



UNITHOLDERS' QUARTERLY REPORT

Six Months Ended June 30, 2009



...helping people live better



Dear Unitholders,

Extencicare Real Estate Investment Trust ("Extencicare REIT" or the "REIT") had a solid second quarter of 2009. The following are the highlights of results reported on August 5, 2009.

- Revenue of \$563.1 million in Q2 2009, an increase of 15.2% (4.2% exclusive of the impact of foreign exchange) compared to Q2 2008.
- EBITDA of \$72.7 million in Q2 2009, an increase of 60.1% (42.8% exclusive of the impact of foreign exchange) compared to Q2 2008.
- EBITDA margins improved to 12.9% in Q2 2009 from 9.3% in Q2 2008.
- AFFO from continuing operations improved 90.1% to \$28.9 million (\$0.396 per basic unit) in Q2 2009 from Q2 2008. The stronger U.S. dollar contributed \$3.6 million (\$0.050 per basic unit) of the AFFO improvement.
- Distributions declared for the first half of 2009 of \$30.6 million represented 57.6% of AFFO from continuing operations of \$53.1 million for the same period.
- Cash on hand of \$94.6 million with no significant debt maturities until 2011 and beyond.
- As expected, CMS announced a reduction in Medicare Part A rates of 1.1% effective October 1, 2009.

The continuing improvement in our operating results during the second quarter demonstrates the success of our back-to-basics operating plan. Our strong EBITDA margins were largely the result of per diem rate enhancements, focused control on operating costs and efficiencies in our administrative processes. As a testament to the inherent strength of our business, we successfully amended and extended our line of credit during the quarter, despite a weak economy and challenging debt markets.

Development Projects

In July 2009 we completed our state-of-the-art 100-bed skilled nursing center in Okemos, Michigan, and will be welcoming our first residents in early August. Our pipeline includes a further five construction projects, with four underway. Our 100-bed skilled nursing centre and 60-unit assisted living center in Summit, Wisconsin, will be completed this November. The 280-bed continuing care center in Red Deer, Alberta, and 140-bed designated assisted living center in Lethbridge, Alberta, will be completed in the summer of 2010 and spring of 2011, respectively. Our 180-bed nursing center in Edmonton, Alberta, is scheduled to commence construction shortly for completion in the fall of 2011.

We have the requisite funding to complete the construction of all of these projects, as a result of the \$120 million financing completed in June 2008, along with approximately \$68 million in Canadian Mortgage and Housing Corporation (CMHC) secured financing on all of our Canadian projects.

EHSI Skilled Nursing Facility Revenue Rates and Census

The average daily Medicare Part A rate for our wholly owned U.S. subsidiary, Extencicare Health Services, Inc. (EHSI), grew 8.3% to US\$452.38 in the 2009 second quarter from the same 2008 period. The average revenue rate for Managed Care clients increased 8.0% to US\$386.22 this quarter from US\$357.74 in the 2008 second quarter, and increased 1.7% from the 2009 first quarter.

Our 2009 same-facility ADC of 14,884 for the first half of 2009 was 228 below the 2008 comparable level of 15,112, with a decline of 256 in Medicare ADC, partially offset by increases in Managed Care and Medicaid ADC. The overall decline in our census levels was evident in a majority of our states, validating our conclusion that the Skilled Mix decline is driven more by the impact of the economy and the deferral of

elective surgeries. We believe our Medicare census was affected by the recession as people chose to defer surgical procedures that would necessitate the type of post-acute care that we typically provide. As the economy recovers, we expect to benefit from the pent up demand for these types of procedures. Conversely, our Managed Care ADC improved from the first half of 2008 and sequentially this year as a result of our focus on the premium payor market segment and the number of Medicare beneficiaries opting out of traditional Medicare Part A benefits.

Medicare and Medicaid Funding Announcements

On July 31, 2009, the Centers for Medicare & Medicaid Services (CMS) issued its final rule for payments to Medicare skilled nursing centers, resulting in the expected net reduction in Medicare Part A rates of 1.1% effective October 1, 2009. As previously announced, CMS plans to implement a recalibration adjustment that would reduce rates by 3.3%, to be partially offset by a market basket increase of 2.2%. Our preliminary estimates indicate that this net rate reduction of 1.1% would reduce our Medicare revenue by approximately US\$4.5 million per annum.

With respect to Medicaid funding, we expect to gain certainty by the end of the third quarter of 2009 on those reimbursement rates that are effective as of July 1, 2009. With the decline in federal and state tax revenue as a result of the recession, state Medicaid budgets are under considerable strain. Our respective state health care associations are lobbying vigorously for continuation of consistent funding in the sector. We anticipate that there may be reductions in three of the states in which we operate, whereas the majority of the other states will retain funding at least at the current levels. While not yet finalized, based on current information, we estimate this could result in a net reduction of US\$9.0 million per annum, or 1.4%, in our Medicaid revenue, net of provider tax changes, which will impact us beginning in the 2009 fourth quarter.

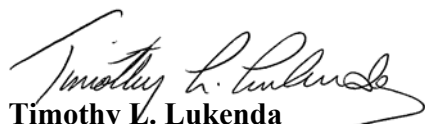
Outlook

While our results from the second quarter of 2009 are indicative of our progress and that we're headed in the right direction, we do anticipate challenges related to government funding. Namely, the impact of near term reimbursement constraints at both the state and federal level.

We are disappointed that cuts of this kind would be introduced to correct a so called "forecasting error" made by the government. This reduction in funding will undoubtedly weaken the long-term care workforce in the midst of a recession and threaten the improvements in care that have been achieved by the profession. Going forward, we will continue to monitor the impact of proposed reimbursement methodology changes for October 1, 2010 and the potential longer term impact of the health care reform initiatives in the U.S. We will continue with our efforts to impact the outcome of the health care reform. In the meantime, we will take the steps required to adapt to changes that lie ahead.

Over the long term, we believe that our sound business model and financial strength provide us with a solid foundation for sustainable growth. We are pleased with our demonstrated improvement in operational performance over the last 12 months. We are confident that we have the people and plans in place to respond to the challenges and opportunities that we may encounter.

Thank you for your continued support.



Timothy L. Lukenda
President and Chief Executive Officer

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Forward-looking Statements

Information provided by Extencicare REIT from time to time, including this Interim 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 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 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; changes in the health care industry in general and the long-term care industry in particular because of political and economic influences; 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; the ability to attract and retain qualified personnel; and the availability and terms of capital to fund capital expenditures.

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

Management's Discussion and Analysis

August 5, 2009

BASIS OF PRESENTATION

This Management's Discussion and Analysis (MD&A) is that of Extencicare Real Estate Investment Trust and its subsidiaries. References to "Extencicare REIT", the "REIT", "we", "us" and "our" in this report mean Extencicare Real Estate Investment Trust alone or together with its subsidiaries, as the context requires. The direct ownership and operation of the senior care centers and ancillary businesses is conducted by the subsidiaries of the REIT. The REIT itself is not a provider of services or products.

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

This MD&A should be read in conjunction with Extencicare REIT's unaudited interim consolidated financial statements for the three and six months ended June 30, 2009, and the notes thereto, together with the MD&A and the audited consolidated financial statements and accompanying notes for the year ended December 31, 2008, found in the REIT's 2008 Annual Report. This discussion 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. Extencicare REIT's accounting policies are in accordance with Canadian generally accepted accounting principles (GAAP) of The Canadian Institute of Chartered Accountants (CICA). All dollar amounts are in Canadian dollars unless otherwise indicated. Except as otherwise specified, references to years indicate the fiscal year ended December 31, 2008, or December 31 of the year referenced.

Certain comparative figures have been reclassified to conform to the presentation in 2009, mainly for discontinued operations identified in 2009.

A discussion of the non-GAAP measures is provided under the heading "Accounting Policies and Estimates – Non-GAAP Measures".

OVERVIEW

Business Overview

Extencicare REIT, through its wholly owned subsidiary operating entities, is a major provider of long-term and short-term senior care services through its network of owned and operated health care centers in North America, operating 264 senior care centers with capacity for 29,473 residents at June 30, 2009.

The REIT's wholly owned U.S. subsidiary, Extencicare Health Services, Inc. and its subsidiaries (collectively "EHSI"), operates 181 senior care centers with capacity for 17,874 residents, and has a significant presence (more than 10% of its resident capacity) in each of Michigan, Pennsylvania, Ohio and Wisconsin. 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 subsidiary, Extencicare (Canada) Inc. and its subsidiaries (collectively "ECI"), operates 83 senior care centers in Canada, with capacity for 11,599 residents. ECI has a significant presence in Ontario, where 75% of its residents are served. Also, through its ParaMed Home Health Care (ParaMed) division, ECI is a major provider of home health care in Ontario and Alberta.

Extencare REIT owns rather than leases a majority of its properties, unlike a number of other long-term care providers. At June 30, 2009, excluding centers under management contracts, we owned or operated under lease arrangements with options to purchase, 220 centers, or 97%, 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 table depicts ownership and management of senior care centers operated by EHSI and ECI at June 30, 2009, excluding those designated as discontinued operations:

By Type of Ownership	Nursing Centers		Assisted Living and Retirement Centers		Rehab Hospital / Chronic Care Units		Total	
	No. of Centers	Resident Capacity	No. of Centers	Resident Capacity	No. of Centers	Resident Capacity	No. of Centers	Resident Capacity
United States								
Owned	159	16,219	3	247	1	24	163	16,490
Leased	7	659	–	–	–	–	7	659
Managed	5	519	6	206	–	–	11	725
Total	171	17,397	9	453	1	24	181	17,874
Canada								
Owned	48	6,363	–	–	–	–	48	6,363
Leased ⁽¹⁾	9	1,155	–	76	–	–	9	1,231
Managed	22	3,253	3	632	1	120	26	4,005
Total	79	10,771	3	708	1	120	83	11,599
Total	250	28,168	12	1,161	2	144	264	29,473

⁽¹⁾ The nine leased centers in Canada are operated by ECI under 25-year capital lease arrangements.

The following table reflects the change in senior care centers operated in the first six months of 2009, and during the 2008 year.

Extencare REIT Senior Care Centers	Six months ended June 30, 2009		Year ended December 31, 2008	
	No. of Centers	Operational Beds/Units	No. of Centers	Operational Beds/Units
As at beginning of the period	266	30,028	269	30,333
Acquisitions ⁽¹⁾	–	–	3	304
Development	–	–	2	177
Managed contracts added	2	229	3	317
Managed contracts matured ⁽¹⁾	(2)	(294)	(3)	(304)
Divested or discontinued ⁽²⁾	(2)	(245)	(8)	(747)
Operational capacity adjustments ⁽³⁾	–	(245)	–	(52)
As at the end of the period	264	29,473	266	30,028

⁽¹⁾ The reduction in managed contracts was due to maturity of contracts in 2009, and to our acquisition of three Manitoba nursing centers (304 beds) in 2008.

⁽²⁾ Refer to the discussion under the heading “Significant Developments – Discontinued Operations”.

⁽³⁾ Reduction in operational capacity in certain states due to beds that have been pulled out of service in order to increase our Medicaid rate and to accommodate rehabilitation suites.

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 and by clustering several long-term care centers together within the geographic areas served, our goal is to build upon our reputation as a leading provider of a full range of long-term care 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. Other 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 rehabilitative residents that results in increasing the percentage of revenue from Medicare and Managed Care (Skilled Mix) funding sources as well as private-pay sources (Quality Mix), and increasing average daily revenue rates;
- actively maintaining and improving our asset portfolio through a disciplined capital reinvestment program or, where appropriate, through disposal of underperforming centers;
- focusing on achieving operational efficiencies in our core business and internal growth, 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;
- increasing market share in the Canadian home health care operations; and
- increasing funds from operations and adjusted funds from operations, by achieving the above goals.

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 Board of Trustees, as well as the opportunity, or exposure, to changes in the price of the trust units of the REIT (the "REIT Units"), which are traded on the Toronto Stock Exchange (TSX) under the symbol "EXE.UN". Since the REIT's inception in November 2006 until December 2008, we paid monthly distributions of \$0.0925 per unit to our unitholders, for annual distributions of \$1.11 per unit. The Board of Trustees of the REIT regularly reviews its distribution policy. Effective January 2009, the REIT reduced its monthly distributions to \$0.07 per unit. The Board of Trustees made this decision after considering the general economic outlook and operating environment, along with past and projected operating performance of the REIT. Based on the closing price of the REIT Units on July 31, 2009, of \$6.21, this represents a yield of 13.5%. More information about distributions, including tax considerations, is provided in the section "Key Performance Indicators – Distributions".

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%. 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 approximately 73% of our revenue year-to-date in 2009 was generated from our U.S. operations, Medicare and Medicaid funding is particularly significant for our financial performance. For a discussion of recent Medicare and Medicaid funding increases, and factors affecting the outlook for future funding, please see the section "Update of Legislative Actions Affecting Revenue – 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. We have implemented a foreign currency hedging strategy 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".

GLOBAL ECONOMIC ENVIRONMENT

The most significant factor impacting the industry this past year, and for the near term, is the global economy. Beginning in the latter part of 2008, the economy and stock markets have suffered a significant downturn as a result of the worldwide credit and liquidity crisis that impacted market values of securities, values of commodities such as oil and gas, interest rates and the foreign exchange markets; and there has been unprecedented job loss in both the U.S. and Canada. With a dramatic reduction in corporate profits and reduced consumer confidence, the fiscal health of provinces, states and federal governments has been dampened; consequently, the future funding of services for which they provide support may be at risk. In response, governments have initiated a number of cost-reduction and job-creation programs. In February 2009, the *American Recovery and Reinvestment Act of 2009* provided US\$787 billion in government stimulus of which US\$86.7 billion was appropriated to increase funding for state Medicaid programs. However, despite this additional funding and the intention to maintain core education, health and unemployment funding, a number of states are facing severe budgetary shortfalls and are considering making cuts in Medicaid funding or providing for below inflationary increases. Due to the impact of significant state budgetary pressures, the majority of states have not finalized their July 2009 rates and there is considerable ongoing lobbying underway to preserve funding, resulting in uncertainty in the potential outcome of state Medicaid rates. Though we do not believe we will have certainty to our Medicaid rates until the end of the third quarter, based on current information, we estimate this could result in a net reduction of 1.4%, or US\$9.0 million in our annual Medicaid revenue, which would impact us beginning in the 2009 fourth quarter. In addition, on July 31, 2009 the Centers for Medicare & Medicaid (CMS) issued its final rule for skilled nursing centers, resulting in a net reduction in Medicare Part A rates of 1.1% effective October 1, 2009, that would reduce our Medicare revenue by approximately US\$4.5 million per annum.

The proposed and much debated U.S. health care reform legislation called the *Affordable Health Choices Act of 2009* has the objective to provide health care coverage for all individuals. This legislation has the potential for future cuts in Medicare funding to skilled nursing centers along with the imposition of increased costs to all employers to provide a minimum level of health care coverage or pay a mandatory tax in lieu of the benefit.

Federal governments have dramatically reduced interest rates and injected funds into the banking industry to stabilize a number of firms and to maintain the flow of credit. However, despite receiving government aid, the banking industry has become extremely cautious of providing credit. In summary, similar to other sectors of the economy, but perhaps to a lesser degree, the health care and long-term care industries will be affected by the events that will unfold this year.

IMPACT OF CURRENT ECONOMY ON THE REIT

Recent global events could pose risks to the REIT and its subsidiaries, such as:

- ability to finance and refinance loans, and the resulting higher cost of borrowing;
- ability to raise capital;
- foreign currency fluctuations;
- state, provincial and federal funding and regulatory pressure; and
- decline in short-term admissions as a result of a slowdown in the number of individuals seeking elective surgery and resulting need for post-acute care.

In terms of the financial impact to date as a result of the declining economy, the REIT has experienced a modest devaluation of certain investments held for self-insured liabilities and incurred a loss during 2008 in the value of its derivative foreign currency contracts due to the increase in the value of the U.S. dollar relative to the Canadian dollar. We believe the decline we experienced during the 2008 fourth quarter and the first half of 2009 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. However, the reduction in interest rates has had little financial impact on the REIT as the interest rate of the majority of the REIT's debt is at fixed rates.

In response to the above potential risks and uncertainties, the REIT has undertaken several courses of action to minimize future risks and maintain liquidity, including:

- reducing distributions and growth projects along with divestiture of underperforming assets;
- focusing on core business and cost reduction initiatives;
- monitoring our cash usage; and
- maintaining solid banking relationships.

With respect to cost reduction initiatives, the REIT commenced a program to focus on its core business and initiated a number of programs to scale down administrative and non wage-related costs in both the U.S. and Canadian operations to yield \$5.0 million in annual savings. These programs were launched in the second half of 2008 and include: initiatives to reduce pharmaceutical and telecommunication costs; implementing real-time labour tracking tools; reducing corporate overhead; utilizing a new food cost tracking tool to assist dietary managers in the selection and ordering of menu items within the allowable budget; tightening our travel policies to eliminate unnecessary spending and create greater efficiencies; and enhancing our procurement departments' ability to achieve efficiencies and volume discounts through tighter controls over spending by centers. In the first half of 2009, we estimate that these initiatives generated savings of \$3.5 million and we are currently estimating savings of \$7.3 million for 2009, thus exceeding our initial estimates of \$5.0 million.

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;

"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 2009 and 2008 operations in this document, refers to those centers that were operated by us on January 1, 2008, and throughout 2008 and 2009; 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. During 2008, approximately 53% of our U.S. resident admissions were Medicare funded, and approximately 23% were Managed Care funded. Therefore, we consider Skilled Mix, and Quality Mix (which includes private-pay residents) to be important performance measurement indicators. Medicaid rates are generally lower than rates earned from other sources.

Our goal in the U.S. skilled nursing center operations is to increase the percentage of revenue derived from Medicare, Managed Care organizations providing Medicare and Medicaid replacement products, CI, private and other Quality Mix residents. 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. In 2007 we completed the implementation of a new data collection and reporting system that allows us to electronically track the condition of the residents and services provided for them. This new electronic system allows us to operate more efficiently within the Resource Utilization Groupings (RUGs) classifications

system, enabling us to ensure appropriate payment for services being delivered and, thereby, increase our average Medicare rates.

SKILLED NURSING CENTER REVENUE BY PAYOR SOURCE

The following table provides the percentage of EHSI's revenue by payor source and the average revenue rates for its skilled nursing centers from continuing operations, excluding prior period settlement adjustments, for the past eight quarters.

	Q1		Q2		Q3		Q4		Year
	2009	2008	2009	2008	2008	2007	2008	2007	2008
(restated for discontinued operations)									
Revenue by Payor Source (%)									
Medicare	34.5	35.8	33.9	35.1	32.9	34.3	32.9	34.8	34.2
Managed Care	10.1	8.2	10.5	9.7	9.7	7.4	9.5	7.4	9.3
Skilled Mix	44.6	44.0	44.4	44.8	42.6	41.7	42.4	42.2	43.5
Private/other	9.0	9.6	9.3	9.3	10.1	9.8	9.9	9.9	9.7
Quality Mix	53.6	53.6	53.7	54.1	52.7	51.5	52.3	52.1	53.2
Medicaid	46.4	46.4	46.3	45.9	47.3	48.5	47.7	47.9	46.8
	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	445.71	410.69	452.38	417.80	419.19	392.14	436.73	411.14	420.70
Managed Care	379.58	334.86	386.22	357.74	361.79	323.91	369.89	332.41	356.51
Private/other	210.89	208.81	214.05	200.59	206.29	200.50	207.36	197.30	205.79
Medicaid	172.80	164.99	171.69	166.24	168.95	162.27	172.40	163.95	168.17
Medicare Part A and B	488.49	447.87	500.47	453.55	460.81	433.32	479.02	448.79	459.79

EHSI's average daily Medicare Part A rate grew 8.3% to US\$452.38 in the 2009 second quarter from US\$417.80 in the 2008 second quarter. The October 1, 2008, market basket inflationary increase accounted for approximately 3.4% of the rate increase, with the remainder primarily related to higher average acuity levels among Medicare patients served. In comparison to the 2009 first quarter, our average daily Medicare Part A grew 1.5% due to a continued improvement in the mix of Medicare residents.

Our percentage of Medicare residents in the nine highest RUGs classifications increased to 41.5% in the 2009 second quarter from 37.5% in the 2008 second quarter, as well as increasing from 41.0% in the 2009 first quarter. In addition, we experienced an increase in the percentage of Medicare residents receiving therapy services to 89.1% this quarter from 87.3% in the 2008 second quarter. However, the percentage declined this quarter from the 2009 first quarter level of 89.4%, which is a similar trend to what occurred in 2008.

The average revenue rate for Managed Care clients increased 8.0% to US\$386.22 this quarter from US\$357.74 in the 2008 second quarter, and increased 1.7% from the 2009 first quarter. This metric is encouraging because the Managed Care segment represents the second highest rate component of our Quality Mix of residents. As such we have been focused on building relationships with key Managed Care organizations and establishing rates that are reflective of the services we are providing.

Our average daily Medicaid rate, excluding prior period settlement adjustments, increased 3.3% in the 2009 second quarter to US\$171.69 compared to the 2008 second quarter. In comparison to the 2009 first quarter average daily Medicaid rate of US\$172.80, we experienced a slight decline of 0.6% this quarter as a result of: (i) a decline in Michigan's rate due to revised estimates for reimbursable costs that impacted our October 1, 2008 rates; and (ii) a unique rate recovery by the State of Washington, thereby decreasing the rates in effect for three months commencing April 1, 2009.

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 2009 and 2008 quarters.

(restated for discontinued operations)	Q1		Q2		Q3	Q4	Total
	2009	2008	2009	2008	2008	2008	2008
Revenue by Payor Source (%)							
Medicare	34.4	35.8	33.9	35.1	32.8	32.8	34.1
Managed Care	10.0	8.2	10.4	9.7	9.6	9.4	9.2
Skilled Mix	44.4	44.0	44.3	44.8	42.4	42.2	43.3
Private/other	9.0	9.6	9.3	9.2	10.1	9.9	9.7
Quality Mix	53.4	53.6	53.6	54.0	52.5	52.1	53.0
Medicaid	46.6	46.4	46.4	46.0	47.5	47.9	47.0
	100.0	100.0	100.0	100.0	100.0	100.0	100.0

On a same-facility basis, our proportion of Skilled Mix revenue declined to 44.3% in the 2009 second quarter from 44.8% in the 2008 second quarter and from 44.4% in the 2009 first quarter, reflecting a decline in Skilled Mix average daily census, as discussed below, partially offset by the improvement in Medicare and Managed Care rates.

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 Legislative Actions Affecting Revenue – United States".

SKILLED NURSING CENTER AVERAGE DAILY CENSUS

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

(restated for discontinued operations)	Q1		Q2		Q3		Q4		Total
	2009	2008	2009	2008	2008	2007	2008	2007	2008
Average Daily Census									
Medicare	2,599	2,817	2,465	2,730	2,527	2,165	2,470	2,491	2,635
Managed Care	981	865	985	959	949	626	923	711	924
Skilled Mix	3,580	3,682	3,450	3,689	3,476	2,791	3,393	3,202	3,559
Private/other	1,573	1,614	1,585	1,627	1,730	1,333	1,717	1,608	1,673
Quality Mix	5,153	5,296	5,035	5,316	5,206	4,124	5,110	4,810	5,232
Medicaid	9,901	9,908	9,825	9,742	9,919	8,174	9,944	9,393	9,878
Total	15,054	15,204	14,860	15,058	15,125	12,298	15,054	14,203	15,110
Census by Payor Type (%)									
Medicare	17.3	18.5	16.6	18.1	16.7	17.6	16.4	17.6	17.4
Managed Care	6.5	5.7	6.6	6.4	6.3	5.1	6.1	5.0	6.1
Skilled Mix	23.8	24.2	23.2	24.5	23.0	22.7	22.5	22.6	23.5
Private/other	10.4	10.6	10.7	10.8	11.4	10.8	11.4	11.3	11.1
Quality Mix	34.2	34.8	33.9	35.3	34.4	33.5	33.9	33.9	34.6
Medicaid	65.8	65.2	66.1	64.7	65.6	66.5	66.1	66.1	65.4
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Average occupancy (%)	89.0	89.1	87.8	87.9	88.3	90.3	87.9	89.5	88.3

EHSI's total skilled nursing center ADC was 14,860 in the 2009 second quarter, reflecting a decline from the 2008 second quarter ADC of 15,058, and the 2009 first quarter ADC of 15,054, due to lower Medicare census. We believe the decline in Medicare census was due to residents deferring elective surgeries due to the economy. Our Managed Care ADC has improved this quarter to 985 from 959 in the 2008 second quarter, and from 981 in the 2009 first quarter. This increase in our Managed Care residents was achieved as a result of our focus on the premium payor market segment and the number of Medicare beneficiaries opting out of traditional Medicare Part A benefits and selecting coverage through a Medicare replacement product.

The comparison of average occupancy levels in 2009 to 2008 is impacted by bed reductions in our operational capacity from year end 2008, due to beds that have been pulled out of service in order to increase our Medicaid rate and to accommodate rehabilitation suites.

The following table provides the ADC, percentage of total ADC, and average occupancy of EHSI's skilled nursing centers from continuing operations, on a same-facility basis, for the 2009 and 2008 quarters.

	Q1		Q2		Q3	Q4	Total
	2009	2008	2009	2008	2008	2008	2008
(restated for discontinued operations)							
Average Daily Census							
Medicare	2,579	2,817	2,447	2,721	2,505	2,448	2,622
Managed Care	965	865	971	955	937	908	916
Skilled Mix	3,544	3,682	3,418	3,676	3,442	3,356	3,538
Private/other	1,560	1,608	1,575	1,616	1,714	1,711	1,663
Quality Mix	5,104	5,290	4,993	5,292	5,156	5,067	5,201
Medicaid	9,877	9,908	9,795	9,735	9,908	9,917	9,867
Total	14,981	15,198	14,788	15,027	15,064	14,984	15,068
Census by Payor Type (%)							
Medicare	17.2	18.5	16.5	18.1	16.6	16.3	17.4
Managed Care	6.5	5.7	6.6	6.4	6.2	6.1	6.1
Skilled Mix	23.7	24.2	23.1	24.5	22.8	22.4	23.5
Private/other	10.4	10.6	10.7	10.7	11.4	11.4	11.0
Quality Mix	34.1	34.8	33.8	35.2	34.2	33.8	34.5
Medicaid	65.9	65.2	66.2	64.8	65.8	66.2	65.5
	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Average occupancy (%)	88.9	89.1	87.8	88.1	88.4	87.9	88.4

During 2008 we experienced a decline in our same-facility ADC from EHSI's skilled nursing centers from 15,198 in the 2008 first quarter to 14,984 in the 2008 fourth quarter. This decline resulted from a voluntary slowdown in admissions at clinically challenged centers, a shift from Medicare to Managed Care residents who typically have a shorter length of stay, an increase in competition in certain markets, and we believe due to initial negative publicity arising from the class action lawsuits previously announced and the impact of the economy.

Our 2009 same-facility ADC levels of 14,981 and 14,788 for the first and second quarter, respectively, were 217 and 239 below the 2008 comparable levels, respectively, with a decline of 238 and 274 in Medicare ADC, respectively, partially offset by increases in Managed Care and Medicaid ADC. Census normally declines between the first and second quarter and in 2008, we experienced a decline of 171 total ADC of which 96 was in Medicare ADC. In comparison to the 2009 first quarter ADC of 14,981, our same-facility ADC declined 193, or 1.3%, to 14,788 in the 2009 second quarter as a result of a decline in Medicare ADC of 132 and Medicaid ADC of 82, partially offset by improvements in Managed Care and private ADC. We believe the decline in Medicare census was due to residents deferring elective surgeries. The increase in our Managed Care residents was achieved as a result of our focus on the premium payor market segment and the number of Medicare beneficiaries opting out of traditional Medicare Part A benefits and selecting coverage through a Medicare replacement product.

Canadian Operations

The funds received by ECI for its nursing homes and home health care services are 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. The following are ECI's average daily revenue rates and occupancy levels for the 2009 and 2008 quarters.

	Q1		Q2		Q3		Q4		Total
	2009	2008	2009	2008	2008	2007	2008	2007	2008
Average revenue rate (\$)	168.14	159.59	172.77	163.91	164.21	155.52	173.91	163.52	165.51
Average occupancy (%)	97.7	97.6	97.9	97.9	98.2	98.6	98.2	98.1	98.0

Revenue from provincial programs represented approximately 65% of ECI's nursing home revenue during the first half of 2009. ECI's average daily revenue rate was \$172.77 in the 2009 second quarter compared to \$163.91 in the 2008 second quarter, representing an increase of 5.4%. The majority of ECI's nursing home operations are in Ontario, which operates under an envelope system, in which a substantial portion of the revenue is tied to flow-through funding, and is therefore matched in the periods in which the related costs for resident care 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, the 2008 fourth quarter average rate of \$173.91 included an Alberta retroactive funding adjustment of \$1.4 million. Excluding this adjustment, the 2008 fourth quarter rate average rate was \$171.86.

In Canada, where the supply of long-term care beds historically has been very restricted, nursing home operators typically enjoy higher occupancy levels than in the United States. Our average occupancy in Canada was unchanged at 97.9% in the 2009 second quarter compared to the 2008 second quarter level and increased from 97.7% in the 2009 first quarter. A slightly lower occupancy level during the winter months is to be expected as a result of flu outbreaks leading to temporary freezes on admissions.

Revenue from provincial programs represented approximately 96% of ECI's home health care revenue during the first half of 2009. Average daily home health care hours of service increased this quarter to 12,557 from 12,486 in the 2008 second quarter and from 12,111 provided in the 2009 first quarter. For the first half of 2009, ParaMed's average daily hours of service increased to 12,335 from 12,293 in the first half of 2008. During 2008, ParaMed provided 4,495,000 hours of service of home health care, of which 96.1% was from business in Ontario and the rest in Alberta. This ratio has remained unchanged for the first half of 2009. 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. The competitive bidding process is expected to resume in the first quarter of 2010.

For more information on government funding in Canada, including recent developments and their impact or expected impact on Extencicare REIT, please see "Update of Legislative Actions Affecting Revenue – Canada".

Development Projects

In July 2009, we completed our state-of-the-art 100-bed skilled nursing center in Okemos, Michigan, and will be welcoming our first residents in early August. We have a further five construction projects in the pipeline, with four underway, and the fifth, in Edmonton, is scheduled to commence shortly (completion dates as indicated in parenthesis):

- 100-bed skilled nursing center in Summit, Wisconsin (November 2009);
- 60-unit assisted living center in Summit, Wisconsin (November 2009);
- 280-bed continuing care center in Red Deer, Alberta (summer 2010);
- 140-bed designated assisted living center in Lethbridge, Alberta (spring 2011); and
- 180-bed nursing center in Edmonton, Alberta (fall 2011).

For further details of the development projects, please refer to "Significant Developments – Development Projects".

In order to fund its development projects, the REIT completed a public offering in June 2008 for net proceeds of \$120.6 million, from the issuance 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 \$34.6 million of REIT Units (3,565,000 REIT Units at \$9.70 per unit). The proceeds from this offering, together with construction financing from Canada Mortgage and Housing Corporation (CMHC), will finance 100% of these projects.

Distributions

The current policy of each of the REIT and Extencicare LP is to pay distributions of \$0.07 per REIT Unit and Exchangeable LP Unit, respectively, to the holders thereof on a monthly basis. The declaration and payment of future distributions is subject to the discretion of the Board of Trustees 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 of Trustees. If the Trustees determine that it would be in the REIT's best interests, they may reduce, for any period, the percentage of Distributable Income to be distributed to holders of REIT Units, which will result in corresponding reductions in distributions to holders of Exchangeable LP Units.

Distributions declared in 2008 totalled \$80.6 million, or \$1.11 per REIT Unit and per Exchangeable LP Unit. Based on total Adjusted Funds from Operations (AFFO) of \$78.8 million, the payout ratio in 2008 was 102.3%, and was 107.6% based on AFFO from continuing operations of \$74.9 million.

Approximately 70% of the distributions made by Extencicare REIT and Extencicare LP in both 2007 and 2008 were tax deferred returns of capital for Canadian residents. Management estimates that, of the monthly distributions to be made in 2009, approximately 70% will also be tax deferred returns of capital for Canadian residents. The adjusted cost base of the REIT Units or Exchangeable LP Units held by a unitholder will generally be reduced by such non-taxable portion of distributions made to the unitholder. To the extent the remaining 30% of distributions of the REIT and Extencicare LP to be made in 2009 are taxed as dividends, those paid to Canadian residents are eligible dividends as per the *Income Tax Act* (Canada) (the "Tax Act"). Extencicare 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. No assurance can be given that the composition of distributions by Extencicare REIT and Extencicare LP for tax purposes will not be changed from that described above. Any change in such composition of the distributions will affect the after-tax return of the unitholder.

In 2008 there was a change impacting all of our unitholders related to the taxation of certain distributions made by us for U.S. tax purposes that commenced with our May 2008 distribution that was paid on June 16, 2008. This is relevant for (i) how certain income will be taxed for U.S. tax purposes to U.S. persons who hold REIT Units and/or Exchangeable LP Units ("U.S. Holders") and (ii) U.S. withholding tax issues for non-U.S. persons who hold REIT Units and/or Exchangeable LP Units ("Non-U.S. Holders"). The change to the composition of distributions for tax purposes does not affect Canadian taxation of distributions paid by us, including our Canadian tax withholding obligations in respect of distributions to non-Canadian holders of our units.

This change to the composition of certain distributions paid by us for U.S. tax purposes arises from the financing structure we implemented in 2007. Interest payments to be made semi-annually in May and November by a U.S. subsidiary of Extencicare REIT will be treated as U.S. source interest income of the REIT and Extencicare LP, and consequently of the unitholders for a portion of distributions paid by us relating to those months for U.S. tax purposes. The amount of U.S. source interest income pertaining to any distributions to be declared in May and November will be disclosed in the distribution press releases for those months and on our website at www.extencicare.com.

The portion of our May 2009 distribution of \$0.07 paid to holders of record on May 30, 2009, that represented U.S. source interest income in Canadian dollars was \$0.02093 per unit. This U.S. source interest income is subject to U.S. withholding tax for Non-U.S. Holders, and U.S. backup withholding tax for U.S. Holders. Unitholders may be eligible for the portfolio interest exemption under Sections 871 and 881 of the Code by submitting a valid Form W-8BEN or Form W-9, as applicable to their broker or administrator.

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 approximately 73% of revenue from continuing operations in the first six months of 2009 (70% for the year 2008). 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 impact of changes in the average exchange rates used in translating the U.S. results for the first half of 2009 and for the year 2008.

	Q1		Q2		Six months		Year	
	2009	2008	2009	2008	2009	2008	2008	2007
Average US/Canadian dollar exchange rate	1.2456	1.0042	1.1672	1.0102	1.2062	1.0072	1.0660	1.0748
Impact on the 2009 Quarter and 2008 Year								
<i>(millions of dollars)</i>								
Revenue	83.6		54.1		137.6		(11.9)	
EBITDA	10.1		7.9		18.1		(1.2)	
Earnings from continuing operations	1.4		3.9		5.3		(1.3)	
Net earnings	1.2		3.9		5.2		(0.9)	
Same-facility Operations								
Revenue	83.1		53.7		136.8			
EBITDA	10.0		7.9		18.0			

The following table illustrates the contribution from our U.S. operations to selected line items of our financial results for the first six months of 2009, 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 will have little impact on the cash flow from our U.S. operations to fund distributions, because we have 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. Continuing Operations	Six months ended	Annualized Impact of One-Cent
	June 30, 2009	Change in Exchange Rate ⁽¹⁾
<i>(millions of dollars)</i>	US\$	C\$
Revenue	691.7	13.8
EBITDA	90.7	1.8
AFFO	38.8	0.8

⁽¹⁾ A weaker Canadian dollar against the U.S. dollar increases reported profits; while a stronger Canadian dollar reduces reported profits.

The valuation of our FCFCs are 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 derivative financial instruments and foreign exchange". Gains or losses on the FCFCs are not subject to cash taxes until realized.

Impact of Foreign Currency Forward Contract Strategy on Distributions

The majority of our distributions are funded by our U.S. operations. To limit the exposure to converting our U.S. cash flow into Canadian dollars, we implemented a foreign currency hedging strategy to maintain FCFCs, provided the conditions are favourable at the time. EHSI has entered into FCFCs to acquire Canadian dollars for US\$4.0 million on a monthly basis to June 2011. The first contract locks EHSI's exchange rate to acquire Canadian dollars at 1.1141 for a 36-month period that commenced in December 2006 and ends in November 2009. A second FCFC covers the seven-month period from December 2009 to June 2010, and provides for the prevailing exchange rate at that time (locked in at a range between 1.00 and 1.1050). Further contracts cover the period from July 2010 to June 2011, and provide for the prevailing exchange rate at that time (locked in at a range between 1.00 and 1.09).

As of June 30, 2009, the fair value of the outstanding FCFCs was a liability of \$7.4 million (US\$6.4 million) compared to \$13.9 million (US\$11.4 million) at December 31, 2008. Management continues to monitor the U.S. to Canadian dollar exchange rate, with the aim of maintaining its foreign exchange hedging strategy. There can be no assurance that the FCFCs we have in place will be sufficient to protect us against currency exchange rate losses.

SUMMARY OF RESULTS

2009 Second Quarter Highlights

- Revenue of \$563.1 million in the 2009 second quarter, an increase of 15.2% (4.2% exclusive of the impact of foreign exchange) compared to \$488.6 million in the 2008 second quarter, due largely to achieving higher per diem rates in Medicare and Managed Care.
- EBITDA of \$72.7 million in the 2009 second quarter, an increase of 60.1% (42.8% exclusive of the impact of foreign exchange) compared to \$45.4 million in the 2008 second quarter, mainly due to cost controls and the absence of a number of unusual and one-time costs incurred during the same quarter last year.
- EBITDA margins improved to 12.9% in the 2009 second quarter from 9.3% in the 2008 second quarter as a result of cost-saving initiatives and continued success from the implementation of the back-to-basics plan.
- Distributions declared for the first half of 2009 of \$30.6 million, or \$0.07 per unit per month, represented 57.6% of AFFO from continuing operations of \$53.1 million for the same period.

The continuing improvement in our operating results during the second quarter demonstrates the success of our back-to-basics operating plan. Our strong EBITDA margins were largely the result of per diem rate enhancements, focused control on operating costs, driving efficiencies in our administrative processes and the absence of non-recurring charges incurred in the second quarter of 2008. Going forward, we will continue to monitor the impact of proposed reimbursement methodology changes for October 1, 2010 and the potential longer term impact of the health care reform initiatives in the U.S. Our strong balance sheet and cash on hand should enable us to effectively manage future challenges as we pursue continued long-term growth.

2009 SECOND QUARTER AND SIX MONTH AFFO

Improvements in EBITDA in 2009 contributed to the improvements in AFFO from continuing operations, partially offset by higher income taxes and financing costs, as well as the impact of fluctuations in facility maintenance capital expenditures between periods. Details of the changes in EBITDA, financing costs and income taxes are discussed under the headings "2009 Second Quarter Financial Review" and "2009 Six Month Financial Review".

AFFO from continuing operations improved \$13.7 million to \$28.9 million (\$0.396 per basic unit) in the 2009 second quarter from \$15.2 million (\$0.214 per basic unit) in the 2008 second quarter, and exclusive of the impact of the weaker Canadian dollar, it increased by \$10.1 million, or 66.4%.

In comparison to the 2009 first quarter, AFFO from continuing operations improved \$4.7 million this quarter from \$24.2 million (\$0.332 per basic unit), and exclusive of the impact of the stronger Canadian dollar, it increased by \$6.2 million or 25.6%.

AFFO from continuing operations improved \$19.7 million to \$53.1 million (\$0.728 per basic unit) in the first six months of 2009 from \$33.4 million (\$0.472 per basic unit) in the same 2008 period, and exclusive of the impact of the weaker Canadian dollar, it improved by \$12.1 million, or 36.2%.

FACILITY MAINTENANCE CAPITAL EXPENDITURES

Facility maintenance capital expenditures of \$7.9 million in the 2009 second quarter were 1.4% of revenue, compared to \$7.6 million, or 1.6% of revenue, in the 2008 second quarter, and \$7.3 million, or 1.3% of revenue, in the 2009 first quarter. For the first half of 2009, facility maintenance capital expenditures were \$15.2 million, or 1.3% of revenue, compared to \$12.1 million, or 1.3% of revenue, in the same period last year. These costs fluctuate on a quarterly basis with the timing of projects and seasonality. Certain 2008 planned projects that commenced last year were carried over to 2009. It is our intention to expend between 1.5% and 2.0% of revenue annually, which is consistent with our objective to maintain and upgrade our centers. We are expecting to spend approximately \$39.0 million in facility maintenance capital expenditures and approximately \$57.0 million in growth capital expenditures in 2009.

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 2009 and 2008 quarters, and for the 2008 year. ⁽¹⁾ Certain comparative figures have been reclassified for discontinued operations identified in 2009.

<i>(millions of dollars unless otherwise noted)</i>	Q1		Q2		Six months ended June 30		Year
	2009	2008	2009	2008	2009	2008	2008
EBITDA from continuing operations	64.8	46.2	72.7	45.4	137.5	91.6	205.0
Depreciation for FFEC	(6.1)	(4.2)	(5.9)	(4.5)	(12.0)	(8.7)	(19.4)
Interest expense, net	(24.7)	(19.9)	(23.8)	(19.8)	(48.5)	(39.7)	(86.3)
	34.0	22.1	43.0	21.1	77.0	43.2	99.3
Current income tax expense ⁽²⁾	(11.7)	(5.7)	(15.6)	(4.9)	(27.3)	(10.6)	(25.4)
FFO (continuing operations)	22.3	16.4	27.4	16.2	49.7	32.6	73.9
Amortization of financing costs	2.5	1.6	2.9	1.6	5.4	3.2	7.7
Principal portion of government capital funding payments	0.6	0.5	0.6	0.5	1.2	1.0	2.2
DI (continuing operations)	25.4	18.5	30.9	18.3	56.3	36.8	83.8
Additional facility maintenance capital expenditures ⁽³⁾	(1.2)	(0.3)	(2.0)	(3.1)	(3.2)	(3.4)	(8.9)
AFFO (continuing operations)	24.2	18.2	28.9	15.2	53.1	33.4	74.9
AFFO (discontinued operations) ⁽⁴⁾	0.2	0.2	0.5	1.5	0.7	1.7	3.9
AFFO ⁽⁵⁾	24.4	18.4	29.4	16.7	53.8	35.1	78.8
Per Basic Unit (\$)							
FFO (continuing operations)	0.306	0.233	0.376	0.227	0.682	0.460	1.020
AFFO (continuing operations)	0.332	0.258	0.396	0.214	0.728	0.472	1.034
AFFO	0.334	0.262	0.404	0.235	0.738	0.497	1.087
Per Diluted Unit (\$)							
FFO (continuing operations)	0.289	0.233	0.348	0.227	0.637	0.460	0.996
AFFO (continuing operations)	0.302	0.252	0.356	0.210	0.658	0.462	0.980
AFFO	0.304	0.255	0.362	0.229	0.666	0.484	1.026
Distributions							
Declared	15,285	19,558	15,317	19,902	30,602	39,460	80,575
Declared per unit (\$)	0.2100	0.2775	0.2100	0.2775	0.4200	0.5550	1.1100
Weighted Average Number of Units (thousands)							
Basic	72,911	70,471	72,914	71,109	72,913	70,790	72,460
Diluted ⁽⁶⁾	86,736	76,250	86,272	77,869	86,733	77,058	82,558

⁽¹⁾ "EBITDA", "FFO", "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⁾ Excludes current tax with respect to the gains or losses from derivative financial instruments, foreign exchange, 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⁾ Diluted weighted average number of units for 2008 assumes conversion of debentures from the date of issuance in June 2008.

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. Certain comparative figures have been reclassified for discontinued operations identified in 2009.

<i>(thousands of dollars unless otherwise noted)</i>	Q1		Q2		Q3		Q4	
	2009	2008	2009	2008	2008	2007	2008	2007
Revenue	584,249	477,432	563,146	488,636	501,950	418,920	576,052	455,598
EBITDA ⁽¹⁾	64,787	46,206	72,740	45,407	51,135	50,171	62,244	50,563
EBITDA margin	11.1%	9.7%	12.9%	9.3%	10.2%	12.0%	10.8%	11.1%
Earnings from continuing operations before undernoted ⁽¹⁾	9,524	7,120	18,402	7,582	8,250	13,996	7,932	13,407
Gain (loss) on derivative financial instruments and foreign exchange, net of taxes	(5,245)	(3,529)	11,688	1,927	(3,197)	2,162	(17,568)	(1,636)
Gain (loss) from asset impairment, disposals and other items, net of taxes	171	–	(380)	–	(1,491)	–	937	–
Earnings (loss) from continuing operations	4,450	3,591	29,710	9,509	3,562	16,158	(8,699)	11,771
Discontinued operations, net of income taxes	(793)	(13)	534	1,168	41	70	4,229	(1,293)
Net earnings (loss)	3,657	3,578	30,244	10,677	3,603	16,228	(4,470)	10,478
Components of Diluted Earnings (Loss) per Unit (\$)								
Continuing operations before undernoted	0.13	0.10	0.25	0.11	0.11	0.20	0.11	0.20
Gain (loss) on derivative financial instruments and foreign exchange	(0.07)	(0.05)	0.16	0.03	(0.05)	0.03	(0.24)	(0.03)
Gain (loss) from asset impairment, disposals and other items	–	–	–	–	(0.02)	–	0.01	–
Earnings (loss) from continuing operations	0.06	0.05	0.41	0.14	0.04	0.23	(0.12)	0.17
Discontinued operations	(0.01)	–	–	0.01	0.01	–	0.05	(0.02)
Net earnings (loss)	0.05	0.05	0.41	0.15	0.05	0.23	(0.07)	0.15
Average US/Canadian dollar exchange rate ⁽²⁾	1.2456	1.0042	1.1672	1.0102	1.0406	1.0477	1.2078	0.9837

⁽¹⁾ Refer to discussion of non-GAAP measures.

⁽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, specific transactions such as gains or losses related to 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 is a reconciliation of earnings (loss) from continuing health care operations before income taxes to EBITDA for each of the eight most recently completed quarters. Certain comparative figures have been reclassified for discontinued operations identified in 2009.

	Q1		Q2		Q3		Q4	
	2009	2008	2009	2008	2008	2007	2008	2007
<i>(thousands of dollars)</i>								
Earnings from continuing operations before income taxes	17,222	8,232	43,592	13,242	9,127	25,523	1,150	17,058
Add (Deduct):								
Depreciation and amortization	17,719	13,505	16,787	14,058	14,610	11,229	17,133	12,575
Accretion of retirement obligations	444	357	424	360	367	300	409	324
Interest expense, net	24,709	19,900	23,767	19,792	21,670	16,544	24,881	18,145
Loss (gain) on derivative financial instruments and foreign exchange	4,950	4,212	(12,424)	(2,045)	3,046	(3,425)	20,131	2,461
Loss (gain) from asset impairment, disposals and other items	(257)	–	594	–	2,315	–	(1,460)	–
EBITDA	64,787	46,206	72,740	45,407	51,135	50,171	62,244	50,563
Segmented EBITDA								
US operations – US\$	41,872	36,605	48,862	32,401	34,013	33,445	38,187	37,761
US operations – C\$	52,155	36,757	57,289	32,746	35,413	34,925	45,611	37,419
Cdn operations – C\$	12,632	9,449	15,451	12,661	15,722	15,246	16,633	13,144
EBITDA	64,787	46,206	72,740	45,407	51,135	50,171	62,244	50,563

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 the “loss (gain) on derivative financial instruments and foreign exchange” 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 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 the case mix index and provider taxes, occur with each state's fiscal year, which is July 1st for the majority of the states in which EHSI operates;
- Medicare rate changes generally occur October 1st (federal fiscal year), and typically include a market basket inflationary increase;
- Ontario long-term care providers receive annual acuity-based flow-through funding adjustments effective April 1st and accommodation funding increases July 1st, and Alberta long-term care providers receive annual inflationary rate increases on April 1st;
- utility costs are generally at their highest in the first quarter and their lowest in the third quarter, with differences between the two of as much as \$3.0 million; and
- fluctuations in the U.S. dollar and foreign currency translation of our U.S. operations.

Further details on the above can be found under the sections “Key Performance Indicators”, “Impact of U.S. Dollar and Foreign Currency Translation”, “Significant Developments” and “Update of Legislative Actions Affecting Revenue”.

2009 SECOND QUARTER FINANCIAL REVIEW

<i>(thousands of dollars unless otherwise noted)</i>	Q2 2009	Q2 2008	\$ Change Q2/09 vs Q2/08	Q1 2009	\$ Change Q2/09 vs Q1/09
Earnings (loss) from Continuing Operations					
U.S. operations (US\$)	20,919	5,939	14,980	5,561	15,358
U.S. operations (C\$)	24,993	5,984	19,009	6,953	18,040
Canadian operations	4,717	3,525	1,192	(2,503)	7,220
Earnings from continuing operations	29,710	9,509	20,201	4,450	25,260
Discontinued operations	534	1,168	(634)	(793)	1,327
Net earnings	30,244	10,677	19,567	3,657	26,587
Diluted Earnings per Unit (\$)					
Earnings from continuing operations	0.41	0.14	0.27	0.06	0.35
Net earnings	0.41	0.15	0.26	0.05	0.36
Earnings (loss) from Continuing Operations before Undernoted Separately Reported Items					
U.S. operations (US\$)	13,950	5,120	8,830	7,808	6,142
U.S. operations (C\$)	16,511	5,182	11,329	9,732	6,779
Canadian operations	1,891	2,400	(509)	(208)	2,099
Earnings from continuing operations before undernoted separately reported items	18,402	7,582	10,820	9,524	8,878
Gain (loss) on derivative financial instruments and foreign exchange, net of taxes	11,688	1,927	9,761	(5,245)	16,933
Gain (loss) from asset impairment, disposals and other items, net of taxes	(380)	–	(380)	171	(551)
Earnings from continuing operations	29,710	9,509	20,201	4,450	25,260
Average US/Canadian dollar exchange rate	1.1672	1.0102		1.2456	

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 1.1672 for the 2009 second quarter, 1.0102 for the 2008 second quarter, and 1.2456 for the 2009 first quarter. However, separately reported items such as gains or losses related to derivative 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

<i>(millions of dollars unless otherwise noted)</i>	Q2		Q2/09 vs Q2/08		Q1	Q2/09 vs Q1/09	
	2009	2008	(\$)	(%)	2009	(\$)	(%)
Revenue	563.1	488.6	74.5	15.2	584.2	(21.1)	(3.6)
Operating expenses	467.8	420.5	47.3	11.2	495.8	(28.0)	(5.6)
Administrative costs	18.9	19.5	(0.6)	(3.1)	19.9	(1.0)	(5.0)
Lease costs	3.7	3.2	0.5	15.6	3.7	–	–
EBITDA	72.7	45.4	27.3	60.1	64.8	7.9	12.2
<i>EBITDA as a % of revenue</i>	12.9%	9.3%			11.1%		

CONSOLIDATED CONTINUING OPERATIONS COMPARED TO THE 2008 SECOND QUARTER

Revenue from continuing operations improved 15.2% to \$563.1 million in the 2009 second quarter from \$488.6 million in the 2008 second quarter, and excluding the impact of the weaker Canadian dollar, revenue grew 4.2%. The contribution to revenue from new centers acquired or built since January 2008 was \$7.1 million this quarter and \$0.9 million in the 2008 second quarter, for an increase of \$6.2 million between quarters. These new centers related to a skilled nursing center that was completed and opened in January 2008, and the acquisition of three Manitoba nursing centers in October 2008 that we had previously operated under management contracts. The weaker Canadian dollar favourably impacted same-facility revenue by \$53.7 million. Excluding this positive foreign exchange impact, revenue from same-facility operations improved between periods by \$14.6 million, or 3.0%, as a result of funding improvements, partially offset by lower U.S. occupancy levels.

EBITDA from continuing operations grew \$27.3 million to \$72.7 million in the 2009 second quarter from \$45.4 million in the same 2008 period, and as a percent of revenue improved to 12.9% from 9.3%. New centers contributed EBITDA of \$1.0 million this quarter. EBITDA from same-facility operations improved \$26.3 million to \$71.7 million in the 2009 second quarter from \$45.4 million in the 2008 second quarter. Excluding the positive impact of the weaker Canadian dollar of \$7.9 million, EBITDA improved \$18.4 million, or 40.5%, reflecting the \$14.6 million improvement in revenue and a \$3.8 million reduction in operating, administrative and lease costs from same-facility operations. The Canadian operations contributed \$2.0 million and the U.S. operations contributed \$16.4 million to the \$18.4 million growth in same-facility EBITDA, which are discussed further below.

Labour-related costs from continuing operations represented 74.1% of operating and administrative costs in the 2009 second quarter compared to 73.9% in the same 2008 period, and as a percent of revenue, were 64.1% and 66.6%, respectively.

CONSOLIDATED CONTINUING OPERATIONS COMPARED TO THE 2009 FIRST QUARTER

Revenue from continuing operations declined \$21.1 million, or 3.6%, from \$584.2 million in the 2009 first quarter. However, exclusive of a negative impact of a stronger Canadian dollar this quarter of \$27.3 million, revenue increased \$6.2 million from the 2009 first quarter. An improvement in revenue from the Canadian operations was partially offset by a decline in revenue from the U.S. operations due to lower census levels.

EBITDA from continuing operations improved \$7.9 million, or 12.2%, from \$64.8 million in the 2009 first quarter to \$72.7 million in the 2009 second quarter. Excluding the negative impact of a stronger Canadian dollar, EBITDA increased \$11.5 million, or 17.8%, with improvements from both the U.S. and Canadian operations, as discussed below.

U.S. Continuing Operations

<i>(millions of dollars unless otherwise noted)</i>	Q2				Q2/09 vs Q2/08		Q1		Q2/09 vs Q1/09	
	2009		2008		(\$)	(%)	2009		(\$)	(%)
	US\$	C\$	US\$	C\$	US\$	US\$	US\$	C\$	US\$	US\$
Revenue	345.4	<i>403.0</i>	333.9	337.3	11.5	3.4%	346.2	<i>431.3</i>	(0.8)	(0.2)%
Operating expenses	282.8	<i>329.6</i>	288.0	290.9	(5.2)	(1.8)%	290.5	<i>361.8</i>	(7.7)	(2.7)%
Administrative costs	11.6	<i>13.5</i>	11.2	<i>11.4</i>	0.4	3.6%	11.7	<i>14.6</i>	(0.1)	(0.9)%
Lease costs	2.2	<i>2.6</i>	2.3	2.3	(0.1)	(4.3)%	2.1	2.7	0.1	4.8%
EBITDA	48.8	<i>57.3</i>	32.4	32.7	16.4	50.6%	41.9	52.2	6.9	16.4%
<i>EBITDA as a % of revenue</i>	14.1%		<i>9.7%</i>				<i>12.1%</i>			

U.S. OPERATIONS COMPARED TO THE 2008 SECOND QUARTER

Revenue from U.S. operations grew 3.4% in its functional currency to US\$345.4 million in the 2009 second quarter compared to US\$333.9 million in the 2008 second quarter, representing an increase of US\$11.5 million, of which US\$1.2 million was from the newly built skilled nursing center in Holland, Michigan that opened in 2008. Revenue from same-facility operations increased by US\$10.3 million, or 3.1%, between periods. Improvements resulted primarily from increases in average nursing center rates contributing additional revenue of US\$16.8 million in the 2009 second quarter. Higher rates reflected both inflationary increases, as well as higher average acuity levels. The favourable impact of higher average rates was only partially offset by lower occupancy levels, which reduced revenue by US\$10.1 million between periods. In addition, our nursing center operations benefited from prior period revenue settlement adjustments this quarter as compared to the 2008 second quarter of US\$0.4 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 2008 second quarter from same-facility U.S. operations.

(US\$ millions)

16.8	– increase in average skilled nursing center rates (Medicare \$7.7 million, Medicaid \$4.9 million, and private/other \$4.2 million)
(10.1)	– decrease in skilled nursing center resident census (Medicare \$(10.4) million, Medicaid \$0.9 million, and private/other \$(0.6) million)
2.3	– increase in nursing ancillary revenue
0.4	– increase in prior period revenue settlement adjustments, primarily due to Medicaid adjustments favourable in Pennsylvania of \$1.7 million partially offset by unfavourable Michigan adjustments of \$1.3 million due to revised estimates for reimbursable costs dating back to October 1, 2008
0.9	– other
10.3	

The operating, administrative and lease costs of our U.S. operations decreased by US\$4.9 million to US\$296.6 million this quarter in comparison to the 2008 second quarter of US\$301.5 million. Labour-related costs represented 70.4% of operating and administrative costs this quarter, compared to 70.0% in the 2008 second quarter, and as a percent of revenue were 59.9% and 62.7%, respectively. The Holland, Michigan skilled nursing center that opened in 2008 and start-up of the Okemos, Michigan skilled nursing center that opened in July increased operating, administrative and lease costs by US\$1.0 million.

U.S. operations same-facility operating, administrative and lease costs decreased by US\$5.9 million this quarter in comparison to the 2008 second quarter. Operating costs were favourably impacted this quarter by lower workers' compensation and health benefit costs, a reduction in state assessment and provider taxes primarily in Michigan, a decline in bad debt provisions, and a reduction in the use of temporary staffing. The significant variances are summarized in the table below.

(US\$ millions)

(1.1)	– decrease in labour-related costs of 0.6%, excluding workers' compensation and health benefits, and including an average wage rate increase of 1.3% in skilled nursing center operations
(1.8)	– decrease in health benefits and workers' compensation
(1.4)	– decrease in provision for bad debts
(1.0)	– decrease in utilities, phone and travel costs
(0.5)	– decrease in state assessment and provider taxes primarily in Michigan
(0.1)	– other costs
(5.9)	

EBITDA from U.S. operations increased US\$16.4 million, or 50.6%, to US\$48.8 million in the 2009 second quarter from US\$32.4 million in the 2008 second quarter, and as a percent of revenue grew to 14.1% from 9.7%. The two new Michigan skilled nursing centers contributed US\$0.2 million to the improvement. EBITDA from same-facility operations was US\$48.7 million this quarter compared to US\$32.5 million in the 2008 second quarter. The improvement in same-facility EBITDA of US\$16.2 million, or 49.8%, was due primarily to funding increases, improved performance of previously challenged skilled nursing centers, and cost controls, partially offset by lower census. In the 2008 second quarter, the impact of start-up and clinically challenged facilities, and prior period workers' compensation charges impacted our earnings by approximately US\$4.0 million.

U.S. OPERATIONS COMPARED TO THE 2009 FIRST QUARTER

In comparison to the 2009 first quarter, revenue from U.S. operations this quarter declined US\$0.8 million, or 0.2%, primarily due to lower census levels partially offset by the impact of one additional day in this quarter. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

EBITDA from U.S. operations increased US\$6.9 million, or 16.4%, to US\$48.8 million in the 2009 second quarter from US\$41.9 million in the 2009 first quarter, and as a percent of revenue was 14.1% compared to 12.1%. This improvement, despite lower revenue, was primarily due to: lower seasonal utility costs of US\$2.2 million, a reduction in bad debt provisions of US\$1.9 million, reduced workers' compensation costs of US\$1.1 million, lower health benefits of US\$1.5 million, and other cost controls.

Canadian Continuing Operations

<i>(millions of dollars unless otherwise noted)</i>	Q2		Q2/09 vs Q2/08		Q1	Q2/09 vs Q1/09	
	2009	2008	(\$)	(%)	2009	(\$)	(%)
Revenue	160.1	151.3	8.8	5.8%	152.9	7.2	4.7%
Operating expenses	138.2	129.6	8.6	6.6%	134.0	4.2	3.1%
Administrative costs	5.4	8.1	(2.7)	(33.3)%	5.3	0.1	1.9%
Lease costs	1.1	0.9	0.2	22.2%	1.0	0.1	10.0%
EBITDA	15.4	12.7	2.7	21.3%	12.6	2.8	22.2%
<i>EBITDA as a % of revenue</i>	9.7%	8.4%			8.2%		

CANADIAN OPERATIONS COMPARED TO THE 2008 SECOND QUARTER

Revenue from Canadian operations grew \$8.8 million, or 5.8%, to \$160.1 million in the 2009 second quarter from \$151.3 million in the 2008 second quarter. Of this improvement, \$10.1 million was derived from nursing home operations, and included a \$4.6 million contribution from the three Manitoba nursing centers acquired in October 2008, with the remainder representing funding to enhance resident care and timing of revenue recognition to match spending under the Ontario nursing home flow-through envelopes. Revenue from home health care operations declined \$0.7 million this quarter despite increased volumes and rates, due to less Caplan funding recognized to match related costs. Other revenue declined \$0.6 million primarily due to lower investment income and management contracts.

Operating, administrative and lease costs increased \$6.1 million, or 4.7%, to \$144.7 million this quarter from \$138.6 million in the 2008 second quarter. Labour-related costs increased \$5.5 million between periods and represented 83.1% of operating and administrative costs in the 2009 second quarter compared to 82.6% in the 2008 second quarter, and as a percent of revenue were 74.5% and 75.2%, respectively. The 2008 second quarter labour costs included a non-recurring \$2.4 million charge for executive compensation.

EBITDA from Canadian operations improved \$2.7 million to \$15.4 million in the 2009 second quarter from \$12.7 million in the 2008 second quarter, of which \$2.4 million related to an executive compensation charge recorded in 2008 and \$0.7 million was from acquisitions. EBITDA from remaining operations declined \$0.4 million primarily due to timing of spending under the Ontario nursing home envelope system, increased labour costs of the home health care operations due to elect-to-work holiday pay and lower investment income, partially offset by funding enhancements.

CANADIAN OPERATIONS COMPARED TO THE 2009 FIRST QUARTER

In comparison to the 2009 first quarter, revenue from Canadian operations improved \$7.2 million, or 4.7%. Revenue from nursing home operations increased \$4.5 million as a result of timing of revenue recognized to match spending under the Ontario nursing home envelopes, funding increases to enhance resident care, and one additional day in the quarter. Home health care revenue increased \$2.8 million due to an increase in average daily hours of service provided, and one more day between periods.

EBITDA from Canadian operations increased \$2.8 million to \$15.4 million in the 2009 second quarter from \$12.6 million in the 2009 first quarter, primarily due to a seasonal decline in utility costs, timing of spending under the Ontario nursing home envelope system, improved margins in the home health care operations and the additional day this quarter.

Depreciation, Amortization and Accretion

Depreciation, amortization and accretion costs were higher by \$2.8 million in the 2009 second quarter compared to the 2008 second quarter, of which \$1.8 million was due to the impact of the weaker Canadian dollar, and the remainder due to completed construction projects and capital maintenance expenditures.

Interest

Interest expense, net of interest income, increased \$4.0 million to \$23.8 million in the 2009 second quarter from \$19.8 million in the 2008 second quarter, of which \$2.0 million was due to the impact of the weaker Canadian dollar. The \$2.0 million balance of the increase was primarily due to the issuance of \$92.0 million of convertible debentures in June 2008 and the assumption of debt related to acquisitions.

Loss (Gain) on Derivative Financial Instruments and Foreign Exchange

The REIT reported a pre-tax gain of \$12.4 million in the 2009 second quarter, which was comprised of a gain of \$9.3 million related to the valuation of derivative financial instruments and a foreign exchange gain of \$3.1 million on intercompany transactions. The 2008 second quarter results included a pre-tax gain of \$2.0 million, related to a \$1.0 million gain on the valuation of derivative financial instruments and a \$1.0 million foreign exchange gain on intercompany borrowings. The 2009 first quarter results included a pre-tax loss of \$5.0 million, related to a \$3.3 million loss on the valuation of derivative financial instruments and a \$1.7 million foreign exchange loss on intercompany borrowings.

EHSI has FCFCs in place to fix the exchange rate on acquiring Canadian dollars in exchange for US\$4.0 million per month until June 2011. For further information on these forward contracts, refer to "Impact of U.S. Dollar and Foreign Currency Translation – Impact of Foreign Currency Forward Contract Strategy on Distributions".

<i>(thousands of dollars unless otherwise noted)</i>	Q2 2009	Q2 2008	Q1 2009
Loss (Gain) on Derivative Financial Instruments and Foreign Exchange			
U.S. operations (US\$)	(7,932)	(1,001)	2,009
U.S. operations (C\$)	(9,609)	(985)	2,484
Canadian operations	(2,815)	(1,060)	2,466
	(12,424)	(2,045)	4,950
Loss (Gain) on Derivative Financial Instruments and Foreign Exchange, Net of Income Tax			
U.S. operations (US\$)	(7,316)	(819)	2,247
U.S. operations (C\$)	(8,873)	(802)	2,779
Canadian operations	(2,815)	(1,125)	2,466
	(11,688)	(1,927)	5,245

With respect to the foreign exchange contracts, the REIT reports a future tax provision (or recovery) for unrealized gains (or losses) on the foreign exchange contracts until the contract payments are made, resulting in realized gains (or losses) and a current tax provision.

Regarding our internal corporate loans, in addition to cross-border internal advances between subsidiaries, we have established a Canadian dollar long-term internal corporate loan between two of our U.S. subsidiaries that has a 25-year amortization period and matures in 2014. The change in the Canadian to U.S. dollar does not result in any consolidated gain or loss on this loan; however, a consequential unrealized tax expense or recovery can exist due to the imbalance in the tax treatments of the related entities. Although the foreign currency exposure cannot be hedged, the REIT believes that due to the long-term nature of the note, it can mitigate any negative tax consequences from the loan structure. The unrealized tax expense or recovery is reported as a future tax provision until realized.

Loss (Gain) from Asset Impairment, Disposals and Other Items

In the 2009 second quarter the REIT reported a pre-tax loss from asset impairment, disposals and other items of \$0.6 million (\$0.4 million after tax), related to the write-off of pre-development costs on a discontinued project.

Income Taxes

The tax provision from continuing operations was \$13.9 million in the 2009 second quarter compared to \$3.7 million in the 2008 second quarter, representing effective tax rates of 31.8% and 28.2%, respectively. The effective tax rates for each period were distorted by the gains and losses from derivative financial instruments, foreign exchange, asset impairment, disposals and other items. Excluding these items, the effective tax rate for the 2009 second quarter was 42.1% compared to 32.3% in the 2008 second quarter. The increase in the effective tax rate this quarter was primarily due to: (i) a higher proportion of income generated from U.S. operations which carry a higher effective rate; and (ii) reduced earnings from the REIT's non-taxable captive insurance companies.

Discontinued Operations

Discontinued operations reported earnings of \$0.5 million in the 2009 second quarter. Discontinued operations in the 2008 second quarter reported earnings of \$1.2 million, which included a release of excess reserves for self-insured general and professional liability claims of \$0.9 million, and a \$0.1 million pre-tax recovery on the disposal of two previously closed facilities for proceeds of \$1.0 million. For further information see "Significant Developments – Discontinued Operations" and *note 8* of the unaudited consolidated financial statements for the six months ended June 30, 2009.

2009 SIX MONTH FINANCIAL REVIEW

The following is a summary of net earnings by reporting segment.

<i>(millions of dollars unless otherwise noted)</i>	Six months ended June 30, 2009				Six months ended June 30, 2008			
	U.S. <i>(US\$)</i>	U.S.	Canada	Total	U.S. <i>(US\$)</i>	U.S.	Canada	Total
Revenue	691.7	834.3	313.1	1,147.4	667.5	672.3	293.8	966.1
Operating expenses	573.3	691.5	272.2	963.7	571.9	576.0	256.2	832.2
Administrative costs	23.3	28.1	10.7	38.8	22.2	22.4	13.6	36.0
Lease costs	4.4	5.3	2.1	7.4	4.4	4.4	1.9	6.3
	601.0	724.9	285.0	1,009.9	598.5	602.8	271.7	874.5
EBITDA	90.7	109.4	28.1	137.5	69.0	69.5	22.1	91.6
Depreciation, amortization and accretion	23.8	28.6	6.7	35.3	22.5	22.7	5.6	28.3
Interest expense, net	25.2	30.5	18.0	48.5	26.5	26.7	13.0	39.7
Earnings from continuing operations before income taxes and undernoted separately reported items	41.7	50.3	3.4	53.7	20.0	20.1	3.5	23.6
Gain (loss) on derivative financial instruments and foreign exchange	5.9	7.1	0.3	7.4	(3.9)	(3.9)	1.8	(2.1)
Gain (loss) from asset impairment, disposals and other items	(0.5)	(0.6)	0.3	(0.3)	–	–	–	–
Earnings from continuing operations before income taxes	47.1	56.8	4.0	60.8	16.1	16.2	5.3	21.5
Income tax expense	20.6	24.8	1.8	26.6	7.1	7.2	1.2	8.4
Earnings from continuing operations	26.5	32.0	2.2	34.2	9.0	9.0	4.1	13.1
Discontinued operations	(0.2)	(0.3)	–	(0.3)	1.1	1.2	–	1.2
Net earnings	26.3	31.7	2.2	33.9	10.1	10.2	4.1	14.3
Components of Diluted Earnings (Loss) per Unit (\$)								
Continuing health care operations before undernoted				0.38				0.21
Gain (loss) on derivative financial instruments and foreign exchange				0.09				(0.02)
Gain (loss) from asset impairment, disposals and other items				–				–
Earnings from continuing operations				0.47				0.19
Discontinued operations				(0.01)				0.01
Net earnings				0.46				0.20
Average US/Canadian dollar exchange rate				1.2062				1.0072

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 1.2062 for the first six months of 2009 and 1.0072 for the first six months of 2008. However, separately reported items such as gains or losses related to derivative 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.

The following is a summary by reporting segment of the after-tax amounts for earnings from continuing health care operations excluding and including the separately reported gains and losses on derivative financial instruments, foreign exchange, asset impairment, disposals and other items.

<i>(millions of dollars unless otherwise noted)</i>	Six months ended June 30, 2009				Six months ended June 30, 2008			
	U.S. <i>(US\$)</i>	U.S.	Canada	Total	U.S. <i>(US\$)</i>	U.S.	Canada	Total
Earnings from continuing operations before undernoted separately reported items	21.8	26.2	1.7	27.9	12.3	12.4	2.3	14.7
Gain (loss) on derivative financial instruments and foreign exchange, net of taxes	5.0	6.1	0.3	6.4	(3.3)	(3.4)	1.8	(1.6)
Gain (loss) from asset impairment, disposals and other items, net of taxes	(0.3)	(0.3)	0.2	(0.1)	–	–	–	–
Earnings from continuing operations	26.5	32.0	2.2	34.2	9.0	9.0	4.1	13.1

Consolidated Continuing Operations

Revenue from continuing operations improved 18.8% to \$1,147.4 million in the first half of 2009 from \$966.1 million in the same 2008 period, and exclusive of the impact of the weaker Canadian dollar, revenue grew 4.5%. The contribution to revenue from new centers acquired or built since January 2008 was \$13.9 million in the first half of 2009 and \$1.2 million in the first half of 2008, for an increase of \$12.7 million between periods. These new centers related to a skilled nursing center that was completed and opened in January 2008, and the acquisition of three Manitoba nursing centers in October 2008 that we had previously operated under management contracts. The weaker Canadian dollar favourably impacted same-facility revenue by \$136.8 million. Exclusive of this positive foreign exchange impact, revenue from same-facility operations improved between periods by \$31.8 million, or 3.3%, due to funding improvements, partially offset by lower U.S. occupancy levels.

EBITDA from continuing operations improved \$45.9 million to \$137.5 million in the first half of 2009 from \$91.6 million in the same 2008 period, and as a percent of revenue improved to 12.0% from 9.5%. New centers contributed EBITDA of \$1.8 million in the first half of 2009 compared to a loss of \$0.2 million in the same 2008 period, for a net improvement of \$2.0 million. EBITDA from same-facility operations improved \$43.9 million to \$135.7 million in the first half of 2009 from \$91.8 million in the same 2008 period. Exclusive of the positive impact of the weaker Canadian dollar of \$18.0 million, EBITDA improved \$25.9 million, or 28.3%, reflecting the \$31.8 million improvement in revenue, partially offset by a \$5.9 million increase in operating, administrative and lease costs from same-facility operations. The Canadian operations contributed \$5.0 million and the U.S. operations contributed \$20.9 million to the \$25.9 million growth in same-facility EBITDA, which are discussed further below.

Labour-related costs from continuing operations represented 73.8% of operating and administrative costs in both of the 2009 and 2008 periods, and as a percent of revenue, were 64.5% and 66.3%, respectively.

U.S. Operations

Revenue from U.S. operations grew 3.6% in its functional currency to US\$691.7 million in the first half of 2009 compared to US\$667.5 million in the same 2008 period, representing an increase of US\$24.2 million, of which US\$3.1 million was from the Holland, Michigan skilled nursing center that opened in 2008. Revenue from same-facility operations increased by US\$21.1 million, or 3.2%, between periods. Improvements resulted primarily from increases in average nursing center rates contributing additional revenue of US\$36.2 million. Higher rates reflected both inflationary increases, as well as higher average acuity levels. The favourable impact of higher average rates was only partially offset by lower occupancy levels, which reduced revenue by US\$18.3 million between periods. In addition, our nursing center operations benefited from prior period revenue settlement adjustments in the first half 2009 as compared to the same 2008 period of US\$1.7 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 for the first six months of 2009 in comparison to the same 2008 period from same-facility U.S. operations.

(US\$ millions)

36.2	– increase in average skilled nursing center rates (Medicare \$15.9 million, Medicaid \$11.2 million, and private/other \$9.1 million)
(18.3)	– decrease in skilled nursing center resident census (Medicare \$(19.3) million, Medicaid \$0.4 million, and private/other \$0.6 million)
2.9	– increase in nursing ancillary revenue
1.7	– increase in prior period revenue settlement adjustments, primarily due to Medicaid adjustments favourable in Pennsylvania of \$1.7 million and other of \$0.7 million, partially offset by unfavourable Michigan adjustments of \$0.7 million due to revised estimates for reimbursable costs dating back to October 1, 2008
(3.3)	– decrease due to one less day between periods
1.9	– other
21.1	

The operating, administrative and lease costs of our U.S. operations increased by US\$2.5 million to US\$601.0 million in the first half of 2009 in comparison to the same 2008 period of US\$598.5 million. Labour-related costs represented 70.3% of operating and administrative costs in the first half of 2009, compared to 69.8% in the same 2008 period, and as a percent of revenue were 60.6% and 62.2%, respectively. The Holland, Michigan skilled nursing center that opened in 2008 and start-up of the Okemos, Michigan skilled nursing center that opened in July increased operating, administrative and lease costs by US\$2.2 million.

U.S. operations same-facility operating, administrative and lease costs increased by US\$0.3 million in the first half of 2009 in comparison to the same 2008 period. Despite an increase in labour costs due to wage rates, operating costs were favourably impacted in the first half of 2009 by lower workers' compensation costs, a reduction in state assessment and provider taxes primarily in Michigan, a decline in bad debt provisions, a reduction in the use of temporary staffing, and one less day between periods. The significant variances are summarized in the table below.

(US\$ millions)

2.4	– rise in labour-related costs of 0.6%, excluding workers' compensation and health benefits, and including an average wage rate increase of 1.5% in skilled nursing center operations, partially offset by one less day in the period
0.2	– increase in health benefits partially offset by favourable workers' compensation costs
(1.9)	– decrease in provision for bad debts
(1.7)	– decrease in state assessment and provider taxes primarily in Michigan, of which \$0.7 million related to 2008
(1.2)	– decrease in advertising
1.2	– increase in food, medical equipment and supplies
1.3	– other costs
0.3	

EBITDA from U.S. operations increased US\$21.7 million, or 31.4%, to US\$90.7 million in the first half of 2009 from US\$69.0 million in the same 2008 period, and as a percent of revenue was 13.1% compared to 10.3%. The two new Michigan skilled nursing centers contributed US\$0.9 million to the improvement. EBITDA from same-facility operations was US\$90.3 million in the first half of 2009 compared to US\$69.5 million in the same 2008 period. The improvement in same-facility EBITDA of US\$20.8 million, or 29.9%, was due primarily to funding increases, improved performance of previously challenged skilled nursing centers, and cost controls, partially offset by lower census. In the first half of 2008, the impact of start-up and clinically challenged facilities, unique bad debt charges for certain facilities in Pennsylvania, and prior period workers' compensation and property tax charges impacted our earnings by approximately US\$8.7 million.

Canadian Operations

Revenue from Canadian operations grew \$19.3 million, or 6.6%, to \$313.1 million in the first six months of 2009 from \$293.8 million in the first six months of 2008. Of this improvement, \$18.9 million was derived from nursing home operations, and included a \$8.7 million contribution from acquisitions, with the remainder representing funding to enhance resident care. Revenue from home health care operations improved by \$1.0 million, with improved volumes and rates partially offset by less Caplan funding recognized to match related costs. Other revenue declined \$0.6 million due to lower investment income and management contracts.

Operating, administrative and lease costs increased \$13.3 million, or 4.9%, to \$285.0 million in the first half of 2009 from \$271.7 million in the same 2008 period. Labour-related costs increased \$12.1 million between periods and represented 82.9% of operating and administrative costs in the first half of 2009 compared to 82.4% in the first half of 2008, and as a percent of revenue were 74.9% and 75.7%, respectively.

EBITDA from Canadian operations improved \$6.0 million to \$28.1 million in the first six months of 2009 from \$22.1 million in the first six months of 2008, of which \$2.4 million related to a non-recurring executive compensation charge recorded in 2008, \$1.0 million was from acquisitions, and the remaining \$2.6 million improvement was primarily due to funding enhancements, lower utility costs and timing of spending under the Ontario nursing home envelope system.

Depreciation, Amortization and Accretion

Depreciation, amortization and accretion costs were higher by \$7.0 million in the first six months of 2009 compared to the same 2008 period. Excluding a \$4.7 million unfavourable impact from the weaker Canadian dollar, these costs rose by \$2.3 million, primarily due to completed construction projects and capital maintenance expenditures.

Interest

Interest expense, net of interest income, increased \$8.8 million to \$48.5 million in the first six months of 2009 from \$39.7 million in the first six months of 2008. Excluding an unfavourable impact of \$5.1 million from the weaker Canadian dollar, net interest costs increased \$3.7 million between periods primarily due to the issuance of \$92.0 million of convertible debentures in June 2008, and the assumption of debt related to acquisitions.

Loss (Gain) on Derivative Financial Instruments and Foreign Exchange

The REIT reported a pre-tax gain of \$7.4 million in the first half of 2009, which was comprised of a gain of \$6.0 million related to the valuation of derivative financial instruments and a foreign exchange gain of \$1.4 million on intercompany transactions. The results for the first half of 2008 included a pre-tax loss of \$2.1 million, related to a \$3.9 million loss on the valuation of derivative financial instruments, partially offset by a \$1.8 million foreign exchange gain on intercompany borrowings. For the year 2008, the REIT recorded a pre-tax loss of \$25.3 million, which was comprised of a loss of \$25.6 million related to the valuation of derivative financial instruments, partially offset by a foreign exchange gain of \$0.3 million on intercompany transactions.

EHSI has FCFCs in place to fix the exchange rate on acquiring Canadian dollars in exchange for US\$4.0 million per month until June 2011. For further information on these forward contracts, refer to "Impact of U.S. Dollar and Foreign Currency Translation – Impact on Distributions – Foreign Currency Forward Contract Strategy".

Loss (Gain) from Asset Impairment, Disposals and Other Items

In the first six months of 2009, the REIT reported a pre-tax loss from asset impairment, disposals and other items of \$0.3 million (\$0.1 million after tax), related to a \$0.6 million charge for the write-off of pre-development costs on a discontinued project, partially offset by a \$0.3 million gain on redemption of convertible debentures acquired under the normal course issuer bid.

Income Taxes

The tax provision from continuing operations was \$26.7 million in the first six months of 2009 compared to \$8.4 million in the same 2008 period, representing effective tax rates of 43.8% and 39.0%, respectively. The effective tax rates for each period were distorted by the gains and losses from derivative financial instruments, foreign exchange, asset impairment, disposals and other items. Excluding these items, the effective tax rate for the first six months of 2009 was 48.0% compared to 37.8% in the first six months of 2008. The increase in the effective tax rate in the first half of 2009 was primarily due to: a higher proportion of income generated from U.S. operations which carry a higher effective rate; (ii) reduced earnings from the REIT's non-taxable captive insurance companies; and (iii) an increase in the effective tax rate of U.S. operations from more non-deductible expenses and change in state income tax rules.

The REIT began recording an income tax provision for SIFT tax in June 2007 as a result of new legislation, retroactive to January 1, 2007. The provision represents management's best estimate based on its understanding of the SIFT tax rules and the REIT's current structure. For further information on the SIFT tax, refer to the discussion under "Significant Developments – Canadian Federal Income Tax on Income Trusts".

Discontinued Operations

Discontinued operations reported a loss of \$0.3 million in the first six months of 2009, which included a pre-tax recovery of \$1.4 million (an after-tax loss of \$0.8 million) on the disposal of two Ohio skilled nursing centers for proceeds of \$11.1 million (US\$8.7 million). Discontinued operations in the first half of 2008 reported earnings of \$1.2 million, which included a release of excess reserves for self-insured general and professional liability claims of \$0.9 million, and a \$1.4 million pre-tax recovery on the disposal of assets for proceeds of \$2.5 million. For further information see "Significant Developments – Discontinued Operations" and *note 8* of the unaudited consolidated financial statements for the six months ended June 30, 2009.

SIGNIFICANT DEVELOPMENTS

The following developments had a significant effect on the financial results of Extencicare REIT for the first half of 2009 in comparison to the year ended 2008.

Canadian SIFT and U.S. REIT Income Tax Updates

CANADIAN FEDERAL INCOME TAX ON INCOME TRUSTS

On October 31, 2006, the day before Extencicare was initially scheduled to have completed 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. Extencicare REIT is a SIFT, and is therefore subject to the SIFT Rules. Furthermore, due to the nature of its income and investments, Extencicare REIT does not qualify for the exemption from the SIFT Rules applicable to "real estate investment trusts" (as defined in the SIFT Rules). As a result, Extencicare 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 Extencicare REIT as a SIFT, although they confirm that Extencicare Trust, which is wholly owned by Extencicare REIT, is not a SIFT. Management has assessed the impact of the SIFT Amendments on Extencicare LP and has concluded that Extencicare LP should not be treated as a SIFT.

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 on or after July 14, 2008 and before 2013.

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.

With respect to the above Canadian SIFT and U.S. REIT income tax matters, which are very complex, senior management is continuing its review of them and their application to the organizational structure of the REIT and its unitholders. The Board of Trustees and senior management of the REIT are continuously reviewing the REIT's strategic objectives and all options available to it in respect thereof with a view to ensuring that the REIT's capital and organizational structure addresses the operational requirements of the business of the REIT and its subsidiaries as well as expansion and development opportunities.

Canadian GST on Long-term Residential Care Centers

On June 18, 2008, Bill C-50, the *Budget Implementation Act, 2008* received Royal Assent. The bill is effective February 27, 2008, and among other things, clarifies rules related to the application of goods and services tax, or GST, to the construction or purchase and operation of residential care centers. These amendments will affect the conditions for claiming a new residential rental property rebate for long-term residential care centers as well as the taxable status of head lease payments, and require self-assessment of GST for builder-operators of such centers. In April 2009, we completed discussions with the Canada Revenue Agency (CRA) regarding the application of these new rules on ECI's capital lease obligations of nine of its Ontario long-term care centers, which discussions concluded with no financial consequence to us. Consequently in 2009, we reversed the balance sheet adjustment to our capital lease obligations and offsetting financing costs.

2009 Ontario Budget – Sales Tax Harmonization

On March 26, 2009, the Province of Ontario released its 2009 budget, which among other things, proposes moving to a single, value-added sales tax at a combined rate of 13 percent on July 1, 2010. A number of our costs are not currently subject to both the goods and services tax and provincial sales tax, and under the harmonized tax regime could be subject to the higher single tax rate. The majority of services we provide as a for-profit provider of long-term care services are classified as exempt under a value-added tax system. We therefore cannot claim input tax credits to recover the value-added taxes that we may pay, nor are we eligible for rebates. Hence, any incremental taxes that may be subject to the services or purchases that we may make will not be recoverable and can only be offset by increases provided by the Ontario government. We are presently assessing the impact of this change, with plans to address the issue with the government, along with others in our industry.

Acquisitions

2008

On October 6, 2008, ECI acquired three Manitoba nursing homes (304 beds) for total consideration of approximately \$26.4 million, including assumption of existing debt of \$9.4 million, for a net cash cost of approximately \$17.0 million, prior to refinancing the properties. ECI refinanced the \$9.4 million of existing mortgages for \$17.0 million of conventional mortgages at a fixed-rate of 5.75%, with a five-year term and monthly payments based on a 25-year amortization period. Prior to the acquisition, ECI had operated these centers under management contracts for five years.

Development Projects

UNITED STATES

In July 2009, we completed the 100-bed skilled nursing center in Okemos, Michigan. EHSI has further internal growth projects underway to add one skilled nursing center (100 beds) and one assisted living center (60 units) in the 2009 fourth quarter. The total cost of these three projects is approximately US\$35.0 million, of which US\$21.0 million has been incurred through June 30, 2009. Two other projects that were in the pre-development stages were deferred at the end of 2008 as a result of the economic climate. The cost of one of these projects in Washington, totalling \$0.6 million (US\$0.5 million) was written off during the 2009 second quarter.

In June 2009, EHSI entered into a 10-year operating lease agreement for the construction of a nursing facility (100 beds) in South Bend, Indiana, which commences upon completion of construction, which is expected to be in the 2011 first quarter.

During 2008, EHSI completed two skilled nursing center projects at a total cost of US\$17.0 million. The first project added 77 beds in Holland, Michigan, of which only 10 beds were operational in the 2008 first quarter, following which all 77 beds were licensed in April 2008 to accept Medicare and Medicaid residents. The second project was a 100-bed skilled nursing center in Sequim, Washington, which replaced a 74-bed skilled nursing center in Port Angeles, Washington, of which 89 beds opened in January 2008, followed by 11 beds in April 2008.

CANADA

ECI has three senior care centers under development in Alberta representing 600 beds at a cost of approximately \$80.0 million, net of government grants, for completion through 2011.

Construction is in progress on the 280-bed continuing care center in Red Deer, Alberta, which is anticipated to be completed in the summer of 2010, at an estimated cost, net of government grants, of \$35.0 million, of which \$14.0 million has been incurred through June 30, 2009.

Construction began in April 2009, on a 140-unit designated assisted living center in Lethbridge, Alberta that will be completed in the spring of 2011. ECI currently operates older nursing centers in Lethbridge (120 beds) and Edmonton (113 beds), Alberta. The Alberta Health Services Board is presently evaluating the long-term needs for nursing center beds. We have agreed that we will cease operating our Lethbridge nursing center when the new center is built in 2011. In the meantime, we are continuing to explore alternate uses thereafter for the building.

In the 2009 third quarter, we anticipate commencing construction on a 180-unit long-term care center in Edmonton, Alberta that will be completed in the fall of 2011. There have been no discussions to date regarding the timing of closure of the Edmonton nursing center.

The estimated cost of the Lethbridge and Edmonton projects, net of government grants is \$45.0 million, of which \$3.0 million has been spent to June 30, 2009. The current combined annual EBITDA of the two existing centers is approximately \$2.3 million. The projected combined annual EBITDA of the two new centers, once fully operational, is expected to exceed \$5.0 million.

During 2007 ECI was awarded three projects representing 480 long-term care beds under the Ontario government's October 2006 emergency room wait time strategy that included the construction of 1,750 new and the replacement of 662 long-term care beds. In December 2008, it was decided that ECI would no longer be participating in these development projects. There were a number of factors considered in making this decision, the most significant being the availability and cost of capital in the current economic climate. At the time the proposals were submitted for these beds, we did not anticipate the global financial crisis. This and other factors have challenged the viability of these projects for ECI. As such, we believe the prudent course of action was to discontinue our involvement in them. All costs incurred totalling \$2.5 million were written off in the 2008 fourth quarter.

Financing Activity

UNITED STATES

EHSI Credit Facility due October 2009

In June 2009, EHSI amended and restated its US\$120.0 million credit facility that was due to mature in October 2009 and was formerly administered by Lehman Brothers, Inc. The amended and restated credit facility (the "EHSI Credit Facility") matures in June 2011 and has an option to extend for a third year to June 2012 upon satisfaction of certain conditions. The maximum borrowings under the EHSI Credit Facility were reduced from \$120.0 million to US\$70.0 million in line with anticipated cash requirements, and EHSI appointed U.S. Bank National Association as the lead arranger and administrative agent. The amount available to be borrowed under the EHSI Credit Facility is the lesser of: (1) 60% of the appraised values of the skilled nursing facilities collateralizing the EHSI Credit Facility; or (2) an amount based on the actual net cash flow of these facilities for the last 12 months. The amount available to be borrowed as of June 30, 2009, was US\$70.0 million. 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 EHSI Credit Facility is secured by mortgages on 21 skilled nursing facilities and is guaranteed by EHSI's parent, Extencicare Holdings, Inc., and EHSI's material domestic subsidiaries. EHSI's wholly owned subsidiary, Tendercare (Michigan) Inc. (Tendercare) and its subsidiaries remain classified as unrestricted subsidiaries under the EHSI Credit Facility; however, the entities are now specified non-recourse subsidiaries and 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.

The amount available to be borrowed under the EHSI Credit Facility as of June 30, 2009, was US\$70.0 million. EHSI had US\$11.0 million drawn and US\$3.7 million securing outstanding letters of credit, leaving the unused portion available for working capital and corporate purposes at US\$55.3 million as of June 30, 2009.

Sovereign Loans due June 2011

In June 2008, Tendercare refinanced US\$49.9 million of mortgage loans owing to LaSalle Bank with US\$51.0 million of mortgage financing from Sovereign Bank and a syndicate of other lenders (the "Sovereign Loans"). The Sovereign Loans are secured by first mortgages on 21 skilled nursing centers in Michigan, and have a three-year term with monthly payments based on a 25-year amortization period. Under the mortgage agreement, Tendercare and its subsidiaries are required to maintain a minimum consolidated fixed charge coverage ratio and the 21 skilled nursing centers securing the

loans are required to maintain a minimum combined debt service coverage ratio. At EHSI's option, the interest rate is equal to either U.S. prime plus a margin of 0.50% or LIBOR plus a margin of 3.25%.

LTC Letters of Credit

In August 2009, one of Extencicare's captive insurance companies, LTC Professional Insurance Company, Ltd. (LTC Professional) secured letters of credits in aggregate for US\$6.8 million in favour of a third-party insurer for general and liability claims. The letters of credit were issued by Bank of Montreal in Chicago and are secured by cash collateral of US\$7.2 million.

CANADA

2009 Mortgage Activity

In January 2009, ECI refinanced a \$6.0 million mortgage on an Ontario nursing center with \$8.9 million of CMHC financing at a fixed rate of 3.52%, with a five-year term, and monthly payments based on a 15-year amortization.

In June 2009, ECI obtained CMHC insured long-term financing on its Lethbridge, Alberta project of \$20.5 million (approximately 93% of the construction costs, net of government grants), plus CMHC fees of \$1.0 million. The loan has a term of 27 years, of which the first two years is for construction, following which it would be amortized over 25 years at a fixed rate of 7.70%. However, once the center is opened, the interest costs will be reimbursed through government funding for the rest of the term.

In July 2009, ECI obtained a CMHC insurance certificate to finance its Edmonton, Alberta project. Management anticipates securing construction financing in August in the amount of approximately \$17.6 million (approximately 77% of the construction costs, net of government grants). The loan is expected to have a term of two years, at which time we will secure long-term financing.

2008 Mortgage Activity

In July 2008, Extencicare refinanced \$10.3 million of mortgage loans on three Ontario nursing homes with \$20.7 million of CMHC financing at a fixed rate of 5.012%, with a five-year term, and monthly payments based on a 15-year amortization period.

In September 2008, ECI obtained CMHC insured construction financing on its Red Deer, Alberta project, for a maximum of \$30.4 million (approximately 87% of the construction costs, net of government grants), plus CMHC fees of \$1.6 million. The terms of the construction financing are over 24 months, with interest-only payments based on 30-day asset backed commercial paper rates plus 1.5%. Management plans to secure long-term financing for this project prior to its completion in the summer of 2010.

RBC Credit Facility

Extencicare has a credit facility with the Royal Bank of Canada (the "RBC Credit Facility") that is due on demand and used primarily to back letters of credit that renew annually. In June 2009, Extencicare amended the RBC Credit Facility to provide for the issuance of a U.S. dollar letter of credit facility of up to US\$22.2 million in addition to the existing \$70.0 million line of credit. The US\$22.2 million letter of credit was issued in favour of a third-party insurer for workers' compensation claims of EHSI that are renewed annually. It was secured by \$29.5 million of restricted cash of Extencicare that was held by RBC in short term investments at June 30, 2009. The \$70.0 million credit facility is secured by 14 Canadian nursing centers, and is guaranteed by certain Canadian operating subsidiaries of Extencicare. As at June 30, 2009, there were \$61.5 million of letters of credit issued against the \$70.0 million line, leaving \$8.5 million available. The letters of credit secure \$44.5 million of Extencicare's executive pension obligations, \$16.8 million of our obligation for contingent liabilities in connection with the sale of our investment in Crown Life Insurance Company (Crown Life) in 2007, and \$0.2 million related to construction. The letter of credit securing the executive pension obligations was renewed in March 2009, with a May 1, 2010, renewal date. The Crown Life letters of credit were renewed in July 2009.

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 and \$34.6 million of REIT Units (3,565,000 REIT Units at \$9.70 per unit). The net proceeds from the offering were \$120.6 million, of which \$27.4 million (US\$27.0 million) was used to reduce the balance outstanding under EHSI's Credit Facility, which arose principally from acquisitions completed last fall, and the remainder will be used to finance internal growth projects under development (see "Significant Developments – Development Projects").

Discontinued Operations

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. Earnings and associated taxes derived from both divested operations and operations that have been classified for disposition are reported separately within the consolidated statements of earnings as discontinued operations.

As at June 30, 2009, EHSI had assets held for sale with a net book value of \$15.3 million (US\$13.2 million) consisting of four skilled nursing centers, as follows: two in Minnesota, one in Ohio and a closed center in Washington. At December 31, 2008, assets held for sale had a net book value of \$13.6 million (US\$11.1 million).

In the 2009 first quarter, EHSI decided to actively pursue the sale of two nursing centers (245 beds) located in Minnesota, resulting in their reclassification to discontinued operations. No impairment charge was recorded since EHSI expects to sell these centers for proceeds in excess of their net book value. In March 2009, EHSI completed the sale of two Ohio skilled nursing centers with a net book value of US\$7.6 million, for net proceeds of US\$8.7 million.

During 2008 the disposal activity included a pre-tax impairment charge of \$0.9 million and a pre-tax recovery of \$8.5 million on the disposal of assets for proceeds of \$20.9 million. EHSI sold the \$0.3 million balance of assets held for sale at the end of 2007, consisting of one closed nursing property and its related licenses in Ohio, and a closed assisted living property in Oregon. In addition, during 2008 EHSI designated three Indiana and three Ohio skilled nursing centers, and one Pennsylvania assisted living center as held for sale, due to their financial and operational performance, with the financial results reclassified to discontinued operations. The Pennsylvania center and three Indiana centers were sold during 2008. As well, EHSI closed a skilled nursing center in Washington following the transfer of the residents to a newly built EHSI skilled nursing center in the region. The financial results of the Washington skilled nursing center were not reclassified to discontinued operations because the operations were transferred to another EHSI skilled nursing center and therefore, remained as part of ongoing operations.

More information on EHSI's discontinued operations is available in *note 8* of the unaudited consolidated financial statements for the six months ended June 30, 2009.

Legal Proceedings

The REIT and its consolidated subsidiaries are defendants in actions brought against them from time to time in connection with 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.

In late 2008, three class action lawsuits were filed against wholly owned U.S. based subsidiaries of the REIT in federal courts in Washington and Minnesota, and in a state court in Wisconsin. All of the lawsuits have essentially the same allegations that our advertising did not match with our regulatory history. The claims also include allegations that the centers admitted residents without due regard to their needs. The Washington complaint involves 15 centers during a four-year period beginning in August 2004; the Minnesota complaint involves 10 centers during a six-year period beginning in October 2002; and the Wisconsin complaint involves 26 centers during a three-year period beginning in November 2005.

Motions to dismiss were granted by the courts in both the Minnesota and Washington actions in March 2009, details of which are provided below. A similar motion to dismiss has been filed in the Wisconsin action that will be heard by the court in August 2009. We believe that the allegations in all of these cases are without merit, and we intend to continue to vigorously defend against the remaining lawsuit in court.

On March 4, 2009, the Minnesota federal district court judge ruled that the class action lawsuit filed in that state was improper and ordered the case dismissed in its entirety. The court stated that the lawyer-driven complaint "failed to identify any solid ground on which the Plaintiff could stand in this litigation". The Honorable Donovan W. Frank rejected all of the class action claims, and held that that the plaintiff's allegations "are so general and unspecific they cannot serve as the basis for a claim". Judge Frank further prohibited the plaintiff's attorneys from attempting to re-file the lawsuit with amended allegations because, given the weakness of the claim, it "would not likely be fruitful".

On March 24, 2009, the Washington federal district court judge ruled that the undisputed evidence demonstrated that the plaintiffs could not prove their supposed claims and issued a final judgement in our favour and ordered the case closed. The

Honorable John C. Coughenour found that the plaintiffs were not misled by any of EHSI's representations, and that none of the plaintiffs suffered any actual injury.

ASSISTED LIVING CONCEPTS, INC. TAX ALLOCATION AGREEMENT

As part of the spin-off of Assisted Living Concepts, Inc. (ALC) in 2006 to Extencicare's shareholders, EHSI and ALC entered into a tax allocation agreement dated as of November 10, 2006 (the "Tax Allocation Agreement"). ALC is asserting that EHSI owes an estimated US\$3.1 million to ALC 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. We disagree with this assertion and do not believe any liability has been incurred. We have not recorded any liability under the Tax Allocation Agreement as of June 30, 2009. It is likely that this issue will be decided prior to the end of 2009 by an independent arbitrator as provided in the Tax Allocation Agreement. If any liability is ultimately recorded, it will be charged directly to retained earnings since the spin-off of ALC was accounted for as a capital transaction in 2006.

UPDATE OF LEGISLATIVE ACTIONS AFFECTING REVENUE

Regulatory Environment Affecting Operations

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. The ongoing pressures from government programs, along with other payors seeking to control costs and/or limit reimbursement rates for medical services, are a risk to us. We also operate in a heavily regulated industry, subject to the scrutiny of federal, state and/or provincial regulators. All long-term care providers are subject to surveys and inspections by government authorities to ensure compliance with applicable laws and licensure requirements of the federal, state and/or provincial funding programs. Each of our nursing centers must comply with regulations regarding staffing levels, resident care standards, occupational health and safety, resident confidentiality, billing and reimbursement, along with environmental, biological and other standards. Government agencies have steadily increased their enforcement activity over the past several years. We continually allocate increased resources to ensure compliance with applicable regulations and to respond to inspections, investigations and/or enforcement actions.

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 had previous investigations from these Medicaid Fraud Units, but is not aware of any liability relating thereto at this time.

In 1998 CMS created the Special Focus Facility (SFF) program for the purpose of decreasing the number of persistently poorly performing nursing centers. Under the SFF program, immediate sanctions must be imposed on a SFF nursing center that fails to achieve and maintain significant progress in correcting deficiencies. Sanctions may include termination from the Medicare and/or Medicaid programs. SFF centers that significantly improve may be removed from the SFF list. EHSI has certain centers currently included in the SFF program, and like other operators, its centers can be subject to the SFF program at any time. These centers are being aggressively monitored by management.

In December 2008, CMS released its Five Star Rating System which assigns a numerical rating between one and five to all long-term care centers. This Five Star Rating System is an attempt to provide the customer with an impression of how health care centers are performing using the following components:

- three years of state survey information;
- nursing staff hours provided to each resident/patient each day with adjustments for acuity of the residents; and
- quality measures or outcome measures that capture data submitted as part of the assessment of residents/patients.

While we applaud the creation of a system to measure and report on quality of care provided by long-term care centers so that consumers have ample information to make decisions about placement in a skilled care center, we believe the Five Star Rating System contains some serious flaws. First and foremost, the survey system in the U.S. is not consistent and varies significantly across the states. To provide a rating that is primarily driven by survey results is not a measure of quality, but rather a measure of how well skilled nursing centers perform in the regulatory survey process. Management believes that the results of surveys conducted under the system often do not accurately reflect how well nursing staff has performed or how customers feel about the services provided. Second, the nursing staff hours are captured in a manner that lends itself to incorrect reporting, and we believe may have understated nursing hours in many of EHSI's centers. The system also fails to reflect the level of additional services in a skilled nursing center such as rehabilitative therapy. Lastly, the quality measures are good tools but may also be subject to misinterpretation in that patients/residents come to long-term care centers with

significant health issues and may not, in all cases, be expected to improve on all such measures. CMS has had discussions with representatives of the industry regarding these concerns and is considering changes to the system.

To the extent that any EHSI skilled nursing center scores low under the Five Star Rating System, that center may experience negative publicity or challenges with maintaining or increasing census. We intend to develop strategies to address ratings in all of our skilled nursing centers whose scores reflect sub-par performance and to generate positive publicity in those communities where centers rate above average.

United States

The majority of the REIT's operations are in the United States where approximately 73% of its revenue was earned in the first half of 2009. EHSI receives payment for its services and products from the federal (Medicare) and state (Medicaid) medical assistance programs, as well as from private payors. Private-pay revenue includes payments from individuals, commercial insurers, HMOs, preferred provider organizations and other charge-based payment sources, including Blue Cross associations and the Department of Veterans Affairs.

MEDICARE FUNDING

Changes in Medicare funding levels typically occur on October 1st each year to coincide with the federal government's fiscal year, and generally represent an inflationary increase for the Medicare Part A rate, otherwise referred to as a "market basket" increase. In August 2008, CMS announced final regulations and rates for Medicare for fiscal 2009, indicating the implementation of a 3.4% market basket increase effective October 1, 2008. EHSI estimates the Medicare rate increase resulted in a net improvement in its average daily Medicare Part A rate of approximately US\$13.38 (3.2% increase), and based on EHSI's Medicare ADC for 2008 of 2,660, this would equate to additional annual revenue of approximately US\$13.0 million. The market basket increases on October 1, 2007, and October 1, 2006 were 3.3% and 3.1%, respectively.

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 caps increased annually for inflation, and amounted to US\$1,740 per annum in 2006, US\$1,780 in 2007, and US\$1,810 in 2008. A one-year exception process to the therapy caps was established in 2005 for individuals who can prove medical necessity for the therapy. This exception process has been further extended through to December 31, 2009 with the passage and veto override of the *Medicare Improvements for Patients and Providers Act* in July 2008. Utilizing previous estimates, the extension of the exception process applies to approximately 35% of EHSI's residents requiring Part B therapy services and therefore, there has been no significant reduction in its Part B therapy revenue.

The Medicare Part D benefit that arose from the *Medicare Prescription Drug Improvement and Modernization Act of 2003* was implemented by CMS effective January 1, 2006, and provides access to prescription drug coverage for Medicare beneficiaries. Medicare Part D is a voluntary drug benefit, except for dually eligible Medicare and Medicaid residents, who must enrol in the program. The program provides a prescription drug benefit through a fee-for-service prescription drug plan, or PDP. For a premium, eligible residents have their drug costs administered through a government contracted PDP provider, who negotiates contracts with the institutional pharmacies, including Omnicare, Inc. (Omnicare), which provides pharmacy services to the majority of EHSI's skilled nursing centers. Omnicare has contracted with the majority of all PDPs to which EHSI's residents subscribe. To date, as a result of the transition plans put into place by CMS, EHSI has not experienced an increase in its drug costs as a result of these changes. However, EHSI could be faced with incremental drug and administrative costs as PDPs exercise their strategies to manage drug costs on behalf of their subscribers.

2009 Proposed CMS Changes

On July 31, 2009, CMS issued its final rule for payments to Medicare skilled nursing centers, resulting in a net reduction in Medicare Part A rates of 1.1% effective October 1, 2009. As previously announced, CMS plans to implement a recalibration adjustment that would reduce rates by 3.3%, to be partially offset by a market basket increase of 2.2%. Our preliminary estimates indicate that this net rate reduction of 1.1% would reduce our Medicare revenue by approximately US\$4.5 million per annum.

CMS' final rule also introduces other modifications to our payment system that would become effective on October 1, 2010, and which would impact resident assessments and, potentially, the rates paid for certain services. Specifically, the final rule establishes a revised case-mix classification methodology (RUG-IV) and implementation schedule for fiscal year 2011, reflecting updated staff time measurement data derived from the recently completed Staff Time and Resource Intensity Verification (STRIVE) project, as well as including information on the transition to the redesigned nursing home resident assessment instrument MDS 3.0, and on a possible new rate component to account for the use of non-therapy ancillaries. The potential impact of these changes is being analyzed but could lead to an adverse change in our per diem

rates, which may be partially mitigated by the type of resident admitted and the care delivery protocol followed. We, along with other post-acute providers, continue to discuss the merits and potential impact of these changes with CMS.

2008 Federal Legislation

In 2008 the Democratic-led Congress acted to turn back several administrative initiatives that would have negatively impacted Medicaid and Medicare services. In late June 2008, the U.S. Congress passed legislation that prevented CMS from implementing six Medicaid regulations that would have meant a loss of federal Medicaid funds that could have negatively impacted Medicaid rates for skilled nursing centers (*Protecting the Medicaid Safety Net Act of 2008*). This legislation was included in the war supplemental spending bill which was signed by President Bush.

In July 2008, the U.S. Congress overrode President Bush's veto of the *Medicare Improvements for Patients & Providers Act*. The new Medicare law extends the Medicare Part B outpatient therapy exceptions process from July 1, 2008 to December 31, 2009, ensuring patient access to the therapy services they need under Medicare Part B. This is critical to long-term care providers as it effectively eliminates the break in the exceptions process. The law precludes the 10% reduction in payments to physicians for 18 months (this includes Part B therapy rates), and delays the competitive bidding program for durable medical equipment for two years.

On August 1, 2008, CMS published notification in the Federal Register of final rules for skilled nursing center rates for the 2009 federal fiscal year. The notice reversed the May 2008 proposed Medicare recalibration adjustment that would have eliminated the annual inflation update of Medicare Part A skilled nursing center rates. The change in policy resulted in a 3.4% increase in Medicare Part A rates effective October 1, 2008. In issuing the rule, CMS noted that it was delaying the proposed Medicare recalibration while it continues to study other potential system changes. Refer to the discussion above under the heading "2009 Proposed CMS changes".

2009 Federal Legislation

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 has been appropriated for a temporary increase in the federal medical assistance percentage, or FMAP. The FMAP is the percentage the federal government reimburses states for Medicaid expenditures. In addition to the temporary increase, the Recovery Act includes a hold harmless provision from any scheduled decline in the matching percentage and prompt payment provisions.

The Recovery Act provides for a 6.2% increase in FMAP for a 27-month period beginning October 1, 2008 through December 31, 2010. In addition, states with higher unemployment rates will receive additional increases that will be adjusted quarterly based upon unemployment statistics.

An additional US\$19 billion is being made available for health information technology. However, long-term care providers will be eligible for only a very limited portion of these funds.

The major concern with the Recovery Act is the lack of any provision linking the increase in FMAP to any required increases in provider rates. States are only required to maintain current levels of Medicaid eligibility. While questions are being raised as to the intent of the U.S. Congress with regard to how the enhanced FMAP can be spent, there is a high probability that governors of each state will use the funding to maintain Medicaid services and rates.

Proposed Fiscal Year 2010 Federal Budget

On February 26, 2009, U.S. President Obama released his budget overview for fiscal year 2010 (the "2010 Budget Overview"). The 2010 Budget Overview includes US\$83.7 billion in Medicare and Medicaid spending reductions from 2010 – 2014, and US\$316.0 billion from 2010 – 2019. These spending reductions are included in the total attributed to the Health Reform Reserve Fund, to be used solely for health care reform initiatives. These reductions affect other providers in addition to those in long-term care. Only limited information is available on the details of these changes and the projected 10-year spending reductions.

While the major focus is on hospital services, the following spending reductions may potentially impact long-term care providers:

- penalize hospitals for Medicare readmissions (US\$8.4 billion);
- create hospital quality incentive payments (US\$12.1 billion);
- establish competitive bidding for Medicare Advantage (US\$177 billion);
- bundle Medicare payments covering hospital and post acute settings (US\$17.8 billion);

- apply policies to assure accurate Medicare payments (US\$2 billion);
- improve the accuracy of Medicaid payment through the National Correct Coding Initiative (US\$620 million); and
- reduce home health payments (US\$37.1 billion).

Similar to past U.S. Presidents' budgets, the initiatives are subject to considerable debate and refinement between the time that the initiatives are outlined and put into place, if at all. Below are those initiatives that may impact long-term care providers and the relative timeframes outlined:

(a) ***Bundled Payments to Hospitals***

The 2010 Budget Overview outlines a proposal to bundle Medicare payments covering hospital and post-acute care settings. According to the 2010 Budget Overview narrative, 18% of hospital discharges experienced hospital readmission within 30 days of the discharge. The 2010 Budget Overview outlines a plan that, starting in 2013, hospitals would receive bundled payments that cover the initial discharge and subsequent 30-day post-acute care, with hospitals having higher rates of readmission receiving lower payments. The bundled payments would initially apply only to the most common discharge diagnoses accounting for at least one-third of the post-acute care admissions in 2013, with it being extended to all discharges in 2015. According to the Congressional Budget Office, the hospitals would capture the savings through reductions in volume or intensity of post-acute services and by contracting with lower cost providers. The annual hospital update factors would be dialled down to capture 80% of the cost reductions and allow hospitals to retain 20% of the produced savings. Rates would be based on the diagnostic related group and average post-acute costs for the diagnosis. Under the plan, the nursing center would be paid by the hospital for days 1-30, but it is not clear how Medicare stays beyond day 30 would be paid. The proposed health reform bill (discussed below) would reduce bundling to a pilot project.

(b) ***Medicare Advantage***

The Administration proposes cutting federal payments to insurers that run Medicare Advantage plans by requiring them to competitively bid to offer plans. The government would pay them based on an average of the bids, saving US\$177 billion over 10 years. Nursing center providers currently contract with Medicare Managed Care providers that offer Medicare Advantage plans and this initiative may have an impact on future contract prices and volumes. This position is also included in the proposed health reform bill discussed below.

Final deliberations on the budget will likely occur after a health reform bill is passed.

Proposed Health Care Reform Bill

America's Affordable Health Choices Act of 2009 (the "Health Choices Act") was introduced into the House of Representatives on July 14, 2009, and proposes to reform the U.S. health care delivery system and contain cost growth. The Health Choices Act requires most individuals to have a minimum level of coverage and requires most employers to provide health coverage for employees. It would offer a new public health plan to compete with private insurers and would provide subsidies to assist lower-income individuals in purchasing health coverage. Three House committees have approved this bill. Progress in the Senate has been delayed by the inability of the Finance Committee and the Health Education Labor and Pension Committees to come to agreement. Details on the Senate bill are not yet available. EHSI currently offers to all of its employees health care coverage under several different programs tailored to meet an individual's budget and risk tolerance. Approximately 50% of EHSI employees have joined one of EHSI's programs. However, it remains uncertain whether EHSI's coverage will meet the minimum requirements to be established by the government and what incremental costs may be incurred to meet the standard when established.

According to the Congressional Budget Office, the Health Choices Act would increase the federal deficit by US\$239 billion over a ten-year period. This includes US\$219 billion in spending cuts and US\$583 billion in additional revenue applied to the total US\$1,042 billion cost. Nursing center Medicare revenue would be cut by US\$44.9 billion over a ten-year period. Associations representing nursing centers are seeking to halve the US\$44.9 billion cut which does not incorporate the US\$16 billion reductions included in CMS's proposed regulatory reforms scheduled for October 2009 and 2010. The Health Choices Act would place the market basket reduction into statute and supports CMS's recalibration to reduce nursing home expenditures. The issue of bundling has been demoted to a pilot initiative and patient rehospitalization penalty provisions will be phased-in. The Part B therapy exception process would be extended for two more years. While U.S. President Obama wants legislation approved by August 2009 it would appear that the timeline is slipping particularly as the Senate moves into a more deliberative mode. Management is reviewing the Health Choices Act to determine its impact on EHSI.

MEDICAID RATES

Each year as of July 1st, EHSI receives new annual Medicaid rates in eight of the 12 states in which it operates skilled nursing centers. With the decline in federal and state revenue, state Medicaid budgets are under considerable scrutiny. There is considerable ongoing lobbying underway to preserve funding, resulting in uncertainty in the potential outcome of state Medicaid rates. We do not believe we will have certainty on our Medicaid rates until the end of the third quarter.

The new Medicaid rates as of July 1, 2009 are known only for Oregon, Ohio and Kentucky. For EHSI's facilities in Oregon and Kentucky, our July 1 2009 rates will increase 5.8% and 0.6% respectively resulting in a US\$0.4 million annual increase in revenue. In Ohio, the Medicaid rates will increase by 4.5%; however, the increase in state provider taxes and increase in non-reimbursed costs will result in an estimated net loss (being revenue offset by incremental costs) of US\$1.2 million annually effective July 1, 2009.

For the other five states in which EHSI operates, the July 1, 2009 Medicaid rates are still under discussion in the respective state legislatures and the level of funding changes has not yet been determined. We anticipate that there may be reductions in our Medicaid rates in three of the states, including Ohio, whereas the majority of the other states will retain funding at least the current levels. Based upon information we currently have, we estimate this could result in a net reduction of US\$9.0 million per annum, or 1.4%, in our Medicaid revenue, net of provider tax changes, which will impact us beginning in the 2009 fourth quarter.

EHSI's total average daily Medicaid rates declined slightly by 0.6% in the 2009 second quarter relative to the 2009 first quarter due to two unique events in the states of Washington and Michigan, as outlined further below.

The State of Washington imposed a unique cut in the Medicaid rate of approximately 7.9% that was specific to the 2009 second quarter, which reduced our average daily rate in that state from US\$169.65 in the 2009 first quarter to US\$156.09, to cover funds deemed to be over-funded from the prior year and the 2009 first quarter. Effective July 1, 2009 the Washington Medicaid rates were to be re-instated and new rates for the 2009/2010 year were to be implemented, however a successful injunction was filed by the state association to defer the implementation of those new rates until the 2009 fourth quarter. In the meantime, our 2009 third quarter average daily Medicaid rates for Washington are forecasted to be US\$167.08, and at this time we cannot forecast the final rates for the balance of 2009/2010.

In the State of Michigan our average daily Medicaid rate declined from US\$174.83 in the 2009 first quarter to US\$170.95 in the 2009 second quarter as a result of revised estimates from a review of our cost reports that determine our effective rates that apply to the 2008/2009 year beginning October 1, 2008, along with a change in the provider tax and associated reimbursement for those rates.

As of July 1, 2008, the increase in Medicaid rates for these eight states, exclusive of the impact of provider taxes and changes in CMI, averaged 2.5%, and for each state was: Indiana – 3.4%; Pennsylvania – 0.2%; Ohio – 2.2%; Washington – 2.1%; Wisconsin – 4.5%; Kentucky – 2.6%; Oregon – 7.8%; and Idaho – 0.8%.

For EHSI's other states in which it operates skilled nursing centers, the increases in Medicaid rates in 2008, exclusive of the impact of provider taxes and changes in CMI were: Delaware (January 1, 2008) – 3.5%, Michigan (October 1, 2008) – 5.1%, Minnesota (October 1, 2008) – 3.8%, and West Virginia (April 1 and October 1, 2008) – 3.6%.

For all 12 states in which EHSI operates, the weighted average increase in Medicaid rates on their respective effective dates in 2008 was 3.0%, exclusive of the impact of provider taxes and CMI changes.

Over the past few years, several states in which EHSI operates received approval from CMS for state plan amendments and waivers, which increases the level of federal funding for each state's Medicaid program, and provides skilled nursing centers with revenue rate increases to offset new or increased state provider taxes.

In December 2006, the *Tax Relief and Health Care Act of 2006* established that the state provider tax limit would be reduced from the 6% established by CMS to 5.5% effective January 1, 2008 through December 31, 2011. The limit returns to 6% after 2011; however, this limit cannot be changed by CMS regulations in the future. The change does not have a material impact on future revenue; however, it does limit the risk for reduced Medicaid rates to the level of funding provided through provider tax funding.

Canada

The fees charged by ECI for its Canadian nursing homes and home health care services are regulated by provincial authorities. Accordingly, provincial programs fund a substantial portion of these fees, with the remainder paid by individuals. Ontario is ECI's largest market for both its long-term care and home health care services. Funding for Ontario long-term care centers is based on reimbursement for the level of care expected to be required by residents. The provincial government allocates funds, or "envelopes", for services such as nursing, programs, food and accommodation. Providers may retain excess funding over costs incurred only with respect to the accommodation envelope, while funding for the other envelopes is returned to the extent costs incurred are below the rates funded, otherwise referred to as "flow-through envelopes".

ONTARIO LONG-TERM CARE LEGISLATION

New legislation governing Ontario long-term care centers, the *Long-term Care Homes Act, 2007* (Bill 140) was given Royal Assent on June 4, 2007, although it will not be proclaimed into law until the regulations dealing with the specific aspects of the legislation are drafted and approved. In May 2009, the government invited comments on the first set of proposed initial draft regulations which address some of the regulations needed to proclaim Bill 140. ECI has provided input on the proposed regulations and anticipates continued involvement in the consultation process. Bill 140 amalgamates three existing pieces of legislation currently governing long-term care centers in the province: the *Nursing Homes Act*; the *Homes for the Aged and Rest Homes Act*; and the *Charitable Institutions Act*. Through consolidation, the government expects that Bill 140 will ensure uniform standards and accountability. Among other things, Bill 140 includes a new licensing process with defined terms for various classes of centers as follows: four years for a center with class "D" beds that have not been upgraded; 10 years for a center with upgraded class "D" beds; 15 years for a center with class "C" and "B" beds; 20 years for a center with class "A" beds; and 25 years for new centers. ECI has 11 new post-1998 long-term care centers in Ontario that qualify for 25-year licenses and the rest are centers with class "C" beds that qualify for 15-year licenses under Bill 140.

Bill 140 does not include a commitment to a capital renewal program for older buildings. However, in July 2007, the Ontario government announced a project to redevelop 35,000 older long-term care beds over the next 10 years. ECI currently owns and operates approximately 3,572 older long-term care beds in 23 "C" rated nursing centers that would benefit from this redevelopment project. In November 2008, the government released further details of this program and indicated the range of the base construction funding subsidy. For nursing centers larger than 100 beds, the daily subsidy is \$13.30 per bed for 25 years. A premium of \$1.00 will be provided to nursing centers that achieve Leadership in Energy and Environmental Design (LEED) silver status. ECI and other operators have been working with the government to clarify the details of the program and to express concerns about the adequacy of the construction funding subsidy. ECI is currently reviewing its buildings to determine the priorities for redevelopment over the next 10 years.

In June 2008, the Ontario Ministry of Health and Long-Term Care (MOHLTC) released a report on staffing and care standards for long-term care centers (the "Sharkey Report"). The report was commissioned by the government partly as a response to calls from the Canadian Auto Workers Union, the Ontario Nurses' Association and others to enact a minimum staffing standard in legislation for long-term care centers. The report recognizes the need for more staff but does not support implementing a minimum staffing standard. The government's implementation team is currently working on a staffing plan template that will be piloted in long-term care centers in the spring of 2009, with an estimated roll out to all nursing centers in the province in the fall of 2009, pending results of the pilot project.

ONTARIO LONG-TERM CARE FUNDING

On April 1st each year, the Ontario government provides acuity-based flow-through funding increases on the government funded portion of the fees based on the provincial resident classification results of the previous year. An increase of 1.27% was announced in June 2009, retroactive to April 1st, compared to 1.87% in 2008. In addition, the Ontario government provided additional funding in 2009 and 2008, targeted to add more nurses and personal service workers in long-term care centers to help manage the rising cost of labour within the flow-through envelopes. As a result, the total annual increase received by ECI in 2009 and 2008 was 3.0% and 4.93%, respectively.

ECI estimates that based on the number of long-term care beds it operates in Ontario, the above flow-through funding increases received in 2009 and 2008 represent additional annual revenue of approximately \$4.6 million and \$6.4 million, respectively. These funding enhancements were provided to the flow-through envelopes and therefore, are offset by additional costs for resident care.

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). The July 2009

increase was \$0.16 per resident per day (or 2.2%) for food costs and \$0.85 per resident per day (or 1.8%) for the non flow-through component. ECI estimates that based on the number of long-term care beds it operates in Ontario, this represents an annual revenue increase of approximately \$1.8 million, of which approximately \$0.3 million is directly allocated to cover food costs, with the remainder available to assist in offsetting inflationary cost increases of accommodation. In comparison, the July 2008 increase was \$0.15 per resident per day (or 2.1%) for food costs and \$0.80 per resident per day (or 1.7%) for the non flow-through component. ECI estimates that based on the number of long-term care beds it operates in Ontario, this represents an annual revenue increase of approximately \$1.7 million, of which approximately \$0.3 million is directly allocated to cover food costs, with the remainder available to assist in offsetting inflationary cost increases of accommodation.

In addition to the July 1st increase above, the Ontario government announced in July 2009, a one-time accommodation funding enhancement of \$1.55 per resident per day for the 2009/2010 fiscal year, retroactive to April 1, 2009. This added funding of 3.32% is anticipated to provide additional annual revenue to ECI of \$2.8 million to assist in enhancing resident care. However, there is no guarantee that this funding will continue next year.

ALBERTA LONG-TERM CARE FUNDING

In Alberta, long-term care providers generally receive annual inflationary rate increases on April 1st and annual CMI funding adjustments on July 1st on the government funded portion of the fees. However, for the past two years, the annual CMI adjustment has not been received because the Alberta government and the new Alberta Health Services Authority are in the process of reviewing the funding methodology for long-term care, including the CMI adjustment. It is not known at this time when their review may be completed and a new methodology implemented.

At this time, Alberta Health Services has not announced the level of funding increase; however, the increase will be retroactive to April 1, 2009. The April 1st weighted average annual inflationary rate increase received by ECI in 2008 was 12.5%, or approximately \$6.3 million of annual revenue. Just over half of the increase received in 2008, or 6.5%, was announced in November 2008, retroactive to April 1, 2008, resulting in ECI receiving \$1.4 million in December 2008, relating to the April 1 to September 30 period.

In July 2008, the Alberta government announced a 7.23% increase to the long-term care accommodation fee (the portion of fees paid by the resident to the nursing center operator) effective November 1, 2008. ECI estimates that this will result in increased annual revenue of approximately \$1.2 million.

The Alberta government has replaced its nine regional health authority boards, the Alberta Mental Health Board, the Alberta Cancer Board and the Alberta Alcohol and Drug Abuse Commission, with a single provincial governance board, the Alberta Health Services Board (AHS). The AHS has been in transition since May 2008 and was established as a legal entity effective April 1, 2009. The AHS, which is responsible for the delivery of health services for the entire province, reports directly to the Minister of Health and Wellness. We anticipate the AHS will be taking a provincial approach to both policy development for long-term care and funding methodologies, although it may yet be several months before changes in these two areas emerge.

ONTARIO HOME CARE LEGISLATION

ECI is a major private-sector provider of home health care services through ParaMed, which operates in Alberta and Ontario. Ontario is ParaMed's largest market, representing approximately 97% of its revenue.

On May 1, 2006, the Ontario government announced funding of \$117.8 million to improve home care, of which \$30.0 million would be used to implement recommendations from a comprehensive review (the "Caplan Report") of the Community Care Access Centre Procurement Process. The announcement stated it was the intention of the government to implement 68 of 70 recommendations from the Caplan Report, which is intended to improve the procurement model with open and transparent practices, enhance the quality and continuity of care, and promote home care workforce stability. A Personal Support Worker Stabilization Strategy resulted in funding that was released in November 2006 on a retroactive basis to April 2006. This funding continues to be paid to providers separately until new contracts under the request for proposal process are negotiated, at which time the funding will be embedded into the new contractual rates. Funds received by ECI were spent on labour-related costs and enhanced field staff travel reimbursements.

The home health care competitive bidding process was frozen in 2004 as a result of the above study undertaken by the Ontario government. Contracts that were due to expire are being extended until the bidding process is resumed. The competitive bidding process is expected to resume in the first quarter of 2010, with a focus on strengthening accountability and ensuring fairness and transparency. ParaMed had recommended the use of public reporting, similar to the long-term care industry, and the government has publicized their intention to implement public reporting of performance measures.

In May 2008, the Ontario government announced a \$38.5 million increase in home care personal support and homemaking services and enhanced integration between hospitals and Community Care Access Centres (CCACs). This will be used to fund an increase in the maximums on hours for personal support and homemaking services by 50% and will remove maximums on personal support and homemaking entirely for patients waiting for a long-term care bed or receiving palliative care services at home. ParaMed may benefit from this to the extent that it has clients that are eligible for the increased maximums.

On December 9, 2008, the Government of Ontario announced that it had amended Regulation 285 of the *Employment Standards Act 2000*, as a result of Ontario Regulation 423/08, by eliminating the provision that exempted elect-to-work employees from the entitlement to public holiday pay beginning January 2, 2009. As the majority of our home care employees are elect to work, this will represent an added cost for ParaMed of approximately \$2.6 million in 2009 and \$2.9 million in 2010. The Ontario Home Care Association, representing its members, has met with the MOHLTC to request reimbursement for these added costs, referencing a clause in the CCAC contracts regarding change in applicable law that directly impacts the cost to deliver services. These discussions with the MOHLTC are ongoing, with no financial commitment made as yet.

Also on December 9, 2008, the Government of Ontario introduced and gave first reading to the *Employment Standards Amendment Act (Temporary Help Agencies)*, or Bill 139, which received Royal Assent on May 6, 2009, and becomes effective in November 2009. Bill 139, among other things, establishes that temporary employees are covered by the *Employment Standards Act* thereby providing them with entitlements to severance and notice of termination. Currently, Bill 139 does not apply to elect-to-work employees of agencies, such as ParaMed, providing services pursuant to contracts with the CCACs. However, the government intends to revoke this exemption in October 2012. Through the Ontario Home Care Association, we will be making submissions that support keeping the exemptions. The current impact of Bill 139 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 June 30, 2009, the REIT had cash and cash equivalents of \$94.6 million compared with \$123.1 million at December 31, 2008, representing a decline of \$28.5 million as a result of a pledge of cash of \$29.5 million as collateral against a letter of credit, resulting in its exclusion from our available cash at period end.

	Three months ended		Six months ended		Year
	June 30		June 30		
<i>(thousands of dollars unless otherwise noted)</i>	2009	2008	2009	2008	2008
Cash provided by operating activities,					
before working capital changes	37,403	18,231	69,349	39,955	95,326
Net change in operating assets and liabilities	(2,972)	(11,533)	1,994	(21,288)	9,816
Cash provided by operating activities	34,431	6,698	71,343	18,667	105,142
Cash used in investing activities	(20,051)	(14,179)	(32,745)	(25,994)	(57,329)
Cash provided by (used in) financing activities	(38,213)	95,533	(66,224)	79,045	26,494
Foreign exchange gain (loss) on U.S. cash held	(1,704)	123	(851)	339	4,543
Increase (decrease) in cash and cash equivalents	(25,537)	88,175	(28,477)	72,057	78,850
Cash and cash equivalents at beginning of period	120,144	28,116	123,084	44,234	44,234
Cash and cash equivalents at period end	94,607	116,291	94,607	116,291	123,084
Average US/Canadian dollar exchange rate	1.1672	1.0102	1.2062	1.0072	1.0660

Cash provided by operating activities was \$71.3 million in the first half of 2009 compared to \$18.7 million in the first half of 2008, with the improvement reflecting the increase in earnings and a favourable change of \$23.3 million in operating assets and liabilities between periods. The source of cash of \$2.0 million for the net change in operating assets and liabilities in the first half of 2009 related mostly to a reduction in accounts receivable, partially offset by a reduction in accounts payable and income taxes payable, and an increase in prepaid expenses. Accounts receivable improved by \$24.9 million in the first half of 2009 primarily due to improved collections and the receipt in January 2009 of the \$8.7 million (US\$7.0 million) return premium associated with the exercise in 2008 of our option to commute our reinsurance coverage for the three-year period covering 2005 to 2007. The use of cash of \$21.3 million for the net change in operating assets and liabilities in the first half of 2008 related to an increase in accounts receivable and prepaid expenses and a reduction in income taxes payable, partially offset by an increase in accounts payable. In the first half of 2008, the increase in accounts

receivable primarily resulted from an increase in trade receivables due to funding improvements and the number of Managed Care residents served. The increase in prepaid expenses for both periods primarily related to the prepayment of reinsurance premiums, property tax, and maintenance contracts, which usually occurs at the beginning of the year.

Cash used in investing activities was \$32.7 million in the first half of 2009 compared to \$26.0 million in the first half of 2008 and primarily reflects expenditures for property and equipment, net of proceeds on disposal of assets.

	Three months ended		Six months ended		Year
	June 30		June 30		
<i>(thousands of dollars unless otherwise noted)</i>	2009	2008	2009	2008	2008
Capital Additions					
Growth expenditures	12,518	8,638	25,789	18,199	39,184
Facility maintenance	7,917	7,639	15,241	12,143	28,350
Consolidated reported	20,435	16,277	41,030	30,342	67,534
Average US/Canadian dollar exchange rate	1.1672	1.0102	1.2062	1.0072	1.0660

Capital additions, excluding acquisitions, were \$41.0 million in the first half of 2009 compared to \$30.3 million in the first half of 2008, as outlined in the table above. Growth expenditures of the REIT relate to the construction of new beds, building improvements or capital costs aimed at earnings growth. The remaining costs are the capital costs to sustain and upgrade existing property and equipment assets, which were \$15.2 million in the first half of 2009 compared to \$12.1 million in the first half of 2008, both representing 1.3% of revenue. These costs fluctuate on a quarterly basis with the timing of projects and seasonality. A number of planned projects from 2008 were carried over to 2009, and as such, the costs for these projects will be incurred this year. It is our intention to expend between 1.5% and 2.0% of revenue annually, which is consistent with our objective to maintain and upgrade our centers. We are expecting to spend \$39.0 million in facility maintenance capital expenditures and \$57.0 million in growth capital expenditures in 2009.

Net proceeds from dispositions of \$10.0 million in the first half of 2009 and \$2.6 million in the first half of 2008 related to the disposal of U.S. centers held for sale (see "Significant Developments – Discontinued Operations").

Cash used in financing activities was \$66.2 million in the first half of 2009 compared to cash provided by financing activities of \$79.0 million in the first half of 2008. Financing activities in the first half of 2009 primarily reflected the payment of distributions of \$30.9 million, the use of cash of \$29.5 million to secure a letter of credit obligation, thereby restricting the cash, the purchase of securities for cancellation under our normal course issuer bid of \$6.2 million, and scheduled debt repayments, partially offset by the issuance of debt. The financing activities in the first half of 2008 primarily reflected net proceeds of \$120.6 million from the issuance of the 2013 Debentures and REIT Units in June 2008, partially offset by the payment of distributions of \$37.8 million. 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. ⁽¹⁾

<i>(millions of dollars)</i>	Q1		Q2		Six months ended June		Year
	2009	2008	2009	2008	2009	2008	2008
Cash provided by operating activities	36.9	12.0	34.4	6.7	71.3	18.7	105.1
Add (Deduct):							
Net change in operating assets and liabilities	(5.0)	9.8	3.0	11.5	(2.0)	21.3	(9.8)
Current tax on gain/loss from derivatives, foreign exchange, asset impairment, disposals and other items	1.7	0.1	(0.5)	(1.3)	1.2	(1.2)	2.7
Net provisions and payments for self-insured liabilities	(2.2)	0.3	(0.5)	6.9	(2.7)	7.2	7.7
Depreciation for FFEC	(6.1)	(4.1)	(5.9)	(4.6)	(12.0)	(8.7)	(19.4)
Principal portion of government capital funding payments	0.6	0.6	0.6	0.5	1.2	1.1	2.2
Other	(0.3)	0.1	0.3	0.1	–	0.2	(0.8)
DI	25.6	18.8	31.4	19.8	57.0	38.6	87.7
Additional facility maintenance capital expenditures ⁽²⁾	(1.2)	(0.4)	(2.0)	(3.1)	(3.2)	(3.5)	(8.9)
AFFO	24.4	18.4	29.4	16.7	53.8	35.1	78.8

⁽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

<i>(millions of dollars unless otherwise noted)</i>	Six months ended June 30, 2009	Year 2008
Unitholders' Deficiency		
REIT and Exchangeable LP units	344.1	346.9
Equity component of convertible debentures	10.0	10.0
Contributed Surplus	0.1	0.6
	354.2	357.5
Accumulated deficit at beginning of period	(410.4)	(343.1)
Net earnings for the period	33.9	13.4
Purchase of units for cancellation in excess of book value	(0.7)	(0.1)
Distributions declared	(30.6)	(80.6)
Accumulated deficit at end of period	(407.8)	(410.4)
Accumulated other comprehensive income	15.6	23.4
Unitholders' deficiency (at period end)	(38.0)	(29.5)
US/Canadian dollar exchange rate (at period end)	1.1630	1.2180

Unit Information <i>(thousands)</i>	July 31, 2009	June 30, 2009	December 31, 2008
REIT Units (TSX symbol: EXE.UN) ⁽¹⁾	69,673.6	69,623.7	70,162.2
Exchangeable LP Units	3,349.1	3,355.4	3,410.2
	73,022.7	72,979.1	73,572.4

⁽¹⁾ Closing market value per the TSX on July 31, 2009, was \$6.21

The closing rates used to translate assets and liabilities of the U.S. operations were 1.1630 at June 30, 2009 and 1.2180 at December 31, 2008. As a result of the stronger Canadian dollar at the end of June 2009, the assets of the REIT's U.S. operations decreased by approximately \$59.2 million, partially offset by a reduction in the liabilities by approximately \$50.8 million, with the net change in foreign currency translation of \$8.4 million included in accumulated other comprehensive income. 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 \$1.5 million, and would be reflected as a change in foreign currency translation adjustments in accumulated other comprehensive income.

DISTRIBUTIONS

In the first half of 2009, we generated DI of \$57.0 million and AFFO of \$53.8 million and declared monthly distributions of \$0.07 per unit to holders of REIT Units and Exchangeable LP Units totalling \$30.6 million, of which \$29.2 million was paid in cash and \$1.4 million by way of issued units under a distribution reinvestment plan, from February 16, 2009 to July 15, 2009. A total of 287,204 units were issued during the first half of 2009 through the distribution reinvestment plan.

During 2008 monthly distributions of \$0.0925 were declared totalling \$80.6 million, of which \$78.0 million was paid in cash and \$2.6 million by way of issued units under a distribution reinvestment plan, to holders of REIT Units and Exchangeable LP Units. A total of 361,096 units were issued during 2008 through the distribution reinvestment plan.

There are a number of factors that affect the quarterly funds generated for distribution that our Board of Trustees takes into consideration in determining the monthly distributions for the year. Factors affecting quarterly trends in earnings are discussed under the headings "Summary of Results" and "2009 Second Quarter Financial Review".

Our current policy is to pay distributions of \$0.07 per REIT Unit and Exchangeable LP Unit, respectively, to the holders thereof on a monthly basis. As was the case in 2008, we estimate that approximately 70% of our 2009 distributions will be tax deferred returns of capital to Canadian residents.

The declaration and payment of future distributions is subject to the discretion of our Board of Trustees 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 of Trustees. If our Trustees determine that it would be in the REIT's best interests, they may reduce, for any period, the percentage of Distributable Income to be distributed to REIT unitholders, which will result in corresponding reductions in distributions on Exchangeable LP Units.

NORMAL COURSE ISSUER BID

On December 18, 2008, the REIT received the approval of the TSX to commence a normal course issuer bid (the "2008 Bid") to purchase for cancellation up to 6.9 million REIT Units, \$11.5 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 15, 2008. The 2008 Bid provides the REIT with flexibility to repurchase units for cancellation until December 28, 2009. During the first half of 2009, the REIT acquired for cancellation 0.9 million REIT Units at a cost of \$5.3 million, \$1.1 million aggregate principal amount of the 2014 Debentures at a cost of \$0.7 million and \$0.2 million aggregate principal amount of the 2013 Debentures at a cost of \$158,500.

During 2008, under a normal course issuer bid for 5.5 million REIT Units that expired in December 2008, the REIT acquired for cancellation 0.8 million REIT Units at a cost of \$3.2 million.

LONG-TERM DEBT

Long-term debt, including current portion, was \$1,294.4 million at June 30, 2009, and was net of \$23.1 million of financing costs. Details on the components, terms and conditions of long-term debt are provided in *note 5* of the unaudited consolidated financial statements for the six months ended June 30, 2009. The REIT and its subsidiaries are in compliance with all of their respective financial covenants as of June 30, 2009.

The following summarizes the changes in the carrying amounts of long-term debt for the first six months of 2009 and the year ended December 31, 2008.

Continuity of Long-term Debt (<i>millions of dollars</i>)	Six months ended June 30, 2009	Year 2008
Long-term debt at beginning of period, prior to equity allocation and financing costs	1,372.6	1,100.5
Issue of long-term debt		
Mortgages	2.8	27.3
Construction financing	9.2	–
2013 Debentures at face value, 7.25%	–	92.0
Sovereign Loans, variable rate	–	51.4
Other	–	1.1
Issue on the EHSI Credit Facility	–	1.1
Increase (decrease) in capital lease obligations ⁽¹⁾	(5.0)	9.4
Repayment of long-term debt	(14.1)	(81.3)
Purchase of convertible debentures for cancellation under NCIB	(1.2)	–
Debt assumed/issued on acquisitions		
Manitoba mortgages, 5.75%	–	9.4
Change due to year-end foreign exchange rate	(38.7)	161.7
	1,325.6	1,372.6
Equity portion of 2013 and 2014 Debentures at end of period	(8.1)	(8.9)
Financing costs at end of period ⁽¹⁾	(23.1)	(30.9)
Long-term debt at end of period	1,294.4	1,332.8
Less: current portion	(22.0)	(42.2)
	1,272.4	1,290.6

⁽¹⁾ The 2009 activity includes the reversal in March of the provision for GST previously recorded in the 2008 second quarter affecting the balance of capital lease obligations with an offset to the financing costs, upon confirmation from the CRA of application of new legislation (see "Significant Developments – Canadian GST on Long-term Residential Care Centers").

Interest Rates

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 \$80.1 million of our long-term debt outstanding at June 30, 2009, excluding financing costs and equity allocation, was at fixed rates. The variable-rate debt related to the Sovereign Loans of US\$50.0 million, the US\$11.0 million drawn on the EHSI Credit Facility and \$9.2 million drawn on the Red Deer construction financing. The weighted average interest rate of our long-term debt was approximately 6.7% at June 30, 2009, compared to 6.7% at December 31, 2008. The weighted average interest rate of our long-term debt at June 30, 2009, for our Canadian and U.S. operations was 7.0% and 6.5%, respectively, compared to 7.2% and 6.4% at December 31, 2008, respectively.

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.

Debt to Adjusted Gross Book Value (AGBV)

Extencicare REIT's financial position continues to be strong, with long-term debt (at face value and including current portion) representing 45.5% of AGBV at June 30, 2009, and excluding the convertible debentures, debt to AGBV was 38.4%.

AGBV is defined in the REIT's Deed of Trust, and in general is determined by taking total reported assets at a period in time, adding back accumulated depreciation and amortization and making a one-time adjustment for incremental value of the assets at the effective date of the Arrangement. The calculations as at June 30, 2009 and December 31, 2008, are indicated in the following table.

<i>(millions of dollars unless otherwise noted)</i>	June 30 2009	December 31 2008
Long-term Debt ⁽¹⁾		
Debt	1,119.9	1,165.6
Convertible debentures (face value)	205.7	207.0
	1,325.6	1,372.6
AGBV		
Total assets	1,719.8	1,806.0
Accumulated depreciation and amortization	518.8	512.0
Incremental value	675.0	675.0
	2,913.6	2,993.0
Long-term Debt to AGBV		
Excluding convertible debentures	38.4%	38.9%
Including convertible debentures	45.5%	45.9%

⁽¹⁾ Long-term debt includes current portion and excludes financing costs.

CONTRACTUAL OBLIGATIONS

The table below provides summary information about the contractual obligations at June 30, 2009. The table excludes self-insured liabilities and conditional asset retirement obligations, totalling \$48.4 million and \$25.9 million, respectively, as of June 30, 2009, due to the uncertainty as to the timing of payments to be made under these obligations.

The contractual obligations table also excludes our defined benefit pension plan obligations, none of which had funding requirements as at June 30, 2009. The accrued benefit liability on our balance sheet as at June 30, 2009, was \$24.7 million (December 31, 2008 – \$24.9 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 \$5.7 million and accrued benefit obligations of \$6.3 million as at June 30, 2009 (December 31, 2008 – \$6.2 million and \$5.9 million, respectively). We do not set aside assets in connection with the supplementary plan and all benefit payments will be paid from cash from operations. The benefit obligations under the supplementary plan are secured by letters of credit totalling \$44.5 million as at June 30, 2009. The expected benefit payments under the supplementary pension plan that will be funded from cash from operations are: \$2.3 million for each of the years 2009 and 2010; \$2.2 million for each of the years 2011 and 2012; and \$2.1 million for 2013. 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 effect on our cash flow requirements with respect to our pension obligations, or our pension expense.

<i>(millions of dollars)</i>	Total	To the end					After
		of 2009	2010	2011	2012	2013	2013
REIT convertible debentures (face value)	205.7	–	–	–	–	91.8	113.9
Canadian Subsidiary Operations							
Long-term debt	180.0	3.6	7.9	17.7	9.2	92.8	48.8
Capital lease obligations	124.0	1.8	3.7	3.9	4.2	4.5	105.9
Operating lease obligations	4.9	1.0	1.8	1.7	0.4	–	–
Purchase obligations	20.0	20.0	–	–	–	–	–
United States Subsidiary Operations ⁽¹⁾							
Long-term debt	811.6	11.2	18.0	649.1	106.6	6.6	20.1
Capital lease obligations	4.4	0.3	0.7	0.7	0.7	0.8	1.2
Operating lease obligations	59.4	3.9	8.5	6.3	5.8	4.9	30.0
Purchase obligations	22.0	22.0	–	–	–	–	–

⁽¹⁾ U.S. dollar denominated obligations are translated to Canadian dollars at a rate of 1.1630.

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".

In June 2009, EHSI entered into an operating lease agreement for the construction of a nursing facility (100 beds) in South Bend, Indiana, which is expected to be completed in the 2011 first quarter. The 10-year lease commences upon completion of construction, with lease payments of US\$1.0 million for the first year and US\$1.1 million for each of the next nine years. EHSI has three optional renewal periods for 10 years each with lease payments to be determined at fair market value.

ACCRUAL FOR SELF-INSURED LIABILITIES

At June 30, 2009, the accrual for self-insured general and professional liabilities was \$48.4 million compared to \$50.4 million at the beginning of the year. The current period provision, net of claims payments, increased the balance of the accrual by \$2.7 million, and the stronger Canadian dollar decreased the balance by \$2.3 million. This was partially offset by a \$2.4 million payment to the former shareholders of LTC Professional, in accordance with the acquisition agreement, as discussed further below. The accrual for self-insured liabilities includes estimates of the costs of both reported claims and claims incurred but not yet reported. Provisions recorded in the first half of 2009 and 2008 for potential general and professional liability claims were \$10.3 million and \$7.1 million, respectively. Payments for self-insured liabilities during the same periods were \$7.6 million and \$14.3 million, respectively.

On January 1, 2008, ECI acquired LTC Professional, Tendercare's affiliated insurance company domiciled in Barbados, for a nominal amount. Consideration for the acquisition will be adjusted annually thereafter based on the actuarial determined liabilities until December 31, 2012, with an option to increase the review period to December 31, 2015. In the 2009 first quarter, payment of \$2.7 million (US\$2.2 million, which included US\$0.2 million in interest) was made to the

former shareholders of LTC Professional on completion of the actuarial valuation of LTC Professional's liabilities as at December 31, 2008.

Following our usual practice of completing an interim independent actuarial review of our resident care liabilities during the 2008 third quarter, we decided to strengthen the level of our reserves by US\$5.5 million in that quarter. The volume of claims and their average settlement values have remained constant, but certain claims have been settled faster than usual this year which has prompted the independent actuary to increase their estimate of our ultimate liability. While we believe the early settlement of these particular claims is an anomaly which will not necessarily continue in the future, we believed it was prudent to record the higher reserve. An independent actuarial review was completed as part of the year-end financial reporting process, which confirmed the adequacy of the balance of the reserves for resident care liability claims as at December 31, 2008.

Management estimates that \$13.1 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 in management's control and therefore, estimates could change in the future. Management believes sufficient reserves have been provided as of June 30, 2009, for estimated costs of self-insured liabilities.

We invest funds to support the accrual for self-insured liabilities. These funds are reported in other assets and totalled \$58.5 million at June 30, 2009, compared to \$67.5 million at December 31, 2008. Most of the risks that Extencare self-insures are long-term in nature and accordingly, claims payments for any particular policy year occur over a long period of time. Management believes there are sufficient cash resources to meet estimated current claims payment obligations.

SPECIFIED CONTINGENT CLAIMS AGAINST CROWN LIFE

Under the Crown Life share sale agreement with The Canada Life Assurance Company (Canada Life) dated June 8, 2007, Extencare remains responsible for specified contingent claims against Crown Life of up to \$16.8 million, for which Extencare has delivered letters of credit to Crown Life in support of the claims. Depending on the type of contingent claim, the letters of credit have various terms ranging from 5 to 15 years. As at June 30, 2009, management estimates that Extencare's remaining aggregate liability for such claims will not exceed \$7.0 million, and has recorded a provision for this amount in other long-term liabilities on the balance sheet. Management assessment of the provision is based on past trends and information received from an independent actuary.

Future Liquidity and Capital Resources

Management is 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. The financing completed in June 2008, in addition to other cash on hand, will adequately cover our planned growth capital expenditures and development projects. Given the current economic conditions, we continue to be prudent to ensure we meet our future operational and capital commitments. We are expecting to spend approximately \$39.0 million in facility maintenance capital expenditures and approximately \$57.0 million in growth capital expenditures in 2009.

At June 30, 2009, our U.S. operations had cash on hand of US\$13.1 million and US\$55.3 million available under the EHSI Credit Facility and our Canadian operations had cash on hand of \$79.3 million and available bank lines of \$8.5 million.

At June 30, 2009, EHSI had outstanding capital expenditure commitments of US\$18.9 million, which included US\$11.9 million related to construction projects in progress, and ECI had outstanding capital expenditure commitments of \$20.0 million related to its construction projects.

Management has obtained its CMHC insurance certificate with respect to its Edmonton, Alberta project, with plans to secure two-year construction financing in the amount of approximately \$17.6 million, following which long-term financing will be sought. Refer to "Significant Developments – Financing Activity".

We had two mortgages totalling US\$7.2 million maturing in July 2009, both of which have been extended to September 2009 and we are confident that these will be refinanced by the end of 2009.

We have no significant debt maturities until 2011, when our US\$50.0 million Sovereign Loans and US\$500.0 million in CMBS financings mature in the second and fourth quarters, respectively, followed by our US\$90.0 million in CMBS

financings maturing in March 2012. We have already commenced steps to refinance this debt. In Canada, the majority of our mortgages are CMHC backed, with no significant maturities until 2013.

RELATED PARTY TRANSACTIONS

In October 2007, EHSI completed the acquisition of Tendercare a privately owned operator of senior care centers in the State of Michigan, which was comprised of 29 skilled nursing centers and one inpatient rehabilitation hospital, for a total of 3,301 operational beds. The total consideration of the acquisition was \$225.0 million (US\$238.2 million), and was comprised of the assumption of debt of US\$76.4 million, the issuance of US\$26.4 million of 7.5% notes, a portion of which was payable based on certain factors being met, and US\$135.4 million in cash. EHSI paid US\$5.4 million of the notes in January 2008 and a further US\$5.0 million in March 2009, upon satisfaction of certain factors being met. The remaining notes of US\$16.0 million are payable commencing in 2010 at US\$4.0 million per annum until maturity in 2013. 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 will occur annually over a four-year period until January 2012. In April 2009, we made a payment of US\$1.7 million pursuant to the annual closing statement adjustments. In addition, in connection with the acquisition of LTC Professional, Tendercare's affiliated insurance company, ECI made a payment of US\$2.2 million pursuant to the annual closing statement adjustments that continue until 2012. For further information on the acquisition of LTC Professional, refer to the discussion under the heading "Liquidity and Capital Resources – Accrual for Self-insured Liabilities".

On April 7, 2008, Tim Lukenda, the former President of Tendercare was appointed President and Chief Executive Officer of Extencicare 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. 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 Extencicare REIT and his previous employer, or with respect to any financial interest that Mr. Lukenda or his family have with Extencicare REIT and its subsidiaries. As part of the acquisition of Tendercare, in addition to normal representative and warranty provisions, EHSI has to 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 services to three long-term care centers that are owned or partially owned by members of Mr. Lukenda's immediate family.

OFF-BALANCE SHEET ARRANGEMENTS

Both ALC and EHSI are the lessees under lease agreements with LTC (the "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 Extencicare 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 Master Leases.

The 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 2008 calendar year was US\$10.7 million. The minimum rent will increase by 2% over the prior year's minimum rent for each of the calendar years 2009 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.

ACCOUNTING POLICIES AND ESTIMATES

Non-GAAP Measures

Extencicare REIT assesses and measures operating results and financial position based on performance measures referred to as "net operating income", "EBITDA", "continuing health care operations before undernoted", "continuing operations before undernoted", "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 earnings (loss) from operations, net earnings (loss) for the period, cash flow, or other measures of financial performance and liquidity reported in accordance with Canadian 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 continuing operations before interest, income taxes, depreciation, amortization, and accretion. In this calculation, the REIT has excluded the line items "loss (gain) on derivative financial instruments and foreign exchange" 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, 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 above line items 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 either "continuing health care operations before undernoted" or "continuing operations before undernoted", as applicable. 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 Extencicare 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 Distributable Income further reduced by facility maintenance (non-growth) capital expenditures not already reflected in the calculation of Distributable Income.

Critical Accounting Policies and Estimates

The REIT's consolidated financial statements have been prepared in accordance with Canadian GAAP. For a full discussion of the REIT's critical accounting policies and estimates, readers should refer to the MD&A of the REIT's 2008 Annual Report. The disclosures in such report have not materially changed since that report was filed; however, to the extent there have been changes in accounting policies or management's estimates, they are discussed under "Significant Developments" and under "New Accounting Policies Adopted". 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 measurement of acquired assets and assumed liabilities in business combinations; the valuation of assets and determination of asset impairment; the valuation of conditional asset retirement obligations; the determination of the accrual for self-insured liabilities; and accounting for tax uncertainties, including valuation allowances for future tax assets.

New Accounting Policies Adopted

Our unaudited interim consolidated financial statements are based upon accounting principles consistent with those used and described in *note 1* of the audited consolidated financial statements of our 2008 Annual Report, except that, effective January 1, 2009, we adopted the new CICA accounting standards and abstracts as described below, which are more fully described in *note 2* of the unaudited consolidated financial statements for the six months ended June 30, 2009.

GOODWILL AND INTANGIBLE ASSETS

Section 3064 "Goodwill and Intangible Assets" replaces previous guidance on accounting for intangible assets. The revised standards reinforce the principle-based approach to the recognition of costs as an asset and clarify the application of the matching concept of revenue and expenses. The new standards clarify the distinction between assets and expenses and add guidance on the definition of an intangible asset and the recognition of internally generated intangible assets. The adoption of this standard did not have an impact on the financial position or the results of operation of the REIT, other than reclassifying certain computer software from property and equipment to intangible assets. The effect of adopting Section 3064 is detailed in *note 2* to the unaudited consolidated financial statements for the six months ended June 30, 2009.

CREDIT RISK AND THE FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

In January 2009, the Emerging Issues Committee of the CICA issued EIC-173 "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". This Abstract provides guidance on Handbook Section 3855 "Financial Instruments – Recognition and Measurement", in particular, the determination of fair value of certain financial assets and financial liabilities. It establishes that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. This guidance is effective for periods ending on or after January 2009, to be applied retrospectively without restatement of prior years. The application of this Abstract does not have a material impact on the financial position or results of the REIT as at June 30, 2009.

Future Change in Accounting Policies

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

TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed its decision to require that all Publicly Accountable Enterprises report under International Financial Reporting Standards (IFRS), with early adoption permitted beginning in 2009. For the REIT, IFRS will be effective for interim and annual periods commencing January 1, 2011, and will include one year of comparative figures for 2010. It is not our intention to early adopt IFRS prior to 2011.

IFRS are based on a conceptual framework similar to Canadian GAAP, although significant differences exist in certain matters of recognition, measurement and disclosure. The classification and components of account balances under IFRS are expected to be different than under Canadian GAAP.

The REIT continues to assess the effects of the IFRS transition on its financial reporting and disclosure requirements. The process will be ongoing as the International Accounting Standards Board (IASB) issues new standards and/or revises its existing recommendations.

During the first half of 2009, we analyzed the key areas where changes in accounting policies will have an impact on our consolidated financial statements. The following update examines several key areas where the adoption of IFRS will likely have a large impact on our consolidated financial statements:

Plant, Property & Equipment (PP&E) – IAS16

Under IAS16, PP&E is measured at its cost on initial recognition, which is consistent with Canadian GAAP. However, under IFRS, the REIT can choose from two alternatives for measuring each class of PP&E subsequent to the date of initial recognition.

The first alternative is the cost model, which is consistent with the historic cost model under Canadian GAAP, whereby each item or class of PP&E is recorded on the balance sheet at cost less accumulated depreciation and accumulated impairment losses.

The second alternative is the revaluation model, whereby the entire class of PP&E (such as land or buildings) is revalued with sufficient regularity to ensure that the carrying value does not differ materially from its fair value at the end of each reporting period.

Under the revaluation model, an initial increase in value for each asset within a class is recorded within equity in a "Revaluation Surplus" account (except where the increase is reversing a previously recorded decrease in fair value; then the increase would be recorded in profit and loss, to the extent of the decrease previously recorded).

An initial decrease in value for each asset within a class is recorded in profit and loss, except where the decrease is reversing a previously recorded increase in fair value, in which case the decrease will first reduce the balance previously recorded in the Revaluation Surplus account.

Separately, IFRS1 *First Time adoption of International Financial Reporting Standards* provides an exemption that allows the REIT to selectively fair value specific assets upon transition, and to use those updated fair values as deemed cost going forward, and to continue with the cost model post adoption of IFRS. Any adjustments from the use of this exemption will be recorded within an equity account (IFRS Transitional Adjustment) in our IFRS compliant Opening Statement of Financial Position.

The REIT will be selecting the above-mentioned IFRS1 exemption to use fair value as deemed cost on selected assets, and to continue using the cost model post-IFRS adoption. We are currently determining the scope and magnitude of this IFRS1 exemption, and will provide an explanation of the impact of this transitional option once the detailed analysis is complete.

Investment Property – IAS40

Under this standard (there is no equivalent under Canadian GAAP), any property held for capital appreciation and/or rental is considered investment property. Similar to PP&E, investment property can be measured, subsequent to initial recognition, using either the cost model or fair value model. However, unlike the revaluation model for PP&E, any positive or negative adjustments relating to the fair value of investment property are recorded directly in profit and loss. Also should the cost model be elected for subsequent measurement of investment property, IFRS requires that the fair values relating to investment property be disclosed.

As the REIT provides services at its senior nursing facilities, we have determined on a preliminary basis that they cannot be considered investment property under IAS40. We have examined the implications of applying IAS40, whereby our owned assisted living centers are designated as investment property. After careful analysis of the implications and costs of applying IAS40, it is our preliminary conclusion to maintain our existing asset classifications and not designate any existing facilities as investment property.

Other Transitional Issues

(a) Employee Benefits – IAS19

Similar to Canadian GAAP, IFRS allows the use of an income statement approach relating to amortization of actuarial experience gains and losses on defined benefit plans whereby the actuarial experience gains and losses are amortized into profit and loss based on the estimated remaining service life of plan members.

Another alternative under IFRS is the balance sheet approach, namely to record all actuarial experience gains and losses directly in Other Comprehensive Income (equity) as they occur. Under this policy choice, our annual pension expense will primarily consist of service cost, interest cost, and return on plan assets.

Separately, IFRS1 provides an exemption that allows the REIT to reset its actuarial experience gains and losses account to zero, as opposed to retrospectively restating this account as if IFRS had always been in effect. Any adjustments from electing this exemption will be recorded within our IFRS Transitional Adjustment account in our IFRS compliant Opening Statement of Financial Position.

The REIT will be making the election for the IFRS1 exemption to reset its actuarial experience gains and losses to zero on the date of transition, and will be applying the balance sheet approach post-IFRS adoption for amortization of actuarial gains and losses.

(b) Business Combinations – IFRS3

Existing Canadian standards on business combinations will be undergoing changes in 2011 to converge with the new IFRS3 requirements. IFRS3 (revised 2008) defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. The revised standard also broadens the definition of a business by stating that it is as an “integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividend, lower costs or other economic benefit”.

Under the revised IFRS3, acquisition-related costs (such as transaction costs) are required to be expensed in the period in which they occur. This is different from our current practice of including acquisition costs in the purchase price calculation.

Under IFRS1, an entity has the option of selecting this exemption to avoid having to restate all previous business combinations (subject to some exceptions) as if IFRS had always been in place. The REIT will be selecting this exemption.

(c) The Effects of Changes in Foreign Exchange Rates – IAS21

Under IFRS1, an entity has the option of setting its cumulative translation adjustment account (i.e. the effect of restating our US operations measured in US dollars to the REIT's reporting currency of Canadian dollars) to zero. The REIT will be selecting this exemption to avoid having to recalculate the build-up of this account as if IFRS had always been in place.

Any adjustments from the use of this exemption will be recorded within our IFRS Transitional Adjustment account in our IFRS compliant Opening Statement of Financial Position.

(d) Changes in Existing Decommissioning, Restoration and Similar Liabilities – IFRIC1

Under IFRS1, an entity has the option to use a simplified method of measuring its site restoration liabilities on transition to IFRS. By selecting this exemption, companies will not have to recalculate the changes in site restoration costs as if IFRS (and specifically IFRIC1) had always been in place. The REIT will be selecting this exemption. Any adjustments from the use of this exemption will be recorded within our IFRS Transitional Adjustment account in our IFRS compliant Opening Statement of Financial Position.

The above update should not be regarded as a complete list of changes that will result from our transition to IFRS. At this stage, in addition to analyzing the differences between Canadian GAAP & IFRS, we are also evaluating the applicable transition exemptions available to first-time adopters. We will provide updates in our future MD&As as we reach preliminary conclusions with respect to accounting policy choices and the expected financial statement impact upon transition.

BUSINESS COMBINATIONS, CONSOLIDATED FINANCIAL STATEMENTS AND NON-CONTROLLING INTERESTS

In January 2009, the CICA issued new Handbook Sections: Section 1582 “Business Combinations”, Section 1601 “Consolidated Financial Statements” and Section 1602 “Non-controlling Interests”. Section 1582 establishes standards for accounting for business combinations and is equivalent to the IFRS standard, IFRS 3 “Business Combinations”. Section 1601, which establishes standards for consolidated financial statement preparation, replaces Section 1600 “Consolidated Financial Statements”, and along with Section 1602, replicates the IFRS standard, IAS 27, “Consolidated and Separate Financial Statements”, other than the disclosure requirements, and provides guidance on accounting for non-controlling interests subsequent to a business combination. All three new sections are to be implemented concurrently, and are effective for fiscal years beginning on or after January 1, 2011, with earlier adoption permitted as of the beginning of a fiscal year. Management is evaluating the potential impact of these new standards.

ADDITIONAL INFORMATION

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

Extendicare Real Estate Investment Trust

Consolidated Statements of Earnings

(Unaudited)

	Three months ended June 30		Six months ended June 30	
<i>(in thousands of dollars except per unit amounts)</i>	2009	2008	2009	2008
Revenue				
Nursing and assisted living centers				
United States	388,537	325,643	804,254	649,057
Canada	118,860	108,763	233,244	214,337
Home health care – Canada	38,819	39,503	74,823	73,814
Outpatient therapy – United States	3,505	3,134	7,236	6,126
Other	13,425	11,593	27,838	22,734
	563,146	488,636	1,147,395	966,068
Operating expenses	467,824	420,462	963,671	832,171
Administrative costs	18,924	19,515	38,847	35,963
Lease costs	3,658	3,252	7,350	6,321
	490,406	443,229	1,009,868	874,455
Earnings before undernoted	72,740	45,407	137,527	91,613
Depreciation and amortization	16,787	14,058	34,506	27,563
Accretion of retirement obligations	424	360	868	717
Interest expense	24,479	21,226	50,316	42,576
Interest income	(712)	(1,434)	(1,840)	(2,884)
Loss (gain) on derivative financial instruments and foreign exchange <i>(note 6)</i>	(12,424)	(2,045)	(7,474)	2,167
Loss from asset impairment, disposals and other items <i>(note 7)</i>	594	-	337	-
Earnings from continuing operations before income taxes	43,592	13,242	60,814	21,474
Income tax expense (recovery)				
Current	15,086	5,173	26,257	11,458
Future	(1,204)	(1,440)	397	(3,084)
	13,882	3,733	26,654	8,374
Earnings from continuing operations	29,710	9,509	34,160	13,100
Earnings (loss) from discontinued operations, net of income taxes <i>(note 8)</i>	534	1,168	(259)	1,155
Net earnings	30,244	10,677	33,901	14,255
Basic and Diluted Earnings per Unit <i>(note 9)</i>				
Earnings from continuing operations	0.41	0.14	0.47	0.19
Net earnings	0.41	0.15	0.46	0.20

See accompanying notes to unaudited consolidated financial statements.
Certain 2008 figures have been revised for comparative purposes *(notes 2 and 8)*.

Extencicare Real Estate Investment Trust Consolidated Balance Sheets

(Unaudited)

<i>(in thousands of dollars)</i>	June 30 2009	December 31 2008
Assets		
Current assets		
Cash and short-term investments	94,607	123,084
Restricted cash <i>(note 5)</i>	29,482	-
Invested assets	917	947
Accounts receivable, less allowances of \$32,335 and \$32,968, respectively	236,168	274,044
Income taxes recoverable	386	-
Future income tax assets	38,814	40,888
Supplies and prepaid expenses	24,303	19,137
	424,677	458,100
Property and equipment	938,609	970,612
Goodwill and other intangible assets <i>(notes 2 and 4)</i>	210,448	225,629
Other assets <i>(note 3)</i>	146,084	151,641
	1,719,818	1,805,982
Liabilities and Unitholders' Deficiency		
Current liabilities		
Accounts payable	37,951	51,434
Accrued liabilities	239,801	252,098
Accrual for self-insured liabilities	13,051	12,533
Current portion of long-term debt <i>(note 5)</i>	21,998	42,217
Income taxes payable	-	4,594
	312,801	362,876
Accrual for self-insured liabilities	35,370	37,838
Long-term debt <i>(note 5)</i>	1,272,435	1,290,596
Other long-term liabilities	74,313	79,198
Future income tax liabilities	62,919	65,006
	1,757,838	1,835,514
Unitholders' deficiency	(38,020)	(29,532)
	1,719,818	1,805,982

See accompanying notes to unaudited consolidated financial statements.

Certain 2008 figures have been revised to conform with the presentation in 2009 *(note 2)*.

Commitments and contingencies *(note 10)*.

Subsequent events *(note 5)*.

Extendicare Real Estate Investment Trust
Consolidated Statements of Cash Flows
(Unaudited)

	Three months ended June 30		Six months ended June 30	
<i>(in thousands of dollars)</i>	2009	2008	2009	2008
Operating Activities				
Net earnings	30,244	10,677	33,901	14,255
Adjustments for:				
Depreciation and amortization	16,782	14,593	34,665	28,656
Provision for self-insured liabilities	4,988	3,207	10,313	7,114
Payments for self-insured liabilities	(4,443)	(10,108)	(7,563)	(14,322)
Future income taxes	(1,204)	(22)	391	(1,161)
Loss (gain) on derivative financial instruments and foreign exchange <i>(note 6)</i>	(12,424)	(2,045)	(7,474)	2,167
Loss from asset impairment, disposals and other items <i>(note 7)</i>	594	-	337	-
Gain from asset disposals, impairment and other items from discontinued operations <i>(note 8)</i>	-	(106)	(1,426)	(474)
Other	2,866	2,035	6,205	3,720
	37,403	18,231	69,349	39,955
Net change in operating assets and liabilities				
Accounts receivable	9,320	7,385	24,903	(10,224)
Supplies and prepaid expenses	608	598	(6,002)	(7,485)
Accounts payable and accrued liabilities	(4,555)	(6,967)	(12,064)	5,607
Income taxes	(8,345)	(12,549)	(4,843)	(9,186)
	(2,972)	(11,533)	1,994	(21,288)
	34,431	6,698	71,343	18,667
Investing Activities				
Capital additions	(20,435)	(16,277)	(41,030)	(30,342)
Net proceeds from dispositions <i>(note 8)</i>	-	1,041	9,995	2,569
Other assets	384	1,057	(1,710)	1,779
	(20,051)	(14,179)	(32,745)	(25,994)
Financing Activities				
Issue of long-term debt	6,337	143,367	12,049	144,329
Repayment of long-term debt	(3,895)	(53,305)	(14,135)	(62,378)
Issue on line of credit	-	(9,038)	-	-
Increase in restricted cash	(29,482)	-	(29,482)	-
Decrease in investments held for self-insured liabilities	6,536	6,956	7,091	7,849
Purchase of securities for cancellation	-	-	(6,189)	(117)
Distributions paid	(14,584)	(18,929)	(30,866)	(37,846)
Issue of units	-	34,580	-	34,580
Financing costs	(2,795)	(9,100)	(2,832)	(9,410)
Other	(330)	1,002	(1,860)	2,038
	(38,213)	95,533	(66,224)	79,045
Foreign exchange gain (loss) on cash held in foreign currency	(1,704)	123	(851)	339
Increase (decrease) in cash and cash equivalents	(25,537)	88,175	(28,477)	72,057
Cash and cash equivalents at beginning of period	120,144	28,116	123,084	44,234
Cash and cash equivalents at end of period	94,607	116,291	94,607	116,291
Supplementary Information				
Cash interest paid in determining earnings	24,602	21,004	44,884	38,929
Cash taxes paid	23,471	15,102	33,070	17,329
Units issued pursuant to Distribution Reinvestment Plan	723	638	1,432	1,275

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

See accompanying notes to unaudited consolidated financial statements.

Extencicare Real Estate Investment Trust
Consolidated Statements of Unitholders' Deficiency
(Unaudited)

Six months ended June 30

<i>(in thousands of dollars for amounts)</i>	2009		2008	
	<i>Number</i>	<i>Amount</i>	<i>Number</i>	<i>Amount</i>
Unit Capital				
REIT Units				
Issued and outstanding at beginning of period	70,162,191	332,910	60,962,653	272,912
Repurchased pursuant to issuer bid <i>(note 13)</i>	(880,500)	(4,153)	(10,000)	(45)
Issued pursuant to Distribution Reinvestment Plan	276,832	1,380	104,806	1,127
Issue of REIT Units	-	-	3,565,000	32,875
Converted from Exchangeable LP Units	65,194	299	748,510	3,343
	69,623,717	330,436	65,370,969	310,212
Exchangeable LP Units				
Issued and outstanding at beginning of period	3,410,227	13,943	9,481,383	42,279
Issued pursuant to Distribution Reinvestment Plan	10,372	51	13,743	148
Converted to REIT Units	(65,194)	(299)	(748,510)	(3,343)
	3,355,405	13,695	8,746,616	39,084
Units issued and outstanding at end of period	72,979,122	344,131	74,117,585	349,296
Equity portion of convertible debentures				
Issued and outstanding at beginning of period		10,045		8,234
Issued during the period		-		1,811
Repurchased pursuant to issuer bid <i>(note 13)</i>		(81)		-
Equity portion of convertible debentures	-	9,964	-	10,045
	72,979,122	354,095	74,117,585	359,341
Contributed Surplus				
Balance at beginning of period		592		-
Transfer to deficit		(592)		-
Purchase of convertible debentures for cancellation		81		-
Balance at end of period		81		-
Deficit				
Balance at beginning of period		(410,447)		(343,151)
Application of contributed surplus		592		-
Adjustment to prior year distribution of ALC <i>(note 10)</i>		(69)		-
Net earnings for the period		33,901		14,255
Purchase of units for cancellation in excess of book value		(1,136)		(72)
Distributions declared		(30,602)		(39,460)
Balance at end of period		(407,761)		(368,428)
Accumulated Other Comprehensive Income				
Balance at beginning of period		23,425		(3,852)
Net change in available-for-sale securities (net of tax expense of \$104 and tax recovery of \$258, respectively)		541		(860)
Unrealized foreign currency translation adjustments		(8,401)		4,191
Balance at end of period		15,565		(521)
		(38,020)		(9,608)

See accompanying notes to unaudited consolidated financial statements.

Extendicare Real Estate Investment Trust
Consolidated Statements of Comprehensive Income
(Unaudited)

	Three months ended June 30		Six months ended June 30	
	2009	2008	2009	2008
<i>(in thousands of dollars)</i>				
Net earnings	30,244	10,677	33,901	14,255
Other comprehensive income (loss), net of income taxes				
Net unrealized gain (loss) on available-for-sale securities (net of tax expense of \$429 and tax recovery of \$134 for the three months, and tax expense of \$197 and tax recovery of \$227 for the six months ended June 30, 2009 and 2008, respectively)	1,422	(527)	657	(799)
Reclassification of gain on available-for-sale securities to earnings (net of tax expense of \$93 and of \$12 for the three months, and tax expense of \$93 and of \$31 for the six months ended June 30, 2009 and 2008, respectively)	(24)	(29)	(116)	(61)
	1,398	(556)	541	(860)
Net change in foreign currency translation adjustment	(13,579)	(621)	(8,401)	4,191
	(12,181)	(1,177)	(7,860)	3,331
Comprehensive income	18,063	9,500	26,041	17,586

See accompanying notes to unaudited consolidated financial statements.

Extencicare Real Estate Investment Trust

Notes to Interim Consolidated Financial Statements

Periods ended June 30, 2009 and 2008
(Tabular amounts in thousands except per unit data)

(Unaudited)

1. BASIS OF PRESENTATION

The unaudited interim consolidated financial statements of Extencicare Real Estate Investment Trust have been prepared in accordance with Canadian generally accepted accounting principles. References to “Extencicare REIT”, the “REIT”, “we”, “us” and “our” in these statements mean Extencicare Real Estate Investment Trust alone or together with its subsidiaries, as the context requires. The direct ownership and operation of the senior care facilities and ancillary businesses is conducted by the subsidiaries of the REIT. The REIT itself is not a provider of services or products. Extencicare REIT trades on the Toronto Stock Exchange (TSX) under the symbol “EXE.UN”.

The consolidated financial statements include those of Extencicare Inc. (Extencicare), an indirect wholly owned subsidiary of Extencicare REIT. Health care operations are conducted through wholly owned subsidiaries, Extencicare Health Services, Inc. and its subsidiaries (collectively “EHSI”) in the United States, and Extencicare (Canada) Inc. and its subsidiaries (collectively “ECI”) in Canada.

The preparation of financial data is based on accounting policies and practices consistent with those used in the preparation of the annual audited consolidated financial statements. All dollar amounts are in Canadian dollars unless otherwise indicated. These unaudited interim consolidated financial statements do not include all disclosures normally provided in annual consolidated financial statements and should be read together with the annual audited consolidated financial statements and the accompanying notes included in our 2008 Annual Report.

Certain comparative figures for the 2009 reported periods have been reclassified to conform to the presentation in 2009, mainly for intangible assets as described in *note 2* and discontinued operations as described in *note 8*.

2. NEW ACCOUNTING POLICIES

a) Accounting Policies Adopted

GOODWILL AND INTANGIBLE ASSETS

In February 2008, the CICA issued the new Handbook Section 3064 “Goodwill and Intangible Assets” to replace existing guidance on accounting for intangible assets. The revised standards reinforce the principle-based approach to the recognition of costs as an asset and clarify the application of the matching concept of revenue and expenses. The new standards clarify the distinction between assets and expenses and add guidance on the definition of an intangible asset and the recognition of internally generated intangible assets. These accounting standards are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2009. The adoption of this standard did not have an impact on the financial position or the results of operations of the REIT, other than reclassifying certain computer software from property and equipment to intangible assets. The comparative figures have been reclassified as follows:

	Dec. 31/08	Jun. 30/08
Consolidated Balance Sheet:		
Decrease in property and equipment	(22,306)	(17,421)
Increase in other intangible assets	22,306	17,421
	Year ending	Period ending
	Dec. 31/08	Jun. 30/08
Consolidated Statement of Earnings:		
Decrease in depreciation	(4,111)	(1,528)
Increase in amortization of other intangible assets	4,111	1,528

CREDIT RISK AND THE FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

In January 2009, the Emerging Issues Committee of the CICA issued EIC-173 “Credit Risk and the Fair Value of Financial Assets and Financial Liabilities”. This Abstract provides guidance on Handbook Section 3855 “Financial Instruments – Recognition and Measurement”, in particular, the determination of fair value of certain financial assets and financial liabilities. It establishes that an entity’s own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. This guidance is effective for periods ending on or after January, 2009, to be applied retrospectively without restatement of prior years. The application of this Abstract does not have a material impact on the financial position or results of the REIT as at June 30, 2009.

b) Future Change in Accounting Policies**TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS**

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed its decision to require all Publicly Accountable Enterprises to report under International Financial Reporting Standards (IFRS), with early adoption permitted starting in calendar year 2009. For the REIT, IFRS will be effective for interim and annual periods commencing January 1, 2011, including the preparation and reporting of one year of comparative figures. It is not our intention to early adopt IFRS prior to January 1, 2011.

The REIT continues to assess the effects of the transition to IFRS on its financial reporting and disclosure requirements. The process will be ongoing as the International Accounting Standards Board (IASB) issues new standards and/or revises its existing recommendations.

BUSINESS COMBINATIONS, CONSOLIDATED FINANCIAL STATEMENTS AND NON-CONTROLLING INTERESTS

In January 2009, the CICA issued new Handbook Sections: Section 1582 “Business Combinations”, Section 1601 “Consolidated Financial Statements” and Section 1602 “Non-controlling Interests”. Section 1582 establishes standards for accounting for business combinations and is equivalent to the IFRS standard, IFRS 3 “Business Combinations”. Section 1601, which establishes standards for consolidated financial statement preparation, replaces Section 1600 “Consolidated Financial Statements”, and along with Section 1602, replicates the IFRS standard, IAS 27, “Consolidated and Separate Financial Statements”, other than the disclosure requirements, and provides guidance on accounting for non-controlling interests subsequent to a business combination. All three new sections are to be implemented concurrently, and are effective for fiscal years beginning on or after January 1, 2011, with earlier adoption permitted as of the beginning of a fiscal year. Management is evaluating the potential impact of these new standards, but does not expect that there will be a material impact on the financial position or results of the REIT.

3. OTHER ASSETS

	June 30 2009	December 31 2008
Investments held for self-insured liabilities:		
Held-to-maturity securities, at amortized cost	6,665	6,979
Available-for-sale securities, at fair value	51,872	60,546
Notes, mortgages and amounts receivable	52,733	53,342
Medicare and Medicaid settlement receivables	19,488	17,224
Assets held for sale	15,326	13,550
	146,084	151,641

The investments held for self-insured liabilities 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 \$2.1 million (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 June 30, 2009, assets held for sale of \$15.3 million (US\$13.2 million) related to two skilled nursing centers in Minnesota (245 beds) that were identified as discontinued operations during the 2009 first quarter (*note 8*), with a carrying value of \$7.1 million (US\$6.1 million); one skilled nursing center in Ohio (100 beds) that was identified as discontinued operations in the 2008 third quarter, with a carrying value of \$6.5 million (US\$5.6 million); and a former 74-bed skilled

nursing center in Port Angeles, Washington, with a carrying value of \$1.7 million (US\$1.4 million), which was replaced by a new 100-bed skilled nursing center constructed during the first half of 2008 in Sequim, Washington.

4. GOODWILL AND OTHER INTANGIBLE ASSETS

	June 30 2009	December 31 2008
Goodwill	189,380	201,974
Other intangible assets	21,068	23,655
	210,448	225,629

In connection with the disposition of the two Ohio centers in March 2009, goodwill was reduced by \$4.4 million (US\$3.5 million) during the 2009 first quarter (*note 8*).

As at June 30, 2009, other intangible assets had a gross carrying value of \$32.6 million and accumulated amortization of \$11.5 million, for a net book value of \$21.1 million. The aggregate amortization expense was \$1.6 million for the second quarter of 2009 (2008 – \$1.3 million) and \$3.5 million for the first six months of 2009 (2008 – \$2.4 million). Prior period balances have been reclassified to reflect the adoption of the new standards on intangible assets (*note 2*).

5. LONG-TERM DEBT

	June 30 2009		December 31 2008	
	US\$	C\$	US\$	C\$
EHSI (payable in US\$)				
CMBS Financing, 6.6525%, due 2011	500,000	581,500	500,000	609,000
Financing costs	(6,385)	(7,425)	(7,583)	(9,236)
CMBS Financing, 6.79%, due 2012	89,688	104,307	90,000	109,620
Financing costs	(1,554)	(1,809)	(1,814)	(2,209)
Line of credit under Credit Facility, variable rates, due 2011	11,000	12,793	11,000	13,398
Financing costs	(2,251)	(2,618)	(1,232)	(1,501)
Sovereign Bank mortgage loans, variable rates, due 2011	50,023	58,177	50,518	61,531
Financing costs	(1,248)	(1,452)	(1,497)	(1,824)
HUD mortgage loans, 5% to 5.5%, due 2018 to 2032	23,925	27,825	24,557	29,910
Other mortgage loans, 5.72% to 6.7%, maturing through to 2009	7,176	8,346	7,310	8,904
Notes payable, 7.5%, maturing through to 2013	16,000	18,608	21,458	26,136
Obligations under capital leases, 5.24% to 7.65%, maturing through to 2015	3,781	4,397	4,092	4,984
Other financing costs	(125)	(143)	(135)	(164)
	690,030	802,506	696,674	848,549
Extendicare REIT and Canadian Subsidiaries (payable in C\$)				
Convertible Unsecured Subordinated Debentures, 5.7%, due 2014		107,409		107,868
Financing costs		(3,605)		(4,040)
Convertible Unsecured Subordinated Debentures, 7.25%, due 2013		90,217		90,242
Financing costs		(3,432)		(3,827)
Mortgages, 3.52% to 9.81%, maturing through to 2023		170,794		171,481
Financing costs		(2,055)		(2,220)
Construction loan, variable rate, due 2011		9,170		–
Obligations under capital leases, average rate of 7.68%, maturing through to 2028		123,992		130,674
Financing costs		(563)		(5,914)
		491,927		484,264
		1,294,433		1,332,813
Less: current portion		21,998		42,217
		1,272,435		1,290,596

The changes to long-term debt since December 31, 2008, are described below.

EHSI

CREDIT FACILITY

In June 2009, EHSI renewed and amended the US\$120.0 million credit facility that was due to mature in October 2009 and was formerly administered by Lehman Brothers, Inc. The renewed and amended credit facility (the “EHSI Credit Facility”) matures in June 2011 and has an option to extend for a third year to June 2012 upon satisfaction of certain conditions. The maximum borrowings under the EHSI Credit Facility were reduced from US\$120.0 million to US\$70.0 million in line with anticipated cash requirements, and the U.S. Bank National Association was appointed as the lead arranger and administrative agent.

The amount available to be borrowed under the EHSI Credit Facility is the lesser of: (1) 60% of the appraised values of the skilled nursing centers collateralizing the EHSI Credit Facility, or (2) an amount based on the actual net cash flow of these centers for the last 12 months. The amount available to be borrowed as of June 30, 2009, was US\$70.0 million.

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.

The EHSI Credit Facility is secured by mortgages on 21 skilled nursing centers and is guaranteed by Extencare Holdings, Inc. and EHSI’s material domestic subsidiaries. Tendercare (Michigan) Inc. (Tendercare) and its subsidiaries remain classified as unrestricted subsidiaries under the EHSI Credit Facility; however, the entities are now specified non-recourse subsidiaries and 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.

As of June 30, 2009, US\$11.0 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 total outstanding letters of credit of US\$3.7 million in favour of a state workers compensation program and certain landlords of leased properties, was US\$55.3 million as of June 30, 2009. The letters of credit are renewed annually in mid-October.

NOTES PAYABLE

Notes payable as at June 30, 2009, were seller notes of US\$16.0 million arising from the Tendercare acquisition from 2007 (*note 14*). These notes have an interest rate of 7.5%, with an original balance totalling US\$26.4 million, consisting of US\$16.0 million payable commencing in 2010 at US\$4.0 million per annum until maturity in 2013 and the balance of the notes of US\$10.4 million payable based upon certain factors being met, but with a term of no longer than 18 months ending April 2009. In January 2008 and March 2009, those factors were met and EHSI paid US\$5.4 million and US\$5.0 million, respectively.

Extencare REIT and Canadian Subsidiaries

CONVERTIBLE UNSECURED SUBORDINATED DEBENTURES

Pursuant to the normal course issuer bid approved by the TSX on December 18, 2008 (the “2008 Bid”), management has acquired for cancellation, \$1.1 million aggregate principal amount of the 5.7% convertible unsecured subordinated debentures, due 2014 (the “2014 Debentures”) at a cost of \$0.7 million and \$0.2 million aggregate principal amount of the 7.25% convertible unsecured subordinated debentures, due 2013 (the “2013 Debentures”) at a cost of \$158,500, commencing January 2009. These transactions resulted in a gain of \$0.3 million (*note 7*). The consideration paid was allocated to the liability and equity elements of these debentures based on their relative fair values at the time of settlement. The approach used in the allocation of consideration paid is consistent with the original allocation of proceeds received by us on issuance of these debentures to the separate elements.

CAPITAL LEASE OBLIGATIONS

On June 18, 2008, Bill C-50, the *Budget Implementation Act, 2008* received Royal Assent. The bill is effective February 27, 2008, and among other things, clarifies rules related to the application of goods and services tax, or GST, to the construction or purchase and operation of residential care facilities. These amendments will affect the conditions for claiming a new residential rental property rebate for long-term residential care centers as well as the taxable status of head lease payments, and require self-assessment of GST for builder-operators of such centers. In April 2009, we completed discussions with the Canada Revenue Agency regarding the application of these new rules on ECI’s capital lease

obligations of nine of its Ontario long-term care centers, discussions of which concluded with no financial consequence to us. Consequently, the balance of our capital lease obligations and related financing costs on the balance sheet as at June 30, 2009, reflected the reversal of the provision recorded in the 2008 second quarter.

MORTGAGES

On January 26, 2009, ECI refinanced a \$6.0 million mortgage on an Ontario nursing center with \$8.9 million of CMHC financing at a fixed rate of 3.52%, with a five-year term, and monthly payments based on a 15-year amortization.

CONSTRUCTION LOAN

In September 2008, ECI secured CMHC insured construction financing on its Red Deer, Alberta project, for a maximum of \$30.4 million (approximately 87% of the construction costs, net of government grants), plus CMHC fees of \$1.6 million. Commencing in January 2009, ECI made its first draw under the loan. The loan is due in February 2011, with interest-only payments based on a floating rate of 30-day asset backed commercial paper rates plus 1.5%. Management plans to secure long-term financing for this project prior to its completion in the summer of 2010.

In June 2009, ECI obtained CMHC insured long-term financing of \$20.5 million on its Lethbridge, Alberta project (approximately 93% of the construction costs, net of government grants). The loan has a term of 27 years, of which the first two years is for construction, following which it would be amortized over 25 years at a fixed rate of 7.70%. However, once the center is opened, the interest costs will be reimbursed through government funding for the rest of the term.

RBC CREDIT FACILITY

Extencicare's \$70.0 million credit facility with the Royal Bank of Canada (the "RBC Credit Facility") is due on demand, is secured by 14 Canadian nursing homes, and is guaranteed by certain Canadian operating subsidiaries of Extencicare. It is used to back letters of credit of which there were \$61.5 million issued and outstanding as at June 30, 2009, leaving \$8.5 million available. The \$61.5 million of letters of credit secured \$44.5 million of Extencicare's executive pension obligations, \$16.8 million of our obligation for contingent liabilities in connection with the sale of our investment in Crown Life Insurance Company (Crown Life) in 2007 and \$0.2 million related to construction projects. The letter of credit securing the executive pension obligations was renewed in March 2009, with a May 1, 2010, renewal date. The Crown Life letters of credit were renewed on July 5, 2009, at the same amount.

In June 2009, Extencicare amended its RBC Credit Facility to provide for the issuance of a U.S. dollar letter of credit facility of up to US\$22.2 million, in addition to the existing \$70.0 million available under the RBC Credit Facility. This US\$22.2 million letter of credit is used to back a third-party insurer for workers' compensation claims of EHSI. At June 30, 2009, the letter of credit securing EHSI's workers' compensation claims was US\$22.2 million, which is due on demand, and is secured by \$29.5 million in cash collateral held by RBC. The cash collateral is currently invested in short term deposits, however as the cash is restricted as to withdrawal, it is presented on the balance sheet as restricted cash within current assets.

Other

LETTER OF CREDIT

In August 2009, one of Extencicare's captive insurance companies, LTC Professional Insurance Company, Ltd. (LTC Professional), secured letters of credits in aggregate for US\$6.8 million in favour of a third-party insurer for general and liability claims. The letters of credit were issued by Bank of Montreal in Chicago and are secured by cash collateral of US\$7.2 million.

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. These costs amounted to \$23.1 million at June 30, 2009.

6. DERIVATIVE FINANCIAL INSTRUMENTS AND FOREIGN EXCHANGE

	Three months ended		Six months ended	
	June 30		June 30	
	2009	2008	2009	2008
Foreign exchange gain	(3,119)	(1,060)	(1,432)	(1,754)
Valuation loss (gain) on foreign currency forward contracts	(9,305)	(532)	(6,042)	4,020
Valuation loss on interest rate swap agreements	–	–	–	354
Gain on termination of interest rate swap agreements	–	(453)	–	(453)
Loss (gain) on derivative financial instruments and foreign exchange	(12,424)	(2,045)	(7,474)	2,167

The foreign exchange gain of \$3.1 million for the second quarter and \$1.4 million for the first half of 2009, and the gain of \$1.1 million and \$1.8 million for the same periods in 2008, respectively, mostly resulted from the settlement of foreign currency denominated notes between EHSI and some of the Canadian-based subsidiaries.

The foreign exchange gain on foreign currency forward contracts (FCFCs) was \$9.3 million in the second quarter of 2009, and \$6.0 million for the first six months. The foreign exchange gain was \$0.5 million in the 2008 second quarter, reducing the loss to \$4.0 million for the six-month period in 2008. This related to revaluation of four 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.

EHSI assumed two interest rate swap agreements in connection with the acquisition of Tendercare in October 2007, with a notional amount of US\$25.8 million that partially offset changes in rates on variable-rate debt of Tendercare, with maturity dates in 2008 and 2011. These swaps were terminated in June 2008, at a lower amount than the carrying value, with a payment of US\$0.9 million to the counterparty, resulting in a gain of \$0.4 million on termination. The revaluation of these agreements before the termination amounted to a loss of \$0.4 million in 2008.

7. ASSET IMPAIRMENT, DISPOSALS AND OTHER ITEMS

	Three months ended		Six months ended	
	June 30		June 30	
	2009	2008	2009	2008
Loss on suspended construction projects	605	–	605	–
Gain on repurchase of securities for cancellation	–	–	(257)	–
Other	(11)	–	(11)	–
Loss from asset impairment, disposals and other items	594	–	337	–

In June 2009, EHSI abandoned one project in Spokane, Washington, and wrote off \$0.6 million of associated costs.

Commencing in 2009, management acquired for cancellation, \$1.1 million aggregate principal amount of the 2014 Debentures at a cost of \$0.7 million and \$0.2 million aggregate principal amount of the 2013 Debentures at a cost of \$158,500. The gain or loss on the purchase of these debentures was calculated by comparing the consideration paid with the carrying value of the debenture, net of the related financing costs, and the carrying value of the equity conversion option extinguished through the transaction. These transactions resulted in a gain of \$0.3 million (*note 5*).

8. DISCONTINUED OPERATIONS

The following is a summary of discontinued operations with prior periods revised for operations identified as discontinued as of June 30, 2009.

	Three months ended		Six months ended	
	June 30		June 30	
	2009	2008	2009	2008
Revenue	8,063	13,684	18,808	28,267
Operating expenses	7,262	13,254	17,638	27,818
Lease costs	10	17	17	29
Earnings before undernoted	791	413	1,153	420
Depreciation and amortization	(5)	536	159	1,093
Accretion expense	13	17	28	40
Interest income, net	(1)	–	(1)	(2)
Earnings (loss) before the undernoted	784	(140)	967	(711)
Gain (loss) from asset impairment, disposals and other items				
Impairment charges	–	–	–	(891)
Recoveries on sale of facilities	–	106	1,426	1,365
	–	106	1,426	474
Earnings (loss) from discontinued operations before income taxes	784	(34)	2,393	(237)
Income tax expense (recovery)	250	(1,202)	2,652	(1,392)
Earnings (loss) from discontinued operations	534	1,168	(259)	1,155
Earnings (loss) per basic and diluted unit (<i>dollars</i>)	0.01	0.01	(0.01)	0.01

2009

MINNESOTA SKILLED NURSING CENTERS

In the first quarter of 2009, due to poor financial performance and the need for future capital outlays, EHSI decided to actively pursue the sale of two skilled nursing centers (245 beds) located in Minnesota. No impairment charge was recorded since we expect to sell them for proceeds in excess of net book value.

2008

In 2008, EHSI decided to actively pursue the sale of seven underperforming facilities in Ohio, Indiana and Pennsylvania. As of June 30, 2009, one of the Ohio facilities remains classified as discontinued operations and is included in assets held for sale.

OHIO AND INDIANA SKILLED NURSING CENTERS

The financial results of skilled nursing centers that were reclassified to discontinued operations in 2008 included three centers in Indiana (310 beds) identified in the second quarter and three centers in Ohio (271 beds) identified in the 2008 third quarter. All three Indiana centers were sold in the 2008 fourth quarter for proceeds of \$13.9 million (US\$11.4 million) at a gain of \$5.5 million (US\$4.5 million); and two of the Ohio centers (171 beds) were sold in March 2009 for proceeds of \$11.1 million (US\$8.7 million) of which \$1.1 million (US\$0.8 million) was in the form of a note, resulting in a gain of \$1.4 million (US\$1.1 million). As a result of the Ohio disposal in March 2009, a \$4.4 million (US\$3.5 million) reduction to goodwill was recorded (*note 4*).

A skilled nursing center (175 beds) located in Dayton, Ohio was closed in May 2007, and was sold in March 2008 for net proceeds of \$1.5 million (US\$1.5 million), resulting in a recovery of \$1.3 million (US\$1.3 million). During the fourth quarter of 2008, bed licenses for this center were sold for proceeds of \$4.4 million (US\$3.7 million), resulting in a gain of \$1.6 million (US\$1.4 million).

PENNSYLVANIA AND OREGON ASSISTED LIVING PROPERTY

The financial results of an assisted living facility (92 units) located in Pennsylvania were reclassified to discontinued operations in the first quarter of 2008, and an impairment charge of \$0.9 million (US\$0.9 million) was recorded to reduce the property to its fair value net of disposal cost. The facility was closed in April 2008 and sold in May 2008 for proceeds of \$0.6 million (US\$0.6 million), resulting in a further loss of \$0.4 million (US\$0.4 million).

EHSI sold a previously closed assisted living center in Oregon in May 2008 for net proceeds of \$0.4 million (US\$0.4 million), resulting in a gain of \$0.5 million (US\$0.5 million).

9. EARNINGS PER UNIT

Basic earnings per unit is calculated using the weighted average number of units outstanding during the period. Diluted earnings per unit, using the “if-converted” method and to the extent the conversion is dilutive, assumes all convertible securities have been converted at the beginning of the period, or at the time of issuance, if later, and any charges or returns on the convertible securities, on an after-tax basis, are removed from net earnings.

The following table reconciles the numerator and denominator of the basic and diluted earnings per unit computation.

	Three months ended June 30		Six months ended June 30	
	2009	2008	2009	2008
Numerator for Basic and Diluted Earnings per Unit				
<i>Earnings from continuing operations</i>				
Net earnings for basic earnings per unit	30,244	10,677	33,901	14,255
Less: loss (earnings) from discontinued operations, net of tax	(534)	(1,168)	259	(1,155)
Earnings from continuing operations for basic earnings per unit	29,710	9,509	34,160	13,100
Add: after-tax interest on convertible debt	2,802	1,644	5,605	3,121
Earnings from continuing operations for diluted earnings per unit	32,512	11,153	39,765	16,221
<i>Net earnings</i>				
Net earnings for basic earnings per unit	30,244	10,677	33,901	14,255
Add: after-tax interest on convertible debt	2,802	1,644	5,605	3,121
Net earnings for diluted earnings per unit	33,046	12,321	39,506	17,376
Denominator for Basic and Diluted Earnings per Unit (thousands)				
Weighted average number of units for basic earnings per unit	72,914	71,109	72,913	70,790
Units issued if all convertible debt was converted ⁽¹⁾	13,813	6,760	13,820	6,268
Total for diluted earnings per unit	86,727	77,869	86,733	77,058
Basic and Diluted Earnings per Unit (in dollars)				
Earnings from continuing operations	0.41	0.14	0.47	0.19
Net earnings	0.41	0.15	0.46	0.20

⁽¹⁾ Units in 2008 were pro-rated for the 11 days in the six months ended June 30, 2008, that the 2013 Debentures were outstanding.

10. COMMITMENTS AND CONTINGENCIES

Property and Equipment Commitments

At June 30, 2009, outstanding capital expenditure commitments for EHSI totalled \$22.0 million (US\$18.9 million). Included in EHSI's outstanding commitments was US\$11.9 million related to development projects in progress, representing 200 nursing beds (100 in Michigan that opened in July 2009, and 100 in Wisconsin) and 60 assisted living units (in Wisconsin). The Wisconsin projects are expected to be completed by December 2009. The total estimated cost of these projects is approximately US\$35.0 million, of which US\$21.0 million was spent through to June 30, 2009. ECI has outstanding capital expenditure purchase commitments totalling \$20.0 million as at June 30, 2009, relating to one development project currently in progress (280 beds in Alberta).

Legal Proceedings

The REIT and its consolidated subsidiaries are defendants in actions brought against them from time to time in connection with 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.

In late 2008, three class action lawsuits were filed against wholly owned U.S. based subsidiaries of the REIT in a federal court in Washington and in Minnesota, and in a state court in Wisconsin. All of the lawsuits have essentially the same allegations that our advertising did not match with our regulatory history. The claims also include allegations that the centers admitted residents without due regard to their needs. Plaintiffs have yet to identify their specific theory for damages in any of the cases. The Washington complaint involves 15 facilities during a four-year period beginning in August 2004; the Minnesota complaint involves 10 facilities during a six-year period beginning in October 2002; and the Wisconsin complaint involves 26 facilities during a three-year period beginning in November 2005.

Motions to dismiss were granted by the courts in both the Minnesota and Washington actions in March 2009.

On March 4, 2009, the Minnesota federal district court judge ruled that the class action lawsuit filed in that state was improper and ordered the case dismissed in its entirety. The court stated that the lawyer-driven complaint "failed to identify any solid ground on which the Plaintiff could stand in this litigation". The Honorable Donovan W. Frank rejected all of the class action claims, and held that that the plaintiff's allegations "are so general and unspecific they cannot serve as the basis for a claim". Judge Frank further prohibited the plaintiff's attorneys from attempting to re-file the lawsuit with amended allegations because, given the weakness of the claim, it "would not likely be fruitful".

On March 24, 2009, the Washington federal district court judge ruled that the undisputed evidence demonstrated that the plaintiffs could not prove their supposed claims and issued a final judgment in our favour and ordered the case closed. The Honorable John C. Coughenour found that the plaintiffs were not misled by any of Extencicare's representations, and that none of the plaintiffs suffered any actual injury.

A similar motion to dismiss has been filed in the Wisconsin action that will be heard by the court in August 2009. We believe that the allegations in all of these cases are without merit, and we intend to continue to vigorously defend against the remaining lawsuit in court.

Assisted Living Concepts, Inc. Tax Allocation Agreement

As part of the spin-off of Assisted Living Concepts, Inc. (ALC) in 2006 to Extencicare's shareholders, EHSI and ALC entered into a Tax Allocation Agreement dated as of November 10, 2006 (the "Tax Allocation Agreement"). ALC is asserting that EHSI owes an estimated US\$3.1 million to ALC under this 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. We disagree with this assertion and do not believe any liability has been incurred. We have not recorded any liability under the Tax Allocation Agreement as of June 30, 2009. It is likely that this issue will be decided prior to the end of 2009 by an independent arbitrator as provided in Tax Allocation Agreement. If any liability is ultimately recorded, it will be charged directly to retained earnings since the spin-off of ALC was accounted for as a capital transaction in 2006.

11. SEGMENTED INFORMATION

	Three months ended		Six months ended	
	June 30		June 30	
	2009	2008	2009	2008
Revenue				
United States	403,037	337,272	834,338	672,288
Canada	160,109	151,364	313,057	293,780
	563,146	488,636	1,147,395	966,068
EBITDA ⁽¹⁾				
United States	57,289	32,746	109,444	69,503
Canada	15,451	12,661	28,083	22,110
	72,740	45,407	137,527	91,613
Earnings from Continuing Operations				
United States	24,993	5,984	31,946	9,015
Canada	4,717	3,525	2,214	4,085
	29,710	9,509	34,160	13,100
			Jun. 30	Dec. 31
			2009	2008
Goodwill				
United States			181,771	194,600
Canada			7,609	7,374
			189,380	201,974
Total Assets				
United States			1,251,078	1,360,290
Canada			468,740	445,692
			1,719,818	1,805,982

⁽¹⁾ EBITDA refers to earnings before interest, taxes, depreciation, amortization, accretion, loss (gain) on derivative financial instruments and foreign exchange, and loss (gain) from asset impairment, disposals and other items.

12. EMPLOYEE FUTURE BENEFITS

The future benefit expense of the REIT's defined benefit pension plans for the second quarter ended June 30, 2009 was \$0.4 million (2008 – \$0.5 million) and \$0.9 million year to date (2008 – \$0.9 million).

13. 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.

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. We monitor the level, nature of debt and leverage ratios, along with our compliance with debt covenants continuously to ensure that sufficient resources exist.

Impact of Global Events on the REIT

There are a number of risks that the global events could pose on the REIT. Below is a summary of the potential uncertainties and significant risks that could have an impact on the REIT:

(a) *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 impact on our earnings. The majority of our costs are wages that cannot be changed given the requirements of our residents and regulations. In addition, any escalation of regulatory pressure by the Centers for Medicare & Medicaid Services (CMS) or States could have a negative impact on our costs and thereby reduce our earnings.

In February 2009, the *American Recovery and Reinvestment Act of 2009* provided US\$787 billion in government stimulus of which US\$86.7 billion was appropriated to increase funding for state Medicaid programs. However, despite this additional funding and the intention to maintain core education, health and unemployment funding, a number of states are facing severe budgetary shortfalls and are considering making cuts in Medicaid funding or providing for below inflationary increases. Due to significant state budgetary pressures, the majority of states have not finalized their July 2009 rates and there are considerable ongoing lobbying efforts to preserve funding, resulting in considerable swings in the potential outcome of state Medicaid rates. We will not have certainty to our Medicaid rates until the end of the third quarter, which would impact us beginning in the 2009 fourth quarter. In addition, on July 31, 2009, CMS issued its final rule for skilled nursing centers, resulting in a net reduction in Medicare Part A rates of 1.1% effective October 1, 2009.

(b) *Decline in short-term admissions as a result of individuals seeking elective surgery*

In the U.S., Medicare and Managed Care funded residents are the source of approximately 76% of our admissions, a component of which come from hospitals after elective surgeries. Our earnings could be eroded should the level of admissions decrease as a result of lower incomes and lower financial resources of our prospective residents.

(c) *Ability to finance and refinance loans and the resulting higher costs of borrowing*

EHSI's CMBS financings have maturities in November 2011 and March 2012. Options for replacement financing are limited, and if the CMBS financings were maturing today, the best option would be to replace them with U.S. Department of Housing and Urban Development (HUD) insured mortgages. HUD insured mortgages provide long-term financing at reasonable rates; however, they involve additional administrative burden to establish and maintain. The CMBS financings have a prepayment penalty that continues through to three months prior to their maturity dates, and is determined based upon the difference between the interest rate on the loans and U.S. Treasury rates. Currently, EHSI would not seek prepayment of any of the debt, thereby limiting its ability to de-leverage.

The amended and restated Credit Facility matures in June 2011 and has an option to extend for a third year to June 2012 upon satisfaction of certain conditions. The Credit Facility matures within nine months of both CMBS financings. The maximum borrowings under the Credit Facility were reduced from US\$120.0 million to US\$70.0 million based upon EHSI's anticipated future cash requirements.

Our leverage has been established as a result of the 2006 reorganization, and in general, leverage ratios are higher in property-based long-term care operators such as the REIT and are required to maximize state reimbursement in certain states. Should leverage ratios of the REIT increase as a result of declining earnings, the REIT may have limited ability to reduce the level of debt to meet lenders expectations.

(d) Ability to raise capital

The REIT's ability to raise capital has been impacted by the economic downturn. There is no guarantee that the REIT could issue securities in the near future. Currently, the REIT has sufficient cash flow to meet its future operating and growth needs and will continue to monitor its cash position.

(e) Foreign currency fluctuations

The strengthening of the U.S. dollar relative to the Canadian dollar resulted in a decline in the valuation of FCFCs during 2008. FCFCs provide the REIT with a consistent flow of cash from our US operations. We have no plans to terminate the FCFCs; however, should we decide to terminate them, as of June 30, 2009 the cost to do so would be the approximate amount of the liability on this date, or US\$6.4 million.

In response to the above potential risks and uncertainties, the REIT has undertaken the following measures to minimize future risks, and to maintain liquidity:

(i) Reduction of distributions and growth projects along with divestiture of underperforming assets

In December, we reduced our distributions effective January 2009 in response to the uncertain economic environment. In addition, we retracted from plans to develop three Ontario projects and deferred two projects in the U.S. We are not actively seeking acquisitions at this time, and have started to execute our plan to divest of a number of underperforming facilities in the U.S. The cash flow from these initiatives can be directed to the acquisition for cancellation of securities and to reduce our leverage.

(ii) Focus on core business and cost reduction initiatives

We commenced a program in the second half of 2008 to focus on our core business and initiated a number of programs to scale down administrative and non wage-related costs in both the U.S. and Canadian operations.

(iii) Continued prudence with cash usage

We are monitoring closely our cash position on a monthly basis and providing information to the Trustees of the Board in order to carefully evaluate any significant cash flow decisions. In the opinion of the REIT, and based upon the information provided to the REIT, the majority of our investments are of high quality and relatively safe from further economic turbulence, and cash is held in secure financial institutions.

(iv) Maintaining solid banking relationships

With the renewal of the U.S. Credit Facility, we plan to carefully select our lenders and continue to strengthen our relationships that have already been in place for a number of years.

Liquidity Risk

Liquidity risk is the risk that the REIT will encounter difficulty in meeting its contractual obligations associated with financial liabilities.

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 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.

At June 30, 2009, we had a balance of \$94.6 million in cash and cash equivalents. EHSI had US\$11.0 million in borrowings under its Credit Facility. The unused portion of the Credit Facility that was available for working capital and corporate purposes, after reduction for outstanding letters of credit of US\$3.7 million, was US\$55.3 million; and the unused portion of Canada's RBC Credit Facility, after reduction for outstanding letters of credit of \$61.5 million, was \$8.5 million (*note 5*).

Normal Course Issuer Bid

We continue to be prudent with our cash usage. In light of the current economic environment, given the high current yields as a result of the low trading prices of our REIT Units and debentures, we believe that repurchasing these instruments has been a wise capital allocation decision. Under the 2008 Bid, we have acquired for cancellation 0.9 million REIT Units at a cost of \$5.3 million, as well as \$1.1 million and \$0.2 million aggregate principal amount of the 2014 Debentures and the 2013 Debentures, respectively (*notes 5 and 7*).

Financial Covenants

EHSI is subject to external financial covenant requirements pursuant to the CMBS financings, Sovereign Bank mortgage loans and the Credit Facility on the level of debt to earnings and cash flow of its operations. 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 June 30, 2009.

Fair Values of Financial Instruments

	June 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Invested assets	917	917	947	947
Accounts receivable, less allowance ⁽¹⁾	252,774	251,588	288,963	288,098
Notes, mortgages and amounts receivable ⁽²⁾	55,615	59,393	55,647	59,647
Investments held for self-insured liabilities	58,537	59,060	67,525	68,387
Financial liabilities:				
Long-term debt ^{(2) (3)}	1,317,535	1,331,564	1,363,748	1,360,805
Foreign currency forward contract liability ⁽²⁾	7,434	7,434	13,934	13,934
Net liabilities	(957,126)	(968,040)	(964,600)	(957,660)
Net unrealized gain (loss)		(10,914)		6,940

⁽¹⁾ Includes long-term portion.

⁽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 table above.

Fair values for investments designated as held to maturity and available for sale are based on quoted market prices.

Loans and receivables include accounts receivable as well as notes and mortgages 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 and mortgages receivable primarily consist of notes and amounts receivable from government agencies, and third-party notes on the sale of assets. 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.

14. RELATED PARTY TRANSACTIONS

In October 2007, EHSI completed the acquisition of Tendercare, a privately owned operator of senior care facilities in the State of Michigan, which was comprised of 29 skilled nursing centers and one inpatient rehabilitation hospital, for a total of 3,301 operational beds. The total consideration of the acquisition was \$225.0 million (US\$238.2 million), and was comprised of the assumption of debt of US\$76.4 million, the issuance of US\$26.4 million of 7.5% seller notes, a portion of which is payable based on certain factors being met (*note 5*), and US\$135.4 million in cash.

On April 7, 2008, Tim Lukenda, the former President of Tendercare was appointed President and Chief Executive Officer of Extencicare 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. 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 Extencicare REIT and his previous employer, or with respect to any financial interest that Mr. Lukenda or his family have with Extencicare REIT and its subsidiaries. As part of the acquisition of Tendercare, in addition to normal representative and warranty provisions, EHSI has to 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 services to three long-term care facilities that are owned or partially owned by members of Mr. Lukenda's immediate family.

In connection with the purchase of Tendercare, EHSI paid the balance due of US\$5.0 million in March 2009 (*note 5*), and made a payment of US\$1.7 million in April 2009 pursuant to the annual closing statement adjustments that continue until January 2012.

Under the terms of the acquisition agreement of LTC Professional in 2008, consideration for the acquisition is to be adjusted annually based upon the actuarial liabilities determined at December 31st of each year through 2012, with an option to extend to 2015. In March 2009, ECI made the first annual settlement of US\$2.2 million.

EXTENDICARE

Facility Location and Resident Capacity

<i>at June 30, 2009</i>								
	Nursing Centers		Assisted Living and Retirement Centers		Rehab Hospital / Chronic Care Units		Total	
	Number of Facilities	Resident Capacity	Number of Facilities	Resident Capacity	Number of Facilities	Resident Capacity	Number of Facilities	Resident Capacity
By State/Province								
United States								
Michigan	30	3,334	1	51	1	24	32	3,409
Pennsylvania	26	3,144	5	155	-	-	31	3,299
Ohio	25	2,576	-	30	-	-	25	2,606
Wisconsin	26	2,189	2	135	-	-	28	2,324
Kentucky	21	1,762	-	-	-	-	21	1,762
Washington	15	1,541	1	47	-	-	16	1,588
Indiana	16	1,524	-	35	-	-	16	1,559
Minnesota	6	727	-	-	-	-	6	727
Idaho	2	194	-	-	-	-	2	194
Oregon	2	166	-	-	-	-	2	166
Delaware	1	120	-	-	-	-	1	120
West Virginia	1	120	-	-	-	-	1	120
Total United States	171	17,397	9	453	1	24	181	17,874
Canada								
Ontario	55	8,140	1	493	1	120	57	8,753
Alberta	14	1,215	-	-	-	-	14	1,215
Manitoba	5	762	2	215	-	-	7	977
Saskatchewan	5	654	-	-	-	-	5	654
Total Canada	79	10,771	3	708	1	120	83	11,599
TOTAL	250	28,168	12	1,161	2	144	264	29,473
By Type of Ownership								
United States								
Owned	159	16,219	3	247	1	24	163	16,490
Leased	7	659	-	-	-	-	7	659
Managed	5	519	6	206	-	-	11	725
Total United States	171	17,397	9	453	1	24	181	17,874
Canada								
Owned	48	6,363	-	-	-	-	48	6,363
Leased	9	1,155	-	76	-	-	9	1,231
Managed	22	3,253	3	632	1	120	26	4,005
Total Canada	79	10,771	3	708	1	120	83	11,599
TOTAL	250	28,168	12	1,161	2	144	264	29,473

Unitholder Information

Stock Exchange Listing

Toronto Stock Exchange – EXE.UN

Transfer Agent

Computershare Trust Company of Canada

Tel: (800) 564-6253

Fax: (866) 249-7775

email: service@computershare.com

www.computershare.com

Unitholder Inquiries and Investor Relations

Jillian Fountain, Secretary

Tel: (905) 470-5534

Fax: (905) 470-4003

email: jfountain@extendicare.com

Published Information

Extendicare REIT's 2008 Annual Report is available for viewing or printing on its website, in addition to news releases, quarterly reports and other filings with the securities commissions.

Printed copies are available upon request to the Secretary.

Visit Extendicare's website @ www.extendicare.com

