

Quality is Our Business

2010 Annual Report



Corporate Profile

Extendicare Real Estate Investment Trust ("Extendicare REIT") is a leading North American provider of post-acute and long-term senior care services. The direct ownership and operation of the senior care centers and ancillary businesses is conducted by wholly owned subsidiaries of Extendicare REIT (collectively "Extendicare"). Through its network of owned and operated health care centers, Extendicare REIT's qualified and experienced workforce of 37,700 individuals is dedicated to helping people live better through a commitment to quality service that includes skilled nursing care, rehabilitative therapies and home health care services. Extendicare REIT's 265 senior care centers in Canada and the United States have capacity to care for approximately 29,400 residents.

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

More information is available at www.extendicare.com.

Financial Highlights

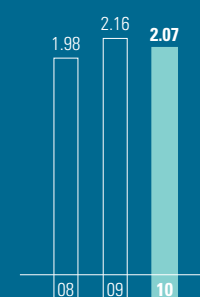
(millions of dollars unless otherwise noted)

	2010	2009	2008
Balance Sheet			
Cash and cash equivalents	267.8	134.0	123.1
Long-term debt (including current portion)	1,222.7	1,234.0	1,332.8
Total assets	1,698.0	1,668.1	1,806.9
Unitholder Information			
Funds from operations (FFO) – continuing operations	106.8	142.0	71.4
FFO from continuing operations (\$ per basic unit)	1.31	1.95	0.99
Adjusted funds from operations (AFFO) – continuing operations	110.4	141.3	72.4
AFFO from continuing operations (\$ per basic unit)	1.35	1.94	1.00
Distributions declared	68.8	61.3	80.6
Distributions declared (\$ per basic unit)	0.84	0.84	1.11
Weighted average units – Basic (thousands)	81,533	73,000	72,460
– Diluted (thousands)	95,346	86,817	82,558

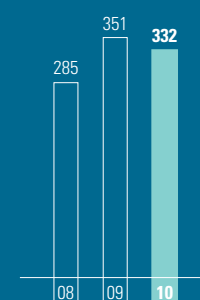
Forward-looking Statements – Information provided by Extendicare REIT from time to time, including this Annual Report, contains or may contain forward-looking statements concerning anticipated future events, results, circumstances, economic performance or expectations with respect to Extendicare REIT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

(1) Refer to non-GAAP measures on page 65.

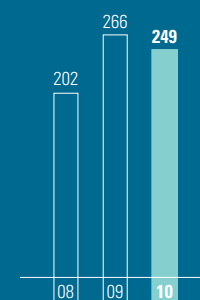
Revenue
(in billions of dollars)



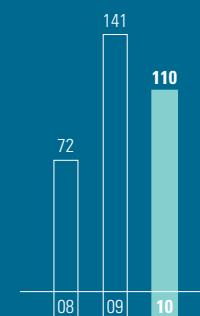
Net Operating Income⁽¹⁾
(in millions of dollars)



EBITDA⁽¹⁾
(in millions of dollars)



AFFO from Continuing Operations⁽¹⁾
(in millions of dollars)



Investment Highlights

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

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



Contents

2	CEO's Message
5	Operations Overview
6	Quality in All Aspects of Our Business
10	Mission, Vision, Values
11	Financial Review
118	Corporate Governance
119	Officers and Executives
120	Five-year Summary
IBC	Unitholder Information

CEO's Message

Fellow Unitholders,

In a year characterized by continuing economic weakness in North America, the implementation of health care reform initiatives in the U.S. and growing regulatory oversight in Canada, Extencare REIT continued to achieve consistent, stable financial and operational performance, while maintaining a strong balance sheet. In 2010, we maintained a market leadership position in the long-term care sector by remaining true to our business strategy, our ongoing focus on cost control and our established commitment to providing quality care and services to our residents.

Excluding the adverse effect of the stronger Canadian dollar, Extencare REIT recorded year-over-year growth in revenue and EBITDA of 2.8% and 1.0%, respectively. Our EBITDA margin was 12.0% in 2010 compared to 12.3% in 2009 due to softness in our U.S. occupancy levels. Also, an unanticipated charge of \$13.9 million (US\$13.5 million) was taken in the third quarter to strengthen our reserves for self-insured general and professional liabilities with respect to pre-2009 claims. Over the past several years, a number of important steps have been taken to positively influence our clinical outcomes and regulatory performance, and we are confident these will enable us to manage our liability risk effectively and reduce the frequency and cost of future claims.

U.S. Operations

Extencare's U.S. operations achieved an EBITDA margin of 12.9% in 2010 compared to 13.2% in 2009. Although our average funding rates increased throughout the year, the delayed economic recovery continued to have a dampening effect on our efforts to increase

our occupancy levels. As part of our efforts to strengthen our census levels Extencare developed the *Life Enhancement Series*, which are programs designed to meet the specialized needs of our patients. For patients requiring intensive short-term rehabilitation, we have established rehabilitation suites in select locations that offer a variety of hotel-style amenities, quality of life programs and predominately private-room accommodations. In the past year, eight such projects were completed, involving 211 beds with an investment of US\$7.1 million. Four additional projects that involve 176 beds at a cost of US\$3.4 million are under way. Two skilled nursing centers have also been added to our portfolio, with the recent openings of a 100-bed center in Indiana last November and a 120-bed center in Michigan in January 2011.

Our marketing initiatives in the U.S. focus on establishing strategic alliances and specific programs to mirror the objectives of our key hospital and other referral sources, who will become important partners under health care reform. Our marketing materials are also being designed to more fully inform our referral sources of our programs and Extencare's quality of care agenda and record. We believe that these initiatives will further enhance our performance as the economy recovers.

U.S. Health Care Reform

The U.S. health care reform legislation enacted into law in March 2010 included a number of reform components planned to be implemented over the next 10 years. These include the establishment of Accountable Care Organizations (ACO), the creation of value-based purchasing demonstrations, Quality Assurance and Performance Improvement mandates, and the overriding goal to reduce or



Timothy L. Lukenda
President & Chief Executive Officer

In 2010, we maintained a market leadership position in the long-term care sector by remaining true to our business strategy, our ongoing focus on cost control and our established commitment to providing quality care and services to our residents.

control per capita cost of health care. In this changing environment, Extencare's strategy for success includes the development of post-acute products and competencies that improve outcome-based care results, minimizing the number of residents who return to hospital after admission to our centers, and aligning with acute and ACO partners to demonstrate our value proposition to stakeholders within the health care system.

On October 1, 2010, the government changed the Medicare reimbursement system with the implementation of MDS 3.0 and RUG-IV. This involved a realignment of the Medicare Part A rates affecting the provision of therapy services provided in skilled nursing centers, as well as improving payments for higher acuity care residents to more accurately reflect the higher costs of care for these residents. In addition, the government implemented changes to the delivery of concurrent therapy and the elimination of the hospital look-back period, which we had initially anticipated would eliminate any potential benefit from the realignment of the rates. In response, our mitigating strategies have offset the adverse effect of these changes. These initiatives, together with the improved payments, have resulted in a 10.5% increase in our average Medicare Part A rates for the fourth quarter of 2010 over the third quarter.

We continue to monitor the challenges and opportunities presented by health care reform initiatives, while taking advantage of the positive elements to grow our business.

U.S. Debt Refinancing

We are in the process of refinancing approximately US\$635 million of long-term debt in our U.S. operations, of which US\$624.5 million matures in 2011 and 2012. We expect to replace this debt with approximately US\$568 million in mortgages insured by the U.S. Department of Housing and Urban Development, at a savings

of approximately US\$11 million in annual interest costs. While the refinancing process is an intensive and cumbersome process, we are confident in our ability to successfully navigate the process to completion.

Canadian Operations

Extencare's Canadian operations EBITDA margin remained unchanged at 10.1% in 2010. We benefited from funding increases in Alberta and Ontario in response to the rising costs of care and the implementation of new government regulations. Overall occupancy levels remained high throughout the year.

On the development side, Extencare opened a state-of-the-art continuing care center in Red Deer, Alberta, in September 2010 that will house 220 long-term care residents and 60 assisted living residents. Also, in January 2011, we opened Fairmont Park, our new 140-unit designated assisted living center in Lethbridge, Alberta with 92 supportive living units and 48 dementia care beds. Our existing 120-bed long-term care center in Lethbridge closed in January 2011. At year-end 2011, we anticipate opening Eaux Claire, our new 180-bed nursing center in Edmonton, Alberta, replacing our 113-bed long-term care center in Edmonton, which will close.

Extencare currently has 23 centers with approximately 3,600 beds that require redevelopment under the Ontario government's mandate to upgrade a total of 35,000 long-term care beds across the province over the next 10 to 15 years. As previously announced, two of our redevelopment projects were approved this past year under Phase One of the program, with construction scheduled to begin in Timmins and Sault Ste. Marie in the spring of 2011. The 256-bed center in Sault Ste. Marie and 180-bed center in Timmins will replace existing centers in these communities, while also increasing our licensed bed capacity by an additional 149 beds.

We have a robust, well established business model, strong balance sheet and experienced management team with the skill and expertise that will enable us to chart our course to continued future success.

Canadian Regulatory Environment

In 2010, considerable effort was made to prepare our Ontario centers for the implementation of the Long-Term Care Homes Act, 2007 that became law on July 1, 2010. This included aligning our policies and procedures with new legislative requirements and providing resources to assist the centers in achieving compliance. While the government has provided funding enhancements to assist the sector in the transition process, it remains uncertain whether meeting the additional requirements will be adequately reimbursed.

During the year, the Ontario government announced that wage freezes are expected to be extended to the broader public sector, including government-funded private sector operations, such as Extendicare's Ontario operations. To date, arbitrators have awarded several union wage increases in the long-term care sector, despite this mandate. As a result, the incremental cost of these arbitrated wage settlements will be an unfunded mandate to our operations.

Due to these numerous government restraints in Ontario, Extendicare faces several pressures in 2011. We expect to mitigate these cost pressures by implementing further cost containment measures at the corporate and regional office levels.

Looking Ahead

Going forward, we continue to invest in our properties and develop new quality centers which, combined with our strategic marketing efforts, are expected to accelerate our performance as we fully emerge from the recession. Most importantly, we continue to enhance the quality of the services and programs we provide to our customers because we believe quality is the key to our success.

We will continue to explore opportunities to expand in related health care businesses. As well, we see an opportunity to pursue consulting and managed contracts for those operators finding it difficult to cope in this environment.

Extendicare has a history of success and a proven track record and, in spite of the current uncertainty in the industry, we remain confident about our capabilities. We have a robust, well established business model, strong balance sheet and experienced management team with the skill and expertise that will enable us to chart our course to continued future success. Within the health care continuum, skilled nursing centers offer cost-effective care to individuals with significant clinical and rehabilitation needs. As a leading low-cost provider of senior care services, we are confident that Extendicare will remain an integral player in the health care arena.

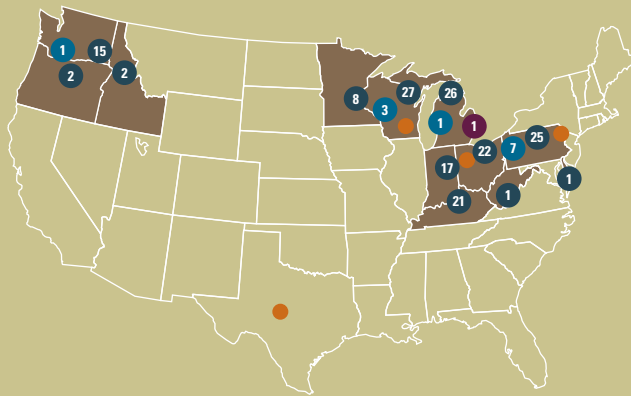
We are dedicated to the provision of quality care, programs and services across our organization. I would like to express my appreciation and gratitude to our customers, our employees, our Board and our unitholders for their dedication, confidence and continued support in achieving our vision. Through our collective efforts, we are well positioned to take advantage of opportunities for continued growth and navigate future challenges. In this way, we are demonstrating to all of our stakeholders that "quality is our business".

(signed)

Timothy L. Lukenda
President & Chief Executive Officer

Operations Overview

U.S. Operations



- Nursing centers
- Assisted living & retirement centers
- Rehab hospital
- ProStep outpatient rehab (21 clinics)

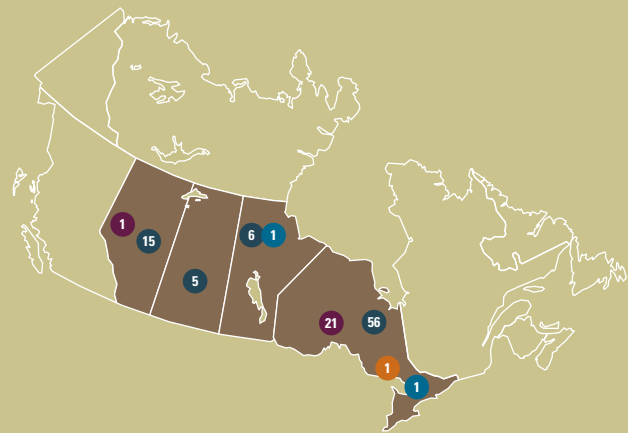
180 centers in 12 states	17,566 beds	33% quality mix census	52% quality mix revenue
---------------------------------------	-----------------------	-------------------------------------	--------------------------------------

- Revenue increased 2.7% to US\$1,365.4 million
- Higher average daily revenue rates from two highest funding sources
 - Medicare Part A: increased 3.9% to US\$471
 - Managed Care: increased 1.6% to US\$422
- Two new skilled nursing centers
 - 100-bed, Michiana Health and Rehabilitation center in Mishawaka, Indiana (November 2010)
 - 120-bed, Capital Area Health and Rehabilitation center in Lansing, Michigan (January 2011)
- The American Healthcare Association and the National Center for Assisted Living awarded 27 National Quality Awards to Extendicare centers
- Completed eight new Active Life Transition Units, 211 beds

Overview

Extendicare REIT's U.S. operations are conducted through its wholly owned subsidiary, Extendicare Health Services Inc. (EHSI). The continued U.S. economic recession affected our U.S. operations and resulted in a decline of our same-facility census mix. We continue to implement short- and longer-term strategies to ensure our U.S. centers are well positioned to increase census as the economy recovers. U.S. operations represented approximately 68% of consolidated revenue and 73% of consolidated EBITDA in 2010.

Canadian Operations



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

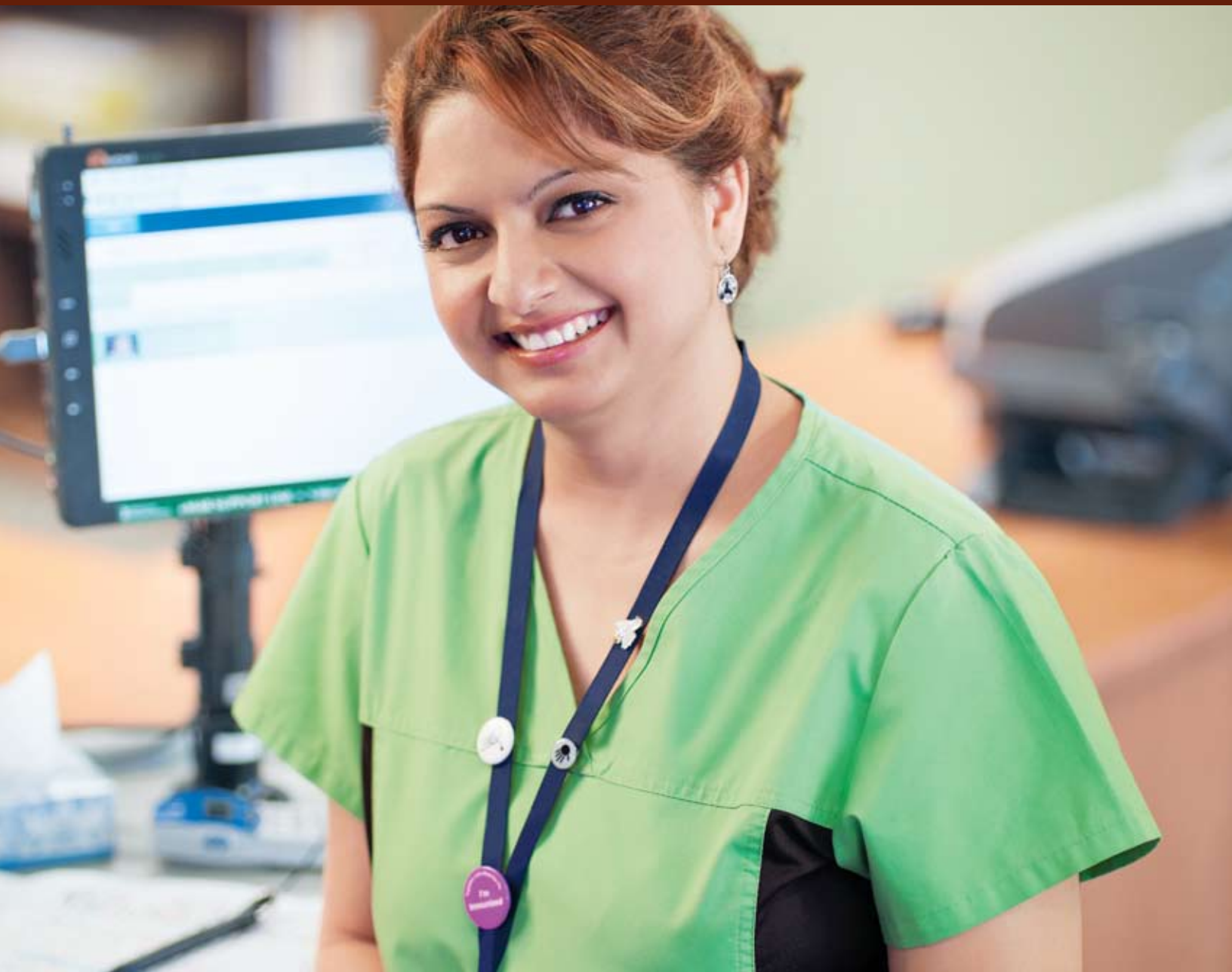
85 centers in 4 provinces	11,789 beds	75% of resident capacity in Ontario	98% occupancy
--	-----------------------	---	-------------------------

- Revenue increased 3.1% to \$662.9 million
- Additional annual revenue gained through funding increases in Alberta and Ontario
- Three new centers in Alberta
 - 280-bed continuing care center in Red Deer (September 2010)
 - 140-bed designated assisted living center in Lethbridge (January 2011)
 - 180-bed nursing center in Edmonton (late 2011)
- Two new state-of-the-art centers planned for construction in Ontario
 - 180-bed nursing center in Timmins (late 2012)
 - 256-bed nursing center in Sault Ste. Marie (late 2012)

Overview

Extendicare REIT's Canadian Operations are conducted through its wholly owned subsidiary, Extendicare (Canada) Inc. (ECI). Our average occupancy levels remained consistently close to full capacity in 2010. We continue to invest in our properties and develop new high-quality locations to meet the needs of our residents. Canadian operations represented approximately 32% of consolidated revenue and 27% of consolidated EBITDA in 2010.

Quality in All Aspects
of Our Business



Delivering quality care is simply good business. Delivering quality products and services in a quality environment ensures we achieve solid financial results while meeting the needs of our customers and creating stable, sustainable returns to unitholders.

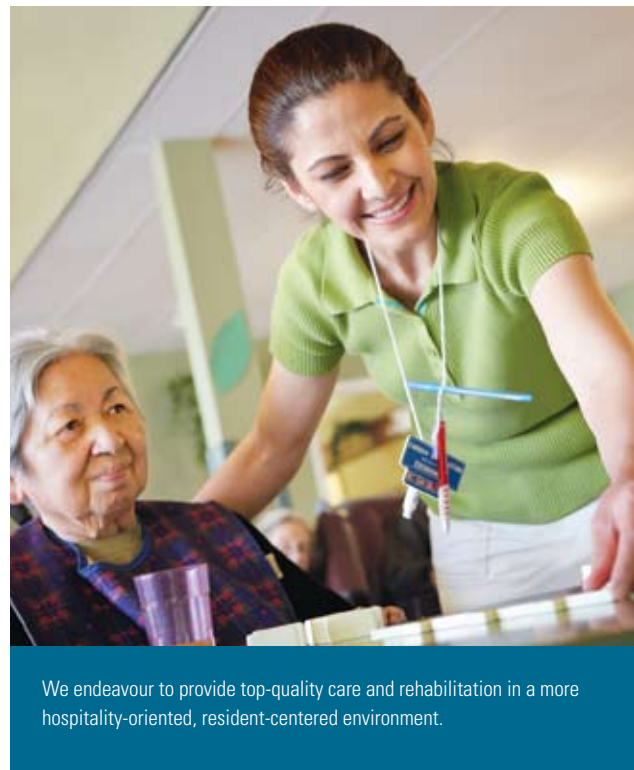
Extendicare's continued success reflects our well-established reputation for quality, honesty, professionalism and respect in the way we treat our patients, residents and our other customers, and it is a testament to how we manage our centers. Although our Canadian and U.S. operations differ, we endeavour to maintain a consistent standard of quality across all of our operations. For us, delivering quality care is simply good business. Delivering quality products and services in a quality environment ensures we achieve solid financial results, while meeting the needs of our customers and creating stable, sustainable returns to unitholders.

Quality Services

At Extendicare, we're playing a leading role in shaping the look of long-term care in the 21st century. We endeavour to provide top-quality care and rehabilitation in a more hospitality-oriented, resident-centered environment and we are recognized in the industry as a quality operator by governments across the country and by providers who frequently call upon our expertise to manage their centers or offer advice.

In the United States, Extendicare is part of the "Quality First" initiative developed by the American Health Care Association and the Alliance for Quality Nursing Home Care. "Quality First" is a national, public pledge focused on improving quality care for patients and residents in long-term care and assisted living centers. It promotes a progressive workplace for employees, supports the development of quality measures, adopts quality improvement practices and publicly discloses the results of our quality performance.

In Canada, the Extendicare National Quality Council supports national quality and performance improvement efforts, as well as encourages a national focus across the organization to ensure our residents receive a consistent standard of care and services in three key areas: quality of care, safety and quality of life.



We endeavour to provide top-quality care and rehabilitation in a more hospitality-oriented, resident-centered environment.

In seeking to provide our customers with the standards of quality care they require, we are committed to hiring people with the skill, knowledge and talent to develop and implement innovative programs and services.

Delivering the Quality Care Experience

As a leading long-term care provider, we are committed to creating a quality environment that provides patient privacy and preserves seniors' dignity. To ensure our mission is accomplished, we focus on measurable quality initiatives to be implemented at all levels of our organization.



As a leading long-term care provider, we create a quality environment with an emphasis on patient privacy, preserving seniors' dignity, quality of life, safety and care for our residents.

In the U.S., we created specialty programs, *Life Enhancement Series*, designed to meet the specific needs of our residents. In Canada, we developed an innovative new design concept for our properties that enables our clients to live in a more residential, resident-directed environment, while receiving quality clinical services.

Extendicare's inaugural *Quality and Social Responsibility Report* produced in 2010 was a significant achievement. The U.S. and Canadian reports demonstrate our company's commitment to being on the leading edge of quality care and to building a lifestyle environment focused on quality of life, safety and quality of care for our residents, to help them live better.

Virtual Care Provider, Inc. is a wholly owned subsidiary of Extendicare that helps providers of post-acute care in over 1,600 communities to solve business challenges with new and emerging technologies. Our ongoing investment in technology enhances the individualized care planning and tracking for our residents, enhances communication capabilities within our centers and optimizes efficiencies in our back-office processes.

The Quality of Our People Defines Who We Are

At Extendicare, we acknowledge the importance of identifying and retaining top-quality employees and recognize the high standards of care they provide. We strive to create enjoyable and rewarding work environments for our team and endeavour to provide a nurturing work environment where employees are respected as professionals and have the opportunity to grow and thrive.



We continually invest in both the renovation of our existing centers and in the design of new health and rehabilitation centers in order to meet our customers' demand for high-quality care in a more residential environment.

In seeking to provide our customers with the standards of quality care they require, we are committed to hiring people with the skill, knowledge and talent to develop and implement innovative programs and services that will optimize the living and working environments for our residents, clients and employees.

We encourage team members to live the Extendicare vision of excellence by offering continuing education opportunities. When new programs are created, employees are given additional training to help them promote overall health and well-being for our customers and to achieve a higher level of functioning whenever possible.

Our *Corporate Compliance Program* represents an invaluable resource to educate our team members and monitor the pulse of the organizational commitment to quality and overall compliance. Through this program, we continue to identify new systems and processes to improve the organization.

Quality Properties

To meet the demands of our customers for high-quality care in a more residential environment, we continually invest in both the renovation of our existing centers and in the design of new health and rehabilitation centers. We are also creating more private suites and home-like environments that provide a warm, inviting feel and have greater amenities. Our two Ontario redevelopment projects under

way in Sault Ste. Marie and Timmins will demonstrate leadership in design and excellence in quality care and are prototypes for the future delivery of health care in the province.

Quality Business

Extendicare's proven business model, ongoing focus on cost management, strong balance sheet and experienced team allow us to navigate our course to continued success. Through the effective communication of our goals and accomplishments, we will achieve profitable growth over the long term and create value for our investors. With a progressive property portfolio, an efficient team and quality services, Extendicare is strategically positioned to take advantage of future opportunities.

Mission, Vision, Values

Our Mission

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

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

Our Vision

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

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

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

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

Our Values

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

Respect | Integrity | Pride | Compassion | Responsiveness | Dignity

2010 Extendicare REIT Financial Review

Table of Contents

Management's Discussion and Analysis	12		59
Basis of Presentation	12	Related Party Transactions	59
Overview	13	Off-balance Sheet Arrangements	59
Key Performance Indicators	18	Risks and Uncertainties	60
Impact of U.S. Dollar and Foreign Currency Translation	24	Accounting Policies and Estimates	65
Adjusted Funds from Operations	25	Additional Information	75
Distributions	27	Financial Statements and Notes	76
Summary of Quarterly Results	28	Management's Responsibility for Financial Statements	76
2010 Financial Review	33	Auditors' Report	77
Significant Developments	38	Consolidated Financial Statements	78
Update of Legislative Actions Affecting Revenue	44	Notes to Consolidated Financial Statements	82
Liquidity and Capital Resources	51		

Forward-looking Statements

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

Forward-looking statements reflect management's 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 Annual Report are expressly qualified by this cautionary statement. Given these risks and uncertainties, readers are cautioned not to place undue reliance on the forward-looking statements of the REIT.

Management's Discussion and Analysis

(March 21, 2011)

Basis of Presentation

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

Extencicare REIT is the successor in interest to Extencicare Inc. (Extencicare) resulting from the conversion of Extencicare to an unincorporated, open-ended limited purpose trust on November 10, 2006, pursuant to a plan of arrangement (the "Arrangement"). Extencicare REIT was established under the laws of the Province of Ontario pursuant to a deed of trust, dated September 11, 2006, as amended and restated on October 28, 2006 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 reflect the consolidated financial position, results of operations and cash flows as if the REIT had always carried on the business formerly carried on by Extencicare.

This MD&A should be read in conjunction with Extencicare REIT's audited consolidated financial statements for years ended 2010 and 2009 and the notes thereto.

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. Extencicare REIT's accounting policies are in accordance with Canadian generally accepted accounting principles (GAAP) of The Canadian Institute of Chartered Accountants (CICA). All dollar amounts are in Canadian dollars unless otherwise indicated. Except as otherwise specified, references to years indicate the fiscal year ended December 31, 2010, or December 31 of the year referenced.

Certain figures have been reclassified to conform with the presentation in 2010, mainly for the reclassification of non-reimbursable bad debts from operating expense to a contra-revenue account. Over the past several years, an increasing number of states have decided to refrain from reimbursing providers for the resident's co-payment portion of Medicare Part B therapy services provided to Medicaid residents who do not have the resources to pay for the services themselves. This was most recently the case in the State of Ohio. As a result, EHSI has reclassified its non-reimbursable Medicare Part B bad debt expense from operating expense to net it with revenue, beginning in 2010. The impact of this reclassification in 2010 and 2009 was to reduce revenue and operating expense from continuing operations by \$6.3 million (US\$6.1 million) and \$5.6 million (US\$4.9 million), respectively.

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

Overview

Business Strategy

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

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

As a result of the recently unprecedented economic times along with the changing regulatory and funding environment in which Extencare REIT operates, and in view of the income tax rules affecting specified investment flow-through trusts (SIFTs), the trustees and management of the REIT are continuously reviewing possible strategies, opportunities and alternatives available to the REIT with a view to enhancing the value of the REIT.

Investment Overview

An investment in the units of Extencare REIT entitles the holder to a monthly cash flow stream, through distributions at the discretion of the board of trustees of the REIT (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 of Trustees 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 February 28, 2011, of \$10.08, this represents a yield of 8.3%. More information about distributions, including tax considerations, is provided under the heading "Distributions".

Our long-term growth and financial performance is influenced by a number of factors. First and foremost among these factors is the demand for senior care centers and other related long-term care services in the United States and Canada. In both countries, the outlook for these services is favourable due to an aging population as the "baby-boomer" generation enters its senior years. For example, the U.S. Census Bureau estimates that the number of Americans aged 65 to 84 will increase by 36.2% between 2010 and 2020 compared to a total population growth of 10.0%. Other important factors affecting results are developments related to government funding in such programs as Medicare and Medicaid in the United States and the envelope funding systems in Ontario. Given that 68.0% of our revenue in 2010 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 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 Legislative Actions Affecting Revenue – United States".

Our financial performance is also affected by changes in the U.S./Canadian dollar exchange rate as the results of our U.S. operations are reported in Canadian dollars and the REIT's distributions are made in Canadian dollars. Consequently, our financial performance benefits when the Canadian dollar weakens relative to the U.S. currency, and conversely our results are negatively impacted when the U.S. dollar weakens relative to the Canadian dollar. However, with respect to our distributions, we have a foreign currency hedging strategy to reduce the risks associated with changes in the U.S. dollar and the impact such changes could have on our Canadian dollar distributions. Information about the impact of currency translation on our financial results, and a review of our foreign currency hedging strategy, is provided in the section "Impact of U.S. Dollar and Foreign Currency Translation".

Management's Discussion & Analysis

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 265 senior care centers with capacity for 29,355 residents at December 31, 2010.

The REIT's wholly owned U.S. subsidiary, Extendicare Health Services, Inc. and its subsidiaries (collectively "EHSI"), operates 180 senior care centers with capacity for 17,566 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 85 senior care centers in Canada, with capacity for 11,789 residents. ECI has a significant presence in Ontario and Alberta, where approximately 75% and 12% of its residents are served, respectively. Also, through its ParaMed Home Health Care (ParaMed) division, ECI is a major provider of home health care in Ontario and Alberta.

Extendicare REIT owns rather than leases a majority of its properties, unlike a number of other long-term care providers. At December 31, 2010, excluding centers under management contracts, we owned or operated under lease arrangements with options to purchase 221 centers, or approximately 98%, of our 225 owned or leased centers. We believe that ownership increases our operating flexibility by allowing us to: refurbish centers to meet changing consumer demands; expand or add assisted living and retirement centers adjacent to our nursing centers; adjust licensed capacity to avoid occupancy-based rate penalties; and divest centers and exit markets at our discretion.

The following table depicts ownership and management of senior care centers operated by EHSI and ECI at December 31, 2010, excluding those designated as discontinued operations.

By Type of Ownership	Nursing Centers		Assisted Living and Retirement Centers		Rehab Hospital/Chronic Care Units		Total	
	No. of Centers	Resident Capacity	No. of Centers	Resident Capacity	No. of Centers	Resident Capacity	No. of Centers	Resident Capacity
United States								
Owned	157	15,959	4	310	1	28	162	16,297
Leased	5	500	–	–	–	–	5	500
Managed	5	519	8	250	–	–	13	769
Total	167	16,978	12	560	1	28	180	17,566
Canada								
Owned	49	6,549	–	–	–	–	49	6,549
Leased ⁽¹⁾	9	1,155	–	76	–	–	9	1,231
Managed ⁽²⁾	24	3,424	2	465	1	120	27	4,009
Total	82	11,128	2	541	1	120	85	11,789
Total	249	28,106	14	1,101	2	148	265	29,355

(1) We operate nine leased centers in Canada under 25-year capital lease arrangements maturing beginning in 2026 through to 2028, and in the U.S. we operate one center under a 10-year capital lease arrangement maturing in 2020.

(2) Ten centers (1,819 beds) in Ontario that ECI had been managing for a receiver have been sold. Consequently, effective January 1, 2011, ECI ceased managing eight of the centers (1,430 beds) and will continue to manage the other two centers for a year. For further details refer to the discussion under the heading "Significant Developments – Managed Contracts".

The following table reflects the change in senior care centers operated during 2010 and 2009.

	2010		2009	
	No. of Centers	Operational Beds/Units	No. of Centers	Operational Beds/Units
Extendicare REIT Senior Care Centers				
As at beginning of the year	258	28,818	266	30,028
Development (owned and leased) ⁽¹⁾	2	320	3	260
Managed contracts added	5	272	3	324
Managed contracts matured	(1)	(148)	(4)	(509)
Divested or discontinued ⁽²⁾	1	113	(10)	(1,089)
Operational capacity adjustments ⁽³⁾	–	(20)	–	(196)
As at the end of the year	265	29,355	258	28,818

(1) 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. 2009 activity: In August we opened a 100-bed skilled nursing center in Okemos, Michigan, and in October we opened a 100-bed skilled nursing center and 60-unit assisted living center in Summit, Wisconsin.

(2) Refer to the discussion under the heading “Significant Developments – Discontinued Operations and Assets Held for Sale”.

(3) The 2009 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, some of which were reinstated during 2010. In addition, the operational capacity of our Lethbridge, Alberta nursing center was reduced by 24 at the end of 2009 and by a further 34 in the 2010 fourth quarter as part of the downsizing plan which led to the eventual closure of the center when the new one opened in January 2011.

Development Projects

During 2010, ECI opened its new Red Deer, Alberta center to long-term care residents (220 beds) in September 2010, and the attached designated assisted living wing (60 units) opened for admissions in February 2011. As well, construction of a skilled nursing center in South Bend, Indiana, totalling 100 beds, was completed in September, and EHSI began operating the center under a capital lease arrangement in November.

The following table summarizes the projects that were not operational as at December 31, 2010. The REIT’s pipeline of remaining projects at year end included two owned construction projects under way in Alberta, Canada, totalling 320 beds, one of which opened in January 2011, and the other is scheduled for completion in late 2011, and two Ontario redevelopment projects totalling 436 beds that are scheduled for completion in 2012. As well, construction of a skilled nursing center in Michigan totalling 120 beds was completed September and EHSI began operating it under an operating lease arrangement on January 1, 2011. We have two existing Alberta centers and two Ontario class “C” centers that will close upon completion of these new centers in their respective areas.

	New Centers		Existing Centers to Close	
	No. of Centers	Beds/Units	No. of Centers	Beds/Units
Development Projects (as at December 31, 2010)				
Canada – Owned Centers Under Way				
Alberta – Lethbridge opened in January 2011 ⁽¹⁾	1	140	(1)	(62)
– Edmonton scheduled for completion Q4/11	1	180	(1)	(122)
Ontario – “C” redevelopment projects – commencing Q2/11 for completion Q4/12	2	436	(2)	(287)
U.S. – Centers under Contractual Lease Obligations (opened in January 2011)	1	120	–	–
	5	876	(4)	(471)

(1) Our existing Lethbridge, Alberta nursing center closed when the new center opened in January 2011. The operational capacity of the existing center was reduced from 120 to 96 at the end of 2009, and by a further 34 in 2010 to 62 prior to its closing.

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

Management's Discussion & Analysis

2011 Refinancing Plan

During 2011, EHSI plans to refinance approximately US\$635 million of debt with approximately US\$568 million in mortgages insured by the U.S. Department of Housing and Urban Development Program (HUD), thereby reducing debt by about US\$67 million with cash on hand. As at December 31, 2010, EHSI had US\$158.6 million of cash on hand in preparation for its 2011 refinancing. Assuming EHSI is able to reduce its debt by US\$67 million and secure an average interest rate, inclusive of associated fees, of 5.3%, interest costs would be reduced by an estimated US\$11 million per annum.

The debt to be refinanced relates primarily to EHSI's commercial mortgage backed securitization (CMBS) financings and mortgage financing from Sovereign Bank and other lenders (the "Sovereign Loans") totalling US\$624.5 million as at December 31, 2010, that mature in 2011 and 2012. As at December 31, 2010, EHSI had CMBS financings of US\$491.7 million that mature in November 2011 (the "2011 CMBS Financing") and US\$87.6 million that mature in March 2012 (the "2012 CMBS Financing"), and the Sovereign Loans of US\$45.2 million that mature in June 2011. The CMBS financings have a prepayment penalty that continues through to three months prior to their maturity dates 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 received approval in July 2010 as a corporate entity to proceed with HUD applications subject to an overall limit of US\$550.0 million. As at December 31, 2010, EHSI had US\$27.5 million in HUD-insured mortgages providing it with the ability to seek up to US\$522.5 million in additional HUD financing. EHSI intends to seek approval from HUD by June 2011 for a further US\$50.0 million of financing capacity, enabling it to seek up to US\$572.5 million in additional HUD financing.

The refinancing is anticipated to be completed in several phases between now and 2012. As at December 31, 2010, EHSI had submitted loan applications to HUD for 19 skilled nursing centers representing mortgages totalling approximately US\$127 million, most of which pertain to the Sovereign Loans. In respect of its CMBS financings, EHSI plans to submit HUD loan applications for a total of 61 skilled nursing centers, seeking mortgages totalling approximately US\$441 million, which brings the total applications to US\$568 million.

EHSI believes that it has full financial capacity to complete the refinancing of the CMBS financings and the Sovereign Loans. EHSI anticipates that HUD will complete the processing of the Sovereign Loans and the 2011 and 2012 CMBS financings in stages through to November 2011 in order to enable EHSI to prepay the Sovereign Loans before June 2011 and both CMBS financings prior to November 2011. After the refinancing is completed, EHSI will have an additional 34 unencumbered centers.

The REIT has taken the appropriate steps to secure bridge financing that would provide flexibility in the refinancing process and to also ensure that alternative financing is available, if required. In order to provide flexibility in the refinancing process, EHSI obtained a letter from a lender in January 2011 (the "Highly Confident Letter"), with a proposal to provide a bridge term loan facility to assist in the execution of the refinancing plan. In providing the Highly Confident Letter the lender conducted suitable due diligence of EHSI's refinancing plan and received approval from its internal credit committee. EHSI has not proceeded to move forward with the bridge term loan at this time. As well, EHSI is in the process of negotiating a loan modification that includes a six-month extension of the maturity of its 2011 CMBS Financing to facilitate the timing of its refinancing process. In addition, as an alternative to HUD financing, EHSI believes, based upon communication with its bankers, that it can secure either a bank term loan and/or issue senior unsecured notes.

EHSI's amended and restated US\$70.0 million credit facility (the "EHSI Credit Facility") matures in June 2011 unless it is extended in whole or in part by the lenders for an additional one-year term. In March 2011, EHSI obtained approval from all of the lenders of the EHSI Credit Facility for the one-year extension term with no change in the financial terms of the loan.

Global Economic Environment

The most significant factor impacting the REIT's industry this past year, and for the near term, is the global economy. Beginning in the latter part of 2008, the economy and stock markets suffered a significant downturn as a result of the worldwide credit and liquidity crisis that impacted market values of securities, values of commodities, such as oil and gas, interest rates and the foreign exchange markets; and there have been unprecedented job losses in both the U.S. and Canada. Though we have seen increases in the values of securities and increased liquidity in the credit market, there continues to be general restraint on a corporate and individual spending level. With a dramatic reduction in corporate profits and reduced consumer confidence, the fiscal health of provincial, state and federal governments have been dampened; consequently, the future funding of services for which they provide support may be at risk.

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

- reducing distributions and growth projects along with divestiture of underperforming assets;
- focusing on core business and cost reduction initiatives;
- monitoring 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;
- 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; and
- ability to finance and refinance loans, and the resulting higher cost of borrowing.

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 74% of our consolidated operating costs, and we are subject to resident and regulatory requirements, which provides us with limited flexibility in managing our labour costs. In addition, any escalation of regulatory pressure by the Centers for Medicare & Medicaid Services (CMS), state or provincial level government agencies could have a negative impact on our costs and thereby reduce our earnings. Federal, state and provincial health care associations have lobbied vigorously for continuation of consistent funding in the sector.

In response to the economic downturn, U.S. governments have initiated a number of cost-reduction and job-creation programs. In February 2009, the *American Recovery and Reinvestment Act of 2009* provided US\$787 billion in government stimulus of which US\$86.7 billion was appropriated to increase funding for state Medicaid programs. However, despite this additional funding and the stated intention to maintain core education, health and unemployment funding, a number of states in which we operate faced severe budgetary shortfalls in 2009 and 2010, and have implemented reductions in Medicaid funding or below inflationary increases. U.S. Congress extended the temporary increase in federal medical assistance percentage, or FMAP, funding through December 31, 2010. In early August 2010, legislation was signed into law by the U.S. President to extend the FMAP funding to June 30, 2011, though on a phased-down basis for most but not all states. An extension beyond June 2011 is unlikely and will negatively impact future state budgets. The impact to Medicare and Medicaid rates is outlined in detail under the heading "Update of Legislative Actions Affecting Revenue – United States".

In response to the economic downturn, the Ontario government implemented a two-year wage freeze beginning in 2010 and indicated its expectation that this 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. Despite this government mandate, arbitrators have awarded increased union wages in the long-term care sector. Other provincial governments have also restrained funding increases in 2010 that could affect ECI's future margins.

In response to the reductions in government funding, we have undertaken a number of initiatives since the latter half of 2008 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.

Management's Discussion & Analysis

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 (2009 – 80%), 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 believe that the majority of long-term care providers in the United States have experienced a decline in short-term admissions. We also believe the decline we experienced since the 2008 fourth quarter in Medicare admissions was in part due to individuals deferring elective surgery due to the economy and the resulting reduction in required post-acute care. Our future earnings could be eroded further should the level of admissions decrease as a result of lower incomes and lower financial resources of our prospective residents.

In response, we have refocused and refined our strategic marketing plans, are working on strategic alliances within the marketplaces where we operate, and have invested to improve the number of rehabilitation suites within our portfolio to increase our market share in communities where we anticipate a return on the investment.

ABILITY TO RAISE FINANCING AND REFINANCE LOANS

In respect of the financing environment, the continuing economic weakness in North America has restricted the ability of companies to raise capital, to finance and refinance loans, and has increased the cost of borrowing.

In the United States, the availability of low-cost and long-term financing is more limited than prior to the global economic downturn, as are the sources and options for financing. As a result, the terms and conditions of financing are less favourable to the REIT. EHSI is currently proceeding with refinancing the majority of the CMBS financings and Sovereign Loans with mortgages insured by HUD. Mortgages insured through HUD are available to all qualifying long-term care operators and represent a low-cost and long-term financing option for the REIT. However, additional administrative costs are required to establish and maintain HUD mortgages. As an alternative to HUD, EHSI believes, based upon communication with its bankers, that it can secure either a bank term loan and/or issue senior unsecured notes. Management continuously monitors its refinancing risks and communicates regularly with lenders to maintain an understanding of the availability and cost of capital.

During 2009, the REIT was successful in renewing its U.S. line of credit and amending its Canadian line of credit and in March 2011 obtained approval for a one-year extension to the U.S. line of credit. During 2010, the REIT has been successful in raising equity in February, arranging new construction loans and/or long-term financings for its Canadian development projects, and securing a new US\$35.0 million mortgage term loan.

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.

Beginning in 2010, we have refined our U.S. revenue payor and census mix categories to reclassify the Medicaid Managed Care contracts from the Managed Care category to the Medicaid category. As a result, our Managed Care, Skilled Mix and Quality Mix categories now consist solely of non-Medicaid clients. This restatement has been made for all comparative periods presented.

In addition, we have reclassified the non-reimbursable Medicare Part B bad debt expense from operating expense to net it with revenue on our statement of earnings. This has the result of reducing our reported weighted average combined Medicare Parts A and B rates. For further information please see the discussion under the heading "Basis of Presentation".

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;

“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 2010 and 2009 operations in this document, refers to those centers that were operated by us on January 1, 2009, and throughout 2009 and 2010; and

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

U.S. Operations

We focus on short-term stay programs and offering care to residents with higher acuity and those requiring rehabilitative care and services in our skilled nursing center operations. These residents are primarily admitted into our centers with Medicare and Managed Care as their primary funding source. During 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. Therefore, we consider Skilled Mix to be an important performance measurement indicator. Medicaid rates are generally lower than rates earned from other sources.

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, increase 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 3.9% to US\$470.88 in 2010 from US\$453.40 in 2009. For the first nine months of 2010, these average daily rate improved by 1.2% over that of the comparable 2009 period, despite a 1.1% reduction in funding effective October 1, 2009. Whereas, for the 2010 fourth quarter, our average daily Medicare Part A rate grew by 12.0% to US\$509.49 from US\$454.76 in the 2009 fourth quarter, and improved by 10.5% over the 2010 third quarter of US\$461.11. This improvement in the 2010 fourth quarter 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 Legislative Actions Affecting Revenue – United States”.

Our percentage of Medicare patients in the “high” to “ultra high” RUGs classifications and percentage of Medicare residents receiving therapy services increased to 78.5% and 90.0% respectively in 2010 as compared to 75.4% and 89.6% in 2009. However, in the 2010 fourth quarter the percentage of Medicare patients in the “high” to “ultra high” categories declined to 77.4% as compared to 77.8% in the 2009 fourth quarter and to 80.0% in the 2010 third quarter. We also experienced a decline in the percentage of Medicare patients receiving therapy services to 84.6% in the 2010 fourth quarter from 90.6% in the 2009 fourth quarter and from 92.8% in the 2010 third quarter. We believe the declines experienced in the 2010 fourth quarter 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, increased by 1.6% in 2010 to US\$422.06 from US\$415.29 in 2009. For the 2010 fourth quarter, this average daily rate increased by 5.9% to US\$443.19 from US\$418.56 in the 2009 fourth quarter, as well as increasing by 5.6% from US\$419.54 in the 2010 third quarter. While changes in our averaged Managed Care rates are reflective of the type of clients served in any particular quarter, the increase we experienced in the 2010 fourth quarter was largely due to the changes in the

Management's Discussion & Analysis

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. In the first nine months of 2010, we experienced a decrease in our Managed Care rates from the comparable 2009 levels due to the termination by managed care organizations of a number of private fee-for-service Medicare Advantage plans that paid above-average rates to EHSI. These plans were terminated as of January 1, 2010, due to the expectation that they would become less profitable in the future due to health care reform. Residents in those plans transferred either to other managed care plans, which in some cases have lower per diem rates, or to Medicare Part A, which generally pays higher per diem rates depending on the nature of the services provided. 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 3.4% in 2010 to US\$180.24 from US\$174.27 in 2009. The impact of the higher Medicaid rates improved revenue this year by US\$20.9 million over 2009, of which approximately US\$8.1 million was offset by higher state provider taxes. For the 2010 fourth quarter, our average Medicaid rate, excluding prior period settlement adjustments, increased by 3.2% to US\$181.80 from US\$177.81 in the 2009 fourth quarter, and increased from US\$180.55 in the 2010 third quarter. For the majority of the states in which we operate, Medicaid rate increases take effect on July 1 and on October 1. For a discussion of recent Medicaid funding changes, please refer to the section "Update of Legislative Actions 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 continuing operations, excluding prior period settlement adjustments, for the past eight quarters and years ended 2010 and 2009.

<i>(restated)</i>	Q1		Q2		Q3		Q4		Year	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Revenue by Payor Source (%)										
Medicare	33.6	34.6	33.9	34.1	32.7	32.8	33.8	31.8	33.5	33.3
Managed Care	9.5	9.4	9.5	9.6	9.5	9.5	9.8	9.9	9.6	9.7
Skilled Mix	43.1	44.0	43.4	43.7	42.2	42.3	43.6	41.7	43.1	43.0
Private/other	9.0	9.1	9.0	9.4	9.3	9.7	9.2	9.4	9.1	9.4
Quality Mix	52.1	53.1	52.4	53.1	51.5	52.0	52.8	51.1	52.2	52.4
Medicaid	47.9	46.9	47.6	46.9	48.5	48.0	47.2	48.9	47.8	47.6
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Average Revenue Rate by Payor Source (US\$)										
Medicare Part A	457.05	447.79	457.74	454.38	461.11	457.09	509.49	454.76	470.88	453.40
Medicare Parts A and B	499.97	487.01	499.77	497.31	509.87	502.29	554.35	499.60	515.47	496.37
Managed Care	409.89	412.52	415.60	417.72	419.54	408.50	443.19	418.56	422.06	415.29
Private/other	225.46	211.84	223.73	215.17	219.29	212.81	221.74	214.58	222.49	213.60
Medicaid	178.25	172.88	179.79	172.06	180.55	174.96	181.80	177.81	180.24	174.27
Weighted average	250.62	245.11	252.63	245.14	251.38	244.79	260.32	246.23	253.83	245.25

The following table provides the percentage of EHSI's revenue by payor source for its skilled nursing centers on a same-facility basis, excluding prior period settlement adjustments, for the past eight quarters and years ended 2010 and 2009.

<i>(restated)</i>	Q1		Q2		Q3		Q4		Year	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Revenue by Payor Source (%)										
Medicare	33.1	34.6	33.3	34.1	32.2	32.8	33.2	31.7	32.9	33.3
Managed Care	9.5	9.4	9.5	9.6	9.4	9.5	9.7	9.8	9.5	9.6
Skilled Mix	42.6	44.0	42.8	43.7	41.6	42.3	42.9	41.5	42.4	42.9
Private/other	9.1	9.1	9.0	9.4	9.3	9.7	9.2	9.4	9.2	9.4
Quality Mix	51.7	53.1	51.8	53.1	50.9	52.0	52.1	50.9	51.6	52.3
Medicaid	48.3	46.9	48.2	46.9	49.1	48.0	47.9	49.1	48.4	47.7
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

On a same-facility basis, the proportion of our Skilled Mix revenue to total revenue declined to 42.4% in 2010 from 42.9% in 2009, and was below the 2009 comparable levels during the first three quarters of 2010. However, in the 2010 fourth quarter we experienced an improvement to 42.9% from 41.5% in the 2009 fourth quarter, as well as increasing from 41.6% in the 2010 third quarter. These movements between periods are largely reflective of the changes in Skilled Mix average daily census, as discussed in the following section, partially offset by increased average daily rates as discussed previously.

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 Legislative Actions 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 view this as the primary reason for the year-over-year decline in our Skilled Mix and Total census as individuals have elected to defer elective surgeries and mitigate the personal cost of their health care needs. As previously noted, we have implemented a number of short and longer term tactics during 2010, 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, we experienced an increase in our same-facility Medicare ADC from the 2010 first quarter to the 2010 second quarter, which was contrary to past seasonal trends. With respect to the third quarter, a decline in our total ADC from the second quarter is not unusual, and is reflective of our seasonal trends prior to 2008. A decline in Medicare ADC, and to a lesser degree total ADC, is generally experienced during the summer months and is consistent with prior years, as there tends to be fewer elective surgeries performed. Our total ADC continued to decline in the 2010 fourth quarter, which we believe is due to the slow economic recovery. While the delayed economic recovery has dampened the success of our strategic marketing efforts, we believe that these initiatives, in conjunction with new centers and targeted renovations to our existing centers, will accelerate our performance as the economy recovers.

The following table provides the ADC, percentage of total ADC, and average occupancy of EHSI's skilled nursing centers from continuing operations, for the past eight quarters and years ended 2010 and 2009.

	Q1		Q2		Q3		Q4		Year	
<i>(restated)</i>	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Average Daily Census										
Medicare	2,393	2,499	2,415	2,385	2,264	2,274	2,223	2,218	2,323	2,343
Managed Care	825	805	817	797	803	813	807	826	813	810
Skilled Mix	3,218	3,304	3,232	3,182	3,067	3,087	3,030	3,044	3,136	3,153
Private/other	1,432	1,513	1,433	1,518	1,500	1,583	1,509	1,520	1,469	1,534
Quality Mix	4,650	4,817	4,665	4,700	4,567	4,670	4,539	4,564	4,605	4,687
Medicaid	9,563	9,538	9,452	9,490	9,488	9,566	9,462	9,590	9,491	9,546
Total	14,213	14,355	14,117	14,190	14,055	14,236	14,001	14,154	14,096	14,233
Census by Payor Type (%)										
Medicare	16.8	17.4	17.1	16.8	16.1	16.0	15.9	15.7	16.5	16.4
Managed Care	5.8	5.6	5.8	5.6	5.7	5.7	5.7	5.8	5.8	5.7
Skilled Mix	22.6	23.0	22.9	22.4	21.8	21.7	21.6	21.5	22.3	22.1
Private/other	10.1	10.6	10.1	10.7	10.7	11.1	10.8	10.7	10.4	10.8
Quality Mix	32.7	33.6	33.0	33.1	32.5	32.8	32.4	32.2	32.7	32.9
Medicaid	67.3	66.4	67.0	66.9	67.5	67.2	67.6	67.8	67.3	67.1
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Average occupancy (%)	87.1	89.3	86.5	88.3	86.1	88.8	85.7	87.5	86.3	88.5

Management's Discussion & Analysis

EHSI's total skilled nursing center ADC declined by 137 to 14,096 in 2010 from 14,233 in 2009, with declines in all categories, with the exception of Managed Care. However, our Skilled Mix of residents as a percent of total ADC improved marginally to 22.3% this year from 22.1% in 2009, 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 2010 was 86.3% compared to 88.5% in 2009, reflecting the decline in ADC. In addition to the impact of the economy, our 2010 occupancy was impacted by the start-up of two skilled nursing centers, one of which opened in the 2009 fourth quarter and the other in November 2010.

Our same-facility ADC for 2010 of 13,978 was 246 below the comparable 2009 level of 14,224. Our Skilled Mix of residents on a same-facility basis declined to 21.8% in 2010 compared to 22.1% in 2009. We believe that both the hospital and long-term care sectors continue to experience lower volumes as a result of the economy.

The following table provides the ADC, percentage of total ADC, and average occupancy of EHSI's skilled nursing centers on a same-facility basis, for the past eight quarters and years ended 2010 and 2009.

<i>(restated)</i>	Q1		Q2		Q3		Q4		Year	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Average Daily Census										
Medicare	2,326	2,499	2,342	2,385	2,196	2,274	2,143	2,198	2,251	2,338
Managed Care	814	805	802	797	781	811	786	816	796	807
Skilled Mix	3,140	3,304	3,144	3,182	2,977	3,085	2,929	3,014	3,047	3,145
Private/other	1,430	1,513	1,425	1,518	1,485	1,583	1,489	1,517	1,457	1,533
Quality Mix	4,570	4,817	4,569	4,700	4,462	4,668	4,418	4,531	4,504	4,678
Medicaid	9,557	9,538	9,440	9,490	9,467	9,566	9,433	9,590	9,474	9,546
Total	14,127	14,355	14,009	14,190	13,929	14,234	13,851	14,121	13,978	14,224
Census by Payor Type (%)										
Medicare	16.5	17.4	16.7	16.8	15.8	16.0	15.5	15.6	16.1	16.4
Managed Care	5.8	5.6	5.7	5.6	5.6	5.7	5.7	5.8	5.7	5.7
Skilled Mix	22.3	23.0	22.4	22.4	21.4	21.7	21.2	21.4	21.8	22.1
Private/other	10.1	10.6	10.2	10.7	10.6	11.1	10.7	10.7	10.4	10.8
Quality Mix	32.4	33.6	32.6	33.1	32.0	32.8	31.9	32.1	32.2	32.9
Medicaid	67.6	66.4	67.4	66.9	68.0	67.2	68.1	67.9	67.8	67.1
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Average occupancy (%)	87.6	89.3	86.9	88.3	86.4	88.8	86.1	87.9	86.8	88.6

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.

The following are ECI's average daily revenue rates and occupancy levels for the past eight quarters and years ended 2010 and 2009.

	Q1		Q2		Q3		Q4		Year	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Average revenue rate (\$)	174.13	168.14	178.04	172.59	175.53	174.01	183.97	178.19	177.97	173.27
Average occupancy (%)	98.0	97.7	98.3	97.9	97.8	98.3	98.0	98.4	98.0	98.1
Average occupancy (same-facility) (%)	98.0	97.7	98.3	97.9	98.2	98.3	98.2	98.4	98.2	98.1

Revenue from provincial programs represented approximately 65% of ECI's nursing home revenue in 2009 and 2010. ECI's average daily revenue rate increased 2.7% to \$177.97 in 2010 from \$173.27 in 2009. The majority of ECI's nursing home operations are in Ontario, which operates under an 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 the following retroactive funding adjustments which affected the comparability of the rates between periods: \$1.2 million in the 2010 second quarter; \$1.0 million in the 2010 fourth quarter; and \$1.0 million in the 2009 third quarter. For further information on funding in Canada, refer to the discussion under the heading "Update of Legislative Actions 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 the new Alberta center, was 98.2% in 2010 compared to 98.1% in 2009. 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 96% of ECI's home health care revenue in 2009 and 2010. Our average daily home health care hours of service decreased this year to 12,061 from 12,476 in 2009. During 2010, ParaMed provided 4,402,000 hours of home health care service (2009 – 4,554,000), 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. The competitive bidding process was expected to resume in 2010. However to date, we have not received any confirmation of when the process will resume.

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

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 68.0% of consolidated revenue from continuing operations in 2010 (2009 – 70.3%). 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 2010 fourth quarter and the 2010 year.

	Q4		Year	
	2010	2009	2010	2009
Average U.S./Canadian dollar exchange rate	1.0130	1.0586	1.0299	1.1420

Impact on 2010 Periods (millions of dollars)

Revenue	(16.5)	(153.1)
EBITDA	(3.0)	(19.7)
Earnings from continuing operations	(1.6)	(4.7)
Net earnings	(1.6)	(4.6)

Same-facility Operations

Revenue	(16.0)	(150.9)
EBITDA	(3.0)	(19.6)

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

U.S. Continuing Operations (millions of dollars)	2010	Annualized Impact of One Cent Change in Exchange Rate ⁽¹⁾	
		US\$	C\$
Revenue	1,365.4		13.7
EBITDA	176.3		1.8
AFFO	88.0		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 derivative financial instruments and foreign exchange". Gains or losses on the FCFCs are not subject to cash taxes until realized.

Impact of Foreign Currency Forward Contract Strategy on Distributions

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

As at December 31, 2010, the fair value of the outstanding FCFCs was a liability of \$0.4 million (US\$0.4 million) compared to a liability of \$0.3 million (US\$0.3 million) at December 31, 2009. Management continues to monitor the U.S. to Canadian dollar exchange rate and to consider future FCFCs to the extent they may be beneficial to us. There can be no assurance that the FCFCs we have in place will be sufficient to protect us against currency exchange rate losses.

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 past eight quarters and years ended 2010 and 2009.⁽¹⁾

<i>(millions of dollars unless otherwise noted)</i>	Q1		Q2		Q3		Q4		Year	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
EBITDA from continuing operations	59.8	63.6	69.6	72.0	51.4	70.7	67.8	59.4	248.6	265.7
Depreciation for FFEC	(5.5)	(6.1)	(5.5)	(6.0)	(5.7)	(5.7)	(5.7)	(5.6)	(22.4)	(23.4)
Interest expense, net	(22.3)	(24.7)	(20.7)	(23.8)	(22.4)	(22.2)	(22.5)	(22.1)	(87.9)	(92.8)
	32.0	32.8	43.4	42.2	23.3	42.8	39.6	31.7	138.3	149.5
Current income tax expense ⁽²⁾	(11.4)	(11.5)	(11.3)	(15.4)	(7.2)	(12.9)	(1.6)	32.3	(31.5)	(7.5)
FFO (continuing operations)	20.6	21.3	32.1	26.8	16.1	29.9	38.0	64.0	106.8	142.0
Amortization of financing costs	2.2	2.5	2.2	2.9	2.2	2.1	2.1	2.1	8.7	9.6
Principal portion of government capital funding payments	0.6	0.6	0.6	0.5	0.6	0.6	0.6	0.6	2.4	2.3
DI (continuing operations)	23.4	24.4	34.9	30.2	18.9	32.6	40.7	66.7	117.9	153.9
Additional facility maintenance capital expenditures ⁽³⁾	0.9	(1.2)	0.4	(2.0)	(2.8)	(2.6)	(6.0)	(6.8)	(7.5)	(12.6)
AFFO (continuing operations)	24.3	23.2	35.3	28.2	16.1	30.0	34.7	59.9	110.4	141.3
AFFO (discontinued operations) ⁽⁴⁾	0.4	1.2	0.3	1.2	(0.4)	0.7	(0.2)	1.7	0.1	4.8
AFFO⁽⁵⁾	24.7	24.4	35.6	29.4	15.7	30.7	34.5	61.6	110.5	146.1
Per Basic Unit (\$)										
FFO (continuing operations)	0.265	0.293	0.393	0.367	0.191	0.409	0.461	0.876	1.310	1.945
AFFO (continuing operations)	0.312	0.318	0.431	0.388	0.191	0.410	0.420	0.820	1.354	1.936
AFFO	0.317	0.334	0.435	0.404	0.185	0.420	0.419	0.844	1.356	2.002
Per Diluted Unit (\$)										
FFO (continuing operations)	0.255	0.278	0.365	0.340	0.194	0.376	0.424	0.768	1.238	1.762
AFFO (continuing operations)	0.286	0.290	0.390	0.349	0.186	0.368	0.381	0.713	1.243	1.720
AFFO	0.291	0.304	0.393	0.362	0.181	0.377	0.379	0.732	1.244	1.775
Distributions (\$)										
Declared (<i>thousands</i>)	16,673	15,285	17,346	15,317	17,382	15,342	17,416	15,360	68,817	61,304
Declared per unit	0.2100	0.2100	0.2100	0.2100	0.2100	0.2100	0.2100	0.2100	0.8400	0.8400
Weighted Average Number of Units (<i>thousands</i>)										
Basic	77,839	72,911	82,576	72,914	82,742	73,039	82,906	73,132	81,533	73,000
Diluted	91,652	86,736	96,389	86,727	96,555	86,852	96,720	86,945	95,346	86,817

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

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

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

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

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

AFFO Review

2010 AFFO

AFFO from continuing operations was \$110.4 million (\$1.354 per basic unit) in 2010 compared to \$141.3 million (\$1.936 per basic unit) in 2009. This decline was primarily due to more favourable current income tax adjustments realized in 2009, as discussed further below, and a \$9.9 million negative effect of a strong Canadian dollar. Otherwise, AFFO was favourably impacted by growth in EBITDA, and lower facility maintenance capital expenditures, partially offset by higher financing costs.

As previously disclosed, our 2009 results were significantly affected by changes between the split of current income taxes and future income taxes, primarily due to an acceleration of tax depreciation. As well, our 2010 results were impacted due to further refinements to our initial estimates of the 2009 acceleration of tax depreciation. While these items had little impact on our net earnings, the changes to current income taxes significantly affected our AFFO. In summary, the acceleration of tax depreciation resulted in a current income tax recovery in the fourth quarters of 2010 and 2009 of \$4.4 million (US\$4.3 million) and \$24.9 million (US\$21.8 million), respectively. As a result, our fourth quarter and annual FFO, DI and AFFO calculations were favourably affected by \$0.054 per basic unit (\$0.047 per diluted unit) in 2010 and \$0.341 per basic unit (\$0.286 per diluted unit) in 2009. For more information refer to the discussion under the heading "Acceleration of Tax Depreciation" located under the section "2010 Financial Review – 2010 Divisional Financial Review – Income Taxes".

Our effective current tax rate on funds from continuing operations was 22.8% for 2010 compared to 5.0% for 2009. After adjusting for the accelerated depreciation item described above, the effective tax rates for 2010 and 2009 were 26.0% and 21.6%, respectively. Other favourable current tax adjustments affected both years resulting in lower effective tax rates than anticipated. As previously indicated, the effective tax rates 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 had initially anticipated that our normal annual effective tax rate on funds from continuing operations would be in the range of 29% to 33%. Looking forward, we estimate that this range will be 27% to 30%, with quarterly fluctuations due to estimates of timing differences and mix of earnings between jurisdictions.

2010 FOURTH QUARTER AFFO

AFFO from continuing operations was \$34.7 million (\$0.420 per basic unit) in the 2010 fourth quarter. In comparison to the 2009 fourth quarter of \$59.9 million (\$0.820 per basic unit), AFFO declined by \$25.2 million. This was primarily due to the favourable effect of the acceleration of tax depreciation and other current income tax adjustments reported in the 2009 fourth quarter relative to the 2010 fourth quarter outlined above and the negative effect of the strong Canadian dollar, partially offset by improvements in EBITDA.

In comparison to the 2010 third quarter, AFFO from continuing operations improved by \$18.6 million this quarter from \$16.1 million (\$0.191 per basic unit). Excluding the \$14.0 million reserve adjustment for self-insured liabilities in the third quarter, AFFO improved this quarter by \$4.6 million. This was primarily due to improvements in EBITDA and lower current income taxes, partially offset by an increase in facility maintenance capital expenditures of \$3.2 million between periods.

Facility maintenance capital expenditures were \$11.7 million in the 2010 fourth quarter, \$12.4 million in the 2009 fourth quarter, and \$8.5 million in the 2010 third quarter, representing 2.2%, 2.4% and 1.7% of revenue, respectively. For 2010, these costs were \$29.9 million compared to \$36.0 million in 2009, representing 1.4% and 1.7% 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 expecting to spend approximately \$39 million in facility maintenance capital expenditures and approximately \$49 million in growth capital expenditures in 2011.

Distributions

The current policy of each of the REIT and Extencicare Limited Partnership (Extencicare LP) is to pay distributions of \$0.07 per REIT Unit and Exchangeable LP Unit of Extencicare LP, respectively, to the holders thereof on a monthly basis. The declaration and payment of future distributions is subject to the discretion of the Board of Trustees and will be dependent upon a number of factors including results of operations, requirements for capital expenditures and working capital, future financial prospects of the REIT, debt covenants and obligations, and any other factors deemed relevant by the Board of Trustees. If the 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, which will result in corresponding reductions in distributions to holders of Exchangeable LP Units.

Distributions declared in 2010 totalled \$68.8 million, or \$0.84 per REIT Unit and per Exchangeable LP Unit (2009 – \$61.3 million, or \$0.84 per unit). Based on total Adjusted Funds from Operations (AFFO) of \$110.5 million, the payout ratio in 2010 was 62.3% (2009 – 42.0%).

Approximately 70% of the distributions made by Extencicare REIT and Extencicare LP since 2006 were tax-deferred returns of capital for Canadian residents. Management estimates that, of the monthly distributions to be made in 2011, approximately 70% 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 *Income Tax Act* (Canada) (the "Tax Act"), published statements of the current administrative and assessing practices of the Canadian Revenue Agency, 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 or Exchangeable LP 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 and Extencicare LP 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.

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

On December 15, 2010, the REIT revoked its U.S. partnership status effective January 1, 2011, 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 *Income Tax Act* (Canada).

Summary of Quarterly Results

The following is a summary of selected consolidated financial information derived from unaudited interim period consolidated financial statements for each of the eight most recently completed quarters. Certain comparative figures have been reclassified to conform with the presentation in 2010. Refer to the discussion under the heading "Basis of Presentation".

<i>(thousands of dollars unless otherwise noted)</i>	Q1		Q2		Q3		Q4	
	2010	2009	2010	2009	2010	2009	2010	2009
Revenue	508,834	565,641	514,371	546,599	517,500	528,326	528,398	521,001
EBITDA⁽¹⁾	59,751	63,558	69,687	71,996	51,395	70,734	67,750	59,382
EBITDA margin	11.7%	11.2%	13.5%	13.2%	9.9%	13.4%	12.8%	11.4%
Earnings from continuing operations before operations before undernoted⁽¹⁾								
	11,201	8,892	21,056	18,230	1,797	17,929	13,933	14,114
Gain (loss) on derivative financial instruments and foreign exchange, net of taxes	3,955	(5,245)	(5,422)	11,688	3,921	10,836	2,350	3,463
Gain (loss) from asset impairment, disposals, financing and other items, net of taxes	–	171	(1,656)	(380)	17	8	1,658	453
Earnings from continuing operations								
	15,156	3,818	13,978	29,538	5,735	28,773	17,941	18,030
Discontinued operations, net of income taxes	410	(161)	(974)	706	(322)	(694)	(237)	(2,302)
Net earnings	15,566	3,657	13,004	30,244	5,413	28,079	17,704	15,728
Components of Diluted Earnings (Loss) per Unit (\$)								
Continuing operations								
before undernoted	0.14	0.12	0.26	0.25	0.02	0.24	0.17	0.20
Gain (loss) on derivative financial instruments and foreign exchange	0.05	(0.07)	(0.07)	0.15	0.05	0.12	0.03	0.04
Gain (loss) from asset impairment, disposals, financing and other items	–	–	(0.02)	–	–	–	0.02	–
Earnings from continuing operations								
	0.19	0.05	0.17	0.40	0.07	0.36	0.22	0.24
Discontinued operations	0.01	–	(0.01)	0.01	(0.01)	(0.01)	(0.01)	(0.03)
Net earnings	0.20	0.05	0.16	0.41	0.06	0.35	0.21	0.21
Average U.S./Canadian dollar exchange rate ⁽²⁾								
	1.0400	1.2456	1.0277	1.1672	1.0391	1.0991	1.0130	1.0586

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

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

The following is a reconciliation of earnings from continuing operations before income taxes to EBITDA for each of the eight most recently completed quarters. Certain comparative figures have been reclassified to conform with the presentation in 2010. Refer to the discussion under the heading "Basis of Presentation".

	Q1		Q2		Q3		Q4	
<i>(thousands of dollars)</i>	2010	2009	2010	2009	2010	2009	2010	2009
Earnings from continuing operations before income taxes	24,611	16,374	25,698	43,290	15,627	42,359	31,353	23,739
Add (Deduct):								
Depreciation and amortization	15,694	17,359	15,785	16,350	16,201	16,179	16,301	16,144
Accretion of asset retirement obligations	400	437	393	416	393	331	386	385
Interest expense, net	22,266	24,695	20,726	23,770	22,366	22,246	22,509	22,104
Loss (gain) on derivative financial instruments and foreign exchange	(3,220)	4,950	4,505	(12,424)	(3,168)	(10,373)	(1,397)	(2,442)
Loss (gain) from asset impairment, disposals, financing and other items	–	(257)	2,580	594	(24)	(8)	(1,402)	(548)
EBITDA	59,751	63,558	69,687	71,996	51,395	70,734	67,750	59,382
Segmented EBITDA								
U.S. operations (US\$)	42,166	40,885	49,996	48,213	32,328	46,519	51,775	40,087
U.S. operations (C\$)	43,851	50,926	51,425	56,545	33,646	51,215	52,614	41,966
Canadian operations	15,900	12,632	18,262	15,451	17,749	19,519	15,136	17,416
EBITDA	59,751	63,558	69,687	71,996	51,395	70,734	67,750	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 the "loss (gain) on derivative financial instruments and foreign exchange" and "loss (gain) from asset impairment, disposals, financing 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 collectively, are usually the highest in the first and second quarters; begin to decline during the latter portion of the second quarter; and are generally at their lowest in the summer months as there tends to be fewer elective surgeries performed;
- Medicaid rate changes, including adjustments for the case mix index and provider taxes, occur with each state's fiscal year, which is July 1st for the majority of the 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 receive annual acuity-based flow-through funding adjustments effective April 1st and accommodation funding increases July 1st, and Alberta long-term care providers receive annual inflationary rate increases on April 1st;
- utility costs are generally at their highest in the first quarter and their lowest in the third quarter, with variances between the two of as much as \$3.5 million; and
- foreign currency exchange rate fluctuations in the U.S. dollar and impact on translation of our U.S. operations.

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

Management's Discussion & Analysis

2010 Fourth Quarter Financial Review

<i>(thousands of dollars unless otherwise noted)</i>	Q4		
	2010	2009	Change
Earnings (loss) from Continuing Operations			
U.S. operations (US\$)	18,439	11,866	6,573
U.S. operations (C\$)	18,793	12,491	6,302
Canadian operations	(852)	5,539	(6,391)
Earnings (loss) from continuing operations	17,941	18,030	(89)
Discontinued operations	(237)	(2,302)	2,065
Net earnings	17,704	15,728	1,976
Diluted Earnings per Unit (\$)			
Earnings from continuing operations	0.22	0.24	(0.02)
Net earnings	0.21	0.21	–
Earnings (loss) from Continuing Operations before Undernoted Separately Reported Items			
U.S. operations (US\$)	15,430	10,125	5,305
U.S. operations (C\$)	15,760	10,647	5,113
Canadian operations	(1,827)	3,467	(5,294)
Earnings from continuing operations before undernoted separately reported items	13,933	14,114	(181)
Gain on derivative financial instruments and foreign exchange, net of taxes	2,350	3,463	(1,113)
Gain from asset impairment, disposals, financing and other items, net of taxes	1,658	453	1,205
Earnings from continuing operations	17,941	18,030	(89)
Average U.S./Canadian dollar exchange rate	1.0130	1.0586	

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 1.0130 for the 2010 fourth quarter and 1.0586 for the 2009 fourth quarter. However, separately reported items such as gains or losses related to derivative financial instruments, foreign exchange, asset impairment, disposals, financing and other items, are translated at the rates of exchange in effect at the time of the transactions.

CONSOLIDATED CONTINUING OPERATIONS COMPARED TO THE 2009 FOURTH QUARTER

<i>(millions of dollars unless otherwise noted)</i>	Q4			
	2010	2009	(\$)	(%)
Revenue	528.4	521.0	7.4	1.4%
Operating expenses	438.4	441.8	(3.4)	(0.8)%
Administrative costs	19.5	16.9	2.6	15.4%
Lease costs	2.7	2.9	(0.2)	(6.9)%
EBITDA	67.8	59.4	8.4	14.1%
EBITDA as a % of revenue	12.8%	11.4%		

Revenue from continuing operations increased by \$7.4 million to \$528.4 million in the 2010 fourth quarter from \$521.0 million in the 2009 fourth quarter. New centers built since January 2009 contributed \$10.5 million to revenue this quarter and \$1.4 million in the 2009 fourth quarter, for a net improvement between quarters of \$9.1 million. These new centers related to a U.S. skilled nursing center that opened in July 2009, a U.S. skilled nursing center and assisted living center that opened in October 2009, a Canadian nursing center that opened in September 2010, and a U.S. skilled nursing center that opened in November 2010. Excluding the \$16.0 million negative effect of the stronger Canadian dollar, 2.8% growth from same-facility operations improved revenue between periods by \$14.3 million as a result of funding improvements, partially offset by lower U.S. census levels.

EBITDA from continuing operations improved by \$8.4 million to \$67.8 million in the 2010 fourth quarter from \$59.4 million in the 2009 fourth quarter, and as a percent of revenue was 12.8% and 11.4%, respectively. New centers earned EBITDA of \$0.1 million in the 2010 fourth quarter compared to a loss of \$0.7 million in the same 2009 period due to start-up costs. Excluding the \$3.0 million negative effect of the stronger Canadian dollar, 17.6% growth from same-facility operations improved EBITDA by \$10.6 million between periods, reflecting the \$14.3 million improvement in revenue and a \$3.7 million increase in operating, administrative and lease costs. Same-facility EBITDA from the U.S. operations increased by \$12.8 million and the Canadian operations was lower by \$2.2 million, which are discussed further below.

Labour-related costs from continuing operations represented 74.2% and 74.4% of operating and administrative costs in the fourth quarter of 2010 and 2009, respectively, and as a percent of revenue, were 64.3% and 65.5%, respectively.

U.S. CONTINUING OPERATIONS COMPARED TO THE 2009 FOURTH QUARTER

	2010		Q4 2009		Change of US\$	
	US\$	C\$	US\$	C\$	(\$)	(%)
<i>(millions of dollars unless otherwise noted)</i>						
Revenue	349.5	354.1	334.2	353.7	15.3	4.6%
Operating expenses	282.5	286.1	280.7	297.6	1.8	0.6%
Administrative costs	13.6	13.8	11.6	12.2	2.0	17.2%
Lease costs	1.6	1.6	1.8	1.9	(0.2)	(11.1)%
EBITDA	51.8	52.6	40.1	42.0	11.7	29.2%
EBITDA as a % of revenue	14.8%		12.0%			

Revenue from U.S. operations grew by 4.6% in its functional currency to US\$349.5 million in the 2010 fourth quarter compared to US\$334.2 million in the 2009 fourth quarter, representing an increase of US\$15.3 million. Revenue from four new centers was US\$6.1 million this quarter compared to US\$1.3 million in the 2009 fourth quarter, representing an increase of US\$4.8 million. Revenue from same-facility operations increased by US\$10.5 million between periods primarily due to the contribution from higher average nursing center rates of US\$16.8 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 12.0% over the 2009 fourth quarter, increasing revenue by US\$10.7 million. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

The following table provides further details on the change in revenue this quarter in comparison to the 2009 fourth quarter from same-facility U.S. operations.

(US\$ millions)

16.8	– increase in average skilled nursing center rates (Medicare \$10.7 million, Medicaid \$3.4 million, and private/other \$2.7 million)
(6.3)	– decrease in skilled nursing center resident census (Medicare \$2.3 million, Medicaid \$2.5 million, and private/other \$1.5 million)
(0.3)	– decrease in prior period revenue settlement adjustments (NIL in 2010 versus \$0.3 million in 2009)
0.3	– Other

10.5

Management's Discussion & Analysis

The operating, administrative and lease costs of our U.S. operations increased by US\$3.6 million to US\$297.7 million this quarter in comparison to the 2009 fourth quarter of US\$294.1 million. Approximately US\$4.1 million of the increase between periods was from new centers, partially offset by reduced same-facility costs of US\$0.5 million, particularly lower drug, food and supply costs. Labour-related costs represented 70.1% of operating and administrative costs this quarter, compared to 70.5% in the 2009 fourth quarter, and as a percent of revenue were 59.4% and 61.7%, respectively.

EBITDA from U.S. operations grew by US\$11.7 million, or 29.2%, to US\$51.8 million in the 2010 fourth quarter from US\$40.1 million in the 2009 fourth quarter, and as a percent of revenue was 14.8% compared to 12.0%. New centres contributed US\$0.1 million to EBITDA this quarter compared to a loss of US\$0.6 million in the 2009 fourth quarter, representing an improvement between periods of US\$0.7 million. Same-facility EBITDA improved by US\$11.0 million, or 27.0%, as a result of higher revenue of US\$10.5 million and lower costs of US\$0.5 million, as previously discussed.

CANADIAN CONTINUING OPERATIONS COMPARED TO THE 2009 FOURTH QUARTER

<i>(millions of dollars unless otherwise noted)</i>	Q4		Change	
	2010	2009	(\$)	(%)
Revenue	174.3	167.3	7.0	4.2%
Operating expenses	152.3	144.2	8.1	5.6%
Administrative costs	5.7	4.7	1.0	21.3%
Lease costs	1.1	1.0	0.1	10.0%
EBITDA	15.2	17.4	(2.2)	(12.6)%
EBITDA as a % of revenue	8.7%	10.4%		

Revenue from Canadian operations grew by \$7.0 million, or 4.2%, to \$174.3 million in the 2010 fourth quarter from \$167.3 million in the 2009 fourth quarter. Of this improvement, \$6.6 million was derived from nursing home operations and included revenue of \$4.5 million from the new Alberta center and favourable prior period funding settlements of \$1.0 million this quarter. Revenue from home health care operations improved by \$0.2 million this quarter due to increased rates, partially offset by a 2.9% decline in volumes. Other revenue increased by \$0.2 million.

Operating, administrative and lease costs increased by \$9.2 million to \$159.1 million this quarter from \$149.9 million in the 2009 fourth quarter, of which \$4.5 million was from the newly opened center. Remaining costs increased by \$4.7 million primarily due to higher labour-related costs, which included severance costs of \$0.9 million. Total labour-related costs represented 82.1% of operating and administrative costs in the 2010 fourth quarter compared to 82.5% in the 2009 fourth quarter, and as a percent of revenue were 74.4% and 73.4%, respectively.

EBITDA from Canadian operations of \$15.2 million in the 2010 fourth quarter was lower by \$2.2 million from \$17.4 million in the 2009 fourth quarter, and as a percent of revenue was 8.7% and 10.4%, respectively. EBITDA was favourably affected by prior period revenue in this quarter of \$1.0 million and funding enhancements, which were offset by higher operating and administrative costs, including severance costs of \$0.9 million, and lower health care volumes.

2010 Financial Review

Selected Annual Information

The following is a summary of selected annual financial information. Certain comparative figures have been reclassified to conform with the presentation in 2010. Refer to the discussion under the heading "Basis of Presentation". A significant portion of the REIT's long-term debt matures in 2011 and has been classified as part of current liabilities, resulting in a decline in the balance of long-term debt at the end of 2010 from prior years. A comparison between the 2010 and the 2009 results is provided in the following discussion "2010 Divisional Financial Review" and under the heading "Liquidity and Capital Resources".

(thousands of dollars unless otherwise noted)

Years ended December 31

	2010	2009	2008
Revenue	2,069,103	2,161,567	1,982,869
Operating expenses	1,736,880	1,810,978	1,698,277
Administrative costs	72,624	72,818	71,441
Lease costs	11,016	12,101	11,324
	1,820,520	1,895,897	1,781,042
EBITDA	248,583	265,670	201,827
Depreciation and amortization	63,981	66,032	58,290
Accretion expense	1,572	1,569	1,470
Interest expense, net	87,867	92,815	86,269
Loss (gain) on derivative financial instruments and foreign exchange	(3,280)	(20,289)	25,344
Loss (gain) from asset impairment, disposals, financing and other items	1,154	(219)	855
Earnings from continuing operations before income taxes	97,289	125,762	29,599
Income tax expense	44,479	45,603	23,175
Earnings from continuing operations	52,810	80,159	6,424
Discontinued operations	(1,123)	(2,451)	6,964
Net earnings	51,687	77,708	13,388
Earnings per Unit (\$)			
Basic			
Earnings from continuing operations	0.65	1.09	0.09
Net earnings	0.63	1.06	0.18
Diluted			
Earnings from continuing operations	0.65	1.05	0.09
Net earnings	0.63	1.02	0.18
Cash Distributions per Unit (\$)	0.8400	0.8400	1.1100
Total assets (at year end)	1,698,010	1,668,065	1,806,922
Long-term debt (at year end)	653,122	1,205,494	1,290,596
U.S./Canadian dollar exchange rate			
Average rate for the year	1.0299	1.1420	1.0660
Closing rate at year end	0.9946	1.0510	1.2180

Management's Discussion & Analysis

2010 Divisional Financial Review

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

(millions of dollars unless otherwise noted)	2010				2009			
	U.S. (US\$)	U.S. (US\$)	Canada	Total	U.S. (US\$)	U.S. (US\$)	Canada	Total
Revenue	1,365.4	1,406.2	662.9	2,069.1	1,329.8	1,518.6	642.9	2,161.5
Operating expenses	1,132.8	1,166.7	570.2	1,736.9	1,100.8	1,257.2	553.8	1,811.0
Administrative costs	49.8	51.3	21.3	72.6	46.2	52.7	20.0	72.7
Lease costs	6.5	6.7	4.3	11.0	7.1	8.0	4.1	12.1
	1,189.1	1,224.7	595.8	1,820.5	1,154.1	1,317.9	577.9	1,895.8
EBITDA	176.3	181.5	67.1	248.6	175.7	200.7	65.0	265.7
Depreciation, amortization and accretion	49.3	50.8	14.7	65.5	47.2	53.9	13.7	67.6
Interest expense, net	50.3	51.7	36.2	87.9	50.1	57.2	35.6	92.8
Earnings from continuing operations before income taxes and undernoted separately reported items	76.7	79.0	16.2	95.2	78.4	89.6	15.7	105.3
Gain on derivative financial instruments and foreign exchange	0.9	0.9	2.4	3.3	12.1	14.0	6.2	20.2
Gain (loss) from asset impairment, disposals, financing and other items	0.1	0.1	(1.3)	(1.2)	(0.5)	(0.6)	0.8	0.2
Earnings from continuing operations before income taxes	77.7	80.0	17.3	97.3	90.0	103.0	22.7	125.7
Income tax expense	36.1	37.2	7.3	44.5	35.2	40.4	5.2	45.6
Earnings from continuing operations	41.6	42.8	10.0	52.8	54.8	62.6	17.5	80.1
Discontinued operations	(1.1)	(1.1)	–	(1.1)	(2.4)	(2.4)	–	(2.4)
Net earnings	40.5	41.7	10.0	51.7	52.4	60.2	17.5	77.7
Earnings from continuing operations before undernoted separately reported items	38.3	39.5	8.5	48.0	42.5	48.5	10.6	59.1
Gain on derivative financial instruments and foreign exchange, net of taxes	2.4	2.4	2.4	4.8	12.7	14.5	6.2	20.7
Gain (loss) from asset impairment, disposals, financing and other items, net of taxes	0.9	0.9	(0.9)	–	(0.4)	(0.4)	0.7	0.3
Earnings from continuing operations	41.6	42.8	10.0	52.8	54.8	62.6	17.5	80.1
Components of Diluted Earnings (Loss) per Unit (\$)								
Continuing operations before undernoted				0.59				0.81
Gain on derivative financial instruments and foreign exchange				0.06				0.24
Gain (loss) from asset impairment, disposals, financing and other items				–				–
Earnings from continuing operations				0.65				1.05
Discontinued operations				(0.02)				(0.03)
Net earnings				0.63				1.02
Average U.S./Canadian dollar exchange rate				1.0299				1.1420

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 1.0299 for 2010 and 1.1420 for 2009. However, separately reported items such as gains or losses related to derivative financial instruments, foreign exchange, asset impairment, disposals, financing and other items, are translated at the rates of exchange in effect at the time of the transactions.

HIGHLIGHTS

- Revenue was \$2,069.1 million in 2010, a 2.8% increase over 2009, excluding the adverse effect of foreign exchange.
- EBITDA was \$248.6 million in 2010, a 1.0% increase over 2009, excluding the adverse effect of foreign exchange.
- EBITDA margins were 12.0% in 2010 (12.7% excluding the Q3 reserve adjustment) compared to 12.3% in 2009.
- Average daily revenue rates for Medicare Part A and Managed Care grew by 3.9% and 1.6%, respectively, in 2010 over 2009.
- AFFO from continuing operations was \$110.4 million (\$1.354 per basic unit) in 2010 compared to \$141.3 million (1.936 per basic unit) in 2009.
- Distributions in 2010 totalled \$68.8 million, or \$0.84 per unit, representing approximately 62% of AFFO from continuing operations for the same period.
- Cash on hand totalled \$267.8 million at December 31, 2010.

In the fourth quarter, Extencare REIT delivered strong financial and operating results on the strength of higher-than-anticipated Medicare rates that reflected the U.S. government's increased commitment to meet the higher costs of care in skilled nursing centers, together with our continued emphasis on diligent operational management. As a result of our sound fourth quarter performance, the REIT achieved solid, stable results for the 2010 year, allowing us to maintain a market leadership position in the long-term care sector and continue our commitment to providing quality services and care to our residents. Our year-end results were solid in spite of the charge of US\$13.5 million taken in the third quarter to strengthen our reserves for self-insured general and professional liabilities with respect to pre-2009 claims.

CONSOLIDATED CONTINUING OPERATIONS

Revenue from continuing operations declined by \$92.4 million to \$2,069.1 million in 2010 from \$2,161.5 million in 2009. New centers built since January 2009 contributed \$25.7 million to revenue in 2010 compared to \$1.5 million in 2009, for a net improvement of \$24.2 million. These new centers related to a U.S. skilled nursing center that opened in July 2009, a U.S. skilled nursing center and assisted living center that opened in October 2009, a Canadian nursing center that opened in September 2010, and a U.S. skilled nursing center that opened in November 2010. Excluding the \$150.9 million negative effect of the stronger Canadian dollar, revenue from same-facility operations improved between periods by \$34.3 million, or 1.6%, as a result of funding improvements, including approximately \$6.0 million of prior period funding settlements, partially offset by lower U.S. census levels.

EBITDA from continuing operations declined by \$17.1 million to \$248.6 million in 2010 from \$265.7 million in 2009, and as a percent of revenue was 12.0% and 12.3%, respectively. New centers contributed earnings of \$1.6 million in 2010 and a loss of \$1.5 million in 2009, for a net improvement in EBITDA of \$3.1 million. Same-facility results were negatively affected by \$19.6 million due to the stronger Canadian dollar and an \$11.8 million increase (US\$13.5 million this year compared to US\$3.2 million in 2009) in prior years' reserves for self-insured liabilities. Excluding these items, EBITDA improved by \$11.2 million, reflecting the \$34.3 million growth in revenue and a \$23.1 million increase in operating, administrative and lease costs, of which \$9.8 million of EBITDA was from U.S. operations and \$1.4 million was from Canadian operations, which are discussed further below.

Labour-related costs from continuing operations represented 74.2% and 74.4% of operating and administrative costs in 2010 and 2009, respectively, and as a percent of revenue, were 64.9% in both years.

U.S. CONTINUING OPERATIONS

Revenue from U.S. operations grew by 2.7% in its functional currency to US\$1,365.4 million in 2010 compared to US\$1,329.8 million in 2009, representing an increase of US\$35.6 million. Four new centers earned revenue of US\$18.4 million in 2010 compared to US\$1.4 million in 2009. Revenue from same-facility operations increased by US\$18.6 million between years primarily due to the contribution from higher average nursing center rates of US\$43.2 million and prior period revenue settlement adjustments of US\$3.4 million, partially offset by lower census levels. Higher average rates reflected changes in Medicare funding, inflationary increases, as well as higher average acuity levels of residents served. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

Management's Discussion & Analysis

The following table provides further details on the change in revenue during 2010 in comparison to 2009 from same-facility U.S. operations.

(US\$ millions)

43.2	– increase in average skilled nursing center rates (Medicare \$14.1 million, Medicaid \$20.9 million, and private/other \$8.2 million)
(27.5)	– decrease in skilled nursing center resident census (Medicare \$14.3 million, Medicaid \$4.6 million and private/other \$8.6 million)
3.4	– increase in prior period revenue settlement adjustments (\$5.0 million in 2010 versus \$1.6 million in 2009)
(0.5)	– other
18.6	

The operating, administrative and lease costs of our U.S. operations increased by US\$35.0 million to US\$1,189.1 million in 2010 compared to US\$1,154.1 million in 2009, of which US\$14.8 million of the increase between years was from new centers. Total labour-related costs represented 69.8% of operating and administrative costs in 2010, compared to 70.6% in 2009, and as a percent of revenue were 60.4% and 60.9%, respectively.

U.S. operations same-facility operating, administrative and lease costs increased by US\$20.2 million in 2010 in comparison to 2009. Operating costs were impacted by an increase in prior years' reserves for self-insured general and professional liabilities of US\$10.3 million (US\$13.5 million in 2010 compared to US\$3.2 million in 2009), higher state provider taxes (US\$8.1 million), increased labour-related costs (1.9% average rate increase in nursing center operations), and higher professional fees and bad debts, partially offset by a reduction in the use of temporary and contract staffing, and lower drug, food, supply and travel costs.

EBITDA from U.S. operations was US\$176.3 million in 2010 compared to US\$175.7 million in 2009, and as a percent of revenue was 12.9% and 13.2%, respectively. Excluding the US\$10.3 million increase in 2010 over 2009 in prior years' reserves for self-insured liabilities, EBITDA improved by US\$10.9 million, with newly opened centers contributing US\$2.2 million of the improvement between years. Remaining same-facility operations grew by US\$8.7 million as a result of the following: higher prior period funding settlements of US\$3.4 million; improved RUGs mix, Medicaid, Medicare and private-pay revenue rates and cost controls, partially offset by lower census.

CANADIAN CONTINUING OPERATIONS

Revenue from Canadian operations grew by \$20.0 million, or 3.1%, to \$662.9 million in 2010 from \$642.9 million in 2009. Of this improvement, \$16.5 million was derived from nursing home operations, and included revenue from the new Alberta center of \$6.7 million. The remaining increase of \$9.8 million in nursing home revenue was primarily due to funding enhancements for resident care and services, which included prior period funding settlements of \$0.5 million this year. Revenue from home health care operations improved by \$2.1 million in 2010 from 2009, and included favourable prior period revenue of \$1.6 million (\$2.1 million received this year to cover costs incurred in 2009 with respect to elect-to-work pay compared to \$0.5 million of prior period revenue received in 2009). Remaining home health care revenue improved by \$0.5 million due to rate improvements, partially offset by a 3.3% decline in volumes. Other revenue increased by \$1.4 million primarily due to new management contracts.

Operating, administrative and lease costs increased by \$17.9 million, or 3.1%, to \$595.8 million in 2010 from \$577.9 million in 2009. The new center accounted for \$6.1 million of the increase and adjustments to prior period accruals reduced costs by \$1.7 million in 2010. Excluding these items, costs increased by \$13.5 million primarily due to higher labour-related costs of \$9.9 million. Total labour-related costs represented 83.2% of operating and administrative costs in 2010 and 2009, and as a percent of revenue were 74.3% in both years.

EBITDA from Canadian operations improved by \$2.1 million, or 3.2%, to \$67.1 million in 2010 from \$65.0 million in 2009, and as a percent of revenue was 10.1% for both years. The improvement in EBITDA was primarily due to a \$3.8 million increase in prior period adjustments between periods (\$4.3 million in 2010 compared to \$0.5 million in 2009) and \$0.7 million from the new center. Remaining EBITDA declined by \$2.4 million, with funding enhancements offset by higher operating and administrative costs, which included severance costs of \$0.9 million, and lower home health care volumes.

DEPRECIATION, AMORTIZATION AND ACCRETION

Depreciation, amortization and accretion costs of \$65.5 million in 2010 were lower by \$2.1 million from \$67.6 million in 2009. The stronger Canadian dollar accounted for a \$5.5 million favourable impact. This was partially offset by a \$2.0 million increase due to completed construction projects and capital maintenance expenditures, as well as an acceleration of depreciation in the amount of \$1.4 million on certain Ontario and Alberta nursing homes. The accelerated depreciation resulted from the implementation of new legislation in 2010 to fix the term of Ontario nursing center licenses and from the pending closure of two Alberta centers. For further details on the new legislation, refer to the discussion under the heading "Ontario Long-term Care Legislation" under the section "Update of Legislative Actions Affecting Revenue – Canada".

INTEREST

Interest expense, net of interest income, decreased by \$4.9 million to \$87.9 million in 2010 from \$92.8 million in 2009, primarily due to the favourable effect of the stronger Canadian dollar of \$5.8 million.

LOSS (GAIN) ON DERIVATIVE FINANCIAL INSTRUMENTS AND FOREIGN EXCHANGE

The REIT reported a pre-tax gain of \$3.3 million in 2010 (\$4.8 million after tax), which was comprised of a foreign exchange gain of \$3.3 million on intercompany transactions. The loss for 2010 from the valuation of derivative financial instruments was minimal. The results for 2009 included a pre-tax gain of \$20.2 million (\$20.7 million after tax), related to a \$12.8 million gain on the valuation of derivative financial instruments and a \$7.4 million foreign exchange gain on intercompany transactions.

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

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

Regarding our internal corporate loans, the foreign exchange gains of our Canadian operations are sheltered with capital losses that have future tax valuation allowances against them. Therefore there is no tax impact on these 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 has a 25-year amortization period and matures in 2014. The change in the Canadian to U.S. dollar exchange rate does not result in any consolidated gain or loss on this loan; however, a consequential unrealized tax expense or recovery can exist due to the imbalance in the tax treatments of the related entities. Although the foreign currency exposure cannot be hedged, the REIT believes that due to the long-term nature of the note, it can mitigate any negative tax consequences from the loan structure. The unrealized tax expense or recovery is reported as a future tax provision until realized. In December 2010, we settled \$60.0 million of the \$90.0 million internal corporate loan with no significant tax impact from the transaction.

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

The results for 2010 included a pre-tax impairment charge of \$1.2 million (nil on an after-tax basis), as a result of performing an impairment analysis on two Canadian nursing homes and a previously closed U.S. center, partially offset by a gain on disposal of non-core assets. In 2009, the REIT reported a pre-tax gain from asset impairment, disposals, financing and other items of \$0.2 million (\$0.3 million after tax), related to the release of a \$0.5 million accrual on settlement of a contingent claim against Crown Life Insurance Company (Crown Life), refer to the discussion under the heading "Liquidity and Capital Resources – Specified Contingent Claims Against Crown Life", a \$0.3 million gain on the redemption of convertible debentures acquired under a normal course issuer bid, partially offset by a charge of \$0.6 million on the write-off of pre-development costs on a discontinued project.

INCOME TAXES

The tax provision from continuing operations was \$44.5 million in 2010 compared to \$45.6 million in 2009, representing effective tax rates of 45.7% and 36.3%, respectively. The effective tax rates for each period were distorted by, among other things, the gains and losses from derivative financial instruments, foreign exchange, asset impairment, disposals, financing and other items. Excluding these items, the effective tax rate for 2010 was 49.6% compared to 43.8% in 2009. As well, the effective tax rates of both periods were impacted by the non-taxable prior year reserves for self-insured general and professional liabilities of \$13.9 million (US\$13.5 million) in 2010 and \$3.7 million (US\$3.2 million) in 2009. Excluding these reserve adjustments, the effective tax rates for 2010 and 2009 would have been 43.3% and 42.3%, respectively.

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

Management's Discussion & Analysis

Acceleration of Tax Depreciation

In respect of our 2009 income tax filings for our U.S. operations that were filed by September 2010, we filed a one-time retroactive change in our U.S. tax accounting method to accelerate the tax depreciation and expensing of certain previously capitalized assets that have occurred over the past seven years. This tax accounting change expenses rather than capitalizes certain expenditures that are frequently required to maintain our properties, and is subject to review by the U.S. Internal Revenue Service (IRS).

As a result of this 2009 tax accounting change, we recorded a recovery of federal and state cash taxes of \$24.9 million (US\$21.8 million) in the 2009 fourth quarter, to be received through a reduction of our 2010 U.S. tax instalments. In addition, upon completion of the 2009 returns in 2010 a further recovery of \$4.4 million (US\$4.3 million) was recorded in the 2010 fourth quarter. An equal offset to these recoveries were charged to the future income tax provision that will be reversed over time. There was no impact to our 2010 and 2009 net earnings, or earnings per unit figures as a result of these tax adjustments.

DISCONTINUED OPERATIONS

Discontinued operations reported a net loss of \$1.1 million in 2010 compared to \$2.4 million in 2009. The 2010 results included a pre-tax loss of \$1.7 million (US\$1.7 million) on the sale of two centers in Pennsylvania and Ohio for net proceeds of \$5.5 million (US\$5.4 million), a pre-tax charge of \$1.0 million (US\$1.0 million) on the early termination of the lease on two Ohio nursing centers, and a pre-tax loss of \$0.3 million (US\$0.3 million) on the sale of four centers in Michigan for net proceeds of \$15.5 million (US\$14.9 million). The 2009 results included a pre-tax impairment charge of \$4.0 million (US\$3.8 million) on the pending disposal of eight skilled nursing centers, a pre-tax impairment charge of \$1.8 million (US\$1.6 million) related to three leased center in Ohio, a pre-tax recovery of \$1.4 million (US\$1.1 million) on disposal of two Ohio skilled nursing centers for net proceeds of \$11.1 million (US\$8.7 million), and a release of excess reserves for self-insured general and professional liability claims of \$1.1 million. For further information see "Significant Developments – Discontinued Operations and Assets Held for Sale" and *note 11* of the 2010 consolidated financial statements.

Significant Developments

The following developments had a significant effect on the financial results of Extencicare REIT for the year ended December 31, 2010 in comparison to the year ended 2009.

Global Economic Environment Impact on Nursing Center Funding, Census and Financing

The most significant factor impacting the REIT's industry this past year, and for the near term, is the global economy. Beginning in the latter part of 2008, the economy and stock markets suffered a significant downturn as a result of the worldwide credit and liquidity crisis that impacted market values of securities, values of commodities such as oil and gas, interest rates and the foreign exchange markets; and there have been unprecedented job losses in both the U.S. and Canada. Though we have seen increases in the values of securities and increased liquidity in the credit market, there continues to be general restraint on a corporate and individual spending level. With a dramatic reduction in corporate profits and reduced consumer confidence, the fiscal health of provincial, state and federal governments have been dampened; consequently, the future funding of services for which they provide support may be at risk. The global economic downturn has impacted nursing center funding, short-term admissions in our U.S. nursing centers and the financing environment. Refer to "Overview – Global Economic Environment" and also *note 19* of the 2010 consolidated financial statements.

Development Projects

2009 COMPLETED PROJECTS

The following table summarizes the construction projects completed during 2009 at a total cost of US\$34.3 million.

Completed Projects – 2009	Date Completed	No. of Centers	Operational Beds/Units
U.S. skilled nursing center, Okemos, Michigan	July/09	1	100
U.S. skilled nursing center, Summit, Wisconsin	October/09	1	100
U.S. assisted living center, Summit, Wisconsin	October/09	1	60
		3	260

PROJECTS COMPLETED AND/OR UNDER WAY IN 2010

The following table depicts the status of the 2010 development projects, two of which were completed and opened by the end of 2010, and an additional two were opened in January 2011. Four of our existing nursing centers in Canada will close upon completion of the new centers, as was the case with our existing center in Lethbridge, Alberta that closed in January 2011. Further details of these projects are provided below.

Development Projects (as at December 31, 2010)	Completed/ Estimated Date	Opened	New Centers		Existing Centers to Close	
			No. of Centers	Beds/ Units	No. of Centers	Beds/ Units
Canada – Owned Centers Completed						
Continuing care center, Red Deer, Alberta	July/10	Sept/10	1	280	–	–
Designated assisted living center, Lethbridge, Alberta ⁽¹⁾	Dec/10	Jan/11	1	140	(1)	(62)
U.S. – Centers under Contractual Lease Obligations						
Skilled nursing center, Lansing, Michigan	Sept/10	Jan/11	1	120	–	–
Skilled nursing center, South Bend, Indiana	Sept/10	Nov/10	1	100	–	–
Canada – Owned Centers under Development						
Long-term care center, Edmonton, Alberta ⁽²⁾	Dec/11		1	180	(1)	(122)
Long-term care center, Sault St. Marie, Ontario	Dec/12		1	256	(1)	(168)
Long-term care center, Timmins, Ontario	Dec/12		1	180	(1)	(119)
			7	1,256	(4)	(471)

(1) Our existing Lethbridge center operated 120 beds, which were gradually transitioned down to 62 beds between 2009 and the 2010 fourth quarter in anticipation of its closure in January 2011.

(2) Our existing Edmonton nursing center (113 beds) is anticipated to close once the new center is completed in late 2011, and we are presently in discussions with Alberta Health Services as to their interest in the existing center and the transition process. In addition, nine beds from another one of our existing centers in the region will close with the opening of the new center.

Owned Centers Completed and/or under Development in 2010

During 2010, we had three centers in Alberta under construction, at a total estimated cost, net of government grants, of \$74.5 million. These projects consisted of a 280-bed continuing care center in Red Deer, a 140-unit designated assisted living center in Lethbridge, and a 180-bed long-term care center in Edmonton. The Red Deer center was completed in July and opened in September 2010, at a cost of \$33.5 million, net of government grants. The new Lethbridge center was completed in December 2010, and opened in January 2011, at a cost of \$21.5 million, net of government grants. The new Edmonton center is anticipated to be completed in late 2011, at an estimated cost of \$19.5 million, net of government grants, of which \$9.0 million has been spent to December 31, 2010.

In May 2010, our construction manager for the three Alberta projects, Medican Holdings Ltd. and related entities, or Medican, was granted protection under the Companies' Creditors Arrangement Act. Presently, notwithstanding some minor delays due to weather conditions, our remaining Alberta project is continuing on time and on budget. We are working closely with Medican to ensure this continues; however, should Medican not be able to fulfill their future obligations our intention would be to replace them with another construction manager.

Following completion of the new Lethbridge center, ECI closed its older nursing center in Lethbridge (at December 2010 – 62 operational beds/ formerly 120 operational beds). ECI owns and operates another nursing center in Edmonton (113 operational beds), which is anticipated to close when the new one opens at the end of 2011. The Alberta Health Services Board is presently evaluating the need for long-term center beds, and we are presently in discussions with them as to their interest in the existing center and the transition process. The combined annual EBITDA of the two existing centers while they were fully operational in 2009 was approximately \$2.7 million, and was approximately \$2.4 million in 2010. The projected combined annual EBITDA of the two new centers, once fully operational, is expected to exceed \$5.0 million.

Management's Discussion & Analysis

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 Legislative Actions 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 2012. ECI currently operates three nursing centers with 387 class "C" beds in these areas. Following completion of the new projects, ECI would 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 total cost of these two projects will be approximately \$72.1 million, of which we anticipate over 75% to be financed through Canada Mortgage and Housing Corporation (CMHC) or conventional financing. 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 centers (387 beds) for 2010 and 2009 was approximately \$2.8 million and \$2.7 million, respectively. It is anticipated that incremental EBITDA for the three centers (536 beds) will be approximately \$2.0 million upon completion of the projects, excluding the capital funding for the two new centers (436 beds).

Centers under Contractual Lease Obligations

In September 2009, EHSI entered into an agreement with a company controlled by the former shareholders of Tendercare (Michigan) Inc. (Tendercare) that includes a partial interest of Tim Lukenda, our President and Chief Executive Officer, and his immediate family (see "Related Party Transactions"). 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 renovation was completed in September and the center is anticipated to be licensed during the 2011 first quarter.

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 per annum thereafter. Construction of the center was completed in September and it received licensure in October.

Financing Activity

CANADA

Equity Offering

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 will increase the REIT's liquidity and balance sheet flexibility, and will be 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 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.

2009 Mortgage Activity

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

In June 2009, ECI obtained CMHC insured long-term financing on its Lethbridge, Alberta project and anticipates borrowings of \$19.6 million (approximately 91% of the construction costs, net of government grants), plus CMHC fees of \$1.0 million. The first two years of the 27-year loan is for construction at a fixed interest rate of 4.25%, following which it will be amortized over 25 years at a fixed rate of 7.70%. Commencing with the opening of the center in January 2011, the interest costs are being reimbursed through government funding for the remainder of the term.

In August 2009, ECI obtained CMHC insured construction financing on its Edmonton, Alberta project of \$16.6 million (approximately 85% of the construction costs, net of government grants) plus CMHC fees of \$0.8 million. The loan has a term of two years, with interest-only payments based on a floating rate of 30-day banker's acceptance plus 2.5%. We plan to secure long-term financing prior to completion of the project in December 2011.

RBC Credit Facility

Extencare has a credit facility with the Royal Bank of Canada (the "RBC Credit Facility") that is due on demand and used primarily to back letters of credit that renew annually. In June 2009, Extencare amended the RBC Credit Facility to provide for the issuance of a U.S. dollar letter of credit facility in addition to the existing \$70.0 million line of credit. As at December 31, 2010, a US\$10.2 million letter of credit (2009 – US\$18.2 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 balance sheet as restricted cash.

UNITED STATES

Status of U.S. Refinancing

During 2011, EHSI plans to refinance approximately US\$635 million of debt with approximately US\$568 million in mortgages insured by the HUD program. 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. As at December 31, 2010, EHSI had US\$27.5 million in HUD-insured mortgages, providing it with the ability to seek up to US\$522.5 million in additional HUD financing. EHSI intends to seek approval from HUD by June 2011 for a further US\$50.0 million of financing capacity, enabling it to seek up to US\$572.5 million in additional HUD financing. For further details on this refinancing plan, refer to the discussion under the heading "Overview – 2011 Refinancing Plan" and *note* 7 of the 2010 consolidated financial statements.

PrivateBank Mortgage Loans due 2013

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 December 31, 2010 was 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 Mortgage and Sovereign Loans

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 mortgage loans in connection with the sale of four Michigan skilled nursing centers.

EHSI Credit Facility

The EHSI Credit Facility was amended and restated in its entirety in June 2009 and provides for borrowings of up to US\$70.0 million. The EHSI Credit Facility matures in June 2011 and has an option to be extended for a third year to June 2012 upon satisfaction of certain conditions. In March 2011, EHSI obtained approval from all of the lenders of the EHSI Credit Facility for the one-year extension term with no change in the financial terms of the loan. The amount available to be borrowed under the EHSI Credit Facility is the lesser of: (i) 60% of the appraised values of the skilled nursing centers collateralizing the EHSI Credit Facility; or (ii) an amount based on the actual net cash flow of these centers for the last 12 months. At EHSI's option, the interest rate is either the eurodollar rate, with a floor set at 2%, plus a margin from 4% to 4.75%, or the U.S. prime rate plus a margin from 3% to 3.75%, with the specific margin based on EHSI's consolidated leverage ratio as defined in the EHSI Credit Facility. The interest rate at December 31, 2010 was 6%.

Management's Discussion & Analysis

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

As at December 31, 2010, EHSI had assets held for sale with a net book value of \$3.3 million (US\$3.4 million) consisting of a skilled nursing center in Michigan (92 beds) and a closed nursing center in Washington, whose beds were transferred to a newly built center in 2008.

During the 2009 fourth quarter, EHSI reached agreement to sell six Michigan skilled nursing centers (667 beds), one Ohio skilled nursing center (100 beds) and one Pennsylvania skilled nursing center (107 beds), which resulted in a pre-tax impairment charge of \$4.0 million (US\$3.8 million). 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 \$0.3 million (US\$0.3 million). The agreement to sell one of the Michigan centers (113 beds) 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 disposal activity during 2009 included the sale of two Ohio skilled nursing centers in March 2009, with a net book value of US\$7.6 million for net proceeds of US\$8.7 million. In addition, EHSI classified three leased Ohio skilled nursing centers (285 beds) as discontinued operations during 2009 and, in the 2009 fourth quarter, transferred one of these operations to another operator. With respect to the remaining two leased skilled nursing centers, EHSI completed the transfer of operations to new operators in the 2010 second quarter, which involved a lease termination settlement of US\$1.0 million. An impairment charge of \$1.8 million (US\$1.6 million) was recorded on the leased centers in the 2009 third quarter.

More information on EHSI's discontinued operations is available in *note 11* of the 2010 consolidated financial statements.

Management Contracts

Since 2002, ECI has been managing for a receiver, as part of a bankruptcy action, 10 nursing centers in Ontario consisting of 1,504 nursing home beds and 315 retirement units. These centers have been sold. Consequently, ECI ceased managing eight of them effective January 1, 2011. With respect to the other two centers, their sale transaction closed at the end of February 2011, and ECI is continuing to manage the centers for one year. Fees earned from management contracts are generally based on a percent of revenue ranging from 3.5% to 4%, but can vary from that depending on the level of services provided, term of the contract and circumstances at the onset of the contract.

Legal Proceedings

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. While it is not possible to predict the ultimate outcome of the various proceedings at this time or to estimate additional costs that may result, such actions are generally resolved within the amounts provided.

On April 19, 2010, Extendicare REIT announced that EHSI had received subpoenas from the U.S. Department of Health and Human Services (DHHS), Office of the Inspector General (OIG), relating to an investigation into the possible submission of claims that may be in violation of the U.S. Social Security Act covering a period from January 1, 2007 to January 1, 2010. EHSI is not aware of any improper claims and intends to furnish all requested information and to cooperate with the DHHS in its investigation. EHSI and its subsidiaries believe that they are in material compliance with the requirements imposed on them by the U.S. Social Security Act.

As previously disclosed in our public filings, the provision of health care services in the United States 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 including EHSI are subject to audits and investigations by various federal and state government authorities. For example, EHSI is currently under investigation involving two centers in Pennsylvania and a center in Michigan with the respective state OIG offices. In such investigations, EHSI cooperates in responding to information requests 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 Extencare 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. Extencare REIT is a SIFT, and is therefore subject to the SIFT Rules. Furthermore, Extencare 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, Extencare 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 Extencare REIT as a SIFT, although they confirm that Extencare Trust, which is wholly owned by Extencare REIT, is not a SIFT. Management has assessed the impact of the SIFT Amendments on Extencare LP and has concluded that Extencare 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.

U.S. FEDERAL INCOME TAX ON REITS

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

With respect to the above Canadian SIFT and U.S. REIT income tax matters, which are very complex, senior management is continuing its review of them and their application to the organizational structure of the REIT and its unitholders.

In view of, among other things, the provisions of the SIFT Amendments that facilitate the conversion of SIFT trusts into corporations, which expire on December 31, 2012, the Board of Trustees and management are continuously reviewing possible strategies, opportunities and alternatives available to the REIT with a view to ensuring that the REIT's capital and organizational structure are efficient and address the operational requirements of the business of the REIT.

ONTARIO – SALES TAX HARMONIZATION

Effective July 1, 2010, the Province of Ontario implemented a single harmonized sales tax, or HST, of 13%. A number of our costs in Ontario, which were not previously subject to either GST or provincial sales tax, are now subject to the higher single tax rate. The majority of services we provide as a for-profit provider of long-term care services in Ontario are classified as exempt under a value-added tax system, such as the HST. As a result, we are not able to claim input tax credits to recover any value-added taxes that we may pay, nor are we eligible for rebates. Consequently, any such incremental taxes will not be recoverable and can only be offset by increased funding provided by the Ontario government. We estimate that the additional cost to us approximates \$1.7 million annually.

Management's Discussion & Analysis

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 IRS 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 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 Legislative Actions 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. The ongoing pressures from government programs, along with other payors seeking to control costs and/or limit reimbursement rates for medical services, are a risk to us.

We also operate in a heavily regulated industry, subject to the scrutiny of federal, state and/or provincial regulators. Our nursing centers must comply with regulations involving such things as staffing levels, resident care standards, occupational health and safety, resident confidentiality, billing and reimbursement, along with environmental, biological and other standards. Government agencies have steadily increased their enforcement activity over the past several years. 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.

United States

The majority of the REIT's operations are in the United States where 68.0% of its revenue from continuing operations was earned in 2010 (2009 – 70.3%). 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% (2009 – 53%) of our U.S. resident admissions were Medicare funding and approximately 27% (2009 – 27%) were Managed Care funded.

MEDICARE FUNDING

Market Basket Annual Increases

Changes in Medicare funding levels typically occur on October 1st of each year to coincide with the federal government's fiscal year, and generally represent an inflationary increase for the Medicare Part A funding, otherwise referred to as a "market basket" increase. The market basket increases on October 1, 2008, 2007 and 2006 were 3.4%, 3.3% and 3.1%, respectively.

The October 1, 2009, Medicare Part A funding changes resulted in a net funding reduction of 1.1%. This represented a forecasting error adjustment that reduced funding by 3.3% and was partially offset by a market basket increase of 2.2%. This net funding reduction of 1.1% is estimated to have reduced our annual Medicare revenue by approximately US\$4.5 million. However, despite the net funding reduction of 1.1%, EHSI's average daily Medicare Part A rate increased by 1.2% in the first nine months of 2010 over the same 2009 period due to EHSI's continued improvement in the mix of Medicare patients served.

In July 2010, CMS issued its final rule for payments to Medicare skilled nursing centers, resulting in a net increase in Medicare Part A funding of 1.7% effective October 1, 2010. This represented a market basket increase of 2.3% partially offset by a forecasting error adjustment of 0.6%. We estimate that this net rate increase of 1.7% will increase our annual Medicare revenue by approximately US\$6.8 million.

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

On October 1, 2010, CMS implemented MDS 3.0, a revised resident assessment tool, and RUG-IV, a revised case-mix classification methodology and implementation schedule. Under the new MDS 3.0 resident assessment tool, residents are assessed on a more frequent and in-depth basis with limitations on the look-back period. Residents are now classified into 66 categories (previously 53). The level of reimbursement within the former 53 categories was realigned under the new 66 categories based upon a re-evaluation of the cost of nursing and therapy services being delivered. In addition, the changes involved the elimination of billing for concurrent therapy services and services provided by technicians.

In the implementation of MDS 3.0 and RUG-IV, 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. We had initially anticipated that the changes to the delivery of concurrent therapy and the elimination of the hospital look-back period would eliminate any potential benefit from the realignment of the rates. However, our effective response and extensive training of our staff have offset the adverse effect of these changes. As a result, these initiatives, together with the improved payments, have resulted in a 10.5% increase in our average Medicare Part A rates and an increase in our margins for the 2010 fourth quarter over the 2010 third quarter.

The final implementation of MDS 3.0 and RUG-IV required Congress to act to revise the delayed implementation of RUG-IV included in the *Protection and Affordable Care Act* (H.R. 3590) that was passed as part of health care reform in March 2010. On December 15, 2010, U.S. President Obama signed into law the *Medicare and Medicaid Extenders Act of 2010* (H.R. 4994), which contained the repeal of the delay in RUG-IV implementation, thereby retroactively approving the payments received since October 1, 2010, under the new RUG-IV rate schedule.

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 will reduce EHSI's Medicare Part B inpatient and outpatient therapy billings by approximately 5% and reduce EHSI's annual revenue by approximately US\$2 million.

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\$1,840 in 2009. A one-year exemption process to the therapy caps was established in 2005 for individuals who can prove medical necessity for the therapy and was further extended through to December 31, 2010. The *Medicare and Medicaid Extenders Act of 2010* has now extended it through December 31, 2011. Based on information currently available, EHSI estimates that without the extension of this exemption beyond 2011, its annual therapy revenue could decline by as much as US\$12.0 million. This estimate 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 Other Future Medicare and Medicaid Changes

In February 2011, the U.S. President released the 2012 fiscal year budget (the "President's Budget"). The President's Budget only serves as a recommendation to the U.S. Congress. While the U.S. House and Senate budget committees will take the document under advisement, they are not required to incorporate any of the President's recommendations into their own budget bills, and often do not. Below is a summary of the significant items within the President's Budget impacting the long-term care sector:

- Reduction in 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; and
- Market Basket Increase – there is no mention in the President's Budget of a Medicare market basket increase, nor any Medicare reductions beyond the productivity adjustment commencing in 2012.

In addition to the President's Budget, the recent vote by The Medicare Payment Advisory Commission (MedPAC) recommended that the U.S. Congress provide no cost-of-living increase for skilled nursing care in fiscal 2012, which would have a negative effect on the long-term care industry. This decision by MedPAC was based solely on its assessment of the Medicare program.

Management's Discussion & Analysis

2010 Health Care Reform Legislation

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. The legislation is complex and it will require time to determine the full impact on individuals, health care providers, and employers. Amendments to PPACA have already been enacted into law on March 30, 2010, with the passage of the *Health Care Education Affordability Act* (HCEAA). HCEAA contains several changes to PPACA. Given the complexity of the legislation and considerable controversy surrounding its passage, it is generally believed that additional amendments will be introduced to address certain unintended consequences of the sweeping legislation before it is fully implemented in 2014. In addition, regulations implementing the new laws will be issued by various government agencies and could have significant impact.

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, 2012, 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 implementation of MDS 3.0 and certain aspects of RUG-IV on October 1, 2010, as discussed above;
- (iii) The extension of the therapy caps exemption process until December 31, 2011. We estimate, before taking preventive measures to bill privately or to reduce associated costs for these services, that this preserved an estimated US\$12 million in Part B therapy revenue;
- (iv) New transparency requirements and additional employee background check requirements for nursing centers;
- (v) 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
- (vi) 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, will take 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. As of January 2011, 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 there will be continued modifications to the legislation before its final implementation in 2014.

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 recession, 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.

For the eight states with changes effective July 1, 2010, the average revenue rates, net of provider taxes, but including CMI changes, increased by 0.9%, resulting in a net US\$3.8 million increase in annual funding. For the three states with changes effective October 1, 2010, the average revenue rates, net of provider taxes, decreased by 0.5%, resulting in a net US\$0.6 million decline in annual funding.

With respect to the 2009 Medicaid rate changes, for all 12 states in which EHSI operates, the net impact of Medicaid revenue rate changes as of their respective effective dates, net of provider taxes, but including CMI changes, was approximately US\$7.4 million, or 1.3%. This increase includes the changes in the states of Pennsylvania and Washington discussed in the next two paragraphs.

In March 2010, the State of Pennsylvania approved an increase in Medicaid rates retroactive to July 1, 2009. The impact of the new rates was to increase annual Medicaid revenue (net of provider taxes) by 2.3%. In the 2010 first quarter, EHSI recorded revenue of US\$0.8 million relating to this increase in rates for the six months ended December 31, 2009. The increase in provider taxes effective July 1, 2009, was already reflected in the 2009 income statement, therefore, no adjustment was necessary in 2010.

In April 2010, the State of Washington approved a 2.5% increase in Medicaid rates retroactive to July 1, 2009, representing approximately US\$1.3 million annually to EHSI. This increase reversed a planned reduction in Medicaid rates announced in 2009 of approximately 5.8%, or US\$9.61 per diem. The impact of this reduction on cash payments to nursing centers was delayed by a temporary restraining order issued by the courts in 2009. However, during the nine months ended March 31, 2010, EHSI recorded revenue based on the planned reduced rates. As a result of the retroactive rate announcement, approximately US\$3 million was recognized in revenue in the 2010 second quarter.

Management's Discussion & Analysis

Extension 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 appropriated for 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. There is little likelihood that the additional FMAP funding will be further extended beyond June 2011. Failure by the federal government to extend this program further could have a detrimental impact on the ability of certain states to fund future growth in their Medicaid programs until the economy recovers.

Canada

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 from location to location with respect to the regulations for providing care and how centers are reimbursed.

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 below funding provided. The accommodation rates are substantially paid for by the resident; however, the province guarantees funding for the 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. For 2010 all of ECI's Ontario nursing homes achieved occupancy levels in excess of 97%.

ONTARIO LONG-TERM CARE LEGISLATION

New legislation governing Ontario long-term care centers, the *Long-Term Care Homes Act, 2007* (the "LTCHA") was given Royal Assent on June 4, 2007, and was proclaimed into law on July 1, 2010. ECI provided input on the proposed regulations that were circulated for comment. The LTCHA consolidates three pieces of legislation governing long-term care centers in the province: the *Nursing Homes Act*; the *Homes for the Aged and Rest Homes Act*; and the *Charitable Institutions Act*. Through consolidation, the government expects that the new legislation and associated regulations will ensure uniform standards and accountability across the provincial long-term care sector. In April 2010, the Ontario government announced funding enhancements for 2010 to assist the sector in the transition process required to implement the changes under the LTCHA. These funding enhancements are described in further detail under the next heading within this section "Ontario Long-term Care Funding".

Among other things, the legislation includes a new licensing process with defined terms for various classes of centers as follows: four years for a center with class "D" beds that have not been upgraded; 10 years for a center with upgraded class "D" beds; 15 years for a center with class "C" and "B" beds; 20 years for a center with class "A" beds; and 25 years for new centers (denoted as being built post-1998). ECI has 11 new post-1998 long-term care centers in Ontario and 23 centers with class "C" beds. The license term for the new centers is the greater of 25 years from the date of the first resident and 20 years from the date the legislation comes into effect. As such, the initial license term for each of ECI's 11 new centers is 20 years from July 1, 2010, because the homes were opened more than five years ago.

In July 2007, the Ontario government announced a project to redevelop 35,000 older long-term care beds in five phases over the next 10 to 15 years. The first round of submissions for approval began in July 2009, with the next round expected in mid-2011. ECI currently owns and operates 3,572 older long-term care beds in 23 "C" rated nursing centers that would benefit from this redevelopment project. In November 2008, the government released 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 for 25 years. 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. ECI and other operators will continue to express concerns about the adequacy of the construction funding subsidy.

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. Twenty-one of ECI's centers were affected by this change in 2010, and a further six are affected in 2011. The remaining centers are being transitioned over the next couple of years. This RUGs model will tie resident needs to costs of care in a more impartial and transparent way. Based on our review of the RUGs data in Ontario and after factoring in an estimated acuity adjustment, we are anticipating a reduction of less than 1%, or approximately \$1.4 million annually, in our flow-through funding in the nursing envelope beginning in April 2011.

In response to the economic downturn, the Ontario government implemented a two-year wage freeze 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. Despite this government mandate, arbitrators have awarded increased union wages in the long-term care sector. As a result, the incremental cost of these wage increases to ECI, and other operators in the sector, will not be funded. Other provincial governments have also restrained funding increases in 2010, which will put further 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.

In June 2010, the Ontario Ministry of Health and Long-Term Care released details of additional funding to assist providers with the implementation of the LTCHA, which took effect on July 1, 2010. This LTCHA funding increases the daily rate by \$1.18, of which \$0.26 is one-time funding for staff training over nine months from July 1, 2010 to March 31, 2011. The annual revenue impact to ECI of the \$0.92 increase in base funding is approximately \$1.7 million. The impact to ECI of the one-time daily rate increase of \$0.26 for staff training is approximately \$0.3 million over nine months. The funds are 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 is staggered to take effect on July 1, 2010 (\$0.60) and October 1, 2010 (\$0.58).

On April 1st each year, the Ontario government provides acuity-based flow-through funding increases on the government-funded portion of the fees based on the provincial resident classification results of the previous year. The April 2010 increase in daily rates was 3.2%, or \$2.83, and included \$0.74 for additional personal support workers. This increase is estimated to represent additional annual revenue to ECI of approximately \$5.2 million (2009 – 3.0% or \$4.6 million). These funding enhancements were provided to the flow-through envelopes and therefore, are offset by additional costs for resident care and services.

On July 1st each year, the Ontario government generally implements annual accommodation funding increases for long-term care providers (the portion of the fees paid for by the residents to the nursing center operators). The July 2010 increase in the daily rates was \$0.02 for food costs and \$0.12 for the non flow-through component, representing annual revenue to ECI of approximately \$0.3 million. In addition, the government confirmed in May 2010, that the \$1.55 daily rate increase for special accommodation funding first implemented in 2009, as described below, would continue in the base funding effective April 1, 2010.

The July 2009 accommodation envelope increases in the daily rates were \$0.16 (or 2.2%) for food costs and \$0.85 (or 1.8%) for the non flow-through component. This represented an annual revenue increase of approximately \$1.8 million, of which approximately \$0.3 million was directly allocated to cover food costs, with the remainder available to assist in offsetting inflationary cost increases of accommodation.

In the 2009 third quarter, the Ontario government announced an accommodation funding enhancement of \$1.55 in the daily rates for the 2009/2010 fiscal year, retroactive to April 1, 2009. This added funding of 3.32% provided additional annual revenue to ECI of approximately \$2.8 million to assist in enhancing resident services, and as indicated above was continued in the base funding for 2010. As a result of the retroactive change in 2009, ECI recorded funding in the 2009 third quarter of which approximately \$0.7 million related to the 2009 second quarter.

ALBERTA LONG-TERM CARE LEGISLATION AND FUNDING

The Alberta government has replaced its nine regional health authority boards, the Alberta Mental Health Board, the Alberta Cancer Board and the Alberta Alcohol and Drug Abuse Commission, with a single provincial governance board, the Alberta Health Services Board (AHS). AHS has been in transition since May 2008 and was established as a legal entity effective April 1, 2009. AHS, which is responsible for the delivery of health services for the entire province, reports directly to the Minister of Health and Wellness. AHS is taking a provincial approach to policy development for long-term care and to the funding methodology for the sector.

Management's Discussion & Analysis

The Alberta government and AHS are in the process of revising the funding methodology for long-term care. Historically, Alberta long-term care providers received annual inflationary rate increases on April 1st and annual CMI funding adjustments on July 1st on the government-funded portion of the fees (although the annual CMI adjustment has not been used since 2005). A new activity-based funding system for continuing care centers commenced on April 1, 2010. However, the new methodology is still under development, and will be phased in starting in the 2010/2011 fiscal year. As part of the new funding system, Alberta long-term care providers received funding increases retroactive to April 1, 2010. The first increase of 2% was announced in August, and had been anticipated and accrued for by ECI already. This represented approximately \$1.1 million of additional annual revenue to ECI. Details of the further funding increases were provided in December, of which ECI's share averaged 3.3%, or \$2.1 million of annual revenue, which resulted in \$1.0 million of funding recorded in the 2010 fourth quarter 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.

In August 2009, the Alberta government announced its fiscal 2009/2010 annual inflationary funding increase, retroactive to April 1, 2009, representing an average 6.4% rate increase to ECI, or annual revenue of approximately \$3.5 million. However, at the same time, the government announced plans to implement a 3% cutback in their funding effective December 1, 2009, as part of a deficit elimination plan. As a result of the above announcements, the net impact to ECI represented additional annual revenue of approximately \$1.9 million. We had already accrued for the majority of the anticipated April 1st increase in our 2009 second quarter results, therefore only approximately \$0.3 million of the funding recognized in the 2009 third quarter related to the second quarter.

ONTARIO HOME HEALTH CARE LEGISLATION AND FUNDING

ECI is a major private-sector provider of home health care services through ParaMed, which operates in Alberta and Ontario. Ontario is ParaMed's largest market, representing approximately 96% of its revenue in 2010.

The home health care competitive bidding process 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 has announced their intention to implement the public reporting of performance measures, which they are continuing to develop. There has been no indication from the government of when 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, this resulted in an added operating expense 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 Community Care Access Centres (CCACs) reimbursed providers for their 2009 costs related to the CCAC contracts, of which ParaMed's portion was approximately \$2.1 million. The CCACs have continued to directly fund these costs in 2010, and have indicated that they will continue to do so until the additional funding is embedded in the billing rates as the contracts are 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, who provide 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 December 31, 2010, the REIT had cash and cash equivalents of \$267.8 million compared with \$134.0 million at December 31, 2009, representing an increase of \$133.8 million, largely due to the net proceeds of the REIT Unit offering in February 2010 of \$82.2 million. A cash pledge of \$10.1 million (US\$10.2 million) as collateral against a letter of credit is excluded from our available cash balance.

<i>(thousands of dollars unless otherwise noted)</i>	2010	2009
Cash provided by operating activities, before working capital changes	142,469	181,149
Net change in operating assets and liabilities		
Accounts receivable	(10,618)	27,328
Other current assets	1,691	(3,401)
Accounts payable and accrued liabilities	(8,633)	16,553
Income taxes	24,448	(36,504)
	6,888	3,976
Cash provided by operating activities	149,357	185,125
Cash used in investing activities	(42,279)	(81,647)
Cash provided by (used in) financing activities	33,437	(85,770)
Foreign exchange loss on U.S. cash held	(6,768)	(6,780)
Increase in cash and cash equivalents	133,747	10,928
Cash and cash equivalents at beginning of year	134,012	123,084
Cash and cash equivalents at end of year	267,759	134,012
Average U.S./Canadian dollar exchange rate	1.0299	1.1420

Cash provided by operating activities was \$149.4 million in 2010 compared to \$185.1 million in 2009, representing a decrease of \$35.7 million. Before changes in net operating assets and liabilities, cash provided by operations declined by \$38.6 million primarily due to favourable current income taxes recorded in 2009 and a \$5.5 million increase in payments for self-insured liabilities during 2010. The 2009 results included favourable current tax adjustments that increased the ending income tax recoverable balance resulting in a use of cash of \$36.5 million at the end of 2009. However, this contributed to reduced income tax instalments throughout 2010, resulting in cash provided from income taxes of \$24.4 million in 2010. A decline in cash from operations resulted from a use of funds in 2010 from the change in the balance of accounts receivable and accounts payable and accrued liabilities compared to the 2009 activity. The change in accounts receivable for 2010 was a use of cash of \$10.6 million compared to a source of cash of \$27.3 million in 2009. The 2010 activity primarily reflects the increase in the 2010 fourth quarter of revenue due to the implementation of changes to the Medicare system. The 2009 activity reflected improved collections and the receipt in January 2009 of an \$8.7 million (US\$7.0 million) return of premium. The change in accounts payable and accrued liabilities for 2010 was a use of cash of \$8.6 million compared to a source of cash of \$16.6 million in 2009, primarily due to timing and settlement of accruals.

Cash used in investing activities was \$42.3 million in 2010 compared to \$81.6 million in 2009 and primarily reflected expenditures for property and equipment, partially offset by proceeds on disposal of assets.

Growth capital expenditures, excluding acquisitions, were \$40.0 million in 2010 compared to \$55.6 million in 2009, 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 \$29.9 million in 2010 compared to \$36.0 million in 2009, representing 1.4% and 1.7% 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 expecting to spend approximately \$39 million in facility maintenance capital expenditures and \$49 million in growth capital expenditures in 2011.

Management's Discussion & Analysis

(thousands of dollars unless otherwise noted)

	2010	2009
Capital Additions		
Growth expenditures	39,991	55,574
Facility maintenance	29,962	36,020
Consolidated reported	69,953	91,594
Average U.S./Canadian dollar exchange rate	1.0299	1.1420

Net proceeds from dispositions of \$29.0 million in 2010 and \$10.0 million in 2009 primarily related to the disposal of U.S. centers held for sale (see "Significant Developments – Discontinued Operations and Assets Held for Sale"), and to non-core assets.

Cash provided by financing activities was \$33.4 million in 2010 compared to cash used in financing activities of \$85.8 million in 2009. Financing activities in 2010 primarily reflected net cash proceeds of \$82.2 million, before income taxes, from the REIT Unit equity offering in February, issuance of long-term debt on refinancing of existing debt, draws on construction financing and the release of restricted cash, partially offset by distribution payments of \$62.8 million and scheduled debt repayments. Financing activities in 2009 primarily reflected distribution payments of \$60.2 million, the use of cash of \$22.4 million to secure a letter of credit obligation, the purchase of securities for cancellation under our normal course issuer bid of \$6.2 million, and scheduled debt repayments, partially offset by the issuance of debt. 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 2010 and 2009.⁽¹⁾

(millions of dollars)	Q1		Q2		Q3		Q4		Year	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Cash provided by operating activities	26.6	36.9	42.3	34.4	45.6	62.0	34.9	51.8	149.4	185.1
Add (Deduct):										
Net change in operating assets and liabilities	4.5	(5.0)	(6.7)	3.0	(15.0)	(19.9)	10.3	17.9	(6.9)	(4.0)
Current tax on gain/loss from derivatives, foreign exchange, asset impairment, disposals, financing and other items	–	1.7	–	(0.5)	4.2	0.1	0.4	0.3	4.6	1.6
Net provisions and payments for self-insured liabilities	(2.4)	(2.2)	4.6	(0.5)	(11.1)	(3.4)	0.4	3.4	(8.5)	(2.7)
Depreciation for FFEC	(5.5)	(6.1)	(5.5)	(6.0)	(5.7)	(5.7)	(5.7)	(5.6)	(22.4)	(23.4)
Principal portion of government capital funding payments	0.6	0.6	0.6	0.5	0.6	0.6	0.6	0.6	2.4	2.3
Other	–	(0.3)	(0.1)	0.5	(0.1)	(0.4)	(0.4)	–	(0.6)	(0.2)
DI	23.8	25.6	35.2	31.4	18.5	33.3	40.5	68.4	118.0	158.7
Additional facility maintenance capital expenditures ⁽²⁾	0.9	(1.2)	0.4	(2.0)	(2.8)	(2.6)	(6.0)	(6.8)	(7.5)	(12.6)
AFFO	24.7	24.4	35.6	29.4	15.7	30.7	34.5	61.6	110.5	146.1

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

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

Capital Structure

(millions of dollars unless otherwise noted)

	2010	2009
Unitholders' Equity (Deficiency)		
REIT and Exchangeable LP units	434.2	345.5
Equity component of convertible debentures	9.9	9.9
Contributed surplus	0.1	0.1
	444.2	355.5
Accumulated deficit at beginning of year	(395.4)	(410.4)
Net earnings for the year	51.7	77.7
Purchase of securities for cancellation in excess of book value and other	(1.1)	(1.4)
Distributions declared	(68.8)	(61.3)
Accumulated deficit at end of year	(413.6)	(395.4)
Accumulated other comprehensive loss	(11.9)	(1.0)
Unitholders' equity (deficiency)	18.7	(40.9)
U.S./Canadian dollar exchange rate (at year end)	0.9946	1.0510

Unit Information (thousands)	Feb. 28, 2011	Dec. 31, 2010	Dec. 31, 2009
REIT Units (TSX symbol: EXE.UN) ⁽¹⁾	79,966.5	79,831.5	69,897.0
Exchangeable LP Units	3,144.1	3,163.7	3,283.0
	83,110.6	82,995.2	73,180.0

(1) Closing market value per the TSX on February 28, 2011, was \$10.08.

The closing rates used to translate assets and liabilities of the U.S. operations were 0.9946 at December 31, 2010 and 1.0510 at December 31, 2009. As a result of the stronger Canadian dollar at December 31, 2010, the assets of the REIT's U.S. operations decreased by approximately \$66.4 million, partially offset by a decrease in the liabilities of approximately \$55.0 million, with the net change in foreign currency translation of \$11.4 million included in accumulated other comprehensive income. Every one cent increase (decrease) in the Canadian dollar against the U.S. dollar would impact the net assets of our U.S. operations by approximately \$1.5 million, and would be reflected as a change in foreign currency translation adjustments in accumulated other comprehensive income.

DISTRIBUTIONS

In 2010, we generated DI of \$118.0 million and AFFO of \$110.5 million and declared monthly distributions of \$0.07 per unit to holders of REIT Units and Exchangeable LP Units totalling \$68.8 million that were paid out from February 15, 2010 to January 17, 2011. The portion paid in cash was \$63.2 million and \$5.6 million was by way of issued units under a distribution reinvestment plan. A total of 586,407 units were issued during 2010 through the distribution reinvestment plan.

During 2009 monthly distributions of \$0.07 were declared totalling \$61.3 million, of which \$58.5 million was paid in cash and \$2.8 million by way of issued units under a distribution reinvestment plan. A total of 488,106 units were issued during 2009 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 "2010 Financial Review".

Our current policy is to pay distributions of \$0.07 per REIT Unit and per Exchangeable LP 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 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, which will result in corresponding reductions in distributions to holders of Exchangeable LP Units.

Management's Discussion & Analysis

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.

There were no purchases for cancellation made by the REIT under a similar normal course issuer bid that expired on January 6, 2011. During 2009, under a normal course issuer bid that expired on December 28, 2009, the REIT acquired for cancellation 0.9 million REIT Units at a cost of \$5.3 million, \$1.1 million aggregate principal amount of its 2014 Debentures at a cost of \$0.7 million and \$0.2 million aggregate principal amount of its 2013 Debentures at a cost of \$158,500.

LONG-TERM DEBT

Long-term debt, including current portion, was \$1,222.7 million at December 31, 2010, and was net of \$19.4 million of financing costs.

The current portion of long-term debt has increased to \$569.6 million at the end of 2010 from \$28.5 million at the end of 2009, primarily due to the pending maturity of the Sovereign Loans of US\$45.2 million in June 2011 and the 2011 CMBS Financing of US\$491.7 million in November 2011. Management is in the process of refinancing this debt as discussed in further detail under the heading "Overview – 2011 Refinancing Plan". Details of the components, terms and conditions of long-term debt are provided in *note 7* of the 2010 consolidated financial statements. The REIT and its subsidiaries are in compliance with all of their respective financial covenants as at December 31, 2010.

The following summarizes the changes in the carrying amounts of long-term debt for 2010 and 2009.

Continuity of Long-term Debt (<i>millions of dollars</i>)	2010	2009
Long-term debt at beginning of year, prior to equity allocation and financing costs	1,260.0	1,372.6
Issue of long-term debt		
Mortgages (net of conversion of \$17.3 of construction financing)	23.5	2.9
PrivateBank Loans	25.7	–
Construction financing	16.1	17.3
Notes payable	3.3	–
Issue (repayment) on the EHSI Credit Facility	(6.8)	14.3
Increase (decrease) in capital lease obligations, other than annual repayments ⁽¹⁾	12.8	(5.0)
Repayment of long-term debt	(46.3)	(22.3)
Purchase of convertible debentures for cancellation under NCIB	–	(1.2)
Change due to year-end foreign exchange rate	(40.4)	(118.6)
	1,247.9	1,260.0
Equity portion of convertible debentures at end of year	(5.8)	(7.4)
Financing costs at end of year ⁽¹⁾	(19.4)	(18.6)
Long-term debt at end of year	1,222.7	1,234.0
Less: current portion	(569.6)	(28.5)
	653.1	1,205.5

(1) The 2010 activity reflects the new capital lease obligation entered into in November 2010 on the Indiana skilled nursing center. The 2009 activity includes the reversal in March of the provision for GST previously recorded in the 2008 second quarter affecting the balance of capital lease obligations with an offset to the financing costs, upon confirmation from the CRA of application of new legislation.

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 \$90.1 million of our long-term debt outstanding at December 31, 2010, excluding financing costs and equity allocation, was at fixed rates. The variable-rate debt related to the Sovereign Loans of US\$45.2 million, the US\$16.9 million drawn on EHSI's Credit Facility, the US\$25.0 million drawn on the PrivateBank Loans and \$3.6 million drawn on the Edmonton construction loan. The weighted average interest rate of our long-term debt was approximately 6.6% at December 31, 2010 (6.6% at December 31, 2009). The weighted average interest rate of our long-term debt at December 31, 2010, for our Canadian and U.S. operations was 6.7% and 6.4%, respectively, compared to 6.8% and 6.5% at December 31, 2009, respectively.

The weighted average term to maturity of our long-term debt, including capital lease obligations, was 4.1 years as at December 31, 2010 (7.0 years for our Canadian operations and 2.0 years for our U.S. operations). Excluding our capital lease obligations, the weighted average term to maturity of our long-term debt was 2.7 years (4.2 years for our Canadian operations and 1.8 years for our U.S. operations).

The following table presents principal, or notional, amounts and related weighted average interest rates by year of maturity for the REIT's debt obligations as at December 31, 2010. It incorporates only exposures that existed at that date and does not consider exposures, or positions that could arise subsequently, or future interest rate movements. As a result, the information has limited predictive value. The ultimate results with respect to interest rate fluctuations will depend on the exposures that occur, hedging strategies at the time and interest rate movements.

<i>(millions of dollars unless otherwise noted)</i>	2011	2012	2013	2014	2015	After 2015	Total	Fair Value
Canadian Operations								
Convertible debentures (at face value)								
Fixed rate	–	–	91.8	113.9	–	–	205.7	222.5
Average interest rate	–	–	7.25%	5.70%	–	–	6.39%	
Long-term debt								
Fixed rate	12.5	9.8	105.3	8.9	2.5	61.5	200.5	212.0
Average interest rate	8.29%	7.71%	8.34%	3.94%	5.09%	5.17%	7.10%	
Variable rate	–	3.6	–	–	–	–	3.6	3.6
Average interest rate	–	3.72%	–	–	–	–	3.72%	
Capital lease obligations								
Fixed rate	3.9	4.2	4.5	4.9	5.2	95.9	118.6	126.2
Average interest rate	7.08%	7.08%	7.08%	7.08%	7.08%	7.08%	7.08%	
United States Operations⁽¹⁾								
Long-term debt								
Fixed rate	496.5	91.8	5.3	1.4	1.3	21.3	617.6	620.2
Average interest rate	6.66%	6.80%	7.02%	5.56%	5.82%	5.29%	6.63%	
Variable rate	62.1	0.4	24.1	–	–	–	86.6	86.1
Average interest rate	4.37%	6.00%	6.00%	–	–	–	4.83%	
Capital lease obligations								
Fixed rate	0.6	0.6	0.7	0.7	0.3	12.4	15.3	15.3
Average interest rate	5.69%	5.90%	5.90%	5.91%	6.01%	8.71	8.18%	

(1) U.S. dollar denominated debt is translated to Canadian dollars at a rate of 0.9946.

Management's Discussion & Analysis

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 43.0% of AGBV at December 31, 2010, and excluding the convertible debentures, debt to AGBV was 35.9%.

AGBV is defined in the REIT's Deed of Trust, and in general is determined by taking total reported assets at a period in time, adding back accumulated depreciation and amortization and making a one-time adjustment for incremental value of the assets at the effective date of the Arrangement.

The calculations as at December 31, 2010 and December 31, 2009, are indicated in the following table.

<i>(millions of dollars unless otherwise noted)</i>	2010	2009
Long-term Debt⁽¹⁾		
Debt	1,042.2	1,054.3
Convertible debentures (face value)	205.7	205.7
	1,247.9	1,260.0
AGBV		
Total assets	1,698.0	1,668.1
Accumulated depreciation and amortization	529.6	509.6
Incremental value	675.0	675.0
	2,902.6	2,852.7
Long-term Debt to AGBV		
Excluding convertible debentures	35.9%	37.0%
Including convertible debentures	43.0%	44.2%

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

ACCRUAL FOR SELF-INSURED LIABILITIES

At December 31, 2010, the accrual for self-insured general and professional liabilities was \$47.4 million compared to \$43.9 million at the beginning of the year, an increase of \$3.5 million. The current period provision, net of claims payments, increased the accrual by \$8.5 million, while the stronger Canadian dollar decreased the accrual by \$2.6 million. This was further offset by \$2.4 million (US\$2.3 million) of payments made to the former shareholders of LTC Professional Insurance Company Ltd. (LTC Professional), in accordance with the acquisition agreement.

Provisions recorded in 2010 and 2009 for potential general and professional liability claims were \$33.3 million and \$22.0 million, respectively. Payments for self-insured liabilities during the same periods were \$24.8 million and \$19.3 million, respectively.

Following our usual practice of completing a 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) in the 2010 third quarter, to a level which we believe is adequate for resident care liability claims as at September 30, 2010. 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. As is the case each year, an update of the interim independent actuarial review was performed as part of the year-end financial reporting process, which confirmed the adequacy of the reserves as at December 31, 2010.

Provisions for loss for our general and professional liability risks are based on management's best available information including actuarially determined estimates. The accrual for self-insured liabilities includes estimates of the costs of both reported claims and an amount, based upon past experiences, for claims incurred but not yet reported. These liabilities are necessarily based on estimates and, while management believes that the provision for loss is adequate, the ultimate liability may be in excess of, or less than, the amounts recorded. 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.

Management estimates that \$16.0 million of the accrual for self-insured general and professional liabilities will be paid within the next year. The timing of payments is not directly in management's control and therefore, estimates could change in the future. Management believes sufficient reserves have been provided as at December 31, 2010, for estimated costs of self-insured liabilities.

We invest funds to support the accrual for self-insured liabilities. These funds are reported in other assets and totalled \$60.9 million at December 31, 2010, compared to \$65.3 million at December 31, 2009. Most of the risks that Extencicare self-insures are long-term in nature and accordingly, claims payments for any particular policy year occur over a long period of time. Management believes there are sufficient cash resources to meet estimated current claims payment obligations.

SPECIFIED CONTINGENT CLAIMS AGAINST CROWN LIFE

Under the June 2007 Crown Life share sale agreement with The Canada Life Assurance Company (Canada Life), Extencicare remains responsible for specified contingent claims against Crown Life. As at December 31, 2010, these claims totalled \$13.9 million, for which Extencicare has delivered letters of credit to Crown Life in support thereof. Depending on the type of contingent claim, the letters of credit have various terms ranging from 5 to 15 years. During 2009, settlement was reached on one of the claims below the amount accrued for this particular claim, resulting in the release of \$0.5 million of the provision. Based on past trends and information received from an independent actuary, management estimates that Extencicare's remaining aggregate liability for such claims will not exceed \$5.6 million, and has recorded a provision for this amount in other long-term liabilities on the balance sheet at December 31, 2010.

OTHER CONTRACTUAL OBLIGATIONS

The table below provides summary information about contractual obligations, other than long-term debt, as at December 31, 2010. 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 conditional asset retirement obligations, totalling \$47.4 million and \$24.2 million, respectively, as at December 31, 2010, and also excludes our defined benefit pension plan obligations, which are described more fully below.

<i>(millions of dollars)</i>	Total	2011	2012	2013	2014	2015	After 2015
Canadian Subsidiary Operations							
Operating lease obligations	10.2	2.2	1.6	1.4	1.3	0.9	2.8
Purchase obligations	8.7	8.7	—	—	—	—	—
United States Subsidiary Operations⁽¹⁾							
Operating lease obligations	35.3	5.6	4.9	3.8	3.5	3.2	14.3
Purchase obligations	13.2	13.2	—	—	—	—	—

(1) Obligations denominated in U.S. dollars are translated to Canadian dollars at a rate of 0.9946.

Included in the \$13.2 million (US\$13.5 million) of purchase obligations of EHSI, is the agreement to acquire a 100-bed skilled nursing center in Ohio for US\$7.5 million at the end of its lease term. The agreement was finalized in November 2010, and is expected to close at the end of March 2011.

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".

As well, EHSI is party to the following arrangement that had not taken effect as at December 31, 2010, and as such, it was not included in the table above. In September 2009, EHSI entered into an agreement with a company controlled by the former shareholders of Tendercare to operate a 120-bed skilled nursing center in Lansing, Michigan, following the renovation of the center. The renovation was completed in September 2010, and under the terms of the agreement, EHSI entered into a 10-year operating lease for US\$0.4 million per annum beginning January 1, 2011 (see "Related Party Transactions").

Defined Benefit Pension Plan Obligations

The contractual obligations table excludes our defined benefit pension plan obligations, none of which had funding requirements as at December 31, 2010. The accrued benefit liability on our balance sheet as at December 31, 2010, was \$24.1 million (December 31, 2009 – \$24.4 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 \$6.1 million and accrued benefit obligations of \$6.9 million as at December 31, 2010 (December 31, 2009 – \$6.1 million and \$6.3 million, respectively). The accrued benefit obligations of the supplementary plan were \$32.2 million as at December 31, 2010 (December 31, 2009 – \$30.0 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 \$41.0 million as at December 31, 2010 (December 31, 2009 – \$44.5 million), which was reduced to \$40.0 million subsequent to year end. The expected annual benefit payments under the supplementary pension plan that will be funded from cash from operations over the next

Management's Discussion & Analysis

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", management has implemented plans to refinance approximately US\$635 million of its U.S. long-term debt, of which US\$624.5 million matures in 2011 and 2012. Management anticipates refinancing this debt with approximately US\$568 million of HUD-insured mortgages and to use cash on hand of about US\$67 million to repay the balance. The refinancing is to be completed in stages, with the first anticipated before June 2011 with the repayment of the Sovereign Loans, and the balance through to November 2011 with the repayment of the CMBS financings. Assuming EHSI is able to secure an average interest rate, inclusive of associated fees, of 5.3%, it intends to reduce its debt by US\$67 million and reduce its interest costs by an estimated US\$11 million per annum. Upon completion of the refinancing, EHSI will have an additional 34 unencumbered centers.

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, the REIT has taken the appropriate steps to secure bridge financing that would provide flexibility in the refinancing process and to also ensure that alternative financing is available, if required. In order to provide flexibility in the refinancing process, EHSI obtained a Highly Confident Letter from a lender in January 2011, with a proposal to provide a bridge term loan facility to assist in the execution of the refinancing plan. In providing the Highly Confident Letter the lender conducted suitable due diligence of EHSI's refinancing plan and received approval from its internal credit committee. EHSI has not proceeded to move forward with the bridge term loan at this time. As well, EHSI is in the process of negotiating a loan modification that includes a six-month extension of the maturity of its 2011 CMBS Financing to facilitate the timing of its refinancing process. In addition, as an alternative to HUD financing, EHSI believes, based upon communication with its bankers, that it can secure either a bank term loan and/or issue senior unsecured notes. For further information refer to *note 7* of the 2010 consolidated financial statements.

Management believes that EHSI has full financial capacity and will execute its plan to complete the refinancing. Management continues to closely monitor the progress of the refinancing and the financial markets. Although we have confidence in the refinancing of the U.S. debt as outlined above, and have taken appropriate steps to obtain comfort that alternative financing is available, at the present time, there can be no assurance given that we will succeed in refinancing our debt prior to its maturity.

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.

At December 31, 2010, EHSI had cash on hand of US\$158.6 million, US\$50.2 million available under the EHSI Credit Facility and US\$10.0 million available under its PrivateBank Loans. Our Canadian operations had cash on hand of \$109.4 million and available bank lines of \$14.9 million at the end of 2010.

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

We are expecting to spend approximately \$39 million in facility maintenance capital expenditures and approximately \$49 million in growth capital expenditures in 2011. At December 31, 2010, EHSI had outstanding capital expenditure commitments of US\$13.3 million, and ECI had outstanding capital expenditure commitments of \$8.7 million related to its construction projects.

Related Party Transactions

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

On April 7, 2008, Tim Lukenda, the former President of Tendercare was appointed President and Chief Executive Officer of Extendicare REIT. Prior to its acquisition by EHSI, Mr. Lukenda owned an approximate 4.6% direct and indirect interest in Tendercare and received, directly or indirectly, on completion of the acquisition of Tendercare an equivalent percentage of the consideration paid by EHSI. As part of Mr. Lukenda's terms of employment, the employment contract provides a mechanism and process that effectively removes Mr. Lukenda from the decision-making process in situations where a conflict of interest may arise on any matter between Extendicare REIT and his previous employer, or with respect to any financial interest that Mr. Lukenda or his family have with Extendicare REIT and its subsidiaries. As part of the acquisition of Tendercare, in addition to normal representation and warranty provisions, EHSI must agree on any adjustments to the final purchase price, before making any payments to Mr. Lukenda or his family. EHSI and ECI also provide certain services to three long-term care centers that are owned or partially owned by members of Mr. Lukenda's immediate family.

With regards to the Tendercare acquisition notes of US\$26.4 million, EHSI settled US\$10.4 million of the notes in January 2008 and March 2009, upon having met certain conditions. The remaining notes of US\$16.0 million are payable commencing in 2010 at US\$4.0 million per annum until maturity in 2013, of which US\$4.0 million was paid in November 2010. Under the terms of the agreement, 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 and is awaiting the court's decision. 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 2010, ECI made a settlement payment of US\$1.5 million (2009 – US\$2.2 million).

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 and his immediate family. The company owns a 120-bed 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 renovation was completed in September 2010 and licensure is anticipated during the 2011 first quarter.

Off-balance Sheet Arrangements

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

The LTC Master Leases provide for an initial 10-year term and three successive 10-year lease terms at the option of the lessee. There are no significant economic penalties if the renewal options are not exercised. The aggregate minimum rental payment for the 2010 calendar year was US\$10.9 million and will increase by 2% for each of the calendar years through 2014. Annual minimum rent during any renewal term will increase by a minimum of 2% over the minimum rent of the immediately preceding year.

Risks and Uncertainties

General Business Risks

Extendicare REIT is subject to general business risks inherent in the long-term care industry, including changing consumer preferences, fluctuations in occupancy levels, the inability to achieve profitable patient/residency fees or funding (including anticipated increases in such fees or funding), increases in labour costs and other operating costs, possible future changes in labour relations, competition from or the oversupply of other similar properties, changes in neighbourhood or location conditions and general economic conditions, health related risks, disease outbreaks and control risks, changes in critical accounting policies, the imposition of increased taxes or new taxes, capital expenditure requirements, changes in interest rates, and changes in the availability and cost of long-term financing which may render refinancing of mortgages difficult or unattractive. Moreover, there is no assurance that the occupancy levels achieved to date and expected in the future will continue or be achieved. Any one of, or a combination of, these factors may adversely affect the business, results of operations and financial condition of the REIT.

Government Funding, Legislative and Regulatory Changes

Extendicare REIT's earnings are highly reliant on government funding and reimbursement programs, both in the U.S. and Canada, and the effective management of staffing and other costs of operations, which are strictly monitored by government regulatory authorities. Given that we operate in a labour-intensive industry, where labour-related costs account for a significant portion of our operating and administrative costs (2010 – 74.2%), government funding constraints could have a significant adverse effect on our results from operations and cash flows. Management is unable to predict whether governments will adopt changes in their reimbursement programs, or if adopted and implemented, what effect such changes will have on the REIT.

Further information on funding and legislative changes affecting our industry can be found under the heading "Update of Legislative Actions Affecting Revenue".

All long-term care providers are subject to surveys and inspections by government authorities to ensure compliance with applicable laws and licensure requirements of the federal, state and/or provincial funding programs. Our nursing centers must comply with regulations involving such things as staffing levels, resident care standards, occupational health and safety, resident confidentiality, billing and reimbursement, along with environmental, biological and other standards. The survey process is intended to review the actual provision of care and services. 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 December 31, 2010, 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.

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.

In the United States, non-compliance with certain laws governing long-term care could result in severe penalties, which may include criminal sanctions and fines, civil monetary penalties and exclusion from the Medicare and Medicaid programs. These penalties could have a material adverse effect on the business, results of operations or financial condition of the REIT.

UNITED STATES

Limitations on U.S. Medicare and Medicaid reimbursement for health care services are continually proposed. Changes in applicable laws and regulations could also have an adverse effect on reimbursement levels from governmental, private and other sources, which could have a significant adverse impact on our results from operations and cash flows.

In addition, legislative and regulatory actions have also resulted in continuing changes to Medicare and Medicaid reimbursement programs. Medicare and Medicaid reimbursement programs are complicated and constantly changing as CMS continues to refine its 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. Further information on funding and legislative changes affecting our industry in the United States can be found under the heading "Update of Legislative Actions Affecting Revenue – United States".

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

Under CMS' Special Focus Facility (SFF) program focusing on poorly performing nursing centers, immediate sanctions, which may include termination of funding, must be imposed on an SFF nursing center that fails to achieve and maintain significant progress in correcting previously identified deficiencies. EHSI has certain centers currently included in the SFF program, and like other operators, its centers can be subject to the SFF program at any time. These centers are being actively monitored by management.

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

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

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

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 is unable to give assurance that a governmental authority will not interpret such requirements in a manner inconsistent with EHSI's interpretation and application. If EHSI fails to comply, even inadvertently, with any of these requirements, it could be required to alter its operations and/or refund payments to the government, and it could be subject to significant 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.

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. Further information on funding and legislative changes affecting our industry in Canada can be found under the heading "Update of Legislative Actions Affecting Revenue – Canada".

Revoking a license by authorities or cancelling a service contract due to inadequate performance by the operator has been historically infrequent in Canada and was 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 correct legitimate problem areas that have been identified.

Debt Financing

A portion of the consolidated cash flow of the REIT and its subsidiaries will be devoted to servicing debt, and there can be no assurance that the REIT will continue to generate sufficient cash flow from operations to meet required interest and principal payments. If the REIT were unable to meet interest or principal payments, it could be required to seek renegotiation of such payments or obtain additional equity, debt or other financing.

As discussed in more detail under the heading "Overview – 2011 Refinancing Plan", management has implemented plans to refinance approximately US\$635 million of its U.S. long-term debt, of which US\$624.5 million matures in 2011 and 2012. Management anticipates refinancing this debt with approximately US\$568 million of HUD-insured mortgages and to use cash on hand to repay the balance. The refinancing is to be completed in stages, with the first anticipated before June 2011 with the repayment of the Sovereign Loans, and the balance through to November 2011 with the repayment of the CMBS financings. Upon completion of the refinancing, EHSI will have an additional 34 unencumbered centers.

Management's Discussion & Analysis

Extendicare's RBC Credit Facility (\$70.0 million of working capital and US\$10.2 million letter of credit facility) is due on demand and is primarily used to back letters of credit that renew annually. The availability under the working capital line was \$14.9 million at December 31, 2010, with letters of credit of \$55.1 million and US\$10.2 million issued.

Recent global events and regulatory developments in the nursing home industry in the United States could pose risks to the REIT's ability to finance and refinance such debt and/or result in a higher cost of borrowing. The REIT cannot predict whether future financing will be available, what the terms of such future financing will be or whether its existing debt agreements will allow for the timely arrangement and implementation of such future financing. If the REIT is unable to obtain additional financing or refinancing when needed or on satisfactory terms, it could have a material adverse effect on the business, operating results and financial condition of the REIT. Refer to the discussion under the heading "Overview – Global Economic Environment" and in *note 19* of the 2010 consolidated financial results.

Debt Covenants

The REIT and its subsidiaries are in compliance with all of their respective financial covenants as at December 31, 2010. However, there can be no assurance that future covenant requirements will be met. EHSI's bank lines and other debt may be affected by its ability to remain in compliance. If EHSI does not remain in compliance, its ability to amend the covenants or refinance its debt may be affected.

Credit and Interest Rates

The REIT assesses interest rate and foreign currency cash flow risk by continually identifying and monitoring changes in interest rate and foreign currency exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities. The REIT maintains risk management control systems to monitor interest rate and foreign currency cash flow risk attributable to its outstanding or forecasted debt obligations as well as its offsetting hedge positions.

In order to meet its monthly distributions, the REIT has limited the amount of debt that may be subject to changes in interest rates. As a result, all but \$90.1 million of the REIT's total long-term debt outstanding of \$1,247.9 million at December 31, 2010, excluding financing costs and equity allocation, was at fixed rates. The REIT does not enter into financial instruments for trading or speculative purposes. The perceived creditworthiness of the REIT may affect the market price or value and the liquidity of the REIT Units.

Capital Intensive Industry

The ability of the REIT and its subsidiaries to maintain and enhance their senior care centers in a suitable condition to meet regulatory standards, operate efficiently and remain competitive in its markets will require the REIT to commit a substantial portion of cash to physical plant and equipment. Certain of the competitors of the REIT may operate centers that are not as old as those owned by the REIT, or that may appear more modern, and therefore may be more attractive to potential patients and residents. It is the REIT's intention to spend between 1.5% and 2% of revenue annually on maintenance capital expenditures, which is consistent with its objective to maintain and upgrade its centers. Over the next 10 to 15 years, ECI will be required to redevelop 23 class "C" long-term care centers in accordance with the Government of Ontario's redevelopment program (see "Update of Legislative Actions Affecting Revenue – Canada – Ontario Long-term Care Legislation"). These as well as other future capital requirements could have a material adverse effect on the business, operating results and financial condition of the REIT.

Liability, Insurance and Litigation

Participants in the long-term care industry continue to face lawsuits alleging negligence, malpractice, or other related claims. Many of these suits have involved large claims and significant defence costs. The REIT and its subsidiaries could face such suits because of the nature of its business, particularly given the age and health demographics of the residents and patients, and the inherent risk in providing care to the elderly. The REIT may be faced with the threat of large verdicts in jurisdictions where juries typically do not decide in favour of long-term care providers. Historically, the long-term care industry has been subject, from time to time, to verdicts of punitive or special damages in unsuccessful defence of claims.

The REIT maintains liability and property insurance policies and/or captive insurance structures in amounts and with the coverage and deductibles it believes are adequate based on the nature and risks of its business, historical experience and industry standards, as well as the type of insurance coverage commercially available in the marketplace. The captive insurance company of the REIT is currently appropriately capitalized, but there is no assurance that it will remain appropriately capitalized in the future if claims against it increase significantly.

The REIT maintains insurance coverage for general and professional liability, trustees', directors' and officers' liability, employers' liability, auto liability, health benefits, business income and in certain states, workers' compensation. General and professional liability policies currently offered in the long-term care industry are generally only offered on a "claims made" basis, as opposed to "occurrence based" coverage. "Claims made" policies are subject to possible rate increases upon renewal due to a step-up factor used by the insurer.

In order to obtain liability insurance at a more reasonable cost or in some instances to obtain coverage at all, the REIT is required to assume substantial self-insurance retention levels for the professional liability claims of its U.S. operations. The REIT estimates the value of losses that may occur within its self-insured retention levels based on historical claims, actuarial valuations, third-party administrator estimates, industry data and advice from consultants and legal counsel and endeavours to reserve for such liabilities. If the estimates of the REIT are inaccurate or if there are an unexpectedly large number of successful claims that result in liabilities in excess of the reserves of the REIT for losses, the operating results of the REIT could be adversely affected. Claims against the REIT, regardless of their merit or eventual outcome, also may have a material adverse effect on the ability of the REIT to attract residents and patients, expand the business of the REIT or maintain favourable standings with regulatory authorities. These claims also require management to devote time to matters unrelated to the operation of the business.

A successful claim against the REIT not covered by, or in excess of, such insurance, or in excess of the reserves of the REIT for self-insured retention levels, could have a material adverse effect on the business, operating results, and financial condition of the REIT. In many states, state law prohibits or limits insurance coverage for the risk of punitive damages arising from professional liability and general liability claims and/or litigation. Furthermore, there are certain types of risks, generally of a catastrophic nature, such as war, non-certified acts of terrorism, or environmental contamination, which are either uninsurable or are not insurable on an economically viable basis. Under these circumstances, the REIT may be liable for such losses.

The REIT has to renew its insurance policies each year and negotiate acceptable terms for coverage, exposing it to the volatility of the insurance markets, including the possibility of rate increases resulting from the claim experience of the REIT Group or the aggregate claim experience of the long-term care industry. Insurance carriers have recently required insureds to significantly increase their self-insured retention levels and/or pay substantially higher premiums for reduced coverage. There can be no assurance that the REIT will be able to obtain insurance in the future or, if available, that such coverage will be available on acceptable terms and provide coverage for perils inherent to the senior care industry.

Foreign Currency Rate Fluctuations

The majority of the REIT's operations are conducted in the United States and the financial position and results are denominated in U.S. dollars. Our U.S. operations accounted for 68.0% of our total revenue in 2010. Our U.S. operations are self-sustaining and their revenue and expenses are translated at average rates of exchange in effect during the period. Assets and liabilities are translated at the exchange rates in effect at the balance sheet date. As a result, the REIT's consolidated financial position is subject to foreign currency fluctuation risk, which could adversely impact its operating results and its cash flows.

The translation effect of the strengthening of the Canadian dollar on the REIT's earnings for 2010 is summarized under the heading "Impact of U.S. Dollar and Foreign Currency Translation". Net earnings from our U.S. continuing operations were US\$41.6 million for 2010. Every one cent increase (decrease) in the Canadian dollar against the U.S. dollar would impact these earnings by \$0.4 million. A similar change in the Canadian dollar would decrease (increase) the net assets of the U.S. operations by approximately \$1.5 million, and would be reflected as a change in foreign currency translation adjustments in accumulated other comprehensive income.

As well, since the distributions to holders of REIT Units and Exchangeable LP Units are denominated in Canadian dollars, the cash available for distribution could be adversely impacted. To partly minimize this risk, EHSI entered into forward contracts to acquire Canadian dollars for US\$4.0 million on a monthly basis to June 2011 (refer to the discussion under the heading "Impact of U.S. Dollar and Foreign Currency Translation – Impact of Foreign Currency Forward Contract Strategy on Distributions"). These FCFCs are not designated as hedging instruments for accounting purposes and, therefore, fair value adjustments on these derivatives are reflected through the statement of earnings. As at December 31, 2010, the fair value of the foreign currency forward contracts was a liability of \$0.4 million (US\$0.4 million) compared to a liability of \$0.3 million (US\$0.3 million) at December 31, 2009. There can be no assurance that the FCFCs that we have put in place will be sufficient to protect against currency exchange rate losses.

Management's Discussion & Analysis

Capital Investment and Continued Growth

Given the current economic conditions, and management's plans to conserve capital, we are not actively seeking acquisition opportunities at this time. However, we expect that there will be opportunities to acquire properties or expand existing centers which may be accretive, but there can be no assurance that this will be the case. Furthermore, as the intention of the REIT is to pay out a substantial proportion of Distributable Income, the ability of the REIT to fund growth will be dependent on external sources of funding. Lack of availability of such funding could limit the future growth of the REIT.

Distributable Income may be dependent upon the ability of the REIT and its subsidiaries to fund a portion of their capital expenditures and working capital with cash generated from operations. As well, the timing and amount of capital expenditures by the REIT will directly affect the amount of cash available for distribution to its unitholders. Distributions may be reduced, or even eliminated, at times when the Board of Trustees deems it necessary to make significant capital or other expenditures.

Canadian Federal Income Tax on Income Trusts

Extencicare REIT is a specified investment flow-through trust, or SIFT, and has been subject to SIFT tax since 2007, in accordance with the Budget Implementation Act, 2007, which received Royal Assent on June 22, 2007. The SIFT Amendments, as described under the heading "Canadian SIFT and U.S. REIT Income Tax Updates – Canada – Canadian Federal Income Tax on Income Trusts" under the "Significant Developments" section of this MD&A, include revisions to the definitions of "SIFT trust" and "SIFT partnership" to specifically exclude certain trusts and partnerships that are wholly owned by a SIFT. The SIFT Amendments do not change the status of 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.

Tax Rules and Regulations

Extencicare REIT and its subsidiaries are subject to audits from federal, state and provincial tax jurisdictions and therefore are subject to risk in the interpretation of tax legislation and regulations. Tax regulations are complex and require careful review by tax management of the REIT and its external tax consultants. Differences in interpretation of those tax rules and regulations could result in tax assessments and penalties for the untimely payment of the determined tax liability.

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.

Future Tax Assets and Liabilities

The REIT and its subsidiaries use the liability method, which takes into account the differences between financial statement treatment and tax treatment of certain transactions, assets and liabilities. A financial statement benefit for tax losses and other future tax assets based on future anticipated taxable earnings has been recognized. As at December 31, 2010, a valuation allowance of \$16.3 million (2009 – \$17.1 million) was recorded primarily against land and capital losses.

Indemnification Obligations between ALC and Extencicare

In connection with the distribution of ALC in 2006, Extencicare and ALC entered into the Separation Agreement, the Tax Allocation Agreement, a number of transitional services agreements, and a number of operating lease and purchase agreements relating to the transfer of EHSI assisted living centers to ALC. These agreements indemnify ALC, Extencicare, their affiliates, directors, officers, employees, investment bankers, attorneys or other advisors or representatives, for all identifiable losses, as incurred, to the extent relating to or arising from the 2006 spin-off of ALC.

The Separation Agreement specifies the procedures and limitations with respect to claims subject to indemnification and provides for contribution in the event that indemnification is not available or insufficient to hold harmless an indemnified party.

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

Specified Contingent Claims Against Crown Life

Under the June 2007 Crown Life share sale agreement with Canada Life, Extencicare remains responsible for specified contingent claims against Crown Life. As at December 31, 2010, these claims totalled \$13.9 million, for which Extencicare has delivered letters of credit to Crown Life in support thereof. Depending on the type of contingent claim, the letters of credit have various terms ranging from 5 to 15 years. Based on past trends and information received from an independent actuary, management estimates that Extencicare's remaining aggregate liability for such claims will not exceed \$5.6 million, and has recorded a provision for this amount in other long-term liabilities on the balance sheet as at December 31, 2010.

Accounting Policies and Estimates

Non-GAAP Measures

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

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

The above line items are calculated on an after-tax basis as a means of deriving the remaining earnings from operations and related earnings per unit, the results of which are referred to as either "continuing health care operations before undernoted" or "continuing operations before undernoted", as applicable. This is a measure commonly used by the REIT and its investors as a means of assessing the performance of the core operations in comparison to prior periods.

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

Critical Accounting Policies and Estimates

The REIT's consolidated financial statements have been prepared in accordance with Canadian GAAP. For a full discussion of the REIT's accounting policies, readers should refer to the accompanying notes to the REIT's December 31, 2010, audited consolidated financial statements and the discussion under the heading "Future Change in Accounting Policies – Transition to International Financial Reporting Standards" that follows this section. 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

Management's Discussion & Analysis

valuation of accounts receivable; the measurement of acquired assets and assumed liabilities in business combinations; the valuation of assets and determination of asset impairment; the valuation of conditional asset retirement obligations; the determination of the accrual for self-insured liabilities; and accounting for tax uncertainties, including valuation allowances for future tax assets. The recorded amounts for such items are based on management's best available information and judgement and accordingly, actual results could differ from those estimated.

REVENUE RECOGNITION AND ACCOUNTS RECEIVABLE

In the United States, revenue from skilled nursing centers is derived from various federal and state medical assistance programs, Managed Care providers (for residents with health maintenance and commercial insurance programs), as well as privately from the residents. Approximately 79% of EHSI's total revenue from all sources was derived from services provided under various federal or state medical assistance programs during 2010 and 2009. EHSI records its skilled nursing center revenue in the period in which the services and products are provided at established rates less contractual adjustments. Contractual adjustments include differences between established billing rates and amounts estimated by management as reimbursable under various reimbursement formulas or contracts in effect. State plan amendments and waivers are submitted to CMS for approval, which can result in changes to revenue pertaining to prior periods. Estimation differences between final settlements and amounts recorded in previous periods are reported as adjustments to revenue in the period such settlements are determined. Due to the complexity of laws and regulations governing the federal and state reimbursement programs, there is a possibility that recorded estimates may change by a material amount.

In Canada, the fees charged by ECI for its nursing homes and home health care services are regulated by provincial authorities (rather than federal authorities). Accordingly, provincial programs fund a substantial portion of these fees, with the remainder paid for by the residents or customers. Each province has a different system for managing the services provided. As a result, there can be significant variability from location to location with respect to the regulations for providing care and how centers are reimbursed. Revenue from provincial programs represented approximately 65% of ECI's nursing home operations, and approximately 96% of its home health care services.

Accounts receivable are recorded at amounts expected from federal, state and provincial reimbursement programs, other third-party payors or from individual residents. Receivables from government agencies represent the only concentrated group of credit risks for the REIT. As at December 31, 2010, receivables from government agencies represented approximately 78% of the total receivables. Management does not believe there is any significant credit risk associated with these government agencies other than possible funding delays. Receivables from other various payors, other than the government, are subject to differing economic conditions and do not represent any concentrated credit risks to the REIT, as there is no significant exposure to any single party. Management estimates which receivables may be collected within one year and reflects those not expected to be collected within one year as non-current assets. Management continually monitors and adjusts the allowances associated with these receivables by conducting a specific account review of amounts in excess of predefined target amounts and aging thresholds, which vary by payor type. Provisions are considered based upon the evaluation of the circumstances for each of these specific accounts. In addition, management has established percentages for allowance for doubtful accounts that are based upon historical collection trends for each payor type and age of these receivables. Accounts receivable that are estimated to be uncollectible, based upon the above process, are fully reserved for in the allowance for doubtful accounts until they are written off or collected. If circumstances change, for instance due to an economic downturn, resulting in higher than expected defaults or denials, management's estimates of the recoverability of receivables could be reduced by a material amount.

Due to differences in the government funding structures for the services provided, the Canadian operations are not subject to the same risks associated with the collection of accounts receivable as are the U.S. operations. As a result, approximately 94% of the REIT's allowance for current accounts receivable at December 31, 2010, was associated with the U.S. operations. The allowance for doubtful accounts for current accounts receivable totalled \$17.8 million and \$24.0 million at December 31, 2010 and 2009, respectively. Days of revenue outstanding have decreased to 37 days at December 31, 2010 from 39 days as at December 31, 2009.

At December 31, 2010, EHSI had \$26.3 million (US\$26.5 million) in Medicare and Medicaid settlement receivables compared to \$26.5 million (US\$25.2 million) at the end of 2009. There was no allowance on these receivable balances. It is expected that \$8.8 million (US\$8.9 million) will be substantially collected within one year and is included in accounts receivable as a current asset, compared to \$9.1 million (US\$8.6 million) at December 31, 2009. The remaining balance has been classified as a long-term receivable in other assets. Medicare settlement receivables primarily relate to reimbursable Part A co-insurance receivables totalling US\$23.2 million and US\$22.4 million as at December 31, 2010 and 2009, respectively. Medicaid settlement receivables pertain to cost-based reimbursement programs. Differences between the final settlement and amounts previously recorded are reported as adjustments to revenue in the period of determination.

MEASUREMENT OF ACQUIRED ASSETS AND LIABILITIES IN BUSINESS COMBINATIONS

Acquisitions of businesses are accounted for using the purchase method. This involves allocating the purchase price paid for a business to the assets acquired, including identifiable intangible assets and the liabilities assumed, based on their fair value at the date of acquisition. Any excess is then recorded as goodwill. The identification of intangible assets includes acquired customers, which the REIT refers to as resident relationships.

In respect of the valuation of real estate acquired, management calculates the fair value of the land and buildings, or properties, using an "as if vacant" approach. The fair value of furniture and equipment is determined on a depreciated replacement cost basis. Resident relationships are valued based upon the valuation methodology outlined below. The purchase price of the acquisition is allocated based upon these assessments with, if applicable, the excess purchase price being recorded as goodwill. These estimates are based upon historical, financial and market information. Imprecision of these estimates can affect the allocation of the purchase price paid on the acquisition of facilities between intangible assets and liabilities and the properties and goodwill values determined, and the related depreciation and amortization.

Resident relationships represent the assets acquired by virtue of acquiring a facility with existing residents and thus avoiding the cost of obtaining new residents, plus the value of lost net resident revenue over the estimated lease-up period of the property. In order to effect such purchase price allocation, management is required to make estimates of the average facility lease-up period, the average lease-up costs and the deficiency in operating profits relative to the facility's performance when fully occupied. Resident relationships are amortized to amortization expense on a straight-line basis over the estimated average resident stay at the facility. Resident relationships are generally amortized over a 16-month period for senior care facilities. The balance of resident relationships was fully amortized in 2009.

VALUATION OF ASSETS AND ASSET IMPAIRMENT

Management periodically assesses the recoverability of long-lived assets when there are indications of potential impairment based on estimates of undiscounted future cash flows. In performing these analyses, management considers such factors as current results, trends and future prospects, in addition to other economic and regulatory factors.

Goodwill and other intangible assets with an indefinite life are tested for impairment at least annually. Goodwill is allocated to reporting units and any potential impairment is identified by comparing the carrying value of a reporting unit with its fair value. The amount of any impairment is calculated by comparing the carrying value of goodwill to its fair value, based on the fair value of the assets and liabilities of the reporting unit.

A substantial change in estimated future cash flows for these assets could materially change their estimated fair values, possibly resulting in additional impairment. Changes which may impact future cash flows include, but are not limited to: competition in the marketplace; decreases in government funding; increases in wages or other operating costs; increased litigation and insurance costs; and increased operational costs resulting from changes in legislation and regulatory scrutiny. As detailed in *notes 10 and 11* of the 2010 consolidated financial statements, the loss from impairment of assets in 2010 was \$2.5 million in continuing operations compared to \$5.8 million in discontinued operations in 2009.

CONDITIONAL ASSET RETIREMENT OBLIGATIONS

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

As at December 31, 2010, the conditional asset retirement obligation, which related to asbestos remediation, was \$24.2 million compared to \$24.8 million at the beginning of the year, with the decline primarily due to the impact of the stronger Canadian dollar. The fair value of the conditional asset retirement obligation was 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 conditional asset retirement obligations: (a) discount rates of 6.75% for facilities located in Canada and 7.10% for facilities located in the U.S.; (b) an estimated timing of the settlement of the conditional obligations ranging from 10 to 30 years; and (c) an estimated undiscounted cash flow amount to settle the asset retirement obligation of approximately \$50.0 million. There were no changes to the initial timing and estimates of undiscounted cash flow amounts in 2010.

Management's Discussion & Analysis

SELF-INSURED LIABILITIES

Insurance coverage for resident care liability and other risks has become difficult to obtain. The REIT self-insures for certain risks related to comprehensive general and professional liability (including malpractice insurance), auto liability, health benefits, employers' liability and workers' compensation. Reinsurance coverage is obtained in amounts and with such coverage and deductibles as management deems appropriate, based on the nature and risks of the business, historical experiences, availability and industry standards.

Management accrues for self-insured liabilities based on past trends and information received from an independent actuary. Management regularly evaluates the appropriateness of the carrying value of the self-insured liabilities through an independent actuarial review. General and professional liability claims are the most volatile and significant of the risks that Extencicare self-insures. Management's estimate of the accrual for general and professional liability costs is significantly influenced by assumptions, which are limited by the uncertainty of predicting future events and assessments regarding expectations of several factors. These include, but are not limited to: the frequency and severity of claims, which can differ materially by jurisdiction; coverage limits of third-party reinsurance; the effectiveness of the claims management process; and the outcome of litigation.

Changes in the level of retained risk and other significant assumptions that underlie management's estimates could have a material effect on the future carrying value of the self-insured liabilities. The REIT reports the annual accrual for potential resident care liability claims on its consolidated statements of cash flows, and for the years ended 2010 and 2009, recorded a provision of \$33.3 million and \$22.0 million, respectively. At December 31, 2010, the accrual for self-insured general and professional liabilities totalled \$47.4 million compared to \$43.9 million at the beginning of the year (see "Liquidity and Capital Resources – Accrual for Self-Insured Liabilities").

SPECIFIED CONTINGENT CLAIMS AGAINST CROWN LIFE

Under the June 2007 Crown Life share sale agreement with Canada Life, Extencicare remains responsible for specified contingent claims against Crown Life. As at December 31, 2010, these claims totalled \$13.9 million, for which Extencicare has delivered letters of credit to Crown Life in support thereof. Depending on the type of contingent claim, the letters of credit have various terms ranging from 5 to 15 years. Management's assessment of the provision to settle the claims is based on past trends and information received from an independent actuary. The estimated provision as at December 31, 2010 was \$5.6 million (see "Liquidity and Capital Resources – Specified Contingent Claims Against Crown Life").

TAX UNCERTAINTIES

Tax uncertainties are assessed and measured using a probability adjusted or expected value model whereby amounts are recorded if there is uncertainty about a filing position, determined by multiplying the amount of the exposure by the probability that the entity's filing position will not be sustained.

Extencicare REIT is a SIFT in accordance with the Tax Act, and has been subject to SIFT tax since January 2007. The SIFT Amendments, as described under the heading "Canadian SIFT and U.S. REIT Income Tax Updates – Canada – Canadian Federal Income Tax on Income Trusts" under the "Significant Developments" section of this MD&A, include revisions to the definitions of "SIFT trust" and "SIFT partnership" to specifically exclude certain trust and partnerships that are wholly owned by a SIFT. These SIFT Amendments do not change the status of 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.

FUTURE TAX ASSETS AND LIABILITIES

The REIT and its subsidiaries use the liability method, which takes into account the differences between financial statement treatment and tax treatment of certain transactions, assets and liabilities. Future tax assets and liabilities are recognized to reflect the expected future tax consequences attributed to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carryforwards. Future tax assets and liabilities are measured using tax rates (enacted or substantially enacted at the balance sheet date) anticipated to apply in the periods that the temporary differences are expected to be recovered or settled. A valuation allowance is established based upon management's estimate of whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future tax assets depends on the generation of taxable income during the periods in which those temporary differences become deductible. In making this assessment, management considers the scheduled reversal of future tax liabilities, projected future taxable income and tax planning strategies. The valuation allowance for future tax assets totalled \$16.3 million and \$17.1 million at December 31, 2010 and 2009, respectively.

New Accounting Policies Adopted

There were no changes in accounting policies in 2010.

Future Change in Accounting Policies

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

TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

In February 2008, the Accounting Standards Board of Canada confirmed its decision to require that all publicly accountable enterprises report under International Financial Reporting Standards (IFRS) for interim and annual periods commencing January 1, 2011, and will include one year of comparative figures for 2010. We will present our first IFRS consolidated financial statements for the first quarter of 2011.

IFRS are based on a conceptual framework similar to Canadian GAAP, although significant differences exist in certain areas relating to recognition, measurement and disclosure of assets and liabilities. The classification and components of our financial statements and extent of disclosures under IFRS are expected to be different than under Canadian GAAP.

The REIT's conversion plan to identify and address implementation issues is as follows:

1. Scoping
2. Planning
3. Design and Build
4. Implement and Review

The transition to IFRS will have an impact on the REIT's financial reporting, business processes, information system, disclosure controls and procedures (DC&P), and internal controls over financial reporting (ICFR). Beginning in 2008, we formed an IFRS task force that undertook the responsibility for the following:

- Completed a diagnostic impact assessment and identified IFRS versus current Canadian GAAP differences.
- Identified the necessary changes to our financial reporting processes and systems in order to support the transition to IFRS.
- Developed and tested the changes in financial reporting systems to support the measurement and disclosure requirements of IFRS.
- Investigated IFRS requirements to evaluate whether significant transactions would be reported or measured differently compared to Canadian GAAP.
- Developed communication material and training for our audit committee and finance staff to understand the expected changes upon transition to IFRS.

During 2010, we were in the Implement and Review phase of the project, whereby financial statements were prepared under both Canadian GAAP and IFRS. The comparative results for 2010 prepared under IFRS will be presented externally along with our 2011 financial statements.

Impact of IFRS Adoption on Business Activities

Deed of Trust

As part of our process of reviewing significant contracts, our Board of Trustees amended the REIT's Deed of Trust regarding the definition of Adjusted Gross Book Value in connection with our option to apply the "fair value as deemed cost" exemption explained in the table below.

The definition of AGBV was amended to include a deduction from the total reported value of the assets of the REIT of an amount equal to the net increase in the gross carrying value of the assets, which deduction is appropriate given the inherent upward adjustment for the incremental value of \$675 million already contained in the definition.

The REIT's Deed of Trust includes investment restrictions based on AGBV but does not contain any borrowing limits based on AGBV. In addition, our quarterly and annual MD&A includes a discussion of the REIT's long-term debt (at face value and including the current portion) to AGBV (determined using the alternative method) as at the end of the most recent financial period and includes a comparison to the relevant prior period. The amendment to the definition of AGBV will allow the REIT to carry the discussion of this ratio forward.

Management's Discussion & Analysis

Financial Covenants

We do not expect the conversion to IFRS to have a significant impact on our debt covenants. For our U.S. operations, we will continue to provide financial statements prepared using U.S. GAAP for our lenders. For our Canadian operations, we do not expect the differences between Canadian GAAP and IFRS to have an impact on debt covenants.

Systems & Processes

We identified changes that would be necessary to our information technology systems resulting from differences in accounting standards, as well as the additional disclosure requirements under IFRS.

For our dual-reporting requirement for the 2010 fiscal period, we have developed a strategy for preparing financial reports under Canadian GAAP, U.S. GAAP and IFRS. We have tested and implemented this solution to support dual reporting, and will be using our financial reporting systems to compile the necessary reconciliations that will be disclosed beginning in the first quarter of 2011.

Controls & Procedures

We involved our internal audit group throughout the IFRS transition process. With their assistance, we assessed the impact of changeover on DC&P and ICFR. We have developed plans to evaluate the operating effectiveness of revised DC&P and ICFR that will be required to support our reporting and disclosure requirements under IFRS.

Impact of IFRS Adoption on Key Performance Metrics

Adjusted Funds from Operations

AFFO is not expected to change significantly under IFRS. The calculation of AFFO would be affected to the extent that EBITDA and net interest expense change under IFRS, the impact of which is not expected to be material.

Earnings per Unit (EPU)

Under 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. The Exchangeable LP Units will be presented as a financial liability; therefore, the basis on which EPU is calculated is different under IFRS. For additional details, please refer to the section titled "IAS 32 Financial Instruments – Presentation" in the following table.

For the purposes of providing a consistent performance metric under IFRS, as a non-GAAP measure, we will continue to disclose EPU within our financial statement notes whereby both the REIT Units and Exchangeable LP Units are included for the denominator of the EPU calculation.

Impact of IFRS Adoption on Statement of Financial Position

The REIT has identified IFRS and Canadian GAAP differences including various first-time adoption exemptions (IFRS 1 exemptions) and policy choices available after IFRS is adopted. The following table summarizes the differences believed to have the most significant impact on our accounting policies, and is not intended to be a comprehensive list of changes that will result from the transition to IFRS. In addition to the accounting policy differences, IFRS is generally expected to result in additional disclosures as compared to Canadian GAAP. The implications of the IFRS impact discussed below have not been audited or reviewed by the REIT's external auditors and as such, are subject to change.

AREA AFFECTED BY IFRS**IFRS 1 EXEMPTIONS & POLICY CHOICES UNDER IFRS****EXPECTED IMPACT ON FINANCIAL STATEMENTS**

IAS 16

Plant, Property & Equipment (PP&E)

On transition, we will be electing to apply the “fair value as deemed cost” exemption to revalue land and buildings of selected nursing centers at fair value.

Opening Balance Sheet:

During 2010, we completed the revaluation of selected nursing centers. 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.

The effect of this exercise would cause an increase in the carrying amount of selected nursing centers. In conjunction with IFRS requirements for performing an impairment test at the “Cash Generating Unit” level, we noted a consequential decrease in goodwill due to the higher carrying values associated with some of the revalued nursing centers (for further details, please refer to the section below labelled “IAS 36 – Impairment”).

Any changes to the carrying amount of the nursing centers and goodwill as a result of the revaluation exercise will be recorded in an equity account for all of our IFRS related transitional adjustments.

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 cap 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.

The net increase to PP&E resulting from our revaluation exercise is expected to be in the range of approximately \$330 million to \$370 million.

Subsequent to transition:

Where selected nursing centers are positively revalued, the associated depreciation expense will increase and will differ from depreciation expense recorded under Canadian GAAP.

Subsequent to transition, the cost model will continue to be used for all categories of PP&E.

Management's Discussion & Analysis

AREA AFFECTED BY IFRS	IFRS 1 EXEMPTIONS & POLICY CHOICES UNDER IFRS	EXPECTED IMPACT ON FINANCIAL STATEMENTS
<p>IAS 19 Employee Benefits</p>	<p>On transition, we will be electing to apply the exemption to reset the actuarial experience loss to zero.</p> <p>Subsequent to transition, we will be recording the actuarial experience gains or losses in other comprehensive income.</p>	<p>Opening Balance Sheet: As a result of the IFRS 1 exemption, our defined benefit pension liability is expected to increase by approximately \$4.5 million, with a corresponding decrease to the IFRS transitional adjustment equity account.</p> <p>Subsequent to transition: Pension expense will no longer include the amortization component of the net actuarial loss. Future actuarial gains and losses will be recorded directly in other comprehensive income as part of equity, and will impact our equity account.</p>
<p>IAS 21 The Effects of Changes in Foreign Exchange Rates</p>	<p>On transition, we will be electing to apply the exemption to reset the cumulative transition adjustment (CTA) balance to zero.</p>	<p>Opening Balance Sheet: As a result of the IFRS 1 exemption, the debit balance of approximately \$1 million on transition will be reclassified to the IFRS transitional adjustments equity account.</p> <p>Subsequent to transition: No significant change. Translation adjustments subsequent to IFRS transition will be presented in the CTA account.</p>
<p>IAS 36 Impairment of Assets</p>	<p>IFRS requires impairment testing to be performed at the "cash-generating unit" (CGU) level. We have identified individual nursing centers as a CGU for the purpose of performing an impairment test.</p> <p>Under Canadian GAAP, we tested goodwill at our segment level, and did not allocate goodwill to individual nursing centers for impairment testing purposes.</p> <p>IFRS requires a one-step impairment test for identifying and measuring impairment, whereby goodwill and corporate assets are allocated to specific CGUs for the purpose of impairment testing.</p> <p>Previously recorded impairment losses (except impairment losses related to goodwill) must be reversed under certain conditions.</p>	<p>Opening Balance Sheet: In conjunction with the revaluation exercise related to PP&E, we completed the impairment tests under IFRS.</p> <p>As a result of the differences in impairment testing methodologies, the potential impairment relating to goodwill under IFRS is estimated to be approximately \$65 million to \$75 million.</p> <p>Subsequent to transition: As IFRS requires a one-step impairment test, more frequent writedowns of PP&E and/or goodwill may be expected.</p> <p>As well, reversals of previous impairment losses of PP&E may occur, which were previously not permitted under Canadian GAAP.</p>

AREA AFFECTED BY IFRS	IFRS 1 EXEMPTIONS & POLICY CHOICES UNDER IFRS	EXPECTED IMPACT ON FINANCIAL STATEMENTS
IFRS 3 (R) Business Combination	<p>We will be electing to apply the IFRS 1 exemption whereby previously completed business combinations will not be retrospectively restated in accordance with IFRS.</p> <p>Under IFRS 3, acquisition related costs can no longer be included with the purchase price allocation. As such, these costs will be expensed as incurred (previously capitalized with purchase price allocation).</p>	<p>Opening Balance Sheet: No significant change.</p> <p>Subsequent to transition: No significant change.</p>
IFRIC 1 Changes in Existing Decommissioning, Restoration & Similar Liabilities	<p>We will be electing to apply the IFRS 1 exemption to measure our asset retirement obligations (ARO) as at the transition date in accordance with IAS 37. This exemption provides a simplified method for recalculating decommissioning liabilities in accordance with IFRS.</p>	<p>Opening Balance Sheet: Our estimates regarding the expected timing and costs associated with remediation have not changed in a material manner. As such, applying the IFRS 1 exemption for this standard is not expected to result in a significant adjustment to the ARO liability previously reported.</p> <p>Subsequent to transition: IFRS requires that the accretion expense related to the ARO liability be presented as part of finance costs on our statement of comprehensive income.</p>
IAS 32 Financial Instruments – Presentation	<p>Under Canadian GAAP, our Exchangeable LP Units as well as the equity portion of convertible debt are presented as equity on the consolidated balance sheet. However, under IFRS, both of these items will be presented as a financial liability.</p> <p><i>Convertible Debentures</i></p> <p>In terms of measurement and valuation, there are two policy choices from which we can select – (1) record the entire convertible debt (the debt host contract and the single compound embedded derivative) at fair value; or (2) continue to record the debt host contract at amortized cost and the single compound embedded derivative at fair value. Under both options, any amount recorded at fair value must be revalued at each reporting date with changes included in net earnings. We will be adopting option (1) for the valuation of our convertible debt; however, we are continuing to assess this policy with other REITs.</p>	<p>Opening Balance Sheet: <i>Exchangeable LP Units</i></p> <p>The Exchangeable LP Units are convertible on a one-for-one basis into REIT Units at the option of the holder; and will automatically be converted into REIT Units on November 10, 2011. On January 1, 2010 there were 3,283,056 Exchangeable LP Units outstanding totalling \$13.4 million, which will be classified as a liability.</p> <p><i>Convertible Debentures</i></p> <p>The single compound embedded derivative of the convertible debt which is currently presented as part of equity under Canadian GAAP will also be classified as a liability. The estimated fair value of the single compound embedded derivative on January 1, 2010, was approximately \$8.1 million.</p> <p>Subsequent to transition: <i>Exchangeable LP Units</i></p> <p>Distributions paid to owners of the Exchangeable LP Units will be presented as part of interest expense.</p> <p><i>Convertible Debentures</i></p> <p>The convertible debt will be remeasured to fair value at each reporting date. Changes in value will be charged to net earnings.</p>

Management's Discussion & Analysis

AREA AFFECTED BY IFRS	IFRS 1 EXEMPTIONS & POLICY CHOICES UNDER IFRS	EXPECTED IMPACT ON FINANCIAL STATEMENTS
IFRS 5 Non-current Assets Held for Sale & Discontinued Operations	<p>The definition of discontinued operations under IFRS is narrower compared to that under Canadian GAAP.</p> <p>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.</p>	<p>Subsequent to transition:</p> <p>We expect to have fewer discontinued operations under IFRS. Results previously aggregated and presented net of tax as discontinued operations during 2010 will be reclassified as continuing operations.</p>

Changes to the statement of financial position are summarized as follows:

- Property and equipment will increase as a result of the “fair value as deemed cost” election under IFRS 1 to revalue the land and building of selected centers.
- Goodwill will decrease due to the differences in impairment testing methodologies as explained above.
- Pension liability included in other long-term liabilities is expected to increase as a result of the IFRS 1 exemption to reset the actuarial experience loss to zero.
- Exchangeable LP Units as well as the equity portion of convertible debt will be reclassified from equity to long-term liabilities under IFRS.
- Convertible debt will be remeasured to fair value at each reporting date.
- The current portion of future income tax assets under Canadian GAAP will be reclassified from current to non-current under IFRS; in addition, future income tax liabilities will be impacted by the tax effect of the adjustments required under IFRS.
- CTA will be reset to zero upon transition as a result of the IFRS 1 exemption.
- All of the changes resulting from the IFRS adoption will be presented as an adjustment to equity upon transition.

Impact of IFRS Adoption on Consolidated Statement of Net Income and Other Comprehensive Income

Significant changes to the statement of net income and other comprehensive income are listed below:

- The definition of discontinued operations is different under IFRS and therefore, results presented as discontinued operations during 2010 under Canadian GAAP will be presented as continuing operations under IFRS; we also expect to have fewer dispositions categorized as discontinued operations in the future.
- Revaluation of property and equipment is expected to result in higher depreciation expense under IFRS.
- Due to the difference in methodologies, impairment is expected to be more frequent than it would otherwise be under Canadian GAAP.
- Pension expense will differ as it will no longer include the amortization of actuarial gains and losses; on the other hand, other comprehensive income will be impacted as future actuarial gains and losses will be recorded through other comprehensive income.
- Distributions on Exchangeable LP Units, which were reported as a reduction of retained earnings, will now be presented as interest expense under IFRS.
- Convertible debt will be recorded at fair value, with changes to be recognized in net earnings.

The International Accounting Standards Board (IASB) has a number of ongoing projects on its agenda. We continue to monitor standards to be issued by the IASB, but we do not expect these new standards to be mandatory for our fiscal 2011 financial statements. Our summary of key expected changes was completed with the expectation that we will apply IFRS as currently written at our transition date. Decisions regarding the early adoption of any new standards will be made as they are issued by the IASB.

Disclosure Controls and Procedures

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

An evaluation of the effectiveness of the DC&P was conducted as at December 31, 2010, by management under the supervision of the REIT's CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that as at December 31, 2010, our disclosure controls and procedures, as defined by National Instrument 52-109, Certification of Disclosures in Issuers' Annual and Interim Filings, are effective.

Internal Control over Financial Reporting

Internal Control over Financial Reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP. Management, under the supervision of the REIT's CEO and CFO, has evaluated the effectiveness of our ICFR using the framework and criteria established by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that our ICFR was effective and that there were no material weaknesses in our ICFR as at December 31, 2010.

Additional Information

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

Management's Responsibility for Financial Statements

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

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

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

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

(signed)

TIMOTHY L. LUKENDA

President and Chief Executive Officer

March 21, 2011

(signed)

DOUGLAS J. HARRIS

Senior Vice President and
Chief Financial Officer

Auditors' Report

To the Unitholders of Extendicare Real Estate Investment Trust

We have audited the accompanying consolidated financial statements of Extendicare Real Estate Investment Trust (the "REIT"), which comprise the balance sheets as at December 31, 2010 and 2009 and the statements of earnings, unitholders' equity (deficiency), cash flows and comprehensive income for the years then ended, and a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

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

AUDITORS' RESPONSIBILITY

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

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

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

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the REIT as at December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed KPMG LLP)

Toronto, Canada

Chartered Accountants,
Licensed Public Accountants

March 21, 2011

Consolidated Statements of Earnings

(in thousands of dollars except per unit amounts)

Years ended December 31	2010	2009
Revenue (note 13)		
Nursing and assisted living centers		
United States	1,356,592	1,463,497
Canada	495,610	479,125
Home health care – Canada	157,177	155,096
Health technology services – United States	17,205	18,853
Outpatient therapy – United States	12,603	13,905
Other	29,916	31,091
	2,069,103	2,161,567
Operating expenses	1,736,880	1,810,978
Administrative costs	72,624	72,818
Lease costs	11,016	12,101
	1,820,520	1,895,897
Earnings before undernoted	248,583	265,670
Depreciation and amortization	63,981	66,032
Accretion of asset retirement obligations	1,572	1,569
Interest expense	92,102	97,059
Interest income	(4,235)	(4,244)
Gain on derivative financial instruments and foreign exchange (note 9)	(3,280)	(20,289)
Loss (gain) from asset impairment, disposals, financing and other items (note 10)	1,154	(219)
Earnings from continuing operations before income taxes	97,289	125,762
Income tax expense (note 14)		
Current	31,723	6,818
Future	12,756	38,785
	44,479	45,603
Earnings from continuing operations	52,810	80,159
Loss from discontinued operations, net of income taxes (note 11)	(1,123)	(2,451)
Net earnings	51,687	77,708
Basic Earnings per Unit (note 15)		
Earnings from continuing operations	0.65	1.09
Net earnings	0.63	1.06
Diluted Earnings per Unit (note 15)		
Earnings from continuing operations	0.65	1.05
Net earnings	0.63	1.02

See accompanying notes to consolidated financial statements.

Certain 2009 figures have been revised for comparative purposes (note 13).

Approved by the Trustees

(signed)

Mel Rhinelander
Chairman and Trustee

(signed)

Timothy L. Lukenda
President and Chief Executive Officer

Consolidated Balance Sheets

(in thousands of dollars)

As at December 31

	2010	2009
Assets		
Current assets		
Cash and short-term investments	267,759	134,012
Restricted cash (note 7)	10,095	22,361
Accounts receivable, less allowances of \$17,796 and \$23,975, respectively	212,610	213,477
Income taxes recoverable	3,182	29,314
Future income tax assets (note 14)	19,190	24,900
Other current assets	19,843	22,187
	532,679	446,251
Property and equipment, including construction-in-progress of \$35,170 and \$41,956, respectively (note 3)	853,760	863,430
Goodwill and other intangible assets (notes 1(k) and 4)	182,024	191,514
Other assets (note 5)	129,547	166,870
	1,698,010	1,668,065
Liabilities and Unitholders' Equity (Deficiency)		
Current liabilities		
Accounts payable	36,167	38,372
Accrued liabilities	229,966	245,260
Accrual for self-insured liabilities (note 6)	16,013	11,321
Current portion of long-term debt (note 7)	569,558	28,538
	851,704	323,491
Accrual for self-insured liabilities (note 6)	31,382	32,562
Long-term debt (note 7)	653,122	1,205,494
Other long-term liabilities (note 8)	66,633	67,555
Future income tax liabilities (note 14)	76,482	79,866
	1,679,323	1,708,968
Unitholders' equity (deficiency)	18,687	(40,903)
	1,698,010	1,668,065

See accompanying notes to consolidated financial statements.

Commitments and contingencies (note 16).

Subsequent events (notes 7, 12 and 19).

Consolidated Statements of Cash Flows

(in thousands of dollars)

Years ended December 31

	2010	2009
Operating Activities		
Net earnings	51,687	77,708
Adjustments for:		
Depreciation and amortization	63,981	67,409
Provision for self-insured liabilities	33,317	22,059
Payments for self-insured liabilities	(24,860)	(19,318)
Future income taxes	6,501	37,982
Gain on derivative financial instruments and foreign exchange (note 9)	(3,280)	(20,289)
Loss (gain) from asset impairment, disposals, financing and other items (note 10)	1,154	(219)
Loss from asset impairment, disposals and other items from discontinued operations (note 11)	3,094	4,326
Other	10,875	11,491
	142,469	181,149
Net change in operating assets and liabilities		
Accounts receivable	(10,618)	27,328
Other current assets	1,691	(3,401)
Accounts payable and accrued liabilities	(8,633)	16,553
Income taxes	24,448	(36,504)
	6,888	3,976
	149,357	185,125
Investing Activities		
Growth capital expenditures	(39,991)	(55,574)
Maintenance capital expenditures	(29,962)	(36,020)
Net proceeds from dispositions (notes 10 and 11)	28,982	9,995
Other assets	(1,308)	(48)
	(42,279)	(81,647)
Financing Activities		
Issue of long-term debt	68,308	20,210
Repayment of long-term debt	(46,344)	(22,329)
Issue (repayment) on line of credit	(6,849)	14,315
Decrease (increase) in restricted cash	12,266	(22,361)
Decrease in investments held for self-insured liabilities	(5,139)	(5,871)
Purchase of securities for cancellation	—	(6,189)
Distributions paid	(62,783)	(60,182)
Issue of units (note 12)	82,212	—
Financing costs	(7,508)	(3,024)
Other	(726)	(339)
	33,437	(85,770)
Foreign exchange loss on cash held in foreign currency	(6,768)	(6,780)
Increase in cash and cash equivalents	133,747	10,928
Cash and cash equivalents at beginning of year	134,012	123,084
Cash and cash equivalents at end of year	267,759	134,012
Supplementary Information		
Cash interest paid in determining earnings	83,095	86,789
Cash taxes paid	13,391	46,077
Interest capitalized (included in capital expenditures)	1,262	1,538
Units issued pursuant to Distribution Reinvestment Plan	5,346	2,805

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

See accompanying notes to consolidated financial statements.

Consolidated Statements of Unitholders' Equity (Deficiency)

(in thousands of dollars for amounts)

Years ended December 31

	2010		2009	
	Number	Amount	Number	Amount
Unit Capital (note 12)				
REIT Units	79,831,466	421,213	69,896,968	332,069
Exchangeable LP Units	3,163,715	12,959	3,283,056	13,436
Units issued and outstanding at end of year	82,995,181	434,172	73,180,024	345,505
Equity portion of convertible debentures	–	9,964	–	9,964
	82,995,181	444,136	73,180,024	355,469
Contributed Surplus				
Balance at beginning of year		81		592
Transfer to deficit		–		(592)
Purchase of convertible debentures for cancellation		–		81
Balance at end of year		81		81
Deficit				
Balance at beginning of year		(395,429)		(410,447)
Application of contributed surplus		–		592
Adjustment to prior year distribution of ALC		(1,082)		(817)
Net earnings for the year		51,687		77,708
Purchase of units for cancellation in excess of book value		–		(1,161)
Distributions declared		(68,817)		(61,304)
Balance at end of year		(413,641)		(395,429)
Accumulated Other Comprehensive Income				
Balance at beginning of year		(1,024)		23,425
Net change in available-for-sale securities (net of tax expense of nil and \$461, respectively)		574		1,362
Unrealized foreign currency translation adjustments		(11,439)		(25,811)
Balance at end of year		(11,889)		(1,024)
		18,687		(40,903)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income

(in thousands of dollars)

Years ended December 31

	2010	2009
Net earnings	51,687	77,708
Other Comprehensive Income (Loss), Net of Income Taxes		
Net unrealized gain on available-for-sale securities (net of tax expense of nil and \$461, respectively)	1,062	1,466
Reclassification of gain on available-for-sale securities to earnings (tax of nil for both years)	(488)	(104)
	574	1,362
Net change in foreign currency translation adjustment	(11,439)	(25,811)
	(10,865)	(24,449)
Comprehensive income	40,822	53,259

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Years ended December 31, 2010 and 2009
(tabular amounts in thousands except per unit data)

1. Summary of Significant Accounting Policies

(a) Basis of Presentation

Extendicare Real Estate Investment Trust is an unincorporated, open-ended real estate investment trust established under the laws of the Province of Ontario by a deed of trust dated September 11, 2006, as amended and restated on October 28, 2006 and on December 15, 2010 (the "Deed of Trust"). References to "Extendicare REIT", the "REIT", "we", "us" and "our" in these statements mean Extendicare Real Estate Investment Trust alone or together with its subsidiaries, as the context requires. The direct ownership and operation of the senior care centers and ancillary businesses is conducted by the subsidiaries of the REIT. The REIT itself is not a provider of services or products. Extendicare REIT trades on the Toronto Stock Exchange (TSX) under the symbol "EXE.UN".

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

Certain comparative figures for the 2009 reported periods have been reclassified to conform with the presentation in 2010, mainly for non-reimbursable bad debts as described in *note 13*.

(b) Basis of Consolidation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and include the accounts of Extendicare REIT, its subsidiaries and its partnerships. All material intercompany transactions and balances have been eliminated.

Through its wholly owned U.S. subsidiary, Extendicare Health Services, Inc. and its subsidiaries (collectively "EHSI") and its wholly owned Canadian subsidiary, Extendicare (Canada) Inc. and its subsidiaries (collectively "ECI"), the REIT is a major provider of long-term care and related services in North America, operating 265 senior care centers as at December 31, 2010.

(c) Use of Estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The more subjective of such estimates are: revenue recognition and the valuation of accounts receivable; the measurement of acquired assets and assumed liabilities in business combinations; the valuation of assets and determination of asset impairment; the valuation of conditional asset retirement obligations; the determination of the accrual for self-insured liabilities; and accounting for tax uncertainties, including valuation allowances for future tax assets. The recorded amounts for such items are based on management's best available information and judgement and accordingly, actual results could differ from those estimated.

(d) Foreign Currency Translation

Foreign operations and foreign currency denominated items are translated to Canadian dollars.

Revenue and expenses of self-sustaining foreign operations are translated at average rates of exchange in effect during the period. Assets and liabilities are translated at the exchange rates in effect at the balance sheet date. Unrealized exchange gains or losses arising on translation are deferred and included in unitholders' deficiency in accumulated other comprehensive income (AOCI). A gain or loss equivalent to a proportionate amount of the unrealized exchange gains and losses accumulated in AOCI is recognized in net earnings when there is a reduction in the net investment of self-sustaining foreign operations from capital transactions, such as dividend distributions or long-term advance repayments.

Monetary items denominated in foreign currency are translated to Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets are acquired or obligations incurred. Revenue and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in net earnings.

(e) 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. Cash and cash equivalents are categorized as held-for-trading financial instruments and are measured at fair value.

(f) Assets Held as Investments

Assets held as investments include two types of assets on the balance sheet: (i) invested assets, and (ii) investments held for self-insured liabilities. Invested assets include primarily equity instruments that have been categorized as available for sale and are measured at cost as they do not have a quoted market price in an active market. Investments held for self-insured liabilities, which Extencare REIT holds as security for the accrual for self-insured liabilities (see *note 1(m)*), are investment grade and categorized as held to maturity or available for sale.

Held-to-maturity investments are valued at amortized cost. Available-for-sale financial assets are valued at fair value. Changes in fair value, except for impairment losses, are recorded in other comprehensive income (OCI) until the asset is derecognized 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 Extencare REIT's right to receive payment is established. Transaction costs are added to the cost of the assets at fair value.

When a decline in fair value of an available-for-sale financial asset (other than a loan or receivable designated as available for sale) has been recognized directly in OCI and there is objective evidence that the asset is impaired and the decline in fair value is other than temporary, the cumulative loss is removed from AOCI and is recognized in net earnings even though the financial asset has not been derecognized. At each balance sheet date, Extencare REIT considers whether there is any objective evidence of an impairment of financial assets, other than those classified as held for trading.

(g) Accounts Receivable

Accounts receivable are recorded at amortized cost. In Canada, ECI has receivables primarily from provincial government agencies. In the United States, EHSI has receivables from federal and state medical assistance programs, other third-party payors and from individuals. Receivables from government agencies represent the only concentrated group of accounts receivable for EHSI. As at December 31, 2010, EHSI had approximately 26% (2009 – 24%) in accounts receivable derived from services provided under various federal Medicare programs respectively, and 37% (2009 – 38%) derived from services provided under various state Medicaid, or medical assistance, programs. Management does not believe there is any credit risks associated with these government agencies other than possible funding delays. Accounts receivable other than from government agencies consist of receivables from various payors that are subject to different economic conditions and do not represent any concentrated credit risks to EHSI.

Notes to Consolidated Financial Statements

Extendicare 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 Extendicare REIT specifically estimates 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.

(h) Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Provisions for depreciation and amortization are computed using the straight-line method at rates based on the following estimated life expectancies.

Buildings	5 to 50 years
Building improvements	5 to 30 years
Furniture and equipment	varying periods not exceeding 15 years
Land improvements	10 to 25 years
Leasehold improvements	the shorter of the useful life of the improvements or the initial term of the lease

Construction in progress includes pre-acquisition costs and other direct costs related to acquisition, development and construction of properties, including interest, which are capitalized until the center is opened. Depreciation of the center, including interest capitalized, is commenced in the month after the center is opened based upon the useful life of the asset, as outlined previously.

Government grants are presented as part of notes, mortgages and other amounts within other assets. Grants that are received throughout the duration of construction projects are netted with the cost of property and equipment; those that are funded over extended periods are present valued and are recorded as notes, mortgages and amounts receivable included in other assets, with an offset to the cost of construction. Forgivable loans issued by the government are accounted for as government grants if the likelihood of repayment is remote.

(i) Leases

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 GAAP, are accounted for as capital leases. An asset is recorded at the time a capital lease is entered into together with its related long-term obligation to reflect its purchase and financing. Property and equipment recorded under capital leases are depreciated on the same basis as described in *note 1(h)*, for periods not to exceed the lease term. 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.

(j) Acquisitions

Acquisitions of businesses are accounted for using the purchase method. This involves allocating the purchase price paid for a business to the assets acquired, including identifiable intangible assets and the liabilities assumed, based on their fair value at the date of acquisition. Any excess is then recorded as goodwill. In allocating the purchase price to identifiable intangible assets in its acquisitions, values are assigned to resident relationships as described in *note 1(k)*. The results of operations of the acquired businesses are included in the consolidated financial statements from the date of acquisition.

(k) Goodwill and Other Intangible Assets

Goodwill represents the cost of acquired net assets in excess of their fair values. Goodwill and other intangible assets with indefinite useful lives are not amortized, but are tested for impairment at least annually. Goodwill is allocated to reporting units and any potential goodwill impairment is identified by comparing the carrying value of a reporting unit with its fair value. If any potential impairment is indicated, it is quantified by comparing the carrying value of goodwill to its fair value, based on the fair value of the assets and liabilities of the reporting unit.

Other intangible assets with definite useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment by assessing the recoverability of the carrying values. Other intangible assets include acquired leasehold rights, which are amortized over the term of the lease.

Resident relationships acquired through the acquisition of senior care centers are another component of other intangible assets. Acquiring resident relationships for existing residents avoids the cost of obtaining 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 term of the agreement.

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

(l) Impairment of Long-lived Assets

Extencicare REIT periodically assesses the recoverability of long-lived assets when there are indications of potential impairment. In performing this analysis, management considers such factors as current results, trends and future prospects, in addition to other economic and regulatory factors. The amount of any impairment is determined as the excess of the asset's net carrying value over its fair value, as determined by its estimated future cash flows discounted using a risk adjusted interest rate or current market value, as appropriate.

(m) Self-insured Liabilities

Extencicare REIT self-insures certain risks related to general and professional liability. The accrual for self-insured liabilities includes estimates of the costs of both reported claims and claims incurred but not reported, and is based on estimates of loss depending on assumptions made by management, including consideration of actuarial projections.

We also self-insure certain risks related to auto liability, health benefits, employers' liability and workers' compensation. Accruals for these self-insured risks are included in accrued liabilities.

(n) Asset Retirement Obligations

Management has determined that an asset retirement obligation exists in the REIT's pre-1980 constructed centers for possible asbestos remediation. 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 conditional asset retirement obligation 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 conditional asset retirement obligations: (a) discount rates of 6.75% for ECI and 7.10% for EHSI; (b) an estimated timing of the settlement of the conditional obligations ranging from 10 to 30 years; and (c) an estimated undiscounted cash flow amount to settle the asset retirement obligation of approximately \$50 million. There were no changes to the initial timing and estimates of undiscounted cash flow amounts in 2010.

(o) Non-monetary Transactions

All non-monetary transactions are measured at fair value unless: the transaction lacks commercial substance; the transaction is an exchange of a product or property held for sale in the ordinary course of business for a product or property to be sold in the same line of business to facilitate sales to customers other than the parties to the exchange; neither the fair value of the assets or services received nor the fair value of the assets or services given up is reliably measurable; or the transaction is a non-monetary, non-reciprocal transfer to owners that represents a spin-off or other form of restructuring or liquidation. 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.

(p) 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.

Notes to Consolidated Financial Statements

Extendicare REIT also offers information technology services to smaller long-term care providers through its wholly owned U.S. subsidiary, Virtual Care Provider, Inc., thereby reducing in-house technology costs for these providers. 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.

(q) 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. Income taxes are calculated using the asset and liability method of tax allocation, which is based on differences between financial reporting and tax bases of assets and liabilities. Future income tax assets or liabilities are 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 income tax assets and liabilities are those rates enacted or substantially enacted at the balance sheet date. In assessing whether the future tax assets are realizable, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future 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 future 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.

(r) Employee Future Benefits

The costs of the defined benefit pension plans are accrued as earned, based on actuarial valuations. Pension fund assets are valued at fair value and the net actuarial gain or loss in excess of 10% of the greater of the benefit obligations and the market value of plan assets is amortized over the average remaining service periods of active employees. Employee future benefit obligations are measured using market interest rates for high-quality debt instruments.

(s) Derivative Financial Instruments

All derivative instruments are recorded on the balance sheet at their respective fair values. 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 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.

(t) Unit Appreciation Rights Plan

For awards under the REIT's unit appreciation rights plan (the "UARP"), the REIT accrues compensation expense on a straight-line basis over a three-year vesting period in an amount by which the Fair Market Value of a trust unit of Extencicare REIT (the "REIT Unit") exceeds the grant price, plus Accrued Distributions. Changes in the quoted market value of the REIT Units between the date of grant and the reporting period date result in a change in the measure of compensation for the award. "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 aggregate amount of cash distributions per REIT Unit declared payable to holders of record during the term of the unit appreciation right (UAR).

(u) Exchangeable Units

Class B limited partnership units (Exchangeable LP Units) of Extencicare Limited Partnership (Extencicare LP) are presented as part of unitholders' equity of the REIT as their features make them economically equivalent to the REIT Units.

2. International Financial Reporting Standards

For interim and annual periods commencing January 1, 2011, the REIT will transition to report in compliance with International Financial Reporting Standards (IFRS), including the preparation and reporting of one year of comparative figures. The change to adopt IFRS was the result of the Accounting Standards Board of Canada's February 2008 decision to require all publicly accountable enterprises to report under IFRS.

The REIT has completed its assessment of accounting policies and practices that are impacted by the transition from Canadian GAAP to IFRS and also concluded the impact analysis on the REIT financial reporting, business processes, information systems, internal controls over financial reporting and disclosure controls. The REIT has completed the majority of quantitative work required to report under IFRS effective January 1, 2011, and is currently in the final stages of implementing system changes to report under IFRS effective the first quarter of 2011. The process of reviewing the assessment of accounting policy changes will be ongoing until the REIT reports its 2011 first quarter results, as the International Accounting Standards Board continues to issue new standards and/or revises its existing recommendations.

3. Property and Equipment

	2010			2009		
	Cost	Accumulated Depreciation and Amortization	Net Book Value	Cost	Accumulated Depreciation and Amortization	Net Book Value
Land and land improvements	73,812	5,939	67,873	73,544	5,470	68,074
Buildings	1,106,501	433,279	673,222	1,082,215	410,566	671,649
Furniture and equipment	142,607	70,641	71,966	140,961	64,583	76,378
Leasehold improvements	8,601	3,072	5,529	8,008	2,626	5,382
Construction in progress	35,170	–	35,170	41,947	–	41,947
	1,366,691	512,931	853,760	1,346,675	483,245	863,430

The cost of assets included in property and equipment under capital leases was \$99.9 million (2009 – \$87.4 million) with accumulated depreciation of \$17.7 million (2009 – \$15.4 million) (note 7).

In 2008, a forgivable loan was granted by the local Regional Health Authority (David Thompson Health Region) for the nursing and assisted living center in Red Deer, Alberta, that was completed in September 2010. Total government grants received for the Red Deer development during 2010 were \$5.7 million (2009 – \$21.2 million), of which \$5.1 million was considered a forgivable loan (2009 – \$16.3 million). In 2009, a forgivable loan was granted by the Chinook Health Authority for the designated assisted living center in Lethbridge, Alberta, that was opened in January 2011. Government grants received for the Lethbridge development during 2010 were \$2.8 million (2009 – \$3.4 million). In 2010, a forgivable loan was granted for the nursing center construction project in Edmonton by the Alberta Health Services Board. Government grants drawn during construction and received during 2010 for the Edmonton project were \$10.2 million. These forgivable government loans are accounted for as government grants as the likelihood of triggering repayment is remote (note 16). All grants were netted with other costs and included in construction in progress until the development is completed and are netted with the cost of the building upon completion.

Notes to Consolidated Financial Statements

Interest is capitalized in connection with the construction of centers and is amortized over their estimated useful life. Interest capitalized in 2010 was \$1.3 million (2009 – \$1.5 million).

The change in property and equipment is summarized in the table below:

	2010	2009
Balance at beginning of year	863,430	970,612
Purchases	65,460	89,128
Disposals, impairment and reclassification of assets held for sale <i>(notes 5 and 11)</i>	14,292	(40,200)
Depreciation	(58,087)	(61,100)
Foreign exchange	(31,335)	(95,010)
	853,760	863,430

4. Goodwill and Other Intangible Assets

	2010	2009
Goodwill		
Balance at beginning of year	173,322	201,974
Additions	890	5,652
Disposals	–	(4,422)
Impairment	–	(3,982)
Foreign exchange	(8,628)	(25,900)
Balance at end of year	165,584	173,322
Other Intangible Assets		
Gross carrying value at beginning of year	31,279	36,925
Additions	4,950	3,677
Write-off of fully amortized assets	(1,869)	(4,712)
Foreign exchange	(1,829)	(4,611)
Gross carrying value at end of year	32,531	31,279
Accumulated amortization at beginning of year	(13,087)	(13,270)
Amortization	(5,894)	(6,309)
Write-off of fully amortized assets	1,869	4,703
Foreign exchange	1,021	1,789
Accumulated amortization at end of year	(16,091)	(13,087)
Net carrying value	16,440	18,192
	182,024	191,514

The purchase price allocation for the three Manitoba nursing centers acquired by ECI in October 2008 was finalized during the 2009 third quarter, resulting in additional goodwill of \$5.7 million. Goodwill of \$0.9 million resulted from the purchase of two clinics by EHSI in 2010.

On the disposition of two Ohio centers in March 2009 *(note 11)*, goodwill was reduced by \$4.4 million (US\$3.5 million), and was further reduced by \$4.0 million (US\$3.8 million) in 2009 with the pending sale of four Michigan centers, one owned Ohio center and one Pennsylvania center in 2010 *(note 11)*.

Other intangible assets are comprised of computer software, purchased licenses and non-compete agreements. Computer software represents the majority of other intangible assets with a gross and net carrying value of \$31.0 million and \$15.1 million (2009 – \$30.1 million and \$17.2 million), respectively.

5. Other Assets

	2010	2009
Investments held for self-insured liabilities		
Available-for-sale securities, at fair value	60,937	59,307
Held-to-maturity securities, at amortized cost	–	6,025
Notes, mortgages and amounts receivable	47,782	50,897
Medicare and Medicaid settlement receivables, less allowance of nil (2009 – nil)	17,481	17,420
Assets held for sale	3,347	33,221
	129,547	166,870

Investments Held for Self-insured Liabilities

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

	2010	2009
Fixed income securities, with maturities due		
In one year or less	5,818	11,619
After 1 year through 5 years	32,969	31,982
After 5 years through 10 years	2,302	3,673
	41,089	47,274
Cash and money market funds	19,848	14,611
Equities	–	3,447
	60,937	65,332

Notes, Mortgages and Amounts Receivable

Included in notes, mortgages and amounts receivable are \$40.0 million (2009 – \$42.6 million) of discounted amounts receivable due from government agencies. These represent amounts funded by the Ontario government for a portion of nursing home construction costs over a 20-year period. As each center was opened, a receivable from the government was recorded based on applying a discount rate equivalent to the yield on a 20-year Ontario government bond. The amounts were discounted at rates ranging from 5.3% to 6.5% and were also treated as a reduction in the cost of the property and equipment related to the center.

Medicare and Medicaid Settlement Receivables

Settlement receivables from both Medicare and Medicaid state programs at December 31, 2010, totalled \$26.3 million (2009 – \$26.5 million), with no allowance. EHSI's Medicare settlement receivables primarily relate to reimbursable Part A co-insurance receivables, which totalled \$23.1 million (US\$23.2 million) and \$23.5 million (US\$22.4 million) at December 31, 2010 and December 31, 2009, respectively. Differences between the final settlement and amounts previously recorded are reported as adjustments to revenue in the period of determination. Medicaid settlement receivables pertain to cost-based reimbursement programs. The amounts expected to be substantially collected within one year are reported as current accounts receivable, and the remaining amounts totalling \$17.5 million (2009 – \$17.4 million) are reported in other assets.

Assets Held for Sale

As at December 31, 2010, assets held for sale of \$3.3 million (US\$3.4 million) relate to a skilled nursing center in Michigan (92 beds) and a former 74-bed skilled nursing property in Port Angeles, Washington, which was replaced by a new 100-bed skilled nursing center opened in 2008 in Sequim, Washington.

6. Self-insured Liabilities

The accrual for self-insured liabilities is based on management's best estimate of the ultimate cost to settle claims. Management regularly evaluates the appropriateness of the carrying value of this liability. General and professional liability claims are the most volatile and significant of the risks for which the REIT self-insures.

Management's estimate of the accrual for general and professional liability claims is significantly influenced by assumptions, which 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. Changes in the level of retained risk and other significant assumptions that underlie management's estimates of self-insured liabilities, could have a material effect on the future carrying value of the self-insured liabilities, as well as on our operating results and liquidity.

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

We invest funds to provide security for the accrual for self-insured liabilities (*note 5*) and believe that we have sufficient cash resources to meet our estimated current claims payment obligations.

7. Long-term Debt

	2010		2009	
	US\$	C\$	US\$	C\$
EHSI (payable in US\$)				
CMBS Financing, 6.6525%, due 2011 (<i>note 18(a)</i>)	491,707	489,054	499,348	524,816
CMBS Financing, 6.79%, due 2012 (<i>note 18(a)</i>)	87,625	87,152	89,029	93,569
PrivateBank mortgage loans, variable rates, due 2013	24,970	24,835	–	–
Line of credit under Credit Facility, variable rates, due 2011	16,885	16,794	23,535	24,735
Sovereign Bank mortgage loans, variable rates, due 2011 (<i>note 18(a)</i>)	45,179	44,935	49,513	52,038
HUD mortgages, 4.6% to 5.5%, due 2018 to 2045	27,457	27,308	23,275	24,462
Other mortgage loans, 5.72% to 6.7%, matured in 2010	–	–	7,039	7,398
Notes payable, 2.0% to 7.5%, maturing through to 2014	14,184	14,107	16,000	16,816
Capital lease obligations, 5.24% to 8.7141%, maturing through to 2020	15,388	15,304	3,489	3,667
	723,395	719,489	711,228	747,501
Financing costs	(9,113)	(9,064)	(9,196)	(9,665)
	714,282	710,425	702,032	737,836
Extendicare REIT and Canadian Subsidiaries (payable in C\$)				
Convertible Unsecured Subordinated Debentures, 5.7%, due 2014		109,139		107,959
Convertible Unsecured Subordinated Debentures, 7.25%, due 2013		90,754		90,387
CMHC mortgages, 3.52% to 9.81%, maturing through to 2020		171,701		150,550
Non-CMHC mortgages, 5.75%, due 2013		16,268		16,605
Capital lease obligations, average rate of 7.08%, maturing through to 2028		118,606		122,279
Construction loan, variable rate, due 2012		3,551		17,317
Construction loan, 4.25%, converting in 2011 to 7.7%, maturing 2036		12,541		14
		522,560		505,111
Financing costs		(10,305)		(8,915)
		512,255		496,196
Total debt net of financing costs		1,222,680		1,234,032
Less: current portion		569,558		28,538
		653,122		1,205,494

EHSI Debt

2011 REFINANCING PLAN

During 2011, EHSI plans to refinance approximately US\$635 million of debt with approximately US\$568 million in mortgages insured by the U.S. Department of Housing and Urban Development Program (HUD), thereby reducing debt by about US\$67 million with cash on hand. As at December 31, 2010, EHSI had US\$158.6 million of cash on hand in preparation for its 2011 refinancing.

The debt to be refinanced relates primarily to EHSI's commercial mortgage backed securitization (CMBS) financings and mortgage financing from Sovereign Bank and other lenders (the "Sovereign Loans") that mature in 2011 and 2012. As at December 31, 2010, EHSI had CMBS financings of US\$491.7 million that mature in November 2011 (the "2011 CMBS Financing") and US\$87.6 million that mature in March 2012 (the "2012 CMBS Financing"), and the Sovereign Loans of US\$45.2 million that mature in June 2011. The CMBS financings have a prepayment penalty that continues through to three months prior to their maturity dates 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 received approval in July 2010 as a corporate entity to proceed with HUD applications subject to an overall limit of US\$550.0 million. As at December 31, 2010, EHSI had US\$27.5 million in HUD-insured mortgages providing it with the ability to seek up to US\$522.5 million in additional HUD financing. EHSI intends to seek approval from HUD by June 2011 for a further US\$50.0 million of financing capacity, enabling it to seek up to US\$572.5 million in additional HUD financing.

The refinancing is anticipated to be completed in several phases between now and 2012. As at December 31, 2010, EHSI had submitted loan applications to HUD for 19 skilled nursing centers representing mortgages totalling approximately US\$127 million, most of which pertain to the Sovereign Loans. In respect of its CMBS financings, EHSI plans to submit HUD loan applications for a total of 61 skilled nursing centers, seeking mortgages totalling approximately US\$441 million, which brings the total applications to US\$568 million.

EHSI anticipates that HUD will complete the processing of the Sovereign Loans and the 2011 and 2012 CMBS financings in stages through to November 2011 in order to enable EHSI to prepay the Sovereign Loans before June 2011 and both CMBS financings prior to November 2011. After the refinancing is completed, EHSI will have an additional 34 unencumbered centers. EHSI has taken the appropriate steps to secure bridge financing that would provide flexibility in the refinancing process and to also ensure that alternative financing is available, if required. Refer to *note 18*.

EHSI's amended and restated US\$70.0 million credit facility (the "EHSI Credit Facility") matures in June 2011 unless it is extended in whole or in part by the lenders for an additional one-year term. In March 2011, EHSI obtained approval from all of the lenders of the EHSI Credit Facility for the one-year extension term with no change in the financial terms of the loan.

CMBS FINANCINGS

The 2011 CMBS Financing was completed on October 16, 2006, for US\$500.0 million through commercial mortgage backed securities. It has a five-year term and matures on November 11, 2011. 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 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 2011 and 2012 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.

Notes to Consolidated Financial Statements

Under the terms of both CMBS loans, 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 financings 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.

In addition, under the terms of both CMBS loans, 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 CMBS loans 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 CMBS financings over the current market U.S. Treasury rate for the period through to the maturity dates.

SOVEREIGN BANK MORTGAGE LOANS

The Sovereign Loans are secured by first mortgages on 17 skilled nursing centers owned by Tendercare (Michigan) Inc. and its subsidiaries (collectively "Tendercare"). These loans have a three-year term and mature on June 1, 2011. The loans are repaid with monthly principal payments based on a 25-year amortization period. Under the loan agreement, Tendercare is required to maintain a minimum consolidated fixed charge coverage ratio and the 17 skilled nursing centers securing the loans are required to maintain a minimum combined debt service coverage ratio. At EHSI's option, the interest rate is equal to LIBOR plus a margin of 3.25% or the U.S. prime rate plus a margin of 0.50%.

EHSI has the option to prepay the balance in whole or in part provided no event of default has occurred and a yield maintenance fee is paid by EHSI for any loan that has a rate based on LIBOR. This premium is equal to the present value of the excess, if any, of (i) interest computed at the current loan rate until the next interest rate change date, over (ii) interest computed for the same period based on the current rate for U.S. Treasury securities with a maturity date closest to the next interest rate change date.

PRIVATEBANK MORTGAGE LOANS

On November 30, 2010, EHSI secured a non-recourse term loan for up to US\$35.0 million on six skilled nursing 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 drew the remainder of the US\$10.0 million available on the term loan in March 2011 and placed mortgages on the remaining centers. The 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%. 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.

CREDIT FACILITY

The EHSI Credit Facility was renewed and amended in June 2009 and provides for borrowings up to US\$70.0 million. The amount available to be borrowed under the EHSI Credit Facility is the lesser of: (i) 60% of the appraised values of the skilled nursing centers collateralizing the EHSI Credit Facility, or (ii) an amount based on the actual net cash flow of these centers for the last 12 months. The amount available to be borrowed as at December 31, 2010 was US\$70.0 million. The EHSI Credit Facility matures on June 23, 2011. Upon satisfaction of certain conditions pertaining to EHSI's refinancing, the lenders, in whole or in part, have an option to extend for a third year to June 2012. In March 2011, EHSI obtained approval from all of the lenders of credit facility for the one-year extension term with no change in the financial terms of the loan.

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

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

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

As at December 31, 2010, US\$16.9 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 total outstanding letters of credit of US\$2.9 million in favour of a state workers' compensation program and of a certain landlord of a leased property, which was released subsequent to the year end, was US\$50.2 million as at December 31, 2010. The letters of credit are renewed annually and mature through to June 2011.

HUD MORTGAGES

The HUD-insured mortgages mature from 2018 through to 2045, with fixed interest rates ranging from 4.6% to 5.5%. These mortgages are 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 and are secured by first mortgages on eight skilled nursing centers and one assisted living center. The HUD regulatory agreements that apply to each mortgage require escrow reserve funds to be deposited with the loan servicer for mortgage insurance premiums, property taxes, insurance and repairs and replacements.

NOTES PAYABLE

Notes payable relate to seller notes of US\$12.0 million at 7.5% arising from the 2007 Tendercare acquisition (*note 20*). The original balance of the seller notes totalled US\$26.4 million, of which US\$10.4 million was settled in January 2008 and March 2009, upon having met certain conditions. The balance of US\$16.0 million is payable commencing in 2010 at US\$4.0 million per annum until maturity in 2013, of which US\$4.0 million was paid in November 2010. Under the terms of the agreement, the balance of acquired working capital is subject to adjustment based upon finalization of the assets subsequently received and liabilities subsequently incurred. The adjustments occur annually 90 days after the anniversary date of the Tendercare acquisition over a four-year period until January 2012. Refer to *note 20* for more information in respect of the settlement of working capital.

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. The 2013 Debentures may not be redeemed by the REIT prior to July 1, 2011, except in the event of the satisfaction of certain conditions after a change of control has occurred. 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

Notes to Consolidated Financial Statements

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. The 2014 Debentures may not be redeemed by the REIT prior to July 1, 2010, except in the event of the satisfaction of certain conditions after a change of control has occurred. 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.

As the 2013 and 2014 debentures are convertible into REIT Units, they were accounted for, in part, as equity. Upon a change of control whereby more than 66% 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 the remaining outstanding debentures.

CMHC MORTGAGES

Extencicare REIT's Canadian subsidiaries have various mortgages insured through the Canadian Mortgage and Housing Corporation or "CMHC" program (the "CMHC Mortgages"). The CMHC Mortgages are secured by several Canadian financial institutions at rates ranging from 3.52% to 9.81% with maturity dates through to 2020.

In September 2008, ECI secured a construction loan insured with CMHC on its Red Deer, Alberta project, for a maximum of \$30.4 million, plus CMHC fees of \$1.6 million. ECI made its first draw under the loan in January 2009. In September 2010, ECI replaced the construction loan with a \$28.7 million 10-year CMHC-insured mortgage at 4.57%.

In January 2009, ECI refinanced a \$6.0 million mortgage on an Ontario nursing center with a five-year \$8.9 million CMHC-insured mortgage at a fixed rate of 3.52%.

NON-CMHC MORTGAGES

In October 2008, ECI assumed \$9.4 million of debt upon the acquisition of three Manitoba nursing centers. These mortgages were refinanced in the same year with five-year conventional mortgages totalling \$17.0 million at a fixed rate of 5.75%.

CAPITAL LEASE OBLIGATIONS

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

CONSTRUCTION LOANS

In June 2009, ECI obtained CMHC-insured long-term financing of \$19.6 million on its Lethbridge, Alberta, project. The loan has a 27-year term, with interest during construction at a fixed rate of 4.25% that converted to a fixed rate of 7.70% in January 2011. Commencing with the opening of the center in January 2011, the interest costs are being reimbursed through government funding for the remainder of the term of the loan.

In August 2009, ECI secured CMHC-insured construction financing of \$16.6 million for the Edmonton, Alberta, development project. The loan has a term of two years, with interest-only payments based on a floating rate of 30-day banker's acceptance plus 2.5%. Management plans to secure long-term financing prior to completion of the project in December 2011.

Other

RBC LINE OF CREDIT AND LETTERS OF CREDIT

Extendicare has a \$70.0 million credit facility with the Royal Bank of Canada (the "RBC Credit Facility") for its Canadian operations that is due on demand. The RBC Credit Facility is secured by 14 Canadian nursing centers and guaranteed by certain Canadian operating subsidiaries of Extendicare. This credit facility is used to back letters of credit of which there were \$55.1 million issued and outstanding as at December 31, 2010, leaving \$14.9 million available. The \$55.1 million of letters of credit secured \$41.0 million of executive pension obligations which was reduced to \$40.0 million subsequent to the year end, \$13.9 million of contingent liabilities in connection with the sale of its investment in Crown Life Insurance Company (Crown Life) in 2007 and \$0.2 million related to construction projects. The Crown Life letters of credit renew annually in July of each year, and can be reduced periodically in connection with settlement of the underlying claims. The Crown Life letters of credit were reduced in July 2009 to \$15.4 million from \$16.8 million in 2008, and further reduced in July 2010 to \$13.9 million.

In addition, Extendicare has a U.S. dollar letter of credit facility with the Royal Bank of Canada to provide for the issuance of a U.S. dollar letter of credit. As at December 31, 2010, a US\$10.2 million letter of credit (2009 – US\$18.2 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 balance sheet 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 \$19.4 million at December 31, 2010 (2009 – \$18.6 million). The increase of \$0.8 million in 2010 related primarily to the addition of \$7.5 million of costs associated with financing of new and refinancing of existing debt, partially offset by amortization charges included in interest expense and changes in foreign exchange.

Below is a summary of the financing costs:

	2010		2009	
	US\$	C\$	US\$	C\$
EHSI (payable in US\$)				
CMBS Financing, 6.6525%, due 2011	2,504	2,490	5,110	5,371
CMBS Financing, 6.79%, due 2012	717	713	1,283	1,348
Line of credit under Credit Facility, variable rates, due 2011	572	569	1,718	1,805
Sovereign Bank mortgage loans, variable rates, due 2011	256	255	936	984
HUD mortgages, 4.6% to 5.5%, due 2018 to 2045	4,549	4,524	37	39
PrivateBank mortgage loans, variable rates, due 2013	426	424	–	–
Other	89	89	112	118
	9,113	9,064	9,196	9,665
Extendicare REIT and Canadian Subsidiaries (payable in C\$)				
Convertible Unsecured Subordinated Debentures, 5.7%, due 2014		2,438		3,211
Convertible Unsecured Subordinated Debentures, 7.25%, due 2013		2,231		3,047
CMHC mortgages, 3.52% to 9.81%, maturing through to 2020		3,569		1,653
Non-CMHC mortgages, 5.75%, due 2013		128		173
Capital lease obligations, average rate of 7.08%, maturing through to 2028		513		545
Construction loan, 4.25%, converting in 2011 to 7.7%, maturing 2036		1,066		256
Construction loan, variable rate, due 2011		360		30
		10,305		8,915
Total financing costs		19,369		18,580
Less: current portion		6,037		7,291
		13,332		11,289

Notes to Consolidated Financial Statements

PRINCIPAL REPAYMENTS

Principal repayments on long-term debt, exclusive of the equity allocation and obligations under capital leases as described in *note 16*, and after giving effect to renewal privileges, are as follows:

Year	Amount
2011	571,095
2012	105,594
2013	226,447
2014	124,222
2015	3,875
2016 and beyond	82,745
	1,113,978

INTEREST RATES

The weighted average interest rate of all long-term debt at December 31, 2010, was approximately 6.6% (2009 – 6.6%). At December 31, 2010, 92.8% of the long-term debt, excluding financing costs and equity allocation, was at fixed rates.

8. Other Long-term Liabilities

	2010	2009
Conditional asset retirement obligation	24,248	24,786
Accrued pension plan obligation (<i>note 17</i>)	21,861	22,187
Deferred compensation	10,941	11,068
Unit appreciation rights	798	158
Liabilities assumed from Crown Life	5,601	5,632
Future lease commitments	1,892	2,146
Fair value of foreign currency forward contract	–	203
Other	1,292	1,375
	66,633	67,555

Conditional Asset Retirement Obligation

The conditional asset retirement obligation relates to possible asbestos remediation of the REIT's pre-1980 constructed centers (*note 1(n)*).

Accrued Pension Plan Obligation

Extendicare REIT provides a defined benefit pension plan, as well as a supplementary plan, which is an unfunded defined benefit pension arrangement for certain of its executives (*note 17*).

Deferred Compensation

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

Unit Appreciation Rights Plan

UARs are granted at the discretion of the board of trustees of the REIT (the "Board of Trustees"), upon recommendation by the human resources committee of the Board of Trustees. Any trustee, director, officer or employee of Extendicare REIT or its affiliates is eligible to participate.

A summary of the UARs that have been granted to date by the Board of Trustees to senior management and the trustees as at December 31, 2010, is as follows:

	2010		2009	
	Units	Weighted Average Vesting Price	Units	Weighted Average Vesting Price
Outstanding, beginning of year	559,000	\$ 6.64	–	\$ –
Granted	628,000	10.04	559,000	6.64
Forfeited	(86,333)	(7.84)	–	–
Outstanding, end of year	1,100,667	\$ 8.48	559,000	\$ 6.64

The vesting price represents the REIT Unit price at which the respective UARs were granted, and equates to the minimum REIT Unit price at which they can be vested. As at December 31, 2010, 1,100,667 UARs were outstanding, with an average remaining contractual life of 1.9 years. During 2010, \$0.6 million was expensed, and the related liabilities included as part of other long-term liabilities were \$0.8 million at December 31, 2010.

In March 2011, the REIT granted 637,000 in UARs at an average unit price of \$11.16.

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

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

Liabilities Assumed from Crown Life

Under the Crown Life share sale agreement with The Canada Life Assurance Company (Canada Life) entered into in June 2007, Extencicare remains responsible for specified contingent claims against Crown Life up to a maximum amount of approximately \$18.8 million, which amount was reduced to \$13.9 million as at December 31, 2010. Extencicare has delivered letters of credit to Crown Life in support of the claims (*note 7*). These letters of credit were reduced in December 2009 to \$15.4 million from \$16.8 million in 2008, and further reduced in July 2010 to \$13.9 million. A contingent liability of \$5.6 million was recorded as at December 31, 2010, representing management's best estimate of the exposure to the contingent claims.

Future Lease Commitments

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

Fair Value of Foreign Currency Forward Contract

At December 31, 2010, the fair value of the foreign currency forward contract was a liability of \$0.4 million (2009 – \$0.3 million), all of which was included in accrued liabilities (2009 – \$0.1 million) and none in other long-term liabilities (2009 – \$0.2 million).

9. Derivative Financial Instruments and Foreign Exchange

	2010	2009
Foreign exchange gain, net	(3,339)	(7,477)
Valuation loss (gain) on foreign currency forward contracts	59	(12,812)
Gain on derivative financial instruments and foreign exchange	(3,280)	(20,289)

Foreign Currency Derivatives

The valuation loss on FCFCs was \$0.1 million in 2010 (2009 – \$12.8 million gain). This related primarily to the revaluation of EHSI contracts that lock in the purchase of Canadian dollars at specified foreign exchange rates for US\$4.0 million per month until June 2011. Three of these contracts had expired by December 2010 (*note 18*).

Notes Due between Canadian and U.S. Subsidiaries

For the year ended December 31, 2010, the REIT recorded a foreign exchange gain of \$3.3 million (2009 – \$7.5 million). This included a foreign exchange gain of \$1.0 million (2009 – \$0.5 million) resulting from payments of intercompany dividends, and the remaining gain related primarily to the settlement of foreign currency-denominated notes between EHSI and some of the Canadian-based subsidiaries.

10. Asset Impairment, Disposals, Financing and Other Items

The following summarizes the components of the loss (gain) from asset impairment, disposals, financing and other items.

	2010	2009
Asset impairment	2,544	–
Gain on disposals	(1,747)	–
Refinancing fees	381	–
Loss on suspended construction projects	–	605
Gain on repurchase of securities for cancellation	–	(257)
Other	(24)	(567)
Loss (gain) from asset impairment, disposals, financing and other items	1,154	(219)

Impairment losses are recognized for long-lived assets used in operations when indicators of impairment are present and the estimated undiscounted cash flows do not appear to be sufficient to recover the carrying amounts of the assets. The impairment loss is measured by comparing the fair value of the assets to their carrying value.

2010

In May 2010, EHSI recorded an impairment loss of \$1.2 million to writedown to fair value a closed nursing center in Washington due to the general decline in property values in the local real estate market. The residents of this facility were moved to a newly constructed building in January 2008. In June 2010, the Canadian operations recorded an impairment loss of \$1.3 million relating to two nursing centers in Ontario as a result of performing an impairment analysis on the centers.

The REIT reported a pre-tax gain of \$1.7 million in December 2010 related to the disposal of U.S. non-core Captive assets with a book value of US\$6.2 million.

2009

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

Commencing in 2009, management acquired for cancellation, \$1.1 million aggregate principal amount of the 2014 Debentures at a cost of \$0.7 million and \$0.2 million aggregate principal amount of the 2013 Debentures at a cost of \$0.2 million. The gain or loss on the purchase of these debentures was calculated by comparing the consideration paid with the carrying value of the debenture, net of the related financing costs, and the carrying value of the equity conversion option extinguished through the transaction. These transactions resulted in a gain of \$0.3 million (*note 12*).

Other gains of \$0.6 million included the reversal of accruals no longer required resulting from the settlement of one of the contingent liabilities assumed from the sale of Crown Life (*note 8*).

11. Discontinued Operations

The following is a summary of results of all discontinued operations with prior periods revised accordingly.

	2010	2009
Nursing center revenue	40,860	93,813
Operating expenses	38,830	85,361
Lease costs	584	2,252
Earnings before undernoted	1,446	6,200
Depreciation, amortization and accretion expense	44	1,456
Interest expense (income)	(10)	6
Earnings before the undernoted	1,412	4,738
Gain (loss) from asset impairment, disposals and other items		
Impairment charges on assets held for sale	–	(5,752)
Recoveries (loss) on sale of centers	(2,081)	1,426
Loss on termination of leases	(1,013)	–
	(3,094)	(4,326)
Earnings (loss) from discontinued operations before income taxes	(1,682)	412
Income tax expense (recovery)	(559)	2,863
Loss from discontinued operations	(1,123)	(2,451)
Basic and diluted loss per unit (<i>in dollars</i>)	(0.02)	(0.03)

2010 Discontinued Operations

Under the terms of a 2009 agreement described below, EHSI completed the sale in April 2010 of two skilled nursing centers in Ohio and Pennsylvania for a total consideration of US\$5.5 million that resulted in a net pre-tax loss of \$1.7 million (US\$1.7 million). In August, EHSI completed the sale of four of six Michigan skilled nursing centers for US\$15.9 million that resulted in a pre-tax loss of \$0.3 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.

Results from all the above facilities were included as discontinued operations in 2010 until they were disposed of.

2009 Discontinued Operations

During the 2009 fourth quarter, EHSI reached an agreement with another long-term care operator 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) for total cash consideration of US\$31.0 million prior to May 31, 2010. The transaction resulted in an impairment charge of \$4.0 million (US\$3.8 million) against goodwill, relating to all of these centers, which was recorded in the 2009 fourth quarter (*note 4*).

In addition, EHSI classified three leased Ohio skilled nursing centers as discontinued operations during 2009 and, in the 2009 fourth quarter, transferred one of these operations to another operator. With respect to the remaining two leased skilled nursing centers, EHSI completed the transfer of operations to new operators in the 2010 second quarter, which involved a lease termination settlement of US\$1.0 million. An impairment charge of \$1.8 million (US\$1.6 million) was recorded on these centers in the 2009 third quarter. Also included in 2009 discontinued operations was the release of excess reserves for self-insured general and professional liability claims of \$1.1 million.

12. Unit Capital

Authorized Capital

The REIT has an unlimited number of REIT Units and an unlimited number of Exchangeable LP Units authorized.

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

The Exchangeable LP Units issued by Extencicare LP are intended, to the greatest extent practicable, to be economically equivalent to REIT Units. Additionally, Exchangeable LP 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. As a result, they have been treated for accounting purposes as REIT Unit equivalents. They are exchangeable on a one-for-one basis for REIT Units at the option of the holder, and will be automatically exchanged for REIT Units on November 10, 2011. Each Exchangeable LP Unit entitles the holder to receive distributions from Extencicare LP that are, to the greatest extent practicable, economically equivalent to the distributions made to holders of REIT Units. During 2010, 0.1 million Exchangeable LP Units were exchanged for REIT Units on a one-for-one basis at the option of the holders (2009 – 0.1 million).

The following summarizes the unit capital activity during the past two years.

<i>(in thousands of dollars for amounts)</i>	2010		2009	
	Number	Amount	Number	Amount
REIT Units				
Issued and outstanding at beginning of year	69,896,968	332,069	70,162,191	332,910
Issued pursuant to DRIP	584,112	5,324	476,300	2,743
Issue of REIT Units	9,228,750	83,321	–	–
Purchased pursuant to issuer bid	–	–	(880,500)	(4,153)
Converted from Exchangeable LP Units	121,636	499	138,977	569
REIT Units	79,831,466	421,213	69,896,968	332,069
Exchangeable LP Units				
Issued and outstanding at beginning of year	3,283,056	13,436	3,410,227	13,943
Issued pursuant to DRIP	2,295	22	11,806	62
Converted to REIT Units	(121,636)	(499)	(138,977)	(569)
Exchangeable LP Units	3,163,715	12,959	3,283,056	13,436
Units issued and outstanding at end of year	82,995,181	434,172	73,180,024	345,505
Equity portion of convertible debentures <i>(note 7)</i>	–	9,964	–	9,964
Unit Capital	82,995,181	444,136	73,180,024	355,469

2010 Equity Offering

On February 4, 2010, the REIT completed a public equity offering of 9,228,750 REIT Units at a price of \$9.35 per unit for aggregate gross proceeds of \$86.3 million (\$82.2 million net of underwriters' fees and offering expenses, before income taxes). The net proceeds of the offering will provide the REIT with greater balance sheet flexibility and liquidity, and will be used to repay indebtedness, fund redevelopment of existing properties and for general purposes.

Distribution Reinvestment Plan

The REIT has implemented a Distribution Reinvestment Plan (DRIP) pursuant to which holders of REIT Units and holders of Exchangeable LP Units who are residents in Canada may elect to reinvest their cash distributions in additional REIT Units or Exchangeable LP Units, as the case may be, on the date of the distribution, at a price equal to 97% of the volume-weighted average trading price of the REIT Units on the TSX for the five trading days immediately preceding the corresponding date of distribution. During 2010, the REIT issued 0.6 million REIT Units at a value of \$5.3 million, and Extencicare LP issued 2,295 Exchangeable LP Units at a value of \$22,000 in connection with the DRIP.

Normal Course Issuer Bid

In January 2011, the REIT received approval from the TSX for its normal course issuer bid (the “2011 Bid”) to purchase for cancellation up to 7.8 million REIT Units, \$11.4 million aggregate principal amount of its 2014 Debentures, and \$9.2 million aggregate principal amount of its 2013 Debentures, representing, in each case, approximately 10% of the public float of the outstanding securities at December 31, 2010. The 2011 Bid provides the REIT’s Board of Trustees with flexibility to repurchase units for cancellation over a period of one year, until January 10, 2012.

There were no purchases for cancellation made by the REIT under a similar normal course issuer bid that expired on January 6, 2011. During 2009, under a normal course issuer bid that expired on December 28, 2009, the REIT acquired for cancellation 0.9 million REIT Units at a cost of \$5.3 million, \$1.1 million aggregate principal amount of its 2014 Debentures at a cost of \$0.7 million and \$0.2 million aggregate principal amount of its 2013 Debentures at a cost of \$0.2 million.

13. Revenue

EHSI derived approximately 79% of its revenue from services provided under the federal (Medicare) and state (Medicaid) programs (2009 – 79%). The Medicare program pays each participating center a prospectively set rate for each resident, which is based on the resident’s acuity. Most Medicaid programs fund participating centers using a case-mix based system, paying prospectively set rates. With respect to Medicaid in states that utilize retrospective reimbursement systems, nursing centers are paid on an interim basis for services provided, subject to adjustments based upon allowable costs, which are generally submitted in cost reports on an annual basis. In these states, revenue is subject to adjustments as a result of cost report settlements with the state.

Funding received by ECI for its nursing homes and home health care services is regulated by provincial authorities. Revenue from provincial programs represented approximately 65% of ECI’s nursing home revenue, and approximately 96% of ECI’s home health care revenue.

Certain figures have been revised to conform with the presentation in 2010, mainly for the reclassification of non-reimbursable bad debts from operating expense to revenue as a contra account. Over the past several years, an increasing number of states have decided to refrain from reimbursing providers for the resident’s co-payment portion of Medicare Part B therapy services provided to Medicaid residents who do not have the resources to pay for the services themselves. This was most recently the case in the State of Ohio. As a result, EHSI has reclassified its non-reimbursable Medicare Part B bad debt expense from operating expense to a contra-revenue account, beginning in 2010. The impact of this reclassification in 2009 was to reduce revenue and operating expense from continuing operations by \$5.6 million (US\$4.9 million). The comparable amount for 2010 was \$6.3 million (US\$6.1 million).

14. Income Taxes

Taxation of Extencicare REIT and its Corporate Subsidiaries

Extencicare REIT is a Canadian unincorporated, open-ended real estate investment trust established under the laws of the Province of Ontario by the Deed of Trust, and is considered a specified investment flow-through trust (SIFT) and has been subject to the new tax regime applicable to SIFTs (the “SIFT Rules”) since January 1, 2007.

Under the SIFT Rules, an income trust that is a SIFT is subject to tax in respect of certain income that is distributed to its unitholders, at rates that are substantially equivalent to the general corporate tax rate applicable to Canadian corporations. Distributions from income in respect of which this tax is payable will be treated in the same manner as taxable dividends from a taxable Canadian corporation in the hands of unitholders and will be eligible for the enhanced dividend tax credit if paid to an individual resident in Canada. This distribution tax does not apply to distributions by a SIFT of taxable dividends received (or deemed to be received) by a SIFT, nor does it apply to distributions that constitute returns of capital. Corporate subsidiaries of the REIT are not subject to tax under the SIFT Rules but are instead subject to corporate income tax in the jurisdictions in which they operate.

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.

Notes to Consolidated Financial Statements

New rules contained in the SIFT Amendments also facilitate the conversion of SIFT trusts into corporations, either through the distribution by a SIFT trust of shares of a taxable Canadian corporation to its unitholders or by the transfer of units of a SIFT trust to a taxable Canadian corporation, followed by a winding up of the SIFT trust. The automatic tax-deferred rollover treatment applies to transactions that occur on or after July 14, 2008, and before 2013.

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

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

Effective Tax Rate

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

	2010	2009
Earnings from continuing health care operations before income taxes	97,289	125,762
Income taxes at statutory rates of 31% (2009 – 33%)	30,159	41,503
Income tax effect relating to the following items:		
Tax rate variance of foreign subsidiaries	9,308	2,511
Foreign exchange gain	(668)	(1,755)
Reversal of previously recognized benefit	2,353	2,001
Non-deductible items	1,540	1,330
Non-taxable income	(120)	(185)
Other items	1,907	198
	44,479	45,603

Current and Future Income Tax Expense

	2010	2009
Current tax expense (recovery):		
Accelerated tax depreciation	(4,442)	(24,868)
Other	36,165	31,686
	31,723	6,818
Future tax expense:		
Accelerated tax depreciation	4,442	24,868
Other items	8,314	13,917
	12,756	38,785
	44,479	45,603

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

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

Summary of Operating and Capital Loss Carryforwards

At December 31, 2010, the REIT's U.S. corporate subsidiaries had net operating loss carryforwards available for U.S. state income tax purposes of \$33.7 million (US\$33.9 million), which expire in the years 2012 through 2030, and had \$8.4 million (US\$8.4 million) of net operating loss carryforwards available for U.S. federal income tax purposes, which expire in the years 2021 through 2030. In addition, the REIT's Canadian corporate subsidiaries had \$31.6 million of net operating loss carryforwards available for Canadian federal income tax purposes, which expire in the years 2014 through 2030. To the extent that it is more likely than not that some or all of the future tax assets will not be realized, a valuation allowance has been established.

At December 31, 2010, there were capital losses available for Canadian income tax purposes of \$24.4 million (2009 – \$28.4 million) that can be carried forward indefinitely to apply against future capital gains. The future tax benefit of these capital losses of \$3.3 million (2009 – \$4.0 million) has been fully offset by the valuation allowance against future tax assets.

Net future tax liabilities increased in 2010 by \$2.3 million to \$57.3 million from \$55.0 million at December 31, 2009. The valuation allowance for future tax assets as at December 31, 2010, and 2009 was \$16.3 million and \$17.1 million, respectively. The net change in the total valuation allowance for 2010 and 2009 was a decrease of \$0.8 million and \$1.0 million, respectively. Management believes it is more likely than not that the REIT's corporate subsidiaries will realize the benefits of these deductible differences, net of the valuation allowances.

Future income taxes are provided for temporary differences between the carrying values of assets and liabilities and their respective tax values as well as available tax loss carryforwards. The significant components of future income tax assets and liabilities are as follows:

	2010	2009
Future income tax liabilities		
Property and equipment	100,532	96,133
Leasehold rights	395	418
Other	16,407	18,650
	117,334	115,201
Future income tax assets		
Self-insurance reserves	9,758	13,472
Employee benefit accruals	18,903	20,431
Operating loss carryforwards	13,744	12,283
Net capital loss carryforwards	3,252	3,981
Deferred revenue	6,159	5,484
Accounts receivable reserves	4,732	7,435
Conditional asset retirement obligation	7,733	8,189
Other	12,113	6,096
	76,394	77,371
Less: valuation allowance	16,352	17,136
	60,042	60,235
Future income tax liabilities, net	57,292	54,966
Current portion of future income tax assets, net	19,190	24,900
Long-term future income tax liabilities, net	76,482	79,866

15. Earnings per Unit

Basic earnings per unit is calculated using the weighted average number of units outstanding during the year. Diluted earnings per unit, using the "if-converted" method and to the extent the conversion is dilutive, assumes all convertible securities have been converted at the beginning of the period, or at the time of issuance, if later, and any charges or returns on the convertible securities, on an after-tax basis, are removed from net earnings. The after-tax interest on convertible debentures have been removed from net earnings and the weighted average number of units has been increased by the number of units which would be issued on conversion of the convertible debentures, pro-rated for the number of days in the year the convertible debentures were outstanding.

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

	2010	2009
Numerator for Basic and Diluted Earnings per Unit		
<i>Earnings from continuing operations</i>		
Net earnings for basic earnings per unit	51,687	77,708
Less: loss from discontinued operations, net of tax	(1,123)	(2,451)
Earnings from continuing operations for basic earnings per unit	52,810	80,159
Add: after-tax interest on convertible debt	11,669	11,209
Earnings from continuing operations for diluted earnings per unit	64,479	91,368
<i>Net earnings</i>		
Net earnings for basic earnings per unit	51,687	77,708
Add: after-tax interest on convertible debt	11,669	11,209
Net earnings for diluted earnings per unit	63,356	88,917
Denominator for Basic and Diluted Earnings per Unit		
Weighted average number of units for basic earnings per unit	81,533,081	72,999,716
Units issued if all convertible debt was converted	13,813,408	13,817,000
Total for diluted earnings per unit	95,346,489	86,816,716
Basic Earnings per Unit <i>(in dollars)</i>		
Earnings from continuing operations	0.65	1.09
Net earnings	0.63	1.06
Diluted Earnings per Unit <i>(in dollars)</i>		
Earnings from continuing operations	0.65	1.05
Net earnings	0.63	1.02

16. Commitments and Contingencies

Capital and Operating Lease Commitments

At December 31, 2010, the REIT was committed under non-cancellable leases requiring future minimum rentals as follows:

	Capital Leases	Operating Leases	Total
2011	13,897	7,810	21,707
2012	13,921	6,507	20,428
2013	13,921	5,182	19,103
2014	13,923	4,746	18,669
2015	13,523	4,082	17,605
2016 and beyond	158,479	17,111	175,590
Total minimum payments	227,664	45,438	273,102
Less: amount representing interest	93,754		
	133,910		

Property and Equipment Commitments

At December 31, 2010, outstanding capital expenditure commitments for EHSI totalled \$13.2 million (US\$13.3 million). ECI had outstanding capital expenditure purchase commitments totalling \$8.7 million as at December 31, 2010, relating to two construction projects.

ECI has a number of internal growth projects under various stages of development, representing two owned senior care centers in Alberta totalling 320 beds, at a cost of approximately \$41 million, net of government grants, one of which opened in Lethbridge in January 2011, and the other one in Edmonton is scheduled for completion in 2011; as well as two Ontario redevelopment projects totalling 436 beds, at a cost of approximately \$72.1 million.

Following completion of the new Lethbridge center, ECI closed its older 120-bed nursing center in Lethbridge. Construction is in progress on the remaining 180-bed long-term care center in Edmonton. It is scheduled for completion in 2011, at an estimated cost, net of government grants, of \$19.5 million, of which \$9.0 million has been spent to December 31, 2010. ECI owns and operates another nursing center in Edmonton (113 operational beds), which is anticipated to close when the new one opens at the end of 2011. With respect to the two Ontario redevelopment projects, they are scheduled to begin construction in the spring of 2011 and will replace two Ontario class "C" centers (287 beds) upon completion at the end of 2012.

In November 2010, EHSI reached a final agreement to acquire a 100-bed skilled nursing center in Ohio for US\$7.5 million at the end of its lease term in March 2011.

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 20*). 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.

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 IRS for years 2005 and 2006 relating to limitations computed under Section 382 of the Internal Revenue 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 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.

Legal Proceedings and Regulatory Risk

The REIT and its consolidated subsidiaries are defendants in actions brought against them from time to time in connection with their operations. While it is not possible to predict the ultimate outcome of the various proceedings at this time or to estimate additional costs that may result, such actions are generally resolved within the amounts provided.

On April 19, 2010, the REIT announced that EHSI had received subpoenas from the U.S. Department of Health and Human Services (DHHS), Office of the Inspector General (OIG), relating to an investigation into the possible submission of claims that may be in violation of the U.S. Social Security Act covering a period from January 1, 2007, to January 1, 2010. EHSI is not aware of any improper claims and intends to furnish all requested information and to cooperate with the DHHS in its investigation. EHSI and its subsidiaries believe that they are in material compliance with the requirements imposed on them by the U.S. Social Security Act.

As previously disclosed in our public filings, the provision of health care services in the United States 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 including EHSI are subject to audits and investigations by various federal and state government authorities.

17. Employee Future Benefits

Retirement compensation arrangements, including defined benefit plans, are maintained for certain employee groups as described below.

The REIT provides a registered defined benefit pension plan, as well as a supplementary plan which is an unfunded defined benefit pension arrangement for certain of its executives, both of which have been closed to new entrants for several years. The registered defined benefit plan was fully funded with plan assets of \$6.1 million and accrued benefit obligations of \$6.9 million as at December 31, 2010. The accrued benefit obligations of the supplementary plan were \$32.2 million as at December 31, 2010. We do not set aside assets in connection with the supplementary plan and the benefit payments made thereunder are funded from our cash from operations. We measure our accrued benefit obligations and the fair value of plan assets for accounting purposes at September 30th of each year. A discount rate of 5.5% was used to determine the benefit expense in 2010, and a discount rate of 4.75% was used to calculate the accrued benefit obligation at the end of 2010. Actuarial valuation reports of the defined benefit pension plan are completed every three years with the last one performed as of October 1, 2009. The next required funding valuation will be effective October 1, 2012. Additional information for these benefit plans is provided in the following tables.

EHSI also maintains defined contribution retirement 401(k) savings plans in the U.S., which are made available to substantially all of its employees. EHSI pays a matching contribution of 25% of every qualifying dollar contributed by plan participants, net of any forfeiture. EHSI incurred expenses and made cash payments of \$2.3 million (2009 – \$3.4 million) related to the 401(k) savings plans.

	2010	2009
Accrued benefit obligations		
Balance at beginning of year	36,303	34,740
Current service cost	136	122
Benefits paid	(2,616)	(2,637)
Interest costs	1,931	2,016
Actuarial losses	3,386	2,062
Balance at end of year	39,140	36,303
Plan assets		
Fair value at beginning of year	6,128	6,197
Employer contributions	2,199	2,242
Actual return on plan assets	367	326
Benefits paid	(2,616)	(2,637)
Fair value at end of year	6,078	6,128
Funded status – plan deficit		
Unrecognized net experience losses	(8,446)	(5,212)
Other	(548)	(543)
	24,068	24,420
Annual benefit plan expense		
Current period service costs	136	122
Interest cost	1,931	2,016
Actual return on plan assets	(367)	(326)
Actuarial losses	3,386	2,062
Plan benefit cost before adjustments to recognize long-term nature of plan benefit cost	5,086	3,874
Adjustments to recognize the long-term nature of plan benefit costs		
Difference between expected and actual return on plan assets	(46)	(94)
Difference between actuarial loss recognized and actual actuarial loss on accrued benefit obligation	(3,188)	(2,041)
Plan benefit expense recognized in the year	1,852	1,739
Reconciliation of funded status to amounts in financial statements		
Accrued benefit liability at beginning of year	24,420	24,901
Pension expense	1,852	1,739
Employer contributions	(2,204)	(2,220)
Accrued benefit liability at end of year	24,068	24,420
Reported in the REIT's balance sheet		
Current accrued liabilities	2,207	2,233
Other long-term liabilities	21,861	22,187
Accrued benefit liability at end of year	24,068	24,420
Percentage of plan assets		
Equities	63%	62%
Fixed income securities	32%	32%
Cash and short-term investments	5%	6%
	100%	100%

	2010	2009
Significant assumptions		
Discount rate for year-end accrued obligation	4.75%	5.50%
Discount rate for period expense	5.50%	6.00%
Expected long-term rate of return on plan assets	7.0%	7.0%
Rate of compensation increase	5.0%	5.0%
Average remaining service years of active employees	7	8

18. Nature and Extent of Risks Arising from Refinancing and Financial Instruments

(a) Refinancing and Liquidity Risk

REFINANCING RISK

As discussed in the Long-term Debt note (*note 7*) under the heading "2011 Refinancing Plan," the REIT has implemented plans to refinance US\$635 million of its U.S. long-term debt, of which US\$624.5 million matures in 2011 and 2012. Management anticipates refinancing this debt with approximately US\$568 million of HUD-insured mortgages and to use cash on hand to repay the balance. The refinancing is to be completed in stages, with the first anticipated before June 2011 with the repayment of the Sovereign Loans, and the balance through to November 2011 with the repayment of the CMBS financings. EHSI intends to seek approval from HUD by June 2011 for a further US\$50.0 million of financing capacity from its current limit of US\$550.0 million.

The REIT recognizes 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 closing dates of the HUD loans. Therefore, the REIT has taken the appropriate steps to secure bridge financing that would provide flexibility in the refinancing process and to also ensure that alternative financing is available, if required. In order to provide flexibility in the refinancing process, EHSI obtained a letter from a lender in January 2011 (the "Highly Confident Letter"), with a proposal to provide a bridge term loan facility to assist in the execution of the refinancing plan. In providing the Highly Confident Letter, the lender conducted suitable due diligence of EHSI's refinancing plan and received approval from its internal credit committee. EHSI has not proceeded to move forward with the bridge term loan at this time. As well, EHSI is in the process of negotiating a loan modification that includes a six-month extension of the maturity of its 2011 CMBS Financing to facilitate the timing of its refinancing process. In addition, as an alternative to HUD financing, EHSI believes, based upon communication with its bankers, that it can secure either a bank term loan and/or issue senior unsecured notes.

EHSI believes that it has full financial capacity and will execute its plan to complete the refinancing. Management continues to closely monitor the progress of the refinancing and the financial markets. Although management has confidence in the refinancing of the U.S. debt as outlined above, and has taken appropriate steps to obtain comfort that alternative financing is available, at the present time, there can be no assurance given that we will succeed in refinancing our debt prior to its maturity.

LIQUIDITY RISK

Liquidity risk is the risk that the REIT will encounter difficulty in meeting its contractual obligations associated with financial liabilities (*note 19*). 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.

(b) Risks Associated with Financial Instruments

In addition to the refinancing and liquidity risks discussed above, the REIT is exposed to the following additional risks as a result of holding financial instruments: credit risk, currency risk and interest rate risk. Below is a description of those risks and the objectives, policies and processes that have been implemented to measure and manage the risks.

CREDIT RISK

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the REIT by failing to discharge its obligation. The nature and maximum exposure to credit risk as at December 31 was:

Carrying Amount	2010	2009
Cash and short-term investments	267,759	134,012
Restricted cash	10,095	22,361
Accounts receivable, less allowance	210,014	210,562
Investments held for self-insured liabilities ⁽¹⁾	60,937	61,885
Notes, mortgages and amounts receivable ⁽²⁾	50,378	53,812
Medicare and Medicaid settlement receivables	17,481	17,420
	616,664	500,052

(1) Excludes equity investments.

(2) Includes current portion.

The majority of our cash and cash equivalents are held with highly rated financial institutions in Canada and the United States.

Receivables from U.S. and Canadian government agencies, which are included in accounts receivable, notes, mortgages and amounts receivable, and Medicare and Medicaid settlement receivables, represented the only concentrated group of credit risks for the REIT. As at December 31, 2010, receivables from government agencies represented approximately 78% of the total receivables. Management does not believe that there is significant credit risk associated with these government agencies other than possible funding delays. Receivables, other than those from government agencies, consist of receivables from various payors and do not represent any concentrated credit risks to the REIT. There is no significant exposure to any single party.

The REIT's investments held for self-insured liabilities are with high-quality financial institutions, as are the counterparties to the foreign currency forward contracts. The REIT limits the amount of exposure to any one institution.

CURRENCY RISK

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The REIT finances and secures Canadian debt on only Canadian operations and assets, and similarly, finances and secures U.S. debt on only U.S. operations and assets. Therefore, there is no currency exposure in respect of the valuation of assets and associated debt. The REIT can raise capital to finance, through cross-border loans or an injection of capital, its U.S. operations. Intercompany advances to the U.S. operations for acquisitions or growth expenditures are subsequently repaid. Any cross-border transactions are subject to exchange fluctuations that may result in realized gains or losses as and when the balances are settled and upon the payment of interest on such loans, as well as any cross-border dividend or return of capital.

The majority of the REIT's operations are conducted in the United States, which accounted for approximately 68% of its total revenue in 2010. All of the REIT's distributions are denominated in Canadian dollars, and therefore, to the extent those distributions are funded by our U.S. operations, the REIT is subject to currency risk. To limit the exposure of converting the REIT's U.S. cash flow into Canadian dollars, we implemented a foreign currency hedging strategy through FCFCs, provided the conditions are favourable at the time. As a result, EHSI has entered into FCFCs to acquire Canadian dollars on a monthly basis to June 2011.

The REIT maintains risk management control systems to monitor foreign currency cash flow risk attributable to its outstanding or forecasted debt obligations as well as its offsetting hedge positions. We do not enter into financial instruments for trading or speculative purposes.

Notes to Consolidated Financial Statements

Our exposure to foreign currency risk as at December 31, 2010 and 2009, was as follows:

<i>(in thousands of US\$)</i>	2010	2009
Assets		
Current assets	372,167	292,916
Property and equipment, goodwill, intangibles & other assets	818,761	843,849
Liabilities		
Current liabilities	748,186	149,938
Long-term debt and other liabilities	290,935	814,763
Net asset exposure	151,807	172,064

Cash Flow Sensitivity

The FCFCs we had in place are listed below:

- for the period to November 2009, FCFCs were locked at a fixed exchange rate;
- from December 2009 to June 2010, exchange rate was locked between 1.00 and 1.1050;
- for July 2010, exchange rate was locked between 1.00 and 1.09; and
- from August 2010 to June 2011, exchange rate was locked between 1.00 and 1.09.

For the first series of FCFCs listed above, since these were locked at a fixed exchange rate, any fluctuation in currency would not have had any impact on our flow of funds from U.S. to Canada. As for the remaining series of FCFCs, if the prevailing exchange rate fell between the ranges, the impact would generally be \$0.5 million per year for every one cent change in exchange rate.

Net Earnings Sensitivity Analysis

Every one cent strengthening of the Canadian dollar against the U.S. dollar would impact net earnings and other comprehensive income by amounts shown below. This analysis assumes that all other variables, in particular interest rates and fair value of the FCFCs, remain constant.

Favourable (unfavourable) impact	2010	2009
Net earnings	(1)	607
Other comprehensive income	(1,518)	(1,721)

INTEREST RATE RISK

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The REIT assesses interest rate risk by continually identifying and monitoring changes in interest rates that may adversely impact expected future cash flows and by evaluating hedging opportunities. The REIT maintains risk management control systems to monitor interest rate risk attributable to its outstanding or forecasted debt obligations as well as its offsetting hedge positions.

In order to meet its monthly distributions, the REIT has limited the amount of debt that may be subject to changes in interest rates. As at December 31, 2010, all but \$90.1 million of our outstanding long-term debt was at fixed rates. We do not enter into financial instruments for trading or speculative purposes.

The interest rate profile of our interest-bearing financial instruments at December 31, 2010 and 2009 was as follows:

Carrying Amount	2010	2009
Fixed-rate instruments:		
Investments held for self-insured liabilities ⁽¹⁾	35,467	54,358
Less: Long-term debt ⁽²⁾⁽³⁾	1,151,934	1,158,508
Net liability in fixed-rate instruments	1,116,467	1,104,150
Variable-rate instruments:		
Long-term debt ⁽²⁾⁽³⁾	90,115	94,104
Total liability in variable-rate instruments	90,115	94,104

(1) Excludes variable-rate instruments.

(2) Excludes financing costs.

(3) Includes current portion.

Fair Value Sensitivity Analysis for Fixed-rate Instruments

We do not designate interest rate derivatives as hedging instruments under a fair-value hedge accounting model; therefore, changes in interest rates would not affect net earnings with respect to these fixed-rate instruments. As at December 31, 2010, there were no fixed-rate instruments designated as held for trading included in invested assets; therefore, changes in interest rates will not have any impact on net earnings for these instruments.

Fair value Sensitivity Analysis for Variable-rate Instruments

Long-term debt is classified as other financial liabilities, which are measured at amortized cost using the effective interest rate method of amortization; therefore, changes in interest rates would not affect other comprehensive income with respect to variable-rate debt.

Cash Flow Sensitivity Analysis for Variable-rate Instruments

A change of 100 basis points in interest rates would have increased or decreased net earnings by amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

	2010		2009	
	100bp increase	100bp decrease	100bp increase	100bp decrease
Favourable (unfavourable) impact				
Net earnings	(623)	623	(566)	566

(c) Fair Values of Financial Instruments

	2010		2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Invested assets ⁽¹⁾	801	801	823	823
Accounts receivable, less allowance ⁽²⁾	227,495	226,434	227,982	227,401
Notes, mortgages and amounts receivable ⁽³⁾	50,378	54,811	53,812	57,287
Investments held for self-insured liabilities	60,937	60,937	65,332	65,763
Financial liabilities:				
Long-term debt ⁽³⁾⁽⁴⁾	1,242,049	1,285,799	1,252,612	1,276,928
Foreign currency forward contract liability ⁽³⁾	381	381	330	330
Net liabilities	(902,819)	(943,197)	(904,993)	(925,984)
Net unrealized loss		40,378		20,991

(1) Included in other current assets.

(2) Includes long-term portion.

(3) Includes current portion.

(4) Excludes financing costs.

Basis for Determining Fair Values

The following summarizes the significant methods and assumptions used in estimating the fair values of financial instruments reflected in the previous table.

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

Loans and receivables include accounts receivable as well as notes and mortgages receivable. Accounts receivable including other long-term receivables, are recorded at amortized cost. The carrying values of accounts receivable approximate fair values due to their short-term maturities, with the exception of certain settlement receivables from third-party payors that are anticipated to be collected beyond one year. The fair values of these settlement receivables are estimated based on discounted cash flows at current borrowing rates. Notes and mortgages receivable primarily consist of notes and amounts receivable from government agencies, and other third-party notes. The fair values for these instruments are based on the amount of future cash flows associated with each instrument, discounted using current applicable rates for similar instruments of comparable maturity and credit quality.

Notes to Consolidated Financial Statements

The fair value of the FCFCs is based upon the valuation as provided by the financial institution that is the counterparty to the agreements.

The fair values for long-term debt are based on the amount of future cash flows associated with each instrument discounted using current applicable rates for similar instruments of comparable maturity and credit quality.

Fair Value Hierarchy

We use a fair value hierarchy to categorize the type of valuation techniques from which fair values are derived. Our use of quoted market prices (Level 1), internal models using observable market information as inputs (Level 2) and internal models without observable market information as inputs (Level 3) for the following financial instruments recorded at fair value were as follows:

	2010		2009	
	Available-for-Sale Securities	Derivative Liabilities	Available-for-Sale Securities	Derivative Liabilities
Level 1 – Valued using quoted market prices	60,937	–	65,763	–
Level 2 – Valued using internal models (with observable market inputs) ⁽¹⁾	–	381	–	330
Level 3 – Valued using internal models (without observable market inputs)	–	–	–	–
	60,937	381	65,763	330

(1) Equity investments of \$801 (2009 – \$823) were not included above as they were stated at cost.

19. Capital Management

The REIT's objective is to preserve a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. We seek to balance the need for maintaining an attractive payout ratio with maintaining adequate capital to grow the business by acquisition or internal growth.

The REIT must access the capital markets periodically to fund acquisitions, growth capital expenditures and certain other expenditures. We monitor the capital markets to assess the conditions for raising capital and the cost of such capital relative to the return on any acquisitions or growth capital projects. In the opinion of the REIT, and based upon the information provided to the REIT, the majority of its investments held are of high quality and relatively safe from further economic turbulence, and cash is held in secure financial institutions. We continuously monitor the level, nature of debt and leverage ratios, along with our compliance with debt covenants, to ensure that sufficient resources exist. We are monitoring our cash position on a monthly basis and plan to preserve our cash to deal with our future refinancing needs. We have implemented a plan to refinance the Sovereign Loans and CMBS financings that mature in 2011 and 2012, as described in more detail under the heading "2011 Refinancing Plan" in *note 7*.

We are providing information to the Board of Trustees on a regular basis in order to carefully evaluate any significant cash flow decisions.

Global Economic Environment

The most significant factor impacting the REIT's industry this past year, and for the near term, is the global economy. Beginning in the latter part of 2008, the economy and stock markets suffered a significant downturn as a result of the worldwide credit and liquidity crisis that impacted market values of securities, values of commodities, such as oil and gas, interest rates and the foreign exchange markets; and there have been unprecedented job losses in both the U.S. and Canada. Though we have seen increases in the values of securities and increased liquidity in the credit market, there continues to be general restraint on a corporate and individual spending level. With a dramatic reduction in corporate profits and reduced consumer confidence, the fiscal health of provincial, state and federal governments have been dampened; consequently, the future funding of services for which they provide support may be at risk.

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

- reducing distributions and growth projects along with divestiture of underperforming assets;
- focusing on core business and cost reduction initiatives;
- monitoring 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;
- 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; and
- ability to finance and refinance loans, and the resulting higher cost of borrowing.

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 74% of our consolidated operating costs, and we are subject to resident and regulatory requirements, which provide us with limited flexibility in managing our labour costs. In addition, any escalation of regulatory pressure by the Centers for Medicare & Medicaid Services (CMS), state and provincial level government agencies could have a negative impact on our costs and thereby reduce our earnings. Federal, state and provincial health care associations have lobbied vigorously for continuation of consistent funding in the sector.

In response to the economic downturn, U.S. governments have initiated a number of cost-reduction and job-creation programs. In February 2009, the *American Recovery and Reinvestment Act of 2009* provided US\$787 billion in government stimulus of which US\$86.7 billion was appropriated to increase funding for state Medicaid programs. However, despite this additional funding and the stated intention to maintain core education, health and unemployment funding, a number of states in which we operate faced severe budgetary shortfalls in 2009 and 2010, and have implemented reductions in Medicaid funding or below inflationary increases. U.S. Congress extended the temporary increase in federal medical assistance percentage, or FMAP, funding through December 31, 2010. In early August 2010, legislation was signed into law by the U.S. President to extend the FMAP funding to June 30, 2011, though on a phased-down basis for most but not all states. An extension beyond June 2011 is unlikely and will negatively impact future state budgets.

In response to the economic downturn, the Ontario government implemented a two-year wage freeze beginning in 2010 and indicated its expectation that this 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. Despite this government mandate, arbitrators have awarded increased union wages in the long-term care sector. Other provincial governments have also restrained funding increases in 2010 that could affect ECI's future margins.

In response to the reductions in government funding, we undertook a number of initiatives since the latter half of 2008 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.

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

In the U.S., Medicare and Managed Care funded residents are the source of approximately 81% of our admissions in 2010 (2009 – 80%), a component of which come from hospitals after elective surgeries.

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

Notes to Consolidated Financial Statements

In response, we have refocused and refined our strategic marketing plans, are working on strategic alliances within the marketplaces where we operate, and have invested to improve the number of rehabilitation suites within our portfolio to increase our market share in communities where we anticipate a return on the investment.

ABILITY TO RAISE FINANCING AND REFINANCE LOANS

In respect of the financing environment, the continuing economic weakness in North America has restricted the ability of companies to raise capital, to finance and refinance loans, and increased the cost of borrowing.

In the United States, the availability of low-cost and long-term financing is more limited than prior to the global economic downturn, as are the sources and options for financing. As a result, the terms and conditions of financing are less favourable to the REIT. EHSI is currently proceeding with refinancing the majority of the CMBS and Sovereign Loan debt with mortgages insured by HUD. Mortgages insured through HUD are available to all qualifying long-term care operators and represent a low-cost and long-term financing option for the REIT. However, additional administrative costs are required to establish and maintain HUD mortgages. As an alternative, EHSI believes it can secure either a bank term loan and/or issue senior unsecured notes. Management continuously monitors its refinancing risks and communicates regularly with lenders to maintain an understanding of the availability and cost of capital.

During 2009, the REIT was successful in renewing the EHSI Credit Facility and amending the RBC Credit Facility, and in March 2011, obtained approval for a one-year extension to the EHSI Credit Facility. During 2010, the REIT has been successful in raising equity in February, arranging new construction loans and/or long-term financings for its Canadian development projects, and securing a new mortgage term loan of up to US\$35.0 million.

Normal Course Issuer Bid

In January 2011, the REIT received the approval of the TSX for its 2011 Bid, to purchase for cancellation up to 7.8 million REIT Units, \$11.4 million aggregate principal amount of its 2014 Debentures, and \$9.2 million aggregate principal amount of its 2013 Debentures, representing in each case, approximately 10% of the public float of the outstanding securities at December 31, 2010. The 2011 Bid provides the REIT with flexibility to repurchase units over a period of one year, until January 10, 2012.

There were no purchases for cancellation made by the REIT under a similar normal course issuer bid that expired on January 6, 2011. During 2009, under a normal course issuer bid that expired on December 28, 2009, the REIT acquired for cancellation 0.9 million REIT Units at a cost of \$5.3 million, \$1.1 million aggregate principal amount of its 2014 Debentures at a cost of \$0.7 million and \$0.2 million aggregate principal amount of its 2013 Debentures at a cost of \$0.2 million.

Capital Structure

The REIT defines its capital structure to include long-term debt, net of cash and cash equivalents, and unit capital.

	2010	2009
Current portion of long-term debt ⁽¹⁾	569,558	28,538
Long-term debt ⁽¹⁾	653,122	1,205,494
Total debt	1,222,680	1,234,032
Less: Cash and cash equivalents	(267,759)	(134,012)
Net debt	954,921	1,100,020
Unit capital	444,136	355,469
	1,399,057	1,455,489

(1) Net of financing costs.

Distributions

In accordance with the REIT's Deed of Trust, distributions to unitholders are declared at the discretion of the REIT's Board of Trustees. The REIT's Deed of Trust provides that on December 31st of each year, unless otherwise determined by the Board of Trustees, without any further actions on the part of the Board of Trustees, the REIT will make payable to unitholders and unitholders will have an enforceable right to payment on such date of a distribution of sufficient net income and net realized capital gains for the taxation year ending on that date, net of any capital losses or non-capital losses recognized on or before the end of such year, such that the REIT will not be liable for ordinary Canadian income taxes for such year, net of tax refunds. The payment of such amounts, if any, will be made on or before the following January 30th. Notwithstanding the foregoing, under the SIFT Rules the REIT will be liable for the SIFT tax in respect of certain income that is distributed to its unitholders. The REIT has no requirements pursuant to the Deed of Trust concerning Debt to Adjusted Gross Book Value or any other financial requirements.

REIT Unit Redemption Rights

REIT Units are redeemable at any time on demand by the holders. Upon receipt by the REIT of a notice to redeem REIT Units, all rights to and under the REIT Units tendered for redemption shall be surrendered and the holder shall be entitled to receive a price per REIT Unit in cash equal to the lesser of:

- a) 95% of the "market price" of the REIT Units on the principal stock exchange or market on which the REIT Units are quoted for trading during the 10 consecutive trading days ending on the trading day immediately prior to the redemption date; and
- b) 100% of the "closing market price" of the REIT Units on the principal stock exchange or market on which the REIT Units are quoted for trading on the redemption date.

The aggregate cash redemption price payable by the REIT in respect of all REIT Units surrendered for redemption during any calendar month shall be satisfied by a cash payment no later than the last day of the month following the month in which the REIT Units were tendered for redemption, and shall not exceed \$100,000, unless waived at the discretion of the Trustees. If the unitholder is not entitled to receive their redemption price in cash upon redemption as a result of the foregoing and other limitations, then each REIT Unit tendered for redemption will be redeemed by way of a distribution *in specie* of securities held by the REIT, subject to any applicable regulatory approvals.

Financial Covenants

EHSI is subject to external financial covenant requirements pursuant to the CMBS financings, Sovereign Loans and PrivateBank Loans and the EHSI Credit Facility on the level of debt to earnings and cash flow of its operations (*note 7*). Management and the Board of Trustees monitor these covenant ratios on a monthly and quarterly basis, respectively. The REIT is in compliance with all these covenants as of December 31, 2010.

20. Related Party Transactions

In October 2007, EHSI completed the acquisition of Tendercare, a privately owned operator of senior care centers in the State of Michigan, which was comprised of 29 skilled nursing centers and one inpatient rehabilitation hospital, for a total of 3,301 operational beds. The total consideration of the acquisition was \$225.0 million (US\$238.2 million), and was comprised of the assumption of debt of US\$76.4 million, the issuance of US\$26.4 million of 7.5% seller notes (*note 7*), and US\$135.4 million in cash.

On April 7, 2008, Tim Lukenda, the former President of Tendercare was appointed President and Chief Executive Officer of Extencicare REIT. Prior to its acquisition by EHSI, Mr. Lukenda owned an approximate 4.6% direct and indirect interest in Tendercare and received, directly or indirectly, on completion of the acquisition of Tendercare an equivalent percentage of the consideration paid by EHSI. As part of Mr. Lukenda's terms of employment, the employment contract provides a mechanism and process that effectively removes Mr. Lukenda from the decision-making process in situations where a conflict of interest may arise on any matter between Extencicare REIT and his previous employer, or with respect to any financial interest that Mr. Lukenda or his family have with Extencicare REIT and its subsidiaries. As part of the acquisition of Tendercare, in addition to normal representative and warranty provisions, EHSI 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 services to three long-term care centers that are owned or partially owned by members of Mr. Lukenda's immediate family.

Notes to Consolidated Financial Statements

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. 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 and is awaiting the court's decision. 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.

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 2010 and 2009, ECI made the annual settlements of US\$1.5 million and US\$2.2 million, respectively.

In September 2009, EHSI entered into an agreement with a company controlled by the former shareholders of Tendercare that includes a partial interest of Mr. Lukenda and his immediate family. The company owns a 120-bed 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 is anticipated to be licensed during the 2011 first quarter (*note 16*).

21. Segmented Information

During 2010, the REIT had 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.

Substantial portions of our revenue are funded by various federal, state, provincial and local government programs. The funding programs from which we receive 10% or more of our continuing operations' revenue are: the United States federal Medicare program, representing revenue of \$453.5 million and \$486.8 million in 2010 and 2009, respectively; and the Ontario provincial government, representing revenue of \$339.9 million and \$335.0 million in 2010 and 2009, respectively.

The significant accounting policies of the reportable operating segments are the same as those described in *note 1*. Information about the REIT's segments and a reconciliation of segment profit to net earnings are as follows:

	2010			2009		
	United States	Canada	Total	United States	Canada	Total
Revenue						
Nursing and assisted living centers	1,356,592	495,610	1,852,202	1,463,497	479,125	1,942,622
Home health care	–	157,177	157,177	–	155,096	155,096
Health technology services	17,205	–	17,205	18,853	–	18,853
Outpatient therapy	12,603	–	12,603	13,905	–	13,905
Other	19,792	10,124	29,916	22,372	8,719	31,091
	1,406,192	662,911	2,069,103	1,518,627	642,940	2,161,567
Operating expenses	1,166,718	570,162	1,736,880	1,257,190	553,788	1,810,978
Administrative costs	51,267	21,357	72,624	52,794	20,024	72,818
Lease costs	6,671	4,345	11,016	7,991	4,110	12,101
	1,224,656	595,864	1,820,520	1,317,975	577,922	1,895,897
Earnings before undernoted	181,536	67,047	248,583	200,652	65,018	265,670
Depreciation and amortization	49,622	14,359	63,981	52,731	13,301	66,032
Accretion expense	1,193	379	1,572	1,191	378	1,569
Interest expense	54,177	37,925	92,102	59,197	37,862	97,059
Interest income	(497)	(3,738)	(4,235)	(605)	(3,639)	(4,244)
Inter-segment interest expense (income)	(1,933)	1,933	–	(1,451)	1,451	–
Gain on derivative financial instruments and foreign exchange	(892)	(2,388)	(3,280)	(14,043)	(6,246)	(20,289)
Loss (gain) on asset impairment, disposals, financing and other items	(122)	1,276	1,154	605	(824)	(219)
Earnings from continuing operations before income taxes	79,988	17,301	97,289	103,027	22,735	125,762
Income tax expense (recovery)						
Current	23,301	8,422	31,723	(628)	7,446	6,818
Future	13,889	(1,133)	12,756	41,029	(2,244)	38,785
Earnings from continuing operations	42,798	10,012	52,810	62,626	17,533	80,159
Loss from discontinued operations, net of income taxes	(1,123)	–	(1,123)	(2,451)	–	(2,451)
Net earnings	41,675	10,012	51,687	60,175	17,533	77,708
Cash used in capital expenditures	34,296	35,657	69,953	56,130	35,464	91,594
Balance sheet:						
Property and equipment	558,377	295,383	853,760	586,321	277,109	863,430
Goodwill	152,558	13,026	165,584	160,296	13,026	173,322
Other intangible assets	14,476	1,964	16,440	16,611	1,581	18,192
Total consolidated assets	1,184,497	513,513	1,698,010	1,194,740	473,325	1,668,065

Corporate Governance

Extencicare REIT's Board of Trustees and management team fully acknowledge the importance of their duty to serve the long-term interests of unitholders.

Extencicare REIT believes that good corporate governance is fundamental for the effective operation of the organization and for maintaining the confidence of investors and increasing unitholder value.

Our governance system is built on the values of trust, transparency and high standards of corporate ethics, and we are committed to the principles of disclosure and a strong, independent board. Our commitment to providing quality services, while building unitholder value, is the basis for a well-established and enduring organization.

Extencicare is dedicated to providing timely, accurate and complete disclosure of all material information to the public. Our Board of Trustees and Committee members operate under Charters that clearly define their roles and responsibilities, including: Stewardship, Independence, Effectiveness and Accountability.

Further information on the Trustees of Extencicare REIT and a description of Extencicare's governance practices may be found in Extencicare's Management Information and Proxy Circular as filed with SEDAR at www.sedar.com and on Extencicare's website at www.extencicare.com.

The Board of Trustees of Extencicare REIT

Mel Rhinelander

Chairman

Timothy L. Lukenda

President and Chief Executive Officer

John F. Angus ^A

Senior Partner of PerformaCorp Inc.

Margery Cunningham ^A

Former Managing Director, Global Head of Product Training, Lehman Brothers

Governor Howard B. Dean ^{HR/GN, QC}

Senior Strategic Advisor and Independent Consultant, McKenna Long & Aldridge LLP, and former Governor of Vermont

George A. Fierheller ^A

President of Four Halls Inc.

Dr. Seth B. Goldsmith ^{A, QC}

Attorney and Professor Emeritus at the University of Massachusetts at Amherst

Benjamin J. Hutzel ^A

Retired Partner at Bennett Jones LLP

Michael J. L. Kirby ^{HR/GN, QC}

Chairman of the Mental Health Commission of Canada, a professional director and a retired member of the Senate of Canada

Alvin G. Libin ^{HR/GN}

President and Chief Executive Officer of Balmon Investments Ltd.

J. Thomas MacQuarrie, O.C. ^A

Senior Partner in the Atlantic Canada law firm of Stewart McKelvey

Honorary Trustee

Frederick B. Ladly

Retired Chairman and Chief Executive Officer of Extencicare

A	Audit Committee
HR/GN	Human Resources, Governance and Nominating Committee
QC	Quality and Compliance Committee

Officers and Executives

Extendicare Real Estate Investment Trust

3000 Steeles Avenue East, Suite 700
Markham, Ontario, Canada
L3R 9W2
Tel: (905) 470-4000
Fax: (905) 470-5588

Mel Rhinelander

Chairman

Timothy L. Lukenda

President and Chief Executive Officer

Douglas J. Harris

Senior Vice President and
Chief Financial Officer

Jillian E. Fountain

Secretary

Extendicare Health Services, Inc.

111 West Michigan Street
Milwaukee, Wisconsin, U.S.A.
53203-2903
Tel: (414) 908-8000
Tel: (800) 395-5000
Fax: (414) 908-8059

Timothy L. Lukenda

Chairman and Chief Executive Officer

Mel Beal

Senior Vice President, Operations

Douglas J. Harris

Senior Vice President,
Chief Financial Officer and Treasurer

David C. Pearce

Vice President, General Counsel and
Chief Compliance Officer

Robert Beyer

Vice President, Purchasing

Stephen Biondi

Vice President, Corporate Quality Officer

William Bryan

Vice President, Design & Development

Loren W. Claypool

Vice President and Chief Information Officer

Timothy Detary

Vice President, Human Resources

Anthony Evers

Vice President and Controller

Richard Gurka

Vice President of ProStep and
Clinical Reimbursement

David Keating

Vice President, Deputy General Counsel

LaRae L. Nelson

Vice President, Reimbursement

Judith Taubenheim

Vice President, Clinical Services

Donna Weimer

Vice President, Sales & Marketing

Jillian E. Fountain

Corporate Secretary

Extendicare (Canada) Inc.

3000 Steeles Avenue East, Suite 700
Markham, Ontario, Canada
L3R 9W2
Tel: (905) 470-4000
Fax: (905) 470-5588

Timothy L. Lukenda

Chairman and Chief Executive Officer

Paul Tuttle

President

Douglas J. Harris

Senior Vice President and
Chief Financial Officer

Deborah Bakti

Vice President, Human Resources

Elaine E. Everson

Vice President and Controller

Richard Luneburg

Vice President, Western Operations

Christina L. McKey

Vice President, Eastern Operations

Katharine O'Reilly

Vice President, Quality and
Performance Improvement

Sue Pearl-Agar

Vice President, ParaMed Home Health Care

Jillian E. Fountain

Corporate Secretary

Five-year Summary

(unaudited) (thousands of dollars unless otherwise noted)	2010	2009	2008	2007	2006
Financial Position					
Property and equipment	853,760	863,430	970,612	837,965	725,949
Health care assets	1,698,010	1,668,065	1,806,922	1,440,163	1,235,791
Equity accounted investments	—	—	—	—	79,931
Long-term debt, including current portion	1,222,680	1,234,032	1,332,813	1,071,711	851,180
Unitholders' equity (deficiency)	18,687	(40,903)	(29,532)	(23,578)	(23,654)
Financial Results					
Revenue					
Nursing and assisted living centers					
United States	1,356,592	1,463,497	1,328,959	1,103,218	1,063,081
Canada	495,610	479,125	446,131	418,658	399,222
Home health care – Canada	157,177	155,096	148,928	141,797	141,104
Health technology services – United States	17,205	18,853	14,328	13,861	12,361
Outpatient therapy – United States	12,603	13,905	12,956	12,259	12,384
Other	29,916	31,091	31,567	33,174	30,808
	2,069,103	2,161,567	1,982,869	1,722,967	1,658,960
EBITDA ⁽¹⁾	248,583	265,670	201,827	203,074	183,640
Earnings (loss) from continuing health care	52,810	80,159	6,424	72,039	(50,176)
Share of equity accounted earnings	—	—	—	1,541	5,220
Earnings (loss) from continuing operations	52,810	80,159	6,424	73,580	(44,956)
Components of Diluted Earnings (Loss) per Unit (\$)					
Continuing health care operations before undernoted	0.59	0.81	0.41	0.82	0.80
Gain (loss) on derivative financial instruments, foreign exchange, restructuring, asset impairment, disposals, financing and other items, net of income taxes	0.06	0.24	(0.32)	0.20	(1.54)
Earnings (loss) from continuing health care operations	0.65	1.05	0.09	1.02	(0.74)
Share of equity accounted earnings	—	—	—	0.02	0.07
Earnings (loss) from continuing operations	0.65	1.05	0.09	1.04	(0.67)
Discontinued operations	(0.02)	(0.03)	0.09	(0.04)	0.14
Net earnings (loss)	0.63	1.02	0.18	1.00	(0.53)
AFFO from continuing operations ⁽¹⁾	110,434	141,360	72,362	82,533	n/a
AFFO from continuing operations per basic unit (\$)	1.35	1.94	1.00	1.17	n/a
Average U.S./Canadian dollar exchange rate	1.0299	1.1420	1.0660	1.0748	1.1341
Other Information					
Number of centers (year end)					
United States	180	176	185	191	156
Canada	85	82	81	78	78
	265	258	266	269	234
Operational resident capacity (year end)					
United States	17,566	17,295	18,634	19,256	15,759
Canada	11,789	11,523	11,394	11,077	11,077
	29,355	28,818	30,028	30,333	26,836
U.S. nursing center average daily census by payor source (%)					
Medicare	16.5	16.4	17.7	18.6	18.8
Managed Care	5.8	5.7	5.3	4.3	4.0
Private/other	10.4	10.8	11.2	11.0	11.5
Medicaid	67.3	67.1	65.8	66.1	65.7
U.S. nursing center revenue by payor source (%)					
Medicare	33.5	33.3	34.5	35.8	36.0
Managed Care	9.6	9.7	8.7	6.8	5.9
Private/other	9.1	9.4	9.8	9.8	10.3
Medicaid	47.8	47.6	47.0	47.6	47.8
Average U.S. nursing centers occupancy (%)					
United States	86.3	88.5	88.4	90.3	91.8
Average Canadian centers occupancy (%)					
Canada	98.0	98.1	98.0	98.2	98.1
ParaMed home health care hours of service	4,402,000	4,554,000	4,495,000	4,571,000	4,776,000
Number of employees (year end)	37,700	38,000	39,100	37,700	33,700
Number of units outstanding (year end)	82,995,181	73,180,024	73,572,418	70,044,036	70,205,003

(1) Refer to discussion of non-GAAP measures on page 65.

Unitholder Information

Extendicare Real Estate Investment Trust

3000 Steeles Avenue East, Suite 700
Markham, Ontario, Canada
L3R 9W2

Tel: (905) 470-4000

Fax: (905) 470-5588

www.extendicare.com

Unitholder Inquiries/ Investor Relations

Jillian Fountain

Secretary

Tel: (905) 470-5534

Fax: (905) 470-4003

email: jfountain@extendicare.com

Transfer Agent

Computershare Trust Company of Canada

Tel: (800) 564-6253

Fax: (866) 249-7775

email: service@computershare.com

www.computershare.com

Annual Meeting

Unitholders are invited to attend the Annual Meeting of Extendicare Real Estate Investment Trust on Tuesday, June 7, 2011, at 2:30 p.m. at The Gallery, TSX Broadcast Centre, 130 King Street West, Toronto, Ontario, Canada.

Voting Rights

Unitholders receive one vote for each Extendicare Real Estate Investment Trust unit (REIT Unit) or Limited Partnership Class B limited partnership unit held.

Exchange Listings/ Trading Profile

Toronto Stock Exchange symbols:

EXE.UN, EXE.DB and EXE.DB.A

2010 REIT Unit trading:

High: \$11.17; Low: \$8.08

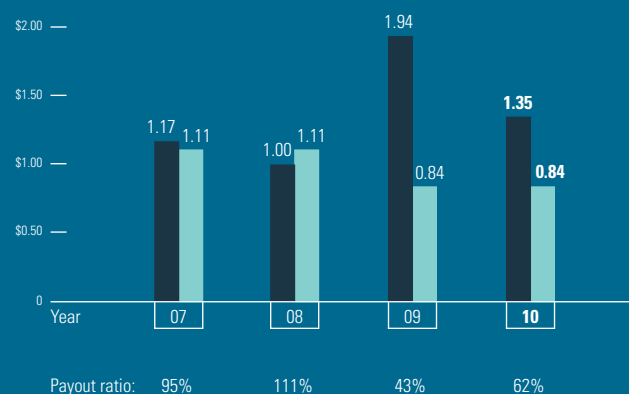
Close: \$9.18; Volume: 60,497,363

Published Information

Extendicare Real Estate Investment Trust's 2010 Annual Report is available for viewing or printing on its website at www.extendicare.com, together with news releases, quarterly reports and other filings with the securities commissions. Printed copies of the annual report are available upon request to the Secretary.

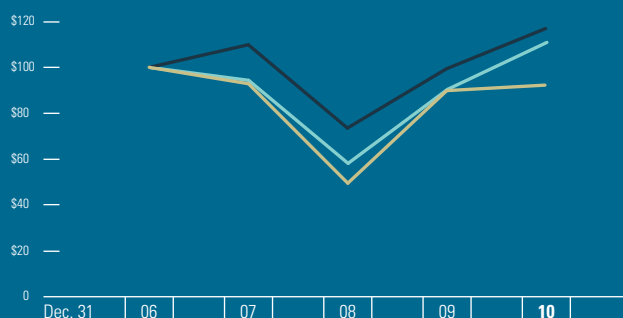
Extendicare REIT AFFO and Cash Distributions

- AFFO from continuing operations (\$ per basic unit)
- Cash distributions (\$ per unit)



Relative Unit Price Performance

- S&P/TSX Capped REIT
- S&P/TSX
- EXE.UN



EXTENDICARE

REAL ESTATE INVESTMENT TRUST

3000 Steeles Avenue East
Suite 700
Markham, Ontario, Canada
L3R 9W2

Tel: (905) 470-4000
Fax: (905) 470-5588
www.extendicare.com

Quality Service | Quality Experience | Quality People | Quality Properties | Quality Business

