

Unitholders' Quarterly Report

 **Nine Months Ended September 30, 2011**

*...helping people
live better*



Dear Unitholders,

Extendicare Real Estate Investment Trust (“Extendicare REIT” or “Extendicare”) reported results for the third quarter of 2011. The following are highlights of the quarterly results reported on November 8, 2011.

- Revenue was \$531.7 million in Q3 2011, a 5.5% increase over Q3 2010, excluding the adverse effect of foreign exchange.
- EBITDA was \$40.8 million in Q3 2011, a \$9.1 million decline over Q3 2010, excluding the adverse effect of foreign exchange. Excluding an increase in prior years’ reserves for self-insured liabilities, EBITDA improved by \$10.1 million.
- EBITDA margin was 7.7% in Q3 2011 compared to 9.8% in Q3 2010, and excluding the reserve adjustment, the margin was 13.6% this quarter compared to 12.4% in Q3 2010.
- AFFO was \$4.5 million (\$0.054 per basic unit) in Q3 2011, and \$57.4 million (\$0.690 per basic unit) for the first nine months of 2011. Excluding the adjustment to prior years’ reserves, AFFO was \$35.9 million (\$0.431 per basic unit) this quarter, and \$88.8 million (\$1.067 per basic unit) for the first nine months of 2011.
- Distributions in the first nine months of 2011 totalled \$52.5 million, or \$0.63 per unit, representing approximately 91% of AFFO for the same period.
- Completion of independent actuarial review for the third quarter necessitated strengthening of reserves for prior years’ liabilities by \$31.4 million (US\$32.1 million), or \$0.38 per basic unit.
- Recorded a non-cash asset impairment charge of pre-tax \$54.0 million this quarter as a result of the Medicare funding changes established by the Centers for Medicare & Medicaid Services (CMS), effective October 1, 2011 (the “CMS Final Rule”).

In the third quarter, Extendicare achieved strong financial and operational results with improved margin performance despite a challenging environment. Our employees have done a great job of staying focused on our priorities and working together to implement significant cost cutting measures to mitigate as much of the impact of the Medicare funding reductions as possible. As a result of their efforts, our residents continue to receive the quality care and services that they deserve.

Provision for Self-insured Liabilities

In the quarter, we strengthened our prior years’ reserves by \$31.4 million (US\$32.1 million), or \$0.38 per basic unit. The provision was incurred by our non-taxable captive insurance company and therefore, equally impacted our EBITDA, net earnings and AFFO. The reserve for self-insured liabilities at the end of September is considered appropriate and adequate based on the interim actuarial review. We completed interim independent actuarial reviews in each of the second and third quarters, and as is the case each year, an update of the independent actuarial review will be performed at year end.

This additional reserve was deemed necessary as a result of higher than anticipated paid settlement amounts, predominantly relating to claims for the years prior to 2009, increases for settlements on known and unknown claims, and adverse claim developments in recent months. An increase in the volume of claims received and accelerated settlements on prior claims, where appropriate, through bulk settlements and other more aggressive claims management practices, were the primary contributors to the determination by the actuary of a need to strengthen the reserves.

CMS Final Rule

As we previously announced, the projected impact of the CMS Final Rule is a reduction in our EBITDA, prior to implementing cost cutting measures, in the range of US\$70 million to US\$80 million. After a thorough review of our operations, we have implemented a number of changes within our organization and secured vendor pricing changes, none of which involve a reduction of direct care staffing at our centers. These savings are anticipated to reduce our general, administrative and non-wage operating costs by an estimated US\$20 million to US\$24 million on an annualized basis, approximately two-thirds of which are in effect as of October 1, 2011. Consequently, we anticipate a net reduction in our EBITDA to be in the range of US\$50 million to US\$56 million.

Update on Status of U.S. Refinancing

As of November 8, 2011, we have closed on and/or received commitments for 48 loans insured with the U.S. Department of Housing and Urban Development (HUD) totalling US\$360.3 million, with a weighted average interest rate of 4.51% and term to maturity of about 33 years. We anticipate obtaining the majority of the remaining 31 HUD commitments before the end of 2011 to enable the final pay-down of the CMBS debt in the first quarter of 2012. The projected annualized interest savings from the refinancing is estimated at US\$18 million, based upon securing an average interest rate of 4.5% inclusive of the mortgage insurance premium for all remaining loan commitments.

Proposed Corporate Conversion

The board of trustees of Extencicare REIT (the "Board") unanimously approved the conversion of Extencicare REIT (the "Conversion") from an income trust structure to a corporate structure, subject to unitholder approval. The Board believes that the reorganization is in the best interests of the unitholders of Extencicare REIT (the "Unitholders") and recommends that the Unitholders approve the Conversion.

The conversion will be completed in accordance with the "exchange method" provided by the "Conversion Rules" provided under the Income Tax Act (Canada), and it is expected that Unitholders will be able to exchange their units of Extencicare REIT for common shares of the new corporation on a tax-deferred basis for Canadian federal income tax purposes. The reorganized structure of Extencicare REIT as a corporation with share capital removes the restriction on non-Canadian ownership imposed on income trusts which may attract new investors, including U.S. and other non-resident investors, and provides a more liquid and attractive market for the common shares of the new corporation than currently exists for Extencicare REIT's units. As well, a corporate structure will potentially enhance our access to larger pools of capital.

The conversion, which is anticipated to be completed by June 30, 2012, will require two-thirds approval of the Unitholders voting in person or by proxy at a special meeting of Unitholders to be held in conjunction with the annual meeting on May 8, 2012, approval of the Ontario Superior Court of Justice and various regulatory approvals, including the approval of the Toronto Stock Exchange.

Outlook

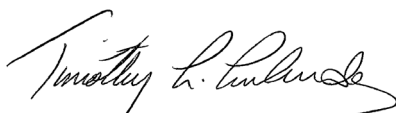
The U.S. skilled nursing industry could face further Medicare rate cuts as the Joint Select Committee on Deficit Reduction, referred to as the "Super Committee," is to propose legislation to reduce spending by an additional US\$1.2 trillion. In recognition of the fact that our industry is still absorbing Medicare cutbacks well in excess of 11% as a result of the CMS Final Rule, we are hopeful that the outcome of the current political negotiations limits any further reductions. Nevertheless, we believe we are at risk for an additional 2% cut at a minimum beginning in January 2013. In addition, the state governments continue to experience budgetary issues, causing pressure on the funding of State Medicaid programs.

In spite of the foregoing, the Board has made a determination to maintain distributions at the current level of \$0.07 per month. The Board will continue to review the distribution policy on a regular basis, taking into consideration factors as they arise.

Extencicare has a proven track record and a history of success, a robust and well-established business model, a strong balance sheet and an experienced management team with the skill and expertise that will enable us to adapt to the challenges and changes in the industry.

We remain confident of the future and we believe that Extencicare will continue to be a leading provider of post-acute and long-term senior care services in North America.

We appreciate your continued support and confidence in our business.



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 applicable accounting policies, including the adoption of International Financial Reporting Standards; changes in regulations governing the industry and the compliance of the REIT and its subsidiaries with such regulations; changes in government funding levels for health care services; changes in tax laws; resident care and class action litigation, including exposure for punitive damage claims and increased insurance costs, and other claims asserted against the REIT and its subsidiaries; the ability to maintain and increase census levels; changes in competition; changes in demographics and local environment economies; changes in foreign exchange and interest rates; changes in the financial markets that may affect refinancing of debt; the availability and terms of capital to fund capital expenditures; and the ability to attract and retain qualified personnel.

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 forward-looking statements of the REIT.

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.

Management's Discussion and Analysis

November 8, 2011

BASIS OF PRESENTATION

Extencicare Real Estate Investment Trust ("Extencicare REIT" or the "REIT") has prepared this Management's Discussion and Analysis (MD&A) to provide information to assist its current and prospective investors' understanding of the financial results for the nine months ended September 30, 2011. This MD&A should be read in conjunction with Extencicare REIT's unaudited interim condensed consolidated financial statements for the nine months ended September 30, 2011, and the notes thereto, together with the MD&A and the audited consolidated financial statements and accompanying notes for the year end December 31, 2010, found in Extencicare REIT's 2010 Annual Report. This material is available on Extencicare REIT's website at www.Extencicare.com. Additional information about Extencicare REIT, including its Annual Information Form for the year ended December 31, 2010, can be found on SEDAR at www.sedar.com.

Extencicare REIT is a leading North American provider of post-acute and long-term senior care services. The REIT itself is not a provider of services or products. The direct ownership and operation of the senior care centers and ancillary businesses is conducted by the subsidiaries of the REIT. This MD&A provides information on Extencicare REIT 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 registered office of Extencicare REIT is located at 3000 Steeles Avenue East, Markham, Ontario, Canada, L3R 9W2.

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, and on December 15, 2010 (the "Deed of Trust"). The conversion has been accounted for as a continuity of interest, and accordingly, the consolidated financial statements of the REIT are reflective as if the REIT had always carried on the business formerly carried on by Extencicare.

This MD&A and the accompanying unaudited interim condensed consolidated financial statements for the nine months ended September 30, 2011, and the notes thereto, have been prepared in accordance with International Financial Reporting Standards (IFRS) for interim financial statements, with effect from January 1, 2010. Periods prior to January 1, 2010, have not been restated. Note 17 of the unaudited interim condensed consolidated financial statements for the nine months ended September 30, 2011, contains a detailed description of the REIT's conversion to IFRS, including a line-by-line reconciliation of its consolidated financial statements prepared under previous Canadian generally accepted accounting principles (GAAP) to those under IFRS for the three and nine months ended September 30, 2010. All dollar amounts are in Canadian dollars unless otherwise indicated. Except as otherwise specified, references to years indicate the fiscal year ended December 31, 2010, or December 31 of the year referenced.

The discussion and analysis in this MD&A is based upon information available to management as of November 8, 2011. This MD&A should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other elements may or may not occur which could affect the REIT in the future.

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

OVERVIEW

Business Strategy

At Extencicare REIT, our strategy is to create value for our unitholders through the effective operation and growth of our core senior care operations, and complementary long-term care services. By emphasizing the quality of care provided to our residents, our goal is to build upon our reputation as a leading provider of a full range of post-acute services in the community. In pursuing this strategy, an overriding objective is to continually enhance the quality of clinically based services provided to our residents and other clients. 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 result 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;
- enhancing our Canadian businesses, including long-term care and home health care operations; and
- increasing funds from operations and adjusted funds from operations, by achieving the above goals.

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

In light of recent Medicare funding reductions that took effect October 1, 2011, and the uncertainty surrounding further potential Medicare and Medicaid funding reductions, management implemented aggressive cost cutting measures to reduce operating and administrative costs, approximately two-thirds of which were in effect as of October 1, 2011. However, none of these cost reduction measures will reduce the direct care staffing to our centers. For more information on recent Medicare and Medicaid funding changes and our mitigation strategies, refer to the discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

In addition, on completion of our debt refinancing, using mortgages insured by the U.S. Department of Housing and Urban Development Program (HUD), which is expected to be completed by the end of the 2012 first quarter, the annual debt service costs of the REIT will be reduced by approximately US\$18 million and EHSI will have 45 unencumbered centers with an approximate value of US\$250 million. For more information on the debt refinancing plan, refer to the discussion under the heading "Overview – Significant 2011 Events and Developments –2011 Refinancing Plan".

The board of trustees of the REIT (the "Board") and management continuously review possible strategies, opportunities and alternatives available to the REIT with a view to enhancing the value of the REIT. Provisions of the *Income Tax Act* (Canada) (the "Tax Act") facilitate the conversion of an income trust structure to a corporate structure by 2013 (the "Conversion Rules"). In view of the Conversion Rules, among other things, the Board unanimously approved on November 8, 2011, the conversion of Extencicare REIT (the "Conversion") from an income trust structure to a corporate structure. The Conversion, which is anticipated to be completed by June 30, 2012, will require two-thirds approval of the unitholders of the REIT (the "Unitholders") voting in person or by proxy at a special meeting of Unitholders (the "Special Meeting") to be held in conjunction with the annual meeting on May 8, 2012. The Board believes that the Conversion is in the best interests of the Unitholders and therefore, recommends its approval. For more information on the proposed conversion, refer to the discussion under the heading "Overview – Significant 2011 Events and Developments – Proposed Corporate Conversion".

The REIT is a SIFT and has been subject to SIFT tax since 2007 at tax rates similar to corporate tax rates. Therefore, following the Conversion, the Board plans to continue with a dividend declaration policy on a similar basis as its current approach to distributions. The declaration and payment of dividends following the Conversion will be subject to the discretion of the Board and will continue to be dependent upon a number of factors, including results of operations, requirements for capital expenditures and working capital, future financial prospects, and other factors deemed relevant by the Board.

The distribution payout ratio of the REIT has been at conservative levels for the past couple of years (2009 – 43%; 2010 – 62%) as we have been managing uncertainty surrounding the economic climate, U.S. health care reform and our 2011 debt refinancing plan. The Board regularly monitors the REIT's cash flow position and projected distribution payout ratio to consider the appropriateness of the REIT's distributions. In spite of the recent and potential for further U.S. funding reductions, the Board has made a determination to maintain distributions at the current level of \$0.07 per month. The Board will continue to review the distribution policy on a regular basis, taking into consideration factors as they arise.

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

Investment Overview

An investment in the units of Extencicare 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 trade on the Toronto Stock Exchange (TSX) under the symbol "EXE.UN". The Board regularly reviews its distribution policy. The present policy of the Board of Trustees is to pay monthly distributions of \$0.07 per unit, or \$0.84 per unit annually. Based on the closing price of the REIT Units on October 31, 2011, of \$7.46, this represents a yield of 11.3%. More information about distributions, including tax considerations, is provided under the heading "Distributions".

The Conversion does not affect the ability of the Board to continue its current policy of declaring distributions, or dividends following the Conversion, on a similar basis as its current approach to distributions. The declaration and payment of dividends by the Board following the Conversion will be subject to its discretion and will be dependent upon a number of factors, including results of operations, requirements for capital expenditures and working capital, future financial prospects, and other factors deemed relevant by the board.

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 67.1% of our revenue earned in the first nine months of 2011 (2010 year – 68.6%) was generated from our U.S. operations, Medicare and Medicaid funding is particularly significant for our financial performance. In March 2010, the U.S. government passed health care reform legislation and in July 2011, the Centers for Medicare & Medicaid Services (CMS) announced reductions to Medicare Part A rates and other policy changes (the "CMS Final Rule") that will have a significant impact on the industry. For a discussion of health care reform, recent Medicare and Medicaid funding changes, and other factors affecting the outlook for future funding, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

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

on our financial results and a review of our foreign currency hedging strategy is provided in the section "Impact of U.S. Dollar and Foreign Currency Translation".

Business Overview

Extendicare REIT, through its wholly owned subsidiary operating entities, is a major provider of short-term and long-term senior care services through its network of owned and operated health care centers in North America, operating 262 senior care centers with capacity for 28,213 residents at September 30, 2011.

The REIT's wholly owned U.S. subsidiary, Extendicare Health Services, Inc. and its subsidiaries (collectively "EHSI"), operates 181 senior care centers with capacity for 17,531 residents, and has a significant presence (more than 10% of its resident capacity) in each of Pennsylvania, Michigan, Wisconsin, Ohio and Kentucky. EHSI offers a continuum of health care services, including nursing care, assisted living and related medical specialty services, such as post-acute care and rehabilitative therapy on an inpatient and outpatient basis.

The REIT's wholly owned subsidiary, Extendicare (Canada) Inc. and its subsidiaries (collectively "ECI"), operates 81 senior care centers in Canada, with capacity for 10,682 residents. ECI has a significant presence in Ontario and Alberta, where approximately 71% and 14% of its residents are served, respectively. Also, through its ParaMed Home Health Care (ParaMed) division, ECI is a major provider of home health care in Ontario and Alberta.

Extendicare REIT owns rather than leases a majority of its properties, unlike a number of other long-term care providers. At September 30, 2011, excluding centers under management contracts, we owned or operated under lease arrangements with options to purchase 222 centers, or approximately 98%, of our 227 owned or leased centers. We believe that ownership increases our operating flexibility by allowing us to: refurbish centers to meet changing consumer demands; expand or add assisted living and retirement centers adjacent to our nursing centers; adjust licensed capacity to avoid occupancy-based rate penalties; and divest centers and exit markets at our discretion.

The following depicts ownership and management of senior care centers operated by EHSI and ECI at September 30, 2011.

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	158	15,904	4	310	1	28	163	16,242
Leased ⁽¹⁾	5	520	—	—	—	—	5	520
Managed	5	519	8	250	—	—	13	769
Total	168	16,943	12	560	1	28	181	17,531
Canada								
Owned	48	6,487	1	200	—	—	49	6,687
Leased ⁽¹⁾	10	1,250	—	76	—	—	10	1,326
Managed	19	2,284	2	265	1	120	22	2,669
Total	77	10,021	3	541	1	120	81	10,682
Total	245	26,964	15	1,101	2	148	262	28,213

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

The following reflects the change in operating capacity of our senior care centers during the first nine months of 2011 and the 2010 year.

Extencicare REIT Senior Care Centers	Nine months ended September 30, 2011		Year 2010	
	No. of Centers	Operational Beds/Units	No. of Centers	Operational Beds/Units
As at beginning of the year	266	29,447	268	29,957
Development (owned and leased) ⁽¹⁾	2	320	2	320
Managed contracts added	4	200	5	272
Managed contracts matured	(8)	(1,445)	(1)	(148)
Closed ⁽²⁾	(1)	(62)	–	(34)
Divested ⁽³⁾	(1)	(92)	(8)	(898)
Operational capacity adjustments ⁽⁴⁾	–	(155)	–	(22)
As at the end of the period	262	28,213	266	29,447

⁽¹⁾ 2011 activity: In January we opened a 140-unit designated assisted living unit in Lethbridge, Alberta, and a 120-bed skilled nursing center in Lansing, Michigan. However, only five of the 120 beds at the Lansing center were initially operational pending certification of the remaining beds at the end of the 2011 first quarter. In February we opened the 60 designated assisted living units of our Red Deer center. 2010 activity: In September we opened a 220-bed nursing center in Red Deer, Alberta, and in November we entered into a lease arrangement on a 100-bed skilled nursing center in South Bend, Indiana.

⁽²⁾ The closed nursing center relates to our Lethbridge, Alberta nursing center that closed in January 2011 upon the opening of our new designated assisted living center in the region. The operational beds of the nursing center were reduced by 34 in the 2010 fourth quarter prior to its closure.

⁽³⁾ Refer to the discussion under the heading “Other Significant Developments – Divestitures and Assets Held for Sale”.

⁽⁴⁾ The 2011 and 2010 reduction in operational capacity was due primarily to U.S. beds that have been pulled out of service in order to increase our Medicaid rate and to accommodate rehabilitation suites.

Significant 2011 Events and Developments

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

CMS FUNDING ANNOUNCEMENT

The July 29, 2011, announcement by CMS of an 11.1% reduction in Medicare rates, effective October 1, 2011, could have a material adverse effect on the post-acute care sector and the consolidated financial position, or results of operations of the REIT. As previously announced, we estimated that the impact of these changes would reduce our EBITDA, prior to implementing cost cutting measures, in the range of US\$70 million to US\$80 million. We have completed a thorough review of our operations and have implemented a number of changes within our organization and secured vendor pricing changes, none of which involve a reduction of direct care staffing at our centers. These savings are anticipated to reduce our general, administrative and non-wage operating costs by an estimated US\$20 million to US\$24 million on an annualized basis, approximately two-thirds of which are in effect as of October 1, 2011. Consequently, we anticipate the negative effect to our EBITDA to be in the range of US\$50 million to US\$56 million. For further details on the announced cuts and their estimated impact to us, please refer to the section “Update of Regulatory and Reimbursement Changes Affecting Revenue – United States”.

IMPAIRMENT OF PROPERTY AND GOODWILL

In accordance with the recently adopted IFRS, we are required to conduct an impairment test upon the occurrence of a triggering event and, at a minimum, annually for indefinite life intangible assets. The CMS Final Rule announced in July, which included an 11.1% reduction in Medicare funding, the elimination of group therapy and changes in assessment practices effective October 1, 2011, necessitated an impairment review of our U.S. property and goodwill as at September 30, 2011.

As a result, we have recorded a non-cash impairment charge this quarter in connection with the revaluation of our U.S. properties and goodwill in the amount of pre-tax \$54.0 million (after-tax \$41.5 million), of which \$22.3 million relates to goodwill that is not tax effected. This impairment charge is a non-cash item and is excluded from our determination of

EBITDA and AFFO. The determination of the impairment is based on the estimated impact to our Medicare funding and therapy operations, along with other factors. The full impact of the CMS Final Rule can only be determined after actual results are known along with a sufficient amount of time that includes the benefit of mitigating factors. Further evaluation of the determination of recoverable amounts will be conducted in 2012. Due to uncertainties in the estimation process, actual results could differ significantly from such estimates. For further information, refer to *note 11* of the unaudited interim condensed consolidated financial statements for the nine months ended September 30, 2011.

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

2011 REFINANCING PLAN

EHSI is in the process of refinancing approximately US\$636 million of debt with approximately US\$559 million in HUD-insured mortgages and US\$77 million of cash on hand. EHSI received approval in July 2010 as a corporate entity to proceed with HUD applications subject to an overall limit of US\$550.0 million, and is awaiting approval to increase the financing capacity by US\$50.0 million to an overall limit of US\$600.0 million. Assuming EHSI is able to reduce its debt by US\$77 million and secure an average interest rate of 4.5%, inclusive of mortgage insurance premium (MIP) fees, interest costs will decline by an estimated US\$18 million per annum. Upon completion of the refinancing, EHSI anticipates having 45 unencumbered centers with an approximate value of US\$250 million.

The debt being refinanced relates to EHSI's commercial mortgage backed securitization (CMBS) financings due in March 2012 (the "March 2012 CMBS Financing") and in May 2012 (the "May 2012 CMBS Financing"), mortgage financing from Sovereign Bank and other lenders (the "Sovereign Loans"), and approximately US\$17.5 million of advances on EHSI's US\$70.0 million credit facility (the "EHSI Credit Facility").

We have submitted 79 HUD-loan applications totalling US\$559 million, and as of November 8, 2011, we have closed on 39 HUD loans with a principal balance of US\$308.6 million. In addition, we have received commitments to close on a further nine HUD loans totalling US\$51.7 million, all of which are under rate lock agreements. Collectively, the weighted average interest rate of the closed loans and those under commitment with a rate lock is 4.51% (including MIP fees of 0.50%), with an average term to maturity of about 33 years. We anticipate obtaining the majority of the remaining 31 HUD commitments before the end of January 2012, with closings to occur in phases through to the end of the 2012 first quarter.

With respect to the debt that has been repaid, in June 2011, we repaid the Sovereign Loans of US\$44.0 million. In August and October 2011, we prepaid US\$194.9 million and US\$172.4 million, respectively, of the May 2012 CMBS Financing. As at November 8, 2011, the outstanding balance of the May 2012 CMBS Financing was US\$115.4 million. In August, we defeased US\$65.6 million of the March 2012 CMBS Financing and plan to defease the balance of US\$21.0 million by the end of November 2011.

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

The March 2012 CMBS Financing has a prepayment penalty that continues through to three months prior to its maturity date that inhibits early repayment of the debt as the penalty is determined based upon the difference between the interest rate on the loans and U.S. Treasury rates over the remaining term of the debt. Over time, the prepayment penalty is reduced. EHSI defeased US\$65.6 million the March 2012 CMBS Financing in August at a cost of US\$1.4 million.

At the present time, management cannot provide full assurance that it will succeed in refinancing all of the debt through HUD prior to its maturity. As an alternative to HUD financing, EHSI believes that it can secure a bank term loan, if necessary. As such, EHSI believes that it has the capability to complete the refinancing as planned. Management continues to closely monitor the progress of the refinancing and the financial markets.

For further information, refer to *note 8* of the unaudited interim condensed consolidated financial statements for the nine months ended September 30, 2011.

SELF-INSURED GENERAL AND PROFESSIONAL LIABILITY PROVISION

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

Based upon the results of the recent independent actuarial review, the REIT recorded an increase in prior years' reserves of \$31.4 million in the 2011 third quarter. This additional reserve was deemed necessary as a result of higher than anticipated paid settlement amounts, predominantly relating to claims for the years prior to 2009, increases for settlements on known and unknown claims, and adverse claim developments in recent months. The REIT has experienced an increase in the volume of claims received and has accelerated settlements on prior claims, where appropriate, through bulk settlements and other more aggressive claims management practices. These factors were the primary contributors to the determination by the actuary of a need to strengthen the reserves.

The increase in claims received has generally resulted from aggressive advertising by a certain law firm in Kentucky that is well known for soliciting liability claims against long-term care providers. We continue to pursue mitigation strategies with a view to reducing our future exposure to liability claims. These efforts include dedicating additional resources to the prevention and management of risks, as well as the adoption of best practices for the management, analysis and defense of pre-existing claims and new claims as they arise. In some instances, this process may result in a decision to divest of selected properties with a view to limiting future claims.

PROPOSED CORPORATE CONVERSION

On November 8, 2011, the Board unanimously approved the conversion of the REIT from an income trust structure to a corporate structure under a new corporation (New Extencicare). The Conversion will be implemented by way of a plan of arrangement.

The Board believes that the Conversion is in the best interests of the Unitholders, and took into account various considerations, including the following in its determination to recommend for approval the Conversion to the Unitholders:

- the Conversion provides Extencicare REIT with an effective and efficient method of converting from an income trust structure to a corporate structure consistent with the Conversion Rules that were designed to facilitate tax-efficient conversions of income trusts to corporations if completed on or before December 31, 2012;
- the Conversion will be completed in accordance with the "exchange method" provided by the Conversion Rules and it is expected that Unitholders will be able to exchange their REIT Units for common shares of New Extencicare on a tax-deferred basis for Canadian federal income tax purposes;
- the reorganized structure of the REIT as a corporation with share capital removes the restriction on non-Canadian ownership imposed on income trusts which may attract new investors, including U.S. and other non-resident investors, and provides a more liquid and attractive market for the common shares of New Extencicare than currently exists for the REIT Units;
- a corporate structure will potentially enhance New Extencicare's access to larger pools of capital;
- New Extencicare will be able to utilize certain provisions of the Tax Act which provide for flexibility in structuring acquisitions on a tax deferred basis and which will allow New Extencicare to use its shares as currency on acquisitions; and
- the Conversion will eliminate the administrative costs associated with the REIT's income trust structure.

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

The Conversion does not affect the ability of the Board to continue its current policy of declaring distributions, or dividends following the Conversion, on a similar basis as its current approach to distributions. The declaration and payment of dividends by New Extendicare will be subject to the discretion of the board of directors and will be dependent upon a number of factors, including results of operations, requirements for capital expenditures and working capital, future financial prospects, and other factors deemed relevant by the board.

Following the completion of the Conversion, the board of directors of New Extendicare will be comprised of the current members of the Board of Trustees of the REIT and senior management of New Extendicare will be comprised of the current senior management of the REIT.

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

REDEMPTION OF EXTENDICARE LIMITED PARTNERSHIP UNITS

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

KEY PERFORMANCE INDICATORS

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

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

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

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

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

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

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

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

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

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

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

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

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

U.S. Operations

We focus on short-term stay programs and offering care to residents with higher acuity and those requiring rehabilitative care and services in our skilled nursing center operations. These residents are primarily admitted into our centers with Medicare and Managed Care as their primary funding source. Medicaid rates are generally lower than rates earned from other sources. Therefore, we consider Skilled Mix to be an important performance measurement indicator. During 2010, approximately 54% were Medicare funded and 27% were Managed Care funded. In total, approximately 81% of our admissions were Medicare or Managed Care funded compared to approximately 80% (53% Medicare and 27% Managed Care) in 2009.

Our goal in the U.S. skilled nursing center operations is to grow revenue by providing higher acuity and short-term rehabilitative services to our residents, thereby increasing the revenue derived from Medicare programs and Managed Care organizations providing Medicare and Medicaid replacement products. Individuals who do not qualify for a funded program pay for the services directly. Therefore, we focus on these payor types to increase average daily revenue rates and improve Quality Mix census as a percentage of the total ADC. Our data collection and reporting system allows us to electronically track the condition of the residents and services provided for them. This electronic system enables us to operate more efficiently within the Resource Utilization Groupings (RUGs) classifications system, by ensuring that appropriate payment is received for services being delivered and, thereby, increasing our average Medicare rates.

SKILLED NURSING CENTER REVENUE BY PAYOR SOURCE

EHSI's average daily Medicare Part A rate, excluding prior period settlement adjustments, increased by 13.2% in the 2011 third quarter to US\$521.24 from US\$460.61 in the 2010 third quarter and increased by 1.0% over the 2011 second quarter rate of US\$515.90. This improvement over the comparable 2010 period was primarily due to changes to the implementation of MDS 3.0 and RUG-IV that took effect October 1, 2010. For a discussion of recent Medicare funding changes, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

Our percentage of Medicare patients in the "high" to "ultra high" RUGs classifications was 79.8% in the 2011 third quarter compared to 80.0% in the 2010 third quarter and increased from 79.2% in the 2011 second quarter. The percentage of Medicare residents receiving therapy services declined to 85.9% this quarter as compared to 92.8% in the 2010 third quarter and increased from 85.6% in the 2011 second quarter. We believe the declines in therapy services experienced over 2010 were primarily due to the implementation of MDS 3.0 and RUG-IV. Under the changes implemented on October 1, 2010, residents are assessed on a more frequent and in-depth basis with limitations on the look-back period and they are now classified into 66 RUGs categories (previously 53). In addition, the changes involved the elimination of billing for concurrent therapy services and for services provided by technicians.

The average revenue rate for Managed Care clients, excluding prior period settlement adjustments, improved by 9.2% to US\$457.71 this quarter from US\$419.31 in the 2010 third quarter and increased by 3.8% over the 2011 second quarter of US\$441.06. While changes in our average Managed Care rates are reflective of the type of clients served in any particular quarter, the increase we experienced over 2010 was largely due to the changes in the implementation of MDS 3.0 and RUG-IV that favourably impacted RUGs-based Managed Care contract rates. Approximately 47% of our Managed Care residents are on RUGs-based contracts. The Managed Care segment represents the second highest rate component of our Quality Mix of residents. As such we will continue to focus on building relationships with key Managed Care organizations and establishing rates that are reflective of the services we are providing.

Our average daily Medicaid rate, excluding prior period settlement adjustments, increased by 1.7% in the 2011 third quarter to US\$183.42 from US\$180.39 in the 2010 third quarter and by 1.3% over the 2011 second quarter rate of \$180.99. However, revenue from the Medicaid rate increases was partially offset by higher state provider taxes, resulting in net increases of less than 1% this quarter over the 2010 third and 2011 second quarters. For the majority of the states in which we operate, Medicaid funding changes take effect in July and October. For a discussion of recent Medicaid funding changes, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

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

	Q1		Q2		Q3		Q4		Year
	2011	2010	2011	2010	2011	2010	2010	2009	2010
<i>(total operations)</i>									
Revenue by Payor Source (%)									
Medicare	36.7	33.3	36.2	33.6	34.8	32.6	33.9	31.4	33.3
Managed Care	10.3	9.4	10.1	9.4	10.0	9.4	9.7	9.8	9.5
Skilled Mix	47.0	42.7	46.3	43.0	44.8	42.0	43.6	41.2	42.8
Private/other	8.1	9.0	8.0	9.1	8.6	9.3	9.2	9.4	9.2
Quality Mix	55.1	51.7	54.3	52.1	53.4	51.3	52.8	50.6	52.0
Medicaid	44.9	48.3	45.7	47.9	46.6	48.7	47.2	49.4	48.0
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Average Revenue Rate by Payor Source (US\$)									
Medicare Part A	515.49	456.35	515.90	457.23	521.24	460.61	508.95	453.59	470.11
Medicare Parts A and B	552.58	499.38	555.03	499.38	569.12	509.19	554.94	499.68	514.96
Managed Care	447.77	406.85	441.06	416.18	457.71	419.31	442.88	417.10	421.11
Private/other	221.07	224.42	228.04	222.74	226.49	218.81	221.51	213.67	221.85
Medicaid	180.20	178.56	180.99	180.08	183.42	180.39	181.58	178.13	180.27
Weighted average	266.40	249.71	266.27	252.15	266.56	250.75	260.08	245.40	253.22

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

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

On a same-facility basis, the proportion of our Skilled Mix revenue to total revenue improved to 44.3% in the 2011 third quarter from 42.1% in the 2010 third quarter, and declined from 46.0% in the 2011 second quarter. The improvement over 2010 is largely reflective of the higher average daily rates, and the decline from the 2011 second quarter is primarily due to lower Skilled Mix census levels, as discussed in the following section.

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

SKILLED NURSING CENTER AVERAGE DAILY CENSUS

We continue to be adversely affected by the U.S. economic recession that has reduced disposable income of individuals and resulted in a general restraint by the public on health care spending. We have implemented a number of short and longer term tactics, which take a more strategic approach to identifying and meeting the program and service needs of each community in which we are located. As indicated in the following analysis, our same-facility ADC is below the comparable 2010 levels, and although we experienced an increase in our same-facility Skilled Mix ADC in the 2011 first quarter from the 2010 first quarter, this trend did not continue into the 2011 second and third quarters. We believe that the decline in total census is due to a reduction in our length of stay for short-term admissions, attributable in part to the implementation of MDS 3.0 and RUG-IV as of October 2010, along with lower hospital census and admissions.

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

	Q1		Q2		Q3		Q4		Year
	2011	2010	2011	2010	2011	2010	2010	2009	2010
<i>(total operations)</i>									
Average Daily Census									
Medicare	2,524	2,498	2,451	2,499	2,296	2,303	2,249	2,322	2,387
Managed Care	871	867	862	835	818	814	810	872	831
Skilled Mix	3,395	3,365	3,313	3,334	3,114	3,117	3,059	3,194	3,218
Private/other	1,396	1,517	1,317	1,512	1,434	1,530	1,529	1,617	1,522
Quality Mix	4,791	4,882	4,630	4,846	4,548	4,647	4,588	4,811	4,740
Medicaid	9,476	10,142	9,477	9,855	9,545	9,715	9,583	10,241	9,822
Total	14,267	15,024	14,107	14,701	14,093	14,362	14,171	15,052	14,562
Census by Payor Type (%)									
Medicare	17.7	16.6	17.4	17.0	16.3	16.0	15.9	15.4	16.4
Managed Care	6.1	5.8	6.1	5.7	5.8	5.7	5.7	5.8	5.7
Skilled Mix	23.8	22.4	23.5	22.7	22.1	21.7	21.6	21.2	22.1
Private/other	9.8	10.1	9.3	10.3	10.2	10.7	10.8	10.8	10.5
Quality Mix	33.6	32.5	32.8	33.0	32.3	32.4	32.4	32.0	32.6
Medicaid	66.4	67.5	67.2	67.0	67.7	67.6	67.6	68.0	67.4
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Average occupancy (%)	86.3	86.2	85.3	86.1	85.6	86.0	85.6	86.7	86.0

EHSI's total skilled nursing center ADC declined by 269 to 14,093 in the 2011 third quarter from 14,362 in the 2010 third quarter, of which 86 of the decline in ADC related to non same-facility operations consisting of 11 centers, and a decline in same-facility census of 183 ADC. EHSI's non same-facility operations represent eight skilled nursing facilities disposed of during 2010, one center disposed of in May 2011, and two new skilled nursing facilities that opened since January 1, 2010. However, our Skilled Mix of residents improved to 22.1% of total ADC this quarter from 21.7% in the 2010 third quarter, reflecting success from our new centers and renovation projects, which are focused on attracting and meeting the needs of short-term high acuity residents.

Our average occupancy in the 2011 third quarter declined to 85.6% from 86.0% in the 2010 third quarter, and increased marginally from 85.3% in the 2011 second quarter. The comparison to the 2010 quarters is impacted by the start-up of two skilled nursing centers, one of which opened in the 2010 fourth quarter and the other in the 2011 first quarter.

Our same-facility ADC of 13,958 for the 2011 third quarter was 183 below the 2010 third quarter level of 14,141 due to lower private/other ADC of 92, Medicaid ADC of 60 and Skilled Mix ADC of 31. In comparison to the 2011 second quarter ADC of 13,973, our same-facility ADC declined by 15 this quarter due to lower Skilled Mix ADC of 194, partially offset by higher private/other ADC of 112 and Medicaid ADC of 67. Our Skilled Mix represented 21.8% of our residents in the 2011 third quarter, compared to 21.7% in the 2010 third quarter and 23.2% in the 2011 second quarter. Our average same-facility occupancy was unchanged at 86.0% this quarter compared to the 2010 third and 2011 second quarters.

The following tables provide the ADC, percentage of total ADC, and average occupancy of EHSI's skilled nursing centers on a same-facility basis, for the 2011 and 2010 quarters and the 2010 year.

	Q1		Q2		Q3		Q4	Year
	2011	2010	2011	2010	2011	2010	2010	2010
<i>(same-facility operations)</i>								
Average Daily Census								
Medicare	2,476	2,405	2,381	2,431	2,237	2,272	2,228	2,333
Managed Care	863	826	858	819	808	804	806	814
Skilled Mix	3,339	3,231	3,239	3,250	3,045	3,076	3,034	3,147
Private/other	1,388	1,439	1,303	1,438	1,415	1,507	1,519	1,476
Quality Mix	4,727	4,670	4,542	4,688	4,460	4,583	4,553	4,623
Medicaid	9,408	9,640	9,431	9,529	9,498	9,558	9,525	9,563
Total	14,135	14,310	13,973	14,217	13,958	14,141	14,078	14,186

	Q1		Q2		Q3		Q4	Year
	2011	2010	2011	2010	2011	2010	2010	2010
<i>(same-facility operations)</i>								
Census by Payor Type (%)								
Medicare	17.5	16.8	17.0	17.1	16.0	16.0	15.8	16.5
Managed Care	6.1	5.8	6.2	5.8	5.8	5.7	5.7	5.7
Skilled Mix	23.6	22.6	23.2	22.9	21.8	21.7	21.5	22.2
Private/other	9.8	10.0	9.3	10.1	10.2	10.7	10.8	10.4
Quality Mix	33.4	32.6	32.5	33.0	32.0	32.4	32.3	32.6
Medicaid	66.6	67.4	67.5	67.0	68.0	67.6	67.7	67.4
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Average occupancy (%)	86.6	87.0	86.0	86.4	86.0	86.0	85.9	86.3

Canadian Operations

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

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

	Q1		Q2		Q3		Q4		Year
	2011	2010	2011	2010	2011	2010	2010	2009	2010
Average revenue rate (\$)	181.16	174.13	182.94	178.04	181.66	175.53	183.97	178.19	177.97
Average occupancy (%)	96.4	98.0	96.7	98.3	97.5	97.8	98.0	98.4	98.0
Average occupancy (same-facility) (%)	97.8	98.1	97.8	98.4	98.1	98.5	98.4	–	98.3

On average, revenue from provincial programs represents approximately 65% of ECI's nursing home revenue throughout the year. ECI's average daily revenue rate increased by 3.5% to \$181.66 in the 2011 third quarter from \$175.53 in the 2010 third quarter, and declined marginally by 0.7% from \$182.94 in the 2011 second quarter. The majority of ECI's nursing home operations are in Ontario, which operates under a funding envelope system, under which a substantial portion of the revenue is tied to flow-through funding, and is therefore matched with the related costs for resident care in the periods in which they are incurred. As a result, ECI's average revenue rates fluctuate by quarter, and are generally at their lowest in the first quarter and their highest in the fourth quarter. In addition, ECI received retroactive funding adjustments that affected the comparability of the rates between periods, as follows: \$1.2 million in the 2010 second quarter; and \$1.0 million in the 2010 fourth quarter. For further information on funding in Canada, refer to the discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada".

In Canada, where the supply of long-term care beds historically has been very restricted in comparison to the United States, nursing home operators typically enjoy higher occupancy levels than operators in the United States. Our same-facility average occupancy in Canada, excluding one new leased centre in Ontario and two new centers and one closed center in Alberta, was 98.1% in the 2011 third quarter compared to 98.5% in the 2010 third quarter, and compared to 97.8% in the 2011 second quarter. In terms of quarterly trends throughout the year, slightly lower occupancy levels are to be expected during the winter months as a result of flu outbreaks which can lead to temporary freezes on admissions.

Revenue from provincial programs represented approximately 97% of ECI's home health care revenue in the first nine months of 2011. Our average daily home health care hours of service increased by 7.0% this quarter to 12,752 from 11,919 in the 2010 third quarter, and increased by 0.3% from 12,713 in the 2011 second quarter. During the 2010 year, ParaMed provided 4,402,000 hours of home health care service, or 12,061 hours per day, of which 95.0% was from Ontario business and the remainder from Alberta. Since 2004, we have been unable to compete for new government contracts in Ontario due to the government's freeze on the competitive bidding process. We have not received any confirmation of when or if the bidding process will resume.

IMPACT OF U.S. DOLLAR AND FOREIGN CURRENCY TRANSLATION

Impact on Financial Statements

The majority of our operations are conducted in the United States, which accounted for 67.1% of consolidated revenue in the first nine months of 2011 (2010 year – 68.6%). As a result, changes in the exchange rates used to translate the results of the U.S. operations to Canadian dollars can affect the comparison of the consolidated results. The table below illustrates the positive/(negative) effect of changes in the average exchange rates used in translating the U.S. results for the 2011 second and third quarters, the first nine months of 2011 and the 2010 year.

	Q2		Q3		Nine months ended September 30		Year	
	2011	2010	2011	2010	2011	2010	2010	2009
Average U.S./Canadian dollar exchange rate	0.9681	1.0277	0.9807	1.0391	0.9781	1.0356	1.0299	1.1420
Impact on Periods (millions of dollars)								
Revenue	(21.4)		(21.2)		(62.0)		(157.5)	
EBITDA	(2.9)		(1.3)		(6.7)		(19.9)	
Net earnings (loss)	(0.7)		2.5		1.2		(4.0)	
AFFO	(1.2)		0.3		(2.1)		(9.9)	
Same-facility Operations								
Revenue	(21.1)		(20.9)		(61.2)			
EBITDA	(2.9)		(1.3)		(6.7)			

The following table illustrates the contribution from our U.S. operations to selected line items of our financial results for the first nine months of 2011 and the 2010 year, and the resulting impact of a one cent change in the Canadian dollar against the U.S. dollar. However, a change in the exchange rate has had limited impact on the cash flow from our U.S. operations to fund distributions, because we had foreign currency forward contracts (FCFCs) in place until June 2011 (refer to discussion below under the heading “Impact of Foreign Currency Forward Contract Strategy on Distributions”).

U.S. Operations (millions of dollars)	Nine months ended September 30, 2011		Year 2010	
	Results	Impact of One Cent Change in Exchange Rate ⁽¹⁾	Results	Impact of One Cent Change in Exchange Rate ⁽¹⁾
	US\$	C\$ (annualized)	US\$	C\$ (annualized)
Revenue	1,078.1	14.4	1,405.0	14.1
EBITDA	117.7	1.6	177.7	1.8
AFFO	37.5	0.5	88.1	0.9

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

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

Impact of Foreign Currency Forward Contract Strategy on Distributions

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

ADJUSTED FUNDS FROM OPERATIONS

The following table provides a reconciliation of our EBITDA to Funds from Operations (FFO), Distributable Income (DI) and AFFO for the 2011 and 2010 quarters and the 2010 year. ⁽¹⁾

<i>(millions of dollars unless otherwise noted)</i>	Q1		Q2		Q3		Nine months ended September 30		Q4	Year
	2011	2010	2011	2010	2011	2010	2011	2010	2010	2010
EBITDA	59.9	60.4	65.1	71.0	40.8	51.2	165.8	182.6	67.6	250.2
Depreciation for FFEC	(5.9)	(5.5)	(5.6)	(5.6)	(5.8)	(5.7)	(17.3)	(16.8)	(5.7)	(22.5)
Accretion costs	(0.5)	(0.5)	(0.5)	(0.6)	(0.5)	(0.5)	(1.5)	(1.6)	(0.5)	(2.1)
Interest expense, net	(21.5)	(21.5)	(22.1)	(19.9)	(22.0)	(21.6)	(65.6)	(63.0)	(21.7)	(84.7)
	32.0	32.9	36.9	44.9	12.5	23.4	81.4	101.2	39.7	140.9
Current income tax expense ⁽²⁾	(10.1)	(11.6)	(11.7)	(12.2)	(9.5)	(7.5)	(31.3)	(31.3)	(1.5)	(32.8)
FFO	21.9	21.3	25.2	32.7	3.0	15.9	50.1	69.9	38.2	108.1
Amortization of financing costs and accretion costs	1.9	1.9	2.9	1.9	4.1	2.0	8.9	5.8	1.9	7.7
Principal portion of government capital funding payments	0.6	0.6	0.7	0.6	0.7	0.6	2.0	1.8	0.6	2.4
DI	24.4	23.8	28.8	35.2	7.8	18.5	61.0	77.5	40.7	118.2
Additional facility maintenance capital expenditures ⁽³⁾	1.2	0.9	(1.5)	0.4	(3.3)	(2.8)	(3.6)	(1.5)	(6.0)	(7.5)
AFFO ⁽⁴⁾	25.6	24.7	27.3	35.6	4.5	15.7	57.4	76.0	34.7	110.7
Per Basic Unit ⁽⁵⁾ (\$)										
FFO	0.263	0.274	0.304	0.399	0.036	0.189	0.603	0.862	0.464	1.326
AFFO	0.308	0.317	0.328	0.435	0.054	0.185	0.690	0.937	0.421	1.358
Per Diluted Unit ⁽⁵⁾ (\$)										
FFO	0.248	0.254	0.282	0.362	0.053	0.184	0.583	0.800	0.419	1.219
AFFO	0.286	0.291	0.304	0.393	0.068	0.181	0.658	0.865	0.381	1.246
Distributions ⁽⁵⁾ (\$)										
Declared <i>(thousands)</i>	17,453	16,673	17,484	17,346	17,534	17,382	52,471	51,401	17,416	68,817
Declared per unit	0.2100	0.2100	0.2100	0.2100	0.2100	0.2100	0.6300	0.6300	0.2100	0.8400
Weighted Average Number of Units ⁽⁵⁾ (thousands)										
Basic	83,082	77,839	83,230	82,576	83,442	82,742	83,253	81,070	82,906	81,533
Diluted	96,895	91,652	96,980	96,389	97,255	96,555	97,045	94,884	96,720	95,346

⁽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 fair value adjustments, and gains or losses on foreign exchange, financial instruments, asset impairment, disposals and other items that are excluded from the computation of AFFO.

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

⁽⁴⁾ A reconciliation of AFFO to cash flow from operating activities is provided under the heading "Liquidity and Capital Resources".

⁽⁵⁾ Per unit amounts, distributions declared and the number of units are based on the total of the REIT Units and Exchangeable LP Units.

AFFO Review

AFFO was \$4.5 million (\$0.054 per basic unit) in the 2011 third quarter compared to AFFO of \$15.7 million (\$0.185 per basic unit) in the 2010 third quarter, a decline of \$11.5 million after excluding the effect of the \$0.3 million effect of the stronger Canadian dollar. Excluding the \$19.2 million (US\$18.6 million) increase between periods in prior years' reserves for self-insured liabilities (refer to "Overview – Significant 2011 Events and Developments"), AFFO improved by \$7.7 million, primarily due to an improvement in EBITDA of \$10.1 million and lower net interest costs of \$1.0 million, partially offset by increased spending of \$1.0 million in facility maintenance capital expenditures.

In comparison to the 2011 second quarter, AFFO declined by \$22.8 million this quarter from \$27.3 million (\$0.328 per basic unit). Excluding the \$31.4 million (US\$32.1 million) increase in prior years' reserves for self-insured liabilities, AFFO improved by \$8.6 million, primarily due to an improvement in EBITDA of \$7.1 million and lower taxes and net interest costs, partially offset by higher facility maintenance capital expenditures of \$2.0 million between periods.

For the first nine months of 2011, AFFO of \$57.4 million (\$0.690 per basic unit) was lower by \$16.5 million in comparison to the same 2010 period of \$76.0 million (\$0.937 per basic unit), after excluding a \$2.1 million negative effect of the stronger Canadian dollar. Excluding the \$19.2 million (US\$18.6 million) increase between periods in prior years' reserves for self-insured liabilities, AFFO improved by \$2.7 million this period, primarily due to an improvement in EBITDA of \$9.1 million, partially offset by higher net interest costs of \$1.5 million and increased spending of \$3.7 million in facility maintenance capital expenditures.

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

Facility maintenance capital expenditures were \$9.1 million in the 2011 third quarter, compared to \$8.5 million in the 2010 third quarter and \$7.1 million in the 2011 second quarter, representing 1.7%, 1.6% and 1.4% of revenue, respectively. For the first nine months of 2011, facility maintenance capital expenditures were \$20.9 million compared to \$18.3 million, representing 1.3% and 1.2% of revenue, respectively. These costs fluctuate on a quarterly basis with the timing of projects and seasonality. It is our intention to spend between 1.5% and 2.0% of revenue annually, which is consistent with our objective to maintain and upgrade our centers. We are projecting to spend up to approximately \$35 million in facility maintenance capital expenditures and approximately \$32 million in growth capital expenditures in 2011.

DISTRIBUTIONS

The current policy of the REIT is to pay distributions of \$0.07 per REIT Unit to the holders thereof on a monthly basis. The declaration and payment of future distributions is subject to the discretion of the Board 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. If the Board of Trustees determines that it would be in the REIT's best interests, it may reduce, for any period, the percentage of Distributable Income to be distributed to holders of REIT Units.

Distributions declared in the first nine months of 2011 totalled \$52.5 million, or \$0.63 per unit, representing approximately 91% of AFFO of \$57.4 million, compared to a payout ratio of 68% in the same 2010 period. For the year ended 2010, distributions declared totalled \$68.8 million, or \$0.84 per unit, representing approximately 62% of AFFO of \$110.7 million.

Approximately 70% of the distributions made by Extendicare REIT since 2006 were tax-deferred returns of capital for Canadian residents. Management estimates that approximately 70% of the monthly distributions to be made in 2011 will also be tax-deferred returns of capital for Canadian residents. Such estimate is based on the current organizational structure of the REIT, certain financial information, the current provisions of the Tax Act, published statements of the current administrative and assessing practices of the Canadian Revenue Agency (CRA), and the specific proposals to amend the Tax Act announced by the Minister of Finance (Canada) prior to the date hereof. The adjusted cost base of the REIT Units will generally be reduced by such non-taxable portion of distributions made to the unitholder (other than the non-taxable portion of capital gains). A unitholder will generally realize a capital gain to the extent that the adjusted cost base of the units would otherwise be a negative amount.

To the extent that the remaining 30% of distributions of the REIT made in 2011 are taxed as dividends, those paid to Canadian residents are eligible dividends under 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.

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

As indicated under the heading "Overview – Significant 2011 Events and Developments – Proposed Corporate Conversion", the Board is seeking approval of the Unitholder for a conversion of the REIT to a corporate structure. Following the Conversion, the Board plans to continue with a dividend declaration policy on a similar basis as its current approach to distributions.

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

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

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

SUMMARY OF QUARTERLY RESULTS

The following is a summary of selected consolidated financial information derived from unaudited interim period consolidated financial statements for each of the eight most recently completed quarters. Except for the 2009 quarters, this information has been prepared in accordance with IFRS. The selected information presented for the 2009 quarters was prepared under previous Canadian GAAP. Refer to the discussion under the heading "Basis of Presentation".

<i>(thousands of dollars unless otherwise noted)</i>	Q1		Q2		Q3		Q4	
	2011	2010	2011	2010	2011	2010	2010	2009
Revenue	519,541	526,580	520,018	527,439	531,664	523,882	532,061	521,001
EBITDA ⁽¹⁾	59,878	60,406	65,081	70,965	40,872	51,213	67,618	59,382
EBITDA margin	11.5%	11.5%	12.5%	13.5%	7.7%	9.8%	12.7%	11.4%
Earnings (loss) before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes ⁽¹⁾	10,285	10,522	15,287	20,825	(12,681)	555	12,401	14,114
Average U.S./Canadian dollar exchange rate ⁽²⁾	0.9856	1.0400	0.9681	1.0277	0.9807	1.0391	1.0130	1.0586

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

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

The following provides a reconciliation of the line items: (i) “net earnings (loss)” to “earnings (loss) before separately reported gains/losses and distributions on Exchangeable LP Units”; and (ii) “(loss) earnings before income taxes” to “EBITDA” for each of the eight most recently completed quarters. Except for the 2009 quarters, this information has been prepared in accordance with IFRS. The selected information presented for the 2009 quarters was prepared under previous Canadian GAAP. Refer to the discussion under the heading “Basis of Presentation”.

<i>(thousands of dollars)</i>	Q1		Q2		Q3		Q4	
	2011	2010	2011	2010	2011	2010	2010	2009
Net earnings (loss)	(8,394)	5,421	30,278	23,692	(34,383)	(15,620)	28,336	15,728
Add (Deduct):								
Fair value adjustment on convertible debentures, net of taxes	8,033	4,993	(7,576)	(4,780)	(9,566)	14,005	(8,783)	–
Fair value adjustment on Exchangeable LP Units, net of taxes	10,555	3,377	(7,305)	(6,766)	(10,468)	5,247	(3,437)	–
Loss (gain) on foreign exchange and financial instruments, net of taxes	(988)	(3,955)	(90)	5,422	308	(3,921)	(2,350)	(3,463)
Loss (gain) from asset impairment, disposals and other items, net of taxes	417	–	(672)	2,583	40,779	171	(2,034)	(453)
Distributions on Exchangeable LP Units, net of taxes	662	686	652	674	649	673	669	–
Discontinued operations, net of taxes	–	–	–	–	–	–	–	2,302
Earnings (loss) before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes	10,285	10,522	15,287	20,825	(12,681)	555	12,401	14,114
Earnings (loss) before income taxes	(145)	13,617	38,979	34,965	(34,856)	(7,056)	40,929	23,739
Add (Deduct):								
Depreciation and amortization	19,223	18,136	18,714	18,232	19,117	18,711	18,798	16,144
Net finance costs	40,231	28,653	8,330	13,737	2,409	39,239	9,293	20,047
Loss (gain) from asset impairment, disposals and other items	569	–	(942)	4,031	54,202	319	(1,402)	(548)
EBITDA	59,878	60,406	65,081	70,965	40,872	51,213	67,618	59,382

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

<i>(thousands of dollars)</i>	Q1		Q2		Q3		Q4	
	2011	2010	2011	2010	2011	2010	2010	2009
Segmented EBITDA								
U.S. operations (US\$)	46,363	42,758	49,045	51,209	22,265	32,120	51,619	40,087
U.S. operations (C\$)	45,695	44,468	47,499	52,676	21,901	33,432	52,443	41,966
Canadian operations	14,183	15,938	17,582	18,289	18,971	17,781	15,175	17,416
EBITDA	59,878	60,406	65,081	70,965	40,872	51,213	67,618	59,382

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

- Medicare and Managed Care admissions are usually the highest in the first and second quarters; begin to decline during the latter portion of the second quarter; and are generally at their lowest in the summer months as there tends to be fewer elective surgeries performed;
- Medicaid rate changes, including adjustments for CMI and provider taxes, occur with each state’s fiscal year, which is July 1st for the majority of the major states in which EHSI operates, and October 1st for Michigan;

- Medicare rate changes generally occur October 1st (federal fiscal year), and typically include a market basket inflationary increase;
- Ontario long-term care providers generally receive annual acuity-based flow-through funding adjustments effective April 1st and accommodation funding increases July 1st, and Alberta long-term care providers generally receive annual inflationary rate increases and acuity-based funding adjustments on April 1st;
- independent actuarial reviews are conducted three times a year, in the second and third quarters and at year end, which may lead to a strengthening, or conversely, a release of the reserves for self-insured liabilities;
- utility costs are generally at their highest in the first quarter and their lowest in the third quarter, with variances between the two of as much as \$3.5 million; and
- foreign currency exchange rate fluctuations between the U.S. and Canadian dollars and impact on translation of our U.S. operations from U.S. dollars to Canadian dollars.

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

2011 THIRD QUARTER FINANCIAL REVIEW

Highlights

- Revenue was \$531.7 million in the 2011 third quarter, a 5.5% increase over the 2010 third quarter, excluding the adverse effect of foreign exchange.
- EBITDA was \$40.8 million in the 2011 third quarter, a \$9.1 million decline over the 2010 third quarter, excluding the adverse effect of foreign exchange. Excluding an increase in prior years' reserves for self-insured liabilities, EBITDA improved by \$10.1 million.
- EBITDA margin was 7.7% in the 2011 third quarter compared to 9.8% in the 2010 third quarter, and excluding the reserve adjustment the margin was 13.6% this quarter compared to 12.4% in the 2010 third quarter.
- Average daily revenue rates for Medicare Part A and Managed Care grew by 13.2% and 9.2%, respectively, in the 2011 third quarter over the 2010 third quarter.

The 2011 third quarter results included an increase in prior years' reserves for self-insured liabilities of \$31.4 million, following the completion of an interim independent actuarial review, and a non-cash impairment charge of pre-tax \$54.0 million to reflect the lower valuation of our U.S. property and goodwill as a result of the CMS Final Rule. For further information on these two charges, refer to the discussion under the heading “Overview – Significant 2011 Events and Developments”.

Consolidated Operations

<i>(millions of dollars unless otherwise noted)</i>	Q3		Q3/11 vs Q3/10		Q2	Q3/11 vs Q2/11	
	2011	2010	\$	%	2011	\$	%
Revenue	531.7	523.9	7.8	1.5%	520.0	11.7	2.3%
Operating expenses	472.7	451.2	21.5	4.8%	435.1	37.6	8.6%
Administrative costs	15.5	18.7	(3.2)	(17.1)%	17.1	(1.6)	(9.4)%
Lease costs	2.7	2.8	(0.1)	(3.6)%	2.7	–	–
EBITDA	40.8	51.2	(10.4)	(20.3)%	65.1	(24.3)	(37.3)%
<i>EBITDA as a % of revenue</i>	<i>7.7%</i>	<i>9.8%</i>			<i>12.5%</i>		
Average U.S./Canadian dollar exchange rate	0.9807	1.0391			0.9681		

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 0.9807 for the 2011 third quarter, 1.0391 for the 2010 third quarter and 0.9681 for the 2011 second quarter. However, separately reported items such as fair value adjustments, gains or losses related to financial instruments, foreign exchange, asset impairment, disposals and other items, are translated at the rates of exchange in effect at the time of the transactions.

CONSOLIDATED OPERATIONS COMPARED TO THE 2010 THIRD QUARTER

Consolidated revenue improved by \$7.8 million to \$531.7 million in the 2011 third quarter from \$523.9 million in the 2010 third quarter. Non same-facility operations contributed \$13.4 million to revenue this quarter and \$8.8 million in the 2010 third quarter, for a net improvement between quarters of \$4.6 million. The non same-facility operations related to 15 centers as follows: eight U.S. skilled nursing centers that were disposed of throughout 2010, a U.S. skilled nursing center that was sold in May 2011, two new leased U.S. skilled nursing centers that opened in November 2010 and January 2011, a newly leased Canadian center in May 2011, two new Canadian centers that opened in September 2010 and January 2011, and one Canadian nursing center that closed in January 2011. Excluding the \$20.9 million negative effect of the stronger Canadian dollar, a 4.7% growth in same-facility operations improved revenue between periods by \$24.1 million as a result of funding improvements, partially offset by lower U.S. census levels.

Consolidated EBITDA declined by \$10.4 million to \$40.8 million in the 2011 third quarter from \$51.2 million in the 2010 third quarter, and was 7.7% and 9.8% of revenue, respectively. Non same-facility operations generated EBITDA of \$1.8 million in the 2011 third quarter compared to \$0.6 million in the same 2010 period. Same-facility results were negatively affected by \$1.3 million due to the stronger Canadian dollar and by a \$19.2 million increase reserves for prior years' self-insured liabilities (US\$32.1 million this period compared to US\$13.5 million in the 2010 third quarter). Excluding these items, EBITDA from same-facility operations improved by \$8.9 million between periods, with \$8.1 million from the U.S. operations and \$0.8 million from the Canadian operations. Consolidated same-facility revenue improvements of \$24.1 million were partially offset by higher costs of \$15.2 million. Details by segmented operations are discussed below.

Consolidated labour-related costs represented 70.3% of operating and administrative costs in the 2011 third quarter of 2011 compared to 72.2% in the 2010 third quarter, and as a percent of revenue, were 64.5% and 64.8%, respectively.

CONSOLIDATED OPERATIONS COMPARED TO THE 2011 SECOND QUARTER

Consolidated revenue improved by \$11.7 million this quarter from \$520.0 million in the 2011 second quarter. Non same-facility operations contributed \$13.4 million to revenue this quarter and \$12.8 million in the 2011 second quarter, for a net improvement between quarters of \$0.6 million. Excluding the positive effect of a weaker Canadian dollar of \$4.5 million, revenue from same-facility operations increased by \$6.6 million with improvements from both the U.S. and Canadian operations, as discussed further below.

Consolidated EBITDA declined by \$24.3 million to \$40.8 million this quarter from \$65.1 million in the 2011 second quarter, and was 7.7% and 12.5% of revenue, respectively. Excluding the \$31.4 million (US\$32.1 million) increase in prior years' reserves for self-insured liabilities this quarter, EBITDA improved by \$7.1 million quarter over quarter, and represented 13.6% and 12.5% of revenue, respectively. Non same-facility operations contributed \$1.8 million to EBITDA this quarter compared to \$1.4 million in the 2011 second quarter, for a net improvement between quarters of \$0.4 million. Excluding the positive effect of a weaker Canadian dollar of \$0.3 million, EBITDA from remaining same-facility operations improved by \$6.4 million, of which \$5.5 million was from our U.S. operations and \$0.9 million was from our Canadian operations, as discussed further below.

U.S. Operations

<i>(millions of dollars unless otherwise noted)</i>	Q3 2011		Q3 2010		Q3/11 vs Q3/10		Q2 2011		Q3/11 vs Q2/11	
	US\$	C\$	US\$	C\$	US\$	%	US\$	C\$	US\$	%
Revenue	362.5	<i>355.4</i>	346.0	<i>359.6</i>	16.5	4.8%	358.0	<i>346.6</i>	4.5	1.3%
Operating expenses	327.5	<i>321.0</i>	299.4	<i>311.1</i>	28.1	9.4%	295.0	<i>285.6</i>	32.5	11.0%
Administrative costs	11.0	<i>10.8</i>	12.9	<i>13.4</i>	(1.9)	(14.7)%	12.4	<i>12.0</i>	(1.4)	(11.3)%
Lease costs	1.7	<i>1.7</i>	1.6	<i>1.7</i>	0.1	6.3%	1.6	<i>1.5</i>	0.1	6.3%
EBITDA	22.3	<i>21.9</i>	32.1	<i>33.4</i>	(9.8)	(30.5)%	49.0	<i>47.5</i>	(26.7)	(54.5)%
<i>EBITDA as a % of revenue</i>	6.1%			<i>9.3%</i>			<i>13.7%</i>			

U.S. OPERATIONS COMPARED TO THE 2010 THIRD QUARTER

Revenue from U.S. operations grew by 4.8% in its functional currency to US\$362.5 million in the 2011 third quarter compared to US\$346.0 million in the 2010 third quarter, representing an increase of US\$16.5 million. Non same-facility revenue was unchanged at US\$4.5 million in both quarters. Revenue from same-facility operations increased by US\$16.5 million between periods primarily due to the contribution from higher average nursing center rates of US\$19.0 million, partially offset by lower census levels. Higher average rates reflected changes in Medicare funding for

the implementation of MDS 3.0 and RUG-IV, inflationary increases, as well as higher average acuity levels of residents served. Our average Medicare Part A rate, which improved by 13.2% over the 2010 third quarter, increased revenue by US\$12.1 million. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

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

(US\$ millions)

19.0	– increase in average skilled nursing center rates (Medicare \$12.1 million, Medicaid \$2.7 million, and private/other \$4.2 million)
(4.7)	– decrease in skilled nursing center resident census (decrease in Medicare \$1.5 million, Medicaid \$1.0 million and private/other \$2.2 million)
(0.1)	– decrease in prior period revenue settlement adjustments (\$1.8 million in 2011 versus \$1.9 million in 2010)
2.3	– increase in outpatient therapy, technology services and other revenue
16.5	

The operating, administrative and lease costs of our U.S. operations increased by US\$26.3 million to US\$340.2 million this quarter in comparison to the 2010 third quarter of US\$313.9 million. Non same-facility operations resulted in a decline in costs of US\$0.8 million between periods. Same-facility costs increased by US\$27.1 million primarily due to the increase in prior years' reserves for self-insured liabilities of US\$18.6 million (US\$32.1 million this quarter compared to US\$13.5 million in the 2010 third quarter), higher labour-related costs of US\$6.6 million, increased state provider taxes of US\$2.1 million, and other cost increases of US\$3.4 million, partially offset by a vendor refund of prior years' charges of US\$3.6 million. Labour costs included severance charges of approximately US\$1.2 million and a lower provision of US\$1.0 million for unit appreciation rights, or UARs, (a credit of US\$0.8 million this quarter versus a charge of US\$0.2 million in the 2010 third quarter). Total labour-related costs represented 63.8% of operating and administrative costs this quarter, compared to 67.2% in the 2010 third quarter, and as a percent of revenue were 59.6% and 60.6%, respectively.

EBITDA from U.S. operations declined by US\$9.8 million to US\$22.3 million in the 2011 third quarter from US\$32.1 million in the 2010 third quarter, and represented 6.1% and 9.3% of revenue, respectively. Non same-facility operations contributed US\$0.5 million to EBITDA this quarter compared to a loss of US\$0.3 million in the 2010 third quarter, for a net contribution of US\$0.8 million between periods. Excluding the increase between quarters in prior years' reserves of US\$18.6 million, same-facility operations improved by US\$8.0 million, resulting from revenue improvements of US\$16.5 million partially offset by higher costs of US\$8.5 million, as previously discussed.

U.S. OPERATIONS COMPARED TO THE 2011 SECOND QUARTER

Revenue from U.S. operations improved by US\$4.5 million in its functional currency to US\$362.5 million in the 2011 third quarter from US\$358.0 million in the 2011 second quarter. Revenue from non same-facility operations was US\$4.5 million this quarter compared to US\$4.7 million in the 2011 second quarter, representing a decline of US\$0.2 million. Revenue from same-facility operations improved by US\$4.7 million between periods, with improvements from higher average rates of US\$2.6 million, higher prior period revenue settlements of US\$1.1 million, other revenue of US\$1.5 million and one extra day in the quarter of US\$3.5 million, partially offset by lower census levels of US\$4.0 million. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

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

(US\$ millions)

3.5	– one extra day in the quarter
2.6	– net increase in skilled nursing center rates (Medicare \$0.6 million and Medicaid \$2.3 million, partially offset by a decrease in private/other \$(0.3) million)
(4.0)	– net decrease in average skilled nursing center residents (decrease in Medicare \$6.8 million, partially offset by an increase in Medicaid \$1.1 million and private/other \$1.7 million)
1.1	– increase in prior period revenue settlement adjustments (\$1.8 million in the third quarter versus \$0.7 million in the second quarter)
1.5	– other
4.7	

The operating, administrative and lease costs of our U.S. operations increased by US\$31.2 million to US\$340.2 million this quarter in comparison to the 2011 second quarter of US\$309.0 million. Costs for non same-facility operations decreased by US\$0.2 million. Same-facility costs were higher by US\$31.4 million primarily due to the increase in prior years' reserves for self-insured liabilities of US\$32.1 million and higher labour-related costs of US\$3.5 million, partially offset by a vendor refund of prior years' charges of US\$3.6 million and other net reductions of \$0.6 million. Labour-related costs included US\$1.2 million of severance charges, partially offset by a US\$0.5 million decline in the provision for UARs (a credit of US\$0.8 million this quarter versus US\$0.3 million last quarter). Total labour-related costs represented 63.8% of operating and administrative costs this quarter, compared to 69.1% in the 2011 second quarter, and as a percent of revenue were 59.6% and 59.3%, respectively.

EBITDA from U.S. operations declined by US\$26.7 million to US\$22.3 million in the 2011 third quarter from US\$49.0 million in the 2011 second quarter, and represented 6.1% and 13.7% of revenue, respectively. Non same-facility centres contributed US\$0.5 million to EBITDA in both quarters. Excluding the US\$32.1 million increase in prior years' reserves this quarter, same-facility EBITDA improved by US\$5.4 million, resulting from higher revenue of US\$4.7 million and lower costs of US\$0.7 million, as previously discussed.

Canadian Operations

<i>(millions of dollars unless otherwise noted)</i>	Q3		Q3/11 vs Q3/10		Q2	Q3/11 vs Q2/11	
	2011	2010	\$	%	2011	\$	%
Revenue	176.3	164.3	12.0	7.3%	173.4	2.9	1.7%
Operating expenses	151.7	140.1	11.6	8.3%	149.5	2.2	1.5%
Administrative costs	4.7	5.3	(0.6)	(11.3)%	5.1	(0.4)	(7.8)%
Lease costs	1.0	1.1	(0.1)	(9.1)%	1.2	(0.2)	(16.7)%
EBITDA	18.9	17.8	1.1	6.2%	17.6	1.3	7.4%
<i>EBITDA as a % of revenue</i>	10.8%	10.8%			10.1%		

CANADIAN OPERATIONS COMPARED TO THE 2010 THIRD QUARTER

Revenue from Canadian operations grew by \$12.0 million, or 7.3%, to \$176.3 million in the 2011 third quarter from \$164.3 million in the 2010 third quarter. Of this improvement, \$9.6 million was derived from nursing home operations and included an increase of \$4.8 million from non same-facility operations. The 2010 third quarter included a \$1.2 million adjustment to reverse funding, with growth from remaining same-facility nursing home operations of \$3.6 million primarily due to funding enhancements. Revenue from home health care operations improved by \$3.1 million this quarter primarily due to a 7.0% increase in volumes. Other revenue declined by \$0.7 million primarily due to the completion of management contracts.

Operating, administrative and lease costs increased by \$10.9 million to \$157.4 million this quarter from \$146.5 million in the 2010 third quarter, of which \$4.5 million was from non same-facility operations and \$6.4 million was from same-facility operations. Adjustments to reverse prior period accruals lowered costs by \$2.4 million in the 2010 third quarter. Excluding these 2010 third quarter adjustments, costs from same-facility operations increased by \$4.0 million in the 2011 third quarter, primarily due to higher labour-related costs. Labour costs included a lower provision for UARs with a credit of \$0.6 million this quarter compared to a charge of \$0.1 million in the 2010 third quarter. Total labour-related costs represented 84.0% of operating and administrative costs in the 2011 third quarter compared to 83.5% in the 2010 third quarter, and as a percent of revenue were 74.5% and 73.9%, respectively.

EBITDA from Canadian operations improved by \$1.1 million to \$18.9 million in the 2011 third quarter from \$17.8 million in the 2010 third quarter and represented 10.8% of revenue in both periods. Non same-facility operations contributed EBITDA of \$1.3 million this quarter compared to \$1.0 million in the 2010 third quarter, for a net improvement of \$0.3 million between periods. Same-facility operations improved by \$0.8 million, with improvements in nursing home and home health care operations, along with a reduction in the provision for UARs, partially offset by prior period adjustments of \$1.2 million recorded in the 2010 third quarter and a lower contribution from managed operations of approximately \$0.7 million primarily due to the completion of contracts.

CANADIAN OPERATIONS COMPARED TO THE 2011 SECOND QUARTER

Revenue from Canadian operations improved by \$2.9 million this quarter to \$176.3 million from \$173.4 million in the 2011 second quarter. Revenue from nursing home operations increased by \$2.1 million, and included a contribution of \$0.6 million from non same-facility operations. Revenue from remaining nursing home operations improved by \$1.5 million primarily due to funding improvements, timing of recognition of funding under the Ontario flow-through envelopes and an extra day in the quarter. Home health care revenue improved by \$0.7 million due to a 0.3% increase in daily volumes and the extra day in the quarter. Other revenue improved by \$0.1 million.

Operating, administrative and lease costs increased by \$1.6 million to \$157.4 million this quarter from \$155.8 million in the 2011 second quarter, of which \$0.2 million was from non same-facility operations. The increase in costs from same-facility operations of \$1.4 million was primarily due to the timing of spending under the Ontario flow-through envelopes, higher home health care volumes and one extra day in the quarter, partially offset by a lower provision for UARs of \$0.6 million (a credit of \$0.6 million this quarter compared to nil in the 2011 second quarter). Total labour-related costs represented 84.0% of operating and administrative costs in the 2011 third quarter compared to 84.2% in the 2011 second quarter, and as a percent of revenue were 74.5% and 75.1%, respectively.

EBITDA from Canadian operations improved by \$1.3 million, or 7.4%, to \$18.9 million in the 2011 third quarter from \$17.6 million in the 2011 second quarter, and represented 10.8% and 10.1% of revenue, respectively. Non same-facility operations contributed \$0.4 million to the improvement in EBITDA. Growth from same-facility operations was \$0.9 million, reflecting the \$2.3 million improvement in revenue, partially offset by the \$1.4 million increase in costs as previously discussed.

Depreciation and Amortization

Depreciation and amortization costs of \$19.1 million in the 2011 third quarter were higher by \$0.4 million from \$18.7 million in the 2010 third quarter. Completed construction projects and capital maintenance expenditures, net of closed or disposed properties, contributed \$1.3 million to the increase, partially offset by a \$0.9 million favourable effect of the stronger Canadian dollar.

Net Finance Costs

	Q3		Change	
	2011	2010	\$	%
<i>(millions of dollars unless otherwise noted)</i>				
Interest, net				
Interest expense	23.8	22.1	1.7	7.7%
Interest income	(1.8)	(0.5)	(1.3)	260.0%
	22.0	21.6	0.4	1.9%
Accretion				
Accretion of decommissioning provisions	0.4	0.4	–	–
Accretion of accrual for self-insured liabilities	0.1	0.1	–	–
	0.5	0.5	–	–
Exchangeable LP Unit distributions	0.7	0.6	0.1	16.7%
Fair Value Adjustments and Loss (Gain) on Foreign Exchange and Financial Instruments				
Fair value adjustment on convertible debentures	(10.6)	14.4	(25.0)	(173.6)%
Fair value adjustment on Exchangeable LP Units	(10.5)	5.3	(15.8)	(298.1)%
Loss (gain) on foreign exchange and financial instruments	0.3	(3.2)	3.5	(109.4)%
	(20.8)	16.5	(37.3)	(226.1)%
Net finance costs	2.4	39.2	(36.8)	(93.9)%

Net finance costs were lower by \$36.8 million at \$2.4 million in the 2011 third quarter compared to \$39.2 million in the 2010 third quarter. This was primarily due to the change in the fair value adjustments of the convertible debt and Exchangeable LP Units of \$40.8 million, partially offset by a \$3.5 million change in the loss (gain) on foreign exchange and financial instruments between periods. Net interest costs were higher by \$0.4 million and included a charge of \$2.6 million related to the amortization of deferred financing costs associated with the modification of the May 2012 CMBS

Financing. Remaining net interest costs were lower by \$2.2 million, benefiting from reduced rates and debt levels, higher interest income, and the positive effect of a stronger Canadian dollar.

Income Taxes

The tax provision was a recovery of \$0.4 million on a pre-tax loss of \$34.8 million in the 2011 third quarter compared to a tax provision of \$8.5 million on a pre-tax loss of \$7.1 million in the 2010 third quarter. The effective tax rates for each period were distorted by, among other things, the fair value adjustments, gains and losses from financial instruments, foreign exchange, asset impairment, disposals, and other items. As well, the effective tax rates of both quarters were impacted by the non-taxable adjustment to prior years' reserves for self-insured liabilities of \$31.4 million (US\$32.1 million) this quarter and \$14.0 million (US\$13.5 million) in the 2010 third quarter. Excluding these items, the effective tax rate for the 2011 third quarter was 38.9% compared to 40.4% in the 2010 third quarter.

2011 NINE MONTH FINANCIAL REVIEW

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

<i>(millions of dollars unless otherwise noted)</i>	Nine months ended September 30							
	2011				2010			
	U.S. <i>(US\$)</i>	U.S.	Canada	Total	U.S. <i>(US\$)</i>	U.S.	Canada	Total
Revenue	1,078.1	1,054.5	516.7	1,571.2	1,051.8	1,089.3	488.6	1,577.9
Operating expenses	918.4	898.3	447.1	1,345.4	884.0	915.5	417.8	1,333.3
Administrative costs	37.1	36.3	15.6	51.9	36.3	37.6	15.6	53.2
Lease costs	4.9	4.8	3.3	8.1	5.4	5.6	3.2	8.8
	960.4	939.4	466.0	1,405.4	925.7	958.7	436.6	1,395.3
EBITDA	117.7	115.1	50.7	165.8	126.1	130.6	52.0	182.6
Depreciation and amortization	44.4	43.4	13.6	57.0	42.4	43.9	11.2	55.1
Loss (gain) from asset impairment, disposals and other items	55.7	55.8	(2.0)	53.8	4.3	4.4	–	4.4
Results from operating activities	17.6	15.9	39.1	55.0	79.4	82.3	40.8	123.1
Interest, net	42.5	41.5	24.1	65.6	37.4	38.8	24.2	63.0
Accretion	1.2	1.2	0.3	1.5	1.3	1.3	0.3	1.6
Distributions on Exchangeable LP Units	–	–	2.0	2.0	–	–	2.0	2.0
Fair value adjustments	–	–	(17.4)	(17.4)	–	–	16.9	16.9
Gain on foreign exchange and financial instruments	(0.4)	(0.4)	(0.3)	(0.7)	(0.5)	(0.5)	(1.4)	(1.9)
Net finance costs	43.3	42.3	8.7	51.0	38.2	39.6	42.0	81.6
Earnings (loss) before income taxes	(25.7)	(26.4)	30.4	4.0	41.2	42.7	(1.2)	41.5
Income tax expense	12.2	11.6	4.9	16.5	23.3	24.1	3.9	28.0
Net earnings (loss)	(37.9)	(38.0)	25.5	(12.5)	17.9	18.6	(5.1)	13.5
Add (Deduct):								
Fair value adjustment on convertible debentures, net of taxes	–	–	(9.1)	(9.1)	–	–	14.2	14.2
Fair value adjustment on Exchangeable LP Units, net of taxes	–	–	(7.2)	(7.2)	–	–	1.9	1.9
Gain on foreign exchange and financial instruments, net of taxes	(0.5)	(0.5)	(0.3)	(0.8)	(1.0)	(1.1)	(1.4)	(2.5)
Loss (gain) from asset impairment, disposals and other items, net of taxes	42.5	42.6	(2.1)	40.5	2.7	2.8	–	2.8
Distributions on Exchangeable LP Units, net of taxes	–	–	2.0	2.0	–	–	2.0	2.0
Earnings before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes	4.1	4.1	8.8	12.9	19.6	20.3	11.6	31.9
Average U.S./Canadian dollar exchange rate				0.9781				1.0356

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 0.9781 for the nine months ended September 30, 2011, and 1.0356 for the nine months ended September 30, 2010. However, separately reported items such as fair value adjustments, gains or losses related to financial instruments, foreign exchange, asset impairment, disposals and other items, are translated at the rates of exchange in effect at the time of the transactions.

Consolidated Operations

Consolidated revenue declined by \$6.7 million to \$1,571.2 million in the first nine months of 2011 from \$1,577.9 million in the first nine months of 2010. Non same-facility operations contributed \$36.8 million to revenue this period and \$39.3 million in the same 2010 period, resulting in lower revenue of \$2.5 million between periods. Exclusive of the negative effect of \$61.2 million from the stronger Canadian dollar, growth from same-facility operations of \$57.0 million, or 3.7%, benefited from funding improvements, partially offset by lower Medicaid and private census levels and prior period revenue.

Consolidated EBITDA declined by \$16.8 million to \$165.8 million in the first nine months of 2011 from \$182.6 million in the first nine months of 2010, and was 10.6% and 11.6% of revenue, respectively. Non same-facility operations contributed \$3.8 million to EBITDA in the first nine months of 2011 compared to \$2.7 million in the same 2010 period. Same-facility results were negatively affected by \$6.7 million due to the stronger Canadian dollar and a \$19.2 million increase in reserves for prior years' self-insured liabilities (US\$32.1 million this period compared to US\$13.5 million in the 2010 period). EBITDA from remaining same-facility operations improved by \$8.0 million, with revenue improvements of \$57.0 million, partially offset by higher costs of \$49.0 million. Details by segmented operations are discussed below.

Consolidated labour-related costs represented 72.9% and 73.5% of operating and administrative costs in the first nine months of 2011 and 2010, respectively, and were 64.8% and 64.6% of revenue, respectively.

U.S. Operations

Revenue from U.S. operations grew by 2.5% in its functional currency to US\$1,078.1 million in the first nine months of 2011 compared to US\$1,051.8 million in the same 2010 period, representing an increase of US\$26.3 million. Non same-facility revenue was US\$13.3 million this period compared to US\$30.2 million in the first nine months of 2010, representing a decline of US\$16.9 million. Revenue from same-facility operations improved by US\$43.2 million between periods primarily due to the contribution from higher average nursing center rates of US\$53.6 million, partially offset by lower census levels. Higher average rates reflected changes in Medicare funding for the implementation of MDS 3.0 and RUG-IV, inflationary increases, as well as higher average acuity levels of residents served. Our average Medicare Part A rate improved by 12.7% over the first nine months of 2010, increasing revenue by US\$38.1 million. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

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

(US\$ millions)

53.6	– increase in average skilled nursing center rates (Medicare \$38.1 million, Medicaid \$5.3 million, and private/other \$10.2 million)
(11.9)	– decrease in skilled nursing center resident census (Medicare \$0.6 million, Medicaid \$6.3 million, and private/other \$5.0 million)
(1.4)	– decrease in prior period revenue settlement adjustments (\$3.6 million in 2011 versus \$5.0 million in 2010)
2.9	– other
43.2	

The operating, administrative and lease costs of our U.S. operations increased by US\$34.7 million to US\$960.4 million in the first nine months of 2011 from US\$925.7 million in the same 2010 period. Non same-facility operations resulted in a decline in costs of US\$17.1 million between periods. Same-facility costs increased by US\$51.8 million primarily due to the increase in prior years' reserves for self-insured liabilities of US\$18.6 million (US\$32.1 million in the 2011 third quarter compared to US\$13.5 million in the 2010 third quarter), higher labour-related costs of US\$20.6 million and other cost increases of US\$12.6 million. The US\$20.6 million increase in labour costs was primarily due to higher staffing levels and a 0.9% average wage increase in nursing home operations. As well, payroll taxes were higher by US\$2.3 million between periods and severance charges of US\$1.2 million were incurred, while the provision for UARs was lower at nil this period compared to a charge of US\$0.4 million last period. Total labour-related costs represented 67.4% of operating and administrative costs in the first nine months of 2011, compared to 68.9% in the same 2010 period, and represented 59.7%

and 60.3% of revenue, respectively. The other cost increases of US\$12.6 million included higher state provider taxes of US\$3.0 million that were implemented with increases in Medicaid revenue rates, along with increases in food, supplies, recruitment costs, professional fees, utilities and travel.

EBITDA from U.S. operations declined by US\$8.4 million to US\$117.7 million in the first nine months of 2011 from US\$126.1 million in the first nine months of 2010, and was 10.9% and 12.0% of revenue, respectively. Non same-facility operations contributed US\$1.1 million to EBITDA this period compared to US\$0.9 million in the first nine months of 2010, for an improvement of US\$0.2 million between periods. Excluding the increase of US\$18.6 million in prior years' reserves between periods, same-facility operations improved by US\$10.0 million, or 7.2%, resulting from higher revenue of US\$43.2 million, partially offset by higher costs of US\$33.2 million, as previously discussed. The lack of Medicaid rate increases in 2010 and 2011 that would normally offset our wage rate and non-wage inflationary increases has resulted in some compression of our U.S. operating margin.

Canadian Operations

Revenue from Canadian operations grew by \$28.1 million, or 5.8%, to \$516.7 million in the first nine months of 2011 from \$488.6 million in the first nine months of 2010. Of this improvement, \$24.4 million was derived from nursing home operations and included an increase of \$15.7 million from non same-facility operations. Growth from same-facility nursing home operations of \$8.7 million was primarily due to funding enhancements, partially offset by lower prior period funding of \$0.5 million (nil this period compared to \$0.5 million received in the 2010 period). Revenue from home health care operations improved by \$5.3 million in the first nine months of 2011 due to a 5.2% increase in volumes and higher rates, partially offset by lower retroactive funding (nil this period compared to \$2.1 million received in the 2010 period). Other revenue declined by \$1.6 million primarily due to the completion of management contracts.

Operating, administrative and lease costs increased by \$29.4 million to \$466.0 million in the first nine months of 2011 from \$436.6 million in the same 2010 period, of which \$14.8 million was from non same-facility operations and \$1.7 million was due to adjustment to prior period accruals that reduced costs in the first nine months of 2010. Remaining costs from same-facility operations increased by \$12.9 million, primarily due to higher labour-related costs, which included a lower provision for UARs of \$0.2 million (\$0.1 million this period compared to \$0.3 million in the 2010 period). Total labour-related costs represented 83.9% of operating and administrative costs in the first nine months of 2011 and 83.6% in the same 2010 period, and represented 75.2% and 74.2% of revenue, respectively.

EBITDA from Canadian operations was \$50.7 million in the first nine months of 2011 compared to \$52.0 million in the first nine months of 2010. Excluding \$4.3 million of prior period adjustments recorded in the first nine months of 2010, EBITDA improved by \$3.0 million, and represented 9.8% of revenue this period compared to 10.6% in the first nine months of 2010, or 9.8% adjusted for prior period adjustments. Non same-facility operations contributed EBITDA of \$2.7 million this period compared to \$1.8 million in the first nine months of 2010, for a net improvement of \$0.9 million between periods. Excluding prior period adjustments, EBITDA from same-facility operations improved by \$2.1 million reflecting higher revenue of \$15.0 million partially offset by higher operating and administrative costs of \$12.9 million. This resulted primarily from improvements in nursing home and home health care operations partially offset by a lower contribution from managed operations of approximately \$1.5 million, as previously discussed.

Depreciation and Amortization

Depreciation and amortization costs of \$57.0 million in the first nine months of 2011 were higher by \$1.9 million from \$55.1 million in the same 2010 period. Completed construction projects and capital maintenance expenditures, net of closed or disposed properties, contributed \$4.5 million to the increase, partially offset by a \$2.6 million favourable effect of the stronger Canadian dollar.

Net Finance Costs

	Nine months ended		Change	
	2011	2010	(\$)	(%)
<i>(millions of dollars unless otherwise noted)</i>				
Interest, net				
Interest expense	69.2	66.5	2.7	4.1%
Interest income	(3.6)	(3.5)	(0.1)	2.9%
	65.6	63.0	2.6	4.1%
Accretion				
Accretion of decommissioning provisions	1.2	1.2	–	–
Accretion of accrual for self-insured liabilities	0.3	0.4	(0.1)	(25.0)%
	1.5	1.6	(0.1)	(6.3)%
Exchangeable LP Unit distributions	2.0	2.0	–	–
Fair Value Adjustments and Gain on Foreign Exchange and Financial Instruments				
Fair value adjustment on convertible debentures	(10.2)	15.0	(25.2)	(168.0)%
Fair value adjustment on Exchangeable LP Units	(7.2)	1.9	(9.1)	(478.9)%
Gain on foreign exchange and financial instruments	(0.7)	(1.9)	1.2	(63.2)%
	(18.1)	15.0	(33.1)	(220.7)%
Net finance costs	51.0	81.6	(30.6)	(37.5)%

Net finance costs were lower by \$30.6 million at \$51.0 million in the first nine months of 2011 compared to \$81.6 million in the first nine months of 2010. This was primarily due to the change in the fair value adjustments of the convertible debt and Exchangeable LP Units of \$34.3 million, partially offset by a \$1.2 million change in the gain on foreign exchange and financial instruments between periods. Net interest costs were higher by \$2.6 million and included a charge of \$3.6 million related to the amortization of deferred financing costs associated with the modification of the May 2012 CMBS Financing and the favourable effect of the stronger Canadian dollar of \$2.4 million.

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

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

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

The REIT recorded a pre-tax loss from asset impairment, disposals and other items of \$53.8 million in the first nine months of 2011 compared to \$4.4 million in the same 2010 period. The 2011 charge included a non-cash impairment charge of \$54.0 million (after-tax \$41.5 million) in connection with the revaluation of our U.S. property and goodwill, resulting from the Medicare funding and therapy changes that took effect October 1, 2011. The portion related to non-taxable goodwill was \$22.3 million. For further information, refer to *note 11* of the unaudited interim condensed consolidated financial statements for the nine months ended September 30, 2011.

Income Taxes

The tax provision was \$16.5 million on pre-tax earnings of \$4.0 million in the first nine months of 2011 compared to a tax provision of \$28.0 million on pre-tax earnings of \$41.5 million in the first nine months of 2010. The effective tax rates for each period were distorted by, among other things, the fair value adjustments, gains and losses on foreign exchange, financial instruments, asset impairment, disposals, and other items. As well, the effective tax rates of both periods were impacted by the non-taxable adjustment to prior years' reserves for self-insured liabilities of \$31.4 million (US\$32.1

million) this period and \$14.0 million (US\$13.5 million) in the 2010 period. Excluding these items, the effective tax rate for the first nine months of 2011 was 39.4% compared to 40.3% in the same 2010 period.

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

OTHER SIGNIFICANT DEVELOPMENTS

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

Global Economic Environment Impact on Nursing Center Funding and Census

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

The global economic downturn has impacted nursing center funding and short-term admissions in our U.S. nursing centers. In response to the economic environment, the REIT has undertaken several courses of action to minimize risks and maintain liquidity, including:

- reducing distributions in January 2009 and growth projects along with divestiture of underperforming assets;
- focusing on core business and cost reduction initiatives;
- monitoring cash usage; and
- maintaining solid banking relationships.

Global events have posed and could continue to pose a number of risks on the REIT. Below is a summary of the potential uncertainties and significant risks that could have an impact on the REIT and its subsidiaries:

- 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.

STATE, PROVINCIAL AND FEDERAL FUNDING AND REGULATORY PRESSURE

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

In response to the economic downturn, 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 stated intention to maintain core education, health and unemployment funding, a number of states in which we operate have faced severe budgetary shortfalls since 2009, resulting in reductions in Medicaid funding or increases at rates below inflation. The federal medical assistance percentage, or "FMAP", funding ended on June 30, 2011. Based on current information, we are estimating that the average of our Medicaid rate increases that take effect in 2011 to be approximately 0.7%. A number of states are facing considerable financial pressures that could result in Medicaid rate reductions in the future.

Since the latter part of 2008, we have undertaken a number of initiatives to reduce our operating and administrative costs without impacting the quality and level of services to the residents that we serve. Those initiatives have been focused on reducing the costs of pharmaceuticals, telecommunications and major supplies through enhanced procurement initiatives; implementing real-time labour tracking tools within our U.S. centers; reducing health care and workers' compensation costs through a number of program initiatives; reducing the level of bad debts through new admission and collection software tools; tightening travel policies and reducing corporate overhead through technology driven solutions.

On July 29, 2011, CMS announced an 11.1% reduction in Medicare rates effective October 1, 2011. In addition, CMS announced the implementation of further changes in the assessment process along with the elimination of group therapy that will result in further Medicare rate reductions effective October 1, 2011.

As a result of the most recent Medicare rate reductions that took effect October 1, 2011, along with continued Medicaid funding restrictions, senior management of EHSI completed a thorough review of its operations and implemented a number of aggressive cost savings measures within its organization, including securing vendor pricing changes. The savings have been realized by reductions in the area operational and corporate office staff, savings in supplies, drugs, and third-party service arrangements with vendors and the elimination of other administrative costs within the organization. These savings are anticipated to reduce the general, administrative and non-wage operating costs of EHSI by an estimated US\$20 million to US\$24 million on an annualized basis. Approximately two-thirds of these savings were in effect as of October 1, 2011. None of these savings involve a reduction of direct care staffing at our centers.

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

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

During the latter part of 2010 and in the first nine months of 2011, we have experienced significant increases in fuel costs that have been passed on to us by our suppliers that either ship their products or provide products that are petroleum based. In addition, we have experienced above inflationary increases on certain other supplies that are cotton-based products, along with certain food products.

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

In the U.S., Medicare and Managed Care funded residents were the source of approximately 81% of our admissions in 2010, a component of which come from hospitals after elective surgeries.

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

In response to the decline in short-term admissions in the U.S., we have refocused and refined our strategic marketing plans, are working on strategic alliances within the marketplaces in which we operate, and have invested to improve the number of rehabilitation suites within our portfolio to increase our market share in communities where we anticipate a return on our investments that meet our criteria.

Development Projects

COMPLETED PROJECTS (2010 AND 2011)

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

Completed Projects (2010 and 2011)	Date Opened for Admissions	No. of Centers	Operational Beds/Units
Canada – Owned Centers			
Continuing care center, Red Deer, Alberta	Sept./10; Feb./11 ⁽¹⁾	1	280
Designated assisted living center, Lethbridge, Alberta	Jan./11 ⁽²⁾	1	140
U.S. – Leased Centers			
Skilled nursing center, South Bend, Indiana	Nov./10	1	100
Skilled nursing center, Lansing, Michigan	Jan./11	1	120
		4	640

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

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

PROJECTS UNDER DEVELOPMENT

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

Development Projects (as at September 30, 2011)	New Centers			Existing Owned Centers to Close	
	Estimated Completion Date	No. of Centers	Beds/Units	No. of Centers	Beds/Units
Canada – Owned Long-term Care Centers					
Edmonton, Alberta	Oct./11	1	180	(1)	(122)
Sault Ste. Marie, Ontario ⁽¹⁾	Q1/13	1	256	(1)	(168)
Timmins, Ontario	Q1/13	1	180	(1)	(119)
		3	616	(3)	(409)

⁽¹⁾ In addition to the owned licensed 168 beds that ECI operates in Sault Ste. Marie, it operates 95 beds at a leased center that will be vacated and 88 beds will be transferred to the new center once it opens. ECI previously managed these beds, and in 2011, the licenses were transferred to ECI in preparation for the completion of the new center.

Owned Centers Completed and/or under Development in 2011

The new 180-bed long-term care center in Edmonton, Alberta was completed in October and began admitting residents in November 2011. The cost of the Edmonton project is an estimated \$19.5 million, net of government grants, of which \$16.4 million had been spent to September 30, 2011. ECI's other existing nursing center in Edmonton (113 operational beds), transferred its residents to the new nursing center, in addition to nine beds from another one of our nursing centers, for a total of 122 beds transferred. ECI is in the process of seeking a purchaser for its closed Edmonton property.

ECI recently completed and opened a designated assisted living center in Lethbridge, Alberta, and closed an existing nursing center in the region. The projected combined annual EBITDA of the two new centers in Alberta (Lethbridge and Edmonton), once fully operational, is expected to exceed \$5.0 million. The combined annual EBITDA of the two centers being replaced was approximately \$2.7 million in 2009 (when they were fully operational) and was \$2.4 million in 2010.

Ontario Redevelopment Projects – 2010 Awarded

As part of the Government of Ontario's initiative to redevelop 35,000 long-term care beds over the next 10 to 15 years (refer to discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada – Ontario Long-term Care Legislation"), ECI received approval to redevelop 287 of its class "C" beds in the cities of Timmins and Sault Ste. Marie, and in connection with this award, we will add a further 149 long-term care beds. As a

result, ECI expects to complete construction of a new 180-bed nursing center in Timmins and a new 256-bed nursing center in Sault Ste. Marie by the end of the 2013 first quarter. ECI currently owns and operates three nursing centers with 387 class "C" beds in these areas. Following completion of the new projects, ECI will own and operate 436 beds in two new centers and 100 class "C" beds in an existing center to be considered for redevelopment at a later date. The additional 149 long-term care beds that were awarded included 88 of 95 beds at a nursing center in Sault St. Marie that ECI managed for a third party. The licenses for these beds were transferred to ECI during the 2011 second quarter and ECI now operates the center's 95 beds under a lease arrangement. Once the project is complete, this leased center will be vacated and 88 of its beds will be transferred to the new center. Conventional financing for approximately 88% of the total estimated cost for the two projects of \$80 million was secured at the end of October 2011. In addition, we will receive capital funding from the government of approximately \$2.0 million annually over a 25-year period. The combined annual EBITDA of the three existing owned centers (387 beds) for 2010 and 2009 was approximately \$2.8 million and \$2.7 million, respectively. It is anticipated that upon completion of the projects the incremental EBITDA for the three centers (536 beds) will be approximately \$2.0 million, excluding the capital funding for the two new centers (436 beds).

Financing Activity

CANADA

2011 Mortgage Activity – October 2011

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

Also in October 2011, ECI signed a commitment letter for the refinancing of its construction loan on the Edmonton, Alberta project, which is anticipated to close in the 2012 first quarter. The commitment is for CMHC insured financing in the amount of \$17.4 million for a term of 10 years, at a fixed rate of 3.81%, with payments amortized over 30 years.

Public Offering of REIT Units – February 2010

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

2010 Mortgage Activity

In July 2010, ECI secured a 10-year mortgage at 4.57% that is insured through the Canada Mortgage and Housing Corporation (CMHC) program for the Red Deer project. The new financing of \$28.7 million (inclusive of CMHC fees of \$1.5 million) replaced the construction loan in September 2010, and has monthly payments based on a 30-year amortization.

UNITED STATES

Sovereign Loans – June 2011

On June 1, 2011, EHSI paid off the remaining balance of its Sovereign Loans of US\$44.0 million using borrowings under the EHSI Credit Facility that were subsequently repaid upon closing of the first phase of the HUD loans at the end of June.

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

EHSI Credit Facility – March 2011

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

U.S. prime rate plus a margin from 3% to 3.75%, with the specific margin based on EHSI's consolidated leverage ratio as defined in the EHSI Credit Facility. The interest rate at September 30, 2011 was 6.25% (December 31, 2010 – 6%).

PrivateBank Mortgage Loans due 2013 – November 2010

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

HUD Mortgages and Sovereign Loans – 2010

On March 11, 2010, EHSI refinanced US\$7.0 million of debt on a skilled nursing (60 beds) and assisted living (62 units) complex in Wausau, Wisconsin with a US\$11.7 million mortgage secured by the HUD program at a fixed rate of 4.6% with a 35-year term.

In August 2010, EHSI repaid US\$3.3 million of its Sovereign Loans and US\$4.7 million of its HUD mortgages in connection with the sale of four Michigan skilled nursing centers.

Divestitures and Assets Held for Sale

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

Prior to the adoption of IFRS, earnings and associated taxes derived from both divested operations and operations that have been classified for disposition were reported separately within the consolidated statements of earnings as discontinued operations. However, the definition of discontinued operations under IFRS is narrower, and requires that the classification to discontinued operations be limited to a component that represents a major line of business or geographical area of operations. Consequently, with the adoption of IFRS, results previously reported as discontinued operations in 2010 have been reclassified as part of continuing operations. The REIT's financial results prior to 2010 have not been restated under IFRS and therefore, still reflect a classification for discontinued operations.

The following table reflects the owned centers that have been disposed of since January 1, 2010. In addition, during 2010, EHSI ceased operating two leased Ohio skilled nursing centers (235 beds) following their transfer to new operators in the 2010 second quarter.

	To date in 2011			2010 Year		
	No. of Centers	Beds/ Units	Sale/ Closed	No. of Centers	Beds/ Units	Sale/ Closed
Disposed Owned Centers						
Canadian Operations						
Alberta – (closed nursing center)	1	–	June			
Net proceeds (<i>millions</i>)			\$1.0			
U.S. Operations						
Michigan – SNFs	1	92	May	4	456	August
Ohio – SNF	–	–	–	1	100	April
Pennsylvania – SNF	–	–	–	1	107	April
	1	92		6	663	
Net proceeds (<i>millions</i>)			US\$3.9			US\$20.3

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

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

As at September 30, 2011, the REIT had assets held for sale with a net book value of \$0.2 million consisting of a closed nursing center in Washington whose beds were transferred to a newly built center in 2008.

Legal Proceedings and Regulatory Actions

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

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

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

Canadian and U.S. Income Tax Updates

CANADIAN FEDERAL INCOME TAX ON INCOME TRUSTS

On October 31, 2006, the day before 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, Extencicare REIT was not eligible for transitional relief from the SIFT tax through 2010 and due to the nature of its income and investments, did not qualify for the exemption from the SIFT Rules applicable to "real estate investment trusts" (as defined in the SIFT Rules). As a result, 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, but there can be no assurance that this will be the case.

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

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

U.S. FEDERAL INCOME TAX ON REITS

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

ALC SPIN-OFF

The Arrangement included the distribution of Assisted Living Concepts, Inc. (ALC) to Extencicare's shareholders and a number of pre-Arrangement transactions.

As part of the spin-off of 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"). In 2009, ALC asserted that EHSI owes an estimated US\$3.1 million to ALC under the Tax Allocation Agreement relating to additional depreciation deductions allowed by the U.S. Internal Revenue Service for years 2005 and 2006 relating to limitations computed under Section 382 of the Code. Subsequent to year end, the parties agreed to settle this matter along with all past and future differences arising from the Tax Allocation Agreement for US\$0.8 million (US\$0.5 million after tax). This settlement had been accrued for at December 31, 2010, and was charged directly to retained earnings since the spin-off of ALC was accounted for as a capital transaction in 2006. In May 2011, EHSI and ALC signed an agreement to terminate the Tax Allocation Agreement and EHSI paid the US\$0.8 million that had been accrued.

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

UPDATE OF REGULATORY AND REIMBURSEMENT CHANGES AFFECTING REVENUE

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

All long-term care providers are subject to surveys, inspections, audits and investigations by government authorities to ensure compliance with applicable laws and licensure requirements of the federal, state and/or provincial funding programs. Nursing centers must comply with applicable regulations which, depending on the jurisdiction in which they operate, may relate to such things as staffing levels, resident care standards, occupational health and safety, resident confidentiality, billing and reimbursement, along with environmental, and other standards. The government review process is intended to review quality of care and services and medical necessity of services provided and billed. Remedies for assessed deficiencies can be levied based upon the scope and severity of the cited deficiencies. Remedies range from the assessment of fines to the withdrawal of payments under the government funding programs. Should a deficiency not be addressed through a plan of correction, a center can be decertified from the funding program. As at September 30, 2011, we had certain centers under a plan of correction at EHSI. While it is not possible to estimate the final outcome of the required corrective action, EHSI has accrued for known costs. In Canada, we have no centers currently subject to sanction as provided for under existing legislation or regulation.

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

United States

The majority of the REIT's operations are in the United States where 67.1% of its revenue was earned in the first nine months of 2011 (2010 year – 68.6%). EHSI receives payment for its services and products from the federal (Medicare) and state (Medicaid) medical assistance programs, Managed Care organizations (including HMO and preferred provider organizations), commercial insurers, the Department of Veterans Affairs, as well as from private payors. During 2010, approximately 54% of our U.S. resident admissions were Medicare funded and approximately 27% were Managed Care funded.

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

EHSI believes its billing practices, operations and compensation and financial arrangements with referral sources and others materially comply with applicable federal and state requirements. However, EHSI cannot give assurance that a governmental authority will not interpret such requirements in a manner inconsistent with EHSI's interpretation and application. If EHSI's practices are found not to comply, even inadvertently, with any of these requirements, it could be subject to criminal, civil and administrative penalties. Even if EHSI successfully defends any action against it for violating these laws or regulations, EHSI could incur significant legal expenses and divert management's attention from the operation of its business. EHSI cannot reasonably predict whether enforcement activities will increase at the federal or state level or the effect of such enforcement activities on its business and its financial results.

MEDICARE FUNDING

Market Basket Annual Increases

Changes in Medicare funding levels typically occur on October 1st of each year to coincide with the federal government's fiscal year, and generally represent an inflationary increase for the Medicare Part A funding, otherwise referred to as a "market basket" increase, which are generally about 3%. In addition, Medicare increases are also periodically adjusted for "forecasting errors" that are identified by CMS based upon filed cost reports.

As discussed in further detail below, changes to the Medicare Part A rates for fiscal 2012 include a market basket update of 2.7% minus a productivity adjustment of approximately 1.0%, effective October 1, 2011.

The October 1, 2010 Medicare Part A funding change was intended to result in a net increase of 1.7% over the prior fiscal year. This represented a 2.3% market basket increase, less a 0.6% forecasting error adjustment. We estimated that this net rate increase of 1.7% would increase our annual Medicare revenue of approximately US\$6.8 million. Further Medicare funding changes included the implementation of the new RUG-IV rate set as discussed below, which in combination with efficient operational reaction to the new MDS 3.0 protocols, resulted in EHSI realizing a net increase of 12.5% over the October 1, 2009 rates.

Medicare Reimbursement Changes Effective October 1, 2011

The implementation in October 2010, of the RUG-IV rate set and MDS 3.0 were intended to be budget neutral. The post implementation review completed by CMS determined that the majority of operators, including EHSI, realized increased Medicare reimbursement beyond the intended 1.7%. In response to this, CMS included several significant changes in its final rule for payments to skilled nursing centers effective October 1, 2011. CMS expects these changes will result in a net

reduction in Medicare Part A rates of approximately 11.1%, along with changes in the assessment process and the elimination for payment of group therapy.

Specifically, CMS' final rule includes, among other things:

- a parity adjustment of an estimated aggregate reduction of 11.1% (a 12.6% recalibration of the CMI, partially offset by a market basket increase net of a productivity adjustment);
- changes to group therapy, which will be defined to be four patients who are simultaneously performing similar activities, and minutes will be allocated;
- implementation of Change of Therapy Medicare-required assessments, or "OMRAs", whenever a patient's RUG-IV classification changes;
- clarification that End of Therapy (EOT) OMRAs must be completed following three consecutive calendar days without therapy services;
- implementation of the EOT-Resumption of therapy (EOT-R) OMRAs, in place of a Start-of-Therapy OMRAs, in cases where the resumption of therapy is no more than five consecutive calendar days after the last day of therapy provided, and there has been no change in the RUG-IV classification; and
- implementation of a new assessment to be completed every seven calendar days to update current therapy provided, regardless of whether there has been a significant change in condition.

We estimate that the 11.1% Medicare rate decrease will result in an annualized reduction in our revenue and EBITDA in the order of approximately US\$57 million, when considering the effect on both our Medicare Part A and Managed Care rates. While it is extremely difficult to analyze the impact of group therapy and assessment policy changes, we estimate that these items will result in an additional reduction to our EBITDA in the range of US\$13 million to US\$23 million. Therefore, the aggregate impact would reduce our EBITDA, prior to cost cut measures, by an estimated US\$70 million to US\$80 million. To mitigate as much of this adverse impact as possible, we completed a thorough review of our operations and implemented a plan to drive efficiencies and reduce costs wherever possible. These savings are anticipated to reduce the general, administrative and non-wage operating costs of EHSI by an estimated US\$20 million to US\$24 million on an annualized basis. Approximately two-thirds of these savings were in effect as of October 1, 2011. None of these savings involve a reduction of direct care staffing at our centers.

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

On October 1, 2010, CMS implemented MDS 3.0, a revised resident assessment tool, and RUG-IV, a revised case-mix classification methodology and implementation schedule, which among other things, increased the RUGs categories from 53 to 66 and provided for the elimination of billing for concurrent therapy services and services provided by technicians. CMS stated that these initiatives were intended to be budget neutral. In order to meet the needs of the new reimbursement system, EHSI increased nursing and therapy staff and realigned its staffing practices to meet the incremental assessment requirements and therapy needs of its residents. As a result of these initiatives, together with the realigned funding rates, EHSI's average Medicare Part A rate increased by 10.5% in the 2010 fourth quarter over the 2010 third quarter, and for the first nine months of 2011 it increased by 12.7% over the same 2010 period.

Medicare Part B Rates

In November 2010, CMS issued a final payment rule for the 2011 Medicare Physician Fee Schedules, effective January 1, 2011. We estimate that the application of a multiple procedure payment reduction policy had reduced EHSI's Medicare Part B inpatient and outpatient therapy billings by approximately 7.5%, resulting in a US\$3.2 million decline in annual revenue.

Effective January 1, 2006, CMS implemented a cap on Part B therapy services for physical and speech therapy, and a second cap for occupational therapy. The annual caps per eligible Part B recipient amounted to US\$1,740 in 2006, and increased annually for inflation to US\$1,860 in 2010. A one-year exemption process to the therapy caps was established in 2005 for individuals who were able to prove medical necessity for the therapy, which exemption was extended to December 31, 2011, by the *Medicare and Medicaid Extenders Act of 2010*. Based on information currently available, EHSI estimates that without the extension of this exemption beyond 2011, its annual therapy revenue may decline by as much as US\$12.0 million. This estimate decline in annual therapy revenue is based on therapy services provided by EHSI in excess of the cap, and assumes such services would not otherwise be requested by the patients. The impact of these caps on EHSI

may be mitigated to the extent that such patients find other means of paying for these services, or EHSI is able to reduce associated costs.

2012 President's Budget and Budget Control Act of 2011

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

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

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

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

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

President's Jobs Bill

On September 19, 2011, the Office of Management and Budget released the President's Plan for Economic Growth and Deficit Reduction, otherwise known as the President's Jobs Bill. This bill contains several proposals that would significantly affect Medicare reimbursement for nursing homes.

The President's Jobs Bill calls for the reduction in recognition of bad debts resulting from a beneficiary's non-payment of coinsurance to 25%. For our dually eligible (Medicare & Medicaid eligible) residents, these unpaid Part A coinsurance amounts are not collectible from the resident. They are normally reimbursed at 100% from either the State Medicaid

programs or Medicare. Such a reduction would affect the coinsurance normally received on about 25% of our Medicare Part A residents. Our non-dually eligible Part A coinsurance bad debt is currently reimbursed at 70%.

The President's Jobs bill also calls for the "realigning" of payments with costs through adjustments to the market basket annual increases for 2014 through 2021. Although sufficient detail is not known, these adjustments are expected to incorporate MedPAC's March 2011 proposal to eliminate these increases beginning in 2012. These annual increases have averaged 2.7% in the last two fiscal years, prior to the productivity adjustment of a negative 1.0%.

The bill's Medicaid program proposals include the provider tax thresholds discussed in the 2012 President's Budget above, as well as reductions in durable medical equipment reimbursement.

2010 Health Care Reform Legislation Remains a Significant Factor

In March 2010, historic health care reform legislation, the *Patient Protection and Affordable Care Act* (H.R. 3590), or "PPACA", was enacted into law at a cost of US\$940 billion over 10 years. Amendments to the PPACA were enacted into law on March 30, 2010, with the passage of the *Health Care Education Affordability Act* (HCEAA). The HCEAA contains several changes to the PPACA. The legislation is complex and there is considerable controversy surrounding its passage. It is generally believed that additional amendments may be introduced to address certain unintended consequences of the sweeping legislation before it is fully implemented in 2014. In addition, regulations implementing the new legislation will be issued by various government agencies and could have a significant impact on individuals, health care providers and employers. We continue to monitor the legislation to determine its impact on us.

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

- (i) A productivity adjustment to Medicare rates commencing October 1, 2011, that will reduce the annual market basket increases by approximately 1%, representing a reduction in Medicare funding of US\$14.6 billion over a 10-year period. We anticipate that the annual impact from this Medicare reduction in rates to be approximately US\$5 million per annum;
- (ii) The extension of the therapy caps exemption process until December 31, 2011. We estimate, before taking preventative measures to bill privately or to reduce associated costs for these services, that this has preserved an estimated US\$12 million in Part B therapy revenue;
- (iii) New transparency requirements and additional employee background check requirements for nursing centers;
- (iv) The creation of a new Independent Medicare Payment Advisory Board that will make recommendations to U.S. Congress on Medicare payment rates on health care providers, including skilled nursing centers; and
- (v) A mandate for CMS to create a national, voluntary pilot bundling payment program by 2013.

The additional following provisions were included in the final act:

- (i) language that requires MedPAC to take Medicaid into consideration during its analyses for providers including skilled nursing and home health;
- (ii) a federal mandate for states to expand home and community based services with increased FMAP to states that rebalance spending between institutional and community based care by October 1, 2015;
- (iii) DHHS must submit a Medicare value-based purchasing plan for skilled nursing centers by October 1, 2011; and
- (iv) as of July 1, 2011, Medicaid will no longer provide payments to states for services related to health care acquired conditions, including conditions acquired in other than hospital settings.

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

to pre-existing health conditions, and coverage of dependent children on a parent's health insurance coverage up to the age of 26, took effect with the first annual renewal after six months from passage of the legislation (January 1, 2011, for EHSI).

EHSI currently offers health care coverage to all of its employees under several different programs tailored to meet an individual's budget and risk tolerance. Approximately 65% of EHSI employees have joined one of EHSI's programs. While it is difficult to quantify the financial impact of the new requirements commencing in 2011, we believe that the mitigation strategies and options provided to our employees will result in no material increase (beyond modest inflationary adjustments) in the cost of providing employee health care coverage in 2011. The legislation has additional requirements slated for 2014. It remains uncertain whether EHSI's coverage will meet the proposed minimum requirements and whether incremental costs will be incurred to meet the proposed standards. We are not able to estimate the impact at this time for a number of reasons. There have been a number of proposed changes to the legislation along with constitutional challenges on the legality of the health care reform act itself. We anticipate that modifications to the legislation will continue to be made before its final implementation in 2014.

On March 31, 2011, CMS outlined in detail proposed new rules on the establishment, rules and regulations pertaining to Accountable Care Organizations (ACOs). The primary purpose of the establishment of ACOs is to help doctors, hospitals, and other health care providers better coordinate care for Medicare patients and to provide a more cost effective and integrated health care system. ACOs create incentives for health care providers to work together to treat an individual patient across care settings – including doctor's offices, hospitals, and long-term care centers. The Medicare Shared Savings Program will reward ACOs that lower growth in health care costs while meeting performance standards on quality of care and putting patients first. Patient and provider participation in an ACO is purely voluntary. There will be a 60-day public comment period on this proposed rule. The role of skilled nursing care in this innovative program or impact on skilled care is not clearly defined at this time.

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

MEDICAID FUNDING

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

Annual Medicaid Rate Increases

With respect to the 12 states in which EHSI operates skilled nursing centers, annual Medicaid rate changes are effective on July 1st in eight of the states (Idaho, Indiana, Kentucky, Ohio, Oregon, Pennsylvania, Washington and Wisconsin); on October 1st in three of the states (Michigan, Minnesota and West Virginia); and January 1st in Delaware. Delaware rates have been frozen since April 2009, resulting in no increase in 2010 and 2011.

The July 1, 2011, Medicaid rates are known for Idaho, Kentucky, Ohio, Oregon, Pennsylvania and Washington. For these states, the July 1, 2011 rates, net of provider taxes, but including CMI changes, will increase by 1.3%, resulting in a US\$4.1 million increase in annual revenue. For the other two states (Indiana and Wisconsin) with changes effective July 1, 2011, we project that the average revenue rates, net of provider taxes, will increase by 1.4%, resulting in a US\$1.5 million increase in annual revenue. However, the final outcomes for these two states could differ from our estimates.

The final rates are not known for the three states (Michigan, Minnesota and West Virginia) with annual Medicaid rate changes effective October 1st. We estimate that the revenue rates for these states will decrease on average by 1.4%, resulting in a US\$1.7 million reduction in our annual revenue. However, the final outcomes for these three states could differ from our estimates.

Based on the above known and estimated projections, the 2011 Medicaid rate changes (net of provider taxes, but including CMI), as of the respective dates for all 12 states in which EHSI operates, are projected to increase by 0.7% compared to an increase of 0.4%, in 2010, representing annual revenue to EHSI of US\$3.9 million and US\$2.1 million, respectively.

Expiration of FMAP Funding

On February 17, 2009, U.S. President Obama signed the *American Recovery and Reinvestment Act of 2009* (the "Recovery Act") with a total estimated cost of US\$787 billion. The Recovery Act specifies that 64% of the package will be allocated for social programs and spending. Of the amounts earmarked for social programs, US\$86.7 billion was allocated to a temporary increase in the FMAP. The FMAP is the percentage that the U.S. 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 provided 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. In early August 2010, the U.S. Congress extended the FMAP funding to June 30, 2011, though on a phased-down basis for most but not all states. Additional FMAP funding will not be further extended beyond June 2011.

Canada

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

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

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

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

Ontario is ECI's largest market for both its long-term care and home health care services. Currently, funding for Ontario long-term care centers is based on reimbursement for the level of care assessed to be required by the residents. The provincial government allocates funds through "funding envelopes", specifically: nursing and personal care, programs and support services, food and accommodation. Providers may retain excess funding over costs incurred only with respect to the accommodation envelope, while funding for the other envelopes, otherwise referred to as "flow-through envelopes", is returned to the extent costs incurred are less than the funding provided. The province sets the rates for standard accommodation, as well as the maximum amounts that a provider can charge for semi-private and private accommodation. The accommodation rates are substantially paid for by the resident; however, the province guarantees funding for standard

accommodation through resident subsidies. Overall funding is occupancy-based, but once the average occupancy level of 97% or higher is achieved, operators in Ontario receive 100% funding. If the average occupancy drops below 97%, but remains above 85%, the center is funded based on actual occupancy plus 3%, and if it falls below 85%, then funding is based on actual occupancy. Prior to 2011, if the average occupancy level fell below 97%, then funding was based on the actual occupancy level.

ONTARIO LONG-TERM CARE LEGISLATION

Ontario Redevelopment Program

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

ECI has 23 "Class C" nursing centers (3,572 beds) that are required to be redeveloped. The first round of submissions for approval under the redevelopment plan began in July 2009, and the next round was expected to take place in mid-2011. There has been no announcement on the timing of the second round of submissions. Under the first phase of the redevelopment program, ECI received approval to redevelop 287 of its class "C" beds and is reviewing its remaining buildings to determine the priorities for redevelopment over the next four phases. Should ECI decide to replace all of its current centers, it estimates that the total capital outlay is approximately \$400 million to \$500 million, depending on a number of factors including construction costs. ECI may choose not to replace certain of its centers and in other cases, form strategic partnerships together with other providers for the replacement of their centers. Approximately 20% to 25% of the total cost will be required to be funded by equity.

ONTARIO LONG-TERM CARE FUNDING

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

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

The Ontario government's budget for 2011 released on March 29, 2011 (the "2011 Ontario Budget"), included a 3% annual funding increase to the long-term care flow-through envelopes for the next three years on April 1st, to assist providers in offsetting costs required to meet the ministry standards in nursing and programming. This 3% increase in the flow-through envelopes was estimated to represent annual revenue to ECI of approximately \$4.9 million. This year the government also provided increased flow-through funding to hire personal support workers and enhance staff training. In addition, each April 1st, Ontario long-term care providers receive CMI funding adjustments based on the provincial resident classification results of the previous year, which resulted in a funding decrease in 2011 for ECI. The funding improvements, coupled with our CMI adjustments, were estimated to increase ECI's annual revenue in the flow-through envelopes by approximately \$3.6 million, and were offset by additional costs for resident care and services. In addition to the funding changes in the flow-through envelopes, the Ontario government provided a 1.2% increase (\$0.58) in

accommodation funding effective April 1, 2011, to address costs associated with the new regulation requirements and enhance staff training, which was estimated to provide ECI with annual revenue of approximately \$1.1 million.

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

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

ALBERTA LONG-TERM CARE LEGISLATION AND FUNDING

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

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

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

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

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

ONTARIO HOME HEALTH CARE LEGISLATION AND FUNDING

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

The 2011 Ontario Budget included a 3% funding increase for home health care. However, it is uncertain how the additional funding are being utilized by the Community Care Access Centres (CCACs) and consequently how it may impact home health care providers, such as ParaMed.

The home health care competitive bidding process in Ontario was frozen in 2004 as a result of a government study intended to improve the procurement model. Consequently, contracts that were due to expire are being extended until the bidding process resumes, with a focus on strengthening accountability and ensuring fairness and transparency. ParaMed

had recommended the use of a public reporting system similar to the long-term care industry. The government is in the process of developing performance measures and has indicated its intention of publicly reporting them. There has been no indication from the government of when or if the bidding process will resume.

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

The *Employment Standards Amendment Act (Temporary Help Agencies), 2009* (the "ESAA"), came into effect in November 2009. The ESAA establishes, among other things, that temporary employees are covered by the *Employment Standards Act, 2000*, thereby providing them with entitlements to severance and notice of termination. Currently, the ESAA does not apply to elect-to-work employees of agencies, such as ParaMed, providing services pursuant to contracts with the CCACs. However, we have been informed that it is the government's intent to revoke this exemption on October 1, 2012. Through the Ontario Home Care Association, we will be making submissions that support keeping these exemptions. The current impact of the ESAA on ParaMed's contracts to parties other than the CCACs is minimal and it is too early to determine what impact it may have on our operations in 2012.

LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash

At September 30, 2011, the REIT had cash and cash equivalents of \$314.3 million compared with \$267.8 million at December 31, 2010, representing an increase of \$46.5 million, largely due to cash from operations and the issuance of HUD-insured mortgages in connection with the completion of the first phase of our U.S. debt refinancing. A cash pledge of \$10.6 million (US\$10.2 million) as collateral against a letter of credit is excluded from our available cash balance.

	Three months ended		Nine months ended		Year
	September 30		September 30		
	2011	2010	2011	2010	2010
<i>(thousands of dollars unless otherwise noted)</i>					
Cash provided by operating activities, before working capital changes and interest and income taxes	62,629	62,227	188,686	190,918	257,741
Net change in operating assets and liabilities					
Accounts receivable	(501)	(217)	8,144	1,941	(10,588)
Other current assets	(699)	626	(6,319)	(2,024)	1,691
Accounts payable and accrued liabilities	138	(38)	(15,785)	(17,181)	(8,477)
	(1,062)	371	(13,960)	(17,264)	(17,374)
Interest and taxes paid					
Interest paid	(17,956)	(18,135)	(61,063)	(61,021)	(85,797)
Interest received	1,824	573	3,651	3,574	4,214
Income taxes paid	(3,734)	(332)	(18,727)	(4,450)	(13,391)
	(19,866)	(17,894)	(76,139)	(61,897)	(94,974)
Cash provided by operating activities	41,701	44,704	98,587	111,757	145,393
Cash used in investing activities	(18,520)	(5,522)	(47,044)	(28,995)	(41,017)
Cash provided by (used in) financing activities	(86,318)	(20,008)	(62,573)	52,733	36,139
Foreign exchange gain (loss) on U.S. cash held	14,418	(3,963)	8,864	(1,754)	(6,768)
Increase (decrease) in cash and cash equivalents	(48,719)	15,211	(2,166)	133,741	133,747
Cash and cash equivalents at beginning of period	314,312	252,542	267,759	134,012	134,012
Cash and cash equivalents at end of period	265,593	267,753	265,593	267,753	267,759
Average U.S./Canadian dollar exchange rate	0.9807	1.0391	0.9781	1.0356	1.0299

Cash provided by operating activities was \$98.6 million in the first nine months of 2011 compared to \$111.8 million in the same period of 2010, representing a decline of \$13.2 million. This decline was primarily due to the increase in income taxes paid of \$14.3 million between periods. The lower amount in the first nine months of 2010 was due to taxes recoverable from the 2009 taxation year that reduced the amounts paid during 2010.

Cash used in investing activities was \$47.0 million in the first nine months of 2011 compared to \$29.0 million in the same 2010 period and primarily reflected expenditures for property, equipment and software, the acquisition of a previously leased skilled nursing center for \$7.3 million, partially offset by proceeds from dispositions. During the first nine months of 2011, net proceeds of \$4.8 million were realized on the disposal of a skilled nursing center in Michigan and a closed nursing center in Alberta, compared to net proceeds of \$21.0 million on the disposal of assets in the same 2010 period.

Purchases of property, equipment and software were \$43.2 million in the first nine months of 2011 compared to \$50.1 million in the same 2010 period. The following table summarizes the components of these expenditures.

	Three months ended		Nine months ended		Year
	September 30		September 30		
<i>(thousands of dollars unless otherwise noted)</i>	2011	2010	2011	2010	2010
Purchase of Property, Equipment and Software					
Growth expenditures	9,263	14,057	22,962	32,574	39,991
Facility maintenance	9,072	8,539	20,882	18,298	29,962
Deduct: capitalized interest	(379)	(220)	(613)	(726)	(1,262)
	17,956	22,376	43,231	50,146	68,691
Average U.S./Canadian dollar exchange rate	0.9807	1.0391	0.9781	1.0356	1.0299

Growth capital expenditures, excluding acquisitions, were \$23.0 million in the first nine months of 2011 compared to \$32.6 million in the same 2010 period, and related to the construction of new beds, building improvements or capital costs aimed at earnings growth. Maintenance capital expenditures, which are the capital costs to sustain and upgrade existing property and equipment assets, were \$20.9 million in the first nine months of 2011 compared to \$18.3 million in the same 2010 period, representing 1.3% and 1.2% of revenue, respectively. These costs fluctuate on a quarterly basis with the timing of projects and seasonality. It is our intention to spend between 1.5% and 2.0% of revenue annually on maintenance capital expenditures, which is consistent with our objective to maintain and upgrade our centers. We are projecting to spend up to approximately \$35 million in facility maintenance capital expenditures and \$32 million in growth capital expenditures in 2011.

Cash provided by (used in) financing activities was \$62.6 million used in the first nine months of 2011 compared to \$52.7 million provided in the same 2010 period. Financing activities for the first nine months of 2011 primarily reflected distribution payments of \$44.6 million, and the early retirement of debt, partially offset by the issuance of HUD-insured mortgages in connection with the refinancing of our U.S. debt. Financing activities in the first nine months of 2010 primarily reflected net cash proceeds of \$82.2 million, before income taxes, from the REIT Unit equity offering in February, the issuance of long-term debt on refinancing of existing debt, and draws on construction financing, partially offset by distribution payments of \$44.9 million on REIT Units and scheduled debt repayments. For information on the change in long-term debt, refer to "Liquidity and Capital Resources – Long-term Debt".

Reconciliation of Cash Provided by Operating Activities to DI and AFFO

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

	Q1		Q2		Q3		Nine months ended September 30		Q4	Year
	2011	2010	2011	2010	2011	2010	2011	2010	2010	2010
<i>(millions of dollars)</i>										
Cash provided by operating activities	28.9	25.6	28.0	41.5	41.7	44.7	98.6	111.8	33.6	145.4
Add (Deduct):										
Net change in operating assets and liabilities, including interest and taxes	(3.3)	4.8	9.3	(6.6)	(6.4)	(14.7)	(0.4)	(16.5)	10.9	(5.6)
Current tax on fair value adjustments, gain/loss on foreign exchange, financial instruments, asset impairment, disposals and other items	–	–	0.5	–	(0.8)	4.2	(0.3)	4.2	0.4	4.6
Net provisions and payments for self-insured liabilities	3.6	(2.4)	(4.7)	4.6	(22.1)	(11.1)	(23.2)	(8.9)	0.6	(8.3)
Exchangeable LP Unit distributions	0.7	0.7	0.6	0.7	0.7	0.6	2.0	2.0	0.7	2.7
Depreciation for FFEC	(5.9)	(5.5)	(5.6)	(5.6)	(5.8)	(5.7)	(17.3)	(16.8)	(5.7)	(22.5)
Principal portion of government capital funding payments	0.6	0.6	0.7	0.6	0.7	0.6	2.0	1.8	0.6	2.4
Other	(0.2)	–	–	–	(0.2)	(0.1)	(0.4)	(0.1)	(0.4)	(0.5)
DI	24.4	23.8	28.8	35.2	7.8	18.5	61.0	77.5	40.7	118.2
Additional facility maintenance capital expenditures ⁽²⁾	1.2	0.9	(1.5)	0.4	(3.3)	(2.8)	(3.6)	(1.5)	(6.0)	(7.5)
AFFO	25.6	24.7	27.3	35.6	4.5	15.7	57.4	76.0	34.7	110.7

⁽¹⁾ “DI” and “AFFO” are not recognized measures under GAAP and do not have a standardized meaning prescribed by GAAP. Refer to the discussion of non-GAAP measures.

⁽²⁾ Represents total facility maintenance capital expenditures less depreciation for furniture, fixtures, equipment and computers (FFEC) already deducted in determining DI.

Capital Structure

	Nine months ended September 30, 2011	Year 2010
<i>(millions of dollars unless otherwise noted)</i>		
Unitholders' Equity		
REIT Units	427.4	421.2
Contributed surplus	0.1	0.1
	427.5	421.3
Accumulated deficit at beginning of period	(287.5)	(262.1)
Net earnings (loss) for the period	(12.5)	41.8
Other/adjustment to prior year distribution of ALC	(0.1)	(1.1)
Distributions declared on REIT Units	(50.5)	(66.1)
Accumulated deficit at end of period	(350.6)	(287.5)
Accumulated other comprehensive loss	(11.6)	(20.8)
Unitholders' equity	65.3	113.0
U.S./Canadian dollar exchange rate <i>(at period end)</i>	1.0482	0.9946

Unit Information (<i>thousands</i>)	Oct. 31, 2011	Sept. 30, 2011	Dec. 31, 2010
REIT Units (TSX symbol: EXE.UN) ⁽¹⁾	80,695.2	80,543.9	79,831.5
Exchangeable LP Units	3,090.1	3,090.4	3,163.7
	83,785.3	83,634.3	82,995.2

⁽¹⁾ Closing market value per the TSX on October 31, 2011, was \$7.46.

The closing rates used to translate assets and liabilities of the U.S. operations were 1.0482 at September 30, 2011, and 0.9946 at December 31, 2010. As a result of the weaker Canadian dollar at September 30, 2011, the assets of the REIT's U.S. operations increased by approximately \$74.5 million, partially offset by an increase in the liabilities of approximately \$62.9 million, with the net change in foreign currency translation of \$11.6 million included in accumulated other comprehensive loss. Every one cent increase (decrease) in the Canadian dollar against the U.S. dollar would impact the net assets of our U.S. operations by approximately \$2.2 million, and would be reflected as a change in foreign currency translation adjustments in accumulated other comprehensive loss.

DISTRIBUTIONS

In the first nine months of 2011, we generated DI of \$61.0 million and AFFO of \$57.4 million and declared monthly distributions of \$0.07 per unit, totalling \$50.5 million, to holders of REIT Units and \$2.0 million to holders of Exchangeable LP Units, for a combined total of \$52.5 million that were paid out from February 15, 2011 to October 17, 2011. The portion paid in cash was \$46.1 million and \$6.3 million was by way of issued units under a distribution reinvestment plan. A total of 638,417 units (636,662 REIT Units and 1,755 Exchangeable LP Units) were issued during the first nine months of 2011 through the distribution reinvestment plan.

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

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

Our current policy is to pay distributions of \$0.07 per REIT Unit to the holders thereof on a monthly basis. As was the case in 2010, we estimate that approximately 70% of our 2011 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 Board determines that it would be in the REIT's best interests, it may reduce, for any period, the percentage of Distributable Income to be distributed to holders of REIT Units.

NORMAL COURSE ISSUER BID

In January 2011, the REIT received the approval of the TSX for its normal course issuer bid (the "2011 Bid"), to purchase for cancellation up to 7.8 million REIT Units, \$11.4 million aggregate principal amount of its convertible unsecured debentures due in June 2014 (the "2014 Debentures"), and \$9.2 million aggregate principal amount of its convertible unsecured debentures due in June 2013 (the "2013 Debentures"), representing in each case approximately 10% of the public float of the outstanding securities at December 31, 2010. The 2011 Bid provides the REIT with flexibility to repurchase securities for cancellation until January 10, 2012, when the market prices of such securities do not fully reflect their underlying value. To date, the REIT has not purchased any securities under the 2011 Bid.

LONG-TERM DEBT

Long-term debt, including current portion, was \$1,267.9 million at September 30, 2011, and was net of \$22.0 million of financing costs. The current portion of long-term debt of \$378.8 million at the end of September 30, 2011, included the May 2012 CMBS Financing of US\$289.6 million and the March 2012 CMBS Financing of US\$21.0 million. Management is in the process of refinancing this debt as discussed in further detail under the heading "Overview – Significant 2011 Events and Developments – 2011 Refinancing Plan". Details of the components, terms and conditions of long-term debt are provided in *note 8* of the unaudited interim condensed consolidated financial statements for the nine months ended September 30, 2011. The REIT and its subsidiaries are in compliance with all of their respective financial covenants as at September 30, 2011.

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

Continuity of Long-term Debt (millions of dollars)	Nine months ended September 30, 2011	Year 2010
Long-term debt at beginning of year, prior to financing costs	1,255.9	1,261.8
Issue of long-term debt		
Mortgages (net of conversion of construction loans)	274.0	23.5
PrivateBank Loans	9.8	25.7
Construction loans	11.0	16.1
Notes payable	0.1	3.3
Net issue (repayment) on the EHSI Credit Facility	12.7	(6.8)
Increase in capital lease obligations, other than annual repayments ⁽¹⁾	–	12.8
Repayment of long-term debt	(323.2)	(46.3)
Revaluation of convertible debentures carried at fair value	(10.2)	6.2
Change due to period-end foreign exchange rate	37.8	(40.4)
	1,267.9	1,255.9
Financing costs at end of period	(22.0)	(14.7)
Long-term debt at end of period	1,245.9	1,241.2
Less: current portion	(378.8)	(571.2)
	867.1	670.0

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

Credit Rating

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

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

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

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

Interest Rates and Aggregate Debt Maturities

In order to meet the REIT's monthly distributions, management has limited the amount of debt that may be subject to changes in interest rates. As a result, all but \$78.3 million of our long-term debt outstanding at September 30, 2011, excluding financing costs and equity allocation, was at fixed rates. The variable-rate debt related to the US\$29.9 million drawn on EHSI's Credit Facility, the US\$34.6 million drawn on the PrivateBank Loans and the \$10.7 million drawn on the Edmonton construction loan.

The weighted average interest rate of our long-term debt was approximately 6.1% at September 30, 2011 (6.6% at December 31, 2010). The weighted average interest rate of our long-term debt at September 30, 2011, for our Canadian and U.S. operations was 6.6% and 5.8%, respectively.

The weighted average term to maturity of our long-term debt, including capital lease obligations, was 11 years as at September 30, 2011 (6.5 years for our Canadian operations and 14.2 years for our U.S. operations), compared to 4.1 years at December 31, 2010. Excluding our capital lease obligations, the weighted average term to maturity of our long-term debt was 10.6 years (3.8 years for our Canadian operations and 14.3 years for our U.S. operations).

The weighted average interest rate of our debt has declined and the weighted average term to maturity has increased as a result of the issuance during the first nine months of 2011 of US\$280.2 million of HUD-insured mortgages, with a weighted average term of about 32 years.

Debt to Adjusted Gross Book Value (AGBV)

Extendicare REIT's financial position continues to be strong, with long-term debt (at face value and including current portion) representing 43.1% of AGBV at September 30, 2011, and excluding the convertible debentures, debt to AGBV was 36.2%.

AGBV is defined in the REIT's Deed of Trust as amended in December 2010 to give consideration to the adoption of IFRS and its impact on the gross carrying value of the assets. In general, AGBV is determined by taking total reported assets at a period in time, adding back accumulated depreciation and amortization, making a one-time adjustment for incremental value of the assets at the effective date of the Arrangement, and deducting an amount equal to the net increase in the gross carrying value of the assets as at January 1, 2010, resulting from the adoption of IFRS. Upon completion of our asset revaluation exercise, the net book value of our assets as at January 1, 2010, increased by \$305.3 million. This was comprised of an increase in property and equipment (including assets held for sale) of \$381.1 million, partially offset by a write down in the carrying value of goodwill of \$75.8 million. In arriving at the net increase in property and equipment, previously recognized accumulated depreciation of \$307.5 million was eliminated to reinstate the net book carrying value of the assets. As a result, the net change in the gross carrying value of the assets was a net decline of \$2.2 million. Therefore, there is no adjustment required to the determination of our AGBV as a result of the adoption of IFRS.

The calculations as at September 30, 2011, and December 31, 2010, are indicated in the following table.

<i>(millions of dollars unless otherwise noted)</i>	Sept. 30, 2011	Dec. 31, 2010
Long-term Debt ⁽¹⁾		
Debt	1,064.3	1,042.2
Convertible debentures (face value)	205.7	205.7
	1,270.0	1,247.9
AGBV		
Total assets	1,965.5	1,979.6
Accumulated depreciation and amortization	302.9	247.7
Incremental value established at inception of the REIT	675.0	675.0
Adjustment to gross book value of assets on adoption of IFRS	—	—
	2,943.4	2,902.3
Long-term Debt to AGBV		
Excluding convertible debentures	36.2%	35.9%
Including convertible debentures	43.1%	43.0%

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

PROVISION FOR SELF-INSURED LIABILITIES

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

At September 30, 2011, the accrual for self-insured general and professional liabilities was \$74.6 million compared to \$46.5 million at the beginning of the year, an increase of \$28.1 million. The current period provision, net of claims payments, increased the accrual by \$23.2 million, with the balance of the increase primarily due to the weaker Canadian dollar.

Provisions recorded in the first nine months of 2011 and 2010 for potential general and professional liability claims were \$49.2 million and \$26.3 million, respectively. Payments for self-insured liabilities were \$26.0 million in the 2011 third quarter and \$18.0 million in the 2010 third quarter.

The results of the 2011 third quarter independent actuarial review necessitated the strengthening of our prior years' reserves this quarter by \$31.4 million (US\$32.1 million). This additional reserve was necessary as a result of higher than anticipated paid settlement amounts predominantly relating to claims for the years prior to 2009, increases for settlements on known and unknown claims and adverse claim developments in recent months.

In the 2010 third quarter, following the completion of the third quarter interim independent actuarial review of our resident care liabilities, we strengthened the level of our reserves for prior years' claims by \$14.0 million (US\$13.5 million), to a level which we believed was adequate at that time. Similarly in the 2009 and 2008 third quarters, following the completion of the interim actuarial review, we increased our reserves for prior years' claims by US\$3.2 million and US\$5.5 million, respectively.

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

Most of the risks that Extendicare self-insures are long-term in nature and accordingly, claims payments for any particular policy year occur over a long period of time. However, management estimates and allocates a current portion of the accrual for self-insured liabilities on the statement of financial position. As at September 30, 2011, management estimated that \$25.2 million of the accrual for self-insured general and professional liabilities will be paid within the next year. The timing of payments is not directly within management's control and therefore, estimates could change in the future.

We invest funds to support the accrual for self-insured liabilities. These funds are reported in other assets and totalled \$48.9 million at September 30, 2011, compared to \$60.9 million at December 31, 2010. Subsequent to September 30, 2011, we injected US\$30.0 million of cash into our captive insurance company to cover the estimated impact of incremental liability claims. Management believes there are sufficient cash resources to meet estimated current claims payment obligations.

SPECIFIED CONTINGENT CLAIMS AGAINST CROWN LIFE

Under the June 2007 Crown Life share sale agreement with The Canada Life Assurance Company (Canada Life), Extencicare was responsible for specified contingent claims against Crown Life, and had accrued provisions for potential settlements (December 31, 2011 – \$13.9 million), which were secured by letters of credit. Settlement on the remaining claims was reached during first nine months of 2011, resulting in the release of excess provisions of \$0.4 million in the 2011 second quarter and \$1.9 million in the 2011 third quarter, and the elimination of the letters of credit.

CONTRACTUAL OBLIGATIONS

The table below provides summary information about the contractual obligations as at September 30, 2011. Due to the uncertainty as to the timing of payments to be made with respect to certain obligations, the table excludes our self-insured liabilities and decommissioning provisions, totalling \$74.6 million and \$26.3 million, respectively, as at September 30, 2011, and also excludes our defined benefit pension plan obligations, which are described more fully below.

<i>(millions of dollars)</i>	Total	To the end of 2011	2012	2013	2014	2015	After 2015
REIT convertible debentures (face value)	205.7	–	–	91.8	113.9	–	–
Canadian Subsidiary Operations							
Long-term debts	204.7	2.2	10.0	105.5	9.1	2.8	75.1
Capital lease obligations	115.7	1.0	4.2	4.5	4.9	5.2	95.9
Operating lease obligations	9.3	0.6	1.8	1.5	1.4	1.1	2.9
Purchase obligations	1.3	0.3	1.0	–	–	–	–
United States Subsidiary Operations ⁽¹⁾							
Long-term debts	728.3	11.5	362.8	45.9	6.4	6.7	295.0
Capital lease obligations	15.7	0.2	0.7	0.7	0.7	0.3	13.1
Operating lease obligations	34.6	1.6	5.8	4.4	3.9	3.6	15.3
Purchase obligations	7.9	7.9	–	–	–	–	–

⁽¹⁾ Obligations denominated in U.S. dollars are translated to Canadian dollars at a rate of 1.0482

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

Defined Benefit Pension Plan Obligations

The contractual obligations table excludes our defined benefit pension plan obligations, none of which had funding requirements as at September 30, 2011. The accrued benefit liability on our balance sheet as at September 30, 2011, was \$34.7 million (December 31, 2010 – \$31.3 million). We currently have defined benefit registered and supplementary plans covering certain executives, both of which have been closed to new entrants since 2000. The registered defined benefit plan was fully funded with plan assets of \$5.6 million and accrued benefit obligations of \$7.4 million as at September 30, 2011 (December 31, 2010 – \$6.3 million and \$6.8 million, respectively). The accrued benefit obligations of the supplementary plan were \$32.9 million as at September 30, 2011 (December 31, 2010 – \$30.9 million). We do not set aside assets in connection with the supplementary plan and the benefit payments will be paid from cash from operations. The benefit obligations under the supplementary plan are secured by letters of credit totalling \$40.0 million as at September 30, 2011 (December 31, 2010 – \$41.0 million). The expected annual benefit payments under the supplementary pension plan that will be funded from cash from operations over the next five years range between \$2.0 million and \$2.2 million. Since the majority of our accrued benefit obligations represent our obligation under our non-registered supplementary plan, which is not required to be funded, the recent capital market turmoil is not expected to have a material adverse effect on our cash flow requirements with respect to our pension obligations, or our pension expense.

Future Liquidity and Capital Resources

As discussed in more detail under the heading "Overview – 2011 Refinancing Plan", Extencare REIT is in the process of refinancing approximately US\$636 million of its U.S. long-term debt. Management anticipates refinancing this debt with approximately US\$559 million of HUD-insured mortgages and US\$77 million of cash on hand. As at November 8, 2011, we have closed on 39 HUD loans totalling US\$308.6 million and have commitments for a further nine HUD loans totalling US\$51.7 million that are anticipated to close in November 2011. Collectively, the weighted average interest rate of the closed and committed loans is 4.51%, with an average term to maturity of about 33 years. We anticipate obtaining the majority of the remaining 31 HUD commitments before the end of January 2012 to enable the final pay-down of the May 2012 CMBS Financing in the first quarter of 2012. Assuming EHSI is able to secure an average interest rate of 4.5%, inclusive of associated fees and reduce its debt by US\$77 million, its interest costs will decline by an estimated US\$18 million per annum. Upon completion of the refinancing, EHSI will have an additional 45 unencumbered centers with an approximate value of over US\$250 million.

We recognize the risks associated with the refinancing of the 2011/2012 debt. Some of the risks concern the timing of the commitments to be received and the closing dates of the HUD loans. Therefore, we have taken the appropriate steps to mitigate these risks. In May 2011, EHSI signed the Loan Modification Agreement, which includes a six-month extension of the maturity of its May 2012 CMBS Financing to facilitate the timing of its refinancing process without any prepayment yield maintenance payment.

At the present time, management cannot provide full assurance that it will succeed in refinancing all of the debt through HUD prior to its maturity. As an alternative to HUD financing, EHSI believes that it can secure a bank term loan, if necessary. As such, EHSI believes that it has the capability to complete the refinancing as planned. Management continues to closely monitor the progress of the refinancing and the financial markets.

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

As at September 30, 2011, EHSI had cash on hand of US\$163.3 million and US\$37.5 million available under the EHSI Credit Facility. Our Canadian operations had cash on hand of \$93.8 million and available bank lines of \$29.5 million at the end of September 2011. Cash of approximately US\$172 million was utilized to prepay CMBS debt in October in preparation for the closing on HUD loans, and US\$30 million was injected into our captive insurance company to cover the estimated impact of incremental liability claims.

In Canada, the majority of our mortgages are CMHC backed, with no significant maturities until 2013.

We are currently projected to spend up to approximately \$35 million in facility maintenance capital expenditures and approximately \$32 million in growth capital expenditures in 2011, although discretionary capital expenditures will be reviewed in light of the recently announced U.S. funding cuts. As at September 30, 2011, EHSI had outstanding capital expenditure commitments of US\$7.5 million, and ECI had outstanding capital expenditure commitments of \$1.3 million related to its construction projects.

RELATED PARTY TRANSACTIONS

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

centers and operates under lease arrangements two long-term care centers that are owned or partially owned by members of Mr. Lukenda's immediate family.

In connection with the purchase of Tendercare, the acquired working capital is subject to annual adjustments that will occur 90 days after the anniversary date of the Tendercare acquisition over a four-year period until January 2012. The first anniversary adjustment increased net working capital by US\$1.7 million and was paid by EHSI in April 2009 with no impact on the consolidated statement of earnings. The second and third anniversary adjustments increased net working capital by US\$0.2 million and US\$0.3 million, respectively. The second anniversary adjustment included a US\$3.1 million adjustment for accrued vacation pay sought by EHSI. In March 2010, the sellers of Tendercare (the "Tendercare Sellers Committee") filed a notice of disagreement, stating that the adjustment for accrued vacation pay was not a permitted adjustment. In April 2010, EHSI submitted a written response stating that its position is in accordance with GAAP and the terms of the agreement. In July 2010, the Tendercare Sellers Committee filed an action for declaratory relief in Michigan state court. In August 2010, EHSI filed a motion to dismiss or stay this action pending arbitration. In June 2011, the court issued its opinion staying the action pending arbitration. EHSI and the Tendercare Sellers Committee have jointly selected an accounting firm to serve as arbitrator to decide this issue, with a decision anticipated in February 2012. EHSI has recorded a receivable of US\$3.1 million from Tendercare with respect to this issue.

In addition, in connection with the acquisition of LTC Professional in 2008, Tendercare's affiliated insurance company, consideration for the acquisition is to be adjusted annually based upon the actuarial liabilities determined at December 31st of each year through to 2012, with an option to extend it annually to 2015. In 2011, ECI made a settlement payment of US\$1.6 million (2010 – US\$1.5 million).

OFF-BALANCE SHEET ARRANGEMENTS

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

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

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

References to "net operating income" in this document are to revenue less direct operating expenses. References to "EBITDA" in this document are to earnings from operations before interest, income taxes, depreciation, amortization, and accretion. In addition, in determining EBITDA, the REIT has excluded the line items: "distributions on Exchangeable LP Units", "fair value adjustments", "loss (gain) on foreign exchange and financial instruments", and "loss (gain) from asset impairment, disposals and other items". These line items are reported separately because they relate to the change in the fair value of, or gains and losses on termination of, convertible debentures, Exchangeable LP Units, interest rate agreements and FCFCs, as well as gains or losses on the disposal or impairment of assets, and foreign exchange gains or

losses on capital items. In addition, in previous years these line items have included provisions for restructuring charges and the write-off of unamortized financing costs on early retirement of debt. These items are reported separately and excluded from EBITDA, because they are transitional in nature and would otherwise distort historical trends. Management believes that certain lenders, investors and analysts use EBITDA to measure a company's ability to service debt and meet other payment obligations, and as a common valuation measurement in the long-term care industry. For example, certain of EHSI's debt covenants use EBITDA in their calculations. EBITDA is presented by the REIT on a consistent basis from period to period, thereby allowing for consistent comparability of its operating performance.

The 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 "earnings before separately reported gains/losses and distributions on Exchangeable LP Units". This is a measure commonly used by the REIT and its investors as a means of assessing the performance of the core operations in comparison to prior periods.

Distributable Income, or "DI", is defined by 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 DI further reduced by facility maintenance (non-growth) capital expenditures not already reflected in the calculation of DI.

Critical Accounting Policies and Estimates

A full discussion of the REIT's critical accounting policies and estimates were provided in the MD&A and the accompanying notes to the audited consolidated financial statement for the year ended December 31, 2010, contained in the REIT's 2010 Annual Report. With the adoption of IFRS on January 1, 2011, the critical accounting policies and estimates have been updated to conform to this adoption. Readers should refer to notes 2, 3 and 17 to our unaudited interim condensed consolidated financial statements for the nine months ended September 30, 2011, for a description and detailed discussion regarding the application of critical accounting estimates and judgements, significant accounting policies and an explanation of the transition to IFRS.

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

New Accounting Policies Adopted

INTERNATIONAL FINANCIAL REPORTING STANDARDS

We have adopted IFRS commencing January 1, 2011, as required by the Accounting Standards Board of the Canadian Institute of Chartered Accountants. A detailed explanation of the impact of transition to IFRS is provided in *note 17* of the unaudited interim condensed consolidated financial statements for the three and nine months ended September 30, 2011. Note 17 includes our elections under IFRS 1 "First-time Adoption of International Financial Reporting Standards", as well as a reconciliations of our statement of financial position and equity from previous Canadian GAAP to IFRS as at September 30, 2010, and reconciliations of our total comprehensive income for the three and nine months ended September 30, 2010.

Impact of IFRS Adoption on Key Performance Metrics

Adjusted Funds from Operations

AFFO did not change significantly under IFRS.

Earnings per Unit (EPU)

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

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

Impact of IFRS Adoption on the Financial Statements

Please refer to *note 17* of the unaudited interim condensed consolidated financial statements for the three and nine months ended September 30, 2011, for a complete summary of the difference and reconciliation between previous Canadian GAAP and IFRS.

Future Change in Accounting Policies

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

Financial Instruments – Disclosures: On October 7, 2010, the International Accounting Standards Board (IASB) issued amendments to IFRS 7 "Financial Instruments: Disclosures", which increase the disclosure requirements for transactions involving transfers of financial assets. This amendment is effective for annual periods beginning on or after July 1, 2011. The REIT will apply the amendment as at January 1, 2012, and does not expect the implementation to have a significant impact on its disclosures.

Financial Instruments: The IASB has issued a new standard, IFRS 9 "Financial Instruments", which will ultimately replace IAS 39 "Financial Instruments: Recognition and Measurement"). The replacement of IAS 39 is a three-phase project with the objective of improving and simplifying the reporting for financial instruments. The issuance of IFRS 9 in November 2009 is the first phase of the project, which provides guidance on the classification and measurement of financial assets and financial liabilities. This standard was to become effective on January 1, 2013, however, on August 4, 2011, the IASB issued an exposure draft that proposes to defer the effective date by two years to January 1, 2015. The REIT is currently assessing the impact of the new standard on its financial statements.

Consolidated Financial Statements: The IASB has issued a new standard, IFRS 10 "Consolidated Financial Statements", which establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 supersedes IAS 27, "Consolidated and Separate Financial Statements" and SIC-12, "Consolidation – Special Purpose Entities", and is effective for annual periods beginning on or after January 1, 2013, with earlier adoption permitted. IFRS 10 provides guidance on the definition of control, which becomes the single basis for consolidation, irrespective of the nature of the investee. The REIT is reviewing the implications of adopting IFRS 10, and does not expect the new standard to have a significant impact on its financial statement presentation.

Disclosure of Interests in Other Entities: The IASB has issued another new standard, IFRS 12 "Disclosure of Interests in Other Entities", which applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. IFRS 12 integrates the disclosure requirements on interests in other entities, currently included in several standards, and also prescribes additional disclosure requirements. The REIT is reviewing the implications of adopting IFRS 10, and does not expect the new standard to have a significant impact on its financial statement presentation.

Presentation of Financial Statements – Other Comprehensive Income: On June 16, 2011, the IASB issued amendments to IAS 1 "Presentation of Financial Statements", which require entities preparing financial statements in accordance with IFRS to group together items within OCI that may be reclassified to the profit or loss section of the income statement and to separately group together items that will not be reclassified to the profit or loss section of the income statement. The amendments also reaffirm existing requirements that profit or loss and OCI should be presented as either a single statement or two consecutive statements. The amendments are effective for financial years commencing on or after July 1, 2012. The REIT is reviewing the implications of these revisions, and does not expect the amended standard to have a significant impact on its financial statement presentation.

Post-employment Benefits: On June 16, 2011 the IASB issued amendments to IAS 19 "Employee Benefits", in order to improve the accounting for pensions and other post-employment benefits. The amendments eliminated the option to defer the recognition of gains and losses, known as the "corridor method" or the "deferral and amortization approach" and instead, requiring re-measurements to be presented in OCI. It also enhances the disclosure requirements, providing better information about characteristics of defined benefit plans and the risks that entities are exposed to through participation in those plans. The amendments are effective for financial years beginning on or after January 1, 2013. Earlier application is permitted. The REIT is already presenting in OCI the re-measurements of the changes in assets and liabilities from defined benefit plans and, therefore, does not expect the amended standard to have a significant impact on its financial statement presentation.

Fair Value Measurement: In May 2011, the IASB issued IFRS 13 "Fair Value Measurement" which is a new standard that defines fair value. It sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements. This new standard is effective for the interim and annual consolidated financial statements commencing January 1, 2013. The REIT is assessing the impact of this new standard.

RISKS AND UNCERTAINTIES

There are certain risks inherent in an investment in and in the activities of Extencare REIT, which investors should carefully consider before investing in REIT Units. Risks and uncertainties are disclosed in the REIT's latest Annual Information Form and in the REIT's 2010 Annual Report. To the extent there have been any changes to those risks factors or uncertainties as of the date of this MD&A, they are discussed under the headings "Overview – Significant 2011 Events and Developments" and "Other Significant Developments".

Extencicare Real Estate Investment Trust
Interim Condensed Consolidated Statement of Financial Position
(unaudited)

<i>(in thousands of Canadian dollars)</i>	<i>notes</i>	September 30	December 31
		2011	2010
Assets			
Current assets			
Cash and short-term investments		265,593	267,759
Restricted cash		10,639	10,095
Accounts receivable		215,385	212,610
Income taxes recoverable		3,252	3,182
Other current assets		27,275	23,670
Total current assets		522,144	517,316
Non-current assets			
Property and equipment, including construction-in-progress of \$34,281 and \$17,470, respectively	5, 11	1,217,779	1,206,656
Goodwill and other intangible assets	11	90,986	110,272
Other assets	6	115,044	126,200
Deferred tax assets		19,554	19,190
Total non-current assets		1,443,363	1,462,318
Total Assets	16	1,965,507	1,979,634
Liabilities and Equity			
Current liabilities			
Accounts payable		35,689	36,167
Accrued liabilities		230,470	230,113
Income taxes payable		13,101	-
Current portion of long-term debt	8	378,862	571,168
Current portion of provisions	7	25,157	16,013
Exchangeable LP Units		21,757	29,264
Total current liabilities		705,036	882,725
Non-current liabilities			
Long-term debt	8	867,069	670,028
Provisions	7	75,720	60,383
Other long-term liabilities	9	49,195	44,155
Deferred tax liabilities		203,514	209,349
Total non-current liabilities		1,195,498	983,915
Total liabilities	16	1,900,534	1,866,640
Unit capital		427,389	421,213
Contributed surplus		81	81
Accumulated deficit		(350,545)	(287,525)
Accumulated other comprehensive loss		(11,952)	(20,775)
Unitholders' equity		64,973	112,994
Total Liabilities and Equity		1,965,507	1,979,634

See accompanying notes to unaudited condensed consolidated financial statements.

Subsequent events (note 8).

Contingencies and commitments (notes 8 and 13).

Extencicare Real Estate Investment Trust
Interim Condensed Consolidated Statement of Earnings (Loss)
(unaudited)

<i>(in thousands of Canadian dollars)</i>	<i>notes</i>	Three months ended		Nine months ended	
		September 30		September 30	
		2011	2010	2011	2010
Revenue					
Nursing and assisted living centers					
United States		342,401	347,774	1,016,470	1,052,308
Canada		132,634	123,046	389,055	364,589
Home health care - Canada		41,723	38,594	121,823	116,485
Health technology services - United States		4,945	4,365	14,154	12,650
Outpatient therapy - United States		3,471	2,610	10,253	9,304
Management, consulting and other services		6,490	7,493	19,468	22,565
Total revenue	16	531,664	523,882	1,571,223	1,577,901
Operating expenses	10	472,632	451,191	1,345,373	1,333,348
Administrative costs	10	15,449	18,648	51,891	53,140
Lease costs		2,711	2,830	8,128	8,829
Total expenses		490,792	472,669	1,405,392	1,395,317
Earnings before undernoted		40,872	51,213	165,831	182,584
Depreciation and amortization		19,117	18,711	57,054	55,079
Loss from asset impairment, disposals and other items	11	54,202	319	53,829	4,350
Results from operating activities		(32,447)	32,183	54,948	123,155
Net interest and accretion		22,515	22,112	67,060	64,610
Distributions on Exchangeable LP Units		649	673	1,963	2,033
Fair value adjustments		(21,092)	19,622	(17,385)	16,869
Loss (gain) on foreign exchange and financial instruments		337	(3,168)	(668)	(1,883)
Net finance costs	12	2,409	39,239	50,970	81,629
Earnings (loss) before income taxes		(34,856)	(7,056)	3,978	41,526
Income tax expense (recovery)					
Current		8,704	11,703	31,000	35,560
Deferred		(9,177)	(3,139)	(14,523)	(7,527)
Total income tax expense (recovery)		(473)	8,564	16,477	28,033
Net earnings (loss) for the period		(34,383)	(15,620)	(12,499)	13,493

See accompanying notes to unaudited condensed consolidated financial statements.

Extencicare Real Estate Investment Trust
Interim Condensed Consolidated Statement of Comprehensive Income (Loss)
(unaudited)

	Three months ended		Nine months ended	
	September 30		September 30	
<i>(in thousands of Canadian dollars)</i>	2011	2010	2011	2010
Net earnings (loss) for the period	(34,383)	(15,620)	(12,499)	13,493
Other comprehensive income (loss), net of income taxes				
Unrealized gain on available-for-sale securities	19	425	129	1,258
Reclassification of realized gain on available-for-sale securities to earnings	(70)	(107)	(117)	(274)
Defined benefit plan actuarial loss	(3,555)	(1,703)	(3,784)	(4,700)
Tax recovery on defined benefit plan actuarial gain	948	455	1,009	1,254
	(2,658)	(930)	(2,763)	(2,462)
Net change in foreign currency translation adjustment	20,290	(11,559)	11,586	(6,855)
Other comprehensive income (loss) for the period, net of tax	17,632	(12,489)	8,823	(9,317)
Total comprehensive income (loss) for the period	(16,751)	(28,109)	(3,676)	4,176

See accompanying notes to unaudited condensed consolidated financial statements.

Extencicare Real Estate Investment Trust
Interim Condensed Consolidated Statement of Changes in Equity

(unaudited)

For the nine months ended September 30, 2010

<i>(amounts in thousands of Canadian dollars)</i>	<i>Number of Units</i>	<i>Unit Capital</i>	<i>Contributed Surplus</i>	<i>Deficit</i>	<i>Accumulated Other Comprehensive Income (AOCI)</i>	<i>Total Unitholders' Equity</i>
Balance at January 1, 2010	69,896,968	332,069	81	(262,157)	(145)	69,848
Total comprehensive income for the period						
Net earnings for the period				13,493	-	13,493
Other comprehensive loss						
Foreign currency translation differences for foreign operations					(6,855)	(6,855)
Net change in fair value of available-for-sale financial assets, net of tax					1,258	1,258
Net change in fair value of available-for-sale financial assets transferred to profit or loss, net of tax					(274)	(274)
Defined benefit plan actuarial gains and losses, net of tax					(3,446)	(3,446)
Total other comprehensive loss		-	-	-	(9,317)	(9,317)
Total comprehensive income for the period		-	-	13,493	(9,317)	4,176
Transactions with unitholders, recorded directly in equity						
Issuance	9,228,750	83,321			-	83,321
DRIP	413,262	3,742			-	3,742
Conversion from Exchangeable LP Units	77,122	316			-	316
Distributions declared				(49,368)	-	(49,368)
Adjustment to prior year distribution of ALC				(623)	-	(623)
Total transactions with unitholders	9,719,134	87,379	-	(49,991)	-	37,388
Balance at September 30, 2010	79,616,102	419,448	81	(298,655)	(9,462)	111,412

For the nine months ended September 30, 2011

<i>(amounts in thousands of Canadian dollars)</i>	<i>Number of Units</i>	<i>Unit Capital</i>	<i>Contributed Surplus</i>	<i>Deficit</i>	<i>Accumulated Other Comprehensive Income (AOCI)</i>	<i>Total Unitholders' Equity</i>
Balance at January 1, 2011	79,831,466	421,213	81	(287,525)	(20,775)	112,994
Total comprehensive loss for the period						
Net loss for the period				(12,499)	-	(12,499)
Other comprehensive loss						
Foreign currency translation differences for foreign operations					11,586	11,586
Net change in fair value of available-for-sale financial assets, net of tax					129	129
Net change in fair value of available-for-sale financial assets transferred to profit or loss, net of tax					(117)	(117)
Defined benefit plan actuarial losses, net of tax					(2,775)	(2,775)
Total other comprehensive income		-	-	-	8,823	8,823
Total comprehensive loss for the period		-	-	(12,499)	8,823	(3,676)
Transactions with unitholders, recorded directly in equity						
DRIP	636,662	5,860			-	5,860
Conversion from Exchangeable LP Units	75,033	308			-	308
Conversion from convertible debentures	704	8			-	8
Distributions declared				(50,508)	-	(50,508)
Other				(13)	-	(13)
Total transactions with unitholders	712,399	6,176	-	(50,521)	-	(44,345)
Balance at September 30, 2011	80,543,865	427,389	81	(350,545)	(11,952)	64,973

See accompanying notes to unaudited condensed consolidated financial statements.

Extencicare Real Estate Investment Trust
Interim Condensed Consolidated Statement of Cash Flows

(unaudited)

<i>(in thousands of Canadian dollars)</i>	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Operating Activities				
Net earnings (loss) for the period	(34,383)	(15,620)	(12,499)	13,493
Adjustments for:				
Depreciation and amortization	19,117	18,711	57,054	55,079
Accrual for self-insured liabilities in provisions	36,364	17,495	49,161	26,928
Payments for self-insured liabilities in provisions	(14,289)	(6,367)	(25,993)	(18,026)
Deferred taxes	(9,177)	(3,139)	(14,523)	(7,527)
Current taxes	8,704	11,703	31,000	35,560
Loss from asset impairment, disposals and other items	54,202	319	53,829	4,350
Net finance costs	2,409	39,239	50,970	81,629
Interest capitalized	(379)	(220)	(613)	(726)
Other	61	106	300	158
	62,629	62,227	188,686	190,918
Net change in operating assets and liabilities				
Accounts receivable	(501)	(217)	8,144	1,941
Other current assets	(699)	626	(6,319)	(2,024)
Accounts payable and accrued liabilities	138	(38)	(15,785)	(17,181)
	61,567	62,598	174,726	173,654
Interest paid	(17,956)	(18,135)	(61,063)	(61,021)
Interest received	1,824	573	3,651	3,574
Income taxes paid	(3,734)	(332)	(18,727)	(4,450)
	41,701	44,704	98,587	111,757
Investing Activities				
Purchase of property, equipment and software	(17,956)	(22,376)	(43,231)	(50,146)
Acquisitions of nursing center, net of cash acquired	-	-	(7,299)	-
Net proceeds from dispositions	-	15,506	4,805	20,988
Other assets	(564)	1,348	(1,319)	163
	(18,520)	(5,522)	(47,044)	(28,995)
Financing Activities				
Issue of long-term debt excluding line of credit	171,410	5,541	294,790	35,679
Repayment of long-term debt excluding line of credit	(262,166)	(14,192)	(323,251)	(34,557)
Issue on line of credit	30,042	-	40,386	-
Repayment on line of credit	(13,615)	-	(27,666)	-
Decrease (increase) in restricted cash	(849)	646	(544)	3,685
Decrease in investments held for self-insured liabilities	7,442	5,821	14,104	14,099
Distributions paid	(14,313)	(15,207)	(44,597)	(44,933)
Issue of units	-	-	-	82,212
Financing costs	(4,300)	(2,667)	(16,423)	(3,407)
Other	31	50	628	(45)
	(86,318)	(20,008)	(62,573)	52,733
Foreign exchange gain (loss) on cash held in foreign currency	14,418	(3,963)	8,864	(1,754)
Increase (decrease) in cash and cash equivalents	(48,719)	15,211	(2,166)	133,741
Cash and cash equivalents at beginning of period	314,312	252,542	267,759	134,012
Cash and cash equivalents at end of period	265,593	267,753	265,593	267,753

See accompanying notes to unaudited condensed consolidated financial statements.

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

Notes to Unaudited Interim Condensed Consolidated Financial Statements

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

Periods ended September 30, 2011 and 2010

(Amounts in thousands of Canadian dollars, unless otherwise noted)

1. GENERAL INFORMATION AND NATURE OF THE BUSINESS

Extencicare Real Estate Investment Trust is an unincorporated, open-ended real estate investment trust established under the laws of the Province of Ontario by a deed of trust dated September 11, 2006, as amended and restated on October 28, 2006 and on December 15, 2010 (the “Deed of Trust”). References to “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 registered office of Extencicare REIT is located at 3000 Steeles Avenue East, Markham, Ontario, Canada, L3R 9W2. The units of Extencicare REIT are traded on the Toronto Stock Exchange (TSX) under the symbol “EXE.UN”.

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”). The conversion has been accounted for as a continuity of interests, and accordingly, the consolidated financial statements of the REIT are reflective as if the REIT had always carried on the business formerly carried on by Extencicare.

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

2. BASIS OF PREPARATION

a) Statement of Compliance

These interim condensed consolidated financial statements have been prepared in accordance with IAS 34 “Interim Financial Reporting” and IFRS 1 “First-time Adoption of International Financial Reporting Standards”, as issued by the International Accounting Standards Board (IASB). The REIT elected January 1, 2010, as the date of transition to International Financial Reporting Standards (IFRS) (the “Transition Date”). Periods prior to January 1, 2010, have not been restated, and are prepared under previous Canadian generally accepted accounting principles (GAAP).

These interim condensed consolidated financial statements do not include all of the information required for full annual financial statements, and should be read in conjunction with the REIT’s 2010 annual consolidated financial statements prepared in accordance with previous Canadian GAAP.

A summary of the differences between IFRS and previous Canadian GAAP is outlined in *note 17* along with reconciliations from previous Canadian GAAP to IFRS. An explanation outlines how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the REIT and reconciliations are provided of equity and total comprehensive income for comparative periods and of equity at the date of transition reported under the previous Canadian GAAP to those reported under IFRS for the same periods.

These interim condensed consolidated financial statements are approved by the board of trustees of the REIT (the “Board of Trustees”) on November 8, 2011.

b) Basis of Measurement

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

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

c) Use of Estimates and Judgement

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

The more subjective of such estimates and judgement are: revenue recognition and the valuation of accounts receivable; the measurement of acquired assets and assumed liabilities in business combinations; the estimation of useful lives of property, equipment and intangible assets with finite lives; the determination of the recoverable amount of cash generating units (CGU) subject to an impairment test; the valuation of decommissioning provisions; the valuation of self-insured liabilities; the valuation of financial assets and liabilities; the valuation of unit appreciation rights liabilities; the identification and valuation of provisions and contingencies; and the accounting for tax uncertainties including valuation allowances and the tax rates used for valuation of deferred taxes. The recorded amounts for such items are based on management's best available information and are subject to assumptions and judgement, which may change as time progresses; accordingly, actual results could differ from estimates.

3. SIGNIFICANT ACCOUNTING POLICIES

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

(a) Basis of Consolidation and Business Combinations

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

The acquisition method of accounting is used to account for the acquisition of subsidiaries. Consideration transferred on the acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed on the date of the acquisition and transaction costs are expensed as incurred. Identified assets acquired and liabilities assumed are generally measured at their fair value on the acquisition date. In fair valuing identifiable intangible assets acquired in its acquisitions, values are assigned to resident relationships as described in *note 3(i)ii*. The excess of fair value of consideration given including the recognized amount of any non-controlling interest of the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill, with any negative goodwill being recognized in the statement of earnings on the acquisition date. For acquisitions prior to January 1, 2010, goodwill represents the amount recognized under previous Canadian GAAP, subject to an impairment test on the Transition Date and certain transaction costs were not expensed. In the transition to IFRS, the REIT elected not to restate business combinations prior to January 1, 2010.

(b) Foreign Currency

i. Foreign operations

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

ii. Foreign currency transactions

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

(c) Cash and Cash Equivalents

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

(d) Accounts Receivable

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

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

(e) Non-current Other Assets

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

(f) Property and Equipment

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

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

On the Transition Date, the REIT determined the individual fair value of each of its centers. Based upon this detailed review, certain centers were restated to reflect their fair value as of January 1, 2010. Certain centers were not selected for revaluation either due to their economic life being limited or where existing and anticipated future cash flows did not warrant the revaluation of the center. Refer to *note 17* for the description of the valuation methodology.

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

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

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

Building components:	
Structure, sprinklers systems	50 years
Roof, windows, elevators	25 years
HVAC and building systems	15 to 25 years
Flooring, interior upgrades	5 to 15 years
Building improvements and extensions	5 to 30 years
Furniture and equipment	5 to 15 years
Computer equipment	3 to 5 years
Land improvements	10 to 25 years
Leasehold improvements	Term of the lease and one renewal term, if at option of REIT, or life of improvement

(g) Government Grants

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

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

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

(h) Leased Assets

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

(i) Goodwill and Other Intangible Assets

i. Goodwill

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

ii. Other intangible assets

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

Intangible assets with indefinite useful lives are measured at cost, are not amortized, and are subject to an impairment test (refer to *note 3(j)*).

Acquired leasehold rights are amortized over the term of the lease including the first renewal option should the option be at the sole election of the REIT and expected to be exercised.

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

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

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

Amortization methods, useful lives and residual values are reviewed at least annually, and adjusted if appropriate.

(j) Impairment

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

i. Non-financial assets

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

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

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

An impairment loss is recognized if the carrying amount of a CGU exceeds its estimated recoverable amount. Impairment losses are recognized in net earnings. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the assets in the CGU on a pro rata basis.

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

ii. Financial assets

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

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

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

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

(k) Investment Held for Self-insured Liabilities

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

(l) Employee Benefits

i. Defined benefit plans

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

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

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

ii. Defined contribution plans

The REIT has corporate specific and multi-employer defined benefit pension plans, which are treated as defined contribution plans for accounting purposes. Defined contribution plans are post-employment plans where the costs are fixed and there are no legal or constructive obligations to pay further amounts. Obligations for such contributions are recognized as employee benefit expense in earnings during the periods in which services are rendered by employees.

iii. Short-term employee benefits

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

iv. Other employee benefits

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

(m) Unit Appreciation Rights Plan

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

(n) Provisions

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

i. Self-insured liabilities

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

ii. Decommissioning provisions

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

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

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

iii. Other provisions

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

(o) Exchangeable LP Units

Class B limited partnership units (Exchangeable LP Units) of Extencicare Limited Partnership (Extencicare LP) are presented as a liability of the REIT. See *note 17*. The classification as financial liabilities does not alter the underlying economic interest of the Exchangeable LP unitholders. They contain features that are economically equivalent to the REIT Units, and will automatically be converted into REIT Units on November 10, 2011. As a result of the classification as financial liabilities, distributions to Exchangeable LP unitholders are presented as a finance cost.

(p) Financial Instruments

i. Financial assets and liabilities

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

Held-to-maturity financial assets

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

Loans and receivables

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

Financial assets at FVTPL

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

AFS

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

Financial liabilities

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

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

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

Summary of Financial Instruments and Classification

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

Below is a classification summary of the REIT financial instruments:

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

Other balance sheet accounts including, but not limited to, prepaid expenses within other current assets, property and equipment, goodwill and intangible assets, deferred income taxes, provisions and employee future benefit obligations are not financial assets or liabilities.

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

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

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

ii. Derivative financial instruments

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

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

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

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

(q) Non-monetary Transactions

All non-monetary transactions are measured at fair value unless (1) the transaction lacks commercial substance; or (2) neither the fair value of the assets or services received nor the fair value of the assets or services given up is reliably measurable. A non-monetary transaction has commercial substance when an entity's future cash flows are expected to change significantly as a result of the transaction.

(r) Revenue

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

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

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

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

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

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

(s) Lease Payments

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

(t) Net Finance Costs

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

(u) Income Taxes

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

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

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

Current and deferred income tax assets and liabilities are offset when the income taxes are levied by the same jurisdiction and there is a legally enforceable right of offset.

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

Tax uncertainties are evaluated on the basis of whether it is more likely than not that a tax position will ultimately be sustained upon examination by the relevant taxing authorities. Tax uncertainties are measured using a probability adjusted or expected value model whereby amounts are recorded if there is any uncertainty about a filing position, determined by multiplying the amount of the exposure by the probability that the entity's filing position will not be sustained.

(v) Discontinued Operations

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

4. FUTURE CHANGES IN ACCOUNTING POLICIES

Financial Instruments – Disclosures

The International Accounting Standards Board (the "IASB") has issued an amendment to IFRS 7 "Financial Instruments: Disclosures" (the "IFRS 7 Amendment"), requiring incremental disclosures regarding transfers of financial assets. The IFRS 7 Amendment is effective for annual periods beginning on or after July 1, 2011. We will apply the amendment at the beginning of the 2012 financial year and we do not expect the implementation to have a significant impact on our disclosures.

Financial Instruments

The IASB has issued a new standard, IFRS 9 "Financial Instruments", which will ultimately replace IAS 39 "Financial Instruments: Recognition and Measurement". The replacement of IAS 39 is a multi-phase project with the objective of improving and simplifying the reporting for financial instruments and the issuance of IFRS 9 is part of the first phase of this project. This standard was to be effective on January 1, 2013; however, on August 4, 2011, the IASB issued an exposure draft which proposes to defer the mandatory effective date by two years to January 1, 2015. The REIT has yet to assess the impact of the new standard on its results of operations, financial position and disclosures.

Consolidated Financial Statements

The IASB has issued a new standard, IFRS 10 "Consolidated Financial Statements", which establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 supersedes IAS 27 "Consolidated and Separate Financial Statements" and SIC-12 "Consolidation – Special Purpose Entities" and is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted, provided that early adoption is also applied on related standards (IFRS 11 "Joint Arrangements", IFRS 12 "Disclosure of Interests in Other Entities", and amendments to IAS27 & IAS28 "Investments in Associates"). IFRS 10 provides guidance on the definition of control, which becomes the single basis for consolidation, irrespective of the nature of the investee. The

REIT is reviewing the implications of adopting IFRS 10, and does not expect the new standard to have a significant impact on its financial statement presentation.

Disclosure of Interests in Other Entities

The IASB has issued another new standard, IFRS 12 “Disclosure of Interests in Other Entities”, which applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. The IFRS is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted, provided that early adoption is also applied on related standards (IFRS 10, IFRS 11, amendments to IAS27 & IAS28). IFRS 12 integrates the disclosure requirements on interests in other entities, currently included in several standards, and also prescribes additional disclosure requirements. The REIT is reviewing the implications of adopting IFRS 10, and does not expect the new standard to have a significant impact on its financial statement presentation.

Presentation of Financial Statement – Other Comprehensive Income

On June 16, 2011, the IASB issued amendments to IAS 1 “Presentation of Financial Statements”, which require entities preparing financial statements in accordance with IFRS to group together items within OCI that may be reclassified to the profit or loss section of the income statement and to separately group together items that will not be reclassified to the profit or loss section of the income statement.

The amendments also reaffirm existing requirements that profit or loss and OCI should be presented as either a single statement or two consecutive statements. The amendments are effective for financial years commencing on or after July 1, 2012. The REIT is reviewing the implications of these revisions, and does not expect the amended standard to have a significant impact on its financial statement presentation.

Post-employment Benefits

On June 16, 2011, the IASB issued amendments to IAS 19 “Employee Benefits”, in order to improve the accounting for pensions and other post-employment benefits.

The amendments make important improvements by:

- eliminating the option to defer the recognition of gains and losses, known as the “corridor method” or the “deferral and amortization approach”;
- streamlining the presentation of changes in assets and liabilities arising from defined benefit plans, including requiring re-measurements to be presented in OCI, thereby separating those changes from changes that many perceive to be the result of an entity’s day-to-day operations; and
- enhancing the disclosure requirements for defined benefit plans, providing better information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in those plans.

The amendments are effective for financial years beginning on or after January 1, 2013. Earlier application is permitted. The REIT is already presenting in OCI the re-measurements of the changes in assets and liabilities from defined benefit plans and therefore, does not expect the amended standard to have a significant impact on its financial statement presentation.

Fair Value Measurement

In May 2011, the IASB issued IFRS 13 “Fair Value Measurement” which is a new standard that defines fair value. It sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements. This new standard is effective for the interim and annual consolidated financial statements commencing January 1, 2013. The REIT is assessing the impact of this new standard.

5. ACQUISITION

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

6. OTHER ASSETS

	September 30 2011	December 31 2010
Investments held for self-insured liabilities: available-for-sale securities at fair value	48,923	60,937
Notes, mortgages and amounts receivable	48,653	47,782
Medicare and Medicaid settlement receivables, less allowance of nil	17,468	17,481
	115,044	126,200

7. PROVISIONS

	September 30 2011	December 31 2010
Accrual for self-insured liabilities	74,613	46,548
Decommissioning provisions	26,264	24,247
Liabilities assumed from Crown Life (note 8)	-	5,601
Total provisions	100,877	76,396
Less: current portion	25,157	16,013
	75,720	60,383

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

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

General and professional liability claim payments for any particular policy year occur over a period of several years. However, management estimates and allocates a portion of the general and professional liability claim payments as current on the statement of financial position.

8. LONG-TERM DEBT

	September 30		December 31	
	2011	2010	2011	2010
	US\$	C\$	US\$	C\$
EHSI (payable in US\$)				
CMBS Financing, 6.6525%, due 2012	289,632	303,592	491,707	489,054
CMBS Financing, 6.79%, due 2012	20,998	22,010	87,625	87,152
PrivateBank mortgage loans, variable rates, due 2013	34,618	36,287	24,970	24,835
Line of credit under Credit Facility, variable rates, due 2012	29,890	31,331	16,885	16,794
Sovereign Bank mortgage loans, variable rates, due 2011	-	-	45,179	44,935
HUD mortgages, 4.23% to 6.152%, due 2018 to 2046	306,547	321,323	27,457	27,308
Notes payable, 0% to 7.5%, maturing through to 2014	13,083	13,713	14,184	14,107
Capital lease obligations, 5.24% to 8.7141%, maturing through to 2020	14,979	15,701	15,388	15,304
	709,747	743,957	723,395	719,489
Financing costs	(15,290)	(16,027)	(9,113)	(9,064)
	694,457	727,930	714,282	710,425
Extencicare REIT and Canadian Subsidiaries (payable in C\$)				
Convertible Unsecured Subordinated Debentures, 5.7%, due 2014		111,652		117,348
Convertible Unsecured Subordinated Debentures, 7.25%, due 2013		91,913		96,392
CMHC mortgages, 3.52% to 9.81%, maturing through to 2020		161,662		171,701
Non-CMHC mortgages, 5.75%, due 2013		16,001		16,268
Capital lease obligations, average rate of 7.08%, maturing through to 2028		115,652		118,606
Construction loan, variable converting in Oct/11 to 3.81%, maturing 2017		10,722		3,551
Construction loan, 4.25%, converting in Oct/11 to 7.7%, maturing 2037		16,339		12,541
		523,941		536,407
Financing costs		(5,940)		(5,636)
		518,001		530,771
Total debt net of financing costs		1,245,931		1,241,196
Less: current portion		378,862		571,168
		867,069		670,028

See *note 17* for details relating to 2010.

Significant changes to long-term debt since December 31, 2010, are described below.

EHSI Debt**REFINANCING PLAN**

EHSI is in the process of refinancing approximately US\$636 million of debt with approximately US\$559 million in mortgages insured by the U.S. Department of Housing and Urban Development Program (HUD) and US\$77 million of cash on hand. EHSI received approval in July 2010 as a corporate entity to proceed with HUD applications subject to an overall limit of US\$550.0 million, and is awaiting approval to increase this to an overall limit of US\$600.0 million.

The debt being refinanced relates to EHSI's commercial mortgage backed securitization (CMBS) financings due March 2012 and May 2012, mortgage financing from Sovereign Bank and other lenders (the "Sovereign Loans"), and approximately US\$17.5 million of advances on EHSI's US\$70.0 million credit facility (the "EHSI Credit Facility").

We have submitted 79 HUD-loan applications totalling US\$559 million, and as of November 8, 2011, we have closed on 39 HUD loans with a principal balance of US\$308.6 million. In addition, we have received commitments to close on a further nine HUD loans totalling US\$51.7 million all of which are under a rate lock agreement. Collectively, the weighted average interest rate of the closed loans and those under commitment with a rate lock is 4.51% (including MIP fees of 0.50%), with an average term to maturity of about 33 years.

We anticipate obtaining the majority of the remaining 31 HUD commitments by the end of January 2012, with closings to occur in phases through to the end of the 2012 first quarter.

With respect to the debt that has been repaid, in June 2011, we repaid the Sovereign Loans of US\$44.0 million. In August and October 2011, we prepaid US\$194.9 million and US\$172.4 million, respectively, of the May 2012 CMBS Financing. As at November 8, 2011, the outstanding balance of the May 2012 CMBS Financing was US\$115.4 million. In August, we defeased US\$65.6 million of the March 2012 CMBS Financing and plan to defease the balance of US\$21.0 million by the end of November 2011.

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

The March 2012 CMBS Financing has a prepayment penalty that continues through to three months prior to its maturity date that inhibits early repayment of the debt as the penalty is determined based upon the difference between the interest rate on the loans and U.S. Treasury rates over the remaining term of the debt. Over time, the prepayment penalty is reduced. EHSI defeased US\$65.6 million of the March 2012 CMBS Financing in August at a cost of US\$1.4 million.

CMBS FINANCINGS

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

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

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

Under the terms of the March 2012 CMBS Financing, EHSI has the option until three months prior to the maturity date to prepay the balance in whole, but not in part, provided no event of default has occurred and a prepayment yield maintenance premium is paid by EHSI. The prepayment yield maintenance premium is an amount equal to the greater of: (i) one percent of the principal amount being prepaid, or (ii) the present value, as at the prepayment date, of interest payments computed using the principal amount being prepaid and an interest rate equal to the excess, if any, of the interest rate on the CMBS financing over the current market U.S. Treasury rate for the period through to the maturity dates. During the last three months prior to the maturity date, EHSI can prepay in full or in part without any prepayment yield maintenance premium. However, in the last three months, properties cannot be released from the March 2012 CMBS Financing under a partial repayment.

In addition, under the terms of the March 2012 CMBS Financing, until three months prior to the maturity date, EHSI has the option to defease a portion of the loan and release properties from the mortgages; provided no event of default has occurred and after the defeasement, the debt service coverage ratio is no less than the greater of (i) the debt service coverage ratio stipulated within the agreement, or (ii) the debt service coverage ratio for the last 12 months of all of the properties before the release. Therefore, depending on the financial performance of the centers in the March 2012 CMBS Financing and debt service coverage ratio, an additional principal payment could be required for EHSI to meet the minimum debt service coverage ratio. Under the defeasement process, depending on the defeasement amount, EHSI is required to make an additional principal payment of 10% to 20% of the allocated loan amounts of the properties being defeased and pay a defeasement yield maintenance premium to the trustee. These funds are used to purchase treasury securities to fund the payment of the defeased loan balances on the maturity date. The defeasement yield maintenance premium is an amount, as at the defeasement date, equal to the present value of interest payments computed using the

principal amount being prepaid and an interest rate equal to the excess, if any, of the interest rate on the March 2012 CMBS Financing over the current market U.S. Treasury rate for the period through to the maturity dates.

For the May 2012 CMBS Financing, under the Loan Modification Agreement described above, EHSI may prepay in part and release properties without any prepayment yield maintenance payment during the period between August 2011 and May 2012.

PRIVATEBANK MORTGAGE LOANS

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

SOVEREIGN BANK MORTGAGE LOANS

On June 1, 2011, the Sovereign Loans, which were secured by first mortgages on 17 skilled nursing centers owned by Tendercare (Michigan) Inc. and its subsidiaries (collectively "Tendercare") were paid off using US\$44.0 million cash obtained from borrowings under the EHSI Credit Facility. This borrowing under the EHSI Credit Facility was then paid off within the same month using proceeds from the closing of the 16 HUD-insured mortgages completed in June 2011 under the first phase of the refinancing.

CREDIT FACILITY

The EHSI Credit Facility was renewed and amended in June 2009 and provides for borrowings up to US\$70.0 million. The amount available to be borrowed under the EHSI Credit Facility is the lesser of: (i) 60% of the appraised values of the skilled nursing centers collateralizing the EHSI Credit Facility, or (ii) an amount based on the actual net cash flow of these centers for the last 12 months. The amount available to be borrowed as at September 30, 2011, was US\$70.0 million. The EHSI Credit Facility was extended in March 2011 to June 2012 with no change in the financial terms of the loan.

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

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

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

As at September 30, 2011, US\$29.9 million was drawn under the EHSI Credit Facility. The unused portion of the EHSI Credit Facility that was available for working capital, and corporate purposes, after reduction for an outstanding letter of credit of US\$2.6 million in favour of a state workers' compensation program, was US\$37.5 million as at September 30, 2011. The letter of credit renews annually and matures through to June 2012.

HUD MORTGAGES

In June 2011, EHSI closed on 16 HUD-insured mortgages with a principal balance of US\$110.5 million, an average interest rate of 4.60% (including MIP of 0.50%) and an average term to maturity of about 32 years. Fifteen of these mortgages are secured by facilities located in Michigan and the other facility is located in Wisconsin.

During the third quarter of 2011, EHSI closed on 17 HUD-insured mortgages with a principal balance of US\$169.6 million and a weighted average interest rate of 4.54% (including MIP fees of 0.50%) and an average term to maturity of about 33 years. As of September 30, 2011, EHSI has a total of 41 HUD-insured loans secured by 41 skilled nursing facilities and one assisted living facility. These mortgages have an average remaining term of 31 years with fixed interest rates ranging from 3.73% to 5.50% (weighted average rate is 4.72% including MIP of 0.50%). No prepayments are allowed in the first two years of the term. Thereafter, prepayment is allowed subject to prepayment penalties of between 3% and 8% of the remaining principal balances, which decrease by 1% per year until no penalty is required. These loans are subject to HUD regulatory agreements that require escrow reserve funds to be deposited with the loan servicer for mortgage insurance premiums, property taxes, insurance and repairs and replacements.

Canadian Debt

CONVERTIBLE UNSECURED SUBORDINATED DEBENTURES

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

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

Both the 2013 and 2014 debentures are convertible into REIT Units, and are remeasured at fair value at each reporting date with changes recognized in net earnings, see *note 17*. Upon a change of control whereby more than 66²/₃% of the units are acquired by any person or group of persons acting jointly, each holder of the 2013 or 2014 debentures may require the REIT to purchase their debentures at 101% of the principal. If 90% or more of the debenture holders do so, the REIT has the right but not the obligation to redeem all of the remaining outstanding debentures.

CONSTRUCTION LOANS

In October 2011, ECI executed construction loans for the new Timmins and Sault Ste. Marie centers in Ontario. Upon completion of the new centers, these construction loans will convert into 25-year mortgages. These loans have fixed interest rates over the construction period and term loan of 5.558% and 5.637%, respectively, and a requirement to maintain a debt service coverage ratio of 1.2 to 1. In addition, ECI executed a rate lock agreement in October 2011 on its new Edmonton nursing center to convert the interest rate from variable to fixed at 3.81%.

Other

RBC LINE OF CREDIT AND LETTERS OF CREDIT

Extencicare has a \$70.0 million demand credit facility with the Royal Bank of Canada (the "RBC Credit Facility") for its Canadian operations. The RBC Credit Facility is secured by 14 Canadian nursing centers and guaranteed by certain Canadian operating subsidiaries of Extencicare. This credit facility is used to back letters of credit of which there were \$40.5 million issued and outstanding as at September 30, 2011, leaving \$29.5 million available. The \$40.5 million of letters of credit secured \$40.0 million of executive pension obligations, and \$0.5 million related to construction projects. The amount securing the contingent liabilities in connection with the sale of its investment in Crown Life Insurance Company (Crown Life) in 2007 was reduced to zero in August 2011 as a result of the settlement of the remaining claims. (*note 7*)

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

In addition, Extencicare has a U.S. dollar letter of credit facility with the Royal Bank of Canada to provide for the issuance of a U.S. dollar letter of credit. As at September 30, 2011, a US\$10.2 million letter of credit (2010 – US\$10.2 million) was issued to a third-party insurer of workers' compensation claims of EHSI and was backed by US\$10.2 million in cash collateral held by RBC and invested in short-term deposits. As the cash is pledged as collateral against the letter of credit facility, its use is restricted and therefore, it is presented on the statement of financial position as restricted cash within current assets.

FINANCING COSTS

Financing costs are deducted from long-term debt and are amortized using the effective interest rate method over the term of the debt. Financing costs included as part of long-term debt amounted to \$22.0 million at September 30, 2011 (2010 – \$14.7 million). The increase of \$7.3 million in 2011 related primarily to the addition of \$14.4 million of costs associated with financing of new and refinancing of existing debt, partially offset by amortization charges included in finance costs and changes in foreign exchange.

Below is a summary of the financing costs:

	September 30		December 31	
	2011		2010	
	US\$	C\$	US\$	C\$
EHSI (payable in US\$)				
CMBS Financing, 6.6525%, due 2012	1,750	1,834	2,504	2,490
CMBS Financing, 6.79%, due 2012	46	48	717	713
Line of credit under Credit Facility, variable rates, due 2012	218	229	572	569
Sovereign Bank mortgage loans, variable rates, due 2011	-	-	256	255
HUD mortgages, 4.23% to 6.152%, due 2018 to 2046	12,842	13,461	4,549	4,524
PrivateBank mortgage loans, variable rates, due 2013	434	455	426	424
Other	-	-	89	89
	15,290	16,027	9,113	9,064
Extencicare REIT and Canadian Subsidiaries (payable in C\$)				
CMHC mortgages, 3.52% to 9.81%, maturing through to 2020		3,027		3,569
Non-CMHC mortgages, 5.75%, due 2013		93		128
Capital lease obligations, average rate of 7.08%, maturing through to 2028		490		513
Construction loans, 4.25%, converting in 2011 to 7.7%, maturing 2037		1,471		1,066
Construction loan, variable converting in 2011 to 5.558%, maturing 2037		157		-
Construction loan, variable converting in 2011 to 3.81%, maturing 2017		702		360
		5,940		5,636
Total financing costs		21,967		14,700
Less: current portion		3,572		4,427
		18,395		10,273

See *note 17* for details relating to 2010.

9. OTHER LONG-TERM LIABILITIES

	September 30	December 31
	2011	2010
Accrued pension plan obligation	32,380	28,983
Deferred compensation	11,896	10,941
Unit appreciation rights	1,119	1,047
Future lease commitments	1,911	1,892
Other	1,889	1,292
	49,195	44,155

See *note 17* for details relating to 2010.

Unit Appreciation Rights Plan

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

A summary of the UARs that have been granted to date by the Board of Trustees to senior management and the trustees as at September 30, 2011, is as follows:

	Nine months ended September 30, 2011		Twelve months ended December 31, 2010	
	Units	Weighted Average Vesting Price	Units	Weighted Average Vesting Price
Outstanding, beginning of period	1,100,667	\$ 8.48	559,000	\$ 6.64
Granted	682,000	10.99	628,000	10.04
Forfeited	(295,667)	(9.11)	(86,333)	(7.84)
Outstanding, end of period	1,487,000	\$ 9.51	1,100,667	\$ 8.48

The vesting price represents the REIT Unit price at which the respective UARs were granted, and equates to the minimum REIT Unit price at which they can be vested. As at September 30, 2011, 1,487,000 UARs were outstanding, with an average remaining contractual life of 1.7 years. The expense has dropped in the 2011 third quarter to a nominal amount on a year-to-date basis, and the related liabilities included as part of other long-term liabilities were \$1.1 million as at September 30, 2011.

10. EXPENSES BY NATURE

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Employee wages and benefits	342,985	339,307	1,018,178	1,018,978
Food, drugs, supplies and other variable costs	46,085	51,416	136,397	144,655
Property based and other costs	99,011	79,116	242,689	222,855
Total operating expenses and administrative costs	488,081	469,839	1,397,264	1,386,488

See *note 17* for details relating to 2010.

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

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Debt settlement	2,107	-	2,107	-
Loss on disposals	-	343	75	2,117
Asset impairment	54,012	-	54,012	1,244
Loss on termination of leases	-	-	-	1,013
Release of provision for contingent liabilities	(1,917)	(24)	(2,365)	(24)
Loss from asset impairment, disposals and other items	54,202	319	53,829	4,350

2011

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

Based on the computations performed in the 2011 third quarter, EHSI has recognized a pre-tax impairment loss of \$54.0 million (US\$53.9 million), of which \$22.3 million (US\$22.3 million) was allocated to goodwill, and \$31.7 million

(US\$31.6 million) to property and equipment. In respect of property and equipment, if future assessments indicate that there is a change in the estimates used to determine the recoverable amount, the impairment loss will be reversed subject to certain limits (*note 3(j)*).

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

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

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

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

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

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

In August 2011, EHSI prepaid US\$194.9 million of the May 2012 CMBS debt and defeased US\$65.6 million of the March 2012 CMBS debt, respectively, resulting in a pre-tax loss of \$2.1 million (US\$2.1 million) on debt settlement that included the defeasance penalty of US\$1.4 million, transaction fees of US\$0.2 million and the write-off of unamortized loan fees on the debt of US\$0.5 million (*note 8*).

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

In June 2011, ECI completed the sale of the Lethbridge, Alberta, property (120-bed closed nursing center) for net proceeds of \$1.0 million that resulted in a pre-tax gain of \$0.2 million in the 2011 second quarter (*note 13*). During the 2011 first quarter when the center closed, a charge of \$0.6 million was incurred related to a mortgage prepayment penalty.

Extendicare had a provision for contingent liabilities previously in connection with the sale of its investment in Crown Life. In April 2011, settlement was reached on one of the claims below the amount accrued for that particular item, resulting in the release of \$0.4 million of the provision. Another settlement was reached in August 2011 for the remaining claim, resulting in the release of the remainder of the provision of \$1.9 million. (*notes 7 and 8*)

2010

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

In May 2010, EHSI recorded an impairment loss of \$1.2 million to reduce to fair value a previously closed nursing center in Washington due to the general decline in property values in the local real estate market.

In the 2010 second quarter, EHSI completed the transfer of two leased skilled nursing centers to new operators which involved a lease termination settlement of \$1.0 million (US\$1.0 million).

12. NET FINANCE COSTS

	Three months ended		Nine months ended	
	September 30		September 30	
	2011	2010	2011	2010
Fair value adjustment on convertible debentures	(10,624)	14,375	(10,167)	15,011
Fair value adjustment on Exchangeable LP Units	(10,468)	5,247	(7,218)	1,858
Distributions on Exchangeable LP Units	649	673	1,963	2,033
Interest expense	23,848	22,133	69,217	66,559
Accretion of decommissioning provisions	399	399	1,196	1,224
Accretion of accrual for self-insured liabilities	104	130	313	388
Foreign exchange loss	337	-	-	-
Finance costs	4,245	42,957	55,304	87,073
Foreign exchange gain	-	2,294	269	1,482
Valuation gain on foreign currency forward contracts	-	874	399	401
Interest income	1,836	550	3,666	3,561
Finance income	1,836	3,718	4,334	5,444
Net finance costs	2,409	39,239	50,970	81,629

See *note 17* for details relating to 2010.

Convertible Debentures

The fair value adjustment on convertible debentures was a gain of \$10.6 million for the 2011 third quarter and a gain of \$10.2 million for the first nine months, and was a loss of \$14.4 million and \$15.0 million, respectively, for the same periods in 2010. This related to the re-measurement of the liability at fair value at the end of each period.

Exchangeable LP Units

The Exchangeable LP Units are intended to be economically equivalent to the REIT Units, to the greatest extent practicable. These units are accompanied by special voting units of the REIT that entitle the holder to receive notice of, attend and vote at all meetings of unitholders of the REIT. They are exchangeable on a one-for-one basis for REIT Units at the option of the holder, and will automatically be exchanged for REIT Units on November 10, 2011. They were presented as a current item as at September 30, 2011 and December 31, 2010.

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

These Exchangeable LP Units are designated as financial liabilities valued at FVTPL with changes in fair value recognized in net earnings as part of finance costs. The fair value adjustment on Exchangeable LP Units resulted in a gain of \$10.5 million for the 2011 third quarter and \$7.2 million for the first nine months, and was a loss of \$5.2 million and \$1.9 million, respectively, for the same periods in 2010. This related to the re-measurement of the liability at fair value at the end of each period.

Notes Due between Canadian and U.S. Subsidiaries

We recorded foreign exchange loss of \$0.3 million for the 2011 third quarter and a gain of \$0.3 million for the first nine months of 2011, and gains of \$2.3 million and \$1.5 million, respectively, for the same periods in 2010. These related primarily to the change in value of foreign currency-denominated notes between EHSI and some of the Canadian-based subsidiaries.

Foreign Currency Derivatives

The valuation adjustment on FCFCs was nil in the 2011 third quarter and a gain of \$0.4 million in the first nine months of 2011, and gains of \$0.9 million and \$0.4 million for the three and nine months in 2010, respectively. This related primarily to the revaluation of EHSI contracts that locked in the purchase of Canadian dollars at specified foreign exchange rates for US\$4.0 million per month until June 2011.

13. COMMITMENTS AND CONTINGENCIES

Property and Equipment Commitments

At September 30, 2011, outstanding capital expenditure commitments for EHSI totalled \$7.9 million (US\$7.5 million). ECI had outstanding capital expenditure purchase commitments totalling \$1.3 million as at September 30, 2011, relating to one construction project and two redevelopment projects.

ECI has a number of internal growth projects under various stages of development, representing an owned senior center in Edmonton, Alberta, totalling 180 beds, at a cost \$19.5 million, net of government grants, that was completed in October 2011; as well as two Ontario redevelopment projects totalling 436 beds, at a cost of approximately \$80 million, net of government grants.

The new 180-bed Edmonton center opened for residents in November, and the residents of the existing nursing center in Edmonton (113 operational beds) were transferred to the new center, following which the older center was closed. With respect to the two Ontario redevelopment projects, they began construction in the spring of 2011 and will replace two Ontario class "C" centers (287 beds) upon completion at the beginning of 2013.

Contractual and Future Skilled Nursing Property Lease Obligations

In September 2009, EHSI entered into an agreement with the company controlled by the former shareholders of Tendercare that includes a partial interest of Mr. Lukenda, our President and Chief Executive Officer, and his immediate family (*note 15*). The company owns a 120-bed skilled nursing center in Lansing, Michigan. Effective January 1, 2011, under the terms of the agreement and immediately following the renovation of the center, EHSI entered into a 10-year operating lease for US\$0.4 million per annum. The center was certified in March 2011.

In June 2009, EHSI entered into an agreement with an unrelated party who constructed a 100-bed skilled nursing center in South Bend, Indiana. Effective November 2010, under the terms of the agreement, EHSI entered into a 10-year capital lease for US\$1.0 million in the first year and US\$1.1 million thereafter.

ALC Spin-Off

The Arrangement included the distribution of Assisted Living Concepts, Inc. (ALC) to Extencicare's shareholders and a number of pre-Arrangement transactions. As part of the spin-off of 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"). In 2009, ALC asserted that EHSI owes an estimated US\$3.1 million to ALC under the Tax Allocation Agreement relating to additional depreciation deductions allowed by the U.S. Internal Revenue Service (IRS) for years 2005 and 2006 relating to limitations computed under Section 382 of the Internal Revenue Code. Subsequent to December 2010, the parties agreed to settle this matter for US\$0.8 million, which EHSI accrued for and charged directly to retained earnings as at December 31, 2010, since the spin-off of ALC was accounted for as a capital transaction in 2006. In May 2011, EHSI and ALC executed a settlement agreement that terminated the Tax Allocation Agreement and EHSI paid the US\$0.8 million to ALC.

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

Legal Proceedings and Regulatory Actions

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

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

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

14. FINANCIAL RISK MANAGEMENT

Refinancing Risk

As discussed in the Long-term Debt note (*note 8*) under the heading “EHSI Debt – Refinancing Plan”, the REIT has implemented plans to refinance US\$636 million of its U.S. long-term debt. Management anticipates refinancing this debt with approximately US\$559 million of HUD-insured mortgages and US\$77 million of cash on hand. As of November 8, 2011, we have closed on and/or received commitments for 48 loans insured with HUD totalling US\$360.3 million, with a weighted average interest rate of 4.51% and term to maturity of about 33 years. We anticipate obtaining the majority of the remaining 31 HUD commitments by the end of January 2012, with closings to occur in phases through to the end of the 2012 first quarter.

The REIT recognizes the significant risks associated with the refinancing of the 2011/2012 debt. Some of the risks concern the timing of the commitments to be received and closing dates of the HUD loans. To mitigate this risk, EHSI signed the Loan Modification Agreement in May 2011 for the May 2012 CMBS Financing that extends the maturity date from November 2011 to May 2012 and, during the period between August 2011 and May 2012, allows EHSI to prepay in part and release properties from the May 2012 CMBS Financing without any prepayment yield maintenance payment. The Loan Modification Agreement enhances the ability to complete the closing of the HUD mortgages. The fee for the Loan Modification was US\$5.4 million.

At the present time, management cannot provide full assurance that it will succeed in refinancing all of the debt through HUD prior to its maturity. As an alternative to HUD financing, EHSI believes that it can secure a bank term loan, if necessary. As such, EHSI believes that it has the capability to complete the refinancing as planned. Management continues to closely monitor the progress of the refinancing and the financial markets.

Liquidity Risk

Liquidity risk is the risk that the REIT will encounter difficulty in meeting its contractual obligations. We manage our liquidity risk through the use of budgets and forecasts. Cash requirements are monitored regularly based on actual financial results and actual cash flows to ensure that there are sufficient resources to meet operational requirements. We ensure that there are sufficient funds for declared and payable distributions and any other future commitments at any point in time. In addition, since there is a risk that long-term debt may not be refinanced or may not be refinanced on as favourable terms or with interest rates as favourable as those of the existing debt, we attempt to appropriately structure the timing of contractual long-term debt renewal obligations and exposures.

Other Risks

Other aspects of the REIT's financial risk management objectives and policies are consistent with those disclosed in the consolidated financial statements as at and for the year ended December 31, 2010.

15. RELATED PARTY TRANSACTIONS

Transactions with Key Management Personnel

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

In connection with the purchase of Tendercare, the acquired working capital is subject to annual adjustments that will occur 90 days after the anniversary date of the Tendercare acquisition over a four-year period until January 2012. The first anniversary adjustment increased net working capital by US\$1.7 million and was paid by EHSI in April 2009 with no impact on the consolidated statement of earnings. The second and third anniversary adjustments increased net working capital by US\$0.2 million and US\$0.3 million, respectively, for a total net liability of US\$0.5 million as of December 31, 2010 and as of September 30, 2011. In March 2010, the former shareholders of Tendercare (the "Tendercare Sellers Committee") filed a notice of disagreement with respect to a working capital adjustment for accrued vacation pay of US\$3.1 million sought by EHSI, stating that it was not a permitted adjustment. In April 2010, EHSI submitted a written response stating that its position is in accordance with GAAP and the terms of the agreement. In July 2010, the Tendercare Sellers Committee filed an action for declaratory relief in Michigan state court. In August 2010, EHSI filed a motion to dismiss or stay this action pending arbitration. In June 2011, the court issued its opinion staying the action pending arbitration. EHSI and the Tendercare Sellers Committee have jointly selected an accounting firm to serve as arbitrator to decide this issue. A decision is anticipated to occur in February 2012. EHSI has recorded a receivable of US\$3.1 million from Tendercare with respect to this issue, which was included in the net liability as of December 31, 2010 and September 30, 2011.

In addition, in connection with the acquisition of LTC Professional in 2008, Tendercare's affiliated insurance company, consideration for the acquisition is to be adjusted annually based upon the actuarial liabilities determined at December 31st of each year through to 2012, with an annual option to extend to 2015. In March of 2011, 2010 and 2009, ECI made the annual settlements of US\$1.6 million, US\$1.5 million and US\$2.2 million, respectively.

16. SEGMENTED INFORMATION

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Revenue				
United States	355,407	359,586	1,054,470	1,089,245
Canada	176,257	164,296	516,753	488,656
	531,664	523,882	1,571,223	1,577,901
			Sep. 30, 2011	Dec. 31, 2010
Total Assets				
United States			1,445,848	1,447,560
Canada			519,659	532,074
			1,965,507	1,979,634
Total Liabilities				
United States			1,216,356	1,165,225
Canada			684,178	701,415
			1,900,534	1,866,640

The REIT has two reportable operating segments: United States operations and Canadian operations. These operations are managed independently of each other because of their geographic areas and regulatory environments. Each operation retains its own management team and is responsible for compiling its own financial information.

The REIT, through its subsidiaries, operates long-term care centers in the United States and Canada. Also offered in the United States are medical specialty services, such as post-acute care and rehabilitative therapy services, as well as health technology services, while home health care services are provided in Canada.

17. EXPLANATION OF TRANSITION TO IFRS

These are the REIT's third interim condensed consolidated financial statements prepared in accordance with IAS 34 and IFRS 1. The accounting policies set out in *note 3* have been applied in preparing the financial statements for the period ended September 30, 2011, the comparative period ended September 30, 2010 and in the preparation of the opening IFRS statement of financial position at the Transition Date.

IFRS 1 requires first-time adopters to retrospectively apply all effective IFRSs for all periods presented. However, it also provides for certain optional exemptions and certain mandatory exceptions for first-time IFRS adopters. Below are the applicable IFRS 1 exemptions and exceptions applied in the conversion from previous Canadian GAAP to IFRS.

IFRS 1 Elective Exemptions**i. Fair value as deemed costs**

An IFRS 1 exemption is available to revalue selective land and buildings at fair value upon transition, and use that fair value as its deemed cost at that date. The exemption is applied on an asset-by-asset basis. We elected to apply the exemption to selected nursing centers upon transition.

ii. Employee benefits

An IFRS 1 exemption is available to reset the cumulative actuarial gain and loss balance to zero upon transition. We elected to apply this exemption on the Transition Date. Further, we have elected to disclose the present value of the defined benefit obligation, fair value of the plan assets, surplus or deficit in the plan, and the experience adjustments arising on the plan assets or liabilities, for each accounting period prospectively from the Transition Date.

iii. Cumulative translation differences

An IFRS 1 exemption is available to reset the cumulative translation adjustment (CTA) balance to zero on the Transition Date. Without the exemption, IFRS requires the retrospective restatement of CTA in accordance with IAS 21 "The Effect of Changes in Foreign Exchange Rates". We elected to apply the exemption to reset the CTA balance to zero on transition.

iv. Borrowing costs

Borrowing costs are required to be capitalized to the cost of qualifying assets based on specific guidance. There was no specific guidance under previous Canadian GAAP; however, we capitalized borrowing costs using a consistent formula. An IFRS 1 exemption is available which provides relief to a first-time adopter from applying the standard, IAS 23 “Borrowing Costs”, retrospectively. We elected to apply the IFRS 1 exemption; therefore, borrowing costs are only capitalized based on specific guidance post IFRS transition.

v. Business combinations

An IFRS 1 exemption is available whereby previously completed business combinations (prior to the Transition Date) are not required to be retrospectively restated in accordance with IFRS 3 “Business Combinations”, subject to some exceptions. We elected to apply this exemption and have not restated any of our past business combinations prior to the Transition Date. In addition, and as a condition under IFRS 1 for applying this exemption, goodwill relating to business combinations that occurred prior to the Transition Date is required to be tested for impairment.

vi. Decommissioning liabilities included in the cost of property, plant and equipment

IFRS provides specific guidance under IFRIC 1 “Changes in Existing Decommissioning, Restoration and Similar Liabilities” to account for changes related to decommissioning provisions. Criteria under previous Canadian GAAP are different. An IFRS 1 exemption is available which provides a simplified method for recalculating decommissioning provisions on the Transition Date. We elected to apply this exemption to measure our decommissioning provision as at the Transition Date in accordance with IAS 37 “Provisions, Contingent Liabilities and Contingent Assets”.

IFRS Mandatory Exemption

Estimates

IFRS requires estimates made for the same date in accordance with previous GAAP to be consistent with those under IFRS. Hindsight cannot be used to create or revise estimates upon transition. The estimates made by the REIT under previous Canadian GAAP were not revised for the application of IFRS except where necessary to reflect revised accounting policies.

Reconciliations of Previous Canadian GAAP to IFRS

In preparing its opening IFRS statement of financial position, the REIT has adjusted amounts reported in its financial statements prepared in accordance with previous Canadian GAAP. An explanation of how the transition from previous Canadian GAAP to IFRS has affected the REIT's financial position, financial performance and cash flows is detailed in the following tables with accompanying notes below.

The following is a reconciliation of the REIT's total equity reported in accordance with previous Canadian GAAP to its total equity in accordance with IFRS as at September 30, 2010.

	Notes	September 30, 2010				
		Previous Canadian GAAP	IFRS reclass	IFRS adjustments	Effect of transition to IFRSs	IFRSs
Assets						
Current assets						
Cash and short-term investments		267,753	-	-	-	267,753
Restricted cash		18,676	-	-	-	18,676
Accounts receivable		206,919	-	-	-	206,919
Deferred tax assets	(e)	22,595	(22,595)	-	(22,595)	-
Other current assets	(f)	23,986	8,380	-	8,380	32,366
Total current assets		539,929	(14,215)	-	(14,215)	525,714
Non-current assets						
Property and equipment	(i)	853,334	-	366,976	366,976	1,220,310
Goodwill and other intangible assets	(l)	187,752	-	(74,247)	(74,247)	113,505
Other assets	(f), (i)	124,638	(8,380)	526	(7,854)	116,784
Deferred tax assets	(e)	-	22,595	-	22,595	22,595
Total non-current assets		1,165,724	14,215	293,255	307,470	1,473,194
Total Assets		1,705,653	-	293,255	293,255	1,998,908
Liabilities and Equity						
Current liabilities						
Accounts payable		31,117	-	-	-	31,117
Accrued liabilities	(h)	235,387	147	-	147	235,534
Income taxes payable		2,665	-	-	-	2,665
Current portion of long-term debt	(j)	93,597	-	1,605	1,605	95,202
Current portion of provisions		11,215	-	-	-	11,215
Total current liabilities		373,981	147	1,605	1,752	375,733
Non-current liabilities						
Long-term debt	(j)	1,129,536	-	26,478	26,478	1,156,014
Provisions	(d), (n)	39,118	30,072	(826)	29,246	68,364
Other long-term liabilities	(d), (h), (k), (m)	67,316	(21,184)	33,070	11,886	79,202
Deferred tax liabilities	(h), (i), (j), (o)	70,435	(2,410)	140,158	137,748	208,183
Total non-current liabilities		1,306,405	6,478	198,880	205,358	1,511,763
Total liabilities		1,680,386	6,625	200,485	207,110	1,887,496
Unit capital						
Unit capital	(j), (k)	442,548	-	(23,100)	(23,100)	419,448
Contributed surplus						
Contributed surplus		81	-	-	-	81
Retained earnings - IFRS transitional adjustment						
Retained earnings - IFRS transitional adjustment	(g), (h), (i), (j), (k), (l), (o), (n)	-	(4,192)	137,464	133,272	133,272
Accumulated deficit						
Accumulated deficit	(h), (i), (j), (k), (m), (n), (o)	(413,470)	136	(18,593)	(18,457)	(431,927)
Accumulated other comprehensive loss						
Accumulated other comprehensive loss	(g), (h), (i), (l), (n)	(3,892)	(2,569)	(3,001)	(5,570)	(9,462)
Unitholders' equity		25,267	(6,625)	92,770	86,145	111,412
Total Liabilities and Equity		1,705,653	-	293,255	293,255	1,998,908

The following is a reconciliation of the REIT's total comprehensive loss reported in accordance with the previous Canadian GAAP to its total comprehensive income in accordance with IFRS for the three-month period ended September 30, 2010.

Three months ended September 30, 2010					
Notes	Previous Canadian GAAP	IFRS reclass	IFRS adjustments	Effect of transition to IFRS	IFRS
CONTINUING OPERATIONS					
Total revenue	517,500	6,382	-	6,382	523,882
Operating expenses	(a) 444,631	6,560	-	6,560	451,191
Administrative costs	(h), (m) 18,649	(62)	61	(1)	18,648
Lease costs	(a) 2,825	5	-	5	2,830
Total expenses	466,105	6,503	61	6,564	472,669
Earnings before undernoted	51,395	(121)	(61)	(182)	51,213
Depreciation and amortization	(a), (i) 16,201	-	2,510	2,510	18,711
Loss from asset impairment, disposals and other items	(b), (l) -	319	-	319	319
Results from operating activities	35,194	(440)	(2,571)	(3,011)	32,183
Accretion of decommissioning provision	(a), (c) 393	(393)	-	(393)	-
Net interest and accretion	(a), (c), (j), (n) 22,366	399	(653)	(254)	22,112
Distributions on Exchangeable LP Units	(k) -	-	673	673	673
Fair value adjustments	(j), (k) -	-	19,622	19,622	19,622
Gain on foreign exchange and financial instruments	(3,168)	-	-	-	(3,168)
Gain from asset impairment, disposals and other items	(a), (b) (24)	24	-	24	-
Net finance costs	19,567	30	19,642	19,672	39,239
Earnings (loss) before income taxes	15,627	(470)	(22,213)	(22,683)	(7,056)
Income tax expense					
Current	(a) 7,251	4,452	-	4,452	11,703
Deferred	(a), (h), (i), (j), (o) 2,641	(4,646)	(1,134)	(5,780)	(3,139)
Total income tax expense (recovery)	9,892	(194)	(1,134)	(1,328)	8,564
Earnings (loss) from continuing operations	5,735	(276)	(21,079)	(21,355)	(15,620)
DISCONTINUED OPERATIONS					
Loss from discontinued operations, net of income taxes	(a) (322)	322	-	322	-
Net earnings (loss) for the period	5,413	46	(21,079)	(21,033)	(15,620)
Other comprehensive income (loss), net of income taxes					
Unrealized gain on available-for-sale securities	425	-	-	-	425
Reclassification of realized gain on available-for-sale securities to earnings	(107)	-	-	-	(107)
Defined benefit plan actuarial loss	(h) -	(1,703)	-	(1,703)	(1,703)
Tax recovery on defined benefit plan actuarial gain	(h) -	455	-	455	455
Net change in foreign currency translation adjustment	(i), (l), (m), (n) 318	(1,248)	-	(1,248)	(930)
	(6,772)	-	(4,787)	(4,787)	(11,559)
Total comprehensive loss for the period, net of tax	(1,041)	(1,202)	(25,866)	(27,068)	(28,109)

The following is a reconciliation of the REIT's total comprehensive income reported in accordance with the previous Canadian GAAP to its total comprehensive income in accordance with IFRS for the nine-month period ended September 30, 2010.

Nine months ended September 30, 2010						
Notes	Previous Canadian GAAP	IFRS reclass	IFRS adjustments	Effect of transition to IFRS	IFRS	
CONTINUING OPERATIONS						
Total revenue	(a)	1,540,705	37,196	-	37,196	1,577,901
Operating expenses	(a)	1,298,494	34,854	-	34,854	1,333,348
Administrative costs	(h), (m)	53,133	(185)	192	7	53,140
Lease costs	(a)	8,245	584	-	584	8,829
Total expenses		1,359,872	35,253	192	35,445	1,395,317
Earnings before undernoted		180,833	1,943	(192)	1,751	182,584
Depreciation and amortization	(a), (i)	47,680	1	7,398	7,399	55,079
Loss from asset impairment, disposals and other items	(b), (l)	-	5,650	(1,300)	4,350	4,350
Results from operating activities		133,153	(3,708)	(6,290)	(9,998)	123,155
Accretion of decommissioning provision	(a), (c)	1,186	(1,186)	-	(1,186)	-
Net interest and accretion	(a), (c), (j), (n)	65,358	1,215	(1,963)	(748)	64,610
Distributions on Exchangeable LP Units	(k)	-	-	2,033	2,033	2,033
Fair value adjustments	(j), (k)	-	-	16,869	16,869	16,869
Gain on foreign exchange and financial instruments		(1,883)	-	-	-	(1,883)
Loss from asset impairment, disposals and other items	(a), (b)	2,556	(2,556)	-	(2,556)	-
Net finance costs		67,217	(2,527)	16,939	14,412	81,629
Earnings before income taxes		65,936	(1,181)	(23,229)	(24,410)	41,526
Income tax expense						
Current	(a)	29,901	5,659	-	5,659	35,560
Deferred	(a), (h), (i), (j), (o)	1,166	(6,090)	(2,603)	(8,693)	(7,527)
Total income tax expense (recovery)		31,067	(431)	(2,603)	(3,034)	28,033
Earnings from continuing operations		34,869	(750)	(20,626)	(21,376)	13,493
DISCONTINUED OPERATIONS						
Loss from discontinued operations, net of income taxes	(a)	(886)	886	-	886	-
Net earnings for the period		33,983	136	(20,626)	(20,490)	13,493
Other comprehensive income (loss), net of income taxes						
Unrealized gain on available-for-sale securities		1,258	-	-	-	1,258
Reclassification of realized gain on available-for-sale securities to earnings		(274)	-	-	-	(274)
Defined benefit plan actuarial loss	(h)	-	(4,700)	-	(4,700)	(4,700)
Tax recovery on defined benefit plan actuarial gain	(h)	-	1,254	-	1,254	1,254
		984	(3,446)	-	(3,446)	(2,462)
Net change in foreign currency translation adjustment	(i), (l), (n)	(3,852)	-	(3,003)	(3,003)	(6,855)
		(2,868)	(3,446)	(3,003)	(6,449)	(9,317)
Total comprehensive income for the period, net of tax		31,115	(3,310)	(23,629)	(26,939)	4,176

Material adjustments to the statement of cash flows for 2010:

As a result of the transition to IFRS, certain items on the statement of cash flows have been impacted as follows:

- distributions to Exchangeable LP unitholders previously recognized in financing activities as “distributions paid” are now recognized as part of “net finance costs” on the statement of comprehensive income which are included in operating activities;
- interest paid and income taxes paid have moved into the body of the statement of cash flows, whereas they were previously disclosed as supplementary information; and
- borrowing costs capitalized in relation to qualifying assets are presented as interest paid in operating activities.

There are no other material differences between the statement of cash flows presented under IFRS and the statement of cash flows presented under the previous Canadian GAAP.

Notes to the reconciliations of previous Canadian GAAP to IFRS**IFRS RECLASSIFICATIONS****a. Discontinued Operations****Requirements under IFRS:**

The definition of discontinued operations under IFRS is narrower compared to that under the previous Canadian GAAP. We defined discontinued operations to be at the individual nursing center level under previous Canadian GAAP. Under IFRS, discontinued operations are limited to a component of the entity that has been disposed of, or is classified as held for sale, and represents a separate major line of business or geographical area of operations. Consequently, results presented as discontinued operations during 2010 were reclassified as continuing operations.

b. Loss (Gain) from Asset Impairment, Disposals and Other Items**Requirements under IFRS:**

Under previous Canadian GAAP, items that were not expected to occur regularly during normal operations were separately disclosed outside of operations. These include asset impairment, disposals and items of a similar nature. Under IFRS, impairment of non-financial assets and other similar items are considered to be part of operating activities.

c. Net Finance Costs**Requirements under IFRS:**

Under previous Canadian GAAP, the decommissioning provision (“accretion of asset retirement obligations” under previous Canadian GAAP), interest income and expense, as well as the “loss (gain) on foreign exchange and financial instruments” were separately disclosed on the statement of earnings. Under IFRS, all of these items are considered to be part of net finance costs. Also included in net finance costs are distributions on Exchangeable LP Units and fair value adjustments; neither of these items existed under previous Canadian GAAP.

d. Provisions**Requirements under IFRS:**

IFRS requires separate disclosure of provisions on the face of the statement of financial position. This was not required under previous Canadian GAAP; therefore, all provisions were reclassified from other long-term liabilities upon transition. These provisions include the accrual for self-insured liabilities, asset retirement obligations and the liabilities assumed from Crown Life.

e. Deferred Income Tax Assets**Requirements under IFRS:**

IFRS does not consider deferred income tax assets as a current item. As a result, it was reclassified from current to non-current under IFRS.

f. Assets Held for Sale**Requirements under IFRS:**

IFRS does not consider “assets held for sale” as a non-current item. As a result, it was reclassified from non-current to current under IFRS.

g. Cumulative Translation Adjustment**Upon transition:**

As stated under the “IFRS 1 Elective Exemption” section, we elected to apply the exemption to deem all CTA that arose prior to the Transition Date in respect of all foreign operations to be nil upon transition.

Reconciliation:

The impact arising from the change is summarized as follows:

	September 30, 2010
Consolidated statement of financial position	
Increase in AOCI:	
CTA as of January 1, 2010	879
Decrease in retained earnings	879

h. Employee Benefits**Upon transition:**

As stated under the “IFRS 1 Elective Exemption” section, we elected to recognize all cumulative actuarial gains and losses that existed at the Transition Date in retained earnings.

Policy choice under IFRS:

Under previous Canadian GAAP, actuarial gains and losses that arose in calculating the present value of the defined benefit obligation and the fair value of plan assets are recognized on a systematic and consistent basis, subject to a minimum required amortization based on a “corridor” approach. The “corridor” was 10% of the greater of the accrued benefit obligation at the beginning of the year and the fair value of plan assets at the beginning of the year. This excess of 10% was amortized as a component of pension expense on a straight-line basis over the expected average service life of active participants. Actuarial gains and losses below the 10% corridor were deferred.

Under IFRS, actuarial experience gains or losses can be either recognized immediately in other comprehensive income or recognized in net earnings using either the corridor method or an alternate method that would result in accelerated recognition. We elected to recognize all actuarial experience gains or losses in other comprehensive income at the end of each period.

As a result, pension expense has been adjusted to remove the amortization of actuarial gains and losses, and the pension obligation as well as OCI have also been revised accordingly.

Requirements under IFRS:

Under previous Canadian GAAP, the measurement date of the defined benefit obligation and plan assets can be a date up to three months prior to the date of the financial statements, provided the entity adopted this practice consistently from year to year. We measured our accrued benefit obligations and the fair value of plan assets for accounting purposes at September 30th of each year. Actuarial valuations of the defined benefit pension plan were completed every three years.

IFRS requires that the present value of the defined benefit obligation and the fair value of plan assets be measured with sufficient regularity such that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date. As a result, we remeasured our defined benefit obligations and plan assets as at January 1, 2010, and the measurement date has been changed to December 31st of each year. Consequently, the unamortized actuarial gains and losses recognized in net earnings under previous Canadian GAAP were reversed, and all actuarial gains and losses arising in periods subsequent to the Transition Date were recognized in other comprehensive income. Actuarial valuations of the defined benefit pension plan will continue to be completed every three years, with the next one to be conducted effective September 30, 2012.

Reconciliation:

The impact arising from the change is summarized as follows:

	Three months ended September 30, 2010	Nine months ended September 30, 2010
Consolidated statement of earnings (loss)		
Decrease in administrative costs:		
Pension expense	62	185
Increase in income before tax	62	185
September 30, 2010		
Consolidated statement of financial position		
Increase in liabilities:		
Pension obligations - current		147
Pension obligations - non-current		8,888
Decrease in AOCI:		
Actuarial losses		(3,448)
Related tax effect		(2,410)
Decrease in retained earnings		3,177

IFRS ADJUSTMENTS**i. Property and Equipment*****Upon transition:***

As stated under the “IFRS 1 Elective Exemption” section, we elected to apply the exemption to revalue the land and building of selected nursing centers at fair value upon transition.

As of the Transition date, the REIT determined the individual fair value for each of its centers. Based upon this detailed review, certain centers were restated to reflect their fair value as of the Transition date. All nursing centers were considered for revaluation, with the exception of nursing centers where we expect their economic life to be limited or centers where we do not expect significant improvements in future cash flows. Our revaluation analysis was conducted internally using valuation methodologies commonly applied in the North American long-term care industry. A capitalized cash flow approach using current market assumptions for capitalization rates was used to determine the total real estate and business value of each nursing center. We then applied a lease coverage ratio to remove the value associated with business operations and goodwill, in order to determine the fair value of the real estate component of each nursing center. In conjunction with the revaluation, IFRS requires that an impairment test be performed at the CGU level upon transition; as a result, certain assets were impaired (see further details under “impairment” under *note 17(l)* below). The carrying value of property and equipment net of impairment was increased by \$380 million as at the Transition Date; consequently, more depreciation was recorded subsequent to the Transition Date based on the higher net deemed costs of the assets.

Below is a summary of the assumptions on capitalization rates and lease coverage ratios used in the determination of fair value:

	<u>Canada</u>	<u>United States</u>
<u>Capitalization rates</u>		
Skilled nursing centers	9%	13%
Assisted living	n/a	9%
<u>Lease coverage</u>		
Skilled nursing centers	1.6	1.6
Assisted living	n/a	1.4

For the Ontario “C” beds and certain other centers in Canada, an 11.5% discount rate was used for impairment testing purposes.

Policy choice under IFRS:

Measurement of the assets subsequent to the Transition Date can be based on either the revaluation model (i.e. fair value model) or the cost model. We have elected to continue using the cost model, similar to the previous Canadian GAAP.

Reconciliation:

The impact arising from the change is summarized as follows:

	<u>Three months ended</u> <u>September 30, 2010</u>	<u>Nine months ended</u> <u>September 30, 2010</u>
Consolidated statement of earnings (loss)		
Increase in depreciation expense	2,510	7,398
Decrease in loss from asset impairment, disposals and other items	-	(1,300)
Decrease in income before tax	2,510	6,098
September 30, 2010		
Consolidated statement of financial position		
Increase in property and equipment		366,976
Increase in other assets		526
Decrease in AOCI - translation adjustment		4,566
Related tax effect		(142,887)
Increase in retained earnings		229,181

j. Convertible Debentures**Requirements under IFRS:**

Under previous Canadian GAAP, our convertible debentures are bifurcated with the debt host contract presented as a liability and the single compound embedded derivative as equity on the consolidated balance sheet. Under IFRS, both of these items are presented as a financial liability. As a result, the equity portion of debentures that was previously included in unit capital was reclassified to long-term debt.

Policy choice under IFRS:

In terms of measurement and valuation, we have elected to designate the convertible debentures as a financial liability at FVTPL. Consequently, any unamortized financing costs of the convertible debentures as at the Transition Date were recognized in retained earnings, and the convertible debentures are remeasured at fair value at each reporting date.

Reconciliation:

The impact arising from the change is summarized as follows:

	Three months ended September 30, 2010	Nine months ended September 30, 2010
Consolidated statement of earnings (loss)		
Increase (decrease) in net finance costs:		
Accretion of equity portion of convertible debentures	(386)	(1,160)
Amortization of financing costs	(397)	(1,191)
Fair value adjustment	14,375	15,011
Decrease in income before tax	13,592	12,660
		September 30, 2010
Consolidated statement of financial position		
Increase in liability		
Convertible debentures - current		1,605
Convertible debentures - non-current		26,478
Decrease in unit capital:		
Equity portion of convertible debentures		(9,964)
Related tax effect		(2,350)
Decrease in retained earnings		15,769

k. Exchangeable LP Units**Requirements under IFRS:**

Previous Canadian GAAP provided an exception which enabled us to present the Exchangeable LP Units as equity. Under IFRS, no such relief is extended. As a result, these units were reclassified from equity to liability. In addition, distributions paid to owners of the Exchangeable LP Units were reclassified as part of finance costs.

Policy choice under IFRS:

We have elected to designate the Exchangeable LP Units as a financial liability at FVTPL. Therefore, these units are remeasured at fair value at each reporting date.

Reconciliation:

The impact arising from the change is summarized as follows:

	Three months ended September 30, 2010	Nine months ended September 30, 2010
Consolidated statement of earnings (loss)		
Increase in net finance costs:		
Distributions on Exchangeable LP Units	673	2,033
Fair value adjustment	5,247	1,858
Decrease in income before tax	5,920	3,891
		September 30, 2010
Consolidated statement of financial position		
Increase in liability		32,878
Decrease in unit capital		(13,136)
Decrease in retained earnings		19,742

l. Impairment**Upon transition:**

In accordance with IFRS, it is required to assess goodwill for impairment upon transition.

Requirements under IFRS:

Under previous Canadian GAAP, assets were tested for impairment using a two-step approach. The carrying value of the assets was first compared to the recoverable amount, defined to be the undiscounted cash flows on the assets; if this first test indicated impairment, impairment loss was then calculated to be the excess of carrying value over the discounted net future cash flows. We assessed goodwill for impairment at our segment level.

Under IFRS, impairment testing is to be performed at the CGU level, which we have identified to be the individual nursing centers. IFRS requires a one-step approach for identifying and measuring impairment, whereby goodwill and corporate assets are allocated to specific CGUs for the purpose of impairment testing. An impairment loss is calculated to be the excess of the carrying value over the recoverable amount, defined to be the greater of fair value less costs to sell and value in use, which is the discounted net future cash flows.

As a result of the lower impairment threshold and the difference in the definition of recoverable amount, we recorded impairment on goodwill (refer to *note 3(j)*).

Previously recorded impairment losses (except impairment losses related to goodwill) must be reversed under certain conditions.

Reconciliation:

The impact arising from the change is summarized as follows:

	September 30, 2010
Consolidated statement of financial position	
Decrease in goodwill	(74,247)
Increase in AOCI - translation adjustment	(1,587)
Decrease in retained earnings	(75,834)

m. Unit Appreciation Rights**Requirements under IFRS:**

Under previous Canadian GAAP, the liability relating to the UARs was determined by calculating the intrinsic value of each right, representing the amount over which the closing unit price exceeds the UAR's strike price, including the accrued distribution payable where closing price exceeds strike price at each reporting date, factoring the time elapsed over the vesting period.

Under IFRS, UARs are to be measured at fair value.

Reconciliation:

The impact arising from the change is summarized as follows:

	Three months ended September 30, 2010	Nine months ended September 30, 2010
Consolidated statement of earnings (loss)		
Increase in administrative costs:		
Unit appreciation rights	61	192
Decrease in income before tax	61	192
		September 30, 2010
Consolidated statement of financial position		
Increase in liability		192
Increase in AOCI - translation adjustment		-
Decrease in retained earnings		192

n. Provisions**Requirements under IFRS:**

Under IFRS, the amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation. The unwinding of the discounting is recorded as accretion included as part of finance costs. As a result, the accrual for self-insured liabilities included in provisions was discounted.

Reconciliation:

The impact arising from the change is summarized as follows:

	Three months ended September 30, 2010	Nine months ended September 30, 2010
Consolidated statement of earnings (loss)		
Increase in net finance costs:		
Accretion on accrual for self-insured liabilities	130	388
Decrease in income before tax	130	388
		September 30, 2010
Consolidated statement of financial position		
Decrease in liability:		
Accrual for self-insured liabilities		(826)
Decrease in equity:		
AOCI - translation adjustment		(22)
Increase in retained earnings		(848)

o. Deferred Tax Liability**Requirements under IFRS:**

Under previous Canadian GAAP, the deferred taxes of the legal entity of the REIT were set up at the rate at which we expect the deferred taxes to reverse, which is the SIFT tax rate.

Under IFRS, to the extent that earnings have not yet been distributed to unitholders, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits. In the case of the legal entity of the REIT, the tax rate applicable to undistributed profits is the highest marginal tax rate of 46.41%. The deferred taxes are then adjusted as distributions are declared.

Reconciliation:

The impact arising from the change is summarized as follows:

	Three months ended September 30, 2010	Nine months ended September 30, 2010
Consolidated statement of earnings (loss)		
Increase in tax expense:		
Deferred tax	15	67
Decrease in net earnings	15	67

September 30, 2010

Consolidated statement of financial position		
Decrease in liability:		
Deferred tax liability		379
Increase in retained earnings		379

All of the above changes increased (decreased) deferred tax liability as follows:

	<i>Notes</i>	September 30, 2010
Reclass of actuarial gains or loss in employee benefits	<i>(h)</i>	(2,410)
Revaluation of property and equipment	<i>(i)</i>	142,887
Remeasurement of convertible debt	<i>(j)</i>	(2,350)
Application of higher tax rate to undistributed earnings	<i>(o)</i>	(379)
Increase in deferred tax liability		137,748

p. Retained Earnings**Reconciliation:**

The above changes increased (decreased) retained earnings (each net of related tax) as follows:

	<i>Notes</i>	September 30, 2010
Reclassification of CTA	<i>(g)</i>	(879)
Reclassification of actuarial gains and losses	<i>(h)</i>	(3,177)
Revaluation of property and equipment	<i>(i)</i>	229,181
Reclassification of convertible debt	<i>(j)</i>	(15,769)
Reclassification of Exchangeable LP Units	<i>(k)</i>	(19,742)
Impairment of goodwill	<i>(l)</i>	(75,834)
Remeasurement of UAR	<i>(m)</i>	(192)
Discounting of provisions	<i>(n)</i>	848
Application of higher tax rate on undistributed earnings	<i>(o)</i>	379
Increase in retained earnings		114,815

EXTENDICARE

Facility Location and Resident Capacity

<i>at September 30, 2011</i>	Nursing Centers		Assisted Living and Retirement Centers		Rehab Hospital / Chronic Care Units		Total	
By State/Province	Number of Centers	Resident Capacity	Number of Centers	Resident Capacity	Number of Centers	Resident Capacity	Number of Centers	Resident Capacity
United States								
Pennsylvania	25	3,037	7	199	-	-	32	3,236
Michigan	27	2,898	1	51	1	28	29	2,977
Wisconsin	27	2,289	3	195	-	-	30	2,484
Ohio	22	2,288	-	30	-	-	22	2,318
Kentucky	21	1,768	-	-	-	-	21	1,768
Indiana	17	1,597	-	35	-	-	17	1,632
Washington	15	1,567	1	50	-	-	16	1,617
Minnesota	8	915	-	-	-	-	8	915
Idaho	2	178	-	-	-	-	2	178
Oregon	2	166	-	-	-	-	2	166
Delaware	1	120	-	-	-	-	1	120
West Virginia	1	120	-	-	-	-	1	120
Total United States	168	16,943	12	560	1	28	181	17,531
Canada								
Ontario	52	7,146	1	293	1	120	54	7,559
Alberta	14	1,339	1	200	-	-	15	1,539
Manitoba	6	882	1	48	-	-	7	930
Saskatchewan	5	654	-	-	-	-	5	654
Total Canada	77	10,021	3	541	1	120	81	10,682
TOTAL	245	26,964	15	1,101	2	148	262	28,213
By Type of Ownership								
United States								
Owned	158	15,904	4	310	1	28	163	16,242
Leased	5	520	-	-	-	-	5	520
Managed	5	519	8	250	-	-	13	769
Total United States	168	16,943	12	560	1	28	181	17,531
Canada								
Owned	48	6,487	1	200	-	-	49	6,687
Leased	10	1,250	-	76	-	-	10	1,326
Managed	19	2,284	2	265	1	120	22	2,669
Total Canada	77	10,021	3	541	1	120	81	10,682
TOTAL	245	26,964	15	1,101	2	148	262	28,213

Unitholder Information

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Published Information

Extendicare REIT's 2010 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.

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