivery of complex clinical care developed around recovery and healing.

Personalized rehabilitation plans help identify patient goals and objectives to be accomplished in order to achieve the best results.

We believe in continuous improvement and are constantly assessing our care processes to improve delivery of care, enhance communication across the continuum, and provide a seamless transition from an acute care setting to a post-acute center. Going forward, we will work to further develop best practices for clinical quality and operational efficiency, while aligning with key health care providers to better coordinate care delivery.

Extendicare's achievements in the delivery of quality care and service continue to be recognized on a national basis. In Canada, all of our long-term care homes as well as our home health care centers are accredited by third-party associations. In the U.S., our Sheboygan Progressive Care Center in Wisconsin was one of only 31 centers in the U.S. to receive the American Health Care Association and National Center for Assisted Living *2011 Achievement in Quality Silver Award*. Also in 2011, 24 of our U.S. centers achieved the *2011 Commitment to Quality Bronze Award*, bringing the total number of Extendicare centers to have received the award to 88, which is almost half of our U.S. centers. These awards are a testament to both our commitment to quality and delivery of quality care for residents in our communities and our determination to be the service provider of choice in our profession.

Moving forward, we will continue to invest in our properties, develop new quality centers and explore opportunities for expansion in health care related businesses in both the U.S. and Canada.

Extendicare employees are committed to delivering quality care in the most cost-effective manner. The overriding objective throughout this past year has been tightly focused on continuous quality improvement and solidifying operations so that our residents receive the care and services they expect from individuals they have come to know and trust.

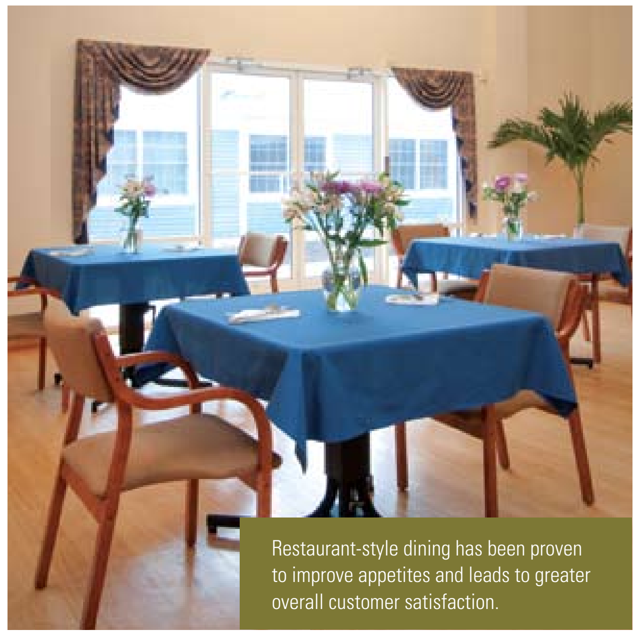
Moving forward, we will continue to invest in our properties, develop new quality centers and explore opportunities for expansion in health care related businesses in both the U.S. and Canada.

Stability

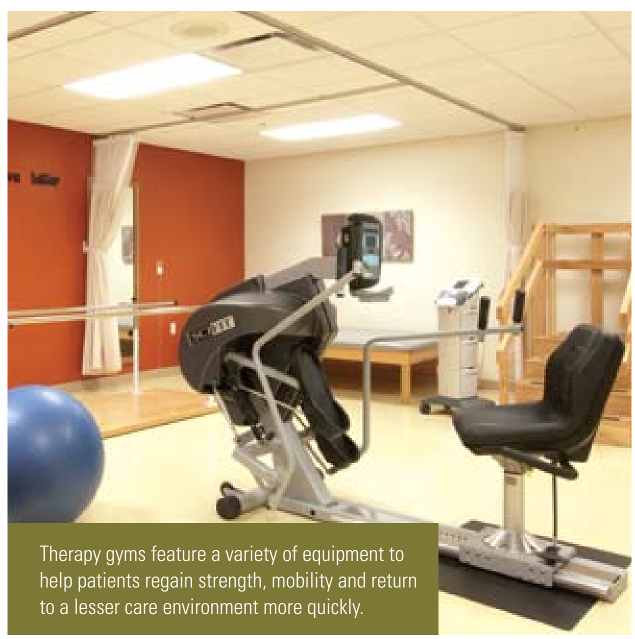
Delivering a quality product in a quality environment allows us to maximize financial performance and deliver sustainable returns to unitholders, while positioning Extendicare well for strategic growth in the health care environment. Despite the incremental costs incurred, Medicare funding reductions, and the increased provision against self-insured general and professional liabilities taken in 2011, Extendicare maintained its unitholder distributions at the current level.

Ensuring a stable return on investment is a priority for Extendicare, as is controlled growth to meet the future demands of a growing demographic. Today's health care budget cuts, increasing costs and the growing number of retiring Baby Boomers will challenge the limits of the current health care system, and the demand for quality, integrated health care services will significantly increase. This generation has high expectations as they do not see health care as merely a "task-based" model of service. Instead, they view it as a care service designed to extend their quality of life as they age.

As we embrace these coming realities, Extendicare's financial stability will position it well to play a key role in the evolution of the health care industry in North America. Our financial health affords us the opportunity to not only be the provider of choice for our patients and residents, but to lead change by piloting new systems of care and maximizing outcomes on a broad scale.



Restaurant-style dining has been proven to improve appetites and leads to greater overall customer satisfaction.



Therapy gyms feature a variety of equipment to help patients regain strength, mobility and return to a lesser care environment more quickly.

Mission, Vision, Values

Our Mission

We help people live better by providing quality, cost-effective health care and rehabilitation primarily to seniors in a resident-directed environment.

We accomplish this by providing remarkable services through highly engaged and motivated members of our team, resulting in an appropriate return to our investors.

Our Vision

Helping people live better, one life at a time, through our people, properties and technology.

People – our experienced and dedicated workforce help improve the quality of people's lives through a commitment to the highest standards of service to residents and their families who entrust us with their health care needs.

Properties – with a track record of over 40 years as an owner and operator of industry-leading North American senior care centers, we are at the forefront in design and excellence in quality care.

Technology – we incorporate technologies into the delivery of health care services to improve care and efficiency.

Our Values

At Extendicare, we value our customers and our team who cares for them. We are committed to treating them with dignity and respect in an atmosphere of compassion. As health care professionals, we take pride in being responsive to the needs of those who rely on us.

Respect ▪ Integrity ▪ Pride ▪ Compassion ▪ Responsiveness ▪ Dignity

Financial Review

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Forward-looking Statements

Information provided by Extendicare REIT from time to time, including this Annual Report, contains or may contain forward-looking statements concerning anticipated future events, results, circumstances, economic performance or expectations with respect to the REIT and its subsidiaries, including its business operations, business strategy, and financial condition. Forward-looking statements can be identified because they generally contain the words "anticipate", "believe", "estimate", "expect", "intend", "objective", "plan", "project" or other similar expressions or the negative thereof.

Forward-looking statements reflect management's current expectations, beliefs and assumptions and are based on information currently available, and the REIT assumes no obligation to update or revise any forward-looking statement, except as required by applicable securities laws. These statements are not representations or guarantees of future performance and are based on estimates and assumptions that involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements of the REIT to differ materially from those expressed or implied in the statements. In addition to the assumptions and other factors referred to specifically in connection with these statements, such factors are identified in the REIT's public filings with the Canadian securities regulators and include, but are not limited to, the following: changes in the overall health of the economy and government; the ability to attract and retain qualified personnel; changes in the health care industry in general and the long-term care industry in particular because of political and economic influences; changes in applicable accounting policies; changes in regulations governing the industry and the compliance of the REIT and its subsidiaries with such regulations; changes in government funding levels for health care services; changes in tax laws; resident care and class action litigation, including exposure for punitive damage claims and increased insurance costs, and other claims asserted against the REIT and its subsidiaries; the ability to maintain and increase census levels; changes in competition; changes in demographics and local environment economies; changes in foreign exchange and interest rates; changes in the financial markets that may affect refinancing of debt; the availability and terms of capital to fund capital expenditures; and the impact of the proposed conversion from an income trust structure to a corporate structure, subject to unitholder approval.

The forward-looking statements contained in this Annual Report are expressly qualified by this cautionary statement. Given these risks and uncertainties, readers are cautioned not to place undue reliance on the forward-looking statements of the REIT.

Management’s Discussion and Analysis

February 29, 2012

Basis of Presentation

Extendicare Real Estate Investment Trust (“Extendicare REIT” or the “REIT”) has prepared this Management’s Discussion and Analysis (MD&A) to provide information to assist its current and prospective investors’ understanding of the financial results for the year ended December 31, 2011. This MD&A should be read in conjunction with Extendicare REIT’s audited consolidated financial statements for the years ended 2011 and 2010, and the notes thereto, found in Extendicare REIT’s 2011 Annual Report. This material is available on Extendicare REIT’s website at www.Extendicare.com. Additional information about Extendicare REIT, including its Annual Information Form, can be found on SEDAR at www.sedar.com.

Extendicare REIT is a leading North American provider of post-acute and long-term senior care services. The REIT itself is not a provider of services or products. The direct ownership and operation of the senior care centers and ancillary businesses is conducted by the subsidiaries of the REIT. This MD&A provides information on Extendicare REIT and its subsidiaries. References to “Extendicare REIT”, the “REIT”, “we”, “us” and “our” in this report mean Extendicare Real Estate Investment Trust alone or together with its subsidiaries, as the context requires. The registered office of Extendicare REIT is located at 3000 Steeles Avenue East, Markham, Ontario, Canada, L3R 9W2.

Extendicare REIT is the successor in interest to Extendicare Inc. (Extendicare) resulting from the conversion of Extendicare to an unincorporated, open-ended limited purpose trust on November 10, 2006, pursuant to a plan of arrangement (the “Arrangement”). Extendicare REIT was established under the laws of the Province of Ontario pursuant to a deed of trust, dated September 11, 2006, as amended and restated on October 28, 2006, and on December 15, 2010 (the “Deed of Trust”). The conversion has been accounted for as a continuity of interest, and accordingly, the consolidated financial statements of the REIT are reflective as if the REIT had always carried on the business formerly carried on by Extendicare.

This MD&A and the accompanying audited consolidated financial statements for the years ended 2011 and 2010, and the notes thereto, have been prepared in accordance with International Financial Reporting Standards (IFRS), with effect from January 1, 2010. Periods prior to January 1, 2010, have not been restated. Note 27 of the 2011 consolidated financial statements contains a detailed description of the REIT’s conversion to IFRS, including a line-by-line reconciliation of its consolidated financial statements prepared under previous Canadian generally accepted accounting principles (GAAP) to those under IFRS for the 2010 year. All dollar amounts are in Canadian dollars unless otherwise indicated. Except as otherwise specified, references to years indicate the fiscal year ended December 31, 2011, or December 31 of the year referenced.

The discussion and analysis in this MD&A is based upon information available to management as of February 29, 2012. This MD&A should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other elements may or may not occur, which could affect the REIT in the future.

We use a number of key performance indicators in this document for monitoring and analyzing our financial results. These performance indicators are not defined by IFRS, and are therefore considered to be non-GAAP measures, which may not be comparable to similar measures presented by other companies. Please refer to the “Key Performance Indicators” section of this MD&A. In addition, a discussion of the non-GAAP measures is provided under the heading “Accounting Policies and Estimates – Non-GAAP Measures”.

Overview

Business Strategy

At Extendicare REIT, our strategy is to create value for our unitholders through the effective operation and growth of our core senior care operations, and complementary long-term care services. By emphasizing the quality of care provided to our residents, our goal is to build upon our reputation as a leading provider of a full range of post-acute services in the community. In pursuing this strategy, an overriding objective is to continually enhance the quality of clinically based services provided to our residents and other clients. The key components of our value-creation strategy include:

- ensuring the continued delivery of quality care and customer service throughout our organization;
- focusing on accommodating short-term, high-acuity and rehabilitation residents that result in increasing the percentage of revenue from Medicare and Managed Care (Skilled Mix) funding sources and higher average daily revenue rates;
- actively maintaining and improving our asset portfolio through a disciplined capital reinvestment program or, where appropriate, through disposition of underperforming or non-strategic centers;
- focusing on achieving operational efficiencies and internal growth in our core business and, when available, growth through new developments and value-creating acquisitions;
- expanding non-government based revenue sources and diversifying within the long-term care industry through our rehabilitative services, information technology, management and consulting businesses;
- enhancing our Canadian businesses, including long-term care and home health care operations; and
- increasing funds from operations and adjusted funds from operations.

For the past several years, the REIT has committed resources to its "back-to-basics" strategy and the prudent stewardship of the management, growth and operations of the business of the REIT carried on through its subsidiaries. This commitment has been successful, particularly in the circumstances involving a weak U.S. economy and a challenging and uncertain regulatory environment.

Effective October 1, 2011, the Centers for Medicare & Medicaid Services (CMS) implemented reductions in Medicare funding to skilled nursing centers along with other changes (the "2011 CMS Final Rule") that, based upon our revised estimates, will reduce EHSI's revenue and EBITDA by between US$64 million and US$74 million on an annualized basis. In light of the 2011 CMS Final Rule, and the uncertainty surrounding further potential Medicare and Medicaid funding reductions, management implemented aggressive cost saving measures to reduce operating and administrative costs by an estimated US$24 million, approximately two-thirds of which were in effect as of October 1, 2011, with the remainder fully in effect as of January 1, 2012. However, none of these cost reduction measures involved a reduction of direct care staffing at our centers. Therefore, the net impact of the 2011 CMS Final Rule on our EBITDA is estimated to be between US$40 million and US$50 million. For more information on recent Medicare and Medicaid funding changes and our mitigation strategies, refer to the discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

During 2011, the REIT strengthened its balance sheet by refinancing a significant portion of its long-term debt with government insured mortgages at lower rates and longer terms to maturity. By the end of 2011, we had closed on US$370.2 million of mortgages insured by the U.S. Department of Housing and Urban Development Program (HUD) to refinance debt in our U.S. operations. In February 2012, we paid off the remaining balance of US$109.9 million on our commercial mortgage backed securitization (CMBS) financing that was due in May 2012, and had closed on a further US$83.2 million of HUD loans. We anticipate closing on the majority of the balance of the approximate US$520 million of new HUD loans by the end of June 2012. As well in Canada, in December 2011, we refinanced $72.4 million of mortgages that were due in March 2013 and insured by the Canadian Mortgage and Housing Corporation (CMHC) with new CMHC mortgages with maturity dates of 2017 and 2022. Collectively, we estimate the savings in annual debt service costs to the REIT will be approximately $25 million. For more information on the debt refinancing plan, refer to the discussion under the heading "Overview – Significant 2011 Events and Developments – 2011 Refinancing Plan".

The board of trustees of the REIT (the "Board" or the "REIT Board") and management continuously review possible strategies, opportunities and alternatives available to the REIT with a view to enhancing the value of the REIT. Provisions of the *Income Tax Act* (Canada) (the "Tax Act") facilitate the conversion of an income trust structure to a corporate structure by 2013 (the "Conversion Rules"). In view of the Conversion Rules, among other things, the Board unanimously approved on November 8, 2011, the conversion of Extendicare REIT (the "Conversion") from an income trust structure to a corporate structure under a new corporation (New Extendicare). The Conversion, which is anticipated to be completed on July 1, 2012, requires two-thirds approval of the unitholders of the REIT (the "Unitholders") voting in person or by proxy at a special meeting of Unitholders (the "Special Meeting") to be held in conjunction with the annual meeting on May 8, 2012. The Board believes that the Conversion is in the best interests of the REIT and the Unitholders and recommends that the Unitholders vote in favour of it. For more information on the proposed conversion, refer to the discussion under the heading "Overview – Significant 2011 Events and Developments – Proposed Corporate Conversion".

Following the completion of the Conversion, it is anticipated that the board of directors of New Extendicare (the "New Extendicare Board") will be comprised of the current members of the REIT Board and that senior management of New Extendicare will be comprised of the current senior management of the REIT and Extendicare Inc.

The declaration and payment of dividends by New Extendicare will be subject to the discretion of the New Extendicare Board, as to the amount of and if and when a dividend is declared and paid, after consideration of the same factors that are currently taken into account by the REIT Board, which factors include results of operations, requirements for capital, future financial prospects and debt covenants, as well as other factors that may be considered to be relevant by the New Extendicare Board. The REIT Board currently anticipates that the New Extendicare Board will declare its first monthly dividend in the month of July, 2012.

The distribution payout ratio of the REIT was approximately 100% for 2011. The 2011 payout ratio increased from prior years due to the strengthening of our reserves for self-insured liabilities in 2011, along with the negative effect of the 2011 CMS Final Rule that took effect October 1, 2011. In 2009, the REIT reduced its distributions in order to manage the uncertainty surrounding the economy, U.S. health care reform and our debt refinancing plans. Consequently, during 2009 and 2010, the payout was at conservative levels of approximately 42% and 62%, respectively. The Board regularly monitors the REIT's cash flow position and projected distribution payout ratio to consider the appropriateness of the REIT's distributions. In spite of the recent and potential for further U.S. funding reductions, the Board has made a determination to maintain distributions at the current level of $0.07 per month. The Board will continue to review the distribution policy on a regular basis, taking into consideration factors as they arise.

We believe that Extendicare REIT is a financially stable company with a conservative capital structure. The ownership of our real estate coupled with our geographic diversity position us favourably to address the numerous funding and regulatory challenges facing the industry. While the U.S. funding reductions will have real consequences in the way we operate our business, we are confident that our efforts, combined with our strategic marketing initiatives, will enable us to be successful in this environment.

Investment Overview

An investment in the units of Extendicare REIT entitles the holder to a monthly cash flow stream, through distributions at the discretion of the REIT Board, as well as the opportunity, or exposure, to changes in the price of the trust units of the REIT (the "REIT Units"), which trade on the Toronto Stock Exchange (TSX) under the symbol "EXE.UN". The Board regularly reviews its distribution policy. The present policy of the Board is to pay monthly distributions of $0.07 per unit, or $0.84 per unit annually. Based on the closing price of the REIT Units on February 29, 2012, of $8.50, this represents a yield of 9.9%. More information about distributions, including tax considerations, is provided under the heading "Distributions".

The REIT is a specified investment flow-through trust, or SIFT, and since 2007 has been subject to SIFT tax at tax rates that are comparable to the general corporate tax rate applicable to Canadian corporations. Therefore, the Conversion itself will not impact the funds available for distribution by New Extendicare to its shareholders.

Our long-term growth and financial performance is influenced by a number of factors. First and foremost among these factors is the demand for senior care centers and other related long-term care services in the United States and Canada. In both countries, the outlook for these services is favourable due to an aging population as the "baby-boomer" generation enters its senior years. For example, the U.S. Census Bureau estimates that the number of Americans aged 65 to 84 will increase by 36.2% between 2010 and 2020 compared to a total population growth of 10.0%. Secondly, other important factors affecting results are developments related to government funding in such programs as Medicare and Medicaid in the United States and the envelope funding systems in Ontario. Given that 66.7% of our revenue from continuing operations that was earned in 2011 (2010 year – 68.4%) was generated from our U.S. operations, Medicare and Medicaid funding is particularly significant for our financial performance. In March 2010, the U.S. government passed health care reform legislation and in July 2011, CMS announced the 2011 CMS Final Rule that includes Medicare funding reductions and other policy changes that will have a significant impact on the industry. For a discussion of health care reform, recent Medicare and Medicaid funding changes, and other factors affecting the outlook for future funding, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States". Lastly, the long-term care services that we provide are in competition to a degree with other health care providers including assisted living centers, home health agencies, hospice providers and long-term acute care, or LTAC, units within hospitals. Increasingly, state Medicaid programs in the U.S. and provincial programs in Canada are attempting to divert potential admissions to assisted living centers and home care programs. In addition, Medicaid programs are utilizing Managed Care programs to limit the length of stay of our residents in the United States.

Our financial performance is also affected by changes in the U.S./Canadian dollar exchange rate as the results of our U.S. operations are reported in Canadian dollars and the REIT's distributions are made in Canadian dollars. Consequently, our financial performance benefits when the Canadian dollar weakens relative to the U.S. currency, and conversely our results are negatively impacted when the U.S. dollar weakens relative to the Canadian dollar. Our distributions are funded from both our U.S. and Canadian operations and, therefore, changes in the value of the U.S. dollar could have an impact on our cash available for distribution. We have a foreign currency hedging strategy whereby we monitor and consider entering into foreign currency forward contracts (FCFCs) to reduce the risks associated with changes in the U.S. dollar and the impact such changes could have on our Canadian dollar distributions. Information about the impact of currency translation on our financial results and a review of our foreign currency hedging strategy is provided in the section "Impact of U.S. Dollar and Foreign Currency Translation".

Business Overview

Extendicare REIT, through its wholly owned subsidiary operating entities, is a major provider of short-term and long-term senior care services through its network of owned and operated health care centers in North America, operating 261 senior care centers with capacity for 28,107 residents at December 31, 2011.

The REIT's wholly owned U.S. subsidiary, Extendicare Health Services, Inc. and its subsidiaries (collectively "EHSI"), operates 179 senior care centers with capacity for 17,369 residents, and has a significant presence (more than 10% of its resident capacity) in each of Pennsylvania, Michigan, Wisconsin, Ohio and Kentucky. EHSI offers a continuum of health care services, including nursing care, assisted living and related medical specialty services, such as post-acute care and rehabilitative therapy on an inpatient and outpatient basis.

The REIT's wholly owned Canadian subsidiary, Extendicare (Canada) Inc. and its subsidiaries (collectively "ECI"), operates 82 senior care centers, with capacity for 10,738 residents. ECI has a significant presence in Ontario and Alberta, where approximately 70% and 15% of its residents are served, respectively. Also, through its ParaMed Home Health Care (ParaMed) division, ECI is a major provider of home health care in Ontario and Alberta.

Extendicare REIT owns rather than leases a majority of its properties, unlike a number of other long-term care providers. At December 31, 2011, excluding centers under management contracts, we owned or operated under lease arrangements with options to purchase 222 centers, or approximately 98%, of our 227 owned or leased centers. We believe that ownership increases our operating flexibility by allowing us to: refurbish centers to meet changing consumer demands; expand or add assisted living and retirement centers adjacent to our nursing centers; adjust licensed capacity to avoid occupancy-based rate penalties; and divest centers and exit markets at our discretion.

The following depicts ownership and management of senior care centers operated by EHSI and ECI at December 31, 2011.

	Nursing Centers		Assisted Living and Retirement Centers		Rehab Hospital/ Chronic Care Units		Total	
By Type of Ownership	No. of Centers	Resident Capacity	No. of Centers	Resident Capacity	No. of Centers	Resident Capacity	No. of Centers	Resident Capacity
United States								
Owned	158	15,902	4	310	1	28	163	16,240
Leased (1)	5	520	–	–	–	–	5	520
Managed	4	399	7	210	–	–	11	609
Total	167	16,821	11	520	1	28	179	17,369
Canada								
Owned	48	6,554	1	200	–	–	49	6,754
Leased (1)	10	1,250	–	76	–	–	10	1,326
Managed	20	2,273	2	265	1	120	23	2,658
Total	78	10,077	3	541	1	120	82	10,738
Total	**245**	**26,898**	**14**	**1,061**	**2**	**148**	**261**	**28,107**

(1) Of the centers operated under lease arrangements: 10 centers are under capital lease arrangements, representing nine centers in Canada under 25-year capital lease arrangements maturing beginning in 2026 through to 2028; and one center in the U.S. is under a 10-year capital lease arrangement maturing in 2020.

The following reflects the change in operating capacity of our senior care centers during the 2011 and 2010 years.

	2011		2010	
Extendicare REIT Senior Care Centers	**No. of Centers**	**Operational Beds/Units**	No. of Centers	Operational Beds/Units
As at beginning of the year	**266**	**29,447**	268	29,957
Development (owned and leased) (1)	**3**	**500**	2	320
Managed contracts added	**6**	**349**	5	272
Managed contracts matured (2)	**(11)**	**(1,765)**	(1)	(148)
Closed (3)	**(2)**	**(175)**	–	(34)
Divested (4)	**(1)**	**(92)**	(8)	(898)
Operational capacity adjustments (5)	**–**	**(157)**	–	(22)
As at the end of the year	**261**	**28,107**	266	29,447

(1) 2011 activity: In January we opened a 140-unit designated assisted living unit in Lethbridge, Alberta, and a 120-bed skilled nursing center in Lansing, Michigan. In February and November, we opened the 60 designated assisted living units of our Red Deer center, and the 180-bed nursing center in Edmonton, Alberta, respectively. 2010 activity: In September we opened a 220-bed nursing center in Red Deer, Alberta, and in November we entered into a lease arrangement on a 100-bed skilled nursing center in South Bend, Indiana.

(2) The 11 matured managed contracts during 2011 related primarily to eight centers that had been managed by ECI under a bankruptcy action that were sold to a third party effective January 1, 2011.

(3) The closed nursing centers relate to our Lethbridge and Edmonton, Alberta nursing centers that closed upon the opening of our new centers in the region. The operational beds of the Lethbridge nursing center were reduced by 34 in the 2010 fourth quarter prior to its closure.

(4) Refer to the discussion under the heading "Other Significant Developments – Divestitures and Assets Held for Sale".

(5) The 2011 and 2010 reduction in operational capacity was due primarily to U.S. beds that have been pulled out of service in order to increase our Medicaid rate and to accommodate rehabilitation suites.

Significant 2011 Events and Developments

This section summarizes the impact of the following items on the operations of the REIT: the 2011 CMS Final Rule, the impairment charge for property and goodwill, the status of our 2011 refinancing plan, divestiture of our U.S. group purchasing organization, the additional provision for self-insured general and professional liabilities, the proposed corporate conversion, and the redemption of Extendicare Limited Partnership units. Refer to the discussion under the heading "Other Significant Developments" for a summary of other developments affecting the financial results or operations of Extendicare REIT.

2011 CMS FINAL RULE

The 2011 CMS Final Rule includes an 11.1% reduction in Medicare funding to skilled nursing centers along with the elimination of group therapy and changes in the assessment process. As previously announced, we estimated that the impact of these changes, prior to implementing cost saving initiatives, would reduce our revenue and EBITDA in the range of US$70 million to US$80 million. However, we estimate that the actual impact on our 2011 fourth quarter results has been approximately US$15 million. The adverse effect was not as much as anticipated due to the transitional rules that delayed the full implementation of the changes during the 2011 fourth quarter. Though we continue to assess the impact of the 2011 CMS Final Rule, our revised estimate of the negative effect on our revenue and EBITDA is in the range of US$64 million to US$74 million, prior to our cost saving measures. We have taken measures to help mitigate the adverse effect of the elimination of group therapy and the assessment process changes, such as employing more therapists and improving productivity.

Prior to October 1, 2011, we completed a thorough review of our operations and implemented a number of changes within our organization and secured vendor pricing concessions. These savings are anticipated to reduce our general, administrative and non-wage operating costs by an estimated US$24 million on an annualized basis, approximately two-thirds of which were in effect as of October 1, 2011, with the remainder fully in effect as of January 1, 2012. None of these cost saving measures involved a reduction of direct care staffing at our centers. Therefore, our revised estimate of the net negative effect of the 2011 CMS Final Rule on our EBITDA, partially offset by our cost saving initiatives, is in the range of US$40 million to US$50 million.

For further details on the announced cuts and their estimated impact to us, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

IMPAIRMENT OF PROPERTY AND GOODWILL

In accordance with the recently adopted IFRS, we are required to conduct an impairment test upon the occurrence of a triggering event and, at a minimum, annually for goodwill and indefinite life intangible assets. The 2011 CMS Final Rule, as discussed above, was announced in July 2011, and therefore, necessitated an impairment review of our U.S. property and goodwill as at September 30, 2011.

As a result, we recorded a non-cash impairment charge in the 2011 third quarter in connection with the revaluation of our U.S. properties and goodwill in the amount of pre-tax $54.0 million (after-tax $41.5 million), of which $22.4 million related to goodwill that is not tax effected. This impairment charge is a non-cash item and is excluded from our determination of EBITDA and AFFO. The determination of the impairment was based on the estimated impact to our Medicare funding and therapy operations, along with other factors. The full impact of the 2011 CMS Final Rule can only be determined after actual results are known along with a sufficient amount of time that includes the benefit of mitigating factors. Further evaluation of the determination of recoverable amounts will be conducted in 2012. Due to uncertainties in the estimation process, actual results could differ significantly from such estimates. For further information, refer to *note 17* of the 2011 consolidated financial statements.

As previously reported, at the time of adoption of IFRS, we elected to revalue selected nursing centers at fair value, which resulted in a net increase in property and goodwill of $305.3 million, with the offset booked to retained earnings, effective January 1, 2010.

2011 REFINANCING PLAN

U.S. Operations

EHSI is in the final stages of refinancing approximately US$636 million of debt with approximately US$520 million in HUD-insured mortgages and US$116 million of cash on hand. As at December 31, 2011, EHSI had closed on 49 HUD loans totalling US$370.2 million in connection with this refinancing and anticipates closing on the majority of the remaining 22 new HUD loans totalling US$149.8 million by the end of June 2012. Upon conclusion of the refinancing, EHSI anticipates it will have closed on approximately US$520 million in new HUD-insured mortgages with a weighted average rate of approximately 4.35%, inclusive of mortgage insurance premium (MIP) fees, and term to maturity of about 33 years. The estimated annualized interest savings from the refinancing is US$20 million.

The debt being refinanced related to EHSI's CMBS financings due in March 2012 (the "March 2012 CMBS Financing") and in May 2012 (the "May 2012 CMBS Financing"), mortgage financing from Sovereign Bank and other lenders (the "Sovereign Loans"), and approximately US$17.5 million of advances on EHSI's US$70.0 million credit facility (the "EHSI Credit Facility"). The Sovereign Loans were repaid in June 2011, and the March 2012 CMBS Financing and May 2012 CMBS Financing were fully repaid by the end of November 2011 and February 2012, respectively.

As at February 29, 2012, of the 71 HUD-loan applications submitted totalling US$520 million, we have closed on 61 HUD loans with a principal balance of US$453.4 million. In addition, we have received commitments to close on a further five HUD loans totalling US$43.8 million, all of which are under rate lock agreements and are anticipated to close in the 2012 first quarter. Collectively, the weighted average interest rate of the closed loans and those under commitment with a rate lock is 4.35% (including MIP fees of 0.50%), with an average term to maturity of about 33 years. We anticipate obtaining and closing on the majority of the remaining five HUD commitments before the end of June 2012.

In July 2010, EHSI received approval as a corporate entity to proceed with HUD applications, subject to an overall limit of US$550.0 million, and in December 2011, received approval to increase the financing capacity to an overall limit of US$585.0 million. EHSI already had approximately US$27 million of HUD loans issued prior to this refinancing plan, and therefore, anticipates utilizing approximately US$547 million of its US$585 million overall limit. EHSI plans to secure further HUD financed loans in 2012 and 2013. As at December 31, 2011, EHSI had US$53 million of cash on hand and upon completion of the refinancing anticipates having US$20 million of cash, and approximately 50 unencumbered centers valued at an estimated US$250 million.

Canadian Operations

In December 2011, the REIT's Canadian operations refinanced $72.4 million in mortgages secured by 20 centers insured by CMHC that were at fixed rates of 9.81% and due to mature in March 2013. The new debt consists of $36.2 million secured by nine centers at a fixed rate of 2.986% maturing in 2022, $22.9 million secured by nine centers at a fixed rate of 2.22% maturing in 2017, and a variable-rate bridge loan of $13.3 million secured by two centers due in June 2013, for which we are seeking to secure new CMHC certificates to replace the existing ones that mature in 2022. A prepayment penalty of approximately $7.5 million was recognized in the 2011 fourth quarter. The estimated annualized interest savings from this refinancing is $5 million.

For further information on the U.S. and Canadian refinancings, refer to *note 11* of the 2011 consolidated financial statements.

DIVESTITURE OF U.S. GROUP PURCHASING ORGANIZATION

In December 2011, EHSI reached an agreement in principle to sell its U.S. group purchasing organization, or GPO, to Navigator Group Purchasing, a subsidiary of Managed Health Care Associates, Inc., resulting in the reclassification of the GPO earnings to discontinued operations for the 2011 and 2010 comparative periods. The transaction was finalized and closed in January 2012, for cash proceeds of US$56 million, and will result in an after-tax gain of approximately US$33 million in the 2012 first quarter.

SELF-INSURED GENERAL AND PROFESSIONAL LIABILITY PROVISION

The REIT assesses the adequacy of its self-insured general and professional liability provision based upon an independent actuary report of its liability claims, which is conducted three times a year, in the second and third quarters and at year end. The accrual for self-insured liabilities is based on management's best estimate of the ultimate cost to resolve general and professional liability claims, including both known claims and claims that have been incurred but not yet reported by the end of the reporting period. Actual results can differ materially from the estimates made due to a number of factors including both other market forces and the assumptions used by management.

The results of the actuarial reviews conducted during the 2011 third quarter and at year end necessitated the strengthening of our prior years' reserves by $31.4 million (US$32.1 million) and $11.4 million (US$11.2 million), respectively. These additional reserves were necessary as a result of higher than anticipated paid settlement amounts, increases for settlements on known and unknown claims and adverse claim developments in the second half of 2011. The total adverse impact of these non-taxable reserves to our 2011 EBITDA, net earnings and AFFO was $42.8 million (US$43.3 million), or $0.51 per basic unit, of which $31.4 million (US$32.1 million), or $0.38 per basic unit, was recorded in the 2011 third quarter and the balance in the fourth quarter.

The REIT has experienced an increase in the volume of claims received and has accelerated settlements on prior years' claims, where appropriate, through bulk settlements and other more aggressive claims management practices. These factors were the primary contributors to the determination by the actuary of a need to strengthen the reserves in the 2011 third quarter. As a result of our initiative to aggressively resolve and close our portfolio of pre-existing claims, we experienced an acceleration in settlement activity in the last half of 2011, which we believe resulted in a further modification of our actuarial projections at year end. We believe that the steps we have taken during the past year, including a more proactive case evaluation and acceleration of the time to resolve existing claims, have improved our positioning relative to our exposures for pre-existing claims. As such, we believe we are adequately reserved for our current exposure on known and unknown claims as at December 31, 2011. Barring any significant adverse new developments, we do not anticipate the need to make further material adjustments to our reserves. Furthermore, we have undertaken a review of our portfolio with a strategy to divest of properties in geographic areas with a significantly higher than average loss experience or where other factors exist that have contributed to the need for unusual reserve adjustments.

For further information on our self-insured liabilities, refer to the discussion under the heading "Accrual for Self-insured Liabilities".

PROPOSED CORPORATE CONVERSION

At a meeting held on November 8, 2011, the Board unanimously approved the conversion of the REIT from an income trust structure to a corporate structure under a new corporation. The Conversion will be implemented by way of a plan of arrangement, subject to the approval of the Unitholders, as recommended by the Board.

In evaluating and approving the Conversion and in making its determination and recommendation, the REIT Board relied upon legal, tax and other advice and information received during the course of its deliberations and considered, among other things, the following factors and benefits of the Conversion:

- the Conversion provides Extendicare REIT with an effective and efficient method of converting from an income trust structure to a corporate structure consistent with the Conversion Rules that were designed to facilitate tax-efficient conversions of income trusts to corporations if completed on or before December 31, 2012 (the "Termination Date");
- because a conversion by the REIT from an income trust structure to a corporate structure after the Termination Date would have negative tax consequences to the REIT and/or subsidiaries of the REIT, and in view of the fact that the REIT has been subject to SIFT tax since its formation, the Board determined (taking into account the advice of counsel) that it would be imprudent for the REIT not to utilize the Conversion Rules to effect the Conversion before the Termination Date;
- the Conversion will be completed in accordance with the "exchange method" provided by the Conversion Rules and Unitholders will be able to exchange their REIT Units for common shares of New Extendicare on a tax-deferred basis for Canadian federal income tax purposes;
- the reorganized structure of the REIT as a corporation with share capital will remove the restriction on non-Canadian ownership imposed on income trusts, which may attract new investors, including U.S. and other non-resident investors, and provide a more liquid and attractive market for the common shares of New Extendicare than the market that currently exists for the REIT Units;
- a corporate structure will potentially enhance New Extendicare's access to larger pools of capital;
- New Extendicare will be able to utilize certain provisions of the Tax Act which provide for flexibility in structuring acquisitions on a tax-deferred basis and which will allow New Extendicare to use its shares as currency on acquisitions; and
- the Conversion will eliminate the administrative costs associated with the REIT's income trust structure.

The REIT Board also considered the unavailability to taxable Canadian Unitholders of the Canadian income tax deferral associated with distributions made by Extendicare REIT that are "returns of capital", but concluded that the benefits of the Conversion and the consequences of not completing the Conversion by the Termination Date were compelling reasons to approve the Conversion and to recommend that Unitholders vote in favour of it.

Under the Conversion, which is anticipated to be completed on July 1, 2012, Unitholders will exchange their REIT Units for common shares of New Extendicare on the basis of one common share of New Extendicare for each REIT Unit. In addition, New Extendicare will assume all of the obligations of Extendicare REIT in respect of the REIT's outstanding 5.70% convertible unsecured subordinated debentures due June 30, 2014, and 7.25% convertible unsecured subordinated debentures due June 30, 2013 (collectively, the "Convertible Debentures"). As a result, following the completion of the Conversion, holders of the Convertible Debentures will be entitled to receive common shares of New Extendicare on the same basis as REIT Units were previously issuable on the conversion thereof.

Following the completion of the Conversion, it is anticipated that the New Extendicare Board will be comprised of the current members of the REIT Board and that senior management of New Extendicare will be comprised of the current senior management of the REIT and Extendicare Inc.

Subject to the discretion of the REIT Board to determine the amount of and when a distribution is declared and paid by the REIT to Unitholders, the REIT expects to continue to pay a monthly distribution of $0.07 per REIT Unit to the Unitholders of record on the last business day of each month up to and including the month immediately preceding the month in which the Conversion is completed. If the Conversion is approved by the Unitholders and completed on July 1, 2012, as anticipated, any distribution in respect of the month of June, 2012 would be the last distribution made by the REIT. After the completion of the Conversion, any distributions made by New Extendicare to its shareholders will be paid as dividends.

The REIT has been subject to SIFT tax since 2007 at tax rates that are comparable to the general corporate tax rate applicable to Canadian corporations. Therefore, the Conversion itself will not impact the funds available for distribution by New Extendicare to its shareholders. The declaration and payment of dividends by New Extendicare will be subject to the discretion of the New Extendicare Board, as to the amount of and if and when a dividend is declared and paid, after consideration of the same factors that are currently taken into account by the REIT Board, which factors include results of operations, requirements for capital, future financial prospects and debt covenants, as well as other factors that may be considered to be relevant by the New Extendicare Board. The REIT Board currently anticipates that the New Extendicare Board will declare its first monthly dividend in the month of July, 2012.

The Conversion must be approved by two-thirds of the votes cast by Unitholders voting in person or by proxy at the Special Meeting to be held in conjunction with the annual meeting on May 8, 2012, approval of the Ontario Superior Court of Justice and various regulatory approvals (including the approval of the TSX). Further details relating to the Conversion will be contained in a management information and proxy circular to be prepared and distributed in connection with the Special Meeting.

REDEMPTION OF EXTENDICARE LIMITED PARTNERSHIP UNITS

In accordance with the Limited Partnership Agreement dated September 11, 2006, on November 10, 2011, Extendicare Limited Partnership (Extendicare LP) redeemed all of its then outstanding units (the "Exchangeable LP Units"). The redemption price for each Exchangeable LP Unit (the "Redemption Price") was $7.31, being the amount equal to the sum of: (a) the $7.24 closing price of a REIT Unit on the TSX on November 9, 2011; and (b) the amount of all declared and unpaid distributions on such Exchangeable LP Unit as of November 10, 2011 (being the October distribution of C$0.07 per unit). The Redemption Price was satisfied by Extendicare LP causing to be delivered to each registered holder of Exchangeable LP Units a certificate or certificates representing one REIT Unit for each Exchangeable LP Unit held by such holder together with a cheque in respect of the remaining portion of the Redemption Price for each Exchangeable LP Unit held by such holder, less any applicable withholding taxes.

Key Performance Indicators

In order to compare the REIT's financial performance between periods, management assesses the key performance indicators for all of its continuing operations. In addition, we assess the operations on a same-facility basis between the reported periods. Set forth below is an analysis of the key performance indicators and a discussion of significant trends when comparing the REIT's financial results.

The following is a glossary of terms for some of our key performance indicators:

"ADC" means average daily census, and is the number of residents occupying a bed over a period of time, divided by the number of days in that period;

"Census" is defined as the number of residents occupying beds (or units in the case of an assisted living center);

"CI" means commercial insurance, which is a form of health care coverage in the United States;

"CMI" means case mix index, which is a measure of the relative cost or resources needed to treat the mix of patients or residents;

"HMO" means health maintenance organization, which is a type of managed care organization that provides a form of health care coverage in the United States;

"Managed Care" refers collectively to HMO and CI payor sources, but does not include HMOs serving Medicaid residents, which are included in the Medicaid category;

"Non-same facility", in the context of comparing our 2011 and 2010 operations in this document, refers to those centers that we have either ceased operating (including those under a sale agreement) or those centers that are new to our portfolio, since January 1, 2010;

"Occupancy" is measured as the percentage of census relative to the total available resident capacity. Total operational resident capacity is the number of beds (or units in the case of an assisted living center) available for occupancy multiplied by the number of days in the period;

"Quality Mix" is the measure of the level of non-Medicaid payor sources. In most states, Medicaid is the least attractive payor source as rates are the lowest among all payor types;

"Same facility", in the context of comparing our 2011 and 2010 operations in this document, refers to those centers that were operated by us on January 1, 2010, and throughout 2010 and 2011; and

"Skilled Mix" refers collectively to Medicare and Managed Care payor sources. These sources generally include residents with short-term rehabilitative needs that we focus on accommodating.

U.S. Operations

We focus on short-term stay programs and offering care to residents with higher acuity and those requiring rehabilitative care and services in our skilled nursing center operations. These residents are primarily admitted into our centers with Medicare and Managed Care as their primary funding source. Medicaid rates are generally lower than rates earned from other sources. Therefore, we consider Skilled Mix to be an important performance measurement indicator. During 2011 approximately 82% (2010 – 81%) of our admissions were Medicare or Managed Care funded, with 53% (2010 – 54%) funded by Medicare and 29% (2010 – 27%) funded by Managed Care.

Our goal in the U.S. skilled nursing center operations is to grow revenue by providing higher acuity and short-term rehabilitative services to our residents, thereby increasing the revenue derived from Medicare programs and Managed Care organizations providing Medicare and Medicaid replacement products. Individuals who do not qualify for a funded program pay for the services directly. Therefore, we focus on these payor types to increase average daily revenue rates and improve Quality Mix census as a percentage of the total ADC. After the short-term rehab portion of a resident's stay, residents who require further longer-term care and who do not have the financial means to pay for their care, seek funding from state Medicaid programs at rates that are generally lower than those earned from other sources.

Our data collection and reporting system allows us to electronically track the condition of the residents and services provided for them. This electronic system enables us to operate more efficiently within the Resource Utilization Groupings (RUGs) classifications system, by ensuring that appropriate payment is received for services being delivered and, thereby, increasing our average Medicare rates.

SKILLED NURSING CENTER REVENUE BY PAYOR SOURCE

EHSI's average daily Medicare Part A rate, excluding prior period settlement adjustments, increased by 7.2% in 2011 to US$503.75 from US$470.11 in 2010. However, the financial impact of the October 2010 implementation of MDS 3.0 and RUG-IV, followed by the 2011 CMS Final Rule, significantly impacted the average daily Medicare Part A rates in each of the quarters subsequent to October 1, 2010. Following the October 2010 funding changes that CMS stated were intended to be budget neutral, our average Medicare Part A rates increased by 12.7% for the first nine months of 2011 over the same 2010 period, or from US$458.01 in 2010 to US$516.23 in 2011. Following the implementation of the 2011 CMS Final Rule, our average Medicare Part A rates declined by 8.9% in the 2011 fourth quarter to US$463.89 from US$508.95 in the 2010 fourth quarter and decreased by 11.0% from the 2011 third quarter rate of US$521.24. The decline in our average Medicare Part A rates in the 2011 fourth quarter was not as much as anticipated due to the transitional rules provided for in the changeover to the new assessment process. For a discussion of recent Medicare funding changes, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

The percentage of Medicare residents receiving therapy services declined to 86.3% in 2011 from 90.0% in 2010, and for the 2011 fourth quarter, was 85.7% as compared to 84.6% in the 2010 fourth quarter. We believe the declines in therapy services experienced over 2010 were primarily due to the implementation of MDS 3.0 and RUG-IV, the result of more frequent assessments, the limitations on the look-back period and the elimination of billing for concurrent and group therapy services.

The average revenue rate for Managed Care clients, excluding prior period settlement adjustments, improved by 5.2% in 2011 to US$442.81 from US$421.11 in 2010. The CMS changes implemented in October 2010 and 2011 discussed above, likewise impacted the Managed Care rates as approximately 45% of our Managed Care residents have rates that are RUGs-based or partially aligned to the Medicare rates. Following the October 2010 funding changes, our average Managed Care rates increased by 8.3% for the first nine months of 2011 over the same 2010 period, or from US$414.02 in 2010 to US$448.30 in 2011. Following the implementation of 2011 CMS Final Rule, our average Managed Care rates declined by 3.9% to US$425.80 in the 2011 fourth quarter from US$442.88 in the 2010 fourth quarter and decreased by 7.0% from the 2011 third quarter of US$457.71. The decline in our average Managed Care rates in the 2011 fourth quarter was not as much as anticipated due to the transitional rules provided for in the changeover to the new assessment process. The Managed Care segment represents the second highest rate component of our Quality Mix of residents. As such we will continue to focus on building relationships with key Managed Care organizations and establishing rates that are reflective of the services we are providing.

Though we continue to assess the impact of the 2011 CMS Final Rule, our revised estimate of the negative effect on our revenue and EBITDA is in the range of US$64 million to US$74 million, prior to our cost saving measures.

Our average daily Medicaid rate, excluding prior period settlement adjustments, increased by 1.2% in 2011 to US$182.49 over US$180.27 in 2010. For the 2011 fourth quarter, our average Medicaid rate increased by 1.8% to US$184.83 from US$181.58 in the 2010 fourth quarter and by 0.8% over the 2011 third quarter rate of $183.42. However, revenue from the Medicaid rate increases was partially offset by higher state provider taxes, resulting in a net increase of 0.9% in 2011. For the majority of the states in which we operate, Medicaid funding changes take effect in July and October. For a discussion of recent Medicaid funding changes, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

The following table provides the percentage of EHSI's revenue by payor source and the average revenue rates for its skilled nursing centers from total operations (includes operations formerly designated as "discontinued"), excluding prior period settlement adjustments, for the past eight quarters and the 2011 and 2010 years.

	Q1		Q2		Q3		Q4		Year	
(total operations)	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010
Revenue by Payor Source *(%)*										
Medicare	**36.7**	33.3	**36.2**	33.6	**34.8**	32.6	**32.2**	33.9	**34.9**	33.3
Managed Care	**10.3**	9.4	**10.1**	9.4	**10.0**	9.4	**9.6**	9.7	**10.0**	9.5
Skilled Mix	**47.0**	42.7	**46.3**	43.0	**44.8**	42.0	**41.8**	43.6	**44.9**	42.8
Private/other	**8.1**	9.0	**8.0**	9.1	**8.6**	9.3	**9.1**	9.2	**8.5**	9.2
Quality Mix	**55.1**	51.7	**54.3**	52.1	**53.4**	51.3	**50.9**	52.8	**53.4**	52.0
Medicaid	**44.9**	48.3	**45.7**	47.9	**46.6**	48.7	**49.1**	47.2	**46.6**	48.0
	100.0	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0
Average Revenue Rate by Payor Source *(US$)*										
Medicare Part A	**515.49**	456.35	**515.90**	457.23	**521.24**	460.61	**463.89**	508.95	**503.75**	470.11
Medicare Parts A and B	**552.58**	499.38	**555.03**	499.38	**569.12**	509.19	**513.24**	554.94	**546.91**	514.96
Managed Care	**447.77**	406.85	**441.06**	416.18	**457.71**	419.31	**425.80**	442.88	**442.81**	421.11
Private/other	**221.07**	224.42	**228.04**	222.74	**226.49**	218.81	**224.17**	221.51	**224.91**	221.85
Medicaid	**180.20**	178.56	**180.99**	180.08	**183.42**	180.39	**184.83**	181.58	**182.49**	180.27
Weighted average	**266.40**	249.71	**266.27**	252.15	**266.56**	250.75	**255.46**	260.08	**263.56**	253.22

The following table provides the percentage of EHSI's revenue by payor source for its skilled nursing centers on a same-facility basis, excluding prior period settlement adjustments, for the past eight quarters and the 2011 and 2010 years.

	Q1		Q2		Q3		Q4		Year	
(same-facility operations)	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010
Revenue by Payor Source *(%)*										
Medicare	**36.5**	33.5	**35.8**	33.8	**34.3**	32.6	**31.9**	33.8	**34.6**	33.5
Managed Care	**10.3**	9.5	**10.2**	9.5	**10.0**	9.5	**9.7**	9.8	**10.0**	9.5
Skilled Mix	**46.8**	43.0	**46.0**	43.3	**44.3**	42.1	**41.6**	43.6	**44.6**	43.0
Private/other	**8.1**	9.0	**8.0**	9.0	**8.7**	9.3	**9.0**	9.2	**8.5**	9.1
Quality Mix	**54.9**	52.0	**54.0**	52.3	**53.0**	51.4	**50.6**	52.8	**53.1**	52.1
Medicaid	**45.1**	48.0	**46.0**	47.7	**47.0**	48.6	**49.4**	47.2	**46.9**	47.9
	100.0	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0

On a same-facility basis, the proportion of our Skilled Mix revenue to total revenue improved to 44.6% in 2011 from 43.0% in 2010. However, in the 2011 fourth quarter we experienced a decline to 41.6% from 43.6% in the 2010 fourth quarter, and a decline from 44.3% in the 2011 third quarter. The improvement over 2010 is largely reflective of the higher average daily rates resulting from the October 2010 funding changes, while the decline in the 2011 fourth quarter is largely a result of the October 2011 funding reductions. In addition, the percentage of Skilled Mix revenue was impacted by lower Skilled Mix census levels, as discussed in the following section.

For more information on Medicare and Medicaid funding in the U.S., including recent developments and their impact or expected impact on Extendicare REIT, please see "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

SKILLED NURSING CENTER AVERAGE DAILY CENSUS

We continue to be adversely affected by the U.S. economic recession that has reduced disposable income of individuals and resulted in a general restraint by the public on health care spending. Lower hospital census has resulted in fewer admissions, and the implementation of MDS 3.0 and RUG-IV as of October 2010 has also resulted in a small reduction in our average length of stay for short-term admissions. In addition, certain state Medicaid programs are attempting to divert potential admissions to assisted living centers and home care programs.

We have implemented a number of short and longer-term tactics, which take a more strategic approach to identifying and meeting the program and service needs of each community in which we are located. Included in these initiatives are the establishment of Active Life Transition Units (ALTUs) that are upgraded suites targeted to attract our short-term rehab residents. We currently have 11 ALTUs and plan to continue to expand the number of centers with ALTUs within certain of our centers. As a result, we have been successful in sustaining our Skilled Mix census as a percentage of total ADC.

The following table provides the ADC, percentage of total ADC, and average occupancy of EHSI's skilled nursing centers from total operations, for the past eight quarters and the 2011 and 2010 years.

	Q1		Q2		Q3		Q4		Year	
(total operations)	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010
Average Daily Census										
Medicare	**2,524**	2,498	**2,451**	2,499	**2,296**	2,303	**2,250**	2,249	**2,379**	2,387
Managed Care	**871**	867	**862**	835	**818**	814	**814**	810	**841**	831
Skilled Mix	**3,395**	3,365	**3,313**	3,334	**3,114**	3,117	**3,064**	3,059	**3,220**	3,218
Private/other	**1,396**	1,517	**1,317**	1,512	**1,434**	1,530	**1,455**	1,529	**1,401**	1,522
Quality Mix	**4,791**	4,882	**4,630**	4,846	**4,548**	4,647	**4,519**	4,588	**4,621**	4,740
Medicaid	**9,476**	10,142	**9,477**	9,855	**9,545**	9,715	**9,532**	9,583	**9,508**	9,822
Total	**14,267**	15,024	**14,107**	14,701	**14,093**	14,362	**14,051**	14,171	**14,129**	14,562
Census by Payor Type *(%)*										
Medicare	**17.7**	16.6	**17.4**	17.0	**16.3**	16.0	**16.0**	15.9	**16.8**	16.4
Managed Care	**6.1**	5.8	**6.1**	5.7	**5.8**	5.7	**5.8**	5.7	**6.0**	5.7
Skilled Mix	**23.8**	22.4	**23.5**	22.7	**22.1**	21.7	**21.8**	21.6	**22.8**	22.1
Private/other	**9.8**	10.1	**9.3**	10.3	**10.2**	10.7	**10.4**	10.8	**9.9**	10.5
Quality Mix	**33.6**	32.5	**32.8**	33.0	**32.3**	32.4	**32.2**	32.4	**32.7**	32.6
Medicaid	**66.4**	67.5	**67.2**	67.0	**67.7**	67.6	**67.8**	67.6	**67.3**	67.4
	100.0	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0
Average occupancy *(%)*	**86.3**	86.2	**85.3**	86.1	**85.6**	86.0	**85.4**	85.6	**85.7**	86.0

EHSI's total skilled nursing center ADC declined by 3%, or 433 ADC, to 14,129 in 2011 from 14,562 in 2010, with declines in Medicaid ADC of 314 and private/other ADC of 121, partially offset by an improvement in Skilled Mix ADC of 2. Of the 433 decline in total ADC, 237 related to non same-facility operations consisting of 11 centers, and the balance of 196 related to a decline in same-facility census. EHSI's non same-facility operations represent eight skilled nursing facilities disposed of during 2010, one center disposed of in May 2011, and two new skilled nursing facilities that opened since January 1, 2010. Despite the decline in ADC, our Skilled Mix of residents improved to 22.8% in 2011 from 22.1% in 2010, reflecting success from our new centers and renovation projects, which are focused on attracting and meeting the needs of short-term, high-acuity residents. Our average occupancy in 2011 was 85.7% compared to 86.0% for 2010.

Our same-facility ADC of 13,990 in 2011 was 1.4%, or 196 ADC, below the 2010 level of 14,186 due to lower Medicaid ADC of 112 and lower private/other ADC of 92, partially offset by an increase in Skilled Mix ADC of 8. Our Skilled Mix represented 22.5% of our residents in 2011 compared to 22.2% in 2010. Our average same-facility occupancy was 86.0% this year compared to 86.3% in 2010.

The following table provides the ADC, percentage of total ADC, and average occupancy of EHSI's skilled nursing centers on a same-facility basis, for the past eight quarters and the 2011 and 2010 years.

	Q1		Q2		Q3		Q4		Year	
(same-facility operations)	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010
Average Daily Census										
Medicare	**2,476**	2,405	**2,381**	2,431	**2,237**	2,272	**2,200**	2,228	**2,323**	2,333
Managed Care	**863**	826	**858**	819	**808**	804	**802**	806	**832**	814
Skilled Mix	**3,339**	3,231	**3,239**	3,250	**3,045**	3,076	**3,002**	3,034	**3,155**	3,147
Private/other	**1,388**	1,439	**1,303**	1,438	**1,415**	1,507	**1,428**	1,519	**1,384**	1,476
Quality Mix	**4,727**	4,670	**4,542**	4,688	**4,460**	4,583	**4,430**	4,553	**4,539**	4,623
Medicaid	**9,408**	9,640	**9,431**	9,529	**9,498**	9,558	**9,466**	9,525	**9,451**	9,563
Total	**14,135**	14,310	**13,973**	14,217	**13,958**	14,141	**13,896**	14,078	**13,990**	14,186
Census by Payor Type *(%)*										
Medicare	**17.5**	16.8	**17.0**	17.1	**16.0**	16.0	**15.8**	15.8	**16.6**	16.5
Managed Care	**6.1**	5.8	**6.2**	5.8	**5.8**	5.7	**5.8**	5.7	**5.9**	5.7
Skilled Mix	**23.6**	22.6	**23.2**	22.9	**21.8**	21.7	**21.6**	21.5	**22.5**	22.2
Private/other	**9.8**	10.0	**9.3**	10.1	**10.2**	10.7	**10.3**	10.8	**9.9**	10.4
Quality Mix	**33.4**	32.6	**32.5**	33.0	**32.0**	32.4	**31.9**	32.3	**32.4**	32.6
Medicaid	**66.6**	67.4	**67.5**	67.0	**68.0**	67.6	**68.1**	67.7	**67.6**	67.4
	100.0	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0
Average occupancy *(%)*	**86.6**	87.0	**86.0**	86.4	**86.0**	86.0	**85.6**	85.9	**86.0**	86.3

Canadian Operations

The funding received by ECI for its nursing homes and home health care services is regulated by provincial authorities (rather than federal authorities), who often set the rates following consultation with the providers and their industry associations. This type of system reduces the potential for a single change or event to significantly affect the reimbursement or regulatory environment for ECI. For more information on government funding in Canada, including recent developments and their impact or expected impact on Extendicare REIT, please see "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada".

The following are ECI's average daily revenue rates and occupancy levels for the past eight quarters and the 2011 and 2010 years.

	Q1		Q2		Q3		Q4		Year	
	2011	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010
Average revenue rate *($)*	**181.16**	174.13	**182.94**	178.04	**181.66**	175.53	**191.00**	183.97	**184.25**	177.97
Average occupancy *(%)*	**96.4**	98.0	**96.7**	98.3	**97.5**	97.8	**97.2**	98.0	**96.9**	98.0
Average same-facility occupancy *(%)*	**97.8**	98.1	**97.8**	98.4	**98.1**	98.5	**97.8**	98.4	**97.9**	98.3

Revenue from provincial programs represented approximately 66% of ECI's nursing home revenue in 2011 (2010 – 65%). ECI's average daily revenue rate increased by 3.5% to $184.25 in 2011 from $177.97 in 2010. The majority of ECI's nursing home operations are in Ontario, which operates under a funding envelope system, under which a substantial portion of the revenue is tied to flow-through funding, and is therefore matched with the related costs for resident care in the periods in which they are incurred. As a result, ECI's average revenue rates fluctuate by quarter, and are generally at their lowest in the first quarter and their highest in the fourth quarter. In addition, ECI received retroactive funding adjustments that affected the comparability of the rates between periods, as follows: $1.2 million in the 2010 second quarter; and $1.0 million in the 2010 fourth quarter. For further information on funding in Canada, refer to the discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada".

In Canada, where the supply of long-term care beds historically has been very restricted in comparison to the United States, nursing home operators typically enjoy higher occupancy levels than operators in the United States. Our same-facility average occupancy in Canada, excluding one new leased center in Ontario and the three new centers and two closed centers in Alberta, was 97.9% in 2011 compared to 98.3% in 2010. In terms of the quarterly trends throughout the year, slightly lower occupancy levels are to be expected during the winter months as a result of flu outbreaks which can lead to temporary freezes on admissions.

Revenue from provincial programs represented approximately 97% of ECI's home health care revenue in 2011 (2010 – 96%). Our average daily home health care hours of service increased by 5.3% this year to 12,695 from 12,061 in 2010. During the 2011 year, ParaMed provided 4,634,000 hours of home health care service (2010 – 4,402,000), of which 95.1% (2010 – 95.0%) was from business in Ontario and the remainder from our Alberta operations. Since 2004, we have been unable to compete for new government contracts in Ontario due to the government's freeze on the competitive bidding process. We have not received any confirmation of when or if the bidding process will resume.

Impact of U.S. Dollar and Foreign Currency Translation

Impact on Financial Statements

The majority of our operations are conducted in the United States, which accounted for 66.7% of consolidated revenue from continuing operations in 2011 (2010 – 68.4%). As a result, changes in the exchange rates used to translate the results of the U.S. operations to Canadian dollars can affect the comparison of the consolidated results. The table below illustrates the positive/(negative) effect of changes in the average exchange rates used in translating the U.S. results for the 2011 fourth quarter and the 2011 year.

	Q4		Year	
	2011	2010	**2011**	2010
Average U.S./Canadian dollar exchange rate	**1.0217**	1.0130	**0.9891**	1.0299
Impact on Periods *(millions of dollars)*				
Revenue	**3.9**		**(57.6)**	
EBITDA	**0.9**		**(5.5)**	
Net loss	**(0.1)**		**1.1**	
AFFO	**0.2**		**(2.0)**	
Same-facility Operations				
Revenue	**3.8**		**(56.9)**	
EBITDA	**0.9**		**(5.5)**	

The following table illustrates the contribution from our U.S. operations to selected line items of our financial results for 2011, and the resulting impact of a one-cent change in the Canadian dollar against the U.S. dollar. However, a change in the exchange rate has had limited impact on the cash flow from our U.S. operations to fund distributions, because we had foreign currency forward contracts (FCFCs) in place until June 2011 (refer to discussion below under the heading "Impact of Foreign Currency Forward Contract Strategy on Distributions").

U.S. Operations	2011	Impact of One-Cent Change in Exchange Rate [1]
(millions of dollars)	*US$*	C$
Revenue	*1,411.1*	14.1
EBITDA	*135.8*	1.4
AFFO	*48.5*	0.5

(1) A weaker Canadian dollar against the U.S. dollar has a positive effect on reported results; while a stronger Canadian dollar has a negative effect on reported results.

The valuation of our FCFCs is marked to market and reported on our balance sheet based upon the current value of the future stream of converted funds. A fluctuation in the Canadian to U.S. dollar exchange rates and valuation of the FCFCs can result in unrealized gains or losses that are reported within our statement of earnings as part of "loss (gain) on foreign exchange and financial instruments". Gains or losses on the FCFCs are not subject to cash taxes until realized.

Impact of Foreign Currency Forward Contract Strategy on Distributions

We have a foreign currency hedging strategy whereby we monitor and consider entering into FCFCs to reduce the risks associated with changes in the U.S. dollar and the impact such changes could have on our Canadian dollar cash available for distribution. EHSI had a contract that matured in June 2011, which converted US$4.0 million into Canadian dollars on a monthly basis at the prevailing exchange rate at that time subject to a floor of 1.00 and a ceiling of 1.09 (whereby US$1.00 converts to C$1.09). Management continues to monitor the U.S. to Canadian dollar exchange rate and to consider future FCFCs to the extent that they may be beneficial to us.

Adjusted Funds from Operations

The following table provides a reconciliation of our EBITDA to Funds from Operations (FFO), Distributable Income (DI) and AFFO for each of the eight most recently completed quarters and for the years ended 2011 and 2010.[1]

(millions of dollars unless otherwise noted)	Q1		Q2		Q3		Q4		Year	
	2011	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010
EBITDA	**58.0**	58.2	**63.3**	68.9	**38.7**	49.3	**40.1**	65.7	**200.1**	242.1
Depreciation for FFEC	**(5.9)**	(5.5)	**(5.6)**	(5.5)	**(5.8)**	(5.7)	**(6.1)**	(5.7)	**(23.4)**	(22.4)
Accretion costs	**(0.5)**	(0.5)	**(0.5)**	(0.6)	**(0.5)**	(0.5)	**(0.5)**	(0.5)	**(2.0)**	(2.1)
Interest expense, net	**(21.5)**	(21.5)	**(22.1)**	(19.9)	**(21.9)**	(21.6)	**(19.8)**	(21.8)	**(85.3)**	(84.8)
	30.1	30.7	**35.1**	42.9	**10.5**	21.5	**13.7**	37.7	**89.4**	132.8
Current income tax expense [2]	**(9.4)**	(10.8)	**(11.0)**	(11.5)	**(8.8)**	(6.7)	**(1.8)**	(0.7)	**(31.0)**	(29.7)
FFO (continuing operations)	**20.7**	19.9	**24.1**	31.4	**1.7**	14.8	**11.9**	37.0	**58.4**	103.1
Amortization of financing costs and accretion costs	**1.9**	1.9	**2.9**	2.0	**4.1**	1.9	**2.5**	1.9	**11.4**	7.7
Principal portion of government capital funding payments	**0.6**	0.6	**0.7**	0.6	**0.7**	0.6	**0.6**	0.6	**2.6**	2.4
DI (continuing operations)	**23.2**	22.4	**27.7**	34.0	**6.5**	17.3	**15.0**	39.5	**72.4**	113.2
Additional facility maintenance capital expenditures [3]	**1.2**	0.9	**(1.5)**	0.4	**(3.3)**	(2.8)	**(4.0)**	(6.0)	**(7.6)**	(7.5)
AFFO (continuing operations)	**24.4**	23.3	**26.2**	34.4	**3.2**	14.5	**11.0**	33.5	**64.8**	105.7
AFFO (discontinued operations) [4]	**1.2**	1.4	**1.1**	1.2	**1.3**	1.2	**1.4**	1.2	**5.0**	5.0
AFFO [5]	**25.6**	24.7	**27.3**	35.6	**4.5**	15.7	**12.4**	34.7	**69.8**	110.7
Per Basic Unit [6] *($)*										
FFO (continuing operations)	**0.249**	0.256	**0.290**	0.384	**0.020**	0.175	**0.142**	0.449	**0.701**	1.264
AFFO (continuing operations)	**0.294**	0.300	**0.315**	0.420	**0.037**	0.170	**0.131**	0.406	**0.777**	1.296
AFFO	**0.308**	0.317	**0.328**	0.435	**0.054**	0.185	**0.147**	0.421	**0.837**	1.358
Per Diluted Unit [6] *($)*										
FFO (continuing operations)	**0.236**	0.239	**0.271**	0.349	**0.039**	0.172	**0.143**	0.406	**0.689**	1.166
AFFO (continuing operations)	**0.274**	0.276	**0.292**	0.380	**0.055**	0.169	**0.134**	0.369	**0.755**	1.194
AFFO	**0.286**	0.291	**0.304**	0.393	**0.068**	0.181	**0.148**	0.381	**0.806**	1.246
Distributions [6] *($)*										
Declared *(thousands)*	**17,453**	16,673	**17,484**	17,346	**17,534**	17,382	**17,630**	17,416	**70,101**	68,817
Declared per unit	**0.2100**	0.2100	**0.2100**	0.2100	**0.2100**	0.2100	**0.2100**	0.2100	**0.8400**	0.8400
Weighted Average Number of Units [6] *(thousands)*										
Basic	**83,082**	77,839	**83,230**	82,576	**83,442**	82,742	**83,869**	82,906	**83,408**	81,533
Diluted	**96,895**	91,652	**96,980**	96,389	**97,255**	96,555	**97,682**	96,720	**97,205**	95,346

(1) "EBITDA", "FFO", "DI" and "AFFO" are not recognized measures under IFRS and do not have a standardized meaning prescribed by IFRS. Refer to the discussion of non-GAAP measures.

(2) Excludes current tax with respect to fair value adjustments, and gains or losses on foreign exchange, financial instruments, asset impairment, disposals and other items that are excluded from the computation of AFFO.

(3) Represents total facility maintenance capital expenditures less depreciation for furniture, fixtures, equipment and computers, or FFEC, already deducted in determining DI.

(4) The impact of discontinued operations affects FFO, DI and AFFO by the same amount.

(5) A reconciliation of AFFO to cash flow from operating activities is provided under the heading "Liquidity and Capital Resources".

(6) Per unit amounts, distributions declared and the number of units are based on the total of the REIT Units and Exchangeable LP Units.

AFFO Review

2011 FOURTH QUARTER AFFO

AFFO was $12.4 million ($0.1470 per basic unit) in the 2011 fourth quarter compared to $34.7 million ($0.421 per basic unit) in the 2010 fourth quarter, representing a decline of $22.5 million, excluding a $0.2 million positive effect of the weaker Canadian dollar. Excluding the $11.5 million (US$11.2 million) change in prior years' reserves for self-insured liabilities, AFFO was lower by $11.0 million, primarily due to a decline in EBITDA of $15.0 million as a result of the 2011 CMS Final Rule along with lower census. Further information on the 2011 CMS Final Rule and increase in reserves for self-insured liabilities can be found under the heading "Overview – Significant 2011 Events and Developments". A discussion of the EBITDA by segmented division can be found under the heading "Summary of Quarterly Results – 2011 Fourth Quarter Financial Review".

2011 AFFO

AFFO of $69.8 million ($0.837 per basic unit) was lower by $38.9 million in comparison to 2010 of $110.7 million ($1.358 per basic unit), after excluding a $2.0 million negative effect of the stronger Canadian dollar. Excluding the $30.7 million (US$29.8 million) increase between periods in prior years' reserves for self-insured liabilities, AFFO declined by $8.2 million this year, primarily due to a decline in EBITDA of $5.8 million, an increase in current income taxes in comparison to the level of pre-tax earnings adjusted for the non-taxable reserves, and increased facility maintenance capital expenditures, partially offset by lower net interest costs. The 2010 results included a current income tax recovery of $4.4 million (US$4.3 million) in connection with the acceleration of tax depreciation. A discussion of the EBITDA by segmented division can be found under the heading "2011 Financial Review".

Facility maintenance capital expenditures were $10.1 million in the 2011 fourth quarter, compared to $11.7 million in the 2010 fourth quarter and $9.1 million in the 2011 third quarter, representing 1.9%, 2.2% and 1.7% of revenue, respectively. For 2011, facility maintenance capital expenditures were $31.0 million compared to $29.9 million, representing 1.5% and 1.4% of revenue, respectively. These costs fluctuate on a quarterly basis with the timing of projects and seasonality. It is our intention to spend between 1.5% and 2.0% of revenue annually, which is consistent with our objective to maintain and upgrade our centers. We are projecting to spend up to approximately $38 million in facility maintenance capital expenditures and approximately $70 million in growth capital expenditures in 2012.

As previously indicated, the effective tax rates on funds from operations (FFO) can be impacted by: adjustments to our estimates of annual timing differences, particularly when dealing with cash-based tax items versus accruals; changes in earnings of our non-taxable entities; as well as from book-to-file adjustments for prior year filings. We anticipate that our normal annual effective tax rate on FFO, excluding the impact of reserve adjustments in our non-taxable captive insurance company, will be in the range of 27% to 30%, with quarterly fluctuations due to estimates of timing differences and mix of earnings between jurisdictions.

Distributions

The current policy of the REIT is to pay distributions of $0.07 per REIT Unit to the holders thereof on a monthly basis. The declaration and payment of future distributions is subject to the discretion of the Board and will be dependent upon a number of factors including results of operations, requirements for capital expenditures and working capital, future financial prospects of the REIT, debt covenants and obligations, and any other factors deemed relevant by the Board. If the Board determines that it would be in the REIT's best interests, it may reduce, for any period, the percentage of Distributable Income to be distributed to holders of REIT Units.

Distributions declared in 2011 totalled $70.1 million, or $0.84 per unit, representing approximately 100% of total AFFO of $69.8 million. For the year ended 2010, distributions declared totalled $68.8 million, or $0.84 per unit, representing approximately 62% of AFFO of $110.7 million.

Approximately 70% of the distributions made by Extendicare REIT since 2006 were tax-deferred returns of capital for Canadian residents. Management estimates that approximately 70% of the monthly distributions to be made by the REIT in 2012 will also be tax-deferred returns of capital for Canadian residents. Such estimate is based on the current organizational structure of the REIT, certain financial information, the current provisions of the Tax Act, published statements of the current administrative and assessing practices of the Canadian Revenue Agency (CRA), and the specific proposals to amend the Tax Act announced by the Minister of Finance (Canada) prior to the date hereof. The adjusted cost base of the REIT Units will generally be reduced by such non-taxable portion of distributions made to the unitholder (other than the non-taxable portion of capital gains). A unitholder will generally realize a capital gain to the extent that the adjusted cost base of the units would otherwise be a negative amount.

To the extent that the remaining 30% of distributions of the REIT made in 2012 are taxed as dividends, those paid to Canadian residents are eligible dividends under the Tax Act. Extendicare REIT is not required to, and does not, calculate its "earnings and profits" pursuant to the *United States Internal Revenue Code of 1986*, as amended (the "Code"), and therefore no portion of its distributions represent qualified dividend income for U.S. tax purposes.

The composition for tax purposes of distributions may change over time, thus affecting the after-tax return to such unitholders.

As indicated under the heading "Overview – Significant 2011 Events and Developments – Proposed Corporate Conversion", the Board is seeking approval of the Unitholders for a conversion of the REIT to a corporate structure. The declaration and payment of dividends by New Extendicare will be subject to the discretion of the New Extendicare Board, as to the amount of and if and when a dividend is declared and paid, after consideration of the same factors that are currently taken into account by the REIT Board, which factors include results of operations, requirements for capital, future financial prospects and debt covenants, as well as other factors that may be considered to be relevant by the New Extendicare Board. The REIT Board currently anticipates that the New Extendicare Board will declare its first monthly dividend in the month of July, 2012.

Change in REIT's U.S. Tax Status Affecting U.S. Unitholders Only

Effective January 1, 2011, the REIT revoked its U.S. partnership status, and therefore, from this time onward will be treated as a corporation for U.S. federal income tax purposes. The change in U.S. tax status from a partnership to a corporation should have no adverse impact on the REIT or its U.S. unitholders, as the change will be effected on a tax-free basis. U.S. unitholders will be affected prospectively as all future income received from the REIT will be treated as distributions from a Canadian corporation for U.S. tax purposes. U.S. unitholders are urged to consult with, and rely solely upon, advice from their own tax advisors with respect to the tax consequences of an investment in REIT Units.

This change of the U.S. federal income tax status of the REIT from a partnership to a corporation does not change the status of the REIT for Canadian income tax purposes or the Canadian taxation of distributions. The REIT continues to be a mutual fund trust and a SIFT under the Tax Act. Extendicare LP remains a partnership for U.S. tax purposes.

Summary of Quarterly Results

The following is a summary of selected consolidated financial information derived from unaudited interim period consolidated financial statements for each of the eight most recently completed quarters. This information has been prepared in accordance with IFRS.

(thousands of dollars unless otherwise noted)	Q1		Q2		Q3		Q4	
	2011	2010	**2011**	2010	**2011**	2010	**2011**	2010
Revenue	**516,553**	523,193	**517,246**	524,393	**528,457**	520,728	**531,826**	529,102
EBITDA (1)	**57,964**	58,172	**63,295**	68,969	**38,774**	49,264	**40,103**	65,665
EBITDA margin	**11.2%**	11.1%	**12.2%**	13.2%	**7.3%**	9.5%	**7.5%**	12.4%
Earnings (loss) from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes (1)	**9,118**	9,173	**14,199**	19,618	**(13,981)**	(631)	**(2,350)**	11,218
Average U.S./Canadian dollar exchange rate (2)	**0.9856**	1.0400	**0.9681**	1.0277	**0.9807**	1.0391	**1.0217**	1.0130

(1) Refer to discussion of non-GAAP measures, and the reconciliation of these line items to GAAP measures that is provided in the table that follows.

(2) These are the actual Bank of Canada average rates of exchange for the period. The year-to-date revenue and expenses of self-sustaining foreign operations are translated at the average year-to-date rates of exchange, and the results of the quarters are calculated by deducting the previously reported year-to-date results from the current year-to-date results. In addition, separately reported items such as fair value adjustments, gains or losses related to financial instruments, foreign exchange, asset impairment, disposals and other items, are translated at rates of exchange in effect at the time of the transactions. Therefore, the effective exchange rates calculated from the translated amounts reported above, may differ from the actual average rates of exchange indicated for the period.

The following provides a reconciliation of the line items: (i) "net earnings (loss)" to "earnings (loss) from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units"; and (ii) "(loss) earnings before income taxes" to "EBITDA" for each of the eight most recently completed quarters. This information has been prepared in accordance with IFRS.

	Q1		Q2		Q3		Q4	
(thousands of dollars)	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010
Net earnings (loss)	**(8,394)**	5,421	**30,278**	23,692	**(34,383)**	(15,620)	**(17,897)**	28,336
Add (Deduct):								
Fair value adjustment on convertible debentures, net of taxes	**8,033**	4,993	**(7,576)**	(4,780)	**(9,566)**	14,005	**9,686**	(8,783)
Fair value adjustment on Exchangeable LP Units, net of taxes	**10,555**	3,377	**(7,305)**	(6,766)	**(10,468)**	5,247	**618**	(3,437)
Loss (gain) on foreign exchange and financial instruments, net of taxes	**(988)**	(3,955)	**(90)**	5,422	**308**	(3,921)	**115**	(2,350)
Loss (gain) from asset impairment, disposals and other items, net of taxes	**417**	–	**(672)**	2,583	**40,779**	171	**6,284**	(2,034)
Distributions on Exchangeable LP Units, net of taxes	**662**	686	**652**	674	**649**	673	**216**	669
Discontinued operations, net of taxes	**(1,167)**	(1,349)	**(1,088)**	(1,207)	**(1,300)**	(1,186)	**(1,372)**	(1,183)
Earnings (loss) from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes	**9,118**	9,173	**14,199**	19,618	**(13,981)**	(631)	**(2,350)**	11,218
Earnings (loss) before income taxes	**(2,036)**	11,413	**37,213**	32,998	**(36,933)**	(8,979)	**(20,125)**	38,999
Add (Deduct):								
Depreciation and amortization	**19,200**	18,106	**18,694**	18,203	**19,096**	18,685	**19,587**	18,775
Net finance costs	**40,231**	28,653	**8,330**	13,737	**2,409**	39,239	**31,974**	9,293
Loss (gain) from asset impairment, disposals and other items	**569**	–	**(942)**	4,031	**54,202**	319	**8,667**	(1,402)
EBITDA	**57,964**	58,172	**63,295**	68,969	**38,774**	49,264	**40,103**	65,665

The following provides the segmented EBITDA for our U.S. and Canadian operations.

	Q1		Q2		Q3		Q4	
(thousands of dollars)	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010
Segmented EBITDA								
U.S. operations *(US$)*	**44,422**	40,610	**47,199**	49,266	**20,125**	30,245	**24,097**	49,690
U.S. operations *(C$)*	**43,782**	42,235	**45,713**	50,679	**19,803**	31,483	**25,064**	50,490
Canadian operations	**14,182**	15,937	**17,582**	18,290	**18,971**	17,781	**15,039**	15,175
EBITDA	**57,964**	58,172	**63,295**	68,969	**38,774**	49,264	**40,103**	65,665

There are a number of factors affecting the trend of our quarterly results. For seasonal trends, while year-over-year quarterly comparisons will remain appropriate, sequential quarters will vary materially. We already report as separate line items "fair value adjustments", "distributions on Exchangeable LP Units", "loss (gain) on foreign exchange and financial instruments" and "loss (gain) from asset impairment, disposals and other items", which are transitional in nature and would otherwise distort historical trends. With respect to our core operations, the significant factors that impact the results from period to period are as follows:

- Medicare and Managed Care admissions are usually the highest in the first and second quarters; begin to decline during the latter portion of the second quarter; and are generally at their lowest in the summer months as there tends to be fewer elective surgeries performed;
- Medicaid rate changes, including adjustments for CMI and provider taxes, occur with each state's fiscal year, which is July 1st for the majority of the major states in which EHSI operates, and October 1st for Michigan;
- Medicare rate changes generally occur October 1st (federal fiscal year), and typically include a market basket inflationary increase;
- Ontario long-term care providers generally receive annual acuity-based flow-through funding adjustments effective April 1st and accommodation funding increases July 1st, and Alberta long-term care providers generally receive annual inflationary rate increases and acuity-based funding adjustments on April 1st;
- independent actuarial reviews are conducted three times a year, in the second and third quarters and at year end, which may lead to a strengthening, or conversely, a release of the reserves for self-insured liabilities;
- utility costs are generally at their highest in the first quarter and their lowest in the third quarter, with variances between the two of as much as $3.5 million; and
- foreign currency exchange rate fluctuations between the U.S. and Canadian dollars and impact on translation of our U.S. operations from U.S. dollars to Canadian dollars.

Further details on the above can be found under the sections "Overview – Significant 2011 Events and Developments", "Key Performance Indicators", "Impact of U.S. Dollar and Foreign Currency Translation", "Other Significant Developments" and "Update of Regulatory and Reimbursement Changes Affecting Revenue".

2011 Fourth Quarter Financial Review

CONSOLIDATED CONTINUING OPERATIONS

	Q4		Change	
(millions of dollars unless otherwise noted)	**2011**	2010	$	%
Revenue	**531.8**	529.1	2.7	0.5%
Operating expenses	**471.5**	441.2	30.3	6.9%
Administrative costs	**17.3**	19.5	(2.2)	(11.3)%
Lease costs	**2.9**	2.7	0.2	7.4%
EBITDA	**40.1**	65.7	(25.6)	(39.0)%
EBITDA as a % of revenue	**7.5%**	12.4%		
Average U.S./Canadian dollar exchange rate	**1.0217**	1.0130		

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 1.0217 for the 2011 fourth quarter and 1.0130 for the 2010 fourth quarter. However, separately reported items such as fair value adjustments, gains or losses related to financial instruments, foreign exchange, asset impairment, disposals and other items, are translated at the rates of exchange in effect at the time of the transactions.

Consolidated Continuing Operations Compared to the 2010 Fourth Quarter

Consolidated revenue from continuing operations improved by $2.7 million to $531.8 million in the 2011 fourth quarter from $529.1 million in the 2010 fourth quarter. Non same-facility operations contributed $17.3 million to revenue this quarter and $10.1 million in the 2010 fourth quarter, for a net improvement between quarters of $7.2 million. The non same-facility operations related to 17 centers as follows: eight U.S. skilled nursing centers that were disposed of throughout 2010, a U.S. skilled nursing center that was sold in May 2011, two new leased U.S. skilled nursing centers that opened in November 2010 and January 2011, a newly leased Canadian center in May 2011, three new Canadian centers that opened in September 2010, January 2011 and November 2011, and two Canadian nursing centers that closed in January and November 2011. Excluding the $3.8 million positive effect of the weaker Canadian dollar, revenue from same-facility operations declined between periods by $8.3 million as a result of U.S. funding reductions and lower U.S. census levels. We estimate that the adverse effect of the 2011 CMS Final Rule on our 2011 fourth quarter revenue was approximately $14.8 million (US$15.0 million). Details by segmented operations are discussed below.

Consolidated EBITDA from continuing operations declined by $25.6 million to $40.1 million in the 2011 fourth quarter from $65.7 million in the 2010 fourth quarter, and was 7.5% and 12.4% of revenue, respectively. Non same-facility operations generated EBITDA of $2.8 million in the 2011 fourth quarter compared to a loss of $0.6 million in the same 2010 period, for a net improvement of $3.4 million between periods. Excluding a $0.9 million positive effect of a weaker Canadian dollar, same-facility EBITDA declined by $29.9 million primarily due to the U.S. funding reductions and an $11.5 million (US$11.2 million) increase in reserves for prior years' self-insured liabilities. Details by segmented operations are discussed below.

Consolidated labour-related costs represented 72.5% of operating and administrative costs in the 2011 fourth quarter compared to 73.8% in the 2010 fourth quarter, and as a percent of revenue, were 66.6% and 64.2%, respectively.

U.S. CONTINUING OPERATIONS

	Q4 2011		Q4 2010		Change of US$	
(millions of dollars unless otherwise noted)	**US$**	**C$**	US$	C$	US$	%
Revenue	**342.2**	***350.3***	350.3	*354.8*	(8.1)	(2.3)%
Operating expenses	**305.0**	***311.7***	285.4	*288.9*	19.6	6.9%
Administrative costs	**11.4**	***11.8***	13.6	*13.8*	(2.2)	(16.2)%
Lease costs	**1.7**	***1.7***	1.6	*1.6*	0.1	6.3%
EBITDA	**24.1**	***25.1***	49.7	*50.5*	(25.6)	(51.5)%
EBITDA as a % of revenue	**7.0%**		14.2%			

U.S. Continuing Operations Compared to the 2010 Fourth Quarter

Revenue from U.S. operations in its functional currency declined by US$8.1 million to US$342.2 million in the 2011 fourth quarter compared to US$350.3 million in the 2010 fourth quarter. Non same-facility revenue was US$4.2 million this quarter compared to US$2.1 million in the same 2010 period, an improvement of US$2.1 million between quarters. Revenue from same-facility operations declined by US$10.2 million between periods primarily due to lower average Medicare and Managed Care rates and lower census levels, partially offset by higher average Medicaid and private/other rates. The decline in our average Medicare and Managed Care rates reflected changes implemented by the 2011 CMS Final Rule. We estimate that the adverse effect of the 2011 CMS Final Rule on our 2011 fourth quarter revenue was approximately US$15.0 million. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

The following table provides further details on the change in revenue this quarter in comparison to the 2010 fourth quarter from same-facility U.S. operations.

(US$ millions)	
(8.6)	– decrease in average skilled nursing center rates (decrease in Medicare $9.4 million and Managed Care $2.1 million, partially offset by an increase in Medicaid $2.6 million and private/other $0.3 million)
(4.2)	– decrease in skilled nursing center resident census (Medicare $1.3 million, Managed Care $0.1 million, Medicaid $1.0 million and private/other $1.8 million)
0.9	– increase in prior period revenue settlement adjustments ($0.9 million in 2011 versus nil in 2010)
1.7	– increase in outpatient therapy, technology services and other revenue
(10.2)	

The operating, administrative and lease costs of our U.S. operations increased by US$17.5 million to US$318.1 million this quarter in comparison to the 2010 fourth quarter of US$300.6 million. Non same-facility operations contributed US$0.6 million to the increase in costs between periods. Same-facility costs increased by US$16.9 million and included an US$11.2 million increase in prior years' reserves for self-insured liabilities this quarter, higher labour-related costs of US$4.4 million, and other cost increases, net of the cost saving initiatives, of US$1.3 million. Total labour-related costs represented 67.4% of operating and administrative costs this quarter, compared to 69.5% in the 2010 fourth quarter, and as a percent of revenue were 62.3% and 59.3%, respectively.

EBITDA from U.S. operations declined by US$25.6 million to US$24.1 million in the 2011 fourth quarter from US$49.7 million in the 2010 fourth quarter, and represented 7.0% and 14.2% of revenue, respectively. Non same-facility operations contributed US$0.1 million to EBITDA this quarter compared to a loss of US$1.4 million in the 2010 fourth quarter, for a net contribution of US$1.5 million between periods. Excluding the increase this quarter in prior years' reserves of US$11.2 million, same-facility operations declined by US$15.9 million, resulting from the decline in revenue of US$10.2 million and higher costs, net of cost saving initiatives, of US$5.7 million, as previously discussed.

CANADIAN CONTINUING OPERATIONS

	Q4		Change	
(millions of dollars unless otherwise noted)	**2011**	2010	$	%
Revenue	**181.5**	174.3	7.2	4.1%
Operating expenses	**159.8**	152.3	7.5	4.9%
Administrative costs	**5.5**	5.7	(0.2)	(3.5)%
Lease costs	**1.2**	1.1	0.1	9.1%
EBITDA	**15.0**	15.2	(0.2)	(1.3)%
EBITDA as a % of revenue	**8.3%**	8.7%		

Canadian Continuing Operations Compared to the 2010 Fourth Quarter

Revenue from Canadian operations grew by $7.2 million, or 4.1%, to $181.5 million in the 2011 fourth quarter from $174.3 million in the 2010 fourth quarter. Of this improvement, $5.8 million was derived from nursing home operations and included an increase of $5.0 million from non same-facility operations. Results were negatively impacted by prior period funding adjustments of $3.0 million (a reversal of $2.0 million this quarter compared to $1.0 million received in the 2010 fourth quarter). Consequently, growth in the 2011 fourth quarter from remaining same-facility nursing home operations was $3.8 million primarily due to funding enhancements. Revenue from home health care operations improved by $2.5 million this quarter primarily due to a 5.5% increase in volumes. Other revenue declined by $1.1 million primarily due to the completion of management contracts.

Operating, administrative and lease costs increased by $7.4 million to $166.5 million this quarter from $159.1 million in the 2010 fourth quarter, of which $3.0 million was from non same-facility operations. Costs from same-facility operations increased by $4.4 million in the 2011 fourth quarter primarily due to higher labour-related costs of approximately $4.3 million. Labour-related costs from total operations represented 82.3% of operating and administrative costs in the 2011 fourth quarter compared to 82.1% in the 2010 fourth quarter, and as a percent of revenue were 75.0% and 74.4%, respectively.

EBITDA from Canadian operations declined by $0.2 million to $15.0 million in the 2011 fourth quarter from $15.2 million in the 2010 fourth quarter and represented 8.3% and 8.7% of revenue, respectively. Non same-facility operations contributed EBITDA of $2.7 million this quarter compared to $0.7 million in the 2010 fourth quarter, for a net improvement of $2.0 million between periods. Same-facility operations declined by $2.2 million and was negatively impacted by prior period revenue adjustments of $3.0 million (a reversal of $2.0 million this quarter compared to $1.0 million received in the 2010 fourth quarter).

DEPRECIATION AND AMORTIZATION

Depreciation and amortization costs of $19.6 million in the 2011 fourth quarter were higher by $0.8 million from $18.8 million in the 2010 fourth quarter. Completed construction projects and capital maintenance expenditures, net of closed or disposed properties, contributed $0.7 million to the increase, with the remainder due to the weaker Canadian dollar between quarters.

LOSS (GAIN) FROM ASSET IMPAIRMENT, DISPOSALS AND OTHER ITEMS

The REIT recorded a pre-tax loss from asset impairment, disposals and other items of $8.7 million in the 2011 fourth quarter compared to a pre-tax gain of $1.4 million in the same 2010 period. The 2011 charge included $8.3 million of penalty fees on the early retirement of debt, primarily the Canadian CMHC mortgages that were refinanced in December. The remaining balance of $0.4 million related to advisor fees incurred in the quarter on the proposed plan to convert the REIT to a corporation. The gain of $1.4 million recorded in the 2010 fourth quarter primarily related to a $1.8 million gain on disposal of assets partially offset by refinancing fees of $0.4 million. For further information, refer to *note 17* of the 2011 consolidated financial statements.

NET FINANCE COSTS

Net finance costs of $31.9 million in the 2011 fourth quarter were $22.6 million higher than the $9.3 million in the 2010 fourth quarter. This was primarily due to the $23.7 million change in the fair value adjustments of the convertible debt and Exchangeable LP Units, and the $1.4 million change in the loss (gain) on foreign exchange and financial instruments between periods. Distributions on the Exchangeable LP Units were lower by $0.5 million because the Exchangeable LP Units were fully redeemed in November 2011 for REIT Units. Net interest costs were lower by $2.0 million and included a charge of $1.2 million related to the amortization of deferred financing costs associated with the modification of the May 2012 CMBS Financing. Remaining net interest costs were lower by $3.2 million and benefited from reduced rates and debt levels, partially offset by the negative effect of a weaker Canadian dollar.

The following table summarizes the components of net finance costs.

	Q4		Change	
(millions of dollars unless otherwise noted)	**2011**	2010	$	%
Interest, net				
Interest expense	**20.4**	22.5	(2.1)	(9.3)%
Interest income	**(0.6)**	(0.7)	0.1	(14.3)%
	19.8	21.8	(2.0)	(9.2)%
Accretion				
Accretion of decommissioning provisions	**0.4**	0.4	–	–
Other accretion	**0.1**	0.1	–	–
	0.5	0.5	–	–
Exchangeable LP Unit distributions	**0.2**	0.7	(0.5)	(71.4)%
Fair Value Adjustments and Loss (Gain) on Foreign Exchange and Financial Instruments				
Fair value adjustment on convertible debentures	**10.8**	(8.8)	19.6	(222.7)%
Fair value adjustment on Exchangeable LP Units	**0.6**	(3.5)	4.1	(117.1)%
Loss (gain) on foreign exchange and financial instruments	**–**	(1.4)	1.4	(100.0)%
	11.4	(13.7)	25.1	(183.2)%
Net finance costs	**31.9**	9.3	22.6	243.0%

INCOME TAXES

The tax provision from continuing operations was a recovery of $0.9 million on a pre-tax loss of $20.1 million in the 2011 fourth quarter compared to a tax provision of $11.8 million on pre-tax earnings of $39.0 million in the 2010 fourth quarter. The effective tax rates for each period were distorted by, among other things, the fair value adjustments, gains and losses from financial instruments, foreign exchange, asset impairment, disposals, and other items. As well, the effective tax rate of the 2011 fourth quarter was impacted by the non-taxable adjustment to prior years' reserves for self-insured liabilities of $11.4 million (US$11.2 million) this quarter. Excluding these items, the effective tax rate for the 2011 fourth quarter was 22.2% compared to 54.5% in the 2010 fourth quarter. The lower effective tax rate for the 2011 fourth quarter was primarily due to the proportion of income or losses among our taxable and non-taxable entities. As well, the fourth quarter results typically include book-to-file adjustments and adjustments to deferred taxes for changes in future tax rates. This contributed to the higher effective tax rate reported in the 2010 fourth quarter.

2011 Financial Review

Selected Annual Information

Except for the 2009 results, the selected annual information has been prepared in accordance with IFRS. The selected information presented for 2009 was prepared under previous Canadian GAAP and has not been restated for discontinued operations identified in 2011 under IFRS. The major differences between Canadian GAAP and IFRS impact "distributions on Exchangeable LP Units", "fair value adjustments" and "discontinued operations". Refer to the discussion under the heading "Basis of Presentation".

At the end of 2010, a significant portion of the REIT's long-term debt was due to mature in 2011 and was therefore classified as part of current liabilities. During 2011, the majority of this debt was refinanced. Refer to the discussion under the heading "Overview – Significant 2011 Events and Developments – 2011 Refinancing Plan".

A comparison between the 2011 and the 2010 results is provided in the following discussion "2011 Divisional Financial Review" and under the heading "Liquidity and Capital Resources".

The following is a summary of selected annual financial information.

(thousands of dollars unless otherwise noted) Years ended December 31	**2011**	2010	2009
Revenue	**2,094,082**	2,097,416	2,161,567
Operating expenses	**1,813,792**	1,771,168	1,810,978
Administrative costs	**69,155**	72,630	72,818
Lease costs	**10,999**	11,548	12,101
	1,893,946	1,855,346	1,895,897
EBITDA	**200,136**	242,070	265,670
Depreciation and amortization	**76,577**	73,769	66,032
Loss (gain) from asset impairment, disposals, financing and other items	**62,496**	2,948	(219)
Results from operating activities	**61,063**	165,353	199,857
Interest, net	**85,312**	84,723	92,815
Accretion	**2,029**	2,128	1,569
Distributions on Exchangeable LP Units	**2,179**	2,702	–
Fair value adjustments	**(6,023)**	4,649	–
Loss (gain) on foreign exchange and financial instruments	**(553)**	(3,280)	(20,289)
Net finance costs	**82,944**	90,922	74,095
Earnings (loss) from continuing operations before income taxes	**(21,881)**	74,431	125,762
Income tax expense	**13,442**	37,527	45,603
Earnings (loss) from continuing operations	**(35,323)**	36,904	80,159
Discontinued operations	**4,927**	4,925	(2,451)
Net earnings (loss)	**(30,396)**	41,829	77,708
Add (Deduct):			
Fair value adjustment on convertible debentures, net of taxes	**577**	5,435	–
Fair value adjustment on Exchangeable LP Units, net of taxes	**(6,600)**	(1,579)	–
Gain on foreign exchange and financial instruments, net of taxes	**(655)**	(4,804)	(20,742)
Loss (gain) from asset impairment, disposals and other items, net of taxes	**46,808**	720	(252)
Distributions on Exchangeable LP Units, net of taxes	**2,179**	2,702	–
Discontinued operations, net of taxes	**(4,927)**	(4,925)	2,451
Earnings from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes	**6,986**	39,378	59,165
Cash distributions per Unit *($)*	**0.8400**	0.8400	0.8400
Total assets *(at year end)*	**1,830,704**	1,994,634	1,668,065
Long-term debt *(at year end)*	**941,742**	670,028	1,205,494
Long-term debt including current portion *(at year end)*	**1,134,440**	1,241,196	1,234,032
U.S./Canadian dollar exchange rate			
Average rate for the year	**0.9891**	1.0299	1.1420
Closing rate at year end	**1.0170**	0.9946	1.0510

2011 Divisional Financial Review

The following is a summary by reporting segment of "revenue", "EBITDA", "net finance costs" and "net earnings", and "earnings before separately reported gains/losses and distributions on Exchangeable LP Units".

(millions of dollars unless otherwise noted)	**U.S.**	**U.S.**	**Canada**	**2011 Total**	U.S.	U.S.	Canada	2010 Total
	(US$)				*(US$)*			
Revenue	***1,411.1***	**1,395.8**	**698.3**	**2,094.1**	*1,392.8*	1,434.5	662.9	2,097.4
Operating expenses	***1,220.2***	**1,206.9**	**606.9**	**1,813.8**	*1,166.1*	1,201.0	570.2	1,771.2
Administrative costs	***48.4***	**48.0**	**21.2**	**69.2**	*49.9*	51.4	21.2	72.6
Lease costs	***6.7***	**6.5**	**4.5**	**11.0**	*7.0*	7.2	4.3	11.5
	1,275.3	**1,261.4**	**632.6**	**1,894.0**	*1,223.0*	1,259.6	595.7	1,855.3
EBITDA	***135.8***	**134.4**	**65.7**	**200.1**	*169.8*	174.9	67.2	242.1
Depreciation and amortization	***58.9***	**58.3**	**18.3**	**76.6**	*56.7*	58.4	15.4	73.8
Loss (gain) from asset impairment, disposals and other items	***56.0***	**56.2**	**6.3**	**62.5**	*2.9*	3.0	–	3.0
Results from operating activities	***20.9***	**19.9**	**41.1**	**61.0**	*110.2*	113.5	51.8	165.3
Interest, net	***52.8***	**52.2**	**33.1**	**85.3**	*50.3*	51.8	32.9	84.7
Accretion	***1.6***	**1.6**	**0.4**	**2.0**	*1.7*	1.7	0.4	2.1
Distributions on Exchangeable LP Units	–	–	**2.2**	**2.2**	–	–	2.7	2.7
Fair value adjustments	–	–	**(6.0)**	**(6.0)**	–	–	4.6	4.6
Gain on foreign exchange and financial instruments	***(0.2)***	**(0.3)**	**(0.3)**	**(0.6)**	*(0.9)*	(0.9)	(2.3)	(3.2)
Net finance costs	***54.2***	**53.5**	**29.4**	**82.9**	*51.1*	52.6	38.3	90.9
Earnings (loss) from continuing operations before income taxes	***(33.3)***	**(33.6)**	**11.7**	**(21.9)**	*59.1*	60.9	13.5	74.4
Income tax expense	***11.1***	**10.8**	**2.6**	**13.4**	*29.1*	30.0	7.5	37.5
Earnings (loss) from continuing operations	***(44.4)***	**(44.4)**	**9.1**	**(35.3)**	*30.0*	30.9	6.0	36.9
Discontinued operations	***5.0***	**4.9**	–	**4.9**	*4.8*	4.9	–	4.9
Net earnings (loss)	***(39.4)***	**(39.5)**	**9.1**	**(30.4)**	*34.8*	35.8	6.0	41.8
Add (Deduct):								
Fair value adjustment on convertible debentures, net of taxes	–	–	**0.6**	**0.6**	–	–	5.4	5.4
Fair value adjustment on Exchangeable LP Units, net of taxes	–	–	**(6.6)**	**(6.6)**	–	–	(1.5)	(1.5)
Gain on foreign exchange and financial instruments, net of taxes	***(0.3)***	**(0.4)**	**(0.3)**	**(0.7)**	*(2.3)*	(2.4)	(2.4)	(4.8)
Loss (gain) from asset impairment, disposals and other items, net of taxes	***42.7***	**42.9**	**3.9**	**46.8**	*0.6*	0.7	–	0.7
Distributions on Exchangeable LP Units, net of taxes	–	–	**2.2**	**2.2**	–	–	2.7	2.7
Discontinued operations, net of taxes	***(5.0)***	**(4.9)**	–	**(4.9)**	*(4.8)*	(4.9)	–	(4.9)
Earnings from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes	***(2.0)***	**(1.9)**	**8.9**	**7.0**	*28.3*	29.2	10.2	39.4
Average U.S./Canadian dollar exchange rate				**0.9891**				1.0299

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 0.9891 for 2011, and 1.0299 for 2010. However, separately reported items such as fair value adjustments, gains or losses related to financial instruments, foreign exchange, asset impairment, disposals and other items, are translated at the rates of exchange in effect at the time of the transactions.

HIGHLIGHTS

- Revenue was $2,094.1 million in 2011, a 2.6% increase over 2010, excluding the adverse effect of foreign exchange.
- EBITDA was $200.1 million in 2011, a $36.5 million decline over 2010, excluding the adverse effect of foreign exchange. Excluding an increase in prior years' reserves for self-insured liabilities, EBITDA declined by $5.8 million due to the 2011 CMS Final Rule, with a margin of 11.6% this year compared to 12.2% in 2010.
- AFFO was $69.8 million ($0.837 per basic unit) in 2011 compared to $110.7 million ($1.358 per basic unit) in 2010. Excluding the adjustment to prior years' reserves, AFFO was $112.6 million ($1.350 per basic unit) this year and $124.7 million ($1.530 per basic unit) in 2010.
- Distributions in 2011 totalled $70.1 million, or $0.84 per unit, representing 100% of AFFO for the same period.

CONSOLIDATED CONTINUING OPERATIONS

Consolidated revenue from continuing operations declined by $3.3 million to $2,094.1 million in 2011 from $2,097.4 million in 2010. Non same-facility operations contributed $60.2 million to revenue this year and $55.0 million in 2010, representing an increase of $5.2 million between years. Exclusive of the negative effect of $56.9 million from the stronger Canadian dollar, growth from same-facility operations of $48.4 million, or 2.4%, benefited from funding improvements, partially offset by the negative effect of the 2011 CMS Final Rule, lower U.S. census levels and prior period revenue. We estimate that the adverse effect of the 2011 CMS Final Rule on our 2011 fourth quarter revenue was approximately $14.8 million (US$15.0 million). Details by segmented operations are discussed below.

Consolidated EBITDA from continuing operations declined by $42.0 million to $200.1 million in 2011 from $242.1 million in 2010, and was 9.6% and 11.5% of revenue, respectively. Non same-facility operations contributed $7.8 million to EBITDA in 2011 compared to $2.8 million in 2010, representing an improvement of $5.0 million between years. Same-facility results were negatively affected by $5.5 million due to the stronger Canadian dollar and a $30.7 million increase in reserves for prior years' self-insured liabilities (US$43.3 million this year compared to US$13.5 million in 2010). EBITDA from remaining same-facility operations declined by $10.8 million, with revenue improvements of $48.4 million offset by higher costs of $59.2 million. Details by segmented operations are discussed below.

Consolidated labour-related costs represented 72.8% and 73.6% of operating and administrative costs in 2011 and 2010, respectively, and were 65.4% and 64.7% of revenue, respectively.

U.S. CONTINUING OPERATIONS

Revenue from U.S. operations grew by 1.3% in its functional currency to US$1,411.1 million in 2011 compared to US$1,392.8 million in 2010, representing an increase of US$18.3 million. Non same-facility revenue was US$17.5 million this year compared to US$32.3 million in 2010, representing a decline of US$14.8 million. Revenue from same-facility operations improved by US$33.1 million primarily due to the contribution from higher average nursing center rates of US$42.5 million, partially offset by lower census levels. Higher average rates reflected the October 2010 changes in Medicare funding for the implementation of MDS 3.0 and RUG-IV, inflationary increases, as well as higher average acuity levels of residents served, partially offset by the 2011 CMS Final Rule implemented on October 1, 2011. We estimate that the adverse effect of the 2011 CMS Final Rule on our 2011 fourth quarter revenue was approximately US$15 million. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

The following table provides further details on the change in revenue during 2011 in comparison to 2010 from same-facility U.S. operations.

(US$ millions)

42.5	– increase in average skilled nursing center rates (Medicare $28.6 million, Managed Care $5.4 million, Medicaid $7.9 million, and private/other $0.6 million)
(13.6)	– decrease in skilled nursing center resident census (decrease in Medicare $1.8 million, Medicaid $7.3 million, and private/other $7.2 million, partially offset by an increase in Managed Care $2.7 million)
(0.5)	– decrease in prior period revenue settlement adjustments ($4.5 million in 2011 versus $5.0 million in 2010)
4.7	– increase in technology services, outpatient therapy and other revenue
33.1	

The operating, administrative and lease costs of our U.S. operations increased by US$52.3 million to US$1,275.3 million in 2011 from US$1,223.0 million in 2010. Non same-facility operations resulted in a decline in costs of US$16.5 million between years. Same-facility costs increased by US$68.8 million primarily due to the increase in prior years' reserves for self-insured liabilities of US$29.8 million (US$43.3 million in 2011 compared to US$13.5 million in 2010), higher labour-related costs of US$25.3 million and other cost increases, net of cost saving measures, of US$13.7 million. The increase in labour costs of US$25.3 million was primarily due to higher staffing levels and a 0.7% average wage increase in nursing home operations. As well, payroll taxes were higher by US$4.5 million between years and we incurred severance charges of US$1.2 million, while the provision for UARs was lower at US$0.1 million this year compared to a charge of US$0.5 million last year. Total labour-related costs represented 67.4% of operating and administrative costs in 2011, compared to 69.0% in 2010, and represented 60.6% and 60.3% of revenue, respectively. The other cost increases of US$13.7 million included higher state provider taxes of US$4.2 million that were implemented with increases in Medicaid revenue rates, along with increases in food, supplies, recruitment costs, utilities and travel.

EBITDA from U.S. operations declined by US$34.0 million to US$135.8 million in 2011 from US$169.8 million in 2010, and was 9.6% and 12.2% of revenue, respectively. Non same-facility operations contributed US$1.2 million to EBITDA this year compared to a loss of US$0.5 million in 2010, for an improvement of US$1.7 million between years. Excluding the increase of US$29.8 million in prior years' reserves between years, EBITDA from same-facility operations declined by US$5.9 million, resulting from higher revenue of US$33.1 million offset by an increase in costs of US$39.0 million, as previously discussed. In addition to the impact of the 2011 CMS Final Rule, the lack of net Medicaid funding increases in 2010 and 2011 that would normally offset our wage rate and non-wage inflationary increases has contributed to compression of our U.S. operating margin.

CANADIAN CONTINUING OPERATIONS

Revenue from Canadian operations grew by $35.4 million, or 5.3%, to $698.3 million in 2011 from $662.9 million in 2010. Of this improvement, $30.3 million was derived from nursing home operations and included an increase of $21.2 million from non same-facility operations. Growth from same-facility nursing home operations of $9.1 million was primarily due to funding enhancements, partially offset by unfavourable prior period funding adjustments of $1.5 million (a $2.0 million revenue reversal in 2011 compared to $0.5 million received in the 2010 period). Revenue from home health care operations improved by $7.8 million in 2011 due to a 5.3% increase in volumes and higher rates, partially offset by lower retroactive funding (nil this period compared to $2.1 million received in the 2010 period). Other revenue declined by $2.7 million primarily due to the completion of management contracts.

Operating, administrative and lease costs increased by $36.9 million to $632.6 million in 2011 from $595.7 million in 2010, of which $17.8 million was from non same-facility operations and $1.7 million was due to adjustment to prior period accruals that reduced costs in 2010. Remaining costs from same-facility operations increased by $17.4 million primarily due to higher labour-related costs, which included a lower provision for UARs of $0.2 million ($0.2 million this year compared to $0.4 million in 2010). Total labour-related costs represented 83.5% of operating and administrative costs in 2011 and 83.2% in 2010, and represented 75.1% and 74.2% of revenue, respectively.

EBITDA from Canadian operations was $65.7 million in 2011 compared to $67.2 million in 2010, and represented 9.4% and 10.1% of revenue, respectively. Excluding the adverse impact of $6.3 million of prior period adjustments (unfavourable $2.0 million this year compared to a favourable $4.3 million recorded in 2010), EBITDA improved by $4.8 million, and represented 9.7% of revenue this year compared to 9.5% in 2010. Non same-facility operations contributed EBITDA of $6.6 million this year compared to $3.2 million in 2010, for a net improvement of $3.4 million between years. Excluding prior period adjustments, EBITDA from same-facility operations improved by $1.4 million reflecting higher revenue of $18.8 million partially offset by higher operating and administrative costs of $17.4 million. This resulted primarily from improvements in nursing home and home health care operations partially offset by a lower contribution from managed operations of approximately $1.6 million, as previously discussed.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization costs of $76.6 million in 2011 were higher by $2.8 million from $73.8 million in 2010. Completed construction projects and capital maintenance expenditures, net of closed or disposed properties, contributed $5.2 million to the increase, partially offset by a $2.4 million favourable effect of the stronger Canadian dollar.

LOSS (GAIN) FROM ASSET IMPAIRMENT, DISPOSALS AND OTHER ITEMS

The REIT recorded a pre-tax loss from asset impairment, disposals and other items of $62.5 million in 2011 compared to $2.9 million in 2010. The 2011 charge included a non-cash impairment charge of $54.0 million (after-tax $41.5 million) in connection with the revaluation of our U.S. property and goodwill, resulting from the Medicare funding and therapy changes that took effect October 1, 2011. The portion related to non-taxable goodwill was $22.4 million. As well, we incurred fees of $11.0 million in 2011 on the early retirement of debt. The remaining balance, a gain of $2.5 million, included a $2.4 million release of excess provisions on the settlement of claims, a $0.5 million gain on disposal, net of other charges of $0.4 million. The 2010 loss of $2.9 million related to a $1.2 million asset impairment charge, a $1.0 million lease termination fee and other charges of $0.7 million. For further information, refer to *note 17* of the 2011 consolidated financial statements.

NET FINANCE COSTS

			Change	
(millions of dollars unless otherwise noted)	**2011**	2010	$	%
Interest, net				
Interest expense	**89.6**	88.9	0.7	0.8%
Interest income	**(4.3)**	(4.2)	(0.1)	2.4%
	85.3	84.7	0.6	0.7%
Accretion				
Accretion of decommissioning provisions	**1.6**	1.6	–	–
Other accretion	**0.4**	0.5	(0.1)	(20.0)%
	2.0	2.1	(0.1)	(4.8)%
Exchangeable LP Unit distributions	**2.2**	2.7	(0.5)	(18.5)%
Fair Value Adjustments and Gain on Foreign Exchange and Financial Instruments				
Fair value adjustment on convertible debentures	**0.6**	6.2	(5.6)	(90.3)%
Fair value adjustment on Exchangeable LP Units	**(6.6)**	(1.6)	(5.0)	312.5%
Gain on foreign exchange and financial instruments	**(0.6)**	(3.2)	2.6	(81.3)%
	(6.6)	1.4	(8.0)	(571.4)%
Net finance costs	**82.9**	90.9	(8.0)	(8.8)%

Net finance costs were lower by $8.0 million at $82.9 million in 2011 compared to $90.9 million in 2010. This was primarily due to the $10.6 million change in the fair value adjustments of the convertible debt and Exchangeable LP Units, partially offset by the $2.6 million change in the gain on foreign exchange and financial instruments between periods. Distributions on the Exchangeable LP Units were lower by $0.5 million because the Exchangeable LP Units were fully redeemed in November 2011 for REIT Units. Net interest costs were higher by $0.6 million and included a charge of $4.8 million related to the amortization of deferred financing costs associated with the modification of the May 2012 CMBS Financing. Remaining net interest costs were lower by $4.2 million and benefited from reduced rates and debt levels and the favourable effect of the stronger Canadian dollar of $2.2 million.

With respect to the revaluation of the convertible debt carried at fair value, the REIT records a deferred tax provision when the fair value is less than the face value of the debt. There is no deferred tax recovery recognized when the fair value of the convertible debt is in excess of its face value.

Regarding our internal corporate loans, the foreign exchange gains of our Canadian operations are sheltered by capital losses that have deferred tax valuation allowances against them. Therefore there is no tax impact on the foreign exchange gains of the Canadian operations. In December 2010, the Canadian operations settled in full the internal corporate loan with the U.S. operations and utilized a portion of the capital losses on the transaction. In addition, we had established a $90.0 million Canadian dollar long-term internal corporate loan between two of our U.S. subsidiaries that had a 25-year amortization period. In December 2010, we settled $60.0 million of the $90.0 million internal corporate loan, and in May 2011 the balance of the loan was settled in full.

INCOME TAXES

The tax provision was $13.4 million on a pre-tax loss of $21.9 million in 2011 compared to a tax provision of $37.5 million on pre-tax earnings of $74.4 million in 2010. The effective tax rates for each period were distorted by, among other things, the fair value adjustments, gains and losses on foreign exchange, financial instruments, asset impairment, disposals, and other items. As well, the effective tax rates of both years were impacted by the non-taxable adjustment to prior years' reserves for self-insured liabilities of $42.8 million (US$43.3 million) this year and $14.0 million (US$13.5 million) in 2010. Excluding these items, the effective tax rate for 2011 was 37.0% compared to 44.1% in 2010.

Extendicare REIT is a SIFT in accordance with the Tax Act, and has been subject to SIFT tax since January 2007. For further information on the SIFT tax, refer to the discussion under the heading "Canadian and U.S. Income Tax Updates – Canadian Federal Income Tax on Income Trusts", under the section "Other Significant Developments".

Other Significant Developments

The discussion under the heading "Overview – Significant 2011 Events and Developments", summarizes the impact of the following items: the 2011 CMS Final Rule, the impairment charge for property and goodwill, the status of our 2011 refinancing plan, divestiture of our U.S. group purchasing organization, the additional provision for self-insured general and professional liabilities, the proposed corporate conversion, and the redemption of Exchangeable LP Units. This section provides a summary of other developments that have impacted the financial results or operations of Extendicare REIT for 2011 in comparison to 2010.

Economic Environment

Beginning in the latter part of 2008, the economy and stock markets suffered a significant downturn as a result of the worldwide credit and liquidity crisis that impacted market values of securities and commodities, interest rates and the foreign exchange markets; and there have been unprecedented job losses in the U.S. and Canada. Although there have been increases in the values of securities and increased liquidity in the credit market, there continues to be general restraint on corporate and individual spending levels. With a dramatic reduction in corporate profits and reduced consumer confidence, the fiscal health of provincial, state and federal governments have been dampened; consequently, the future funding of services for which they provide support may be constrained.

The most significant factor impacting the REIT's industry this past year, and for the near term, is the economic environment that has resulted in a reduction in admissions to our U.S. nursing centers along with a concerted effort by federal, provincial and state governments to restrain funding increases of health programs, and in certain cases to implement funding reductions. In response to the economic environment, the REIT has undertaken several courses of action to minimize risks and maintain liquidity, including:

- reducing growth projects along with divestiture of underperforming assets and non-core businesses;
- implementing significant cost reduction initiatives;
- refinancing a significant portion of long-term debt with low cost government-insured mortgages;
- reducing distributions in January 2009 and monitoring cash usage; and
- maintaining solid banking relationships.

For the near term, there are no indications that the economy and economic risks affecting the industry are improving. Therefore, the REIT plans to continue to monitor and implement steps to address these challenges. Below is a summary of the past and future uncertainties and significant risks that could have an impact on the REIT and its subsidiaries.

STATE, PROVINCIAL AND FEDERAL FUNDING AND REGULATORY PRESSURE

Reductions in Medicaid, Medicare and provincial funding for long-term care due to the economic downturn could have a material adverse effect on our earnings. Our business is highly labour intensive, with labour costs representing approximately 73% of our consolidated operating costs. As a result of resident and regulatory requirements, we have limited ability to reduce or manage our labour costs. In addition, any escalation of regulatory pressure by CMS, state or provincial level government agencies could have a negative impact on our operating costs and thereby reduce our earnings.

A number of states in which we operate have faced severe budgetary shortfalls since 2009, resulting in reductions in Medicaid funding or increases at rates below inflation. The temporary increase in funding for state Medicaid programs, through the federal medical assistance percentage, or FMAP funding increase, ended on June 30, 2011. As a result, a number of states are facing considerable financial pressures that could result in future Medicaid rate reductions, despite some economic improvement in certain regions.

Effective October 1, 2011, CMS implemented reductions in Medicare funding to skilled nursing centers, along with other changes that, based upon our revised estimates will reduce EHSI's revenue and EBITDA by between US$64 million and US$74 million on an annualized basis. We have taken measures to help mitigate the adverse effect of the elimination of group therapy and the assessment process changes, such as employing more therapists and improving productivity.

A more detailed discussion of recent developments impacting Medicare and Medicaid rates is provided under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

As a result of the most recent Medicare rate reductions that took effect October 1, 2011, along with continued Medicaid funding restrictions, senior management of EHSI completed a thorough review of its operations and implemented a number of aggressive cost saving measures within its organization, including securing vendor pricing changes. The savings have been realized by reductions in the area of operational and corporate office staff, savings in supplies, drugs, and third-party service arrangements with vendors and the elimination of other administrative costs within the organization. These savings are anticipated to reduce the general, administrative and non-wage operating costs of EHSI by an estimated US$24 million on an annualized basis. Approximately two-thirds of these savings were in effect as of October 1, 2011, with the balance fully implemented as of January 1, 2012. None of these cost saving measures involved a reduction of direct care staffing at our centers. Therefore, the net impact of the 2011 CMS Final Rule on our EBITDA is estimated to be between US$40 million and US$50 million.

In response to the economic downturn, the Ontario government implemented a wage freeze for labour contracts being renewed over the next two years beginning in 2010, and indicated its expectation that this wage freeze should be extended to the government-funded private sector, including the long-term care sector, by announcing that it would not provide funding for any wage increases. ECI has complied with these expectations. However, arbitrators have awarded increased union wages in the long-term care sector affecting ECI, despite this mandate.

DECLINE IN SHORT-TERM ADMISSIONS IN THE U.S.

In the U.S., Medicare and Managed Care funded residents were the source of approximately 82% of our admissions in 2011 (2010 – 81%), a component of which come from hospitals after elective surgeries. Over the past three years, our average skilled nursing center occupancy rates have declined from 87.9% in 2009 to 86.0% in 2010 and 85.7% in 2011. However, due to our strategic focus on short-term rehab residents, our Skilled Mix census as a percentage of a total center census has improved over the past three years from 21.9% in 2009 to 22.1% in 2010 and 22.8% in 2011.

In respect of Medicare admissions, the global economic downturn that began in 2008 and continuing slow recovery has reduced disposable income of individuals, reduced employment and resulted in a general restraint by the public on health care spending. As a result, the number of individuals seeking elective surgery and hence the need for post-acute care has declined. We believe the decline we have experienced since the 2008 fourth quarter in Medicare admissions was in part due to individuals deferring elective surgery due to the economy and the resulting reduction in required post-acute care. Our future earnings could be eroded further should the level of admissions decrease as a result of lower financial resources of our prospective residents.

Another reason for the decline in census has been the concerted effort by state Medicaid programs to shift potential residents to home care programs and assisted living centers along with Managed Care programs constraining the period of coverage in skilled nursing centers in order to reduce costs to the Medicaid program.

In response to the decline in short-term admissions in the U.S., we have refocused and refined our strategic marketing plans, are working on strategic alliances within the marketplaces in which we operate, and have invested to improve the number of rehabilitation suites within our portfolio to increase our market share in communities where we anticipate returns on our investments that meet our criteria. Included in these initiatives are the establishment of Active Life Transition Units (ALTUs) that are upgraded suites targeted to attract our short-term rehab residents. We currently have 11 ALTUs and plan to continue to expand the number of centers with ALTUs within certain of our centers.

Development Projects

COMPLETED PROJECTS (2010 AND 2011)

The following table summarizes the construction projects completed during 2010 and 2011. The two Alberta projects were completed at a cost of $55.0 million, net of government grants. The two U.S. projects are owned by third-parties, and are operated by EHSI under 10-year lease arrangements.

Completed Projects *(2010 and 2011)*	Date Opened for Admissions	No. of Centers	Operational Beds/Units
Canada – Owned Centers			
Continuing care center, Red Deer, Alberta	Sept./10; Feb./11 (1)	1	280
Designated assisted living center, Lethbridge, Alberta	Jan./11 (2)	1	140
Nursing Center, Edmonton, Alberta	Nov./11 (3)	1	180
U.S. – Leased Centers			
Skilled nursing center, South Bend, Indiana	Nov./10	1	100
Skilled nursing center, Lansing, Michigan	Jan./11	1	120
		5	**820**

(1) The Red Deer center consists of 220 long-term care beds that opened for admissions in September 2010, and an attached designated assisted living wing (60 units) opened for admissions in February 2011.

(2) The new Lethbridge center was completed in December 2010 and opened in January 2011. Our existing Lethbridge center closed upon the opening of the new center, and had been transitioned down to 62 beds at the end of 2010 (from 120 beds) in anticipation of its closure in January 2011.

(3) The new Edmonton center was completed in October 2011 and opened in November 2011. Residents from our existing Edmonton center (122 beds) that closed and 9 beds from another one of our centers were transferred to the new center.

PROJECTS UNDER DEVELOPMENT

The following table depicts the status of the development projects in progress in Ontario, Canada. Two of our existing nursing centers in the region will close upon completion of the new centers. Further details of these projects are provided below.

	New Centers			Existing Owned Centers to Close	
Development Projects *(as at December 31, 2011)*	Estimated Completion Date	No. of Centers	Beds/Units	No. of Centers	Beds/Units
Canada – Owned Long-term Care Centers					
Sault Ste. Marie, Ontario (1)	Q1/13	1	256	(1)	(161)
Timmins, Ontario	Q2/13	1	180	(1)	(119)
		2	436	(2)	(280)

(1) In addition to closing and transferring 161 beds from the owned nursing center that ECI operates in Sault Ste. Marie to the new center when it opens, ECI will also transfer 95 beds from a leased center that it operates in the region.

Owned Centers Completed and/or under Development in 2011

The new 180-bed long-term care center in Edmonton, Alberta was completed in October and began admitting residents in November 2011. The cost of the Edmonton project was approximately $19.5 million, net of government grants. Residents from ECI's existing nursing center in Edmonton (113 operational beds) that closed and nine beds from another one of our nursing centers were transferred to the new center. ECI is in the process of seeking a purchaser for its closed Edmonton property.

Also in Alberta, ECI completed construction of a designated assisted living center in Lethbridge, Alberta, in December 2010, and began admitting residents in January 2011 (140 units). An existing nursing center in the region (120 beds) was closed and sold following the opening of the new center.

The combined annual EBITDA of the two new centers in Alberta (Lethbridge and Edmonton), once fully operational, is expected to exceed $5.0 million. The combined annual EBITDA of the two centers that closed was approximately $2.7 million in 2009 (when they were fully operational).

Ontario Redevelopment Projects – 2010 Awarded

As part of the Government of Ontario's initiative to redevelop 35,000 long-term care beds over the next 10 to 15 years (refer to discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada – Ontario Long-term Care Legislation"), ECI received approval to redevelop 280 of its class "C" beds in the cities of Timmins and Sault Ste. Marie and, in connection with this award, we will add a further 156 long-term care beds. ECI began construction in the spring of 2011 and expects to complete a new 180-bed nursing center in Timmins and a new 256-bed nursing center in Sault Ste. Marie by the end of the 2013 first quarter. ECI currently owns and operates three nursing centers with 387 class "C" beds in these areas. Following completion of the new projects, ECI will own and operate 436 beds in two new centers and 107 class "C" beds in an existing center to be considered for redevelopment at a later date. The additional 156 long-term care beds that were awarded included 95 beds at a nursing center in Sault Ste. Marie that ECI previously managed for a third party, and which ECI now operates under a lease arrangement. The 95 beds from this leased center will move to the new center when it's completed.

The cost of the two Ontario projects is estimated to be $80 million, of which $2.5 million had been spent to December 31, 2011. Conventional financing for approximately 88% of the total estimated cost for the two projects was secured at the end of October 2011. In addition, we will receive capital funding from the government of approximately $2.0 million annually over a 25-year period. The combined annual EBITDA of the three existing owned centers (387 beds) for 2011 was approximately $2.8 million. It is anticipated that upon completion of the projects the incremental EBITDA for the three centers (536 beds) will be approximately $2.0 million, excluding the capital funding for the two new centers (436 beds).

Financing Activity

For details on the refinancing of a significant portion of the REIT's U.S. and Canadian long-term debt, refer to the discussion under the heading "Overview – Significant 2011 Events and Developments – 2011 Refinancing Plan".

CANADA

2011 Mortgage Activity – Development Projects

In October 2011, ECI secured conventional long-term financing on its Sault Ste. Marie and Timmins projects in Ontario for up to $41.4 million and $28.6 million, respectively. The first two years of the loans is for construction with interest-only payments, following which the loans will be amortized over 25 years. Both loans contain fixed rates for the full 27-year term of 5.637% and 5.558%, respectively, and a requirement to maintain a debt service coverage ratio of 1.2 to 1.

In January 2012, ECI executed a 10-year $17.4 million CMHC-insured mortgage agreement at a fixed rate of 3.81%, with payments amortized over 30 years, on its new Edmonton nursing center, to replace a construction loan.

Public Offering of REIT Units – February 2010

On February 4, 2010, Extendicare REIT completed a public equity offering of 9,228,750 REIT Units, including the exercise in full of an over-allotment option of 1,203,750 REIT Units, at a price of $9.35 per unit for aggregate gross proceeds of $86.3 million ($82.2 million net of underwriters' fees and offering expenses, before income taxes). The net proceeds of the offering increased the REIT's liquidity and balance sheet flexibility, and were used to repay indebtedness, fund redevelopment of the REIT's existing properties, and for general trust purposes.

2010 Mortgage Activity

In September 2010, ECI executed a 10-year $28.7 million CMHC-insured mortgage agreement at a fixed rate of 4.57%, with monthly payments amortized over 30 years, for the Red Deer project, to replace a construction loan.

UNITED STATES

Sovereign Loans – June 2011

On June 1, 2011, EHSI paid off the remaining balance of its Sovereign Loans of US$43.0 million using borrowings under the EHSI Credit Facility that were subsequently repaid upon closing of the first phase of the HUD loans at the end of June.

In May 2011, EHSI repaid US$1.7 million of the Sovereign Loans relating to the sale of the Saginaw, Michigan, nursing center.

EHSI Credit Facility – March 2011

In March 2011, EHSI obtained approval from all of the lenders of the EHSI Credit Facility to extend the term from June 2011 to June 2012 with no change in the financial terms of the US$70.0 million loan. The amount available to be borrowed under the EHSI Credit Facility is the lesser of: (i) 60% of the appraised values of the skilled nursing centers collateralizing the EHSI Credit Facility; or (ii) an amount based on the actual net cash flow of these centers for the last 12 months. At EHSI's option, the interest rate is either the eurodollar rate, with a floor set at 2%, plus a margin from 4% to 4.75%, or the U.S. prime rate plus a margin from 3% to 3.75%, with the specific margin based on EHSI's consolidated leverage ratio as defined in the EHSI Credit Facility. The interest rate at December 31, 2011 was 6.43% (December 31, 2010 – 6%).

EHSI is currently in the process of renewing the EHSI Credit Facility prior to its June 2012 maturity date.

PrivateBank Mortgage Loans due 2013 – November 2010

On November 30, 2010, EHSI secured a non-recourse term loan for up to US$35.0 million on six skilled nursing centers and one assisted living center located in Minnesota, Wisconsin and Michigan, with the PrivateBank (the "PrivateBank Loans"). On closing, EHSI drew US$25.0 million of the term loan and in March 2011 drew the remaining US$10.0 million. The resulting mortgages on the seven centers are cross-collateralized with each center. The PrivateBank Loans have a three-year term that matures on November 30, 2013. The loans are repaid with monthly principal payments based on a 25-year amortization period. Under the mortgage agreement, the combined operations are required to maintain a minimum consolidated fixed charge coverage ratio and debt service coverage ratio. At EHSI's option, the interest rate is equal to: (i) LIBOR, subject to a LIBOR floor set at 2%, plus a margin of 4%, or (ii) the U.S. prime rate, subject to a floor of 6%. The interest rate at December 31, 2011 was 6% (December 31, 2010 – 6%). EHSI has the option to prepay the balance in whole or in part subject to a prepayment fee of 2% for the first two years of the agreement and 1% during the final year, with no prepayment fee during the last six months of the agreement.

Divestitures and Assets Held for Sale

Extendicare REIT continually assesses the performance of its asset portfolio, and for those assets that fail to meet operating and financial standards, a decision may be made to dispose of the asset. Assets to be disposed of are recorded at the lower of the carrying value or estimated fair value net of disposal costs.

Prior to the adoption of IFRS, earnings and associated taxes derived from both divested operations and operations that have been classified for disposition were reported separately within the consolidated statements of earnings as discontinued operations. However, the definition of discontinued operations under IFRS is narrower, and requires that the classification to discontinued operations be limited to a component that represents a major line of business or geographical area of operations. Consequently, with the adoption of IFRS, results previously reported as discontinued operations in 2010 have been reclassified as part of continuing operations. The REIT's financial results prior to 2010 have not been restated under IFRS and therefore, still reflect the classification for discontinued operations as reported at the end of 2010 under previous Canadian GAAP. As well, the results presented prior to 2010 under previous Canadian GAAP have not been restated for operations identified as discontinued under IFRS in 2011. During 2011, the REIT classified its U.S. group purchasing operations as discontinued operations as a result of its pending sale in January 2012, as discussed further below.

The following table reflects the owned centers that have been disposed of during 2011 and 2010. In addition, during 2010, EHSI ceased operating two leased Ohio skilled nursing centers (235 beds) following their transfer to new operators in the 2010 second quarter.

	2011				2010			
Disposed Owned Centers	**No. of Centers**	**Beds/Units**	**Month Sold**	**Net Proceeds *(millions)***	No. of Centers	Beds/Units	Month Sold	Net Proceeds *(millions)*
Canadian Operations								
Alberta (closed nursing center)	**1**	**–**	**June**	**$1.0**				
U.S. Operations								
Michigan – SNFs	**1**	**92**	**May**		4	456	August	
Ohio – SNF	**–**	**–**	**–**		1	100	April	
Pennsylvania – SNF	**–**	**–**	**–**		1	107	April	
	1	**92**		**US$3.9**	6	663		US$20.3

In May 2011, EHSI completed the sale of the Saginaw, Michigan, skilled nursing center for net proceeds of $3.8 million (US$3.9 million) that resulted in a pre-tax gain of $0.3 million (US$0.3 million).

In June 2011, ECI completed the sale of its closed nursing center in Lethbridge, Alberta, for net proceeds of $1.0 million that resulted in a pre-tax gain of $0.2 million in the 2011 second quarter. During the 2011 first quarter, a charge of $0.6 million was recorded related to the prepayment penalty on the mortgage for this property when the center was closed.

In December 2011, EHSI reached an agreement in principle to sell its group purchasing organization, or GPO, to Navigator Group Purchasing, a subsidiary of Managed Health Care Associates, Inc., resulting in the reclassification of our U.S. GPO operations to discontinued operations. The transaction was finalized and closed in January 2012, for cash proceeds of US$56.0 million, and will result in an after-tax gain of approximately US$33 million in the 2012 first quarter.

As at December 31, 2011, the REIT had assets held for sale with a net book value of $3.4 million consisting of a closed nursing center in Alberta, a closed nursing center in Washington and the U.S. group purchasing operations.

Legal Proceedings and Regulatory Actions

The REIT and its consolidated subsidiaries are defendants in actions brought against them from time to time in connection with their operations. Recently adopted U.S. health care reform legislation is calling for more government oversight of the long-term care industry and operators are experiencing an increase in government investigations, audits and scrutiny of their operations. It is not possible to predict the ultimate outcome of the various proceedings at this time or to estimate additional costs that may result. However, based on current knowledge, management does not believe that liabilities, if any, arising from pending litigation will have a material adverse effect on the consolidated financial position, or results of operations of the REIT.

As previously disclosed, EHSI has received subpoenas from the U.S. Department of Health and Human Services (DHHS), Office of the Inspector General (OIG), relating to the possible submission of claims that may be in violation of the U.S. Social Security Act and to the provision of rehabilitation services. EHSI and its subsidiaries believe that they are in material compliance with the requirements imposed on them by the U.S. Social Security Act, and intend to furnish all requested information and to cooperate with the OIG in its investigations. The DHHS, OIG, CMS and other federal, state and provincial enforcement agencies may conduct additional investigations related to our business in the future that may, individually or in the aggregate, have a material adverse effect on the business or financial condition of the REIT.

The provision of health care services is subject to complex laws and regulations at the federal, state and provincial government levels, including laws that are intended to prevent health care fraud and abuse. On an ongoing basis, long-term care providers are subject to surveys, inspections, audits and investigations by various government authorities to ensure compliance with applicable laws and licensure requirements. In such circumstances, the REIT cooperates in responding to information requests and takes the necessary corrective actions and, where appropriate, estimates costs that may result from such investigations to the extent such costs are predictable or determinable.

Canadian and U.S. Income Tax Updates

CANADIAN FEDERAL INCOME TAX ON INCOME TRUSTS

On October 31, 2006, the day before Extendicare was initially scheduled to complete the Arrangement, the Minister of Finance (Canada) (the "Finance Minister") announced proposals to amend the Tax Act to alter the taxation regime applicable to certain publicly traded entities that are specified investment flow-through trusts or partnerships, or "SIFTs", and their investors (the "SIFT Rules"). The SIFT Rules were subsequently enacted by Bill C-52, the *Budget Implementation Act, 2007*, which received Royal Assent on June 22, 2007. Because Extendicare completed the Arrangement on November 10, 2006, Extendicare REIT has been subject to the SIFT Rules since its formation. Furthermore, Extendicare REIT was not eligible for transitional relief from the SIFT tax through 2010 and due to the nature of its income and investments, did not qualify for the exemption from the SIFT Rules applicable to "real estate investment trusts" (as defined in the SIFT Rules). As a result, Extendicare REIT has been subject to the SIFT tax since January 1, 2007.

Bill C-10, which received Royal Assent on March 12, 2009, included certain amendments to the SIFT Rules (the "SIFT Amendments"), including revisions to the definitions of "SIFT trust" and "SIFT partnership" to specifically exclude certain trusts and partnerships that are wholly owned by a SIFT, with effect from October 31, 2006. The SIFT Amendments do not change the status of Extendicare REIT as a SIFT, although they confirm that Extendicare Trust, which is wholly owned by Extendicare REIT, is not a SIFT. Management has assessed the impact of the SIFT Amendments on Extendicare LP and has concluded that Extendicare LP should not be treated as a SIFT, but there can be no assurance that this will be the case.

New rules contained in the SIFT Amendments also facilitate the conversion of SIFT trusts into corporations, either through the distribution by a SIFT trust of shares of a taxable Canadian corporation to its unitholders or by the transfer of units of a SIFT trust to a taxable Canadian corporation, followed by a winding up of the SIFT trust. The automatic tax-deferred rollover treatment applies to transactions that occur before 2013.

In view of, among other things, the Conversion Rules that expire on December 31, 2012, the Board will be seeking Unitholder approval for the conversion of the REIT to a corporate structure at a Special Meeting to be held in conjunction with its next annual meeting in May 2012. For further information on the Conversion, refer to the discussion under the heading "Overview – Significant 2011 Events and Developments – Proposed Corporate Conversion".

U.S. FEDERAL INCOME TAX ON REITS

On July 30, 2008, the U.S. *Housing and Economic Recovery Act of 2008* was signed into law containing certain revisions to the *REIT Investment Diversification and Employment Act* (the "RIDEA") that provide, among other things, greater structural and operating flexibility to U.S. health care REITs. The RIDEA permits U.S. health care REITs to use taxable REIT subsidiaries (TRSs) in the same manner as lodging REITs. A TRS will continue to be required to use an independent contractor to manage or operate health care centers, but payments collected by a REIT from its TRS in connection with renting health care centers will now be treated as qualified income under the REIT tests.

ALC SPIN-OFF

The Arrangement included the distribution of Assisted Living Concepts, Inc. (ALC) to Extendicare's shareholders and a number of pre-Arrangement transactions. As part of the spin-off of ALC in 2006 to Extendicare's shareholders, EHSI and ALC entered into a tax allocation agreement dated as of November 10, 2006 (the "Tax Allocation Agreement").

In 2009, ALC asserted a claim against EHSI under the Tax Allocation Agreement relating to additional depreciation deductions allowed by the U.S. Internal Revenue Service for years 2005 and 2006 relating to limitations computed under Section 382 of the Code. In December 2010, the parties agreed to settle this matter along with all past and future differences arising from the Tax Allocation Agreement for US$0.8 million (US$0.5 million after tax). This settlement was charged directly to retained earnings since the spin-off of ALC was accounted for as a capital transaction in 2006.

In connection with the Arrangement, EHSI received a note upon the transfer of ALC to its Canadian affiliate, which was subsequently repaid by way of cash, settlement against other notes and dividends of US$476.6 million. Based upon internal calculations, management believes there was sufficient surplus as to not attract any Canadian taxes from the transactions relating to the repayment of the note. The REIT and its Canadian subsidiaries are currently under audit by the CRA. Should the CRA determine that the available surplus was less than the amount determined by management, Canadian capital gains tax would apply to the shortfall.

Update of Regulatory and Reimbursement Changes Affecting Revenue

We operate in a competitive marketplace and depend substantially on revenue derived from government sources, with the remaining revenue derived from commercial insurers, managed care plans and private individuals. Ongoing pressures from government programs, along with other health care payors seeking to control costs and/or limit reimbursement rates for medical services, are a risk to us. Government agencies have steadily increased their enforcement activity over the past several years. As a result, in addition to increasing resources to improve the quality of services provided to our residents, we are continually allocating increased resources to ensure compliance with applicable regulations and to respond to inspections, investigations and/or enforcement actions. Our costs to respond to and/or defend surveys, inspections, audits and investigations are significant and are likely to increase in the current environment.

Non-compliance with applicable laws and licensure requirements governing long-term care could result in adverse consequences, including severe penalties, which may include criminal sanctions and fines, civil monetary penalties and other sanctions, including the loss of our right to participate in the Medicare and Medicaid programs, or one or more third-party payor networks. We may be required to refund amounts that have been paid to us by federal, state and/or provincial funding programs. These penalties could have a material adverse effect on the business, results of operations or financial condition of the REIT.

United States

The majority of the REIT's operations are in the United States where 66.7% of its revenue from continuing operations was earned in 2011 (2010 year – 68.4%). EHSI receives payment for its services and products from the federal (Medicare) and state (Medicaid) medical assistance programs, Managed Care organizations (including HMO and preferred provider organizations), commercial insurers, the Department of Veterans Affairs, as well as from private payors. During 2011, approximately 53% of our U.S. resident admissions were Medicare funded and approximately 29% were Managed Care funded.

MEDICARE FUNDING

Market Basket Annual Increases

Changes in Medicare funding levels typically occur on October 1st of each year to coincide with the federal government's fiscal year, and generally represent an inflationary increase for the Medicare Part A funding, otherwise referred to as a "market basket" increase. In addition, Medicare increases are also periodically adjusted for "forecasting errors" that are identified by CMS based upon filed cost reports.

The net market basket increases on October 1, 2011 and 2010 were both 1.7%. Changes to the Medicare Part A rates for fiscal 2012, effective October 1, 2011, included a market basket update of 2.7% minus a productivity adjustment of approximately 1.0%. For fiscal 2011, effective October 1, 2010, the net 1.7% increase represented a 2.3% market basket increase, less a 0.6% forecasting error adjustment. We estimated that this net rate increase of 1.7% would increase our annual Medicare revenue of approximately US$6.8 million. These market basket increases were prior to the impact of the implementation of MDS 3.0 and RUGs-IV in October 1, 2010, and the 2011 CMS Final Rule implemented on October 1, 2011, that included a parity adjustment, the elimination of group therapy and changes in the assessment process, as discussed below.

Medicare Reimbursement Changes Effective October 1, 2011

The implementation of the RUG-IV rate set and MDS 3.0 by CMS in October 2010 was intended to be budget neutral. The post-implementation review completed by CMS determined that the majority of operators, including EHSI, realized increased Medicare reimbursement beyond the intended 1.7%. EHSI realized a net increase in its average Medicare Part A rates of 12.7% for the first nine months of 2011 over the same 2010 period.

In response to this, the 2011 CMS Final Rule includes a parity adjustment of 12.6% along with changes in the assessment process and the elimination of payment for group therapy. More specifically, the 2011 CMS Final Rule included, among other things, the following changes effective October 1, 2011:

- a parity adjustment of an estimated aggregate reduction of 11.1% (a 12.6% recalibration of the CMI, partially offset by a market basket increase net of a productivity adjustment);
- changes to group therapy, which will be defined to be four patients who are simultaneously performing similar activities, and minutes will be allocated;
- implementation of Change of Therapy Medicare-required assessments, or "OMRAs", whenever a patient's RUG-IV classification changes;

- clarification that End of Therapy (EOT) OMRAs must be completed following three consecutive calendar days without therapy services;
- implementation of the EOT-Resumption of therapy (EOT-R) OMRAs, in place of a Start-of-Therapy OMRAs, in cases where the resumption of therapy is no more than five consecutive calendar days after the last day of therapy provided, and there has been no change in the RUG-IV classification; and
- implementation of a new assessment to be completed every seven calendar days to update current therapy provided, regardless of whether there has been a significant change in condition.

Following the implementation of the 2011 CMS Final Rule, EHSI's 2011 fourth quarter average Medicare Part A rates declined by 11.0% to US$463.89 from US$521.24 in the 2011 third quarter. Also, EHSI's 2011 fourth quarter average Managed Care rates declined by 7.0% to US$425.80 from US$457.71 in the 2011 third quarter. This decline in rates represented lower revenue in the 2011 fourth quarter of approximately US$15 million. This revenue reduction was not as much as our initial estimate of the negative effect of US$70 million to US$80 million on an annualized basis, due to the transitional rules provided for in the changeover to the new assessment process that minimized the full impact of the changes in the 2011 fourth quarter. Though we continue to assess the impact of the changes, our revised estimate of the negative effect on our revenue and EBITDA, prior to our cost saving measures, is in the range of US$64 million to US$74 million. We have taken measures to help mitigate the adverse effect of the elimination of group therapy and the assessment process changes, such as employing more therapists and improving productivity.

To mitigate as much of this adverse impact as possible, we completed a thorough review of our operations and implemented a plan to drive efficiencies and reduce costs wherever possible. These savings are anticipated to reduce the general, administrative and non-wage operating costs of EHSI by an estimated US$24 million on an annualized basis. Approximately two-thirds of these savings were in effect as of October 1, 2011, with the balance fully implemented as of January 1, 2012. None of these cost saving measures involved a reduction of direct care staffing at our centers. Consequently, based upon our revised estimate of the impact of the 2011 CMS Final Rule, we anticipate the negative effect on our EBITDA to be in the range of US$40 million to US$50 million.

MDS 3.0/RUG-IV Medicare Reimbursement Change Effective October 1, 2010

On October 1, 2010, CMS implemented MDS 3.0, a revised resident assessment tool, and RUG-IV, a revised case-mix classification methodology and implementation schedule, which among other things, increased the RUGs categories from 53 to 66 and provided for the elimination of billing for concurrent therapy services and services provided by technicians. CMS stated that these initiatives were intended to be budget neutral. In order to meet the needs of the new reimbursement system, EHSI increased nursing and therapy staff and realigned its staffing practices to meet the incremental assessment requirements and therapy needs of its residents. As a result of these initiatives, together with the realigned funding rates, EHSI's average Medicare Part A rate increased by 12.7% in the first nine months of 2011 over the same 2010 period.

Medicare Part B Rates

In November 2011, CMS issued a final payment rule for the 2012 Medicare Physician Fee Schedules that includes revised fee screen rates for our Part B therapy services that are proposed to decrease by 27.4% effective January 1, 2012. The estimated annual impact of the rate decrease to EHSI is approximately US$11 million. The proposed reduction in physician fees along with the fee screen rates is a contentious issue. In December 2011, U.S. Congress passed and the President signed a law that delayed the rate decreases until March 1, 2012, and it is expected that U.S. Congress will pass another law further delaying or modifying these rate decreases.

Effective January 1, 2006, CMS implemented a cap on Part B therapy services for physical and speech therapy, and a second cap for occupational therapy. The annual caps per eligible Part B recipient amounted to US$1,740 in 2006, and increased annually for inflation to US$1,870 in 2011 and US$1,880 in 2012. A one-year exemption process to the therapy caps was established in 2005 for individuals who were able to prove medical necessity for the therapy, which exemption was extended to December 31, 2011, by the *Medicare and Medicaid Extenders Act of 2010*. On December 23, 2011, U.S. Congress passed and the President signed a two-month continuation of the Medicare therapy cap exemptions process, and on February 16, 2012, the therapy cap exemptions were extended through to December 31, 2012. Based on information currently available, EHSI estimates that without the extension of this exemption, its annual therapy revenue may decline by as much as US$22 million, or US$16 million should the Part B fee screen rate changes as part of the 2012 Medicare Fee Schedules Bill discussed above become effective. This estimated decline in annual therapy revenue is based on therapy services provided by EHSI in excess of the proposed cap, and assumes no mitigating actions taken and no recovery for services rendered from the individual receiving such services. The impact of these caps on EHSI may be mitigated to the extent that such patients find other means of paying for these services, or if EHSI is able to reduce associated costs.

Effective January 1, 2011, CMS implemented the application of the multiple procedure reduction policy that reduced EHSI's Medicare Part B inpatient and outpatient therapy billings by approximately 7.5%, or approximately US$3.2 million in annual revenue.

2012 President's Budget and Budget Control Act of 2011

On August 2, 2011, the U.S. President signed the Budget Control Act (BCA) as passed by the House of Representatives and Senate. The BCA brings significant change to the federal budget process by forcing significant cuts to future federal spending while raising the national debt limit. Following months of negotiations and facing default, a process was put into place to reduce the federal deficit. We have been advised that the BCA imposes caps on discretionary spending starting October 1, 2011, that will generate US$917 billion in savings over the next 10 years. It also puts in place a process to find, by the end of the year, another US$1.2 trillion to US$1.5 trillion in deficit reductions over the next 10 years. While caps on discretionary spending are put into place, the act does not specifically make hard policy choices on how to implement cuts. It will be up to Congress and a special bipartisan and bicameral committee to establish policy. The BCA does not make any changes to entitlements but rather imposes caps on spending. To comply with the law, Congress must reduce spending by about US$25 billion for the budget cycle starting in October.

The special Joint Select Committee on Deficit Reduction, referred to as the "Super Committee" was to propose legislation no later than January 15, 2012, to reduce spending by the additional US$1.2 trillion. As the Super Committee was unable to make a recommendation and U.S. Congress failed to pass legislation, a process of sequestration will be put into place on January 2, 2013. Sequestration would be applied proportionally to non-exempt programs (Medicaid, Medicare benefits, Social Security, unemployment insurance, low-income programs, and civilian and military retirement programs are exempt). Medicare payments to providers are not exempt but are limited by law to a maximum of a 2% reduction. In addition, a number of recommendations also impacting the industry are being considered including a phased-in clawback of Medicare funds that CMS believes to have overpaid to the long-term care sector as a result of the October 1, 2010, implementation of MDS 3.0 and RUG-IV.

In February 2011, the U.S. President released the 2012 fiscal year budget (the "President's Budget"). The significant item within the President's Budget impacting the long-term care sector is the proposed reduction in the Medicaid Provider Tax Threshold. Commencing in 2015, the Medicaid Provider Tax Threshold would be reduced in phases over a three-year period. In the interim, the maximum percentage would be allowed to rise to 6.0% from 5.5% on October 1, 2011. Commencing in fiscal year (FY) 2015, the percentage would be phased down to: 4.5% in FY 2015; 4.0% in FY 2016; and 3.5% in FY 2017 and beyond. Provider taxes provide a significant source of FMAP funding and therefore could have a negative effect on state budgets during the phase-down period.

On March 5, 2011, House Budget Chairman Paul Ryan (R-WI) released his budget proposal for FY 2012 (the "House Budget Proposal"). Compared to the President's Budget, the House Budget Proposal would cut spending by US$6.2 trillion over the next 10 years and cut the federal deficit by US$4.4 trillion over 10 years. When compared to current policy funding levels, known as the Congressional Budget Office baseline, the plan would cut spending by US$5.8 trillion over the coming decade and reduce projected deficits by US$1.6 trillion.

The House Budget Proposal serves as a blueprint for setting monetary targets for savings. The committees of jurisdiction, Ways & Means for Medicare, and Energy & Commerce for Medicaid, must put together separate legislation to meet the savings targets through cuts to these programs. Most notably, the House Budget Proposal would transition Medicaid from an entitlement to a state block grant giving states the spending authority on the use of federal funds and Medicare would be transitioned to a voucher system to supplement the purchase of private health insurance. The bill would also repeal the *Patient Protection and Affordable Care Act* (H.R. 3590), which is discussed below and remains a possibility if there is a change in the Presidency and Senate control following the 2012 election.

President's Jobs Bill

On September 19, 2011, the Office of Management and Budget released the President's Plan for Economic Growth and Deficit Reduction, otherwise known as the President's Jobs Bill. This bill included a provision for the extension of the payroll tax cuts enacted as part of the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*, and contained several proposals intended to fund the tax cut extension.

Although the President's Jobs Bill was not passed in its original form, similar proposals contained in the bill have been legislated in order to fund the tax cut extension. For example, U.S. Congress passed a two-month payroll tax cut extension on December 23, 2011.

More recently the Conference Committee dealing with the payroll tax cut, the extension of the Part B therapy cap exemptions, and the 2012 Medicare Physician Fee Schedules reached agreement on the reduction to reimbursable bad debts, which was also proposed in the President's Jobs Bill. On February 16, 2012, the Conference Committee reached agreement for a 35% phased-in reduction to reimbursable bad debts for dually eligible residents starting in fiscal year 2013 to 88%, 76% in fiscal year 2014 and ultimately to 65% in fiscal year 2015. For dually eligible (Medicare & Medicaid eligible) residents, should the resident be unable to pay their Part A co-insurance amounts due to a lack of resources, long-term care operators are to bill the Medicaid program for unpaid amounts. In certain states, the Medicaid program reimburses the operator for unpaid amounts, whereas if they do not, the operator can obtain reimbursement through the Medicare program by submitting unpaid claims through their annual filing of cost reports. In the majority of states where EHSI operates, the Medicaid program does not reimburse its centers for unpaid Part A co-insurance and therefore, EHSI files for reimbursement of approximately US$21 million per annum in reimbursable bad debts. The phased-in reduction of ultimately 35% over three years would result in an annual reduction of revenue to EHSI of approximately US$2.5 million in the first year, reaching approximately US$7.3 million in the third year. This is essentially cutting the Medicare rates of the nursing centers upon commencement of the co-insurance period, being day 20 of the resident's stay. Separately, EHSI obtains reimbursable bad debts for non-dually eligible Part A co-insurance bad debts of approximately US$0.6 million that is currently reimbursed at 70% that will be reduced to 65% in 2012.

We anticipate the inclusion of similar proposals contained in the President's Jobs Bill in future legislation in order to fund the tax cut extension, which would significantly affect Medicare reimbursement for nursing homes. For example, the President's Jobs bill also called for the "realigning" of payments with costs through adjustments to the market basket annual increases for 2014 through 2021. Although sufficient detail is not known, these adjustments were expected to incorporate MedPAC's March 2011 proposal to eliminate these increases beginning in 2012. These annual increases have averaged 2.7% in the last two fiscal years, prior to the productivity adjustment of a negative 1.0%.

MedPAC Recommendations Issued January 2012

The Medicare Payment Advisory Committee (MedPAC) made several recommendations to Congress in January 2012 to address what it considers Part A overpayments to skilled nursing centers. The recommendations include the elimination of the skilled market basket index for October 1, 2012 and rate rebasing beginning with October 1, 2013. The proposed rebasing would be accomplished via an initial reduction of 4%, with subsequent reductions over an appropriate transition period until Medicare's payments are more aligned with what MedPAC considers providers' costs. MedPAC is also proposing that U.S. Congress should direct the U.S. Secretary to reduce payments to skilled nursing centers with high risk-adjusted rehospitalization rates for their Medicare-covered skilled nursing center stays.

The American Health Care Association (AHCA) has stated publicly that MedPAC continues to make recommendations on Medicare rates without taking into consideration Medicaid rates that do not reimburse nursing centers for the costs of care. Therefore, AHCA disagrees with the elimination of the market basket index for October 1, 2012 as well as the proposed rebasing. It is important to note that MedPAC can only make recommendations to Congress.

2010 Health Care Reform Legislation Remains a Significant Factor

In March 2010, historic health care reform legislation, the *Patient Protection and Affordable Care Act* (H.R. 3590), or "PPACA", was enacted into law at a cost of US$940 billion over 10 years. Amendments to the PPACA were enacted into law on March 30, 2010, with the passage of the *Health Care Education Affordability Act* (HCEAA), which contains several changes to the PPACA. The legislation is complex and there is considerable controversy surrounding its passage. Several states have challenged whether the PPACA is in breach of the U.S. Constitution and during 2012 the result of either of those challenges, or the election, could impact the full implementation of PPACA.

It is generally believed that additional amendments may be introduced to address certain unintended consequences of the sweeping legislation before it is fully implemented in 2014. In addition, various government agencies will be required to issue regulations to properly implement the new legislation, which could have a significant impact on individuals, health care providers and employers. At this point in time, management is not able to determine the final form of the health care reform changes, nor estimate the impact of such on the business, results of operations and financial condition of the REIT.

The key aspects of the legislation that are specific to and impact long-term care providers, among other aspects, are as follows:

(i) A productivity adjustment to Medicare rates commencing October 1, 2011, that will reduce the annual market basket increases by approximately 1%, representing a reduction in Medicare funding of US$14.6 billion over a 10-year period. We anticipate that the annual impact from this Medicare reduction in rates to be approximately US$5 million per annum;

(ii) New transparency requirements and additional employee background check requirements for nursing centers;

(iii) The creation of a new Independent Medicare Payment Advisory Board that will make recommendations to U.S. Congress on Medicare payment rates for health care providers, including skilled nursing centers; and

(iv) A mandate for CMS to create a national, voluntary pilot bundling payment program by 2013.

The additional following provisions were included in the final act:

(i) language that requires MedPAC to take Medicaid into consideration during its analyses for providers including skilled nursing and home health;

(ii) a federal mandate for states to expand home and community-based services with increased FMAP to states that rebalance spending between institutional and community-based care by October 1, 2015;

(iii) DHHS must submit a Medicare value-based purchasing plan for skilled nursing centers by October 1, 2011; and

(iv) as of July 1, 2011, Medicaid will no longer provide payments to states for services related to health care acquired conditions, including conditions acquired in other than hospital settings.

In addition, the health care reform legislation requires all individuals to have a minimum level of health care coverage and requires employers to provide health coverage, with certain stipulations, for employees. The legislation will increase the number of individuals with health care insurance coverage by mandating all individuals to obtain coverage by 2014 through their employer or directly through insurance companies or marketplace "exchanges". For employers, health care coverage must provide a minimum credible coverage and the employee's portion of the coverage must be affordable based upon the employee's income. An employer tax is applied if the employer does not provide any coverage to its employees, or if the employees opt out of the offered coverage and seek a tax credit for insurance purchased from the "exchanges". Some provisions, most notably the elimination of lifetime and annual limits, the prohibition on the denial of coverage due to pre-existing health conditions, and coverage of dependent children on a parent's health insurance coverage up to the age of 26, took effect for EHSI on January 1, 2011.

EHSI currently offers health care coverage to all of its qualifying employees under several different programs tailored to meet an individual's budget and risk tolerance. Approximately 65% of EHSI employees have joined one of EHSI's programs. There has been no material impact of the legislation on our health plan costs as a result of certain plan changes that we implemented to date. While it is difficult to quantify the future financial impact of the new requirements due to potential changes in legislation being considered, we believe that the mitigation strategies and options provided to our employees will result in no material increase (beyond modest inflationary adjustments) in the cost of providing employee health care coverage in 2012. The legislation has additional requirements slated for 2014. Presently, it remains uncertain whether EHSI's coverage will meet the proposed minimum requirements and whether incremental costs will be incurred to meet the proposed standards. We are not able to estimate the impact at this time for the reasons outlined above. We anticipate that modifications to the legislation will continue to be made before its final implementation in 2014.

In October 2011, CMS issued final rules on the establishment and operation of Accountable Care Organizations (ACOs). The primary purpose of ACOs is to help doctors, hospitals, and other health care providers better coordinate care for Medicare patients and to provide a more cost effective and integrated health care system. ACOs create incentives for health care providers to work together to treat an individual patient across care settings – including doctor's offices, hospitals, and long-term care centers. The Medicare Shared Savings Program will reward ACOs that lower growth in health care costs while meeting performance standards on quality of care and putting patients first. Patient and provider participation in an ACO is purely voluntary.

Management is continuing to analyze the impact of the new health care reform legislation in respect of the anticipated reductions in Medicare funding, health care insurance program changes for its employees and the resulting costs and incremental reporting, training and regulatory changes. At this point in time, U.S. organizations are not able to predict the final form of the health care reform changes and therefore management is not able to clearly quantify the impact of such on the business, results of operations and financial condition of the REIT. Management intends to closely analyze the legislation and any subsequent amendments, and proactively respond in a manner with a view to taking advantage of new opportunities and minimize EHSI's exposure to new risks.

MEDICAID FUNDING

The decline in state tax revenue and increased demand for unemployment and Medicaid services, as a result of the economic downturn, has put state Medicaid budgets under considerable strain. Many states have implemented or expanded their provider tax programs (a tax imposed on providers of long-term care) as a means to increase the levels of funding contributed by the federal government to their Medicaid programs. However, these additional federal funds have only partially mitigated funding cuts of some of the states. Our respective federal and state health care associations have lobbied vigorously for continuation of consistent funding in the sector.

Annual Medicaid Rate Increases

With respect to the 12 states in which EHSI operates skilled nursing centers, annual Medicaid rate changes are effective on July 1st in eight of the states (Idaho, Indiana, Kentucky, Ohio, Oregon, Pennsylvania, Washington and Wisconsin); on October 1st in three of the states (Michigan, Minnesota and West Virginia); and January 1st in Delaware.

The July 1, 2011, Medicaid rates have been issued for Idaho, Kentucky, Ohio, Oregon, Pennsylvania and Washington. The net Medicaid funding for these states, defined as Medicaid rates less provider taxes, increased by approximately 1.1%, or US$3.5 million on an annualized basis. The Indiana and Wisconsin net Medicaid funding changes have not been issued, but are anticipated to increase by 1.7%, or US$1.8 million on an annualized basis, retroactive to July 1, 2011. The October 1, 2011, net Medicaid funding for Michigan, Minnesota and West Virginia decreased by approximately 0.1%, or US$0.1 million on an annualized basis.

The 2011 net Medicaid funding, as of the respective dates for all 12 states in which EHSI operates, is anticipated to increase by 0.9%, or US$5.2 million on an annualized basis (2010 – net increase of 0.4%, or US$2.1 million). This estimate could be impacted by CMI changes and Medicaid occupancy changes, along with other factors.

Expiration of Increased Federal Medical Assistance Percentages (FMAP) Funding

On February 17, 2009, U.S. President Obama signed the *American Recovery and Reinvestment Act of 2009* (the "Recovery Act") with a total estimated cost of US$787 billion. The Recovery Act specifies that 64% of the package will be allocated for social programs and spending. Of the amounts earmarked for social programs, US$86.7 billion was allocated to a temporary increase in the FMAP that ended on June 30, 2011.

Canada

In Canada, provincial legislation and regulations closely control all aspects of operation and funding of nursing centers, including the fee structure, the adequacy of physical centers, standards of care and accommodation, equipment and personnel. In some provinces, the government has delegated responsibility for the funding and administration of long-term care programs to regional health authorities.

In most provinces, a license must be obtained from the applicable provincial ministry of health in order to operate a nursing center. In addition to the license procedure, or in some cases in place of, operators in Alberta, Manitoba and Ontario are required to sign service contracts that incorporate service expectations with the provincial government or regional health authority. These contracts specify the services to be provided and the remuneration to be received. Nursing center licenses and service contracts are subject to annual renewals and do not represent any guarantee of continued operation beyond the term of the license or contract. However, Ontario's new *Long-Term Care Homes Act, 2007* (the "LTC Act 2007"), that was proclaimed into force on July 1, 2010, provides for, among other things: new licensing procedures that include more rigorous standards for license review (including public hearings); fixed license terms for up to 25 years, depending on bed classifications (licenses can be revoked in cases of non-compliance); more onerous duties imposed on long-term care operators; unannounced annual inspections; and a more comprehensive enforcement regime. Long-term care operators will be given three years' notice before the end of a license's term as to whether a new license will be issued.

The fees charged by ECI for its Canadian nursing centers and home health care services are regulated by provincial authorities. Accordingly, provincial programs fund a substantial portion of these fees, with the remainder paid for by the residents or customers. Each province has a different system for managing the services provided. As a result, there can be significant variability in the regulations governing the provision of and reimbursement for care from location to location.

Ontario is ECI's largest market for both its long-term care and home health care services. Currently, funding for Ontario long-term care centers is based on reimbursement for the level of care assessed to be required by the residents. The provincial government allocates funds through "funding envelopes", specifically: nursing and personal care, programs and support services, food and accommodation. Providers may retain excess funding over costs incurred only with respect to the accommodation envelope, while funding for the other envelopes, otherwise referred to as "flow-through envelopes", is returned to the extent costs incurred are less than the funding provided. The province sets the rates for standard accommodation, as well as the maximum amounts that a provider can charge for semi-private and private accommodation. The accommodation rates are substantially paid for by the resident; however, the province guarantees funding for standard accommodation through resident subsidies. Overall funding is occupancy-based, but once the average occupancy level of 97% or higher is achieved, operators in Ontario receive 100% funding. During 2011, if the average occupancy fell below 97%, but remained above 85%, the center was funded based on actual occupancy plus 3%, and if it fell below 85%, then funding was based on actual occupancy. At this time it is unclear what the policy will be for 2012 should occupancy fall below 97%. Prior to 2011, if the average occupancy level fell below 97%, then funding was based on the actual occupancy level.

ONTARIO LONG-TERM CARE LEGISLATION

Ontario Redevelopment Program

In July 2007, the Ontario government initiated plans to redevelop 35,000 older long-term care beds in five phases over the next 10 to 15 years, and provide qualified applicants with a 25-year construction funding subsidy. In November 2008, the government released the range of the base construction funding subsidy, which for nursing centers larger than 100 beds is a daily subsidy of $13.30 per bed over a 25-year period, and an additional $1.00 per bed if the center is LEEDs silver compliant. The majority of operators believe that the level of capital funding is insufficient given the current costs of construction and the new design standards. Should operators choose not to replace their centers, it could have a significant impact on the number of nursing center beds in the province, which will offer both risks and opportunities for others in the marketplace. ECI and other operators continue to express concerns about the adequacy of the construction funding subsidy. The government has commenced a review of the program and we are awaiting a report on their recommendations and or proposed changes to the program.

ECI has 23 class "C" nursing centers (3,572 beds) that require redevelopment to meet the new standards. The first round of submissions for approval under the redevelopment plan began in July 2009, and the next round was expected to take place in mid-2011. There has been no announcement on the timing of the second round of submissions. Under the first phase of the redevelopment program, ECI received approval to redevelop 280 of its class "C" beds and is reviewing its remaining buildings to determine the priorities for redevelopment over the next four phases. Should ECI decide to replace or redevelop all of its remaining class "C" beds, management estimates that the total capital outlay will be in the range of $375 million to $475 million, depending on a number of factors including construction costs. Management estimates that approximately 20% to 25% of the total cost will be required to be funded by equity. ECI may choose not to replace certain of its centers and in other cases, form strategic partnerships with other providers for the replacement of their centers.

ONTARIO LONG-TERM CARE FUNDING

All Ontario long-term care centers have implemented a new resident assessment instrument, referred to as MDS 2.0. In April 2010, the Ontario government began using the MDS 2.0 data to drive a new case-mix classification methodology using 34 categories under a RUGs-based funding model. This RUGs model will tie resident needs to costs of care in a more impartial and transparent way. Twenty-seven of ECI's centers have now been affected by this change and will be fully transitioned to the new funding model by April 2012. ECI's remaining seven homes will begin transitioning to the new funding model in April 2012, and will have completely transitioned by April 2015.

In June 2010, the Ontario Ministry of Health and Long-Term Care (MOHTLC) released details of additional funding to assist providers with the implementation of the LTC Act of 2007, which was proclaimed into force on July 1, 2010. This funding increased the daily rate by $1.18, of which $0.26 was one-time funding for staff training over a period of nine months ending on March 31, 2011. The annual revenue impact to ECI of the $0.92 increase in base funding was approximately $1.7 million. The impact to ECI of the one-time daily rate increase of $0.26 for staff training was approximately $0.3 million over nine months. The funds were spread across the envelopes, with $0.57 of the daily rate allocated to the flow-through envelopes to provide for more registered dieticians, restorative and recreational programs and staff training, and $0.61 of the daily rate was allocated to the accommodation envelope to provide for more nutrition managers, food service workers and staff training. As well, the increase in daily rates was staggered, such that $0.60 took effect on July 1, 2010, and $0.58 took effect on October 1, 2010.

The Ontario government's budget for 2011 released on March 29, 2011 (the "2011 Ontario Budget"), included a 3% annual funding increase to the long-term care flow-through envelopes for the next three years on April 1st, to assist providers in offsetting costs required to meet the ministry standards in nursing and programming. Given the province's fiscal situation and the recommendations contained in a February 2012 report published by the Commission on the Reform of Ontario's Public Services, commonly referred to as the "Drummond Report", the province's ability to follow through on their funding commitments is unclear, although health and education have been identified as priorities. The 3% increase in the flow-through envelopes was estimated to represent annual revenue to ECI of approximately $4.9 million. This year the government also provided increased flow-through funding to hire personal support workers and enhance staff training. In addition, each April 1st, Ontario long-term care providers receive CMI funding adjustments based on the provincial resident classification results of the previous year, which resulted in a funding decrease in 2011 for ECI. The funding improvements, coupled with our CMI adjustments, were estimated to increase ECI's annual revenue in the flow-through envelopes by approximately $3.6 million, and were offset by additional costs for resident care and services. In addition to the funding changes in the flow-through envelopes, the Ontario government provided a 1.2% increase ($0.58) in accommodation funding effective April 1, 2011, to address costs associated with the new regulation requirements and enhance staff training, which was estimated to provide ECI with annual revenue of approximately $1.1 million.

On July 1st each year, the Ontario government generally implements annual accommodation funding increases for long-term care providers (the portion of the fees paid for by the residents to the nursing center operators). In 2011, instead of increasing the resident fees, the Ontario government provided a one-time funding increase to long-term care providers that would have otherwise been received through a co-payment increase. The government indicated that this funding would continue to June 30, 2012, with a continued review of the co-payment and per diem funding on an annual basis. This July 2011 increase in the daily rates was $0.13 for food costs and $0.69 for the non flow-through component, representing annual revenue to ECI of approximately $1.5 million (2010 – $0.3 million).

In response to the economic downturn, the Ontario government implemented a wage freeze for labour contracts being renewed over the next two years beginning in 2010, and indicated its expectation that this should be extended to the government-funded long-term care sector, by announcing that it would not provide funding for any wage increases. ECI has complied with these expectations. However, arbitrators have awarded increased union wages in the long-term care sector affecting ECI, despite this mandate. As a result, the incremental cost of these arbitrated wage increases to ECI, and other operators in the sector, will put pressure on ECI's operating margins. ECI expects to mitigate these cost pressures by implementing further cost containment measures at the corporate and regional office levels.

ALBERTA LONG-TERM CARE LEGISLATION AND FUNDING

In Alberta, a new activity-based funding system for continuing care centers commenced on April 1, 2010. However, Alberta Health Services (AHS) continues to adjust the formulas and has begun the process of determining the quality indicators that will also impact the funding. The quality indicators are anticipated to be implemented in three phases over three years and include such things as: family satisfaction survey results; immunization rates; medication reconciliations; and the implementation of quality improvement initiatives based on the RAI-MDS indicators. The first phase has been announced and consists of four unequally weighted quality indicators, which will determine an operators' eligibility for 0.2% of its government funding for the fiscal year 2011-2012.

Effective April 1, 2011, the Alberta government provided a funding increase to long-term care providers of up to 3.8%, and additional acuity-adjusted funding of up to 1% for those operators below target provincial funding levels. ECI's funding improved by an average of 3.7% representing annual revenue of approximately $2.7 million.

In August and December 2010, Alberta long-term care providers received funding increases under the new funding system retroactive to April 1, 2010, which increased ECI's annual funding by about $3.3 million, and resulted in the receipt by ECI of $1.0 million of funding in the 2010 fourth quarter that related to prior quarters.

In April 2010, we received notification from AHS of one-time funding to be provided to offset expenses incurred in preparation for the new activity-based funding system, as well as to offset costs incurred in maintenance, repairs and equipment needs within the nursing centers for the period April 1, 2009 to March 31, 2010. As a result, ECI received retroactive funding of $1.2 million in the 2010 second quarter, of which $0.9 million related to 2009.

In October 2010, the Alberta government announced a 3% increase in the long-term care accommodation fees (the portion paid directly by the residents), effective February 1, 2011, to reflect the rising costs of delivering accommodation and related services. The last time there was an increase in the accommodation fees was in November 2008. ECI estimates that this 3% increase will contribute additional annual revenue of approximately $0.7 million.

ONTARIO HOME HEALTH CARE LEGISLATION AND FUNDING

ECI is a major private-sector provider of home health care services in Canada through ParaMed, which operates in Alberta and Ontario. Ontario is ParaMed's largest market, representing approximately 96% of its revenue in 2011.

The 2011 Ontario Budget included a 3% funding increase for home health care. It is not clear how the additional funding has been utilized by the Community Care Access Centres (CCACs) and consequently how it has impacted home health care providers, such as ParaMed.

The home health care competitive bidding process in Ontario was frozen in 2004 as a result of a government study intended to improve the procurement model. Consequently, contracts that were due to expire are being extended until the bidding process resumes, with a focus on strengthening accountability and ensuring fairness and transparency. ParaMed had recommended the use of a public reporting system similar to the long-term care industry. The government is in the process of developing performance measures and has indicated its intention of publicly reporting them. There has been no indication from the government of when or if the bidding process will resume.

Beginning on January 2, 2009, the Ontario government eliminated the provisions that exempted elect-to-work employees from the entitlement to public holiday pay. As the majority of our home health care employees are elect-to-work employees, this resulted in increased operating costs for ParaMed of $3.1 million in 2010 and $2.5 million in 2009. Requests for reimbursement for these added costs were made directly to the MOHTLC by ParaMed and the Ontario Home Care Association. Consequently in 2010, the CCACs reimbursed providers for their 2009 costs related to the CCAC contracts, of which ParaMed's portion was approximately $2.1 million. The CCACs continued to directly fund these costs until the additional funding was embedded in the billing rates as the contracts were renewed.

The *Employment Standards Amendment Act (Temporary Help Agencies), 2009* (the "ESAA"), came into effect in November 2009, and established, among other things, that temporary employees are covered by the *Employment Standards Act, 2000*, thereby providing them with entitlements to severance and notice of termination. Currently, the ESAA does not apply to elect-to-work employees of agencies, such as ParaMed, providing services pursuant to contracts with the CCACs. However, this exemption expires September 30, 2012, following which the ESAA will apply to all elect-to-work employees. Through the Ontario Home Care Association, we will be making submissions to retain the elect-to-work exemptions or provide funding to cover the added costs. The current impact of the ESAA on ParaMed's contracts to parties other than the CCACs is minimal and it is too early to determine what impact it may have on our operations in 2012.

Liquidity and Capital Resources

Sources and Uses of Cash

At December 31, 2011, the REIT had cash and cash equivalents of $80.0 million compared with $267.8 million at December 31, 2010, representing a decrease of $187.8 million, largely due to cash used in the refinancing of a significant portion of our U.S. debt. Cash pledged of $16.8 million (US$16.6 million) is excluded from our available cash balance as it relates to US$10.2 million held by RBC as collateral against a letter of credit and US$6.4 million held in escrow pursuant to the HUD regulatory agreements for working capital purposes.

(thousands of dollars unless otherwise noted)	**2011**	2010
Cash provided by operating activities, before working capital changes and interest and income taxes	**238,547**	257,741
Net change in operating assets and liabilities		
Accounts receivable	**(10,545)**	(10,588)
Other current assets	**(11,210)**	1,691
Accounts payable and accrued liabilities	**(4,525)**	(8,477)
	(26,280)	(17,374)
Interest and taxes paid		
Interest paid	**(83,531)**	(85,797)
Interest received	**4,278**	4,214
Income taxes paid	**(26,235)**	(13,391)
	(105,488)	(94,974)
Cash provided by operating activities	**106,779**	145,393
Cash used in investing activities	**(67,906)**	(41,017)
Cash provided by (used in) financing activities	**(227,243)**	36,139
Foreign exchange gain (loss) on U.S. cash held	**629**	(6,768)
Increase (decrease) in cash and cash equivalents	**(187,741)**	133,747
Cash and cash equivalents at beginning of year	**267,759**	134,012
Cash and cash equivalents at end of year	**80,018**	267,759
Average U.S./Canadian dollar exchange rate	**0.9891**	1.0299

Cash provided by operating activities was $106.8 million in 2011 compared to $145.4 million in 2010, representing a decline of $38.6 million. This decline was primarily due to the decline in earnings during the year and the increase in income taxes paid of $12.8 million between years. The lower amount of cash taxes paid in 2010 was due to taxes recoverable from the 2009 taxation year that reduced the amounts paid during 2010.

Cash used in investing activities was $67.9 million in 2011 compared to $41.0 million in 2010 and primarily reflected expenditures for property, equipment and software, the acquisition of a previously leased skilled nursing center for $7.3 million, partially offset by proceeds from dispositions. During 2011, net proceeds of $4.8 million were realized on the disposal of a skilled nursing center in Michigan and a closed nursing center in Alberta, compared to net proceeds of $29.0 million on the disposal of assets in 2010.

Purchases of property, equipment and software were $64.3 million in 2011 compared to $68.7 million in 2010. Growth capital expenditures, excluding acquisitions, were $33.5 million in 2011 compared to $40.0 million in 2010, and related to the construction of new beds, building improvements or capital costs aimed at earnings growth. Maintenance capital expenditures, which are the capital costs to sustain and upgrade existing property and equipment assets, were $31.0 million in 2011 compared to $29.9 million in 2010, representing 1.5% and 1.4% of revenue, respectively. These costs fluctuate on a quarterly basis with the timing of projects and seasonality. It is our intention to spend between 1.5% and 2.0% of revenue annually on maintenance capital expenditures, which is consistent with our objective to maintain and upgrade our centers. We are projecting to spend up to approximately $38 million in facility maintenance capital expenditures and $70 million in growth capital expenditures in 2012.

The following table summarizes the components of property, equipment and software expenditures.

Purchase of Property, Equipment and Software *(thousands of dollars unless otherwise noted)*	**2011**	2010
Growth expenditures	**33,528**	39,991
Facility maintenance	**30,975**	29,962
Deduct: capitalized interest	**(195)**	(1,262)
	64,308	68,691
Average U.S./Canadian dollar exchange rate	**0.9891**	1.0299

Cash provided by (used in) financing activities was $227.2 million used in 2011 compared to $36.1 million provided in 2010. During 2011, debt repayments were $113.2 million in excess of new debt issued, primarily reflecting the activities of the 2011 refinancing plan. As well, the REIT made cash distributions of $58.4 million to holders of REIT Units during 2011 and incurred financing fees of $28.3 million. Financing activities in 2010 primarily reflected net cash proceeds of $82.2 million, before income taxes, from the REIT Unit equity offering in February, the issuance of long-term debt on refinancing of existing debt, and draws on construction financing, partially offset by cash distributions of $60.1 million to holders of REIT Units and scheduled debt repayments. For information on the change in long-term debt, refer to "Liquidity and Capital Resources – Long-term Debt".

Reconciliation of Cash Provided by Operating Activities to DI and AFFO

The following table provides a reconciliation of the cash provided by operating activities to DI and AFFO for the past eight quarters and the 2011 and 2010 years. (1)

	Q1		Q2		Q3		Q4		Year	
(millions of dollars)	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010
Cash provided by operating activities	**29.0**	25.6	**28.1**	41.5	**42.0**	44.7	**7.7**	33.6	**106.8**	145.4
Add (Deduct):										
Net change in operating assets and liabilities, including interest and taxes	**(3.4)**	4.8	**9.2**	(6.6)	**(6.7)**	(14.7)	**23.4**	10.9	**22.5**	(5.6)
Current tax on fair value adjustments, gain/loss on foreign exchange, financial instruments, asset impairment, disposals and other items	**–**	–	**0.5**	–	**(0.9)**	4.2	**(2.4)**	0.4	**(2.8)**	4.6
Net provisions and payments for self-insured liabilities	**3.6**	(2.4)	**(4.7)**	4.6	**(22.1)**	(11.1)	**(7.0)**	0.6	**(30.2)**	(8.3)
Exchangeable LP Unit distributions	**0.7**	0.7	**0.6**	0.7	**0.7**	0.6	**0.2**	0.7	**2.2**	2.7
Depreciation for FFEC	**(5.9)**	(5.4)	**(5.6)**	(5.6)	**(5.8)**	(5.7)	**(6.1)**	(5.7)	**(23.4)**	(22.4)
Principal portion of government capital funding payments	**0.6**	0.6	**0.7**	0.6	**0.7**	0.6	**0.6**	0.6	**2.6**	2.4
Other	**(0.2)**	(0.1)	**–**	–	**(0.1)**	(0.1)	**–**	(0.4)	**(0.3)**	(0.6)
DI	**24.4**	23.8	**28.8**	35.2	**7.8**	18.5	**16.4**	40.7	**77.4**	118.2
Additional facility maintenance capital expenditures (2)	**1.2**	0.9	**(1.5)**	0.4	**(3.3)**	(2.8)	**(4.0)**	(6.0)	**(7.6)**	(7.5)
AFFO	**25.6**	24.7	**27.3**	35.6	**4.5**	15.7	**12.4**	34.7	**69.8**	110.7

(1) "DI" and "AFFO" are not recognized measures under GAAP and do not have a standardized meaning prescribed by GAAP. Refer to the discussion of non-GAAP measures.
(2) Represents total facility maintenance capital expenditures less depreciation for furniture, fixtures, equipment and computers (FFEC) already deducted in determining DI.

Capital Structure

(millions of dollars unless otherwise noted)	**2011**	2010
Unitholders' Equity		
REIT Units	**453.1**	421.2
Contributed surplus	**0.1**	0.1
	453.2	421.3
Accumulated deficit at beginning of year	**(287.5)**	(262.1)
Net earnings (loss) for the year	**(30.4)**	41.8
Other/adjustment to prior year distribution of ALC	**(0.4)**	(1.1)
Distributions declared on REIT Units	**(67.9)**	(66.1)
Accumulated deficit at end of year	**(386.2)**	(287.5)
Accumulated other comprehensive loss	**(18.7)**	(20.8)
Unitholders' equity	**48.3**	113.0
U.S./Canadian dollar exchange rate *(at year end)*	**1.0170**	0.9946

Unit Information *(thousands)*	**Feb. 29, 2012**	**Dec. 31, 2011**	Dec. 31, 2010
REIT Units (TSX symbol: EXE.UN) (1)	**84,417.5**	**84,121.5**	79,831.5
Exchangeable LP Units	**–**	**–**	3,163.7
	84,417.5	**84,121.5**	82,995.2

(1) Closing market value per the TSX on February 29, 2012, was $8.50.

The closing rates used to translate assets and liabilities of the U.S. operations were 1.0170 at December 31, 2011, and 0.9946 at December 31, 2010. As a result of the weaker Canadian dollar at December 31, 2011, the assets of the REIT's U.S. operations increased by approximately $45.6 million, partially offset by an increase in the liabilities of approximately $40.3 million, with the net change in foreign currency translation of $5.3 million included in accumulated other comprehensive loss. Every one-cent increase (decrease) in the Canadian dollar against the U.S. dollar would impact the net assets of our U.S. operations by approximately $2.5 million, and would be reflected as a change in foreign currency translation adjustments in accumulated other comprehensive loss.

DISTRIBUTIONS

In 2011, we generated DI of $77.4 million and AFFO of $69.8 million and declared monthly distributions of $0.07 per unit totalling $70.1 million that were distributed to holders of REIT Units ($67.9 million) and Exchangeable LP Units ($2.2 million) from February 15, 2011 to January 16, 2012. The portion distributed in cash was $60.2 million and $9.9 million was by way of issued units under a distribution reinvestment plan. A total of 1,125,603 units (1,123,294 REIT Units and 2,309 Exchangeable LP Units) were issued during 2011 through the distribution reinvestment plan.

During 2010, monthly distributions of $0.07 were declared totalling $68.8 million, of which $63.2 million was distributed in cash and $5.6 million by way of issued units under a distribution reinvestment plan. A total of 586,407 REIT and Exchangeable LP units were issued during 2010 through the distribution reinvestment plan.

There are a number of factors that affect the quarterly funds generated for distribution that our Board takes into consideration in determining the monthly distributions for the year. Factors affecting quarterly trends in earnings are discussed under the headings "Adjusted Funds from Operations", "Summary of Quarterly Results" and "2011 Financial Review".

Our current policy is to pay distributions of $0.07 per REIT Unit to the holders thereof on a monthly basis, of which approximately 70% is distributed by way of tax-deferred returns of capital to Canadian residents.

The declaration and payment of future distributions is subject to the discretion of our Board and will be dependent upon a number of factors including results of operations, requirements for capital expenditures and working capital, future financial prospects of the REIT, debt covenants and obligations, and any other factors deemed relevant by the Board. If our Board determines that it would be in the REIT's best interests, it may reduce, for any period, the percentage of Distributable Income to be distributed to holders of REIT Units.

LONG-TERM DEBT

Long-term debt, including current portion, was $1,134.4 million at December 31, 2011, and was net of $22.2 million of financing costs. The current portion of long-term debt was $192.7 million at the end of 2011, and included the May 2012 CMBS Financing of $111.8 million (US$109.9 million) that was repaid in full in February 2012 as part of the debt refinancing plan, as discussed in further detail under the heading "Overview – Significant 2011 Events and Developments – 2011 Refinancing Plan".

Details of the components, terms and conditions of long-term debt are provided in *note 11* of the 2011 consolidated financial statements. The REIT and its subsidiaries are in compliance with all of their respective financial covenants as at December 31, 2011.

The following summarizes the changes in the carrying amounts of long-term debt for 2011 and 2010.

Continuity of Long-term Debt *(millions of dollars)*	**2011**	2010
Long-term debt at beginning of year, prior to financing costs	**1,255.9**	1,261.8
Issue of long-term debt		
Mortgages	**390.5**	23.5
PrivateBank Loans	**9.9**	25.7
Construction loans	**1.9**	16.1
Notes payable	**0.1**	3.3
Net issue (repayment) on the EHSI Credit Facility	**35.7**	(6.8)
Increase in capital lease obligations, other than annual repayments (1)	**–**	12.8
Repayment of long-term debt	**(551.2)**	(46.3)
Revaluation of convertible debentures carried at fair value	**0.6**	6.2
Change due to period-end foreign exchange rate	**13.2**	(40.4)
	1,156.6	1,255.9
Financing costs at end of year	**(22.2)**	(14.7)
Long-term debt at end of year	**1,134.4**	1,241.2
Less: current portion	**(192.7)**	(571.2)
	941.7	670.0

(1) The 2010 activity reflects the new capital lease obligation entered into in November 2010 on the Indiana skilled nursing center.

Credit Rating

Moody's Investor Services Inc. (Moody's) has assigned the REIT a Corporate Family Rating of "B1" with a "stable" outlook. The "stable" rating outlook means that the rating is not likely to change. A "B" rating is considered speculative and subject to high credit risk. Moody's applies numerical modifiers 1, 2 and 3 in each rating classification, and the modifier "1" indicates that the security ranks in the higher end of its generic rating category.

Moody's Corporate Family Ratings are generally employed for speculative-grade corporate issuers. A Corporate Family Rating is an opinion of a corporate family's ability to honour all of its financial obligations and is assigned to a corporate family as if it had a single class of debt and a single consolidated legal entity structure.

A Corporate Family Rating does not reference an obligation or class of debt and thus does not reflect priority of claim. It applies to all affiliates under the management control of the entity to which it is assigned. Moody's employs the general long-term rating scale for Corporate Family Ratings.

The ratings accorded to the REIT are not recommendations to purchase, hold or sell the REIT's securities. There can be no assurance that any rating will remain in effect for any given period of time or that any rating will not be withdrawn or revised by a rating agency at any time.

Interest Rates and Aggregate Debt Maturities

In order to meet the REIT's monthly distributions, management has limited the amount of debt that may be subject to changes in interest rates. As a result, all but $102.3 million of our long-term debt outstanding at December 31, 2011, excluding financing costs and equity allocation, was at fixed rates. The variable-rate debt related to US$53.0 million drawn on EHSI's Credit Facility, US$34.5 million drawn on the PrivateBank Loans, and the $13.3 million bridge loan on two Canadian centers.

The 2011 refinancing of our U.S. and Canadian debt with government-insured mortgages at lower rates and with longer terms to maturity reduced our weighted average interest rates and terms to maturity.

The weighted average interest rate of our long-term debt was approximately 5.5% at December 31, 2011 (5.7% for our Canadian operations and 5.3% for U.S. operations), compared to 6.6% at December 31, 2010. The weighted average term to maturity of our long-term debt, including capital lease obligations, was 14.5 years as at December 31, 2011 (7.2 years for our Canadian operations and 20.6 years for our U.S. operations), compared to 4.1 years at December 31, 2010. Excluding our capital lease obligations, the weighted average term to maturity of our long-term debt was 14.5 years (4.9 years for our Canadian operations and 20.9 years for our U.S. operations).

Our consolidated interest coverage ratio for 2011 was 2.4 times (2010 – 2.9 times). Interest coverage is defined as EBITDA divided by net interest.

The following table presents principal, or notional, amounts and related weighted average interest rates by year of maturity for the REIT's debt obligations as at December 31, 2011. It incorporates only exposures that existed at that date and does not consider exposures, or positions that could arise subsequently, or future interest rate movements. As a result, the information has limited predictive value. The ultimate results with respect to interest rate fluctuations will depend on the exposures that occur, hedging strategies at the time and interest rate movements.

(millions of dollars unless otherwise noted)	2012	2013	2014	2015	2016	After 2016	Total	Fair Value
Canadian Operations								
Convertible debentures (at face value)								
Fixed rate	–	91.8	113.9	–	–	–	205.7	214.3
Average interest rate	–	7.25%	5.70%	–	–	–	6.39%	
Long-term debt								
Fixed rate	10.1	41.3	15.9	9.7	15.6	94.6	187.2	194.0
Average interest rate	3.54%	4.88%	3.36%	3.27%	3.82%	4.53%	4.33%	
Variable rate	1.0	12.3	–	–	–	–	13.3	13.3
Average interest rate	3.12%	3.12%	–	–	–	–	3.12%	
Capital lease obligations								
Fixed rate	4.2	4.5	4.9	5.2	5.7	90.2	114.7	132.4
Average interest rate	7.08%	7.08%	7.08%	7.08%	7.08%	7.08%	7.08%	
United States Operations (1)								
Long-term debt								
Fixed rate	123.9	11.5	7.8	8.1	8.5	363.2	523.0	541.6
Average interest rate	6.57%	5.67%	4.67%	4.7%	4.7%	4.55%	5.06%	
Variable rate	54.5	34.5	–	–	–	–	89.0	89.0
Average interest rate	6.43%	6.00%	–	–	–	–	6.26%	
Capital lease obligations								
Fixed rate	0.6	0.7	0.7	0.3	0.1	12.7	15.1	15.1
Average interest rate	5.90%	5.90%	5.91%	6.01%	8.71%	8.71%	8.28%	

(1) U.S. dollar denominated debt is translated to Canadian dollars at a rate of 1.0170.

ACCRUAL FOR SELF-INSURED LIABILITIES

The accrual for self-insured liabilities is based on management's best estimate of the ultimate cost to resolve general and professional liability claims, including both known claims and claims that have been incurred but not yet reported by the end of the reporting period. General and professional liability claims are the most volatile and significant of the risks for which the REIT self-insures. Actual results can differ materially from the estimates made due to a number of factors including the assumptions used by management and other market factors.

At December 31, 2011, the accrual for self-insured general and professional liabilities was $79.4 million compared to $46.5 million at the beginning of the year, representing an increase of $32.9 million. The current period provision, net of claims payments, increased the accrual by $30.2 million, with the balance of the increase primarily due to the weaker Canadian dollar.

Provisions recorded in 2011 and 2010 for potential general and professional liability claims were $65.3 million and $33.1 million, respectively. Payments for self-insured liabilities were $35.1 million in 2011 and $24.9 million in 2010.

The results of the actuarial reviews conducted during the 2011 third quarter and at year end necessitated the strengthening of our prior years' reserves by $31.4 million (US$32.1 million) and $11.4 million (US$11.2 million), respectively. These additional reserves were necessary as a result of higher than anticipated paid settlement amounts, increases for settlements on known and unknown claims and adverse claim developments in the second half of 2011.

In the 2010 third quarter, following the completion of the third quarter interim independent actuarial review of our resident care liabilities, we strengthened the level of our reserves for prior years' claims by $14.0 million (US$13.5 million), to a level which we believed was adequate at that time. Similarly in 2009, we increased our reserves for prior years' claims by US$3.2 million.

Management regularly evaluates and periodically engages an independent third-party actuary to provide a report to determine the appropriateness of the carrying value of this liability. In 2011, we commenced the practice of performing an independent actuarial review three times during the calendar year, and added a review in the second quarter, in addition to the normal third and fourth quarter reviews. Assumptions underlying the determination of the liability are limited by the uncertainty of predicting future events and assessments regarding expectations of several factors. Such factors include, but are not limited to: the frequency and severity of claims, which can differ materially by jurisdiction; trends in claims along with unique and identifiable settlements; coverage limits of third-party reinsurance; the effectiveness of the claims management process; and the outcome of litigation. Therefore, management's estimate of the accrual for general and professional liability claims is significantly influenced by assumptions that are subject to judgement by management and the actuary, which may cause the provision to fluctuate from one reporting period to another. Differences between the ultimate claims costs and our historical provisions for loss and actuarial assumptions and estimates could have a material adverse effect on our business, operating results and financial condition.

Most of the risks that Extendicare self-insures are long-term in nature and accordingly, claims payments for any particular policy year occur over a long period of time. However, management estimates and allocates a current portion of the accrual for self-insured liabilities on the statement of financial position. As at December 31, 2011, management estimated that $24.4 million of the accrual for self-insured general and professional liabilities will be paid within the next year. The timing of payments is not directly within management's control and therefore, estimates could change in the future.

Within our Bermuda-based captive insurance company, we hold investments sufficient to support the accrual for self-insured liabilities and to meet the required statutory solvency and liquidity rations. These invested funds are reported in other assets and totalled $83.6 million at December 31, 2011, compared to $60.9 million at December 31, 2010. This increase of $22.7 million reflects a cash injection of US$30.0 million into our captive insurance company to cover the estimated incremental self-insured liabilities, net of the claims payments and operating activities of the captive. A further US$8.6 million of cash was injected in the 2012 first quarter to ensure the captive was adequately capitalized for regulatory purposes. Management believes there are sufficient cash resources to meet estimated current claims payment obligations.

SPECIFIED CONTINGENT CLAIMS AGAINST CROWN LIFE

Under the June 2007 Crown Life share sale agreement with The Canada Life Assurance Company (Canada Life), Extendicare was responsible for specified contingent claims against Crown Life, and had accrued provisions for potential settlements (December 31, 2010 – $13.9 million), which were secured by letters of credit. Settlement on all of the remaining claims was reached during 2011, resulting in the release of excess provisions of $0.5 million in the 2011 second quarter and $1.9 million in the 2011 third quarter, and the elimination of the letters of credit.

OTHER CONTRACTUAL OBLIGATIONS

The table below provides summary information about the contractual obligations, other than long-term debt, as at December 31, 2011. Due to the uncertainty as to the timing of payments to be made with respect to certain obligations, the table excludes our self-insured liabilities and decommissioning provisions, totalling $79.4 million and $26.1 million, respectively, as at December 31, 2011, and also excludes our defined benefit pension plan obligations, which are described more fully below.

(millions of dollars)	Total	2012	2013	2014	2015	2016	After 2016
Canadian Subsidiary Operations							
Operating lease obligations	9.2	2.1	1.6	1.5	1.1	0.8	2.1
Purchase obligations	64.5	54.9	9.6	–	–	–	–
United States Subsidiary Operations (1)							
Operating lease obligations	32.1	5.6	4.3	3.8	3.5	3.4	11.5
Purchase obligations	5.0	5.0	–	–	–	–	–

(1) Obligations denominated in U.S. dollars are translated to Canadian dollars at a rate of 1.0170.

In addition to the operating lease amounts identified in the table above, EHSI remains party to ALC's master leases with LTC Properties following the Arrangement. For further details on these commitments, refer to "Off-balance Sheet Arrangements".

Defined Benefit Pension Plan Obligations

The contractual obligations table excludes our defined benefit pension plan obligations, none of which had funding requirements as at December 31, 2011. The accrued benefit liability on our balance sheet as at December 31, 2011, was $35.2 million (December 31, 2010 – $31.3 million). We currently have defined benefit registered and supplementary plans covering certain executives, both of which have been closed to new entrants since 2000. The registered defined benefit plan was fully funded with plan assets of $5.6 million and accrued benefit obligations of $7.6 million as at December 31, 2011 (December 31, 2010 – $6.3 million and $6.7 million, respectively). The accrued benefit obligations of the supplementary plan were $33.2 million as at December 31, 2011 (December 31, 2010 – $30.9 million). We do not set aside assets in connection with the supplementary plan and the benefit payments will be paid from cash from operations. The benefit obligations under the supplementary plan are secured by letters of credit totalling $40.0 million as at December 31, 2011 (December 31, 2010 – $41.0 million). The expected annual benefit payments under the supplementary pension plan that will be funded from cash from operations over the next five years range between $2.0 million and $2.2 million. Since the majority of our accrued benefit obligations represent our obligation under our non-registered supplementary plan, which is not required to be funded, the recent capital market turmoil is not expected to have a material adverse effect on our cash flow requirements with respect to our pension obligations, or our pension expense.

Future Liquidity and Capital Resources

As discussed in more detail under the heading "Overview – Significant 2011 Events and Developments – 2011 Refinancing Plan", Extendicare REIT is in the final stages of refinancing approximately US$636 million of its U.S. long-term debt. Management anticipates refinancing this debt with approximately US$520 million of HUD-insured mortgages and US$116 million of cash on hand. As at December 31, 2011, we had closed on 49 HUD loans totalling US$370.2 million. In February 2012, the balance of the May 2012 CMBS Financing of US$109.9 million was repaid in full, and we anticipate closing on the majority of the remaining 22 HUD loans totalling US$149.8 million by the end of June 2012. Upon conclusion of the refinancing, EHSI anticipates closing on approximately US$520 million in HUD-insured mortgages with a weighted average all-in rate of approximately 4.35% and term to maturity of about 33 years, which is anticipated to reduce our interest costs by approximately US$20 million per annum. Together with the annual interest savings of approximately $5 million resulting from the December 2011 refinancing of $72.4 million of our Canadian debt, we anticipate total interest savings of approximately $25 million per annum.

As at December 31, 2011, EHSI had cash on hand of US$53.3 million and US$14.4 million available under the EHSI Credit Facility. Our Canadian operations had cash on hand of $25.2 million and available bank lines of $29.5 million at the end of December 2011. Upon completion of the refinancing, we anticipate having approximately $30 million of cash on hand, exclusive of working capital requirements, and approximately 50 unencumbered centers in the U.S. valued at an estimated US$250 million.

We are currently projected to spend up to approximately $38 million in facility maintenance capital expenditures and approximately $70 million in growth capital expenditures in 2012. As at December 31, 2011, EHSI and ECI had outstanding capital expenditure commitments totalling US$4.9 million and $64.5 million, respectively. ECI's commitments relate to the Timmins and Sault Ste. Marie construction projects.

Given the current refinancing plan, management remains confident that cash from operating activities, together with available bank credit facilities, will be sufficient to meet the REIT's current requirements to support ongoing operations, facility maintenance capital expenditures, and debt repayment obligations. The REIT structure necessitates raising funds through debt financings and the capital markets to fund strategic acquisitions and growth capital expenditures.

Related Party Transactions

On April 7, 2008, Tim Lukenda, the former President of Tendercare, was appointed President and Chief Executive Officer of Extendicare REIT. Prior to its acquisition by EHSI, Mr. Lukenda owned an approximate 4.6% direct and indirect interest in Tendercare and received, directly or indirectly, on completion of the acquisition of Tendercare an equivalent percentage of the consideration paid by EHSI. EHSI completed the acquisition of Tendercare, a privately owned operator of senior care centers in the State of Michigan, in October 2007 for $225.0 million (US$238.2 million), which was comprised of 29 skilled nursing centers and one inpatient rehabilitation hospital, for a total of 3,301 operational beds. As part of Mr. Lukenda's terms of employment, the employment contract provides a mechanism and process that effectively removes Mr. Lukenda from the decision-making process in situations where a conflict of interest may arise on any matter between Extendicare REIT and his previous employer, or with respect to any financial interest that Mr. Lukenda or his family have with Extendicare REIT and its subsidiaries. As part of the acquisition of Tendercare, in addition to normal representation and warranty provisions, EHSI must agree on any adjustments to the final purchase price, before making any payments to Mr. Lukenda or his family. EHSI and ECI also provide certain management services to two long-term care centers and operate under lease arrangements two long-term care centers that are owned or partially owned by members of Mr. Lukenda's immediate family.

In connection with the purchase of Tendercare, the acquired working capital is subject to annual adjustments that will occur 90 days after the anniversary date of the Tendercare acquisition over a four-year period until January 2012. The first anniversary adjustment increased net working capital by US$1.7 million and was paid by EHSI in April 2009 with no impact on the consolidated statement of earnings. The second and third anniversary adjustments increased net working capital by US$0.2 million and US$0.3 million, respectively. The second anniversary adjustment included a US$3.1 million adjustment for accrued vacation pay sought by EHSI. In March 2010, the sellers of Tendercare (the "Tendercare Sellers Committee") filed a notice of disagreement, stating that the adjustment for accrued vacation pay was not a permitted adjustment. In April 2010, EHSI submitted a written response stating that its position is in accordance with GAAP as required under the terms of the agreement. In February 2012, an independent accounting firm selected jointly by EHSI and the Tendercare Sellers Committee concluded in favour of the Tendercare Sellers Committee stating that Tendercare's former treatment of vacation pay was in accordance with GAAP. There was no material financial impact in respect of this arbitration decision on the results of operations or financial position of the REIT.

In addition, in connection with the acquisition of LTC Professional in 2008, Tendercare's affiliated insurance company, consideration for the acquisition is to be adjusted annually based upon the actuarial liabilities determined at December 31st of each year through to 2012, with an option to extend it annually to 2015. In 2011, ECI made a settlement payment of US$1.3 million (2010 – US$1.5 million).

Off-balance Sheet Arrangements

Both ALC and EHSI are the lessees under lease agreements with LTC (the "LTC Master Leases"), which cover 37 assisted living properties operated by ALC. LTC declined to remove EHSI as a party to the leases following the distribution of ALC. Therefore, EHSI continues to be bound by the terms of the leases, while only ALC has a financial interest in the leased properties. Pursuant to a separation agreement entered into between Extendicare Inc. and ALC (the "Separation Agreement"), ALC has indemnified EHSI against any claims arising as a result of ALC's non-performance relating to the LTC Master Leases. EHSI, being a party to the LTC Master Lease, has to approve any renewal options being exercised.

The LTC Master Leases provide for an initial 10-year term and three successive 10-year lease terms at the option of the lessee. There are no significant economic penalties if the renewal options are not exercised. The aggregate minimum rental payment for the 2011 calendar year is US$11.1 million and will increase by 2% for each of the calendar years through 2014. Annual minimum rent during any renewal term will increase by a minimum of 2% over the minimum rent of the immediately preceding year.

Risks and Uncertainties

General Business Risks

Extendicare REIT is subject to general business risks inherent in the long-term care industry, including increased government regulation and oversight, changing consumer preferences, fluctuations in occupancy levels, the inability to achieve adequate government funding increases, increases in labour costs and other operating costs, possible future changes in labour relations, competition from or the oversupply of other similar properties, changes in neighbourhood or location conditions and general economic conditions, health related risks, disease outbreaks and control risks, changes in accounting principles and policies, the imposition of increased taxes or new taxes, capital expenditure requirements, changes in interest rates, and changes in the availability and cost of long-term financing that may render refinancing of long-term debt difficult or unattractive. Any one of, or a combination of, these factors may adversely affect the business, results of operations and financial condition of the REIT.

Risks Related to Government Funding and Regulatory Changes

Extendicare REIT's earnings are highly reliant on government funding and reimbursement programs, both in the U.S. and in Canada, and the effective management of staffing and other costs of operations, which are strictly monitored by government regulatory authorities. Given that we operate in a labour-intensive industry, where labour-related costs account for a significant portion of our operating and administrative costs (2011 – 72.8%), government funding constraints could have a significant adverse effect on our results from operations and cash flows. Management is unable to predict whether governments will adopt changes in their funding and reimbursement programs, and if adopted and implemented, what effect such changes will have on the REIT.

Further information on funding and legislative changes affecting the industry can be found under "Update of Regulatory and Reimbursement Changes Affecting Revenue".

All long-term care providers are subject to surveys, inspections, audits and investigations by government authorities to ensure compliance with applicable laws and licensure requirements of the federal, state and/or provincial funding programs. Nursing centers must comply with applicable regulations which, depending on the jurisdiction in which they operate, may relate to such things as staffing levels, resident care standards, occupational health and safety, resident confidentiality, billing and reimbursement, along with environmental and other standards. The government review process is intended to determine compliance with survey and certification requirements, and other applicable laws. Remedies for survey deficiencies can be levied based upon the scope and severity of the cited deficiencies. Remedies range from the assessment of fines to the withdrawal of payments under the government funding programs. Should a deficiency not be addressed through a plan of correction, a center can be decertified from the funding program. As at December 31, 2011, we had certain centers under plans of correction at EHSI, but no centers had been decertified. While it is not possible to estimate the final outcome of the required corrective action, the REIT has accrued for known remedial costs.

Government agencies have steadily increased their enforcement activity over the past several years. As a result, in addition to increasing resources to improve the quality of services provided to its residents, we are continually allocating increased resources to ensure compliance with applicable regulations and to respond to inspections, investigations and/or enforcement actions. Our costs to respond to and/or defend surveys, inspections, audits and investigations are significant and are likely to increase in the current environment.

Non-compliance with applicable laws governing long-term care could result in adverse consequences, including severe penalties, which may include criminal sanctions and fines, civil monetary penalties and fines, administrative and other sanctions, including the loss of our right to participate in the Medicare and Medicaid programs, or one or more third-party payor networks. We may be required to refund amounts that have been paid to us by federal, state and/or provincial funding programs. These penalties could have a material adverse effect on the business, results of operations or financial condition of the REIT.

UNITED STATES

Limitations on U.S. Medicare and Medicaid reimbursement for health care services are continually proposed. Medicare and Medicaid reimbursement programs are complicated and constantly changing as CMS and the various states continue to refine their programs. There are considerable administrative costs incurred by EHSI in monitoring the changes made within the programs, determining the appropriate actions to be taken to respond to those changes and implementing the required actions to meet the new requirements and minimize the repercussions of the changes to EHSI's reimbursement rates and costs. There can be no assurance that Medicare and Medicaid reimbursement programs will remain at levels comparable to present levels or that they will, in the future, be sufficient to cover the costs allocable to patients eligible for reimbursement pursuant to such programs. Therefore, government funding constraints could have a significant adverse effect on the REIT's results from operations and cash flow. Further information on funding and legislation changes affecting our industry in the United States can be found under "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

EHSI participates in federal and state health care programs and therefore, is subject to a variety of federal and state laws that are intended to prevent health care fraud and abuse. Violation of these laws is punishable by criminal, civil and administrative penalties, including, in some instances, exclusion from participation in federal and state health care programs. These laws include, but are not limited to, anti-kickback laws, false claims laws, physician self-referral laws and federal criminal health care fraud laws. EHSI cannot reasonably predict whether enforcement activities will increase at the federal or state level or the effect of such enforcement activities on its business and its financial results.

U.S. federal law requires each state to have a Medicaid Fraud Control Unit, which is responsible for investigating provider fraud and resident abuse in Medicaid-funded centers. EHSI has been investigated by these Medicaid Fraud Units previously, but it is not aware of any liability relating thereto at this time. Management believes that EHSI and its subsidiaries have been and continue to be in material compliance with all of these laws as they apply to its companies.

EHSI believes its billing practices, operations and compensation and financial arrangements with referral sources and others materially comply with applicable federal and state requirements. However, EHSI cannot give assurance that a governmental authority will not interpret such requirements in a manner inconsistent with EHSI's interpretation and application.

CANADA

In Canada, provincial legislation and regulations closely control all aspects of the operation and funding of nursing centers, including the fee structure, subsidies, the adequacy of physical centers, standards of care and accommodation, equipment and personnel. There can be no assurance that the currently level of fees and subsidies will be continued or that such fees will increase commensurate with ECI's costs of care. A reduction of such fees or subsidies could have an adverse effect on the business, results of operations and financial condition of the REIT. Further information on funding and legislation changes affecting our industry in the United States can be found under "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada".

The revocation of a license by authorities or cancellation of a service contract due to inadequate performance by the operator has been historically infrequent in Canada and is usually preceded by a series of warnings, notices and other sanctions. ECI has never had such a license or service contract revoked. While ECI endeavours to comply with all regulatory requirements in its Canadian nursing centers, it is not unusual for stringent inspection procedures to identify deficiencies in operations. Every effort is made to avoid and mitigate notices of deficiencies through quality assurance strategies. As well, all efforts are undertaken to correct all legitimate problem areas that have been identified through regulatory inspections.

In Ontario, the LTC Act 2007, which was proclaimed into force in July 2010, provides for, among other things: new licensing procedures that include more rigorous standards for license review (including public hearings); fixed license terms for up to 25 years; more onerous duties imposed on long-term care operators; unannounced annual inspections; and a more comprehensive enforcement regime. While the Ontario government has provided funding enhancements to assist the health care sector in the transition process, it remains uncertain whether adequate funding will be provided for the additional requirements imposed by the legislation.

In July 2007, the Ontario government initiated plans to redevelop 35,000 older long-term care beds in five phases over the next 10 to 15 years, and provide qualified applicants with a 25-year construction funding subsidy. ECI currently owns and operates 3,572 older long-term care beds in 23 "C" rated centers that would benefit from this redevelopment project. ECI and other operators continue to express concerns about the adequacy of the Ontario government's construction funding subsidy of $13.30 per bed per day (see "Ontario Long-term Care Legislation – Ontario Redevelopment Program" under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada").

Risks Related to Litigation

LIABILITY, INSURANCE AND LITIGATION

Operators within the long-term care industry, including the REIT, face lawsuits alleging negligence, malpractice, or other related claims, and as a result, incur significant costs in connection with defending general and professional liability claims, workers' compensation claims, and property basis claims. In addition to large compensatory claims, plaintiffs' attorneys also seek significant punitive damages and attorney's fees. The REIT maintains insurance coverage for the significant majority of risk associated with claims in respect to general and professional liability, trustees', directors' and officers' liability, employers' liability, auto liability, health and dental benefits, business income and property. General and professional liability policies currently offered in the long-term care industry are generally only offered on a "claims made" basis, as opposed to "occurrence based" coverage. "Claims made" policies are subject to possible rate increases upon renewal due to a step-up factor used by the insurer.

The REIT maintains general and professional liability and property insurance policies through third-party insurers, along with retaining a portion of risk within its Bermuda-based captive insurance structure, in amounts and with the coverage and deductibles it believes are adequate based on the nature and risks of its business, historical experience and industry standards, as well as the type of insurance coverage commercially available in the marketplace. Provisions for loss for our professional liability risks are based upon management's best available information including actuarial estimates. The Bermuda-based captive insurance company of the REIT is currently appropriately capitalized, but there can be no assurance that it will remain appropriately capitalized in the future should claims against the REIT increase significantly.

From time to time, EHSI has elected to self-insure the risk associated with workers' compensation claims up to a certain per claim limit and aggregate exposure limit, along with the arrangement of third-party insured products. In addition, EHSI self-insures its health and dental coverage. The REIT's costs are subject to changes caused by the number and nature of claims incurred. The REIT employs risk management personnel to assist its centers in the appropriate measures to maintain a safe workplace environment and to manage workers' compensation claims. If the REIT is not able to control these costs, this could adversely affect the business, results of operations and financial condition of the REIT.

A successful claim against the REIT not covered by, or in excess of, such insurance, or in excess of the reserves of the REIT for self-insured retention levels, could have a material adverse effect on the business, operating results, and financial condition of the REIT. In many states, state law prohibits or limits insurance coverage for the risk of punitive damages arising from professional liability and general liability claims and/or litigation. Furthermore, there are certain types of risks, generally of a catastrophic nature, such as war, non-certified acts of terrorism, or environmental contamination, which are either uninsurable or are not insurable on an economically viable basis. Under these circumstances, the REIT may be liable for such losses. Also, in order to obtain liability insurance at a more reasonable cost or in some instances to obtain coverage at all, the REIT is required to assume self-insurance retention levels for its professional liability claims. The REIT estimates the value of losses that may occur within its self-insured retention levels based on historical claims, actuarial valuations, third-party administrator estimates, industry data and advice from consultants and legal counsel and endeavours to reserve for such liabilities. If the estimates of the REIT are inaccurate or if there are an unexpectedly large number of successful claims that result in liabilities in excess of the reserves of the REIT for losses, the operating results of the REIT could be negatively affected. Claims against the REIT, regardless of their merit or eventual outcome, also may have a material adverse effect on the ability of the REIT to attract residents and patients, expand the business of the REIT or maintain favourable standings with regulatory authorities. These claims also require management to devote time to matters unrelated to the operation of the business.

The REIT has to renew its insurance policies each year or on a periodic basis and negotiate acceptable terms for coverage, exposing it to the volatility of the insurance markets, including the possibility of rate increases resulting from the claim experience of the REIT or the aggregate claim experience of the long-term care industry. There can be no assurance that the REIT will be able to obtain insurance in the future or, if available, that such coverage will be available on acceptable terms and provide coverage for perils inherent to the senior care industry.

COMPLIANCE WITH REGULATORY REQUIREMENTS

EHSI is subject to review or audit by federal and state governmental agencies to verify compliance with the requirements of the Medicare and Medicaid programs. Audits under the Medicare and Medicaid programs have intensified in recent years. Private payors may also have the right to review or audit our files. These activities could result in an obligation to repay amounts received pursuant to these programs. The payment of penalties, exclusion from participation in one or more government programs or a loss of a contract with a private payor could materially adversely affect the business results of operations and financial condition of the REIT.

EHSI is also subject to lawsuits under the Federal False Claims act and comparable state laws. These lawsuits, which may be initiated by whistleblowers, can involve significant monetary damages, attorneys' fees and the award of bounties to private plaintiffs who successful bring these suits and to the government programs.

There are a number of federal, state and provincial laws protecting the confidentiality of certain patient health information, including patient records, and restricting the use and disclosure of that protected information. In particular, the privacy rules under the *Health Insurance Portability and Accountability Act of 1996* (HIPAA) in the U.S. and under the *Personal Information Protection and Electronic Documents Act* (PIPEDA) in Canada protect medical records and other personal health information by limiting their use and disclosure of health information to the minimum amount reasonably necessary to accomplish the intended purpose. If the REIT was found to be in violation of the privacy or security rules under HIPAA, PIPEDA or other laws protecting the confidentiality of patient health information, it could be subject to sanctions and civil or criminal penalties, which could increase its liabilities, harm its reputation and have a material adverse effect on the business, results of operations and financial condition of the REIT.

INDEMNIFICATION OBLIGATIONS BETWEEN ALC AND EXTENDICARE

In connection with the distribution of ALC in 2006, Extendicare and ALC entered into the Separation Agreement, the Tax Allocation Agreement, a number of transitional service agreements, and a number of operating leases and purchase agreements relating to the transfer of EHSI assisted living centers to ALC. Pursuant to the Separation Agreement, ALC has agreed to indemnify, defend and hold harmless Extendicare and certain of its related parties for identifiable losses relating to or arising from certain specified matters, including matters relating to or arising from ALC's assisted living care business and Extendicare has agreed to indemnify, defend and hold harmless ALC and certain related parties from certain other specified matters, including matters relating to those assets and liabilities that were not transferred to ALC as part of the separation. In 2010, EHSI and ALC agreed to terminate the Tax Allocation Agreement as all tax matters regarding the prior years had been resolved to their satisfaction.

The indemnification obligations of ALC and Extendicare under the Separation Agreement could be significant. Extendicare cannot determine whether it will have to indemnify ALC for any substantial obligations after the distribution of ALC. Also, Extendicare cannot assure that if ALC has to indemnify Extendicare for any substantial obligations, ALC will be able to satisfy those obligations.

Risks Related to Tax Rules and Regulations

Extendicare REIT is subject to audits from federal, state and provincial tax jurisdictions and therefore is subject to risk in the interpretation of tax legislation and regulations. Tax regulations are complex and require careful review by tax management of the REIT and its external tax consultants. Differences in interpretation of those tax rules and regulations could result in tax assessments and penalties for the untimely payment of the determined tax liability, which could have a material adverse effect on the business, results of operations and financial condition of the REIT.

CANADIAN FEDERAL INCOME TAX ON INCOME TRUSTS

Extendicare REIT is a specified investment flow-through trust, or SIFT, and has been subject to SIFT tax since 2007, in accordance with the *Budget Implementation Act, 2007*, which received Royal Assent on June 22, 2007. The SIFT Amendments, as described under the heading "Canadian and U.S. Income Tax Updates – Canadian Federal Income Tax on Income Trusts" under the "Other Significant Developments" section of this MD&A, include revisions to the definitions of "SIFT trust" and "SIFT partnership" to specifically exclude certain trusts and partnerships that are wholly owned by a SIFT. The SIFT Amendments do not change the status of Extendicare REIT as a SIFT, although they confirm that Extendicare Trust, which is wholly owned by Extendicare REIT, is not a SIFT. Management has assessed the impact of the SIFT Amendments on Extendicare LP and has concluded that Extendicare LP should not be treated as a SIFT, but there can be no assurance that this will be the case.

ALC SPIN-OFF

In connection with the Arrangement, EHSI received a note upon the transfer of ALC to its Canadian affiliate, which was subsequently repaid by way of cash, settlement against other notes and dividends of US$476.6 million. Based upon internal calculations, management believes there was sufficient surplus as to not attract any Canadian taxes from the transactions relating to the repayment of the note. The REIT and its Canadian subsidiaries are currently under audit by the CRA. Should the CRA determine that the available surplus was less than the amount determined by management, Canadian capital gains tax would apply to the shortfall.

Risks Related to Financing and Foreign Currency Exposure

DEBT FINANCING

Due to the level of real property ownership by the REIT, a significant portion of the consolidated cash flow of the REIT is devoted to servicing debt, and there can be no assurance that the REIT will continue to generate sufficient cash flow from operations to meet required interest and principal payments. If the REIT were unable to meet interest or principal payments, it could be required to seek renegotiation of such payments or obtain additional equity, debt or other financing.

EHSI is currently in the process of renewing the EHSI Credit Facility prior to its June 2012 maturity date. At December 31, 2011, EHSI had utilized US$55.6 million of the US$70.0 million available under the line.

Extendicare's RBC Credit Facility ($70.0 million of working capital and US$10.2 million letter of credit facility) is due on demand and is primarily used to back letters of credit that renew annually. The availability under the working capital line was $29.5 million at December 31, 2011, with letters of credit of $40.5 million and US$10.2 million issued.

Global financial markets and economic events over the past few years have resulted in heightened scrutiny of banking institutions in the lending of credit, and the financial markets continue to be affected by the state of the economy in North America. The REIT cannot predict whether future financing will be available, what the terms of such future financing will be (including, whether it will result in a higher cost of borrowing) or whether its existing debt agreements will allow for the timely arrangement and implementation of such future financing. If the REIT is unable to obtain additional financing or refinancing when needed or on satisfactory terms, it could have a material adverse affect on the business, operating results and financial condition of the REIT.

DEBT COVENANTS

The REIT is in compliance with all of its financial covenants as at December 31, 2011. However, there can be no assurance that future covenant requirements will be met. The REIT's bank lines and other debt may be affected by its ability to remain in compliance. If the REIT does not remain in compliance with its financial covenants, its ability to amend the covenants or refinance its debt may be affected.

CREDIT AND INTEREST RATES

In order to meet its monthly distributions, the REIT has limited the amount of debt that may be subject to changes in interest rates. As a result, all but $102.3 million of the REIT's total long-term debt outstanding at December 31, 2011, was at fixed rates. The REIT primarily finances its senior care centers through fixed-rate mortgages and considers securing interest rate swap agreements for any variable-rate debt. The REIT maintains risk management control systems to monitor interest rate risk attributable to its outstanding or forecasted debt obligations as well as its offsetting hedge positions. The REIT does not enter into financial instruments for trading or speculative purposes.

FOREIGN CURRENCY RATE FLUCTUATIONS

The majority of the REIT's operations are conducted in the United States and the financial position and results are denominated in U.S. dollars. The U.S. operations accounted for 66.7% of our consolidated revenue from continuing operations and 68.8% of our adjusted funds from operations in 2011. The revenues and expenses of the self-sustaining U.S. operations are translated at average rates of exchange in effect during the period. Assets and liabilities are translated at the exchange rates in effect at the balance sheet date. As a result, the REIT's consolidated financial position is subject to foreign currency fluctuation risk, which could adversely impact its operating results and its cash flows.

As well, the REIT's distributions are denominated in Canadian dollars from the operating cash flow generated by both the Canadian and U.S. operations of the REIT. As a result, the cash available for distribution could be adversely impacted by foreign currency fluctuations. Management has a foreign currency hedging strategy whereby it monitors and considers entering into foreign currency forward contracts (FCFCs) to reduce the risks associated with changes in the U.S. dollar and the impact such changes could have on the REIT's Canadian dollar distributions. The REIT had an FCFC contract in place until June 2011. Management continues to monitor the exchange rates and to consider future FCFCs to the extent that they may be beneficial to us. There can be no assurance that the FCFCs that the REIT may put in place in the future will be sufficient to protect against currency exchange rate losses.

Risks of Property Ownership

REAL PROPERTY OWNERSHIP

All real property investments are subject to a degree of risk. They are affected by various factors, including changes in general economic conditions (such as the availability of long-term mortgage funds) and in local conditions (such as an oversupply of space or a reduction in demand for real estate in the area), the attractiveness of the properties to patients and residents, competition from other available space and various other factors. In addition, fluctuations in interest rates could have a material adverse effect on the business, operating results and financial condition of the REIT.

Extendicare REIT owns or operates under capital lease arrangements 98% of its senior care centers, excluding those under management contracts. Senior care centers are limited in terms of alternative uses and therefore their values are directly driven by the cash flow from operations. The value of real property depends, in part, on government funding and reimbursement programs. The income of the REIT and funds available for distributions to Unitholders would be adversely affected if federal, state or provincial governments reduced their funding or reimbursement programs, or if a significant number of patients and residents of the senior care centers were to become unable to meet their financial obligations or experienced significant economic setbacks. In addition, overbuilding in any of the market areas of the REIT could cause its properties and centers to experience decreased occupancy or depressed margins, which could adversely affect the business, operating results and financial condition of the REIT. Moreover, certain significant expenditures involved in real property investments, such as real estate taxes, maintenance costs, and mortgage payments represent liabilities which must be met regardless of whether the property is producing any income.

Real property investments are relatively illiquid. This illiquidity will tend to limit the ability of the REIT to vary its portfolio promptly in response to changed economic or investment conditions. There is a risk that the REIT would not be able to sell its assets or that it may realize sale proceeds of less than the current book value of its properties.

CAPITAL INTENSIVE INDUSTRY

The REIT must commit a substantial portion of its funds to maintain and enhance its senior care centers and equipment to meet regulatory standards, operate efficiently and remain competitive in its markets. Certain of the competitors of the REIT may operate centers that are not as old as those owned by the REIT, or that may appear more modern, and therefore may be more attractive to potential patients and residents. Over the next 10 to 15 years, ECI will be required to redevelop 23 class "C" long-term care centers in accordance with the Government of Ontario's redevelopment program (see "Ontario Long-term Care Legislation – Ontario Redevelopment Program" under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada"). These as well as other future capital requirements could have a material adverse effect on the business, operating results and financial condition of the REIT.

Risks Related to Growth Activities

CONTINUED GROWTH

The REIT expects that it will have opportunities to acquire properties or expand existing centers which may be accretive, but there can be no assurance that this will be the case. The ability of the REIT to fund growth will be dependent, in part, on external sources of funding. Lack of availability of such funding could limit the future growth of the REIT.

State and provincial efforts to regulate the construction or expansion of health care providers could impair the ability of the REIT to expand through construction and redevelopment. Most of the states in which EHSI currently operates have adopted laws to regulate the expansion of nursing centers. Certificate of need laws generally require that a state agency approve certain acquisitions or physical plant changes and determine that a need exists prior to the addition of beds or services. Some states also prohibit, restrict or delay the issuance of certificates of need, making it difficult to grow our operations other than by acquisition of existing operations and licensure rights from other providers. Many states have established similar certificates of need processes to regulate the expansion of assisted living centers, but the restrictions are less than those for nursing centers. Similarly in Canada, the provinces restrict the number of licensed nursing center beds and any new licenses are awarded through an RFP process.

If certificates of need or other similar approvals are required in order to expand operations of the REIT, the failure of the REIT or inability to obtain the necessary approvals, changes in standards applicable to such approvals and possible delays and expenses associated with obtaining such approvals could adversely affect the ability of the REIT to expand and, accordingly, to increase its revenue and earnings.

ACQUISITIONS

The success of the acquisition activities of the REIT will be determined by numerous factors, including the ability of the REIT to identify suitable acquisition targets, competition for acquisition opportunities, purchase price, ability to obtain adequate financing on reasonable terms, financial performance of the centers after acquisition, and the ability of the REIT to effectively integrate and operate the acquired centers. Acquired properties may not meet financial or operational expectations due to unexpected costs associated with acquiring the property, as well as the general investment risks inherent in any real estate investment or acquisition. Moreover, newly acquired long-term care centers may require significant management attention or capital expenditures that would otherwise be allocated to existing centers. Any failure by the REIT to identify suitable candidates for acquisition or operate the acquired centers effectively may have an adverse effect on the business, results of operations and financial condition of the REIT.

Accounting Policies and Estimates

Non-GAAP Measures

Extendicare REIT assesses and measures operating results and financial position based on performance measures referred to as "net operating income", "EBITDA", "earnings (loss) from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units", "Distributable Income", "Funds from Operations", "Adjusted Funds from Operations" and "Adjusted Gross Book Value". These are not measures recognized under GAAP and do not have standardized meanings prescribed by GAAP. These non-GAAP measures are presented in this document because either: (i) management believes that they are a relevant measure of the ability of the REIT to make cash distributions; or (ii) certain ongoing rights and obligations of the REIT may be calculated using these measures. Such non-GAAP measures may differ from similar computations as reported by other issuers and, accordingly, may not be comparable to similarly titled measures as reported by such issuers. They are not intended to replace net earnings (loss) for the period, cash flow, or other measures of financial performance and liquidity reported in accordance with GAAP.

References to "net operating income" in this document are to revenue less direct operating expenses. References to "EBITDA" in this document are to earnings from operations before interest, income taxes, depreciation, amortization, and accretion. In addition, in determining EBITDA, the REIT has excluded the line items: "distributions on Exchangeable LP Units", "fair value adjustments", "loss (gain) on foreign exchange and financial instruments", and "loss (gain) from asset impairment, disposals and other items". These line items are reported separately because they relate to the change in the fair value of, or gains and losses on termination of, convertible debentures, Exchangeable LP Units, interest rate agreements and FCFCs, as well as gains or losses on the disposal or impairment of assets, and foreign exchange gains or losses on capital items. In addition, in previous years these line items have included provisions for restructuring charges and the write-off of unamortized financing costs on early retirement of debt. These items are reported separately and excluded from EBITDA, because they are transitional in nature and would otherwise distort historical trends. Management believes that certain lenders, investors and analysts use EBITDA to measure a company's ability to service debt and meet other payment obligations, and as a common valuation measurement in the long-term care industry. For example, certain of EHSI's debt covenants use EBITDA in their calculations. EBITDA is presented by the REIT on a consistent basis from period to period, thereby allowing for consistent comparability of its operating performance.

The separately reported line items discussed above are calculated on an after-tax basis as a means of deriving the remaining earnings from operations and related earnings per unit, the results of which are referred to as "earnings before separately reported gains/losses and distributions on Exchangeable LP Units". This is a measure commonly used by the REIT and its investors as a means of assessing the performance of the core operations in comparison to prior periods.

Distributable Income, or "DI", is defined by Extendicare REIT's Deed of Trust as net earnings (loss) of the REIT, on a consolidated basis, as determined in accordance with GAAP, subject to certain adjustments as set out in the REIT's Deed of Trust. Funds from Operations, or "FFO", is defined as net earnings (loss) of the REIT adjusted for non-cash items and other items not representative of the REIT's operating performance. Adjusted Funds from Operations, or "AFFO", is defined as DI further reduced by facility maintenance (non-growth) capital expenditures not already reflected in the calculation of DI.

Critical Accounting Policies and Estimates

For a full discussion of the REIT's accounting policies, readers should refer to the accompanying notes to the REIT's December 31, 2011, audited consolidated financial statements and the discussion under the heading "Future Change in Accounting Policies" that follows this section. With the adoption of IFRS on January 1, 2011, the critical accounting policies and estimates have been updated to conform to this adoption. Readers should refer to *notes 2, 3* and *27* to our 2011 consolidated financial statements, for a description and detailed discussion regarding the application of critical accounting estimates and judgements, significant accounting policies and an explanation of the transition to IFRS.

Management considers an understanding of the REIT's accounting policies in the following discussion to be essential to an understanding of the REIT's financial statements because their application requires significant judgement and reliance on estimations of matters that are inherently uncertain. There is measurement uncertainty relating to the accounting policies applied to: revenue recognition and the valuation of accounts receivable; the determination of the recoverable amount of cash generating units (CGU) subject to an impairment test; the valuation of decommissioning provisions; the valuation of self-insured liabilities; the valuation of financial assets and liabilities; the valuation of unit appreciation rights liabilities; and accounting for tax uncertainties and the tax rates used for valuation of deferred tax assets. The recorded amounts for such items are based on management's best available information and are subject to assumptions and judgement, which may change as time progress; accordingly, actual results could differ from those estimated.

REVENUE RECOGNITION AND ACCOUNTS RECEIVABLE

In the United States, revenue from skilled nursing centers is derived from various federal and state medical assistance programs, Managed Care providers (for residents with health maintenance and commercial insurance programs), as well as privately from the residents. EHSI derived approximately 80% of its revenue from services provided under various federal or state medical assistance programs during 2011 and 2010. EHSI records its skilled nursing center revenue in the period in which the services and products are provided at established rates less contractual adjustments. Contractual adjustments include differences between established billing rates and amounts estimated by management as reimbursable under various reimbursement formulas or contracts in effect. State plan amendments and waivers are submitted to CMS for approval, which can result in changes to revenue pertaining to prior periods. Differences between final settlements and amounts recorded in previous periods are reported as adjustments to revenue in the period such settlements are determined. Due to the complexity of laws and regulations governing the federal and state reimbursement programs, there is a possibility that recorded estimates may change by a material amount.

Extendicare REIT also offers information technology services to smaller long-term care providers through its wholly owned U.S. subsidiary, Virtual Care Provider, Inc. This revenue source is primarily derived from application hosting, customer support, telecommunications, equipment sales and consulting services, and is recognized as these services are provided and equipment is delivered to our customers.

In addition, EHSI derives outpatient therapy revenue in the U.S. by providing rehabilitation therapy services to outside third parties at its clinics. This revenue source is primarily from Managed Care, workers' compensation, self-pay clients and partly from Medicare and Medicaid. Revenue is recognized in the period in which services are provided.

In Canada, the fees charged by ECI for its nursing homes and home health care services are regulated by provincial authorities (rather than federal authorities). Accordingly, provincial programs fund a substantial portion of these fees, with the remainder paid for by the residents or customers. Each province has a different system for managing the services provided. As a result, there can be significant variability from location to location with respect to the regulations for providing care and how centers are reimbursed. In 2011, revenue from provincial programs represented approximately 66% of ECI's nursing home operations, and approximately 97% of its home health care services.

Accounts receivable are recorded at amounts expected from federal, state and provincial reimbursement programs, other third-party payors or from individual residents. Receivables from government agencies represent the only concentrated group of accounts receivable for the REIT. As at December 31, 2011, receivables from government agencies represented approximately 73% of the total receivables. Management does not believe there is any significant credit risk associated with these government agencies other than possible funding delays. Receivables from other than government agencies consist of receivables from Managed Care providers, commercial insurers and private individuals that are subject to differing economic conditions, none of which represents any concentrated credit risk to the REIT, as there is no significant exposure to any single party. Management estimates which receivables may be collected within one year and reflects those not expected to be collected within one year as non-current assets. Management periodically evaluates the adequacy of its allowance for doubtful accounts by conducting a specific account review of amounts in excess of predefined target amounts and aging thresholds, which vary by payor type. Provisions are considered based upon the evaluation of the circumstances for each of these specific accounts. In addition, management has established percentages for allowance for doubtful accounts that are based upon historical collection trends for each payor type and age of these receivables. Accounts receivable that are specifically estimated to be uncollectible, based upon the above process, are fully reserved for in the allowance for doubtful accounts until they are written off or collected. If circumstances change, for instance due to an economic downturn, resulting in higher than expected defaults or denials, management's estimates of the recoverability of receivables could be reduced by a material amount.

Due to differences in the government funding structures for the services provided, the Canadian operations are not subject to the same risks associated with the collection of accounts receivable as are the U.S. operations. As a result, approximately 93% of the REIT's allowance for current accounts receivable at December 31, 2011, was associated with the U.S. operations. The allowance for doubtful accounts for current accounts receivable totalled $16.7 million and $17.8 million at December 31, 2011 and 2010, respectively. Days of revenue outstanding were 38 days at December 31, 2011 compared to 37 days as at December 31, 2010. This increase was primarily due to changes in Medicare billings implemented in December 2011 that resulted in a delay in processing payments.

At December 31, 2011, EHSI had $33.5 million (US$32.9 million) in Medicare and Medicaid settlement receivables pertaining to reimbursable Medicare Part A co-insurance receivables, compared to $26.3 million (US$26.5 million) at the end of 2010. There was no allowance on these receivable balances. It is expected that $10.4 million (US$10.2 million) will be substantially collected within one year and is included in accounts receivable as a current asset, compared to $8.9 million (US$8.9 million) at December 31, 2010. The remaining balance has been classified as a long-term receivable in other assets. Differences between the final settlement and amounts previously recorded are reported as adjustments to revenue in the period of determination.

VALUATION OF CASH GENERATING UNITS AND IMPAIRMENT

Non-financial assets consist of property and equipment, intangible assets with finite lives, intangible assets with indefinite lives and goodwill. A CGU is defined to be the smallest group of assets that generates cash inflows from continuing use that is largely independent of the cash inflows of other assets. The REIT has identified each individual center as a CGU.

The carrying amounts of non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill, and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated annually at the same time or more frequently if warranted. An impairment loss is recognized in net earnings if the carrying amount of an asset or its related CGU exceeds its estimated recoverable amount.

The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. Goodwill and indefinite life intangible assets are allocated to their respective CGUs for the purpose of impairment testing. Indefinite life intangible assets and corporate assets, which do not generate separate cash flows and are utilized by more than one CGU, are allocated to each CGU for the purpose of impairment testing and are not tested for impairment separately.

Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the assets in the CGU on a pro rata basis. An impairment loss in respect of goodwill is not reversed. In respect of other non-financial assets, impairment losses recognized in prior periods are assessed at each reporting date for any indication that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount, and only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

The 2011 CMS Final Rule announcement in July 2010 triggered the necessity for impairment testing of our U.S. operations in the 2011 third quarter. This resulted in the recognition of a pre-tax impairment loss of $54.0 million (US$53.9 million), of which $22.4 million (US$22.3 million) was allocated to goodwill and the balance to property and equipment. Goodwill was assessed at December 31, 2011, and there was no further impairment.

The determination of recoverable amounts can be significantly impacted by estimates related to current market valuations, current and future economic conditions in the geographical markets of each CGU, and management's strategic plans within each of its markets. Estimates and assumptions used in the determination of the impairment loss were based upon information that was known at the time, along with future outlook.

In performing the 2011 third quarter impairment test on the U.S. operations, the key assumptions used to determine the recoverable amounts were as follows: capitalization rates of 13.1% for nursing centers and 9.1% for assisted living centers; annual maintenance capital expenditures per bed of US$300; and management fees of 5% of revenue. The recoverable amount calculations used discounted pre-tax cash flow projections determined from financial projections based upon both historical and forecasted amounts on which capitalization rates were applied. The calculation was based on the following key assumptions: cash flows were projected based upon historical financial performance along with the forecast impact of Medicare rate reductions in the coming year and past experience on average daily census, factoring in the historical maintenance capital expenditures and management fees; and capitalization rates were based on industry standards on recent transactions.

Based upon this impairment assessment performed for the U.S. operations in the 2011 third quarter, a 10-basis point increase in the capitalization rate would cause a $0.2 million increase in goodwill impairment. Goodwill was assessed at December 31, 2011, and there is no further impairment on the goodwill. As for our Canadian operations, an impairment assessment was performed at the end of 2011, which determined that there was no impairment of the assets. A 10-basis point increase in the capitalization rate applied for the Canadian operations impairment test would have had no impact on the results.

DECOMMISSIONING PROVISIONS

Management has determined that future costs could be incurred for possible asbestos remediation of the REIT's pre-1980 constructed centers. Though asbestos is currently not a health hazard in any of these centers, appropriate remediation procedures may be required to remove potential asbestos-containing materials, consisting primarily of floor and ceiling tiles, in connection with any major renovation or demolition.

As at December 31, 2011, the decommissioning provision, which related to asbestos remediation, was $26.1 million compared to $24.2 million at the beginning of the year, with the increase primarily due to the accretion in value. The fair value of the decommissioning provision is estimated by computing the present value of the estimated future costs of remediation based on estimated expected dates of remediation. The computation is based on a number of assumptions, which may vary in the future depending upon the availability of new information, changes in technology and in costs of remediation, and other factors.

The following assumptions were used in calculating the decommissioning provision: (a) discount rates of 6.75% for centers located in Canada and 7.10% for centers located in the U.S.; (b) an estimated timing of the settlement of the provision ranging from 10 to 30 years; and (c) an estimated undiscounted cash flow amount to settle the provision of approximately $50.0 million. There were no changes to the initial timing and estimates of undiscounted cash flow amounts in 2011.

SELF-INSURED LIABILITIES

The REIT self-insures for certain risks related to comprehensive general and professional liability (including malpractice insurance), and to a limited degree, workers' compensation (for certain periods), auto liability and health benefits. The REIT maintains liability insurance policies through third-party insurers as well as retaining a portion of the risk within its Bermuda-based captive at a level which the REIT believes to be adequate based upon the nature and risks of its business, historical experience and industry standards along with the type of insurance coverage commercially available in the marketplace. The employee related self-insured risks are primarily due within twelve months and therefore are not discounted and are included within accrued liabilities as a current liability. The accrual for self-insured liabilities is discounted based upon the projected timing of future payment obligations.

General and professional liability claims are the most volatile and significant type of risks for which the REIT self-insures. Furthermore, claim payments for any particular policy year can occur over a period of several years that are limited by state or provincial regulations. The accrual for self-insured liabilities is based on management's best estimate of the ultimate cost to resolve general and professional liability claims, including both known claims and claims that have been incurred but not yet reported by the end of the reporting period. The REIT estimates the value of losses that may occur within its self-insured retention levels based upon individual assessment of the settlement using historical information and industry data, supported by actuarial projections, advice from legal counsel, consultants and external risk management. Actual results can differ materially from the estimates made due to a number of factors including the assumptions used by management and other market forces.

Management regularly evaluates and periodically engages an independent third-party actuary to provide a report to determine the appropriateness of the carrying value of this liability. Assumptions underlying the determination of the liability are limited by the uncertainty of predicting future events and assessments regarding expectations of several factors. Such factors include, but are not limited to: the frequency and severity of claims, which can differ materially by jurisdiction; trends in claims along with unique and identifiable settlements; coverage limits of third-party reinsurance; the effectiveness of the claims management process; and the outcome of litigation. Therefore, management's estimate of the accrual for general and professional liability claims is significantly influenced by assumptions that are subject to judgement by management and the actuary, which may cause the provision to fluctuate from one reporting period to another.

At December 31, 2011, the accrual for self-insured general and professional liabilities was $79.4 million compared to $46.5 million at the beginning of the year. Changes in the level of retained risk and other significant assumptions that underlie management's estimates could have a material effect on the future carrying value of the self-insured liabilities. For example a 1% variance in the accrual for self-insured liabilities at December 31, 2011, would have impacted our net earnings by approximately $0.8 million. For further information refer to the discussion under the heading "Liquidity and Capital Resources – Accrual for Self-Insured Liabilities".

TAX UNCERTAINTIES

Tax uncertainties are evaluated on the basis of whether it is more likely than not that a tax position will ultimately be sustained upon examination by the relevant taxing authorities. Tax uncertainties are measured using a probability adjusted or expected value model whereby amounts are recorded if there is uncertainty about a filing position, determined by multiplying the amount of the exposure by the probability that the entity's filing position will not be sustained. The assessment of tax uncertainties relies on estimates and assumptions and may involve a series of judgements about future events. New information may become available that causes the REIT to change its judgement regarding the adequacy of existing tax liabilities. Such changes to tax liabilities will impact tax expense in the period that such a determination is made.

Extendicare REIT is a SIFT in accordance with the Tax Act, and has been subject to SIFT tax since January 2007. The SIFT Amendments, as described under the heading "Canadian and U.S. Income Tax Updates – Canadian Federal Income Tax on Income Trusts" under the "Other Significant Developments" section of this MD&A, include revisions to the definitions of "SIFT trust" and "SIFT partnership" to specifically exclude certain trust and partnerships that are wholly owned by a SIFT. These SIFT Amendments do not change the status of Extendicare REIT as a SIFT, although they confirm that Extendicare Trust, which is wholly owned by Extendicare REIT, is not a SIFT. Management has assessed the impact of the SIFT Amendments on Extendicare LP and has concluded that Extendicare LP should not be treated as a SIFT, but there can be no assurance that this will be the case.

DEFERRED TAX ASSETS AND LIABILITIES

The REIT and its subsidiaries use the liability method, which takes into account the differences between financial statement treatment and tax treatment of certain transactions, assets and liabilities. Deferred tax assets and liabilities are recognized to reflect the expected future tax consequences attributed to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using tax rates (enacted or substantially enacted at the balance sheet date) anticipated to apply in the periods that the temporary differences are expected to be recovered or settled. In assessing whether the deferred tax assets are realizable, management considers whether it is probable (which the REIT has defined as "more likely than not") that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. At December 31, 2011, there were capital losses available for Canadian income tax purposes of $21.7 million (2010 – $24.4 million) that can be carried forward indefinitely to apply against future capital gains. No deferred tax assets have been recognized for the future tax benefit of these capital losses of $2.9 million (2010 – $3.3 million).

New Accounting Policies Adopted

INTERNATIONAL FINANCIAL REPORTING STANDARDS

We have adopted IFRS commencing January 1, 2011, as required by the Accounting Standards Board of the Canadian Institute of Chartered Accountants. A detailed explanation of the impact of transition to IFRS is provided in *note 27* of the 2011 consolidated financial statements. *Note 27* includes our elections under IFRS 1 "First-time Adoption of International Financial Reporting Standards", as well as a reconciliations of our statement of financial position and equity from previous Canadian GAAP to IFRS as at January 1, 2010 and December 31, 2010, and reconciliations of our total comprehensive income for the twelve months ended December 31, 2010.

Impact of IFRS Adoption on Key Performance Metrics

Adjusted Funds from Operations

AFFO did not change significantly under IFRS.

Earnings per Unit (EPU)

Under previous Canadian GAAP, both the REIT Units and Exchangeable LP Units were treated as equity, and were both considered for the EPU calculations presented on our financial statements.

Under IFRS, our REIT Units are considered "puttable instruments" under IAS 32, and can continue to be presented as equity. However, the Exchangeable LP Units are presented as a financial liability under IFRS. Therefore, the REIT is no longer reporting EPU under IFRS. However, the REIT discloses FFO, DI and AFFO on a per unit basis, treating the Exchangeable LP Units as equity, as it believes these are more relevant measures of the REIT's performance and of its ability to distribute cash.

Impact of IFRS Adoption on the Financial Statements

Please refer to *note 27* of the 2011 consolidated financial statements for a complete summary of the difference and reconciliation between previous Canadian GAAP and IFRS.

Future Change in Accounting Policies

The following new accounting policies have been issued, and will impact us at a future date.

Financial Instruments: In November 2009, the International Accounting Standards Board (the "IASB") issued IFRS 9 "Financial Instruments (IFRS 9 (2009))", and in October 2010, the IASB published amendments to IFRS 9 (IFRS 9 (2010)). In December 2011, the IASB issued an amendment to IFRS 9 to defer the mandatory effective date to annual periods beginning on or after January 1, 2015. The REIT has yet to assess the impact of the new standard on its results of operations, financial position and disclosures.

Financial Instruments – Disclosures: In October 2010, the IASB issued amendments to IFRS 7 "Disclosures – Transfers of Financial Assets", which is effective for annual periods beginning on or after January 1, 2012. We do not expect the amendments to have a material impact on the financial statements, because of the nature of the REIT's operations and the types of financial assets that it holds.

Consolidated Financial Statements: In May 2011, the IASB issued IFRS 10 "Consolidated Financial Statements", which is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. If an entity applies this standard earlier, it shall also apply IFRS 11 "Joint Arrangements", IFRS 12 "Disclosure of Interests in Other Entities", IAS 27 (2011) and IAS 28 (2011) "Investments in Associates" at the same time. The REIT intends to adopt IFRS 10 in its financial statements for the annual period beginning on January 1, 2013, and does not expect this new standard to have a significant impact on its financial statements.

Disclosure of Interests in Other Entities: In May 2011, the IASB issued IFRS 12 "Disclosure of Interests in Other Entities", which is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. If an entity applies some of the requirements of this standard earlier, it does not need to apply IFRS 10, IFRS 11, IAS 27 (2011) and IAS 28 (2011) at the same time. The REIT intends to adopt IFRS 12 in its financial statements for the annual period beginning on January 1, 2013, and does not expect this new standard to have a significant impact on its financial statements.

Fair Value Measurement: In May 2011, the IASB published IFRS 13 "Fair Value Measurement", which is effective prospectively for annual periods beginning on or after January 1, 2013. The disclosure requirements of IFRS 13 need not be applied to comparative information for periods before initial application. The REIT is assessing the impact of this new standard.

Presentation of Financial Statement – Other Comprehensive Income: In June 2011, the IASB published amendments to IAS 1 "Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income", which are effective for annual periods beginning on or after July 1, 2012 and are to be applied retrospectively. Early adoption is permitted. The REIT intends to adopt the amendments in its financial statements for the annual period beginning on January 1, 2013. As the amendments only require changes in the presentation of items in other comprehensive income, we do not expect these amendments to have a material impact on the financial statements.

Post-employment Benefits: In June 2011, the IASB published an amended version of IAS 19 "Employee Benefits". Adoption of the amendments is required for annual periods beginning on or after January 1, 2013, with early adoption permitted. The amendments are generally applied retrospectively with certain exceptions. The REIT currently reflects changes in assets and liabilities from defined benefit pension plans within other comprehensive income; therefore, we do not expect the amended standard to have a significant impact on its financial statement presentation.

Offsetting Financial Assets and Liabilities: In December 2011, the IASB published "Offsetting Financial Assets and Financial Liabilities" and issued new disclosure requirements in IFRS 7 "Financial Instruments: Disclosures". The effective date for the amendments to IAS 32 "Financial Instruments: Presentation" is annual periods beginning on or after January 1, 2014. The effective date for the amendments to IFRS 7 is annual periods beginning on or after January 1, 2013. These amendments are to be applied retrospectively. The REIT does not expect the amendments to have a significant impact on its financial statements.

Disclosure Controls and Procedures

Disclosure Controls and Procedures (DC&P) are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), on a timely basis so that appropriate decisions can be made regarding public disclosure.

An evaluation of the effectiveness of the DC&P was conducted as at December 31, 2011, by management under the supervision of the REIT's CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that as at December 31, 2011, our disclosure controls and procedures, as defined by National Instrument 52-109, Certification of Disclosures in Issuers' Annual and Interim Filings, are effective.

Internal Control over Financial Reporting

Internal Control over Financial Reporting (ICFR) is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP. Management, under the supervision of the REIT's CEO and CFO, has evaluated the effectiveness of our ICFR using the framework and criteria established by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that our ICFR was effective and that there were no material weaknesses in our ICFR as at December 31, 2011.

Additional Information

Additional information about Extendicare REIT, including the Annual Information Form, may be found on the SEDAR website at www.sedar.com and on Extendicare's website at www.extendicare.com. A copy of this document and other public documents of the REIT are available upon request to the Secretary of the REIT.

Management's Responsibility for Financial Statements

The accompanying consolidated financial statements of Extendicare Real Estate Investment Trust (the "REIT") and other financial information contained in this Annual Report are the responsibility of management. The consolidated financial statements have been prepared in conformity with International Financial Reporting Standards, using management's best estimates and judgements, where appropriate. In the opinion of management, these consolidated financial statements reflect fairly the financial position, results of operations and cash flows of the REIT within reasonable limits of materiality. The financial information contained elsewhere in this Annual Report has been reviewed to ensure consistency with that in the consolidated financial statements.

A system of internal accounting and administrative controls is maintained by management to provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition and that financial records are properly maintained to provide accurate and reliable financial statements.

The board of trustees of the REIT (the "Board of Trustees") is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Board of Trustees carries out this responsibility principally through its independent Audit Committee comprised of unrelated and outside trustees. The Audit Committee meets regularly during the year to review significant accounting and auditing matters with management and the independent auditors and to review the interim and annual consolidated financial statements of the REIT.

The consolidated financial statements have been audited by KPMG LLP, Chartered Accountants, which has full and unrestricted access to the Audit Committee. KPMG's report on the consolidated financial statements follows.

(signed)

TIMOTHY L. LUKENDA

President and Chief Executive Officer

(signed)

DOUGLAS J. HARRIS

Senior Vice President and
Chief Financial Officer

February 29, 2012

Independent Auditors' Report

To the Unitholders of Extendicare Real Estate Investment Trust

We have audited the accompanying consolidated financial statements of Extendicare Real Estate Investment Trust (the "REIT"), which comprise the consolidated statements of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010, and the consolidated statements of earnings (loss), comprehensive income (loss), changes in equity and cash flows for the years ended December 31, 2011 and December 31, 2010, and notes, comprising a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the REIT as at December 31, 2011, December 31, 2010 and January 1, 2010 and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

(signed KPMG LLP)

Chartered Accountants,
Licensed Public Accountants

Toronto, Canada
February 29, 2012

Consolidated Statements of Financial Position

(in thousands of Canadian dollars)	*Notes*	**December 31, 2011**	December 31, 2010	January 1, 2010
Assets				
Current assets				
Cash and short-term investments		**80,018**	267,759	134,012
Restricted cash	*11*	**16,848**	10,095	22,361
Accounts receivable	*5*	**222,707**	212,610	213,477
Income taxes recoverable		**8,223**	3,182	29,314
Other current assets		**32,279**	23,670	56,123
Total current assets		**360,075**	517,316	455,287
Non-current assets				
Property and equipment	*6*	**1,192,913**	1,206,656	1,243,870
Goodwill and other intangible assets	*7*	**87,269**	110,272	115,680
Other assets	*8*	**154,695**	126,200	133,649
Deferred tax assets	*20*	**35,752**	34,190	36,400
Total non-current assets		**1,470,629**	1,477,318	1,529,599
Total Assets	*26*	**1,830,704**	1,994,634	1,984,886
Liabilities and Equity				
Current liabilities				
Accounts payable and accrued liabilities	*9*	**266,934**	266,280	283,778
Income taxes payable		**10,519**	–	–
Long-term debt	*11*	**192,698**	571,168	30,126
Provisions	*10*	**24,408**	16,013	11,321
Exchangeable LP Units	*13, 18*	**–**	29,264	–
Total current liabilities		**494,559**	882,725	325,225
Non-current liabilities				
Long-term debt	*11*	**941,742**	670,028	1,219,330
Provisions	*10*	**81,120**	60,383	61,743
Other long-term liabilities	*12, 13, 18*	**49,638**	44,155	72,830
Deferred tax liabilities	*20*	**215,326**	224,349	235,910
Total non-current liabilities		**1,287,826**	998,915	1,589,813
Total liabilities	*26*	**1,782,385**	1,881,640	1,915,038
Unit capital	*13*	**453,150**	421,213	332,069
Contributed surplus		**81**	81	81
Accumulated deficit		**(386,174)**	(287,525)	(262,157)
Accumulated other comprehensive loss		**(18,738)**	(20,775)	(145)
Unitholders' equity		**48,319**	112,994	69,848
Total Liabilities and Equity		**1,830,704**	1,994,634	1,984,886

See accompaning notes to consolidated financial statements.

Subsequent events *(note 11)*.

Commitments and contingencies *(notes 11 and 21)*.

Approved by the Trustees

(signed)

Mel Rhinelander
Chairman and Trustee

(signed)

Timothy L. Lukenda
President and Chief Executive Officer

Consolidated Statements of Earnings (Loss)

(in thousands of Canadian dollars)

Years ended December 31	*Notes*	**2011**	2010
CONTINUING OPERATIONS			
Revenue			
Nursing and assisted living centers			
United States		**1,355,289**	1,397,452
Canada		**525,831**	495,610
Home health care – Canada		**165,030**	157,177
Health technology services – United States		**19,120**	17,205
Outpatient therapy – United States		**13,750**	12,603
Management, consulting and other services		**15,062**	17,369
Total revenue	*15, 20*	**2,094,082**	2,097,416
Operating expenses		**1,813,792**	1,771,168
Administrative costs		**69,155**	72,630
Lease costs		**10,999**	11,548
Total expenses	*16*	**1,893,946**	1,855,346
Earnings before depreciation, amortization, loss from asset impairment, disposals and other items		**200,136**	242,070
Depreciation and amortization		**76,577**	73,769
Loss from asset impairment, disposals and other items	*17*	**62,496**	2,948
Results from operating activities		**61,063**	165,353
Interest expense		**89,634**	88,967
Accretion of decommissioning provisions		**1,606**	1,614
Other accretion		**423**	514
Distributions on Exchangeable LP Units		**2,179**	2,702
Fair value adjustments		**–**	4,649
Finance costs		**93,842**	98,446
Interest revenue		**4,322**	4,244
Fair value adjustments		**6,023**	–
Gains on foreign exchange and financial instruments		**553**	3,280
Finance income		**10,898**	7,524
Net finance costs	*18*	**82,944**	90,922
Earnings (loss) before income taxes		**(21,881)**	74,431
Income tax expense (recovery)			
Current		**28,280**	34,320
Deferred		**(14,838)**	3,207
Total income tax expense	*20*	**13,442**	37,527
Earnings (loss) from continuing operations		**(35,323)**	36,904
DISCONTINUED OPERATIONS			
Earnings from discontinued operations, net of income taxes	*19, 20*	**4,927**	4,925
Net earnings (loss)		**(30,396)**	41,829

See accompaning notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income (Loss)

(in thousands of Canadian dollars) Years ended December 31	*Notes*	**2011**	2010
Net earnings (loss)		**(30,396)**	41,829
Other comprehensive income (loss), net of income taxes			
Unrealized gain on available-for-sale securities	*14*	**59**	1,062
Reclassification of realized gain on available-for-sale securities to earnings	*14*	**(115)**	(488)
Defined benefit plan actuarial loss, net of tax		**(3,280)**	(2,197)
Net change in foreign currency translation adjustment	*14*	**5,373**	(19,007)
Other comprehensive income (loss), net of tax		**2,037**	(20,630)
Total comprehensive income (loss)		**(28,359)**	21,199

See accompaning notes to consolidated financial statements.

Consolidated Statements of Changes in Equity

	For the twelve months ended December 31, 2010					
(amounts in thousands of Canadian dollars)	*Number of Units*	Unit Capital	Contributed Surplus	Deficit	Accumulated OCI (loss)	Total Unit-holders' Equity
Balance at January 1, 2010	*69,896,968*	332,069	81	(262,157)	(145)	69,848
Total comprehensive income						
Net earnings				41,829		41,829
Other comprehensive loss						
Foreign currency translation differences for foreign operations					(19,007)	(19,007)
Net change in fair value of available-for-sale financial assets, net of tax					1,062	1,062
Net change in fair value of available-for-sale financial assets transferred to profit or loss, net of tax					(488)	(488)
Defined benefit plan actuarial gains and losses, net of tax					(2,197)	(2,197)
Total other comprehensive loss		–	–	–	(20,630)	(20,630)
Total comprehensive income		–	–	41,829	(20,630)	21,199
Transactions with unitholders, recorded directly in equity						
Issuance *(note 13)*	*9,228,750*	83,321				83,321
DRIP	*584,112*	5,324				5,324
Conversion from Exchangeable LP Units	*121,636*	499				499
Distributions declared				(66,115)		(66,115)
Adjustment to prior year distribution of ALC				(1,082)		(1,082)
Total transactions with unitholders	*9,934,498*	89,144	–	(67,197)	–	21,947
Balance at December 31, 2010	*79,831,466*	421,213	81	(287,525)	(20,775)	112,994

Consolidated Statements of Changes in Equity

	For the twelve months ended December 31, 2011					
(amounts in thousands of Canadian dollars)	***Number of Units***	**Unit Capital**	**Contributed Surplus**	**Deficit**	**Accumulated OCI (loss)**	**Total Unit-holders' Equity**
Balance at January 1, 2011	***79,831,466***	**421,213**	**81**	**(287,525)**	**(20,775)**	**112,994**
Total comprehensive loss						
Net loss				**(30,396)**		**(30,396)**
Other comprehensive income						
Foreign currency translation differences for foreign operations					**5,373**	**5,373**
Net change in fair value of available-for-sale financial assets, net of tax					**59**	**59**
Net change in fair value of available-for-sale financial assets transferred to profit or loss, net of tax					**(115)**	**(115)**
Defined benefit plan actuarial losses, net of tax					**(3,280)**	**(3,280)**
Total other comprehensive income		**–**	**–**	**–**	**2,037**	**2,037**
Total comprehensive loss		**–**	**–**	**(30,396)**	**2,037**	**(28,359)**
Transactions with unitholders, recorded directly in equity						
DRIP	***1,123,294***	**9,245**				**9,245**
Conversion from Exchangeable LP Units	***3,166,024***	**22,684**				**22,684**
Conversion from convertible debentures	***704***	**8**				**8**
Distributions declared				**(67,921)**		**(67,921)**
Other				**(332)**		**(332)**
Total transactions with unitholders	***4,290,022***	**31,937**	**–**	**(68,253)**	**–**	**(36,316)**
Balance at December 31, 2011	***84,121,488***	**453,150**	**81**	**(386,174)**	**(18,738)**	**48,319**

See accompaning notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(in thousands of Canadian dollars)

Years ended December 31	**2011**	2010
Operating Activities		
Net earnings (loss)	**(30,396)**	41,829
Adjustments for:		
Depreciation and amortization	**76,658**	73,877
Accrual for self-insured liabilities in provisions	**65,266**	33,137
Payments for self-insured liabilities in provisions	**(35,103)**	(24,860)
Deferred taxes	**(14,838)**	3,206
Current taxes	**31,316**	37,419
Loss from asset impairment, disposals and other items	**62,496**	2,948
Net finance costs	**82,944**	90,923
Interest capitalized	**(195)**	(1,262)
Other	**399**	524
	238,547	257,741
Net change in operating assets and liabilities		
Accounts receivable	**(10,545)**	(10,588)
Other current assets	**(11,210)**	1,691
Accounts payable and accrued liabilities	**(4,525)**	(8,477)
	212,267	240,367
Interest paid	**(83,531)**	(85,797)
Interest received	**4,278**	4,214
Income taxes paid	**(26,235)**	(13,391)
Net cash from operating activities	**106,779**	145,393
Investing Activities		
Purchase of property, equipment and software	**(64,308)**	(68,691)
Purchase of nursing center, net of cash acquired	**(7,299)**	–
Net proceeds from dispositions	**4,805**	28,982
Purchase of other assets	**(1,104)**	(1,308)
Net cash from investing activities	**(67,906)**	(41,017)
Financing Activities		
Issue of long-term debt, excluding line of credit	**402,327**	68,308
Repayment of long-term debt, excluding line of credit	**(551,250)**	(46,344)
Issue on line of credit	**81,195**	–
Repayment on line of credit	**(45,474)**	(6,849)
Decrease (increase) in restricted cash	**(6,753)**	12,266
Decrease in investments held for self-insured liabilities	**(21,053)**	(5,139)
Distributions paid	**(58,375)**	(60,081)
Issue of units	**–**	82,212
Financing costs	**(28,315)**	(7,508)
Other	**455**	(726)
Net cash from financing activities	**(227,243)**	36,139
Increase (decrease) in cash and cash equivalents	**(188,370)**	140,515
Cash and cash equivalents at beginning of year	**267,759**	134,012
Foreign exchange gain (loss) on cash held in foreign currency	**629**	(6,768)
Cash and cash equivalents at end of year	**80,018**	267,759

See accompaning notes to consolidated financial statements.

Cash distributions for REIT and Exchangeable LP units are at the discretion of the Board of Trustees.

Notes to Consolidated Financial Statements

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Years ended December 31, 2011 and 2010
(Tabular amounts in thousands of Canadian dollars, unless otherwise noted)

1. General Information and Nature of the Business

Extendicare Real Estate Investment Trust is an unincorporated, open-ended real estate investment trust established under the laws of the Province of Ontario by a deed of trust dated September 11, 2006, as amended and restated on October 28, 2006 and on December 15, 2010 (the "Deed of Trust"). References to "Extendicare REIT", the "REIT", "we", "us" and "our" in these statements mean Extendicare Real Estate Investment Trust alone or together with its subsidiaries, as the context requires. The registered office of Extendicare REIT is located at 3000 Steeles Avenue East, Markham, Ontario, Canada, L3R 9W2. The units of Extendicare REIT are traded on the Toronto Stock Exchange (TSX) under the symbol "EXE.UN".

Extendicare REIT is the successor in interest to Extendicare Inc. (Extendicare) resulting from the conversion of Extendicare to an unincorporated, open-ended limited purpose trust on November 10, 2006, pursuant to a plan of arrangement (the "Arrangement"). The conversion has been accounted for as a continuity of interests, and accordingly, the consolidated financial statements of the REIT are reflective as if the REIT had always carried on the business formerly carried on by Extendicare.

At a meeting held on November 8, 2011, the board of the trustees of the REIT (the "Board of Trustees") unanimously approved the conversion of the REIT (the "Conversion") from an income trust structure to a corporate structure under a new corporation (New Extendicare). The Board of Trustees unanimously determined that the Conversion is in the best interests of the REIT and its unitholders (the "Unitholders") and recommends that the Unitholders vote in favour of it. In evaluating and approving the Conversion and in making its determination and recommendation, the Board of Trustees relied upon legal, tax and other advice and information received during the course of its deliberations. The Conversion must be approved by two-thirds of the votes cast by Unitholders voting in person or by proxy at a special meeting of Unitholders to be held on May 8, 2012, and is also subject to the approval of the Ontario Superior Court of Justice and regulatory approvals, including the approval of the TSX.

Under the Conversion, which is anticipated to be completed on July 1, 2012, Unitholders will exchange their REIT Units for common shares of New Extendicare on the basis of one common share of New Extendicare for each REIT Unit. In addition, New Extendicare will assume all of the obligations of Extendicare REIT in respect of the REIT's outstanding 5.70% convertible unsecured subordinated debentures due June 30, 2014, and 7.25% convertible unsecured subordinated debentures due June 30, 2013 (collectively, the "Convertible Debentures"). As a result, following the completion of the Conversion, holders of the Convertible Debentures will be entitled to receive common shares of New Extendicare on the same basis as REIT Units were previously issuable on the conversion thereof.

Extendicare REIT is a leading North American provider of post-acute and long-term senior care services. The REIT itself is not a provider of services or products. The direct ownership and operation of the senior care centers and ancillary businesses is conducted by the subsidiaries of the REIT. Through our wholly owned U.S. subsidiary, Extendicare Health Services, Inc. and its subsidiaries (collectively "EHSI") and our wholly owned Canadian subsidiary, Extendicare (Canada) Inc. and its subsidiaries (collectively "ECI"), our principle business is the provision of post-acute, rehabilitative therapies and long-term care through our network of owned and operated senior care centers that include skilled nursing centers in the United States and nursing centers in Canada.

2. Basis of Preparation

(a) Statement of Compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). These are the REIT's first consolidated financial statements prepared in accordance with IFRS, and IFRS 1 First-time Adoption of Financial Reporting Standards has been applied. The REIT transitioned to IFRS as at January 1, 2010 (the "Transition Date"). Periods prior to January 1, 2010, have not been restated, and are prepared under previous Canadian generally accepted accounting principles (GAAP).

A summary of the differences between IFRS and previous Canadian GAAP is outlined in *note 27* along with reconciliations from previous Canadian GAAP to IFRS. An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the REIT is set out in that note; reconciliations of equity and total comprehensive income for comparative periods as well as reconciliations of equity at the date of transition reported under the previous Canadian GAAP to those reported under IFRS for the same periods are also provided.

These consolidated financial statements were approved by the Board of Trustees on February 29, 2012.

(b) Basis of Measurement

The consolidated financial statements have been prepared on the historical cost basis except for financial assets and liabilities classified or designated at fair value through profit or loss (FVTPL) or designated as available for sale (AFS) that have been measured at fair value. Refer to *note 3* for the classification of financial assets and liabilities.

The REIT's consolidated financial statements are presented in Canadian dollars, which is the REIT's functional currency. All financial information presented in Canadian dollars has been rounded to the nearest thousand, unless otherwise noted.

(c) Use of Estimates and Judgement

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

The more subjective of such estimates and judgement are:

- revenue recognition *(note 15)*;
- valuation of accounts receivable *(notes 5 and 23(a))*;
- determination of the recoverable amount of cash generating units (CGU) subject to an impairment test *(note 7)*;
- valuation of decommissioning provisions *(note 10)*;
- valuation of self-insured liabilities *(note 10)*;
- valuation of financial assets and liabilities *(note 23(b))*;
- valuation of unit appreciation rights liabilities *(note 12)*; and
- accounting for tax uncertainties and the tax rates used for valuation of deferred taxes *(note 20)*.

The recorded amounts for such items are based on management's best available information and are subject to assumptions and judgement, which may change as time progresses; accordingly, actual results could differ from estimates.

3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and in preparing the opening IFRS statement of financial position on January 1, 2010, the REIT's Transition Date.

(a) Basis of Consolidation

The consolidated financial statements include the accounts of Extendicare REIT and its subsidiaries. All material intercompany transactions and balances have been eliminated. The financial statements of the REIT's subsidiaries are included within the REIT's consolidated financial statements from the date that control commences until the date that control ceases, and are prepared for the same reporting period as the REIT, using consistent accounting policies.

The acquisition method of accounting is used to account for the acquisition of subsidiaries. Consideration transferred on the acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed on the date of the acquisition and transaction costs are expensed as incurred. Identified assets acquired and liabilities assumed are generally measured at their fair value on the acquisition date. In determining the fair value of identifiable intangible assets acquired, values are assigned to resident relationships as described in *note 3(i)ii*. The excess of fair value of consideration given over the fair value of the identifiable net assets acquired is recorded as goodwill, with any negative goodwill being recognized in net earnings on the acquisition date.

For acquisitions prior to January 1, 2010, goodwill represents the amount recognized under previous Canadian GAAP, subject to an impairment test on the Transition Date. In the transition to IFRS, the REIT elected not to restate business combinations prior to January 1, 2010.

(b) Foreign Currency

i. Foreign operations

The assets and liabilities of foreign operations are translated at exchange rates at the reporting date. The income and expenses of foreign operations are translated at average rates of exchange for the period. The resulting translation adjustments are included in accumulated other comprehensive income (AOCI) in unitholders' equity. When a foreign operation is disposed of, the relevant amount in the cumulative amount of foreign currency translation differences is transferred to net earnings as part of the profit or loss on disposal. When only part of the interest in a subsidiary that includes a foreign operation is disposed of, the relevant proportion of such cumulative amount is reattributed to non-controlling interest. Foreign exchange gains and losses related to intercompany loans that are, in substance, part of the net investment in a foreign operation are included in AOCI. Foreign exchange gains and losses on intercompany loans with planned or foreseeable settlement are included in "net finance costs" within net earnings.

ii. Foreign currency transactions

Transactions in foreign currencies are translated at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognized in net earnings, except for differences arising on the retranslation of available-for-sale equity instruments which are recognized in other comprehensive income (OCI). Non-monetary items that are measured at historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Foreign exchange gains and losses presented in net earnings are included in "net finance costs".

(c) Cash and Cash Equivalents

Cash and cash equivalents include unrestricted cash and short-term investments less bank overdraft and outstanding cheques. Short-term investments, comprised of money market instruments, have a maturity of 90 days or less from their date of purchase.

(d) Accounts Receivable

Receivables from government agencies represent the only concentrated group of accounts receivable for EHSI and ECI. In the United States, EHSI has receivables from federal and state medical assistance programs, other third-party payors and from individuals. In Canada, ECI has receivables primarily from provincial government agencies. Management does not believe there is any credit risk associated with these government agencies other than possible funding delays. Accounts receivable other than from government agencies consist of receivables from Managed Care providers, commercial insurers and private individuals that are subject to different economic conditions, none of which represents any concentrated credit risk to EHSI.

The REIT periodically evaluates the adequacy of its provision for receivable impairment by conducting a specific account review of amounts in excess of predefined target amounts and aging thresholds, which vary by payor type. Allowances for uncollectibility are considered based upon the evaluation of the circumstances for each of these specific accounts. In addition, the REIT has established percentages for provision for receivable impairment, which are based upon historical collection trends for each payor type and age of the receivables. Accounts receivable that are specifically estimated to be uncollectible, based upon the above process, are fully reserved for in the provision for receivable impairment until they are written off or collected.

(e) Non-current Other Assets

Certain investments held for self-insured liabilities included in other assets are investment grade and categorized as available for sale. Invested assets included in other assets consist of primarily equity instruments that have been categorized as available for sale.

(f) Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and accumulated impairment losses. The cost is based upon either the acquisition or constructed cost or the fair value determined as of the Transition Date.

Cost includes expenditures that are directly attributable to the acquisition or development of the asset. Property and equipment acquired as a result of a business combination are valued as outlined in *note 3 (a)*. Centers that are constructed or that are in progress include all incurred expenditures for the development and other direct costs related to the acquisition of land, development and construction of the centers, including borrowing costs of assets meeting certain criteria that are capitalized until the center is completed for its intended use.

On the Transition Date, the REIT determined the individual fair value of each of its centers. Based upon this detailed review, certain centers were restated to reflect their fair value as of January 1, 2010. Certain centers were not selected for revaluation either due to their economic life being limited or where existing and anticipated future cash flows did not warrant the revaluation of the center. Refer to *note 27* for the description of the valuation methodology.

Refer to *note 3(j)* for the accounting policy for the determination of impairment losses.

Property and equipment are classified into components when parts of an item have different useful lives. The cost of replacing a component of an item is recognized in the carrying amount of the item if there is a future economic benefit and its cost can be measured reliably. Any undepreciated carrying value of the assets being replaced will be derecognized and charged to net earnings upon replacement. The costs of the day-to-day maintenance of property and equipment are recognized in net earnings as incurred.

Depreciation and amortization are computed on a straight-line basis based on the useful lives of each component of property and equipment. Depreciation of nursing centers under construction commences in the month after the center is available for its intended use based upon the useful life of the asset, as outlined below. The depreciation methods, useful lives and residual values are reviewed at least annually, and adjusted if appropriate.

Building components:	
Structure, sprinklers systems	50 years
Roof, windows, elevators	25 years
HVAC and building systems	15 to 25 years
Flooring, interior upgrades	5 to 15 years
Building improvements and extensions	5 to 30 years
Furniture and equipment	5 to 15 years
Computer equipment	3 to 5 years
Land improvements	10 to 25 years
Leasehold improvements	Term of the lease and renewal that is reasonably certain to be exercised

(g) Government Grants

Government grants are recognized depending on the purpose and form of the payment from the government.

Forgivable loans issued by the government are accounted for as government grants if there is reasonable assurance the REIT will meet the terms for forgiveness of the loan. Forgivable loans granted by a provincial or health authority body for the construction of a senior care center where the grants are received throughout the duration of the construction project, are netted with the cost of property and equipment to which they relate when such payments are received.

Capital funding payments for the development of a senior care center that are received from a provincial body subsequent to construction over extended periods of time are present valued and are recorded as notes, mortgages and amounts receivable included in other assets, with an offset to the cost of property and equipment upon inception; as these grants are received over time, the accretion of the receivables are recognized in interest revenue within "net finance costs" in net earnings.

(h) Leased Assets

Leases that substantially transfer all of the benefits and risks of ownership of property to the lessee, or otherwise meet the criteria for capitalizing a lease under IFRS, are accounted for as a finance lease. A leased asset is recognized upon commencement of a finance lease and is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Property and equipment recognized as finance leases are depreciated on the same basis as described in *note 3(f)*.

(i) Goodwill and Other Intangible Assets

i. Goodwill

Goodwill represents the excess amount of consideration given over the fair value of the underlying net assets acquired in a business combination, and is measured at cost less accumulated impairment losses. Goodwill arising from acquisitions prior to January 1, 2010, is included on the basis of its deemed cost, which represents the amount recorded under previous Canadian GAAP, subject to an impairment test on the Transition Date. Goodwill is not amortized, but is tested for impairment on an annual basis or more frequently if there are indicators that goodwill may be impaired, see *note 3(j)*.

ii. Other intangible assets

Other intangible assets that are acquired and have finite useful lives are measured at cost less accumulated amortization and accumulated impairment losses (refer to *note 3(j)*). Intangible assets with finite lives are amortized based on cost. Subsequent expenditures are capitalized only if a future benefit exists. All other expenditures, including expenditures on internally generated goodwill, are recognized in net earnings as incurred.

Intangible assets with indefinite useful lives are measured at cost, without amortization, and are subject to an impairment test (refer to *note 3(j)*).

Purchased licenses for resident relationships acquired through the acquisition of senior care centers are intangible assets. Acquiring resident relationships for existing residents of acquired centers represent the cost of having to obtain new residents. These intangible assets include a value of lost net resident revenue over the estimated lease-up period of the property, and are amortized on a straight-line basis, based upon a review of the residents' average length of stay. Resident relationships are generally amortized over a 16-month period for senior care centers. Amortization of the resident relationships asset is included within amortization expense in net earnings.

Non-compete agreements acquired through acquisitions are amortized on a straight-line basis over the period until the agreement expires.

Computer software is amortized over five to seven years and internally developed software over a three-year period.

Amortization methods and useful lives are reviewed at least annually, and are adjusted when appropriate.

(j) Impairment

Impairment of financial and non-financial assets is assessed on a regular basis. All impairment losses are charged to "loss (gain) from asset impairment, disposals and other items" as part of "Results from operating activities" in net earnings.

i. Non-financial assets

Non-financial assets consist of property and equipment, intangible assets with finite lives, intangible assets with indefinite lives and goodwill.

The carrying amounts of non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill, and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated annually at the same time or more frequently if warranted. An impairment loss is recognized in net earnings if the carrying amount of an asset or its related CGU exceeds its estimated recoverable amount. A CGU is defined to be the smallest group of assets that generates cash inflows from continuing use that is largely independent of the cash inflows of other assets. The REIT has identified each individual center as a CGU.

The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. Goodwill and indefinite life intangible assets are allocated to their respective CGUs for the purpose of impairment testing. Indefinite life intangible assets and corporate assets that do not generate separate cash flows and are utilized by more than one CGU are allocated to each CGU for the purpose of impairment testing, and are not tested for impairment separately.

Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the assets in the CGU on a pro rata basis. An impairment loss on goodwill is not reversed. In respect of other non-financial assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

ii. Financial assets

A financial asset is any asset that consists of: cash; a contractual right to receive cash or another financial asset, or exchange financial assets or financial liabilities under potentially favourable conditions; an equity instrument of another entity; or certain contract that will or may be settled in the REIT's own equity instruments.

Financial assets are reviewed at each reporting date and are deemed to be impaired when objective evidence resulting from one or more events subsequent to the initial recognition of the asset indicates the estimated future cash flows of the asset has been negatively impacted. For assets carried at amortized cost or cost and debt securities, the criteria of this assessment includes significant financial difficulty of the issuer or obligor, the disappearance of an active market for that financial asset because of financial difficulties, or observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets. For equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is also objective evidence that the assets are impaired.

For assets carried at amortized cost or cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate, and will be recognized in net earnings. Impairment losses can be reversed to the extent it was previously recognized in net earnings.

For assets classified as available for sale, the cumulative impairment loss is the difference between the asset's carrying amount and the fair value plus any losses accumulated in the OCI. Impairment losses on equity instruments cannot be reversed, whereas impairment losses on debt instruments can be reversed to the extent they were previously recognized in net earnings.

(k) Investment Held for Self-insured Liabilities

The REIT, through its captive insurance subsidiary, holds investments as security for self-insured liabilities. The majority of these investments are investment grade. These investments are classified as either available for sale or held to maturity. Investments held for sale are designated as available for sale and are valued at fair market value, and held-to-maturity investments are valued at amortized cost. (Refer to *note 3(p)*).

(l) Employee Benefits

i. Defined benefit plans

Defined benefit plans are post-employment plans with a defined obligation to employees in return for the services rendered during the term of their employment with the REIT. The net obligation of these plans is calculated separately for each plan by estimating the present value of future benefit that employees have earned in return for their service in the current and prior periods. Any unrecognized past service costs and the fair value of any plan assets are deducted. The discount rate used in deriving the present value is the yield at the reporting date on AA credit-rated corporate bonds that have maturity dates approximating the REIT's obligations and that are denominated in the same currency in which the benefits are expected to be paid.

The calculation of the future benefit of the plan is performed annually by a qualified actuary using the project unit credit method. When the calculation results in a benefit to the plan, the recognized asset is limited to the total of any unrecognized past service costs and the present value of economic benefits available in the form of reductions in future contributions to the plan.

All actuarial gains and losses arising from defined benefit plans are recognized in OCI during the period in which they are incurred.

ii. Defined contribution plans

The REIT has corporate specific and multi-employer defined benefit pension plans, as well as deferred compensation plans. Multi-employer defined benefit pension plans are accounted for as defined contribution plans as the liability per employer is not available. Deferred compensation plans are also accounted for as defined contribution plans. Defined contribution plans are post-employment plans where the costs are fixed and there are no legal or constructive obligations to pay further amounts. Obligations for such contributions are recognized as employee benefit expense in net earnings during the periods in which services are rendered by employees.

iii. Short-term employee benefits

The REIT has vacation, paid sick leave, and short-term disability plans along with other health, drug and welfare plans for its employees. These employee benefit obligations are measured on an undiscounted basis and are expensed as the related services are rendered.

iv. Other employee benefits

The REIT self-insures, to a limited degree, certain risks in EHSI including workers' compensation (for certain periods), auto liability and health benefits. These employee related self-insured risks are primarily due within twelve months and therefore are not discounted and are included within accounts payable and accrued liabilities as a current liability.

(m) Unit Appreciation Rights Plan

Awards under the REIT's unit appreciation rights plan (the "UARP") have a three-year vesting period. Until the liability is settled, the REIT reports the liability on a pro-rata basis at fair value at each reporting date. The fair value of the unit appreciation right (UAR) and the Accrued Distributions is determined by using an option pricing model based on the remaining vesting term and the amount by which the "Fair Market Value" of a trust unit of Extendicare REIT (the "REIT Unit") exceeds the grant price, plus Accrued Distributions. "Fair Market Value" of a REIT Unit, on any particular date, means the volume-weighted average trading price of the REIT Unit on the TSX for the 10 trading days immediately preceding such date. "Accrued Distributions" means the product of the aggregate amount of cash distributions per REIT Unit declared payable to holders of record during the term of the UAR and the probability of the award being in the money at the end of the vesting period. Changes in fair value are recognized in net earnings in the period during which these are incurred.

(n) Provisions

A provision is recognized when there is a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation, and that obligation can be measured reliably. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects the current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as accretion and recognized as part of net finance costs. Provisions are reviewed on a regular basis and adjusted to reflect management's best current estimates. Due to the judgemental nature of these items, future settlements may differ from amounts recognized. Provisions are comprised of estimated self-insured liabilities, decommissioning provisions and other legal claims and obligations.

i. Self-insured liabilities

Extendicare REIT self-insures certain risks related to general and professional liability. The accrual for self-insured liabilities includes the estimated costs of both reported claims and claims incurred but not yet reported. The provision for self-insured liabilities is based on estimates of loss based upon assumptions made by management supported by actuarial projections and the advice of external risk management and legal counsel. The accrual for self-insured liabilities is discounted based upon the projected timing of future payment obligations.

ii. Decommissioning provisions

Management has determined that future costs could be incurred for possible asbestos remediation of the REIT's pre-1980 constructed centers. Though asbestos is currently not a health hazard in any of these centers, appropriate remediation procedures may be required to remove potential asbestos-containing materials, consisting primarily of floor and ceiling tiles, in connection with any major renovation or demolition.

The fair value of the decommissioning provision related to asbestos remediation is estimated by computing the present value of the estimated future costs of remediation based on estimated expected dates of remediation. The computation is based on a number of assumptions, which may vary in the future depending upon the availability of new information, changes in technology and in costs of remediation, and other factors.

The following assumptions were used in calculating the decommissioning provision: (a) discount rates of 6.75% for ECI and 7.10% for EHSI; (b) an estimated timing of the settlement of the provision ranging from 10 to 30 years; and (c) an estimated undiscounted cash flow amount to settle the decommissioning provision of approximately $50 million.

iii. Other provisions

Other provisions include legal claims that meet the above definition of a provision, along with lease restructuring and employee termination payments. Provisions are not recognized for future operating losses.

(o) Exchangeable LP Units

Prior to November 10, 2011, the outstanding Class B limited partnership units (Exchangeable LP Units) of Extendicare Limited Partnership (Extendicare LP) contained features that were economically equivalent to the REIT Units. These units were presented as a liability of the REIT and distributions to Exchangeable LP Unitholders were presented as a finance cost. On November 10, 2011, the remaining Exchangeable LP Units were automatically converted into REIT Units.

(p) Financial Instruments

i. Financial assets and liabilities

The REIT classifies financial assets and liabilities according to their characteristics and the related management's intention for use for purposes of their valuation on the Transaction Date and on an ongoing basis. Financial assets and liabilities are classified into one of the five classifications being: held-to-maturity financial assets, loans and receivables, financial assets at FVTPL, AFS and financial liabilities. Following is a description of the valuation methodology.

Held-to-maturity financial assets

Held-to-maturity financial assets are those that the REIT has the positive intent and ability to hold to maturity. Held-to-maturity financial assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, held-to-maturity financial assets are measured at amortized cost using the effective interest method, less any impairment losses. Any sale or reclassification of a more than insignificant amount of held-to-maturity investments not close to their maturity would result in the reclassification of all held-to-maturity investments as available-for-sale investments, and prevent the REIT from classifying investment securities as held to maturity for the current and the following two financial years.

Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

Financial assets at FVTPL

Assets designated as FVTPL are financial assets that are acquired for the purpose of selling in the short term. These assets are initially recognized and subsequently carried at fair value with changes recorded in net earnings and all transaction costs are expensed as incurred.

AFS

AFS financial assets are assets that are not classified in any of the previous categories or are designated as such by management. These assets are initially recognized at fair value plus transaction costs, and subsequently carried at fair value with changes, except for impairment losses, recorded in OCI until the assets are derecognized through sale or impairment, at which time the cumulative gain or loss previously recognized in AOCI is recognized in net earnings. Interest calculated using the effective interest rate method on available-for-sale financial assets is recognized in net earnings. Dividends on available-for-sale equity instruments are recognized in net earnings when Extendicare REIT's right to receive payment is established.

Financial liabilities

Financial liabilities include FVTPL and other financial liabilities, these are liabilities incurred or assumed in the conduct of business or specific transactions. Financial liabilities are initially measured at fair value and subsequently measured at either amortized cost or fair value. Financial liabilities that are designated as FVTPL are subsequently measured at fair value with changes recognized in net earnings as part of finance costs, whereas those that are designated as other financial liabilities are subsequently measured at amortized costs.

The REIT has convertible debentures that can be converted to units at the option of the holder and the number of units to be issued does not vary with changes in fair value. These debentures are designated as financial liabilities valued at FVTPL.

The Exchangeable LP Units were also designated as financial liabilities valued at FVTPL; therefore, they were valued at fair value initially and on an ongoing basis, with changes in fair value recognized in net earnings as part of finance costs.

Summary of Financial Instruments and Classification

All of the REIT's financial instruments are classified as loans and receivables, AFS, held to maturity or financial liabilities.

Below is a classification summary of the REIT financial instruments:

Asset / Liability	Classification	Measurement
Cash	Loans and receivables	Amortized cost
Total receivables	Loans and receivables	Amortized cost
Notes, mortgages and amounts receivable	Loans and receivables	Amortized cost
Investments held for self-insured liabilities – Available for sale	AFS	Fair value
Investments held for self-insured liabilities – Held to maturity	Held to maturity	Amortized cost
Accounts payable, accrued liabilities	Other financial liabilities	Amortized cost
Long-term debt excluding convertible debentures	Other financial liabilities	Amortized cost
Convertible debentures	FVTPL	Fair value
Exchangeable LP Units	FVTPL	Fair value

Other items on the statement of financial position including, but not limited to, prepaid expenses within other current assets, property and equipment, goodwill and intangible assets, deferred income taxes, provisions and employee benefit obligations are not financial assets or liabilities.

For financial instruments reported at fair value, the REIT uses the fair value hierarchy as follows:

Level 1 – quoted market prices in active markets for identical assets or liabilities;
Level 2 – inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); or
Level 3 – unobservable inputs such as inputs for the asset or liability that are not based on observable market data.

Where possible, the REIT will use the highest of the fair value hierarchy levels.

ii. Derivative financial instruments

From time to time, the REIT uses derivative financial instruments to manage risks from fluctuations in exchange rates and interest rates. All derivative instruments, including embedded derivatives that must be separately accounted for, are valued at their respective fair values in the consolidated financial statements unless they are effective cash-flow hedging instruments.

On the date a derivative contract is entered into, the REIT assesses whether or not to designate the derivative (or non-derivative) as either a hedge of the fair value of a recognized asset or liability (a "fair-value hedge") or a hedge of the variability of cash flows to be received or paid related to a recognized asset or liability or a forecasted transaction (a "cash-flow hedge") or as a hedge of a net investment in a foreign operation. At the inception of any hedge and on an ongoing basis, we assess whether the derivatives that are used in the hedging transactions are highly effective in offsetting changes in fair values or cash flows of the hedged items. We currently do not have any fair-value, cash-flow or net investment hedges.

Management uses foreign currency forward contracts (FCFCs) to limit the exposure of converting U.S. cash flow into Canadian dollars. These are not designated as fair-value or cash-flow hedges for accounting purposes; therefore, gains or losses arising from the change in fair values are recognized in net earnings during the year.

The REIT does not enter into financial instruments for trading or speculative purposes.

(q) Revenue

In the United States, revenue from skilled nursing centers is derived from various federal and state medical assistance programs, Managed Care providers (for residents with health maintenance and commercial insurance programs), as well as privately from the residents. Revenue is recorded in the period in which services and products are provided at established rates less contractual adjustments. Contractual adjustments include differences between established billing rates and amounts estimated by management as reimbursable under various reimbursement formulas or contracts in effect. Differences between final settlements and amounts recorded in previous years are reported as adjustments to revenue in the period such settlements are determined.

Extendicare REIT also offers information technology services to smaller long-term care providers through its wholly owned U.S. subsidiary, Virtual Care Provider, Inc., which we believe reduces their in-house technology costs for these services. This revenue source is primarily derived from application hosting, customer support, telecommunications, equipment sales and consulting services, and is recognized as these services are provided and equipment is delivered to our customers.

In addition, EHSI derives outpatient therapy revenue in the U.S. by providing rehabilitation therapy services to outside third parties at its clinics. This revenue source is primarily from Managed Care, workers' compensation, self-pay clients and partly from Medicare and Medicaid. Revenue is recognized in the period in which services are provided.

In Canada, fees charged for its nursing centers and home health care services are regulated by provincial authorities. Provincial programs fund a substantial portion of these fees. Revenue is recorded in the period in which services and products are provided.

Assisted living center revenue in the U.S. and Canada is primarily derived from private-pay residents and is recognized in the period in which the services are provided and at rates established by the REIT based upon the services provided and market conditions in the area of operation.

Extendicare REIT also offers management, consulting, group purchasing, accounting and administrative services to third parties in both Canada and the United States. Revenue is recorded in the period in which services are provided.

(r) Lease Payments

Rental payments under operating leases are expensed as incurred. Operating leases with defined scheduled rent increases are recognized on a straight-line basis over the lease term.

(s) Finance Costs and Finance Income

Finance costs include interest expense on long-term debt, accretion of the discount on provisions and on decommissioning provisions, distributions on the Exchangeable LP Units, losses on the change in fair value of financial liabilities designated as FVTPL including convertible debentures and Exchangeable LP Units (refer to *note 3(p)i*). Finance income includes interest income on funds invested, gains on the change in fair value of financial liabilities designated as FVTPL including convertible debentures and Exchangeable LP Units, and the change in foreign exchange on non-Canadian based financial assets.

(t) Income Taxes

Extendicare REIT and its subsidiaries are subject to income taxes as imposed by the jurisdictions in which they operate, in accordance with the relevant tax laws of such jurisdictions. The provision for income taxes for the period comprises current and deferred income tax.

Current income tax is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the jurisdictions in which we operate. Deferred income tax is calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse.

The income tax rates used to measure deferred tax assets and liabilities, for other than the REIT legal entity, are those rates enacted or substantially enacted at the reporting date, and are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. Deferred tax assets and liabilities recorded within the REIT legal entity that pertain to undistributed earnings and the change in fair value of the convertible debentures are recorded at the highest marginal personal tax rate. A deferred tax asset is not recorded should the fair value of the convertible debentures be in excess of the principal balance of the convertible debentures. There are no deferred taxes recorded for the change in fair value of the Exchangeable LP Units.

Current and deferred income tax assets and liabilities are offset when there is a legally enforceable right of offset; and the income taxes are levied by the same taxation authority on either the same taxable entity or different taxable entities, which intend either to settle current tax liabilities and assets on a net basis or to realize the assets and settle the liabilities simultaneously, for each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

In assessing whether the deferred tax assets are realizable, management considers whether it is probable (which the REIT has defined as "more likely than not") that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment.

Tax uncertainties are evaluated on the basis of whether it is more likely than not that a tax position will ultimately be sustained upon examination by the relevant taxing authorities. Tax uncertainties are measured using a probability adjusted or expected value model whereby amounts are recorded if there is any uncertainty about a filing position, determined by multiplying the amount of the exposure by the probability that the entity's filing position will not be sustained. The assessment of tax uncertainties relies on estimates and assumptions and may involve a series of judgements about future events. New information may become available that causes the REIT to change its judgement regarding the adequacy of existing tax liabilities. Such changes to tax liabilities will impact tax expense in the period that such a determination is made.

(u) Discontinued Operations

A discontinued operation is a component of the REIT's business that represents a separate major line of business or geographical area of operations that has been disposed of or is held for sale. Classification as a discontinued operation occurs upon disposal or when the operation meets the criteria to be classified as held for sale, if earlier. When an operation is classified as a discontinued operation, the comparative statement of earnings and cash flow information is re-presented as if the operation had been discontinued from the start of the comparative period.

4. Future Changes in Accounting Policies

Financial Instruments

In November 2009, the International Accounting Standards Board (the "IASB") issued IFRS 9 "Financial Instruments (IFRS 9 (2009))", and in October 2010, the IASB published amendments to IFRS 9 (IFRS 9 (2010)). In December 2011, the IASB issued an amendment to IFRS 9 to defer the mandatory effective date to annual periods beginning on or after January 1, 2015. The REIT has yet to assess the impact of the new standard on its results of operations, financial position and disclosures.

Financial Instruments – Disclosures

In October 2010, the IASB issued amendments to IFRS 7 "Disclosures – Transfers of Financial Assets", which is effective for annual periods beginning on or after January 1, 2012. We do not expect the amendments to have a material impact on the financial statements, because of the nature of the REIT's operations and the types of financial assets that it holds.

Consolidated Financial Statements

In May 2011, the IASB issued IFRS 10 "Consolidated Financial Statements" that is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. If an entity applies this standard earlier, it shall also apply IFRS 11 "Joint Arrangements", IFRS 12 "Disclosure of Interests in Other Entities", IAS 27 (2011) and IAS 28 (2011) "Investments in Associates" at the same time. The REIT intends to adopt IFRS 10 in its financial statements for the annual period beginning on January 1, 2013, and does not expect this new standard to have a significant impact on its financial statements.

Disclosure of Interests in Other Entities

In May 2011, the IASB issued IFRS 12 "Disclosure of Interests in Other Entities" that is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. If an entity applies some of the requirements of this standard earlier, it does not need to apply IFRS 10, IFRS 11, IAS 27 (2011) and IAS 28 (2011) at the same time. The REIT intends to adopt IFRS 12 in its financial statements for the annual period beginning on January 1, 2013, and does not expect this new standard to have a significant impact on its financial statements.

Fair Value Measurement

In May 2011, the IASB published IFRS 13 "Fair Value Measurement" that is effective prospectively for annual periods beginning on or after January 1, 2013. The disclosure requirements of IFRS 13 need not be applied to comparative information for periods before initial application. The REIT is assessing the impact of this new standard.

Presentation of Financial Statement – Other Comprehensive Income

In June 2011, the IASB published amendments to IAS 1 "Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income", which are effective for annual periods beginning on or after July 1, 2012 and are to be applied retrospectively. Early adoption is permitted. The REIT intends to adopt the amendments in its financial statements for the annual period beginning on January 1, 2013. As the amendments only require changes in the presentation of items in OCI, we do not expect these amendments to have a material impact on the financial statements.

Post-employment Benefits

In June 2011, the IASB published an amended version of IAS 19 "Employee Benefits". Adoption of the amendments is required for annual periods beginning on or after January 1, 2013, with early adoption permitted. The amendments are generally applied retrospectively with certain exceptions. The REIT currently reflects changes in assets and liabilities from defined benefit pension plans within OCI; therefore, we do not expect the amended standard to have a significant impact on our financial statement presentation.

Offsetting Financial Assets and Liabilities

In December 2011, the IASB published "Offsetting Financial Assets and Financial Liabilities" and issued new disclosure requirements in IFRS 7 "Financial Instruments: Disclosures". The effective date for the amendments to IAS 32 "Financial Instruments: Presentation" is annual periods beginning on or after January 1, 2014. The effective date for the amendments to IFRS 7 is annual periods beginning on or after January 1, 2013. These amendments are to be applied retrospectively. The REIT does not expect the amendments to have a significant impact on its financial statements.

5. Accounts Receivable

	December 31, 2011	December 31, 2010	January 1, 2010
Trade receivables	**186,938**	175,853	179,395
Retroactive rate accruals	**35,374**	31,421	29,350
Other receivables	**23,472**	22,817	22,152
Total Receivables – Net of Allowance *(note 23 (a))*	**245,784**	230,091	230,897
Less: Non-current portion *(note 8)*	**(23,077)**	(17,481)	(17,420)
Accounts Receivable	**222,707**	212,610	213,477

6. Property and Equipment

	Land & land improvements	Buildings	Furniture & Equipment	Leashold improvements	Construction in progress	Total
Cost or deemed cost						
January 1, 2010	158,541	1,088,811	141,967	8,008	24,260	1,421,587
Additions	1,719	8,786	13,778	677	57,830	82,790
Government grants	–	–	–	–	(18,592)	(18,592)
Interest capitalized	–	–	–	–	1,262	1,262
Transfer to assets held for sale	2,137	32,701	4,687	2,764	–	42,289
Disposals	(2,211)	(26,374)	(4,537)	(2,688)	–	(35,810)
Write-off of fully-depreciated assets	–	(729)	(1,458)	(562)	–	(2,749)
Transfer from (to) construction in progress	1,927	34,356	6,012	73	(42,368)	–
Other	(945)	19,233	(11,355)	737	(4,677)	2,993
Effect of movements in exchange rates	(7,310)	(42,444)	(5,530)	(408)	(245)	(55,937)
December 31, 2010	153,858	1,114,340	143,564	8,601	17,470	1,437,833
Additions	**2,554**	**15,163**	**14,714**	**295**	**50,400**	**83,126**
Government grants	**–**	**–**	**–**	**–**	**(12,600)**	**(12,600)**
Interest capitalized	**–**	**–**	**–**	**–**	**195**	**195**
Transfer to assets held for sale	**348**	**3,202**	**(324)**	**–**	**–**	**3,226**
Disposals	**(397)**	**(7,363)**	**(629)**	**–**	**–**	**(8,389)**
Write-off of fully-depreciated assets	**–**	**(4,142)**	**(2,357)**	**(3)**	**–**	**(6,502)**
Impairment loss *(note 7)*	**–**	**(31,657)**	**–**	**–**	**–**	**(31,657)**
Transfer from (to) construction in progress	**2,337**	**28,676**	**5,839**	**(2,547)**	**(34,305)**	**–**
Other	**(278)**	**(90)**	**(2,903)**	**2,494**	**(2,486)**	**(3,263)**
Effect of movements in exchange rates	**2,953**	**17,061**	**2,516**	**135**	**96**	**22,761**
December 31, 2011	**161,375**	**1,135,190**	**160,420**	**8,975**	**18,770**	**1,484,730**
Accumulated depreciation						
January 1, 2010	225	109,404	64,615	3,473	–	177,717
Additions	5,483	43,810	16,469	959	–	66,721
Transfer to assets held for sale	270	6,484	2,654	2,746	–	12,154
Disposals	(296)	(6,409)	(2,687)	(2,761)	–	(12,153)
Write-off of fully-depreciated assets	–	(729)	(1,458)	(562)	–	(2,749)
Other	1	(13)	(5,921)	(1)	–	(5,934)
Effect of movements in exchange rates	(192)	(1,469)	(2,729)	(189)	–	(4,579)
December 31, 2010	5,491	151,078	70,943	3,665	–	231,177
Additions	**5,364**	**40,119**	**17,071**	**7,446**	**–**	**70,000**
Transfer to assets held for sale	**26**	**155**	**(411)**	**–**	**–**	**(230)**
Disposals	**(19)**	**(3,588)**	**(366)**	**33**	**–**	**(3,940)**
Write-off of fully-depreciated assets	**–**	**(4,142)**	**(2,357)**	**(3)**	**–**	**(6,502)**
Other	**(19)**	**2,470**	**(2,112)**	**(2,505)**	**–**	**(2,166)**
Effect of movements in exchange rates	**266**	**1,718**	**1,417**	**77**	**–**	**3,478**
December 31, 2011	**11,109**	**187,810**	**84,185**	**8,713**	**–**	**291,817**
Carrying amounts						
At January 1, 2010	158,316	979,407	77,352	4,535	24,260	1,243,870
At December 31, 2010	148,367	963,262	72,621	4,936	17,470	1,206,656
At December 31, 2011	**150,266**	**947,380**	**76,235**	**262**	**18,770**	**1,192,913**

The cost of assets included in property and equipment under finance leases was $100.3 million (December 31, 2010 – $99.9 million; January 1, 2010 – $87.4 million) with accumulated depreciation of $20.6 million (December 30, 2010 – $17.7 million; January 1, 2010 – $15.4 million) *(note 11)*.

In March 2011, EHSI purchased a 100-bed skilled nursing center in Ohio, which EHSI had previously leased, for cash of US$7.5 million.

Between 2008 and 2011, forgivable loans were granted by several regional Health Authorities in the Province of Alberta for a portion of construction costs of a nursing and an assisted living center in Red Deer, a designated assisted living center in Lethbridge and a nursing center in Edmonton and from a municipality in the Province of Ontario for a nursing center in Timmins. As of December 31, 2011, all forgivable loans in respect of these projects have been received. The forgivable government loans received are accounted for as government grants as the likelihood of triggering repayment is remote *(note 21)*. All grants were netted with other costs and included in construction in progress until the development is completed and are netted with the cost of the building upon completion.

Based upon the impairment assessment we performed for the U.S. in 2011 third quarter, a 10-basis point increase in capitalization rate would cause a $0.9 million increase in impairment. As for Canada, there would be no change in our impairment as of January 1, 2010, if we increase our capitalization rate by 10 basis points.

Interest is capitalized in connection with the construction of centers and is amortized over their estimated useful life at 6.39% (2010 – 3%). Interest capitalized in 2011 was $0.2 million (2010 – $1.3 million).

7. Goodwill and Other Intangible Assets

	December 31, 2011	December 31, 2010
Goodwill		
Balance at beginning of year	**93,820**	97,488
Additions	**349**	890
Impairment loss	**(22,357)**	–
Effect of movements in exchange rates	**1,511**	(4,558)
Balance at end of year	**73,323**	93,820
Other Intangible Assets		
Gross carrying value at beginning of year	**32,543**	31,279
Additions	**1,248**	4,950
Write-off of fully amortized assets	**(73)**	(1,869)
Effect of movements in exchange rates	**2,829**	(1,817)
Gross carrying value at end of year	**36,547**	32,543
Accumulated amortization at beginning of year	**(16,091)**	(13,087)
Amortization	**(6,657)**	(5,894)
Write-off of fully amortized assets	**73**	1,869
Effect of movements in exchange rates	**74**	1,021
Accumulated amortization at end of year	**(22,601)**	(16,091)
Net carrying value	**13,946**	16,452
Goodwill and Other Intangible Assets	**87,269**	110,272

Goodwill

In July 2011, Centers for Medicare and Medicaid Services "CMS" announced Medicare rate reductions in conjunction with changes in the assessment process and the elimination of group therapy that reduced Medicare funding effective October 1, 2011. As a result of this announcement, EHSI tested each of its centers for impairment in the reported values of both property and equipment, and goodwill. For the purpose of impairment testing, goodwill and corporate assets are allocated to EHSI's CGUs *(note 3(j))*. The carrying value of the assets was then compared to the recoverable amount for each CGU to determine if there was any impairment. The recoverable amount of a CGU is determined to be the greater of fair value less cost to sell and value-in-use calculations. Any impairment loss was allocated first to goodwill, and the remainder to property and equipment. An impairment loss on goodwill cannot be reversed in the future.

Based on the computations performed in the 2011 third quarter, EHSI has recognized a pre-tax impairment loss of $54.0 million (US$53.9 million), of which $22.4 million (US$22.3 million) was allocated to goodwill, and $31.7 million (US$31.6 million) to property and equipment. In respect of property and equipment, if future assessments indicate that there is a change in the estimates used to determine the recoverable amount, the impairment loss will be reversed subject to certain limits *(note 3(j))*. Goodwill was assessed at December 31, 2011, and there was no further impairment on the goodwill.

The determination of recoverable amounts can be significantly impacted by estimates related to current market valuations, current and future economic conditions in the geographical markets of each CGU, and management's strategic plans within each of its markets. Estimates and assumptions used in the determination of the impairment loss were based upon information that was known at the time, along with future outlook.

The key assumptions used to determine recoverable amount are as follows:

Capitalization rates:	
Nursing centers	13.1%
Assisted living centers	9.1%
Maintenance capital expenditure per bed *(in dollars)*	US$300
Management fee as a % of revenue	5.0%

The recoverable amount calculations used discounted pre-tax cash flow projections determined from financial projections based upon both historical and forecasted amounts on which capitalization rates were applied. The calculation was based on the following key assumptions:

- Cash flows were projected based upon historical financial performance along with the forecast impact of Medicare rate reductions in the coming year and past experience on average daily census, factoring in the historical maintenance capital expenditures and management fees.
- Capitalization rates were based on industry standards on recent transactions.

Based upon the impairment assessment we performed for the U.S. in 2011 third quarter, a 10-basis point increase in capitalization rate would cause a $0.2 million increase in goodwill impairment. As for Canada, based upon the impairment assessment we performed at the end of the year, there would be no impairment if we increase our capitalization rate by 10 basis points.

The full impact of the 2011 CMS Final Rule can only be determined after sufficient actual results are known along with a sufficient amount of time that includes the benefit of mitigating factors. Further evaluation of the determination of recoverable amounts will be conducted in 2012. Due to uncertainties in the estimation process, actual results could differ significantly from such estimates.

Goodwill of $0.3 million and $0.9 million resulted from the purchase of three clinics by EHSI in 2011 and two clinics in 2010, respectively. Goodwill for these clinics was allocated on the same basis as other CGUs and the goodwill policy applied. These were assessed at December 31, 2011, and there was no impairment.

Other intangible assets

Other intangible assets are comprised of computer software, purchased licenses and non-compete agreements. Computer software represents the majority of other intangible assets with a gross and net carrying value of $34.8 million and $12.6 million (December 31, 2010 – $31.0 million and $15.1 million; January 1, 2010 – $30.1 million and $17.2 million), respectively.

8. Other Assets

	December 31, 2011	December 31, 2010	January 1, 2010
Investments held for self-insured liabilities			
Available-for-sale securities, at fair value	**83,608**	60,937	59,307
Held-to-maturity securites, at amortized cost	**–**	–	6,025
Notes, mortgages and amounts receivable	**48,010**	47,782	50,897
Medicare and Medicaid settlement receivables, less allowance of nil *(note 5)*	**23,077**	17,481	17,420
	154,695	126,200	133,649

Investments Held for Self-insured Liabilities

The REIT holds investments within its Bermuda-based captive insurance company for self-insured liabilities that are subject to insurance regulatory requirements and are categorized as held to maturity or available for sale. The investment portfolio is comprised of U.S. dollar-denominated cash, money market funds and investment-grade corporate and government securities. Certain of these investments in the amount of $15.2 million (US$14.9 million) (December 31, 2010 – $12.9 million or US$13.0 million; January 1, 2010 – $1.9 million or US$1.8 million) have been pledged as collateral for letters of credit issued by the banker of the REIT's captive insurance company in favour of ceding companies. As at December 31, 2011, all investments were categorized as available for sale.

	December 31, 2011	December 31, 2010	January 1, 2010
Fixed income securities, with maturities due:			
In one year or less	**17,760**	5,818	11,619
After 1 year through 5 years	**36,743**	32,969	31,982
After 5 years through 10 years	**2,323**	2,302	3,673
	56,826	41,089	47,274
Cash and money market funds	**26,782**	19,848	14,611
Equities	**–**	–	3,447
	83,608	60,937	65,332

Financial assets include the following:

	December 31, 2011	December 31, 2010	January 1, 2010
Available for sale			
U.S. Treasuries	**13,227**	11,236	14,438
U.S. Agency Bonds	**17,630**	15,213	371
Corporate Bonds	**25,969**	14,640	26,440
	56,826	41,089	41,249
Held to maturity			
U.S. Treasuries	**–**	–	5,816
U.S. Agency Bonds	**–**	–	209
	–	–	6,025
	56,826	41,089	47,274

Notes, Mortgages and Amounts Receivable

Included in notes, mortgages and amounts receivable are $37.2 million (December 31, 2010 – $40.0 million; January 1, 2010 – $42.6 million) of discounted amounts receivable due from government agencies. These represent amounts funded by the Ontario government for a portion of nursing home construction costs over a 20-year period. As each center was opened, a receivable from the government was recorded based on applying a discount rate equivalent to the yield on a 20-year Ontario government bond. The amounts were discounted at rates ranging from 5.3% to 6.5% and were also treated as a reduction in the cost of the property and equipment related to the center.

Medicare and Medicaid Settlement Receivables

Settlement receivables from both Medicare and Medicaid state programs at December 31, 2011, totalled $33.5 million (December 31, 2010 – $26.3 million; January 1, 2010 – $26.5 million), with no allowance. EHSI's Medicare settlement receivables primarily relate to reimbursable Part A co-insurance receivables. Differences between the final settlement and amounts previously recorded are reported as adjustments to revenue in the period of determination. Medicaid settlement receivables pertain to cost-based reimbursement programs. The amounts expected to be substantially collected within one year are reported as current accounts receivable, and the remaining amounts totalling $23.1 million (December 31, 2010 – $17.5 million; January 1, 2010 – $17.4 million) are reported in other assets.

9. Accounts Payable and Accrued Liabilities

	December 31, 2011	December 31, 2010	January 1, 2010
Accounts payable	**42,241**	36,167	38,372
Accrued liabilities	**224,693**	230,113	245,406
Total	**266,934**	266,280	283,778

10. Provisions

	Accrual for self-insured liabilities	Decommis-sioning provisions	Liabilities assumed from Crown Life	Total
Non-current	31,325	24,786	5,632	61,743
Current	11,321	–	–	11,321
January 1, 2010	42,646	24,786	5,632	73,064
January 1, 2010	42,646	24,786	5,632	73,064
Provisions recorded	33,137	1,615	–	34,752
Provisions used	(24,860)	(1,179)	(7)	(26,046)
Provisions reversed	–	–	(24)	(24)
Other	(2,367)	–	–	(2,367)
Accretion	497	–	–	497
Effect of movements in exchange rates	(2,505)	(975)	–	(3,480)
December 31, 2010	46,548	24,247	5,601	76,396
Non-current	30,535	24,247	5,601	60,383
Current	16,013	–	–	16,013
December 31, 2010	46,548	24,247	5,601	76,396
January 1, 2011	**46,548**	**24,247**	**5,601**	**76,396**
Provisions recorded	**65,266**	**1,604**	**–**	**66,870**
Provisions used	**(35,103)**	**(167)**	**(3,204)**	**(38,474)**
Provisions reversed	**–**	**–**	**(2,397)**	**(2,397)**
Accretion	**792**	**–**	**–**	**792**
Effect of movements in exchange rates	**1,920**	**421**	**–**	**2,341**
December 31, 2011	**79,423**	**26,105**	**–**	**105,528**
Non-current	**55,015**	**26,105**	**–**	**81,120**
Current	**24,408**	**–**	**–**	**24,408**
December 31, 2011	**79,423**	**26,105**	**–**	**105,528**

Accrual for Self-insured Liabilities

Within the long-term care industry, operators including the REIT are subject to lawsuits alleging negligence, malpractice, or other related claims. The REIT maintains liability insurance policies through third-party insurers as well as retaining a portion of the risk within its Bermuda-based captive at a level that the REIT believes to be adequate based upon the nature and risks of its business, historical experience and industry standards along with the type of insurance coverage commercially available in the marketplace.

The accrual for self-insured liabilities is based on management's best estimate of the ultimate cost to resolve general and professional liability claims, including both known claims and claims that have been incurred but not yet reported by the end of the reporting period. The REIT estimates the value of losses that may occur within its self-insured retention levels based upon individual assessment of the settlement using historical information and industry data, supported by actuarial projections, advice from legal counsel, consultants and external risk management. General and professional liability claims are the most volatile and significant type of risks for which the REIT self-insures, furthermore, claim payments for any particular policy year can occur over a period of several years that are limited by state or provincial regulations. Actual results can differ materially from the estimates made due to a number of factors including the assumptions used by management and other market forces.

Management regularly evaluates and periodically engages an independent third-party actuary to provide a report to determine the appropriateness of the carrying value of this liability. Assumptions underlying the determination of the liability are limited by the uncertainty of predicting future events and assessments regarding expectations of several factors. Such factors include, but are not limited to: the frequency and severity of claims, which can differ materially by jurisdiction; trends in claims along with unique and identifiable settlements; coverage limits of third-party reinsurance; the effectiveness of the claims management process; and the outcome of litigation. Therefore, management's estimate of the accrual for general and professional liability claims is significantly influenced by assumptions that are subject to judgement by management and the actuary, which may cause the provision to fluctuate from one reporting period to another.

Management estimates and allocates a portion of the general and professional liability claim payments as current on the statement of financial position.

Decommissioning Provisions

The decommissioning provisions relate to possible asbestos remediation of the REIT's pre-1980 constructed centers *(note 3(n)ii)*.

Liabilities Assumed from Crown Life

Under the June 2007 Crown Life share sale agreement with The Canada Life Assurance Company (Canada Life), Extendicare was responsible for specified contingent claims against Crown Life, and had accrued provisions for potential settlements that were secured by letters of credit amounting to $13.9 million in December 31, 2010. Settlement on all of the remaining claims was reached during 2011, resulting in the release of the remaining excess provisions of $2.4 million in 2011 and the elimination of the letters of credit.

11. Long-term Debt

	Interest rate	Year of maturity		**December 31, 2011**	December 31, 2010	January 1, 2010
			US$	**C$**	C$	C$
EHSI *(payable in US$)*						
HUD mortgages	4.23% – 6.152%	2018 – 2046	*395,339*	**402,060**	27,308	24,462
May 2012 CMBS Financing	6.6525%	2012	*109,887*	**111,755**	489,054	524,816
March 2012 CMBS Financing	6.79%	2012	–	**–**	87,152	93,569
Line of credit under Credit Facility	variable	2012	*53,000*	**53,901**	16,794	24,735
PrivateBank mortgage loans	variable	2013	*34,490*	**35,076**	24,835	–
Finance lease liabilities	5.24% – 8.7141%	2015 – 2020	*14,823*	**15,075**	15,304	3,667
Notes payable	0% – 7.5%	2012 – 2014	*9,083*	**9,238**	14,107	16,816
Sovereign Bank mortgage loans	variable	2011	–	**–**	44,935	52,038
Other mortgage loans			–	**–**	–	7,398
			616,622	**627,105**	719,489	747,501
Financing costs			*(15,330)*	**(15,591)**	(9,064)	(9,665)
			601,292	**611,514**	710,425	737,836
Extendicare REIT and Canadian Subsidiaries *(payable in C$)*						
Convertible Unsecured Subordinated Debentures	5.7%	2014		**116,778**	117,348	112,222
Convertible Unsecured Subordinated Debentures	7.25%	2013		**97,531**	96,392	95,290
CMHC mortgages	2.22% – 5.012%	2013 – 2022		**166,308**	171,701	150,550
Non-CMHC mortgages	5.75%	2013		**15,912**	16,268	16,605
Finance lease liabilities	averaging 7.08%	2026 – 2028		**114,667**	118,606	122,279
Construction loans	5.637% – 7.7%	2037 – 2038		**18,288**	16,092	17,331
				529,484	536,407	514,277
Financing costs				**(6,558)**	(5,636)	(2,657)
				522,926	530,771	511,620
Total debt net of financing costs				**1,134,440**	1,241,196	1,249,456
Less: current portion				**192,698**	571,168	30,126
				941,742	670,028	1,219,330

EHSI Debt

2012 REFINANCING PLAN

EHSI is in the final stages of refinancing approximately US$636 million of debt with approximately US$520 million in HUD-insured mortgages and US$116 million of cash on hand. In July 2010, EHSI received approval as a corporate entity to proceed with HUD applications, subject to an overall limit of US$550.0 million, and in December 2011, received approval to increase the financing capacity to an overall limit of US$585.0 million.

The debt being refinanced related to EHSI's CMBS financings due in March 2012 (the "March 2012 CMBS Financing") and in May 2012 (the "May 2012 CMBS Financing"), mortgage financing from Sovereign Bank and other lenders (the "Sovereign Loans"), and approximately US$17.5 million of advances on EHSI's US$70.0 million credit facility (the "EHSI Credit Facility"). The Sovereign Loans were repaid in June 2011, and the March 2012 CMBS Financing and May 2012 CMBS Financing were fully repaid by the end of November 2011 and February 2012, respectively.

As at December 31, 2011, EHSI had closed on 49 HUD loans totalling US$370.2 million in connection with this refinancing. Upon conclusion of the refinancing, EHSI anticipates it will have closed on approximately US$520 million in new HUD-insured mortgages with a weighted average rate of 4.4% and term to maturity of about 32 years. Prior to the 2011/2010 refinancing, EHSI already had approximately US$27 million of HUD loans; therefore, it anticipates utilizing approximately US$547 million of its US$585.0 million overall limit. EHSI plans to secure further HUD financed loans in 2012 and 2013.

As of February 29, 2012, of the 71 HUD-loan applications submitted totalling approximately US$520 million, we have closed on 61 HUD loans with a principal balance of US$453.4 million. In addition, we have received commitments to close on a further five HUD loans totalling US$43.8 million, all of which are under rate lock agreements and are anticipated to close in the 2012 first quarter. Collectively, the weighted average interest rate of the closed loans and those under commitment with a rate lock is 4.35% (including mortgage insurance premium (MIP) fees of 0.50%), with an average term to maturity of about 33 years. We anticipate obtaining and closing on the majority of the remaining five HUD commitments before the end of June 2012.

HUD MORTGAGE LOANS

Below is a summary of the outstanding HUD-insured mortgages as of December 31, 2011:

Final Maturity Dates	# of Loans	Principal Balance	Average Interest Rate(1)
2017 – 2021	4	US$ 7,627	5.78%
2022 – 2026	1	2,866	5.75%
2027 – 2031	1	2,128	5.75%
2032 – 2036	3	23,200	4.67%
2037 – 2041	14	90,028	4.57%
2042 – 2046	32	249,267	4.51%
After 2046	2	20,222	4.32%
Total	57	US$ 395,338	4.57%

(1) Includes MIP fees of 0.50% for HUD mortgage insurance.

As of December 31, 2011, EHSI has a total of 57 HUD-insured loans secured by 57 skilled nursing centers and one assisted living facility. These mortgages have an average remaining term of 31 years with fixed interest rates ranging from 3.60% to 5.50%. The weighted average interest rate, including the MIP of 0.50%, is 4.57%. Depending on the mortgage agreement, prepayments are allowed only after 12 months or 24 months from the inception of the mortgage, and thereafter subject to prepayment penalties of 8% or 9%, respectively, of the remaining principal balances. The prepayment penalties will then decrease each subsequent year by 1% until no penalty is required. As of December 31, 2011, US$380.4 million of the mortgages were within the no-prepayment term, and US$14.9 million were subject to prepayment fees ranging from 2% to 4%.

All HUD-insured mortgage loans are non-recourse loans to EHSI. All mortgages are subject to HUD regulatory agreements that require escrow reserve funds to be deposited with the loan servicer for mortgage insurance premiums, property taxes, insurance and for capital replacements expenditures. As of December 31, 2011, EHSI has escrow reserve funds of US$5.8 million with the loan servicer that are reported within other current assets. In addition, cash for working capital purposes is restricted from distribution to EHSI from the real estate special purpose entities within the HUD mortgage structures. As of December 31, 2011, restricted cash for working capital was US$6.4 million.

CMBS FINANCINGS

The May 2012 CMBS Financing was completed on October 16, 2006, for US$500.0 million through commercial mortgage backed securities. The original maturity date was November 11, 2011, but this date was extended to May 11, 2012, under the Loan Modification Agreement described below. It has a fixed interest rate of 6.6525%, with interest-only monthly payments for the first three years, and monthly principal and interest payments thereafter, based upon a 25-year amortization.

The March 2012 CMBS Financing was completed on March 6, 2007, for US$90.0 million. It has a five-year term that matures on March 11, 2012, and has a fixed interest rate of 6.79%, with interest-only monthly payments for the first two years, and monthly principal and interest payments thereafter, based upon a 25-year amortization.

The CMBS financings were collateralized by first mortgages on 86 and 14 of EHSI's skilled nursing centers, respectively, and all other assets owned by these centers including personal property and receivables. Under both financings, EHSI is required to maintain: a consolidated leverage ratio, exclusive of any notes owing to Extendicare REIT and its subsidiaries, of less than 5.5 to 1.0 and a lease debt service coverage ratio of at least 1.05 to 1.00. EHSI is required to fund capital replacement reserves on a monthly basis, plus amounts to cover any significant renovations; however, these funds are recuperated upon evidence of the work being completed. In the event of default, the lenders may appoint an interim manager and charge a default rate of interest and/or foreclose on the mortgages and other collateral securing the loans.

In May 2011, EHSI signed an agreement to modify its May 2012 CMBS Financing (the "Loan Modification Agreement") for a fee of US$5.4 million. The Loan Modification Agreement extended the maturity date from November 2011 to May 2012 *(note 17)* and, during the period between August 2011 and May 2012, allowed EHSI to prepay in part and release properties from this loan without any prepayment yield maintenance payment. The Loan Modification Agreement enhanced the ability to complete the closing of the HUD mortgages in stages.

In August 2011, we defeased US$65.6 million of the March 2012 CMBS Financing followed by a defeasement of the remaining balance of US$21.0 million in December 2011. In August and October 2011, we prepaid US$194.9 million and US$172.4 million, respectively, of the May 2012 CMBS Financing. In February 2012, we prepaid the final US$108.0 million of May 2012 CMBS Financing. A total of US$2.5 million was charged to net earnings for the costs incurred on defeasement and loan modification fees along with other settlement costs *(note 17)*.

CREDIT FACILITY

The EHSI Credit Facility was renewed and amended in June 2009 and provides for borrowings up to US$70.0 million. The amount available to be borrowed under the EHSI Credit Facility is the lesser of: (i) 60% of the appraised values of the skilled nursing centers collateralizing the EHSI Credit Facility, or (ii) an amount based on the actual net cash flow of these centers for the last 12 months. The amount available to be borrowed as at December 31, 2011, was US$70.0 million. The EHSI Credit Facility was extended in March 2011 to June 2012 with no change in the financial terms of the loan.

The EHSI Credit Facility is used to back letters of credit and for general corporate purposes, and requires EHSI to comply with various financial covenants, including fixed charge coverage, debt leverage, and tangible net worth ratios. It contains customary covenants and events of default and is subject to various mandatory prepayment and commitment reductions. If an event of default occurs, the lenders may accelerate the maturity of the loan under the EHSI Credit Facility, charge a default rate of interest, and/or foreclose on the mortgages and other collateral securing the EHSI Credit Facility. EHSI is permitted to make voluntary prepayments at any time.

The EHSI Credit Facility is secured by mortgages on 21 skilled nursing centers and is guaranteed by EHSI's parent, Extendicare Holdings, Inc., and certain of EHSI's material domestic subsidiaries. Tendercare and its subsidiaries are classified as specified non-recourse subsidiaries and unrestricted subsidiaries under the EHSI Credit Facility; however, the entities are considered restricted subsidiaries solely with respect to certain financial covenants. Tendercare and certain of its subsidiaries have also given a limited guarantee and granted a security interest in their accounts receivable, chattel paper and instruments, and any books and records pertaining thereto to the lender.

At EHSI's option, the interest rate is either the eurodollar rate, with a floor set at 2%, plus a margin from 4% to 4.75%, or the U.S. prime rate plus a margin from 3% to 3.75%. The specific margin is based on EHSI's consolidated leverage ratio as defined in the EHSI Credit Facility.

As at December 31, 2011, US$53.0 million was drawn under the EHSI Credit Facility. The unused portion of the EHSI Credit Facility that was available for working capital, and corporate purposes, after reduction for an outstanding letter of credit of US$2.6 million in favour of a state workers' compensation program, was US$14.4 million as at December 31, 2011. The letter of credit renews annually and matures through to June 2012.

EHSI is currently in the process of renewing the EHSI Credit Facility prior to its June 2012 maturity date.

PRIVATEBANK MORTGAGE LOANS

On November 30, 2010, EHSI secured a non-recourse term loan for up to US$35.0 million on six skilled nursing centers and one assisted living center located in Minnesota, Wisconsin and Michigan with the PrivateBank (the "PrivateBank Loans"). On closing, EHSI drew US$25.0 million of the term loan secured by five of the seven centers, and in March 2011 drew the remainder of the US$10.0 million. The resulting mortgages on the seven centers are cross-collateralized with each other. The PrivateBank Loans have a three-year term that matures on November 30, 2013. The loans are repaid with monthly principal payments based on a 25-year amortization period. Under the mortgage agreement, the combined operations are required to maintain a minimum consolidated fixed charge coverage ratio and debt service coverage ratio. At EHSI's option, the interest rate is equal to: (i) LIBOR, subject to a LIBOR floor set at 2%, plus a margin of 4%, or (ii) the U.S. prime rate subject to a floor of 6%. EHSI has the option to prepay the balance in whole or in part subject to a prepayment fee of 2% for the first two years of the agreement and 1% during the final year, with no prepayment fee during the last six months of the agreement.

NOTES PAYABLE

Notes payable relate to seller notes of US$8.0 million at 7.5% arising from the 2007 Tendercare acquisition *(note 25)*. The original balance of the seller notes totalled US$26.4 million of which US$10.4 million was settled in January 2008 and March 2009, upon having met certain conditions. The balance of US$16.0 million was payable commencing in 2010 at US$4.0 million per annum until maturity in 2013, of which US$4.0 million was paid in each of November 2010 and 2011. Under the terms of the agreement, the balance of acquired working capital is subject to adjustment based upon finalization of the assets subsequently received and liabilities subsequently incurred. The adjustments occur annually 90 days after the anniversary date of the Tendercare acquisition over a four-year period until January 2012. EHSI anticipates resolution of the working capital amounts in the second quarter of 2012. Refer to *note 25* for more information in respect of the settlement of working capital.

SOVEREIGN BANK MORTGAGE LOANS

On June 1, 2011, EHSI paid off the remaining balance of its Sovereign Loans of US$43.0 million using borrowings under the EHSI Credit Facility that were subsequently repaid upon closing of the first phase of the HUD loans. The Sovereign Loans were formally secured by first mortgages on 17 skilled nursing centers owned by Tendercare (Michigan) Inc. and its subsidiaries (collectively "Tendercare").

Canadian Debt

CONVERTIBLE UNSECURED SUBORDINATED DEBENTURES

On June 19, 2008, the REIT completed a public offering of $92.0 million of 7.25% convertible unsecured subordinated debentures, with an $11.35 conversion price, due June 30, 2013 (the "2013 Debentures"), and 3,565,000 REIT Units at $9.70 per unit for aggregate proceeds of $34.6 million. Interest is payable semi-annually. On or after July 1, 2011 but prior to July 1, 2012, these debentures may be redeemed by the REIT in whole at any time or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest, on a notice of not more than 60 days and not less than 30 days prior, provided that the volume-weighted average trading price of the REIT Units on the TSX for the 20 consecutive trading days ending on the fifth trading day immediately preceding the date on which notice of redemption is given is not less than 125% of the conversion price. On or after July 1, 2012, these debentures may be redeemed by the REIT in whole at any time or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest, on a notice of not more than 60 days and not less than 30 days prior.

On June 21, 2007, Extendicare REIT completed a public offering of $115.0 million of 5.7% convertible unsecured subordinated debentures, with a $19.90 conversion price, due June 30, 2014 (the "2014 Debentures"). Interest is payable semi-annually. On or after July 1, 2010, but prior to July 1, 2012, the redemption features, dates, terms and conditions are identical to the 2013 Debentures described above.

Both the 2013 and 2014 debentures are convertible into REIT Units, and are remeasured at fair value at each reporting date with changes recognized in net earnings, see *note 18*. Upon a change of control whereby more than 66⅔% of the units are acquired by any person or group of persons acting jointly, each holder of the 2013 or 2014 debentures may require the REIT to purchase their debentures at 101% of the principal. If 90% or more of the debenture holders do so, the REIT has the right but not the obligation to redeem all of the remaining outstanding debentures.

CMHC MORTGAGES

Extendicare REIT's Canadian subsidiaries have various mortgages insured through the Canadian Mortgage and Housing Corporation or "CMHC" program (the "CMHC Mortgages"). The CMHC Mortgages are secured by several Canadian financial institutions at rates ranging from 2.22% to 5.012% with maturity dates through to 2022.

On December 30, 2011, the REIT's Canadian operations refinanced mortgages on 20 centers insured by the CMHC totalling $72.4 million at a rate of 9.81% that were due to mature in March 2013, with new mortgages totalling the same amount. The new debt consists of $36.1 million on nine centers at a rate of 2.986% maturing in 2022, $22.9 million on nine centers at a rate of 2.22% maturing in 2017, and a bridge loan of $13.3 million on two centers that are seeking to secure new CMHC certificates to replace their existing CMHC certificates maturing in 2013. A prepayment penalty of approximately $7.5 million was recognized in the 2011 fourth quarter *(note 17)*.

In September 2010, ECI executed a 10-year agreement for a $28.7 million CMHC-insured mortgage on its Red Deer, Alberta center at a fixed rate of 4.57% to replace a construction loan.

In August 2009, ECI secured CMHC-insured construction financing of $16.6 million for the Edmonton, Alberta, development project. The loan has a term of two years, with interest-only payments based on a floating rate of 30-day banker's acceptance plus 2.5%. In January 2012, ECI secured a 10-year CMHC-insured mortgage for $17.4 million on this center at a fixed interest rate of 3.81%, with payments amortized over 30 years.

NON-CMHC MORTGAGES

Non-CMHC mortgages are related to three Manitoba nursing centers that were assumed upon acquisition in 2008 that were subsequently refinanced in the same year. These are conventional mortgages at a fixed rate of 5.75% due in 2013 .

FINANCE LEASE LIABILITIES

In November 2010, EHSI entered into a 10-year finance lease for a 100-bed skilled nursing center in South Bend, Indiana *(note 21)*.

ECI obtained financing of $125.4 million in 2001 from BCP Long-Term Care Facilities Inc. (BCP) to build eight Ontario nursing centers and entered into another arrangement in 2003 with BCP for $14.4 million of financing for an additional Ontario nursing home. ECI is operating the centers for BCP under 25-year finance lease arrangements at an average interest rate of 7.08%.

Finance lease liabilities are payable as follows:

As at December 31	**Future minimum lease payments 2011**	**Interest 2011**	**Present value of minimum lease payments 2011**	Future minimum lease payments 2010	Interest 2010	Present value of minimum lease payments 2010
Less than one year	**13,962**	**9,107**	**4,855**	13,897	9,397	4,500
Between one and five years	**54,713**	**32,757**	**21,956**	55,288	34,185	21,103
More than five years	**145,646**	**42,715**	**102,931**	158,479	50,172	108,307
	214,321	**84,579**	**129,742**	227,664	93,754	133,910

CONSTRUCTION LOANS

In October 2011, ECI secured conventional long-term financing on its Timmins and Sault Ste. Marie centers in Ontario. The first two years of the loans are for construction with interest-only payments, following which the loans will be amortized over 25 years. Both loans contain fixed rates for the full 27-year term of 5.637% and 5.558%, respectively, and a requirement to maintain a debt service coverage ratio of 1.2 to 1.

In June 2009, ECI secured long-term financing of $19.6 million on its Lethbridge, Alberta, designated assisted living center. The loan has a 27-year term, with interest during construction at a fixed rate of 4.25% that converted to a fixed rate mortgage at 7.70% in January 2011. Commencing with the opening of the center in January 2011, the interest costs were being reimbursed through government funding for the remainder of the term of the loan. The final draw on the mortgage as a construction loan was received in February 2012.

Other

RBC LINE OF CREDIT AND LETTERS OF CREDIT

Extendicare has a $70.0 million demand credit facility with the Royal Bank of Canada (the "RBC Credit Facility") for its Canadian operations. The RBC Credit Facility is secured by 14 Canadian nursing centers and guaranteed by certain Canadian operating subsidiaries of Extendicare. This credit facility is used to back letters of credit of which there were $40.5 million issued and outstanding as at December 31, 2011, leaving $29.5 million available. The $40.5 million of letters of credit secured $40.0 million of executive pension obligations, and $0.5 million related to construction projects. The amount previously securing the contingent liabilities in connection with the sale of its investment in Crown Life Insurance Company (Crown Life) in 2007 was reduced to zero in August 2011 as a result of the settlement of the remaining claims *(note 10)*.

In October 2011, Extendicare amended its RBC Credit Facility to reduce the maximum limit for the future transfer and assignment of the existing licensed beds at the current Timmins and Sault Ste. Marie centers upon completion of the new centers. This reduction will occur upon the assignment of the licensed beds of the Sault Ste. Marie and Timmins centers in the amounts of $5.0 million and $2.5 million, respectively.

In addition, Extendicare has a U.S. dollar letter of credit facility with the Royal Bank of Canada to provide for the issuance of a U.S. dollar letter of credit. As at December 31, 2011, a US$10.2 million letter of credit (2010 – US$10.2 million) was issued to a third-party insurer of workers' compensation claims of EHSI and was backed by US$10.2 million in cash collateral held by RBC and invested in short-term deposits. As the cash is pledged as collateral against the letter of credit facility, its use is restricted; therefore, it is presented on the statement of financial position as restricted cash within current assets.

RESTRICTED CASH

Restricted Cash is made up of the US$10.2 million in cash held by RBC as collateral for a letter of credit issued to a third-party insurer in respect of the workers' compensation claims described above and US$6.4 million held pursuant to the HUD regulatory agreements for working capital purposes.

UNDRAWN BORROWING FACILITIES

The REIT has the following undrawn borrowing facilities:

	December 31, 2011	December 31, 2010
Variable Rate		
Expiring within one year	**44,176**	64,806
Expiring beyond one year	**–**	–
Total	**44,176**	64,806

The facilities expiring within one year are annual facilities subject to review at various dates during 2012.

FINANCING COSTS

Financing costs are deducted from long-term debt and are amortized using the effective interest rate method over the term of the debt. Financing costs included as part of long-term debt amounted to $22.1 million at December 31, 2011 (2010 – $14.7 million). The increase of $7.4 million in 2011 related primarily to the addition of $17.3 million of costs associated with financing of new and refinancing of existing debt, partially offset by amortization charges included in finance costs and changes in foreign exchange.

Below is a summary of the financing costs:

	Interest rate	Year of maturity		**December 31, 2011**	December 31, 2010	January 1, 2010
			US$	**C$**	C$	C$
EHSI *(payable in US$)*						
HUD mortgages	4.23% – 6.152%	2018 – 2046	*14,502*	**14,750**	4,524	39
May 2012 CMBS Financing	6.6525%	2012	*310*	**315**	2,490	5,371
March 2012 CMBS Financing	6.79%	2012	–	**–**	713	1,348
Line of credit under Credit Facility	variable	2012	*146*	**148**	569	1,805
PrivateBank mortgage loans	variable	2013	*372*	**378**	424	–
Sovereign Bank mortgage loans	variable	2011	–	**–**	255	984
Other			–	**–**	89	118
			15,330	**15,591**	9,064	9,665
Extendicare REIT and Canadian Subsidiaries *(payable in C$)*						
CMHC mortgages	2.22% – 5.012%	2013 – 2022		**3,879**	3,569	1,653
Non-CMHC mortgages	5.75%	2013		**115**	128	173
Finance lease obligations	averaging 7.08%	2026 – 2028		**482**	513	545
Construction loans	5.637% – 7.7%	2037 – 2038		**2,082**	1,426	286
				6,558	5,636	2,657
Total financing costs				**22,149**	14,700	12,322
Less: current portion				**1,707**	4,427	5,703
				20,442	10,273	6,619

PRINCIPAL REPAYMENTS

Principal repayments on long-term debt, exclusive of finance lease liabilities, are as follows:

Year	Amount
2012	189,550
2013	191,466
2014	137,614
2015	17,776
2016	24,081
2017 and beyond	457,783
	1,018,270

INTEREST RATES

The weighted average interest rate of all long-term debt at December 31, 2011, was approximately 5.5% (2010 – 6.6%). At December 31, 2011, 91.1% of the long-term debt, excluding financing costs, was at fixed rates.

12. Other Long-term Liabilities

	December 31, 2011	December 31, 2010	January 1, 2010
Accrued pension plan obligation *(note 22)*	**33,020**	29,210	26,559
Exchangable LP Units *(notes 13 and 18)*	**–**	–	31,321
Deferred compensation	**11,635**	10,941	11,068
Unit appreciation rights	**1,348**	1,047	158
Future lease commitments	**1,826**	1,892	2,146
Fair value of foreign currency forward contract	**–**	–	203
Other	**1,809**	1,065	1,375
	49,638	44,155	72,830

Deferred Compensation

EHSI maintains an unfunded deferred compensation plan offered to all corporate employees defined as highly compensated by the U.S. Internal Revenue Code in which participants may defer up to 10% of their base salary. EHSI will match up to 50% of the amount deferred. EHSI also maintains non-qualified deferred compensation plans covering certain executive employees.

Unit Appreciation Rights Plan

UARs are granted at the discretion of the Board of Trustees of the REIT. Any trustee, director, officer or employee of Extendicare REIT or its affiliates is eligible to participate.

A summary of the UARs that have been granted to date by the Board of Trustees to senior management and the trustees as at December 31st is as follows:

	2011		2010	
	Units	**Weighted Average Vesting Price**	Units	Weighted Average Vesting Price
Outstanding, beginning of year	**1,100,667**	**$8.48**	559,000	$6.64
Granted	**682,000**	**10.99**	628,000	10.04
Forfeited	**(320,250)**	**(9.20)**	(86,333)	(7.84)
Outstanding, end of year	**1,462,417**	**$9.49**	1,100,667	$8.48

The fair value of UARs was measured based on the Black-Scholes model. The inputs used in the fair value measurement for 2011 and 2010 are as follows:

- Unit price – $7.93
- Volatility – 35.00%
- Risk-free interest rate – 0.95% to 0.97%

Other inputs include:

	2011	2010
Strike price	**$7.58 – $11.16**	$8.52 – $10.09
Expected remaining life	**2.2 years – 2.6 years**	1.2 years – 1.9 years

The vesting price represents the REIT Unit price at which the respective UARs were granted, and equates to the minimum REIT Unit price at which they can be vested. As at December 31, 2011, 1,462,417 UARs were outstanding, with an average remaining contractual life of 1.5 years (2010 – 1.9 years). During 2011, $0.3 million was expensed (2010 – $0.9 million), and the related liabilities included as part of other long-term liabilities were $1.3 million as at December 31, 2011 (2010 – $1.0 million).

Awards under the UARP cliff vest after three years, subject to conditions as described below, and permit the participants to receive, at the election of the Board of Trustees, either a payment in cash or equivalent value of REIT Units acquired on the TSX. Vesting of UARs is subject to continued employment of the participant, with pro-rating provisions in the event of the participant's death, retirement or termination of employment as described below, a minimum REIT Unit price, and may also be subject to achieving operating performance measures, as determined by the Board of Trustees at the date of grant. Consideration for vested UARs is equal to the appreciation in the Fair Market Value of the vested UARs from the date of grant of the UAR, plus Accrued Distributions.

The UARP contains provisions providing for adjustments in the event of a corporate reorganization, including an amalgamation or merger of the REIT with or into another entity, or in the event of a change in control (as defined in the UARP). Upon termination of employment (for cause) of a participant, all of his or her UARs shall be cancelled and terminated without payment. In the event of the death, retirement, or termination of employment (other than for cause) of a participant, that occurs on or after the first anniversary date of the date of grant of a particular UAR, the number of UARs available to vest for the remaining term of such grant is pro-rated based on the elapsed time since the date of grant. The balance of the number of UARs under such grant shall be cancelled and terminated without payment. If the date of any such event occurs prior to the first anniversary date of the date of grant of a particular UAR, then such UAR is cancelled and terminated without payment.

Future Lease Commitments

The effects of scheduled rent increases included in minimum lease payments are recognized on a straight-line basis over the lease term. The amount recorded as future lease commitments represents the cumulative excess of lease expense computed on a straight-line basis for the lease term over actual lease payments.

13. Unit Capital

Authorized Capital

The REIT has an unlimited number of REIT Units authorized.

Each REIT Unit is transferable and represents an equal and undivided beneficial interest in the assets of the REIT. Each REIT Unit entitles the holder to one vote at all meetings of unitholders of the REIT. Holders of REIT Units are entitled to receive non-cumulative distributions from the REIT (whether of net earnings, net realized capital gains or other amounts) if, as and when declared by the Board of Trustees. REIT Units are redeemable upon demand by the unitholders, and may be purchased by the REIT for cancellation through offers made to, and accepted by, such holders. Otherwise, the REIT Units have no conversion, retraction, redemption or pre-emptive rights.

The REIT had an unlimited number of Exchangeable LP Units issued by Extendicare LP which were intended, to the greatest extent practicable, to be economically equivalent to REIT Units. Additionally, Exchangeable LP Units were accompanied by special voting units of the REIT that entitled the holder to receive notice of, attend and vote at all meetings of unitholders of the REIT. The Exchangeable LP Units were exchangeable on a one-for-one basis for REIT Units at the option of the holder, and all remaining Exchangeable LP Units were automatically exchanged for REIT Units on November 10, 2011. Each Exchangeable LP Unit entitled the holder to receive distributions from Extendicare LP that were, to the greatest extent practicable, economically equivalent to the distributions made to holders of REIT Units. During 2011, 3.2 million Exchangeable LP Units were exchanged for REIT Units on a one-for-one basis (2010 – 0.1 million).

2010 Equity Offering

On February 4, 2010, the REIT completed a public equity offering of 9,228,750 REIT Units at a price of $9.35 per unit for aggregate gross proceeds of $86.3 million ($82.2 million net of underwriters' fees and offering expenses, before income taxes).

Distribution Reinvestment Plan

The REIT has implemented a Distribution Reinvestment Plan (DRIP) pursuant to which holders of REIT Units and holders of Exchangeable LP Units who are residents in Canada may elect to reinvest their cash distributions in additional REIT Units or Exchangeable LP Units, as the case may be, on the date of the distribution, at a price equal to 97% of the volume-weighted average trading price of the REIT Units on the TSX for the five trading days immediately preceding the corresponding date of distribution. During 2011, the REIT issued 1.1 million REIT Units at a value of $9.2 million in connection with the DRIP (2010 – $0.6 million at a value of $5.3 million).

Normal Course Issuer Bid

In January 2011, the REIT received approval from the TSX for its normal course issuer bid (the "2011 Bid") to purchase for cancellation up to 7.8 million REIT Units, $11.4 million aggregate principal amount of its 2014 Debentures, and $9.2 million aggregate principal amount of its 2013 Debentures, representing, in each case, approximately 10% of the public float of the outstanding securities at December 31, 2010. There were no purchases for cancellation made and the 2011 Bid expired on January 10, 2012.

14. Equity Reserves

Equity reserves are included in AOCI and are comprised of fair value and translation reserves, as follows:

	Unrealized gains/losses on AFS securities	Realized gains/losses on AFS securities	Total fair value reserve	Translation reserve	Total equity reserves
Balance, January 1, 2010	11	(156)	(145)	–	(145)
Recognized during the year	1,062	(488)	574	(19,007)	(18,433)
Balance, December 31, 2010	1,073	(644)	429	(19,007)	(18,578)
Recognized during the year	**59**	**(115)**	**(56)**	**5,373**	**5,317**
Balance, December 31, 2011	**1,132**	**(759)**	**373**	**(13,634)**	**(13,261)**

Fair value reserve

The fair value reserve comprises the cumulative net change in the fair value of available-for-sale financial assets until the investments are derecognized or impaired.

Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

15. Revenue

EHSI derived approximately 80% of its revenue from services provided under the federal (Medicare) and state (Medicaid) programs in both 2011 and 2010. The Medicare program pays each participating center a prospectively set rate for each resident, which is based on the resident's acuity. Most Medicaid programs fund participating centers using a case-mix based system, paying prospectively set rates. With respect to Medicaid in states that utilize retrospective reimbursement systems, nursing centers are paid on an interim basis for services provided, subject to adjustments based upon allowable costs, which are generally submitted in cost reports on an annual basis. In these states, revenue is subject to adjustments as a result of cost report settlements with the state.

Funding received by ECI for its nursing homes and home health care services is regulated by provincial authorities. Revenue from provincial programs represented approximately 66% of ECI's nursing home revenue (2010 – 65%), and approximately 97% of ECI's home health care revenue (2010 – 96%).

16. Expenses by Nature

	2011	2010
Employee wages and benefits	**1,370,347**	1,358,686
Food, drugs, supplies and other variable costs	**185,627**	192,784
Property based and other costs	**326,973**	292,328
Total operating expenses and administrative costs	**1,882,947**	1,843,798
Lease costs	**10,999**	11,548
Total expenses	**1,893,946**	1,855,346

17. Loss from Asset Impairment, Disposals and Other Items

	2011	2010
Asset impairment	**54,012**	1,244
Debt settlement	**11,015**	–
Loss (gain) on disposals	**(494)**	334
Release of provision for contingent liabilities	**(2,397)**	–
Loss on termination of leases	**–**	1,013
Refinancing fees	**–**	381
Other	**360**	(24)
Loss from asset impairment, disposals and other items	**62,496**	2,948

2011

As a result of the CMS announcement in July 2011 to reduce Medicare rates along with other changes *(note 7)*, EHSI has recognized a pre-tax impairment loss of $54.0 million (US$53.9 million) in the 2011 third quarter, of which $22.4 million (US$22.3 million) was allocated to goodwill *(note 7)*, and $31.7 million (US$31.6 million) to property and equipment *(note 6)*. In respect of property and equipment, if future assessments indicate that there is a change in the estimates used to determine the recoverable amount, the impairment loss will be reversed subject to certain limits *(note 3(j))*.

In December 2011, the REIT's Canadian operations refinanced $72.4 million in mortgages secured by 20 CMHC-insured centers that were at fixed rates of 9.81% and due to mature in March 2013 *(note 11)*. As a result, a prepayment penalty of approximately $7.5 million was recognized in the 2011 fourth quarter.

During the third and fourth quarters of 2011, EHSI prepaid US$367.3 million of the May 2012 CMBS debt and defeased US$86.6 million of the March 2012 CMBS debt, respectively. EHSI recorded a pre-tax loss of $2.5 million (US$2.5 million) on retirement of debt that included a defeasance penalty of $1.4 million (US$1.4 million), transaction fees of $0.3 million (US$0.3 million), and the write-off of unamortized loan fees on the debt of $0.8 million (US$0.8 million) *(note 11)*.

In October 2011, the new 180-bed long-term care center in Edmonton, Alberta, was completed. The existing nursing center in Edmonton (113 operational beds) was closed in November and a charge of $0.4 million mortgage prepayment penalty was incurred.

In June 2011, ECI completed the sale of the Lethbridge, Alberta, property (120-bed closed nursing center) for net proceeds of $1.0 million that resulted in a pre-tax gain of $0.2 million in the 2011 second quarter. During the 2011 first quarter when the center closed, a charge of $0.6 million was incurred related to a mortgage prepayment penalty.

In May 2011, EHSI completed the sale of the Saginaw, Michigan skilled nursing center for net proceeds of $3.8 million (US$3.9 million) that resulted in a pre-tax gain of $0.3 million (US$0.3 million). This completed the transaction under the 2009 agreement described below.

Previously, Extendicare had a provision for contingent liabilities in connection with the sale of its investment in Crown Life. In April 2011, settlement was reached on one of the claims below the amount accrued for that particular item, resulting in the release of $0.5 million of the provision. Another settlement was reached in August 2011 for the remaining claim, resulting in the release of the remainder of the provision of $1.9 million *(notes 10 and 11)*.

2010

In 2009, EHSI reached an agreement to sell six Michigan skilled nursing centers (667 beds), one owned skilled nursing center in Ohio (100 beds), and one skilled nursing center in Pennsylvania (107 beds). In April 2010, EHSI completed the sale of the Pennsylvania and Ohio centers for cash consideration of US$5.5 million, which resulted in a net pre-tax loss of $1.7 million (US$1.7 million). In August 2010, EHSI completed the sale of four of the six Michigan centers for cash consideration of US$15.9 million that resulted in a pre-tax loss of $0.4 million (US$0.3 million). The agreement to sell one of the Michigan centers was terminated; and in February 2011, the purchaser exercised the option to acquire the remaining Michigan nursing center for total consideration of US$4.1 million, the sale of which was finalized in May 2011.

In December 2010, the REIT reported a pre-tax gain of $1.7 million related to the disposal of U.S. non-core assets with a book value of US$6.2 million; and EHSI incurred costs of $0.4 million relating to an application to extend the maturity date of the CMBS loan maturing November 2011 *(note 11)*.

In the 2010 second quarter, EHSI completed the transfer of two leased skilled nursing centers to new operators, which involved a lease termination settlement of $1.0 million (US$1.0 million); and EHSI recorded an impairment loss of $1.2 million to reduce to fair value a previously closed nursing center in Washington due to the general decline in property values in the local real estate market.

18. Finance Costs and Finance Income

Convertible Debentures

The fair value adjustment on convertible debentures was a loss of $0.6 million for 2011 and $6.2 million for 2010. This related to the remeasurement of the liability at fair value at the end of each period.

Exchangeable LP Units

The Exchangeable LP Units were intended to be economically equivalent to the REIT Units, to the greatest extent practicable. These units were accompanied by special voting units of the REIT that entitled the holder to receive notice of, attend and vote at all meetings of unitholders of the REIT. They were exchangeable on a one-for-one basis for REIT Units at the option of the holder, and all remaining Exchangeable LP Units were automatically exchanged for REIT Units on November 10, 2011.

Each Exchangeable LP Unit entitled the holder to receive distributions from Extendicare LP that were economically equivalent to the distributions made to holders of REIT Units, to the greatest extent practicable. Distributions on Exchangeable LP Units were recognized in net earnings as part of finance costs.

These Exchangeable LP Units were designated as financial liabilities valued at FVTPL with changes in fair value recognized in net earnings as part of finance costs. The fair value adjustment on Exchangeable LP Units resulted in a gain of $6.6 million for 2011 and $1.6 million for 2010.

Notes Due between Canadian and U.S. Subsidiaries

We recorded foreign exchange gains of $0.2 million for 2011 and $3.3 million for 2010. These related primarily to the change in value of foreign currency-denominated notes between EHSI and some of the Canadian-based subsidiaries.

Foreign Currency Derivatives

The valuation adjustment on FCFCs was a gain of $0.4 million in 2011 and a loss of $0.1 million in 2010. This related primarily to the revaluation of EHSI contracts that locked in the purchase of Canadian dollars at specified foreign exchange rates for US$4.0 million per month until June 2011. There were no outstanding FCFCs as at December 31, 2011.

19. Discontinued Operations

In December 2011, EHSI reached an agreement in principal to sell its group purchasing organization ("GPO") to Navigator Group Purchasing, a subsidiary of Managed Health Care Associates, Inc. The sale of EHSI's GPO was completed in January 2012 for approximately US$56 million; therefore, GPO's operations were reclassified as discontinued operations.

The following is a summary of results of all discontinued operations with prior periods re-presented accordingly.

	2011	2010
Results from discontinued operations		
Other revenue	**12,286**	12,546
Operating expenses	**4,194**	4,362
Lease costs	**48**	52
Total expenses	**4,242**	4,414
Earnings before depreciation and amortization	**8,044**	8,132
Depreciation and amortization	**81**	108
Earnings before income taxes	**7,963**	8,024
Income tax expense	**3,036**	3,099
Earnings from discontinued operations	**4,927**	4,925
Cash flows from discontinued operations		
Net cash from operating activities	**4,697**	5,147
Net cash from investing activities	**(53)**	(66)
Net cash from financing activities	**–**	–
Effect on cash flows	**4,644**	5,081

20. Income Taxes

Taxation of Extendicare REIT and its Corporate Subsidiaries

Extendicare REIT is a Canadian unincorporated, open-ended real estate investment trust established under the laws of the Province of Ontario by the Deed of Trust, and is a mutual fund trust and a specified investment flow-through (SIFT) trust for income tax purposes. The REIT has been subject to the tax regime applicable to SIFT trusts (the "SIFT Rules") since January 1, 2007.

Under the SIFT Rules, an income trust that is a SIFT trust is subject to tax in respect of certain income that is distributed to its unitholders, at rates that are substantially equivalent to the general corporate tax rate applicable to Canadian corporations. Distributions from income in respect of which this tax is payable will be treated in the same manner as taxable dividends from a taxable Canadian corporation in the hands of unitholders and will be eligible for the enhanced dividend tax credit if paid to an individual resident in Canada. This distribution tax does not apply to distributions by a SIFT trust of taxable dividends received (or deemed to be received) by a SIFT trust from a Canadian corporation or income earned from non-Canadian subsidiaries. Corporate subsidiaries of the REIT are not subject to tax under the SIFT Rules but are instead subject to corporate income tax in the jurisdictions in which they operate.

The SIFT Amendments also facilitate the conversion of SIFT trusts into corporations, either through the distribution by a SIFT trust of shares of a taxable Canadian corporation to its unitholders or by the transfer of units of a SIFT trust to a taxable Canadian corporation, followed by a winding up of the SIFT trust. The automatic tax-deferred rollover treatment applies to transactions that occur before 2013.

On December 15, 2010, the REIT revoked its U.S. partnership status effective January 1, 2011; therefore, from this time onward, it will be treated as a corporation for U.S. federal income tax purposes. The change in U.S. tax status from a partnership to a corporation should have no adverse impact on the REIT or its U.S. unitholders, as the change will be effected on a tax-free basis. U.S. unitholders will be affected prospectively as all future income received from the REIT will be treated as distributions from a Canadian corporation for U.S. tax purposes. U.S. unitholders are urged to consult with, and rely solely upon, advice from their own tax advisors with respect to the tax consequences of an investment in REIT Units.

This change of the U.S. federal income tax status of the REIT from a partnership to a corporation does not change the status of the REIT for Canadian income tax purposes or the Canadian taxation of distributions. The REIT continues to be a mutual fund trust and a SIFT trust under the *Income Tax Act (Canada)*.

Tax Recognized in Net Earnings (Loss)

	2011	2010
Current tax expense (recovery)		
Current year	**31,332**	37,029
Accelerated tax depreciation	**(2,483)**	(4,442)
Other prior year adjustments	**2,467**	4,832
	31,316	37,419
Deferred tax expense (recovery)		
Origination and reversal of temporary difference	**(16,605)**	168
Accelerated tax depreciation	**2,692**	4,442
Change in recognized deductible temporary differences	**(925)**	(1,403)
	(14,838)	3,207
Total tax expense	**16,478**	40,626
Tax expense from continuing operations	**13,442**	37,527
Tax from discontinued operations	**3,036**	3,099
Total tax expense	**16,478**	40,626

In respect of the 2009 income tax filings of our U.S. operations, we filed a one-time retroactive change in our U.S. tax accounting method to accelerate the tax depreciation and to expense certain previously capitalized assets that have occurred over the past seven years. Instead of capitalizing certain expenditures, the tax accounting change expenses those that are frequently required to maintain our properties. This retroactive change is subject to review by the U.S. Internal Revenue Service (IRS).

As a result of this tax accounting change, a recovery of federal and state cash taxes of $24.9 million (US$21.8 million) was recorded in the 2009 fourth quarter, which were received through a reduction of our 2010 U.S. tax instalments. In addition, upon completion of the 2009 and 2010 returns in 2010 and 2011, respectively, further recoveries of $4.4 million (US$4.3 million) were recorded in 2010 and $2.5 million (US$2.5 million) in 2011. An equal offset to these recoveries, excluding interest, was charged to the deferred income tax provision that will be reversed over time.

Tax Recognized in Other Comprehensive Income (Loss)

	2011			2010		
	Before tax	**Tax recovery**	**Net of tax**	Before tax	Tax recovery	Net of tax
Foreign currency translation differences for foreign operations	**5,373**	**–**	**5,373**	(19,007)	–	(19,007)
Available-for-sale financial assets	**(56)**	**–**	**(56)**	574	–	574
Deferred benefit plan actuarial gains (losses)	**(4,402)**	**1,122**	**(3,280)**	(2,996)	799	(2,197)
	915	**1,122**	**2,037**	(21,429)	799	(20,630)

Effective Tax Rate

The major factors that caused variations from the expected combined Canadian federal and provincial statutory income tax rates were the following:

	2011	2010
Earnings (loss) from continuing operations before income taxes	**(21,881)**	74,431
Income taxes at statutory rates of 28.25% (2010 – 31%)	**(6,181)**	23,074
Income tax effect relating to the following items:		
Tax rate variance of foreign subsidiaries	**11,294**	7,778
Foreign exchange gain	**(121)**	(668)
Reversal of previously recognized benefit	**1,709**	2,353
Non-deductible items	**9,857**	3,208
Non-taxable income	**(2,442)**	(120)
Other items	**(674)**	1,902
	13,442	37,527

Summary of Operating and Capital Loss Carryforwards

At December 31, 2011, the REIT's U.S. corporate subsidiaries had net operating loss carryforwards available for U.S. state income tax purposes of $29.6 million (US$29.1 million), which expire in the years 2012 through 2031, and had $9.2 million (US$9.0 million) of net operating loss carryforwards available for U.S. federal income tax purposes, which expire in the years 2021 through 2031. In addition, the REIT's Canadian corporate subsidiaries had $34.7 million of net operating loss carryforwards available for Canadian federal income tax purposes, which expire in the years 2015 through 2031. To the extent that it is more likely than not that some or all of the deferred tax assets will not be realized, no deferred tax asset has been established.

At December 31, 2011, there were capital losses available for Canadian income tax purposes of $21.7 million (2010 – $24.4 million) that can be carried forward indefinitely to apply against future capital gains. No deferred tax assets have been recognized for the future tax benefit of these capital losses of $2.9 million (2010 – $3.3 million).

Net deferred tax liabilities decreased in 2011 by $10.6 million to $179.6 million from $190.2 million at December 31, 2010. Management believes it is more likely than not that the REIT's corporate subsidiaries will realize the benefits of these deductible differences.

Recognized Deferred Tax Assets and Liabilities

Deferred tax assets and liabilities are attributable to the following:

	December 31, 2011	December 31, 2010	January 1, 2010
Deferred tax assets	**35,752**	34,190	36,400
Deferred tax liabilities	**215,326**	224,349	235,910
Deferred tax liabilities, net	**179,574**	190,159	199,510

Movement in Temporary Differences

Deferred income taxes are provided for temporary differences between the carrying values of assets and liabilities and their respective tax values as well as available tax loss carryforwards. The significant components of deferred income tax assets and liabilities and the movement in these balances during the year are as follows.

	Balance January 1, 2010	Recognized in net earnings	Recognized in other comprehensive income	Recognized directly in equity	Recognized in other comprehensive income re: FX	Balance December 31, 2010
Deferred tax liabilities						
Property and equipment	252,032	5,539	–	–	(12,110)	245,461
Leasehold rights	418	(1)	–	–	(22)	395
Other	16,093	(56)	–	(1,109)	(1,052)	13,876
	268,543	5,482	–	(1,109)	(13,184)	259,732
Deferred tax assets						
Self-insurance reserves	13,472	(3,108)	–	–	(606)	9,758
Employee benefit accruals	21,636	(877)	799	–	(717)	20,841
Operating loss carryforwards	6,721	1,522	–	–	(6)	8,237
Deferred revenue	5,484	675	–	–	–	6,159
Accounts receivable reserves	7,435	(2,386)	–	–	(317)	4,732
Decommissioning provision	8,189	(124)	–	–	(332)	7,733
Other	6,096	6,573	–	–	(556)	12,113
	69,033	2,275	799	–	(2,534)	69,573
Deferred tax liabilities, net	199,510	3,207	(799)	(1,109)	(10,650)	190,159

	Balance January 1, 2011	**Recognized in net earnings**	**Recognized in other comprehensive income**	**Other**	**Recognized in other comprehensive income re: FX**	**Balance December 31, 2011**
Deferred tax liabilities						
Property and equipment	**245,461**	**(15,660)**	**–**	**–**	**4,497**	**234,298**
Leasehold rights	**395**	**(139)**	**–**	**–**	**9**	**265**
Other	**13,876**	**2,614**	**–**	**1,123**	**803**	**18,416**
	259,732	**(13,185)**	**–**	**1,123**	**5,309**	**252,979**
Deferred tax assets						
Self-insurance reserves	**9,758**	**3,241**	**–**	**–**	**305**	**13,304**
Employee benefit accruals	**20,841**	**(1,580)**	**1,122**	**–**	**281**	**20,664**
Operating loss carryforwards	**8,237**	**2,628**	**–**	**–**	**32**	**10,897**
Deferred revenue	**6,159**	**(1,716)**	**–**	**–**	**–**	**4,443**
Accounts receivable reserves	**4,732**	**(2,334)**	**–**	**–**	**41**	**2,439**
Decommissioning provision	**7,733**	**665**	**–**	**–**	**152**	**8,550**
Other	**12,113**	**749**	**–**	**–**	**246**	**13,108**
	69,573	**1,653**	**1,122**	**–**	**1,057**	**73,405**
Deferred tax liabilities, net	**190,159**	**(14,838)**	**(1,122)**	**1,123**	**4,252**	**179,574**

21. Commitments and Contingencies

Operating Lease Commitments

At December 31, 2011, the REIT was committed under non-cancellable leases requiring future minimum rentals as follows:

	Operating Leases
2012	7,731
2013	5,903
2014	5,328
2015	4,574
2016	4,199
2017 and beyond	13,594
Total minimum payments	41,329

Property and Equipment Commitments

At December 31, 2011, outstanding capital expenditure commitments for EHSI totalled $5.0 million (US$4.9 million). ECI had outstanding capital expenditure purchase commitments totalling $64.5 million as at December 31, 2011, relating to two redevelopment projects.

Construction of the two Ontario redevelopment projects totalling 436 beds, at a cost of approximately $80 million net of government grants, began in the spring of 2011. The new 180-bed nursing center in Timmins and a new 256-bed nursing center in Sault Ste. Marie will replace two Ontario class "C" centers (280 beds) upon completion by the end of 2013 first quarter.

Contractual and Future Skilled Nursing Property Lease Obligations

In September 2009, EHSI entered into an agreement with the company controlled by the former shareholders of Tendercare, which includes a partial interest of Mr. Lukenda, our President and Chief Executive Officer, and his immediate family *(note 25)*. The company owns a 120-bed skilled nursing center in Lansing, Michigan. Effective January 1, 2011, under the terms of the agreement and immediately following the renovation of the center, EHSI entered into a 10-year operating lease for US$0.4 million per annum. The center was certified in March 2011.

In June 2009, EHSI entered into an agreement with an unrelated party who constructed a 100-bed skilled nursing center in South Bend, Indiana. Effective November 2010, under the terms of the agreement, EHSI entered into a 10-year finance lease for US$1.0 million in the first year and US$1.1 million thereafter *(note 11)*.

ALC Spin-Off

The Arrangement included the distribution of Assisted Living Concepts, Inc. (ALC) in 2006 to Extendicare's shareholders and a number of pre-Arrangement transactions. As part of the spin-off of ALC in 2006 to Extendicare's shareholders, EHSI and ALC entered into a tax allocation agreement dated as of November 10, 2006 (the "Tax Allocation Agreement").

In 2009, ALC asserted a claim against EHSI under the Tax Allocation Agreement relating to additional depreciation deductions allowed by the IRS for years 2005 and 2006 relating to limitations computed under Section 382 of the Internal Revenue Code. In December 2010, EHSI agreed to settle this matter for US$0.8 million (US$0.5 million after tax) and terminate the Tax Allocation Agreement. The settlement was charged directly to retained earnings since the spin-off of ALC was accounted for as a capital transaction in 2006.

In connection with the Arrangement, EHSI received a note upon the transfer of ALC to its Canadian affiliate, which was subsequently repaid by way of cash, settlement against other notes and dividends of US$476.6 million. Based upon internal calculations, management believes there was sufficient surplus as to not attract any Canadian taxes from the transactions relating to the repayment of the note. The REIT and its Canadian subsidiaries are currently under audit by the Canada Revenue Agency (CRA). Should the CRA determine that the available surplus was less than the amount determined by management, Canadian capital gains tax would apply to the shortfall.

Legal Proceedings and Regulatory Actions

The REIT and its subsidiaries are defendants in actions brought against them from time to time in connection with their operations. Recently adopted U.S. health care reform legislation is calling for more government oversight of the long-term care industry and operators are experiencing an increase in government investigations, audits and scrutiny of their operations. It is not possible to predict the ultimate outcome of the various proceedings at this time or to estimate additional costs that may result. However, based on current knowledge, management does not believe that liabilities, if any, arising from pending litigation will have a material adverse effect on the consolidated financial position, or results of operations of the REIT.

EHSI has received subpoenas from the U.S. Department of Health and Human Services (DHHS), Office of the Inspector General (OIG), relating to the possible submission of claims that may be in violation of the U.S. Social Security Act and to the provision of rehabilitation services. EHSI and its subsidiaries believe that they are in material compliance with the requirements imposed on them by the U.S. Social Security Act, and intend to furnish all requested information and to cooperate with the OIG in its investigation. The DHHS, OIG, CMS and other federal and state enforcement agencies may conduct additional investigations related to our business in the future that may, individually or in the aggregate, have a material adverse effect on the business or financial condition of EHSI.

The provision of health care services is subject to complex laws and regulations at the federal and state government levels, including laws that are intended to prevent health care fraud and abuse. On an ongoing basis, long-term care providers are subject to surveys, inspections, audits and investigations by various government authorities to ensure compliance with applicable laws and licensure requirements. In such circumstances, the REIT cooperates in responding to information requests and takes the necessary corrective actions and, where appropriate, estimates costs that may result from such investigations, to the extent such costs are predictable or determinable.

22. Employee Benefits

Retirement compensation arrangements are maintained for certain employee groups as described below.

Defined Benefit Plans

The REIT provides a registered defined benefit pension plan, as well as a supplementary plan that is an unfunded defined benefit pension arrangement for certain of its executives, both of which have been closed to new entrants for several years. The registered defined benefit plan was fully funded with plan assets of $5.6 million and accrued benefit obligations of $7.6 million as at December 31, 2011. The accrued benefit obligations of the supplementary plan were $33.3 million as at December 31, 2011. We do not set aside assets in connection with the supplementary plan and the benefit payments made thereunder are funded from our cash from operations. We measure our accrued benefit obligations and the fair value of plan assets for accounting purposes at December 31st of each year. A discount rate of 5.0% was used to determine the benefit expense in 2011, and a discount rate of 4.0% was used to calculate the accrued benefit obligation at the end of 2011. Actuarial valuation reports of the defined benefit pension plans are completed every three years with the last one performed as of October 1, 2009. The next required funding valuation will be effective October 1, 2012.

The different types of defined benefit plans of the REIT are listed below.

	Funded defined benefit plan			Unfunded supplementary defined benefit plan			Total		
	Dec 31, 2011	Dec 31, 2010	Jan 1, 2010	**Dec 31, 2011**	Dec 31, 2010	Jan 1, 2010	**Dec 31, 2011**	Dec 31, 2010	Jan 1, 2010
Fair value of plan assets	**5,644**	6,259	6,115	**–**	–	–	**5,644**	6,259	6,115
Present value of obligations	**7,587**	6,762	6,105	**33,253**	30,890	28,948	**40,840**	37,652	35,053
Surplus (deficit)	**(1,943)**	(503)	10	**(33,253)**	(30,890)	(28,948)	**(35,196)**	(31,393)	(28,938)
Experience gains (losses) arising on plan assets							**(582)**	152	n/a
Experience losses arising on plan liabilities							**(21)**	(420)	n/a

Additional information for these benefit plans is provided in the following tables.

	2011	2010
PRESENT VALUE OF DEFINED BENEFIT OBLIGATIONS		
Accrued benefit obligations		
Balance at beginning of year	**37,652**	35,053
Current service cost	**149**	128
Benefits paid	**(2,606)**	(2,624)
Interest costs	**1,825**	1,947
Actuarial losses	**3,820**	3,148
Balance at end of year	**40,840**	37,652
Plan assets		
Fair value at beginning of year	**6,259**	6,115
Employer contributions	**2,180**	2,203
Expected return on assets	**393**	413
Actual return on plan assets	**(582)**	152
Benefits paid	**(2,606)**	(2,624)
Fair value at end of year	**5,644**	6,259
Defined benefit obligations	**35,196**	31,393

The expected contribution for the coming year is approximately $2.2 million.

	December 31, 2011	December 31, 2010	January 1, 2010
Reported in the REIT's statement of financial position			
Current accrued liabilities	**2,176**	2,183	2,379
Other long-term liabilities *(note 12)*	**33,020**	29,210	26,559
Accrued benefit liability at end of year	**35,196**	31,393	28,938

	December 31, 2011	December 31, 2010	January 1, 2010
PERCENTAGE OF PLAN ASSETS			
Equities	**60%**	63%	62%
Fixed income securities	**34%**	32%	32%
Cash and short-term investments	**6%**	5%	6%
	100%	100%	100%

	2011	2010
EXPENSE RECOGNIZED IN NET EARNINGS		
Annual benefit plan expense		
Current service costs	**149**	128
Interest cost	**1,825**	1,947
Expected return on plan assets	**(393)**	(413)
Plan benefit expense recognized in the year – included in operating expenses and administrative costs	**1,581**	1,662

	2011	2010
ACTUARIAL GAINS OR LOSSES RECOGNIZED IN OTHER COMPREHENSIVE LOSS		
Amount accumulated in retained earnings, January 1	**(2,197)**	–
Recognized during the year	**(3,280)**	(2,197)
Amount recognized in retained earnings at December 31	**(5,477)**	(2,197)

	2011	2010
SIGNIFICANT ACTUARIAL ASSUMPTIONS		
Discount rate for year-end accrued obligation	**4.00%**	4.75%
Discount rate for period expense	**5.00%**	5.50%
Expected long-term rate of return on plan assets	**6.5%**	7.0%
Rate of compensation increase	**2.0%**	5.0%
Average remaining service years of active employees	**6**	7

The present value of the pension obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of pension obligations.

The REIT determines the appropriate discount rate at the end of each year. This is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the REIT considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability.

Defined Contribution Plans

Both Canada and the U.S. offer defined contribution plans. Canada maintains registered savings and defined contribution plans, while EHSI maintains defined contribution retirement 401(k) savings plans in the U.S. Canada matches up to 120% of the employees' contributions according to seniority, subject to a maximum, based on the salary of the plan participants. Contributions expensed by Canada in 2011 and 2010 were $11.5 million and $10.9 million, respectively. EHSI also pays a matching contribution of 25% of every qualifying dollar contributed by plan participants, net of any forfeiture. Contributions expensed by EHSI in 2011 and 2010 were US$2.7 million and US$2.4 million, respectively.

23. Management of Risks and Financial Instruments

(a) Management of Risks

MANAGEMENT OF LIQUIDITY RISK

Liquidity risk is the risk that the REIT will encounter difficulty in meeting its contractual obligations. We manage our liquidity risk through the use of budgets and forecasts. Cash requirements are monitored regularly based on actual financial results and actual cash flows to ensure that there are sufficient resources to meet operational requirements. We ensure that there are sufficient funds for declared and payable distributions and any other future commitments at any point in time. In addition, since there is a risk that long-term debt may not be refinanced or may not be refinanced on as favourable terms or with interest rates as favourable as those of the existing debt, we attempt to appropriately structure the timing of contractual long-term debt renewal obligations and exposures.

The following are the contractual maturities of financial liabilities, including estimated interest payments:

As at December 31, 2011	Carrying amount	Contractual cash flows	Less than 1 year	1–2 years	2–5 years	More than 5 years
Convertible debentures	**214,309**	**231,951**	13,150	101,624	117,177	–
CMBS Financings	**111,755**	**119,189**	119,189	–	–	–
Line of Credit	**53,901**	**57,369**	57,369	–	–	–
HUD mortgages	**402,060**	**420,403**	7,406	7,793	25,493	379,711
PrivateBank mortgage loans	**35,076**	**37,181**	589	36,592	–	–
CMHC mortgages	**166,308**	**197,593**	16,760	43,094	51,601	86,138
Non-CMHC mortgages	**15,912**	**17,571**	1,293	16,278	–	–
Finance lease obligations	**129,742**	**214,321**	13,962	13,963	40,750	145,646
Construction loans	**18,288**	**44,301**	1,631	1,675	5,083	35,912
Notes payable	**9,238**	**9,913**	5,471	4,408	34	–
Accounts payable	**42,241**	**42,241**	42,241	–	–	–
	1,198,830	**1,392,033**	279,061	225,427	240,138	647,407

As at December 31, 2010	Carrying amount	Contractual cash flows	Less than 1 year	1–2 years	2–5 years	More than 5 years
Convertible debentures	213,740	245,101	13,150	13,150	218,801	–
CMBS Financings	576,206	614,656	523,184	91,472	–	–
Line of Credit	16,794	17,801	17,801	–	–	–
HUD mortgages	27,308	28,786	1,128	1,196	4,034	22,428
PrivateBank mortgage loans	24,835	26,325	382	416	25,527	–
Sovereign loans	44,935	46,620	46,620	–	–	–
CMHC mortgages	171,701	211,484	24,474	20,400	109,598	57,012
Non-CMHC mortgages	16,268	18,862	1,292	1,293	16,277	–
Finance lease obligations	133,910	227,664	13,897	13,921	41,367	158,479
Construction loans	16,092	32,730	1,098	5,001	3,801	22,830
Notes payable	14,107	15,130	5,247	5,413	4,470	–
Accounts payable	36,167	36,167	36,167	–	–	–
	1,292,063	1,521,326	684,440	152,262	423,875	260,749

The gross outflows presented above represent the contractual undiscounted cash flows.

MANAGEMENT OF CREDIT RISK

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the REIT by failing to discharge its obligation. The nature and maximum exposure to credit risk as at December 31 was:

	Carrying Amount	
	2011	2010
Cash and short-term investments	**80,018**	267,759
Restricted cash *(note 11)*	**16,848**	10,095
Total receivables, net of allowance [1] *(note 5)*	**245,784**	230,091
Investments held for self-insured liabilities *(note 8)*	**83,608**	60,937
Notes, mortgages and amounts receivable *(note 8)*	**48,010**	47,782
	474,268	616,664

(1) Includes non-current portion.

Cash and Short-term Investments

The majority of our cash and cash equivalents are held with highly rated financial institutions in Canada and the United States.

Restricted Cash

The restricted cash is cash held for collateral and regulatory requirements with no credit risks *(note 11)*.

Total Receivables, net of allowance

The maximum exposure to credit risk for accounts receivable at the reporting date is the carrying value of each class of receivable, denominated in the following currencies. The REIT does not hold any collateral as security.

	2011			2010		
	Carrying amount			Carrying amount		
	U.S. Dollar	**Canadian Dollar**	**Total**	U.S. Dollar	Canadian Dollar	Total
Trade receivables	**168,744**	**18,194**	**186,938**	157,464	18,389	175,853
Retroactive rate receivables	**33,475**	**1,899**	**35,374**	26,347	5,074	31,421
Other receivables	**15,821**	**7,651**	**23,472**	14,161	8,656	22,817
	218,040	**27,744**	**245,784**	197,972	32,119	230,091

Receivables from U.S. and Canadian government agencies, which are included in accounts receivable, notes, mortgages and amounts receivable, and Medicare and Medicaid settlement receivables, represented the only concentrated group of credit risks for the REIT. As at December 31, 2011, receivables from government agencies represented approximately 73% of the total receivables. Management does not believe that there is significant credit risk associated with these government agencies other than possible funding delays. Management continually monitors reports from trade associations or notes from provincial, state or federal agencies that announce possible delays that are rare to occur and usually associated with changes of fiscal intermediaries or changes in information technology or forms.

Receivables, other than those from government agencies, consist of receivables from various payors and do not represent any concentrated credit risks to the REIT. There is no significant exposure to any single party.

As of December 31, 2011, the U.S. operations (mainly EHSI) had trade receivables of $168.7 million (2010 – $157.5 million) which were fully performing and collectible in the amounts outlined above. EHSI continually monitors the collection of all trade receivables and assesses the collectability of accounts on an individual basis in addition to the aging of the balances by payor type. The majority of balances between 90 and 365 days pertain to residents awaiting confirmation of Medicaid eligibility or those involving deferred claims with Health Maintenance Organizations (HMOs); whereas the balances over 365 days primarily involve claims against private residents that were denied HMO or Medicaid benefits. In 2011, EHSI incurred a provision for receivable impairment of $15.6 million (2010 – $17.9 million).

As of December 31, 2011, retroactive rate receivables of $33.5 million (2010 – $26.3 million) primarily pertain to reimbursable bad debt claims under the Medicare program along with rate settlements involving cost-based state Medicaid programs with retrospective systems of reimbursement.

As of December 31, 2011, ECI had trade receivables of $18.2 million (2010 – $18.4 million) which were fully performing and collectible in the amounts outlined above. ECI continually monitors the collection of all trade receivables and assesses the collectability of accounts on an individual basis in addition to the aging of the balances by payor type. The majority of balances over 365 days involve amounts due from private individuals. In 2011, ECI incurred a provision for receivable impairment of $0.7 million (2010 – $0.6 million).

The aging analysis of these trade receivables is as follows:

As at December 31	**2011**	2010
Current	**110,554**	113,279
Between 30 and 90 Days	**59,441**	45,505
Between 90 and 365 Days	**26,828**	26,428
Over 365 Days	**6,790**	8,437
Less: Provision for receivable impairment	**(16,675)**	(17,796)
Total	**186,938**	175,853

Movements on the REIT's provision for receivable impairment are as follows:

	2011	2010
At January 1	**17,796**	23,975
Increase in provision for receivable impairment	**16,292**	18,520
Receivables written off as uncollectible	**(17,745)**	(23,648)
Other	**332**	(1,051)
At December 31	**16,675**	17,796

The increase in provision for receivable impairment has been included in operating expenses in net earnings. In general, amounts charged to the provision for impairment of trade receivables are written off when there is no expectation of recovering additional cash.

Investments for Self-insured Liabilities

The REIT's investments held for self-insured liabilities include investments in corporate or government fixed rate bonds with ratings above a rating of AAA- along with U.S. treasuries. Cash held for self-insured liabilities are with high-quality financial institutions. The REIT limits the amount of exposure to any one institution.

Notes, Mortgages and Amounts Receivable

Included in notes, mortgages and amounts receivable are $37.2 million (2010 – $40.0 million) of discounted amounts receivable due from government agencies. These represent amounts funded by the Ontario government for a portion of nursing home construction costs over a 20-year period. The REIT does not consider there to be any credit exposure for these amounts due from government agencies.

MANAGEMENT OF CURRENCY RISK

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The REIT finances and secures Canadian debt on only Canadian operations and assets, and similarly, finances and secures U.S. debt on only U.S. operations and assets. Therefore, there is no currency exposure in respect of the valuation of assets and associated debt. The REIT can raise capital to finance its U.S. operations through cross-border loans or an injection of capital. Intercompany advances to the U.S. operations for acquisitions or growth expenditures are subsequently repaid. Any cross-border transactions are subject to exchange fluctuations that may result in realized gains or losses as and when the balances are settled and upon the payment of interest on such loans, as well as any cross-border dividend or return of capital.

Our exposure to foreign currency risk as at December 31, 2011 and 2010 was as follows:

(in thousands of US$)	**2011**	2010
Assets		
Current assets	**273,284**	356,694
Property and equipment, goodwill and other intangible assets, and other assets	**1,053,764**	1,098,725
Liabilities		
Current liabilities	**373,803**	748,186
Long-term debt and other liabilities	**706,502**	423,365
Net asset exposure	**246,743**	283,868

Net Earnings Sensitivity Analysis

The majority of the REIT's operations are conducted in the United States, which accounted for approximately 67% of its total revenue in 2011.

Every one cent strengthening of the Canadian dollar against the U.S. dollar would impact net earnings and OCI by the amounts shown below. This analysis assumes that all other variables, in particular interest rates and fair value of the FCFCs, remain constant.

Favourable (unfavourable) impact	**2011**	2010
Net earnings	**(2)**	(1)
Other comprehensive income	**(2,467)**	(2,839)

Cash Flow Sensitivity

All of the REIT's distributions are denominated in Canadian dollars; therefore, to the extent these distributions are funded by our U.S. operations, the REIT is subject to currency risk. To limit the exposure of converting the REIT's U.S. cash flow into Canadian dollars, we monitor the U.S. to Canadian dollar and, should the conditions be considered favourable, implement a foreign currency hedging strategy through the purchase of FCFCs.

The REIT maintains risk management control systems to monitor foreign currency cash flow risk attributable to its outstanding or forecasted debt obligations as well as its offsetting hedge positions. We do not enter into financial instruments for trading or speculative purposes.

MANAGEMENT OF INTEREST RATE RISK

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The REIT assesses interest rate risk by continually identifying and monitoring changes in interest rates that may adversely impact expected future cash flows and by evaluating hedging opportunities. The REIT maintains risk management control systems to monitor interest rate risk attributable to its outstanding or forecasted debt obligations as well as its offsetting hedge positions.

In order to meet its monthly distributions, the REIT has limited the amount of debt that may be subject to changes in interest rates. As at December 31, 2011, 91.1% of our outstanding long-term debt was at fixed rates and $102.3 million of long-term debt was subject to interest rate fluctuations. We do not enter into financial instruments for trading or speculative purposes.

The interest rate profile of our interest-bearing financial instruments at December 31, 2011 and 2010 was as follows:

	Carrying Amount	
	2011	2010
Fixed-rate instruments:		
Investments held for self-insured liabilities [1]	**62,262**	46,703
Less: Long-term debt [2][3]	**1,054,291**	1,165,781
Net liability in fixed-rate instruments	**992,029**	1,119,078
Variable-rate instruments:		
Long-term debt [2][3]	**102,298**	90,115
Total liability in variable-rate instruments	**102,298**	90,115

(1) Excludes variable-rate instruments.

(2) Excludes financing costs.

(3) Includes current portion.

Fair Value Sensitivity Analysis for Fixed-rate Instruments

We do not designate interest rate derivatives as hedging instruments under a fair-value hedge accounting model; therefore, changes in interest rates would not affect net earnings with respect to these fixed-rate instruments. As at December 31, 2011, there were no fixed-rate instruments designated as held for trading; therefore, changes in interest rates will not have any impact on net earnings for these instruments.

Fair Value Sensitivity Analysis for Variable-rate Instruments

Long-term debt other than convertible debentures is classified as other financial liabilities, which are measured at amortized cost using the effective interest rate method of amortization; therefore, changes in interest rates would not affect OCI with respect to variable-rate debt.

Cash Flow Sensitivity Analysis for Variable-rate Instruments

A change of 100 basis points in interest rates would have increased or decreased net earnings by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

	2011		2010	
Favourable (unfavourable) impact	**100bp increase**	**100bp decrease**	100bp increase	100bp decrease
Net earnings	**(193)**	**193**	(623)	623

(b) Fair Values of Financial Instruments

As at December 31, 2011	**Loans and receivables**	**Available for sale**	**Designated at fair value**	**Other financial liabilities**	**Total carrying amount**	**Fair value**
Financial assets:						
Cash and short-term investments	**80,018**	**–**	**–**	**–**	**80,018**	**80,018**
Invested assets (1)	**650**	**–**	**–**	**–**	**650**	**650**
Trade and other receivables (2)	**243,029**	**–**	**–**	**–**	**243,029**	**241,889**
Notes, mortgages and amounts receivable	**50,765**	**–**	**–**	**–**	**50,765**	**57,090**
Investments held for self-insured liabilities	**–**	**83,608**	**–**	**–**	**83,608**	**83,608**
	374,462	**83,608**	**–**	**–**	**458,070**	**463,255**
Financial liabilities:						
Accounts payable	**–**	**–**	**–**	**42,241**	**42,241**	**42,241**
Long-term debt excluding convertible debentures (2) (3)	**–**	**–**	**–**	**942,280**	**942,280**	**985,451**
Convertible debentures	**–**	**–**	**214,309**	**–**	**214,309**	**214,309**
	–	**–**	**214,309**	**984,521**	**1,198,830**	**1,242,001**

As at December 31, 2010	Loans and receivables	Available for sale	Designated at fair value	Other financial liabilities	Total carrying amount	Fair value
Financial assets:						
Cash and short-term investments	267,759	–	–	–	267,759	267,759
Invested assets (1)	801	–	–	–	801	801
Trade and other receivables (2)	227,495	–	–	–	227,495	226,434
Notes, mortgages and amounts receivable	50,378	–	–	–	50,378	54,811
Investments held for self-insured liabilities	–	60,937	–	–	60,937	60,937
	546,433	60,937	–	–	607,370	610,742
Financial liabilities:						
Accounts payable	–	–	–	36,167	36,167	36,167
Foreign currency forward contract liability	–	–	381	–	381	381
Long-term debt excluding convertible debentures (2) (3)	–	–	–	1,042,156	1,042,156	1,072,059
Convertible debentures	–	–	213,740	–	213,740	213,740
	–	–	214,121	1,078,323	1,292,444	1,322,347

(1) Included in other current assets.
(2) Includes current portion.
(3) Excludes financing costs.

Basis for Determining Fair Values

The following summarizes the significant methods and assumptions used in estimating the fair values of financial instruments reflected in the previous table.

Fair values for investments designated as held to maturity and available for sale are based on quoted market prices.

Items designated as loans and receivables include cash, accounts receivable as well as notes, mortgages and amounts receivable. Accounts receivable, including other long-term receivables, are recorded at amortized cost. The carrying values of accounts receivable approximate fair values due to their short-term maturities, with the exception of certain settlement receivables from third-party payors that are anticipated to be collected beyond one year. The fair values of these settlement receivables are estimated based on discounted cash flows at current borrowing rates. Notes, mortgages and amounts receivable primarily consist of notes and amounts receivable from government agencies, and other third-party notes. The fair values for these instruments are based on the amount of future cash flows associated with each instrument, discounted using current applicable rates for similar instruments of comparable maturity and credit quality.

The fair value of the FCFCs is based upon the valuation as provided by the financial institution that is the counterparty to the agreements.

The fair values for long-term debt are based on the amount of future cash flows associated with each instrument discounted using current applicable rates for similar instruments of comparable maturity and credit quality.

Fair Value Hierarchy

We use a fair value hierarchy to categorize the type of valuation techniques from which fair values are derived. Our use of quoted market prices (Level 1), internal models using observable market information as inputs (Level 2) and internal models without observable market information as inputs (Level 3) for the following financial instruments recorded at fair value were as follows:

As at December 31, 2011	**Level 1**	**Level 2**	**Level 3**	**Total**
Available-for-sale securities	**83,608**	**–**	**–**	**83,608**
Total assets	**83,608**	**–**	**–**	**83,608**
Financial liabilities designated at fair value through profit or loss	**214,309**	**–**	**–**	**214,309**
Total liabilities	**214,309**	**–**	**–**	**214,309**

As at December 31, 2010	Level 1	Level 2	Level 3	Total
Available-for-sale securities	60,937	–	–	60,937
Total assets	60,937	–	–	60,937
Derivative liabilities	–	381	–	381
Financial liabilities designated at fair value through profit or loss	213,740	–	–	213,740
Total liabilities	213,740	381	–	214,121

24. Capital Management

The REIT's objective is to preserve a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. We seek to balance the need for maintaining an attractive payout ratio with maintaining adequate capital to grow the business by acquisition or internal growth. There were no changes in the REIT's approach to capital management during the year.

The REIT must access the capital markets periodically to fund acquisitions, growth capital expenditures and certain other expenditures. We monitor the capital markets to assess the conditions for raising capital and the cost of such capital relative to the return on any acquisitions or growth capital projects. Funds raised in the capital markets that are not deployed in acquisitions or growth projects are held in high-quality investments with surplus cash held in secure institutions. We manage our cash position and prepare monthly cash flow projections over the remaining and future fiscal period, and we continuously monitor the level, nature and maturity dates of debt and level of leverage and interest coverage ratios to ensure our compliance with debt covenants. We provide information to the Board of Trustees on a regular basis in order to carefully evaluate any significant cash flow decisions.

Economic Environment

Beginning in the latter part of 2008, the economy and stock markets suffered a significant downturn as a result of the worldwide credit and liquidity crisis that impacted market values of securities, values of commodities, interest rates and the foreign exchange markets; and there have been unprecedented job losses in both the U.S. and Canada. Although there have been increases in the values of securities and increased liquidity in the credit market, there continues to be general restraint on corporate and individual spending levels. With a dramatic reduction in corporate profits and reduced consumer confidence, the fiscal health of provincial, state and federal governments have been dampened; consequently, the future funding of services for which they provide support may be constrained.

The most significant factor impacting the REIT's industry this past year, and for the near term, is the economic environment that has resulted in a reduction in admissions to our U.S. nursing centers along with a concerted effort by federal, provincial and state governments to restrain funding increases of health programs, and in certain cases to implement funding reductions. In response to the economic environment, the REIT has undertaken several courses of action to minimize risks and maintain liquidity, including:

- reducing growth projects and divesting underperforming assets and non-core businesses;
- implementing significant cost reduction initiatives;
- refinancing a significant portion of long-term debt with low-cost government-insured mortgages;
- reducing distributions in January 2009 and monitoring cash usage; and
- maintaining solid banking relationships.

For the near term, there are no indications that the economy and economic risks that affect the industry are improving. Therefore, the REIT plans to continue to monitor and implement steps to address these challenges. Below is a summary of the past and future uncertainties and significant risks that could have an impact on the REIT and its subsidiaries.

STATE, PROVINCIAL AND FEDERAL FUNDING AND REGULATORY PRESSURE

Reductions in Medicaid, Medicare and provincial funding for long-term care due to the economic downturn could have a material adverse effect on our earnings. Our business is highly labour intensive, with labour costs representing approximately 73% of our consolidated operating costs. As a result of resident and regulatory requirements, we have limited ability to reduce or manage our labour costs. In addition, any escalation of regulatory pressure by the CMS, state and provincial level government agencies could have a negative impact on our costs and thereby reduce our earnings.

A number of states in which we operate have faced severe budgetary shortfalls since 2009, resulting in reductions in Medicaid funding or increases at rates below inflation. The temporary increase in funding for state Medicaid programs, through the federal medical assistance percentage, or FMAP funding increase, ended on June 30, 2011. As a result, a number of states are facing considerable financial pressures that could result in future Medicaid rate reductions, despite some economic improvement in certain regions.

In October 2011, CMS reduced Medicare Part A rates to skilled nursing centers by approximately 11.1% and implemented further changes in the assessment process and the elimination for payment of group therapy. As a result, our average Medicare Part A and Managed Care rates declined by 11.0% and 7.0%, respectively, from the 2011 third quarter levels, thereby reducing revenue and earnings in the 2011 fourth quarter. To mitigate as much of this adverse impact as possible, we completed a thorough review of our operations and implemented a plan to drive efficiencies and reduce costs wherever possible. None of the cost saving measures involved a reduction of direct care staffing at our centers.

In response to the economic downturn, the Ontario government implemented a wage freeze for labour contracts being renewed over the next two years beginning in 2010, and indicated its expectation that this wage freeze should be extended to the government-funded private sector, including the long-term care sector, by announcing that it would not provide funding for any wage increases. ECI has complied with these expectations. However, arbitrators have awarded increased union wages in the long-term care sector affecting ECI, despite this mandate.

DECLINE IN SHORT-TERM ADMISSIONS IN THE U.S.

In the U.S., Medicare and Managed Care funded residents are the source of the majority of our admissions. In respect of Medicare admissions, the global economic downturn that began in 2008 and the continuing slow recovery has reduced disposable income of individuals, reduced employment and resulted in a general restraint by the public on health care spending. As a result, the number of individuals seeking elective surgery and hence the need for post-acute care has declined. We believe the decline we experienced since the 2008 fourth quarter in Medicare admissions was in part due to individuals deferring elective surgery due to the economy and the resulting reduction in required post-acute care. Our future earnings could be eroded further should the level of admissions decrease as a result of lower incomes and lower financial resources of our prospective residents.

Another reason for the decline in census has been the concerted effort by state Medicaid programs to shift potential residents to home care programs and assisted living centers along with Managed Care programs constraining the period of coverage in skilled nursing centers in order to reduce costs to the Medicaid program.

In response, we have refocused and refined our strategic marketing plans, are working on strategic alliances within the marketplaces in which we operate, and have invested to improve the number of rehabilitation suites within our portfolio to increase our market share in communities where we anticipate a return on the investment that meets our criteria.

Normal Course Issuer Bid

In January 2011, the REIT received approval from the TSX for the 2011 Bid *(note 13)*. There were no purchases for cancellation made and the 2011 Bid was expired on January 10, 2012.

Capital Structure

The REIT defines its capital structure to include long-term debt, net of cash and cash equivalents, and unit capital.

	December 31, 2011	December 31, 2010	January 1, 2010
Current portion of long-term debt [(1)]	**192,698**	571,168	30,126
Long-term debt [(1)]	**941,742**	670,028	1,219,330
Total debt	**1,134,440**	1,241,196	1,249,456
Less: Cash and cash equivalents	**(80,018)**	(267,759)	(134,012)
Net debt	**1,054,422**	973,437	1,115,444
Unit capital	**453,150**	421,213	332,069
	1,507,572	1,394,650	1,447,513

(1) Net of financing costs.

Distributions

In accordance with the REIT's Deed of Trust, distributions to unitholders are declared at the discretion of the REIT's Board of Trustees. The REIT's Deed of Trust provides that on December 31st of each year, unless otherwise determined by the Board of Trustees, without any further actions on the part of the Board of Trustees, the REIT will make payable to unitholders and unitholders will have an enforceable right to payment on such date of a distribution of sufficient net earnings and net realized capital gains for the taxation year ending on that date, net of any capital losses or non-capital losses recognized on or before the end of such year, such that the REIT will not be liable for ordinary Canadian income taxes for such year, net of tax refunds. The payment of such amounts, if any, will be made on or before the following January 30th. Notwithstanding the foregoing, under the SIFT Rules, the REIT will be liable for the SIFT tax in respect of certain income that is distributed to its unitholders. The REIT has no requirements pursuant to the Deed of Trust concerning Debt to Adjusted Gross Book Value or any other financial requirements.

REIT Unit Redemption Rights

REIT Units are redeemable at any time on demand by the holders. Upon receipt by the REIT of a notice to redeem REIT Units, all rights to and under the REIT Units tendered for redemption shall be surrendered and the holder shall be entitled to receive a price per REIT Unit in cash equal to the lesser of:

a) 95% of the "market price" of the REIT Units on the principal stock exchange or market on which the REIT Units are quoted for trading during the 10 consecutive trading days ending on the trading day immediately prior to the redemption date; and

b) 100% of the "closing market price" of the REIT Units on the principal stock exchange or market on which the REIT Units are quoted for trading on the redemption date.

The aggregate cash redemption price payable by the REIT in respect of all REIT Units surrendered for redemption during any calendar month shall be satisfied by a cash payment no later than the last day of the month following the month in which the REIT Units were tendered for redemption, and shall not exceed $100,000, unless waived at the discretion of the Trustees. If the unitholder is not entitled to receive their redemption price in cash upon redemption as a result of the foregoing and other limitations, then each REIT Unit tendered for redemption will be redeemed by way of a distribution *in specie* of securities held by the REIT, subject to any applicable regulatory approvals.

Financial Covenants

EHSI is subject to external financial covenant requirements pursuant to the CMBS financings, PrivateBank Loans and the EHSI Credit Facility on the level of debt to earnings and cash flow of its operations; and ECI is also subject to external financial covenant requirements for its construction loans on the level of debt to cash flow of its operations *(note 11)*. Management and the Board of Trustees monitor these covenant ratios on a monthly and quarterly basis, respectively. The REIT is in compliance with all these covenants as of December 31, 2011.

25. Related Party Transactions

(a) Transactions with Key Management Personnel

In 2008, Tim Lukenda, the former President of Tendercare, was appointed President and Chief Executive Officer of Extendicare REIT. Prior to its acquisition by EHSI, Mr. Lukenda owned an approximate 4.6% direct and indirect interest in Tendercare and received, directly or indirectly, on completion of the acquisition of Tendercare an equivalent percentage of the consideration paid by EHSI. In October 2007, EHSI completed the $225.0 million acquisition (US$238.2 million) of Tendercare, which was comprised of 29 skilled nursing centers and one inpatient rehabilitation hospital in Michigan, for a total of 3,301 operational beds. As part of Mr. Lukenda's terms of employment, the employment contract provides a mechanism and process that effectively removes Mr. Lukenda from the decision-making process in situations where a conflict of interest may arise on any matter between Extendicare REIT and his previous employer, or with respect to any financial interest that Mr. Lukenda or his family have with Extendicare REIT and its subsidiaries. As part of the acquisition of Tendercare, in addition to normal representative and warranty provisions, EHSI must agree on any adjustments to the final purchase price as described above, before making any payments to Mr. Lukenda or his family. EHSI and ECI also provide certain management services to two long-term care centers and operate, under lease arrangements, two other long-term care centers that are owned or partially owned by members of Mr. Lukenda's immediate family.

In connection with the purchase of Tendercare, the acquired working capital is subject to annual adjustments that will occur 90 days after the anniversary date of the Tendercare acquisition over a four-year period until January 2012. The first anniversary adjustment increased net working capital by US$1.7 million and was paid by EHSI in April 2009 with no impact on the consolidated net earnings. The second and third anniversary adjustments increased net working capital by US$0.2 million and US$0.3 million, respectively, for a total net liability of US$0.5 million as of December 31st of 2011 and 2010. EHSI anticipates resolution of the fourth anniversary adjustment in the second quarter of 2012. In March 2010, the former shareholders of Tendercare (the "Tendercare Sellers Committee") filed a notice of disagreement with respect to a working capital adjustment for accrued vacation pay of US$3.1 million sought by EHSI, stating that it was not a permitted adjustment. In April 2010, EHSI submitted a written response stating that its position is in accordance with the terms of the agreement. In February 2012, an independent accounting firm selected jointly by EHSI and the Tendercare Sellers Committee concluded in favour of the Tendercare Sellers Committee stating that Tendercare's former treatment of vacation pay was in accordance with the terms of the agreement. There was no material financial impact in respect of this arbitration decision in the 2011 financial statements.

In addition, in connection with the acquisition of LTC Professional in 2008, Tendercare's affiliated insurance company, consideration for the acquisition is to be adjusted annually based upon the actuarial liabilities determined at December 31st of each year through to 2012, with an annual option to extend to 2015. In March of 2011, 2010 and 2009, ECI made annual settlements of US$1.3 million, US$1.5 million and US$2.2 million, respectively.

(b) Compensation of Key Management Personnel

The remuneration of key management personnel and trustees of the REIT during the years ended December 31, 2011 and 2010 was as follows:

	2011	2010
Short-term benefits	**4,266**	4,112
Post employment benefits	**203**	216
Unit appreciation rights	**222**	330
	4,691	4,658

26. Segmented Information

The REIT has two reportable operating segments: United States operations and Canadian operations. These operations are managed independently of each other because of their geographic areas and regulatory environments. Each operation retains its own management team and is responsible for compiling its own financial information.

Through its subsidiaries, the REIT operates long-term care centers in the United States and Canada. Also offered in the United States are medical specialty services, such as post-acute care and rehabilitative therapy services, as well as health technology services, while home health care services are provided in Canada.

Intersegment adjustments in the following tables reflect the reversal of intercompany amounts that are eliminated prior to the preparation of the REIT's consolidated financial statements.

	United States	Canada	Eliminations	Total
Total Assets				
As at December 31, 2011	1,349,608	481,272	(176)	1,830,704
As at December 31, 2010	1,447,560	547,194	(120)	1,994,634
As at January 1, 2010	1,548,538	503,051	(66,703)	1,984,886
Total Liability				
As at December 31, 2011	1,098,640	683,921	(176)	1,782,385
As at December 31, 2010	1,165,225	716,535	(120)	1,881,640
As at January 1, 2010	1,222,907	758,834	(66,703)	1,915,038
Total Capital Expenditures				
Year ended December 31, 2011	31,973	32,530	–	64,503
Year ended December 31, 2010	34,296	35,657	–	69,953

	December 31, 2011			
	United States	Canada	Eliminations	Total
CONTINUING OPERATIONS				
Revenue				
Nursing and assisted living centers	1,355,289	525,831	–	1,881,120
Home health care	–	165,030	–	165,030
Health technology services	19,120	–	–	19,120
Outpatient therapy	13,750	–	–	13,750
Management, consulting and other services	7,571	7,491	–	15,062
Total revenue	1,395,730	698,352	–	2,094,082
Operating expenses	1,206,881	606,911	–	1,813,792
Administrative costs	47,941	21,214	–	69,155
Lease costs	6,546	4,453	–	10,999
Total expenses	1,261,368	632,578	–	1,893,946
Earnings before depreciation, amortization, loss from asset impairment, disposals and other items	134,362	65,774	–	200,136
Depreciation and amortization	58,242	18,335	–	76,577
Loss from asset impairment, disposals and other items	56,195	6,301	–	62,496
Results from operating activities	19,925	41,138	–	61,063
Interest expense	52,539	37,226	(131)	89,634
Accretion of decommissioning provisions	1,234	372	–	1,606
Other accretion	423	–	–	423
Distributions on Exchangeable LP Units	–	2,179	–	2,179
Fair value adjustments	–	–	–	–
Finance costs	54,196	39,777	(131)	93,842
Interest revenue	388	4,065	(131)	4,322
Fair value adjustments	–	6,023	–	6,023
Gains on foreign exchange and financial instruments	250	303	–	553
Finance income	638	10,391	(131)	10,898
Net finance costs	53,558	29,386	–	82,944
Earnings (loss) before income taxes	(33,633)	11,752	–	(21,881)
Income tax expense (recovery)				
Current	23,280	5,000	–	28,280
Deferred	(12,499)	(2,339)	–	(14,838)
Total income tax expense	10,781	2,661	–	13,442
Earnings (loss) from continuing operations	(44,414)	9,091	–	(35,323)
DISCONTINUED OPERATIONS				
Earnings from discontinued operations, net of income taxes	4,927	–	–	4,927
Net earnings (loss)	(39,487)	9,091	–	(30,396)

	United States	Canada	Eliminations	Total
				December 31, 2010
CONTINUING OPERATIONS				
Revenue				
Nursing and assisted living centers	1,397,452	495,610	–	1,893,062
Home health care	–	157,177	–	157,177
Health technology services	17,205	–	–	17,205
Outpatient therapy	12,603	–	–	12,603
Management, consulting and other services	7,245	10,124	–	17,369
Total revenue	1,434,505	662,911	–	2,097,416
Operating expenses	1,201,006	570,162	–	1,771,168
Administrative costs	51,408	21,222	–	72,630
Lease costs	7,204	4,344	–	11,548
Total expenses	1,259,618	595,728	–	1,855,346
Earnings before depreciation, amortization, loss (gain) from asset impairment, disposals and other items	174,887	67,183	–	242,070
Depreciation and amortization	58,446	15,323	–	73,769
Loss (gain) from asset impairment, disposals and other items	2,972	(24)	–	2,948
Results from operating activities	113,469	51,884	–	165,353
Interest expense	54,177	36,724	(1,934)	88,967
Accretion of decommissioning provisions	1,236	378	–	1,614
Other accretion	514	–	–	514
Distributions on Exchangeable LP Units	–	2,702	–	2,702
Fair value adjustments	–	4,649	–	4,649
Finance costs	55,927	44,453	(1,934)	98,446
Interest revenue	2,441	3,737	(1,934)	4,244
Fair value adjustments	–	–	–	–
Gains on foreign exchange and financial instruments	892	2,388	–	3,280
Finance income	3,333	6,125	(1,934)	7,524
Net finance costs	52,594	38,328	–	90,922
Earnings before income taxes	60,875	13,556	–	74,431
Income tax expense (recovery)				
Current	25,898	8,422	–	34,320
Deferred	4,102	(895)	–	3,207
Total income tax expense	30,000	7,527	–	37,527
Earnings from continuing operations	30,875	6,029	–	36,904
DISCONTINUED OPERATIONS				
Earnings from discontinued operations, net of income taxes	4,925	–	–	4,925
Net earnings	35,800	6,029	–	41,829

27. Explanation of Transition to IFRS

These are the REIT's first consolidated financial statements prepared in accordance with IFRS 1. The accounting policies set out in *note 3* have been applied in preparing the financial statements for the period ended December 31, 2011, the comparative period ended December 31, 2010 and in the preparation of the opening IFRS statement of financial position at the Transition Date.

IFRS 1 requires first-time adopters to retrospectively apply all effective IFRSs for all periods presented. However, it also provides for certain optional exemptions and certain mandatory exceptions for first-time IFRS adopters. Below are the applicable IFRS 1 exemptions and exceptions applied in the conversion from previous Canadian GAAP to IFRS.

IFRS 1 Elective Exemptions

i. Fair value as deemed costs

An IFRS 1 exemption is available to revalue selective land and buildings at fair value upon transition, and use that fair value as its deemed cost at that date. The exemption is applied on an asset-by-asset basis. We elected to apply the exemption to selected nursing centers upon transition.

ii. Employee benefits

An IFRS 1 exemption is available to reset the cumulative actuarial gain and loss balance to zero upon transition. We elected to apply this exemption on the Transition Date. Furthermore, we have elected to disclose the present value of the defined benefit obligation, fair value of the plan assets, surplus or deficit in the plans, and the experience adjustments arising on the plan assets or liabilities, for each accounting period prospectively from the Transition Date.

iii. Cumulative translation differences

An IFRS 1 exemption is available to reset the cumulative translation adjustment (CTA) balance to zero on the Transition Date. Without the exemption, IFRS requires the retrospective restatement of CTA in accordance with IAS 21 "The Effect of Changes in Foreign Exchange Rates". We elected to apply the exemption to reset the CTA balance to zero on transition.

iv. Borrowing costs

Borrowing costs are required to be capitalized to the cost of qualifying assets based on specific guidance. There was no specific guidance under previous Canadian GAAP; however, we capitalized borrowing costs using a consistent formula. An IFRS 1 exemption is available which provides relief to a first-time adopter from applying the standard, IAS 23 "Borrowing Costs", retrospectively. We elected to apply the IFRS 1 exemption; therefore, borrowing costs are only capitalized based on specific guidance post IFRS transition.

v. Business combinations

An IFRS 1 exemption is available whereby previously completed business combinations (prior to the Transition Date) are not required to be retrospectively restated in accordance with IFRS 3 "Business Combinations", subject to some exceptions. We elected to apply this exemption and have not restated any of our past business combinations prior to the Transition Date. In addition, and as a condition under IFRS 1 for applying this exemption, goodwill relating to business combinations that occurred prior to the Transition Date is required to be tested for impairment.

vi. Decommissioning liabilities included in the cost of property, plant and equipment

IFRS provides specific guidance under IFRIC 1 "Changes in Existing Decommissioning, Restoration and Similar Liabilities" to account for changes related to decommissioning provisions. Criteria under previous Canadian GAAP are different. An IFRS 1 exemption is available which provides a simplified method for recalculating decommissioning provisions on the Transition Date. We elected to apply this exemption to measure our decommissioning provision as at the Transition Date in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets".

IFRS Mandatory Exemption

Estimates

IFRS requires estimates made for the same date in accordance with previous GAAP to be consistent with those under IFRS. Hindsight cannot be used to create or revise estimates upon transition. The estimates made by the REIT under previous Canadian GAAP were not revised for the application of IFRS except where necessary to reflect revised accounting policies.

Reconciliations of Previous Canadian GAAP to IFRS

In preparing its opening IFRS statement of financial position, the REIT has adjusted amounts reported in its financial statements prepared in accordance with previous Canadian GAAP. An explanation of how the transition from previous Canadian GAAP to IFRS has affected the REIT's financial position, financial performance and cash flows is detailed in the following tables with accompanying notes.

The following is a reconciliation of the REIT's total equity reported in accordance with previous Canadian GAAP to its total equity in accordance with IFRS as at January 1, 2010.

						January 1, 2010
	Notes	Previous Canadian GAAP	IFRS reclass	IFRS adjustments	Effect of transition to IFRS	IFRS
Assets						
Current assets						
Cash and short-term investments		134,012	–	–	–	134,012
Restricted cash		22,361	–	–	–	22,361
Accounts receivable		213,477	–	–	–	213,477
Income taxes recoverable		29,314	–	–	–	29,314
Deferred tax assets	*(e)*	24,900	(24,900)	–	(24,900)	–
Other current assets	*(f)*	22,187	33,936	–	33,936	56,123
Total current assets		446,251	9,036	–	9,036	455,287
Non-current assets						
Property and equipment	*(i)*	863,430	–	380,440	380,440	1,243,870
Goodwill and other intangible assets	*(l)*	191,514	–	(75,834)	(75,834)	115,680
Other assets	*(f), (i)*	166,870	(33,936)	715	(33,221)	133,649
Deferred tax assets	*(e)*	11,500	24,900	–	24,900	36,400
Total non-current assets		1,233,314	(9,036)	305,321	296,285	1,529,599
Total Assets		1,679,565	–	305,321	305,321	1,984,886
Liabilities and Equity						
Current liabilities						
Accounts payable and accrued liabilities	*(h)*	283,632	146	–	146	283,778
Long-term debt	*(j)*	28,538	–	1,588	1,588	30,126
Provisions		11,321	–	–	–	11,321
Total current liabilities		323,491	146	1,588	1,734	325,225
Non-current liabilities						
Long-term debt	*(j)*	1,205,494	–	13,836	13,836	1,219,330
Provisions	*(d), (n)*	32,562	30,417	(1,236)	29,181	61,743
Other long-term liabilities	*(d), (h), (k)*	67,555	(26,045)	31,320	5,275	72,830
Deferred tax liabilities	*(h), (i), (j), (o)*	91,366	(1,205)	145,749	144,544	235,910
Total non-current liabilities		1,396,977	3,167	189,669	192,836	1,589,813
Total liabilities		1,720,468	3,313	191,257	194,570	1,915,038
Unit capital	*(j), (k)*	355,469	–	(23,400)	(23,400)	332,069
Contributed surplus		81	–	–	–	81
Retained earnings –						
IFRS transitional adjustment	*(g), (h), (i), (j), (k), (l), (o), (n)*	–	(4,192)	137,464	133,272	133,272
Accumulated deficit		(395,429)	–	–	–	(395,429)
Accumulated other comprehensive loss	*(g)*	(1,024)	879	–	879	(145)
Unitholders' equity (deficiency)		(40,903)	(3,313)	114,064	110,751	69,848
Total Liabilities and Equity		1,679,565	–	305,321	305,321	1,984,886

The following is a reconciliation of the REIT's total equity reported in accordance with previous Canadian GAAP to its total equity in accordance with IFRS as at December 31, 2010.

		December 31, 2010				
	Notes	Previous Canadian GAAP	IFRS reclass	IFRS adjustments	Effect of transition to IFRS	IFRS
Assets						
Current assets						
Cash and short-term investments		267,759	–	–	–	267,759
Restricted cash		10,095	–	–	–	10,095
Accounts receivable		212,610	–	–	–	212,610
Income taxes recoverable		3,182	–	–	–	3,182
Deferred tax assets	*(e)*	19,190	(19,190)	–	(19,190)	–
Other current assets	*(f)*	19,843	3,827	–	3,827	23,670
Total current assets		532,679	(15,363)	–	(15,363)	517,316
Non-current assets						
Property and equipment	*(i)*	853,760	(38)	352,934	352,896	1,206,656
Goodwill and other intangible assets	*(l)*	182,024	12	(71,764)	(71,752)	110,272
Other assets	*(f), (i)*	129,547	(3,801)	454	(3,347)	126,200
Deferred tax assets	*(e)*	15,000	19,190	–	19,190	34,190
Total non-current assets		1,180,331	15,363	281,624	296,987	1,477,318
Total Assets		1,713,010	–	281,624	281,624	1,994,634
Liabilities and Equity						
Current liabilities						
Accounts payable and accrued liabilities	*(h)*	266,133	147	–	147	266,280
Long-term debt	*(j)*	569,558	–	1,610	1,610	571,168
Provisions		16,013	–	–	–	16,013
Exchangeable LP units	*(k)*	–	–	29,264	29,264	29,264
Total current liabilities		851,704	147	30,874	31,021	882,725
Non-current liabilities						
Long-term debt	*(j)*	653,122	–	16,906	16,906	670,028
Provisions	*(d), (n)*	31,382	29,849	(848)	29,001	60,383
Other long-term liabilities	*(d), (h), (m)*	66,633	(22,727)	249	(22,478)	44,155
Deferred tax liabilities	*(h), (i), (j), (o)*	91,482	(1,939)	134,806	132,867	224,349
Total non-current liabilities		842,619	5,183	151,113	156,296	998,915
Total liabilities		1,694,323	5,330	181,987	187,317	1,881,640
Unit capital	*(j), (k)*	444,136	–	(22,923)	(22,923)	421,213
Contributed surplus		81	–	–	–	81
Retained earnings –						
IFRS transitional adjustment	*(g), (h), (i), (j), (k), (l), (o), (n)*	–	(4,192)	137,464	133,272	133,272
Accumulated deficit	*(h), (i), (j), (k), (m), (n), (o)*	(413,641)	180	(7,336)	(7,156)	(420,797)
Accumulated other comprehensive loss	*(g), (h), (i), (l), (m), (n)*	(11,889)	(1,318)	(7,568)	(8,886)	(20,775)
Unitholders' equity		18,687	(5,330)	99,637	94,307	112,994
Total Liabilities and Equity		1,713,010	–	281,624	281,624	1,994,634

The following is a reconciliation of the REIT's total comprehensive income reported in accordance with the previous Canadian GAAP to its total comprehensive income in accordance with IFRS for the year ended December 31, 2010.

		Twelve months ended December 31, 2010				
	Notes	Previous Canadian GAAP	IFRS reclass	IFRS adjustments	Effect of transition to IFRS	IFRS
CONTINUING OPERATIONS						
Total revenue	*(a)*	2,056,557	40,859	–	40,859	2,097,416
Operating expenses	*(a), (n)*	1,732,518	38,830	(180)	38,650	1,771,168
Administrative costs	*(h), (m)*	72,624	(246)	252	6	72,630
Lease costs	*(a)*	10,964	584	–	584	11,548
Total expenses		1,816,106	39,168	72	39,240	1,855,346
Earnings before depreciation, amortization, loss from asset impairment, disposals and other items		240,451	1,691	(72)	1,619	242,070
Depreciation and amortization	*(a), (i)*	63,873	–	9,896	9,896	73,769
Loss from asset impairment, disposals and other items	*(b), (l)*	–	4,248	(1,300)	2,948	2,948
Results from operating activities		176,578	(2,557)	(8,668)	(11,225)	165,353
Interest expense	*(j)*	92,102	–	(3,135)	(3,135)	88,967
Accretion of decommissioning provision	*(a), (c)*	1,572	42	–	42	1,614
Other accretion	*(n)*	–	–	514	514	514
Loss from asset impairment, disposals and other items	*(a), (b)*	1,154	(1,154)	–	(1,154)	–
Distributions on Exchangeable LP Units	*(k)*	–	–	2,702	2,702	2,702
Fair value adjustments	*(j), (k)*	–	–	4,649	4,649	4,649
Finance costs		94,828	(1,112)	4,730	3,618	98,446
Interest revenue	*(a)*	4,235	9	–	9	4,244
Gains on foreign exchange and financial instruments	*(c)*	3,280	–	–	–	3,280
Finance income		7,515	9	–	9	7,524
Net finance costs		87,313	(1,121)	4,730	3,609	90,922
Earnings before income taxes		89,265	(1,436)	(13,398)	(14,834)	74,431
Income tax expense						
Current	*(a)*	28,624	5,696	–	5,696	34,320
Deferred	*(a), (h), (i), (j), (o)*	12,756	(6,189)	(3,360)	(9,549)	3,207
Total income tax expense		41,380	(493)	(3,360)	(3,853)	37,527
Earnings from continuing operations		47,885	(943)	(10,038)	(10,981)	36,904
DISCONTINUED OPERATIONS						
Earnings from discontinued operations, net of income taxes	*(a)*	3,802	1,123	–	1,123	4,925
Net earnings		51,687	180	(10,038)	(9,858)	41,829
Other comprehensive loss, net of income taxes						
Unrealized gain on available-for-sale securities		1,062	–	–	–	1,062
Reclassification of realized gain on available-for-sale securities to earnings		(488)	–	–	–	(488)
Defined benefit plan actuarial loss, net of tax	*(h)*	–	(2,197)	–	(2,197)	(2,197)
Net change in foreign currency translation adjustment	*(i), (l), (m), (n)*	(11,439)	–	(7,568)	(7,568)	(19,007)
Other comprehensive loss, net of tax		(10,865)	(2,197)	(7,568)	(9,765)	(20,630)
Total comprehensive income		40,822	(2,017)	(17,606)	(19,623)	21,199

Material adjustments to the statement of cash flows for 2010:

As a result of the transition to IFRS, certain items on the statement of cash flows have been impacted as follows:

- distributions to Exchangeable LP unitholders previously recognized in financing activities as “distributions paid” are now recognized as part of “net finance costs” on the statement of earnings which are included in operating activities;
- interest paid and income taxes paid have been moved into the body of the statement of cash flows, whereas they were previously disclosed as supplementary information; and
- borrowing costs capitalized in relation to qualifying assets are presented as interest paid in operating activities.

There are no other material differences between the statement of cash flows presented under IFRS and the statement of cash flows presented under the previous Canadian GAAP.

Notes to the reconciliations of previous Canadian GAAP to IFRS

IFRS RECLASSIFICATIONS

(a) Discontinued Operations

Requirements under IFRS:

The definition of discontinued operations under IFRS is narrower compared to that under the previous Canadian GAAP. We defined discontinued operations to be at the individual nursing center level under previous Canadian GAAP. Under IFRS, discontinued operations are limited to a component of the entity that has been disposed of, or is classified as held for sale, and represents a separate major line of business or geographical area of operations. Consequently, results presented as discontinued operations during 2010 were reclassified as continuing operations. The discontinued operations currently presented for 2010 were identified in 2011 under the IFRS criteria.

(b) Loss from Asset Impairment, Disposals and Other Items

Requirements under IFRS:

Under previous Canadian GAAP, items that were not expected to occur regularly during normal operations were separately disclosed outside of operations. These include asset impairment, disposals and other items of a similar nature. Under IFRS, impairment of non-financial assets and other similar items are considered to be part of operating activities.

(c) Net Finance Costs

Requirements under IFRS:

Under previous Canadian GAAP, the accretion of the decommissioning provision (“accretion of asset retirement obligations” under previous Canadian GAAP), interest revenue and expense, as well as the “loss (gain) on foreign exchange and financial instruments” were separately disclosed on the statement of earnings. Under IFRS, all of these items are considered to be part of net finance costs. Also included in net finance costs are distributions on Exchangeable LP Units and fair value adjustments; neither of these items existed under previous Canadian GAAP.

(d) Provisions

Requirements under IFRS:

IFRS requires separate disclosure of provisions on the face of the statement of financial position. This was not required under previous Canadian GAAP; therefore, all provisions were reclassified from other long-term liabilities upon transition. These provisions include the accrual for self-insured liabilities, decommissioning provision and the liabilities assumed from Crown Life.

(e) Deferred Income Tax Assets

Requirements under IFRS:

IFRS does not consider deferred income tax assets as a current item. As a result, it was reclassified from current to non-current under IFRS.

(f) Assets Held for Sale

Requirements under IFRS:

IFRS does not consider “assets held for sale” as a non-current item. As a result, it was reclassified from non-current to current under IFRS.

(g) Cumulative Translation Adjustment

Upon transition:

As stated under the "IFRS 1 Elective Exemptions" section, we elected to apply the exemption to deem all CTA that arose prior to the Transition Date in respect of all foreign operations to be nil upon transition.

Reconciliation:

The impact arising from the change is summarized as follows:

	December 31, 2010	January 1, 2010
Consolidated statement of financial position		
Increase in AOCI:		
CTA as of January 1, 2010	879	879
Decrease in retained earnings	879	879

(h) Employee Benefits

Upon transition:

As stated under the "IFRS 1 Elective Exemptions" section, we elected to recognize all cumulative actuarial gains and losses that existed at the Transition Date in retained earnings.

Policy choice under IFRS:

Under previous Canadian GAAP, actuarial gains and losses that arose in calculating the present value of the defined benefit obligation and the fair value of plan assets are recognized on a systematic and consistent basis, subject to a minimum required amortization based on a "corridor" approach. The "corridor" was 10% of the greater of the accrued benefit obligation at the beginning of the year and the fair value of plan assets at the beginning of the year. This excess of 10% was amortized as a component of pension expense on a straight-line basis over the expected average service life of active participants. Actuarial gains and losses below the 10% corridor were deferred.

Under IFRS, actuarial experience gains or losses can be either recognized immediately in OCI or recognized in net earnings using either the corridor method or an alternative method that would result in accelerated recognition. We elected to recognize all actuarial experience gains or losses in OCI at the end of each period.

As a result, pension expense has been adjusted to remove the amortization of actuarial gains and losses, and the pension obligation as well as OCI have also been revised accordingly.

Requirements under IFRS:

Under previous Canadian GAAP, the measurement date of the defined benefit obligation and plan assets can be a date up to three months prior to the date of the financial statements, provided the entity adopted this practice consistently from year to year. We measured our accrued benefit obligations and the fair value of plan assets for accounting purposes at September 30th of each year. Actuarial valuations of the defined benefit pension plan were completed every three years.

IFRS requires that the present value of the defined benefit obligation and the fair value of plan assets be measured with sufficient regularity such that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date. As a result, we remeasured our defined benefit obligations and plan assets as at January 1, 2010, and the measurement date has been changed to December 31st of each year. Consequently, the unamortized actuarial gains and losses recognized in net earnings under previous Canadian GAAP were reversed, and all actuarial gains and losses arising in periods subsequent to the Transition Date were recognized in OCI. Actuarial valuations of the defined benefit pension plan will continue to be completed every three years, with the next one to be conducted effective October 1, 2012.

Reconciliation:

The impact arising from the change is summarized as follows:

	Twelve months ended December 31, 2010
Consolidated statement of earnings (loss)	
Decrease in administrative costs:	
Pension expense	246
Increase in income before tax	246

	December 31, 2010	January 1, 2010
Consolidated statement of financial position		
Increase in liabilities:		
Pension obligations – current	147	146
Pension obligations – non-current	7,122	4,372
Decrease in AOCI:		
Actuarial losses	(2,197)	–
Related tax effect	(1,939)	(1,205)
Decrease in retained earnings	3,133	3,313

IFRS ADJUSTMENTS

(i) Property and Equipment

Upon transition:

As stated under the "IFRS 1 Elective Exemptions" section, we elected to apply the exemption to revalue the land and building of selected nursing centers at fair value upon transition.

As of the Transition date, the REIT determined the individual fair value for each of its centers. Based upon this detailed review, certain centers were restated to reflect their fair value as of the Transition date. All nursing centers were considered for revaluation, with the exception of nursing centers where we expect their economic life to be limited or centers where we do not expect significant improvements in future cash flows. Our revaluation analysis was conducted internally using valuation methodologies commonly applied in the North American long-term care industry. A capitalized cash flow approach using current market assumptions for capitalization rates was used to determine the total real estate and business value of each nursing center. We then applied a lease coverage ratio to remove the value associated with business operations and goodwill in order to determine the fair value of the real estate component of each nursing center. In conjunction with the revaluation, IFRS requires that an impairment test be performed at the CGU level upon transition; as a result, certain assets were impaired (see further details under "impairment" under *note 27(l)* below). The carrying value of property and equipment net of impairment was increased by $380 million as at the Transition Date; consequently, more depreciation was recorded subsequent to the Transition Date based on the higher net deemed costs of the assets.

Below is a summary of the assumptions on capitalization rates and lease coverage ratios used in the determination of fair value:

	Canada	United States
Capitalization rates:		
Skilled nursing centers	9%	13%
Assisted living	n/a	9%
Lease coverage:		
Skilled nursing centers	1.6	1.6
Assisted living	n/a	1.4

For the Ontario "C" beds and certain other centers in Canada, an 11.5% discount rate was used for impairment testing purposes.

Policy choice under IFRS:

Measurement of the assets subsequent to the Transition Date can be based on either the revaluation model (i.e. fair value model) or the cost model. We have elected to continue using the cost model, similar to the previous Canadian GAAP.

Reconciliation:

The impact arising from the change is summarized as follows:

	Twelve months ended December 31, 2010
Consolidated statement of earnings (loss)	
Increase in depreciation expense	9,896
Decrease in loss from asset impairment, disposals and other items	(1,300)
Decrease in income before tax	8,596

	December 31, 2010	January 1, 2010
Consolidated statement of financial position		
Increase in property and equipment	352,934	380,440
Increase in other assets	454	715
Increase in AOCI – translation adjustment	11,587	–
Related tax effect	(137,337)	(148,306)
Increase in retained earnings	227,638	232,849

(j) Convertible Debentures

Requirements under IFRS:

Under previous Canadian GAAP, our convertible debentures are bifurcated with the debt host contract presented as a liability and the single compound embedded derivative as equity on the consolidated statement of financial position. Under IFRS, both of these items are presented as a financial liability. As a result, the equity portion of debentures that was previously included in unit capital was reclassified to long-term debt.

Policy choice under IFRS:

In terms of measurement and valuation, we have elected to designate the convertible debentures as a financial liability at FVTPL. Consequently, any unamortized financing costs of the convertible debentures as at the Transition Date were recognized in retained earnings, and the convertible debentures are remeasured at fair value at each reporting date.

Reconciliation:

The impact arising from the change is summarized as follows:

	Twelve months ended December 31, 2010
Consolidated statement of earnings (loss)	
Increase (decrease) in net finance costs:	
Accretion of equity portion of convertible debentures	(1,547)
Amortization of financing costs	(1,588)
Fair value adjustment	6,228
Decrease in income before tax	3,093

	December 31, 2010	January 1, 2010
Consolidated statement of financial position		
Increase in liability:		
Convertible debentures – current	1,610	1,588
Convertible debentures – non-current	16,906	13,836
Decrease in unit capital:		
Equity portion of convertible debentures	(9,964)	(9,964)
Related tax effect	(2,166)	(2,111)
Decrease in retained earnings	6,386	3,349

(k) Exchangeable LP Units

Requirements under IFRS:

Previous Canadian GAAP provided an exception which enabled us to present the Exchangeable LP Units as equity. Under IFRS, no such relief is extended. As a result, these units were reclassified from equity to liability. In addition, distributions paid to owners of the Exchangeable LP Units were reclassified as part of finance costs.

Policy choice under IFRS:

We have elected to designate the Exchangeable LP Units as a financial liability at FVTPL. Therefore, these units were remeasured at fair value at each reporting date.

Reconciliation:

The impact arising from the change is summarized as follows:

	Twelve months ended December 31, 2010
Consolidated statement of earnings (loss)	
Increase (decrease) in net finance costs:	
Distributions on Exchangeable LP Units	2,702
Fair value adjustment	(1,579)
Decrease in income before tax	1,123

	December 31, 2010	January 1, 2010
Consolidated statement of financial position		
Increase in liability	29,264	31,320
Decrease in unit capital	(12,959)	(13,436)
Decrease in retained earnings	16,305	17,884

(l) Impairment

Upon transition:

In accordance with IFRS, it is required to assess goodwill for impairment upon transition.

Requirements under IFRS:

Under previous Canadian GAAP, assets were tested for impairment using a two-step approach. The carrying value of the assets was first compared to the recoverable amount, defined to be the undiscounted cash flows on the assets; if this first test indicated impairment, impairment loss was then calculated to be the excess of carrying value over the discounted net future cash flows. We assessed goodwill for impairment at our segment level.

Under IFRS, impairment testing is to be performed at the CGU level, which we have identified to be the individual nursing centers. IFRS requires a one-step approach for identifying and measuring impairment, whereby goodwill and corporate assets are allocated to specific CGUs for the purpose of impairment testing. An impairment loss is calculated to be the excess of the carrying value over the recoverable amount, defined to be the greater of fair value less costs to sell and value in use, which is the discounted net future cash flows.

As a result of the lower impairment threshold and the difference in the definition of recoverable amount, we recorded impairment on goodwill (refer to *note 3(j)*).

Previously recorded impairment losses (except impairment losses related to goodwill) must be reversed under certain conditions.

Reconciliation:

The impact arising from the change is summarized as follows:

	December 31, 2010	January 1, 2010
Consolidated statement of financial position		
Decrease in goodwill	(71,764)	(75,834)
Increase in AOCI – translation adjustment	(4,070)	–
Decrease in retained earnings	(75,834)	(75,834)

(m) Unit Appreciation Rights

Requirements under IFRS:

Under previous Canadian GAAP, the liability relating to the UARs was determined by calculating the intrinsic value of each right, representing the amount over which the closing unit price exceeds the UAR's strike price, including the accrued distribution payable where closing price exceeds strike price at each reporting date, factoring the time elapsed over the vesting period.

Under IFRS, UARs are to be measured at fair value.

Reconciliation:

The impact arising from the change is summarized as follows:

	Twelve months ended December 31, 2010
Consolidated statement of earnings (loss)	
Increase in administrative costs:	
Unit appreciation rights	252
Decrease in income before tax	252

	December 31, 2010	January 1, 2010
Consolidated statement of financial position		
Increase in liability	249	–
Increase in AOCI – translation adjustment	3	–
Decrease in retained earnings	252	–

(n) Provisions

Requirements under IFRS:

Under IFRS, the amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation. The unwinding of the discounting is recorded as accretion included as part of finance costs. As a result, the accrual for self-insured liabilities included in provisions was discounted.

Reconciliation:

The impact arising from the change is summarized as follows:

	Twelve months ended December 31, 2010
Consolidated statement of earnings (loss)	
Decrease in operating expense:	
Expense on accrual for self-insured liabilities	(180)
Increase in net finance costs:	
Other accretion	514
Decrease in income before tax	334

	December 31, 2010	January 1, 2010
Consolidated statement of financial position		
Decrease in liability:		
Provisions – non-current	848	1,236
Decrease in equity:		
AOCI – translation adjustment	54	–
Increase in retained earnings	902	1,236

(o) Deferred Tax Liability

Requirements under IFRS:

Under previous Canadian GAAP, the deferred taxes of the legal entity of the REIT were set up at the rate at which we expect the deferred taxes to reverse, which is the SIFT tax rate.

Under IFRS, to the extent that earnings have not yet been distributed to unitholders, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits. In the case of the legal entity of the REIT, the tax rate applicable to undistributed profits is the highest marginal tax rate of 46.41%. The deferred taxes are then adjusted as distributions are declared.

Reconciliation:

The impact arising from the change is summarized as follows:

	Twelve months ended December 31, 2010
Consolidated statement of earnings (loss)	
Increase in tax expense:	
Deferred tax	81
Decrease in net earnings	81

	December 31, 2010	January 1, 2010
Consolidated statement of financial position		
Decrease in liabiltiy:		
Deferred tax liability	365	446
Increase in retained earnings	365	446

All of the above changes increased (decreased) deferred tax liability as follows:

	Notes	December 31, 2010	January 1, 2010
Reclass of actuarial gains or loss in employee benefits	*(h)*	(1,939)	(1,205)
Revaluation of property and equipment	*(i)*	137,337	148,306
Remeasurement of convertible debentures	*(j)*	(2,166)	(2,111)
Application of higher tax rate to undistributed earnings	*(o)*	(365)	(446)
Increase in deferred tax liability		132,867	144,544

(p) Retained Earnings

Reconciliation:

The above changes increased (decreased) retained earnings (each net of related tax) as follows:

	Notes	December 31, 2010	January 1, 2010
Reclassification of CTA	*(g)*	(879)	(879)
Reclassification of actuarial gains and losses	*(h)*	(3,133)	(3,313)
Revaluation of property and equipment	*(i)*	227,638	232,849
Reclassification of convertible debentures	*(j)*	(6,386)	(3,349)
Reclassification of Exchangeable LP Units	*(k)*	(16,305)	(17,884)
Impairment of goodwill	*(l)*	(75,834)	(75,834)
Remeasurement of UARs	*(m)*	(252)	–
Discounting of provisions	*(n)*	902	1,236
Application of higher tax rate on undistributed earnings	*(o)*	365	446
Increase in retained earnings		126,116	133,272

28. Significant Subsidiaries

The following is a list of the significant subsidiaries as of December 31, 2011, all of which are 100% directly or indirectly owned by the REIT.

	Jurisdiction of Incorportion
Extendicare (Canada) Inc.	Canada
Extendicare Health Services, Inc.	Delaware
Extendicare Health Facilities, Inc.	Wisconsin
Extendicare Homes, Inc.	Delaware
Extendicare Northwestern Ontario Inc.	Canada
Fir Lane Terrace Convalescent Center, Inc.	Washington
Indiana Health and Rehabilitation Centers Partnership	Delaware
Laurier Indemnity Company, Ltd.	Bermuda
New Orchard Lodge Limited	Canada
Northern Health Facilities, Inc.	Delaware
Tendercare (Michigan) Inc.	Michigan

Corporate Governance

Extendicare REIT's Board of Trustees and management team fully acknowledge the importance of their duty to serve the long-term interests of unitholders.

Extendicare REIT believes that good corporate governance is fundamental for the effective operation of the organization and for maintaining the confidence of investors and increasing unitholder value.

Our governance system is built on the values of trust, transparency and high standards of corporate ethics, and we are committed to the principles of disclosure and a strong, independent board. Our commitment to providing quality services, while building unitholder value, is the basis for a well-established and enduring organization.

Extendicare is dedicated to providing timely, accurate and complete disclosure of all material information to the public. Our Board of Trustees and Committee members operate under Charters that clearly define their roles and responsibilities, including: Stewardship, Independence, Effectiveness and Accountability.

Further information on the Trustees of Extendicare REIT and a description of Extendicare's governance practices may be found in Extendicare's Management Information and Proxy Circular as filed with SEDAR at www.sedar.com and on Extendicare's website at www.extendicare.com.

The Board of Trustees of Extendicare REIT

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A	Audit Committee
B	Buyback Commitee
HR/GN	Human Resources, Governance and Nominating Committee
QC	Quality and Compliance Committee

Officers and Executives

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Timothy L. Lukenda
President and Chief Executive Officer

Douglas J. Harris
Senior Vice President and
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Jillian E. Fountain
Secretary

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Chief Financial Officer and Treasurer

Jillian E. Fountain
Corporate Secretary

Stephen Biondi
Vice President, External Affairs

William Bryan
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Loren W. Claypool
Vice President and Chief Information Officer

Timothy Detary
Vice President, Human Resources

Dylan Mann
Vice President and Controller

David Keating
Vice President, Deputy General Counsel

LaRae L. Nelson
Vice President, Reimbursement

David C. Pearce
Vice President, General Counsel and
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Judith Taubenheim
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Jillian E. Fountain
Corporate Secretary

Deborah Bakti
Vice President, Human Resources

Elaine E. Everson
Vice President and Controller

Richard Luneburg
Vice President, Western Operations

Christina L. McKey
Vice President, Eastern Operations

Katharine O'Reilly
Vice President, Quality and
Performance Improvement

Sue Pearl-Agar
Vice President, ParaMed Home Health Care

Five-year Summary[1]

(unaudited) (thousands of dollars unless otherwise noted)	**2011**	2010	2009	2008	2007
Financial Position					
Property and equipment	**1,192,913**	1,206,656	863,430	970,612	837,965
Total assets	**1,830,704**	1,994,634	1,668,065	1,806,922	1,440,163
Long-term debt, including current portion	**1,134,440**	1,241,196	1,234,032	1,332,813	1,071,711
Unitholders' equity (deficiency)	**48,319**	112,994	(40,903)	(29,532)	(23,578)
Financial Results					
Revenue					
Nursing and assisted living centers					
United States	**1,355,289**	1,397,452	1,463,497	1,328,959	1,103,218
Canada	**525,831**	495,610	479,125	446,131	418,658
Home health care – Canada	**165,030**	157,177	155,096	148,928	141,797
Health technology services – United States	**19,120**	17,205	18,853	14,328	13,861
Outpatient therapy – United States	**13,750**	12,603	13,905	12,956	12,259
Management, consulting and other services	**15,062**	17,369	31,091	31,567	33,174
	2,094,082	2,097,416	2,161,567	1,982,869	1,722,967
EBITDA[2]	**200,136**	242,070	265,670	201,827	203,074
Earnings (loss) from continuing operations before separately reported items[2]	**6,986**	39,378	59,165	29,345	57,667
Net earnings (loss)	**(30,396)**	41,829	77,708	13,388	70,381
AFFO[2]	**69,847**	110,736	146,137	78,794	85,510
AFFO per basic unit *($)*	**0.84**	1.36	2.00	1.09	1.22
Distributions declared per unit *($)*	**0.84**	0.84	0.84	1.11	1.11
Distribution payout ratio *(% of AFFO)*	**100**	62	42	102	91
Average U.S./Canadian dollar exchange rate	**0.9891**	1.0299	1.1420	1.0660	1.0748
Other Information					
Number of centers *(year end)*					
United States	**179**	181	176	185	191
Canada	**82**	85	82	81	78
	261	266	258	266	269
Operational resident capacity *(year end)*					
United States	**17,369**	17,658	17,295	18,634	19,256
Canada	**10,738**	11,789	11,523	11,394	11,077
	28,107	29,447	28,818	30,028	30,333
U.S. nursing center average daily census by payor source *(%)*					
Medicare	**16.8**	16.4	16.2	17.2	18.1
Managed Care	**6.0**	5.7	5.7	5.2	4.3
Skilled Mix	**22.8**	22.1	21.9	22.4	22.4
Private/other	**9.9**	10.5	10.7	11.1	10.8
Medicaid	**67.3**	67.4	67.4	66.5	66.8
U.S. nursing center revenue by payor source *(%)*					
Medicare	**34.9**	33.3	32.9	33.7	35.1
Managed Care	**10.0**	9.5	9.6	8.6	6.8
Skilled Mix	**44.9**	42.8	42.5	42.3	41.9
Private/other	**8.5**	9.2	9.3	9.7	9.7
Medicaid	**46.6**	48.0	48.2	48.0	48.4
Average U.S. nursing centers occupancy *(%)*	**85.7**	86.0	87.9	88.4	90.3
Average Canadian centers occupancy *(%)*	**96.9**	98.0	98.1	98.0	98.2
ParaMed home health care hours of service	**4,634,000**	4,402,000	4,554,000	4,495,000	4,571,000
Number of employees *(year end)*	**38,100**	37,700	38,000	39,100	37,700
Number of units outstanding *(year end)*	**84,121,488**	82,995,181	73,180,024	73,572,418	70,044,036

(1) The selected information for 2011 and 2010 has been prepared in accordance with IFRS. The selected information presented for 2009 and prior years was prepared under previous Canadian GAAP and has not been restated for discontinued operations identified in 2011 under IFRS.

(2) Refer to discussion of non-GAAP measures on page 71.

Unitholder Information

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Transfer Agent

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Fax: (866) 249-7775
email: service@computershare.com

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Annual and Special Meeting

Unitholders are invited to attend the Annual and Special Meeting of Extendicare Real Estate Investment Trust on May 8, 2012 at 2:30 p.m. at the Toronto Board of Trade, First Canadian Place, Toronto, Ontario, Canada.

Voting Rights

Unitholders receive one vote for each Extendicare Real Estate Investment Trust unit (REIT Unit) held.

Exchange Listings/ Trading Profile

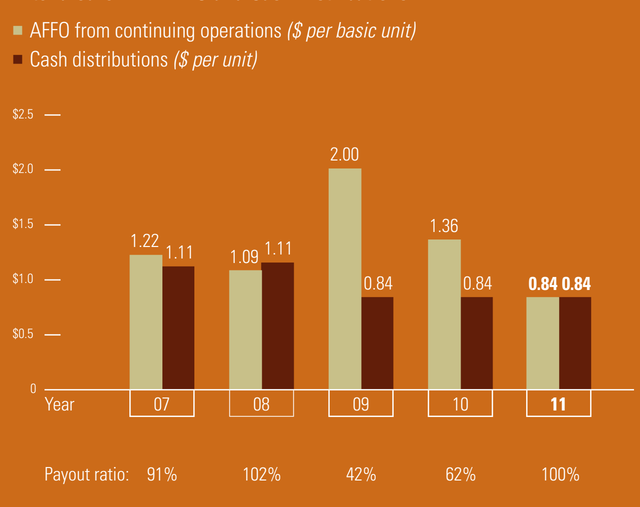
Toronto Stock Exchange symbols:
EXE.UN, EXE.DB and EXE.DB.A

2011 REIT Unit trading:
High: $13.35; Low: $6.18
Close: $8.50; Volume: 66,531,858

Published Information

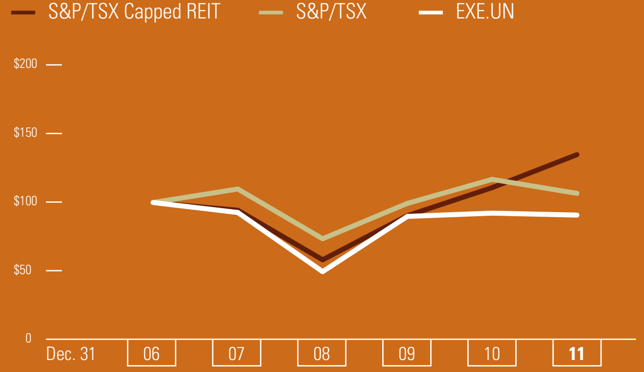
Extendicare Real Estate Investment Trust's 2011 Annual Report is available for viewing or printing on its website at www.extendicare.com, together with news releases, quarterly reports and other filings with the securities commissions. Printed copies of the annual report are available upon request to the Secretary.

Extendicare REIT AFFO and Cash Distributions(1)



(1) The AFFO for 2010 and 2011 have been prepared in accordance with IFRS. The AFFO for 2009 and prior years were prepared under previous Canadian GAAP.

Relative Unit Price Performance
(assuming a $100 investment is made at December 31, 2006)



EXTENDICARE

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